

VERMONT STATE TEACHERS' RETIREMENT SYSTEM

Meeting of the Board of Trustees

February 16, 2005

Board Members present:

JOSEPH MACKEY, Chairperson (Active No. 29334), term expiring July 1, 2005

JON HARRIS, Vice-Chairperson (Active No. 25669), term expiring July 1, 2007

JAY KAPLAN, Association of Retired Teachers of Vermont, term expiring July 1, 2008

VAUGHN ALTEMUS, representing Commissioner of Education

JEB SPAULDING, VT State Treasurer

Board Members Absent:

THOMAS CANDON, representing Commissioner of BISHCA

Also attending:

Cynthia Webster, Director of Retirement Operations

David Minot, Director of Investment Services

Dick Charlton, Ellen Griggs, Kevin Kondry, New England Pension Consultants

Melissa Perel, New England Pension Consultants – via conference call

Angelo Dorta, VT-NEA

Dave Grundy, Association of Retired Teachers of Vermont

John Malpiede, citigroup©

Chester Johnson, Government Finance Advisors – via conference call

Wayne Calderara, Alternate for Retired Vermont State Employees' Association

Joel Cook, VT-NEA

The Chairperson, Joe Mackey, called the meeting to order at 8:08 a.m. on Wednesday, February 16, 2005, held in the Suzanna's Restaurant Conference Room at the Hilltop Inn, Airport Road, Berlin, Montpelier, Vermont.

ITEM 1: Approval of the Minutes of January 6, 2005

On a motion by Mr. Kaplan seconded by Mr. Altemus, the Board unanimously voted to approve the minutes of January 6, 2005, as submitted.

ITEM 2: Investment Consultant Quarterly Report for Q4/04 – NEPC

Mr. Charlton, Ms. Griggs and Mr. Kondry reviewed the fourth quarter 2004 performance. They reported the market value of the fund balance at approximately \$1.341 billion and a gross quarterly return of 9.1%, an out performance of the 7.6% median public fund. The one-year return was 12.9% vs. the median public fund at 11.0%, three-year return 8.9% vs. the median public fund at 4.6% and a five-year return of 5.1% vs. 4.1%. The Board conducted a brief conversation on bond and fixed income management, allocations, etc. and agreed the topic was worth extensive and continued discussions.

ITEM 3: Investment Management Presentations

Delaware Investments & Mondrian Investment Partners: Ryan Brist, Managing Director Fixed Income Investments, and John Campbell, President Global Institutional Services representing Delaware

Investments, and Christopher A. Moth, Director and CIO, Daniel Philips, Portfolio Manager, and Patricia M. Karolyi, Senior VP Client Services, representing Mondrian, appeared before the Board. The global fixed income portfolio was reported to have a market value of approximately \$230 million with a Q4/04 return of 6.5% compared to the CITI WGB index of 8.5%; one-year performance was 10.0% vs. the benchmark of 10.4%, three-year return 13.0% vs. the benchmark of 14.9%, and five-year return 10.3% vs. 8.8%.

Ms. Karolyi explained that Mondrian was located in London, England, with US offices in Philadelphia and that the firm had recently completed a management lead buyout from Delaware Asset Management. The new organization is a partnership that had ownership spread across most employees, (senior management owning 57%), and Hellman and Fredman LLC. As part of the buyout agreement, Delaware would continue in a relationship for two year to sub-advise Mondrian in some product management.

Mr. Campbell explained the two managers share the Global Fixed Income mandate with Delaware Investments managing the domestic fixed income portion and Mondrian Partners managing the global fixed income portion of the mandate. He said to date there were no client exits as a result of the change in structure. The Board was further advised that the current relationship arrangement would be evaluated at the end of two years; however, from every indication the relationship was very copasetic and was expected to continue.

J & W Seligman: Dorothy Buckley, Managing Director Institutional Client Services and Rick Ruvkun, Managing Director and Portfolio Manager, appeared before the Board. The small cap growth portfolio was reported to have a market value of approximately \$89.3 million with a Q4/04 return of 14.9% compared to the Russell 2000 Growth index of 15.1%; one-year return was 14.7% vs. the benchmark of 14.3%, three-year return 5.6% vs. the benchmark of 5.8%, and five-year return 0.5% vs. (3.6%).

ITEM 4: International Equity Manager Preliminary Review of RFP Responses

The Board reviewed the International Equity Manager Search book dated February 2005, prepared by NEPC as a result of the authorized search to replace Putnam Investments. The terminated manager's allocation was placed with an SSgA Index fund since November 2003.

Ms. Griggs advised the Board that Wellington Investments, who submitted a completed RFP and was selected as one of the 15 firms to be considered, withdrew their completed RFP and would not honor their obligation. Therefore, of the 40 managers who submitted complete "best in class" international manager RFPs for a target allocation of approximately \$101 million or 8% of assets, 14 remained as profiled for the Board's consideration. The State and Municipal Retirement Systems were also interested in the search and agreed to participate in the process. Wayne Calderara, representing the VSERS joined the meeting.

Melissa Perel, NEPC Director of Equity Research, joined the meeting via conference call to assist the Board.

The Board narrowed their review to the following eight firms:

- Acadian Asset Management, Inc.
- Grantham, Mayo, Van Otterloo & Co. (GMO)
- LSV Asset Management
- Mondrian Investment Partners LTD
- New Star Institutional Managers LTD
- Pырford International Plc.
- The Boston Company Asset Management, LLC
- UBS Global Asset Management (Americas), Inc.

By consensus the Board reduced the list to the following five firms:

- Acadian Asset Management, Inc.
- Grantham, Mayo, Van Otterloo & Co. (GMO)
- Mondrian Investment Partners LTD.
- Pырford International Plc.
- UBS Global Asset Management (Americas), Inc.

NEPC will arrange finalist presentations to be held at a later date, probably in May 2005. The VSERS and VMERS Boards would also be invited to here the presentations.

ITEM 5: Ratify the Disability Retirement for: Marsha Lane

On a motion by Mr. Kaplan seconded by Mr. Altemus, the Board unanimously voted to approve the disability retirement for Marsha Lane, as recommended by the Medical Review Board.

ITEM 6: Director of Finance and Investments Report

A. Update of Index Management Fees/Contract Issues

The Board reviewed the final fee proposals from PIMCO, T. Rowe, and SSgA for the new domestic equity index management contracts.

Mr. Kaplan asked if each of the managers could adhere to the Policy Guidelines regarding tobacco investments. Upon discussion NEPC agreed to contact each manger to discuss compliance. The Board also discussed the option to grant a waiver, in accordance with the Policy, if needed.

Mr. Kaplan strongly disagreed with granting a waiver or permitting fund management outside the guidelines. Mr. Kaplan further expanded on the history of the original tobacco legislation process, his position, and debates that ensued at that time.

Mr. Spaulding stated the Board would be acting consistent with the Policy Guidelines and would not be backtracking on its policy of avoiding investments in tobacco companies by granting a waiver in this case.

On a motion by Mr. Spaulding seconded by Mr. Altemus, the Board voted to approve the final fee negotiations of PIMCO .324%, T. Rowe .300%, and SSgA .031%, as presented by NEPC, and instruct NEPC to work with the Treasurer's Office to initiate contracts and the transition, providing there were no violations of the Investment Guideline Policy; however if there were any obstacles, the Board hereby granted prior approval pursuant to the General Guidelines of the Investment Guideline Policy. Mr. Spaulding, Mr. Altemus, Mr. Mackey, and Mr. Harris voted yes. Mr. Kaplan voted no.

Mr. Minot discussed the proposal to engage SSgM, State Street Global Management, as a sole source entity to handle the ultimate transition functions for the three systems. Additionally Mr. Minot explained the current custodian bank contract language regarding their services. NEPC will also provide a letter in support of the action to be used along with the Bulletin 3.5 waiver request.

On a motion by Mr. Mackey seconded by Mr. Harris, the Board unanimously voted to approve the request for the sole source engagement of SSgM for the purpose of transition management from the actively managed accounts to the new index managed accounts.

Mr. Minot and Mr. Spaulding advised the Board of the VMERS Global Bond search result and recommendation. Mr. Minot also advised the Board of the VSERS real estate finalist presentations scheduled for 2/17/05.

B. Loomis Sayles Proposal Discussion

Mr. Minor reviewed the proposal submitted dated January 6, 2005.

On a motion by Mr. Kaplan seconded by Mr. Harris, the Board unanimously voted to accept the proposal, with the exception that 144A securities are limited to 15%.

C. Other

Mr. Minot discussed STIF/SPIF sweep info, STIF/SPIF investment policy, State Street bank fees regarding active vs. index management, and will provide further details on the topics of commission recapture, proxy voting, and soft dollar reporting at a future meeting.

ITEM 7: Treasurer's Report

Mr. Spaulding reviewed his written report. He reported on pending unitization legislation, disability statistics, and the status of an upcoming environmentally conscious manager RFP for a potentially small allocation by the Teacher and State systems.

A. Actuary Recommendation Re: GASB 25 Reporting

The Board received a letter dated February 15, 2005, from David Driscoll regarding the current frozen initial liability (FIL) GASB 25 reporting method vs. alternatives, i.e. Entry Age Normal (EAN), and/or statutory amendments. The Board discussed the ramifications of changing the funding method and its

effect on the “funding ratio”. The Board agreed to continue discussion upon receipt of additional information from Mr. Driscoll regarding the cost of an EAN comparison report. However, the Board agreed it was important to know the implications of the alternative method, and further agreed they would like to see the results of a report using an EAN method. Mr. Spaulding will advise the Board of the report cost, when available.

B. Under Funding Discussion – Pension Obligation Bonds

John Malpiede from citigroup© appeared before the Board, and Chester Johnson from Government Finance Advisors joined the meeting via conference call.

Mr. Malpiede reviewed his February 16, 2005, presentation, *Pension Funding Alternatives*, providing general information of the mechanics of pension obligation bonds. Mr. Johnson shared his opinion regarding rating agency, and credit and debt management perspectives, including the impact to the State as a whole.

Mr. Charlton shared his opinions. He acknowledged the actual under funded obligation was unknown, and that his most troublesome concern was that the State would use their annual appropriation to pay the obliged bond payment, and still not fully fund the system, compounding the problem. He summarized that the three major plan components of “money in”, “earnings”, and “money out” should be comprehensively evaluate by the Board before seeking a major solution.

C. Integrity Report

Mr. Spaulding advised the Board that Rep. Atkins had presented a bill to eliminate the Integrity Report, however he was not aware of its current status. Mr. Cook asked the Board whether they would take a formal position regarding the bill.

Mr. Spaulding remarked on his question regarding the section of statute that requires the Governor elect to include the actuarial report into the budget. He advised that at his request the AG’s Office rendered an opinion that that section of the statue was so “old” that it was no longer applicable or enforceable.

On a motion by Mr. Mackey seconded by Mr. Kaplan, the Board unanimously voted to support H.0133, the repeal of the Governors Integrity Report.

D. Under Funding Solution Discussion – State Education Fund

Mr. Spaulding advised that a study committee would be convened, comprised of all the stakeholders to discuss under funding issue.

Mr. Harris asked to be notified, as timely as possible, of hearing and committee meetings. Ms. Webster would try to send information.

E. Other

Mr. Spaulding also advised the Board the Attorney General's Office would be conducting an RFP to seek a firm to monitor class action suits, and provide reporting. The Board will be kept advised of the results. Mr. Kaplan asked for information regarding this issue from the AG is placed on the next meeting agenda.

Mr. Spaulding also reported the Governor had recommended setting \$2 million in a health care savings account to be used for future liabilities.

ITEM 10: Director of Retirement Operations Report

A. Legislative Update

Ms. Webster distributed a February 8, 2005, memo regarding S.0021 Minimum pension increase for Group A members. The anticipated cost of the proposal represented an approximate \$1.9 million annual liability.

The Board discussed the irresponsibility of the Legislature to initiate and assume another annual liability that the system cannot pay for. The Board agreed they support the concept of the bill; however, given the under funding of the system, they could not support the prudence of the bill.

Ms. Webster distributed copies of Title 16 §1945, and explained the tax department has recommended amendment to clarify the tax language to be similar to the VSERS language in Title 3 §476.

B. SDIA Report

Ms. Webster advised the Board an RFP would be initiated to assume third-party administration of the program. The plan is to consolidate all services, including (but not limited to) customer relations, check distribution, 1099R reporting, etc. The Board will be kept advised of the results.

C. Other

Ms. Webster distributed a February 15, 2005, AG's opinion regarding whether the Board had the authority to waive the statutory requirements in 16 §1937, vesting, after returning to service.

At 4:45 p.m. on a motion by Mr. Spaulding seconded by Mr. Kaplan, the Board unanimously voted to enter into executive session pursuant to Title 1 § 313, to discuss a personnel matter.

At 4:50 p.m. the Board exited the executive session.

Ms. Webster distributed the new rate sheets for the health care premiums, effective 7/1/05, representing an approximate 12% increase.

Ms. Webster shared information regarding the balance of the travel budget, approximately \$969.00.

Mr. Mackey expressed his opinion regarding the need to educate members, citing many of the issues discussed today. Mr. Spaulding agreed, however, said he felt client conferences were not the same as other types of opportunities, such as organizational, NCTR, NAST, NCPERS, etc. or not-for-profit. He said he felt the perception of attendance at client conferences was not prudent.

Mr. Mackey and Mr. Kaplan requested approval to attend the State Street Client Conference, April 3, 2005 through April 6, 2005, held in Tucson, AZ. He explained the approximate expenses for room and transportation would be approximately \$1,300 plus daily per diem. He explained the conference was similar to NEPC's client conference.

On a motion by Mr. Mackey seconded by Mr. Harris the Board voted to authorize Mr. Kaplan's attendance at the State Street Conference April 3 through April 6, 2005. Mr. Mackey, Mr. Harris, Mr. Kaplan, and Mr. Altemus voted yes. Mr. Spaulding voted no.

Mr. Altemus explained his vote for approval by was based on the fact that Mr. Kaplan had already booked the trip in good faith, within the rules at the time. He gave notice; however, that he expected to support Mr. Spaulding's position in future votes.

Mr. Harris asked that the travel policy be included in a future agenda.

Mr. Spaulding advised the Board the State Retirement Systems (VSERS, VSTRS, and VMERS) received a nomination for Small Pension Fund of the Year Award from *Money Management Letter*. Mr. Minot will attend the meeting in AZ to accept the award.

ITEM 11: Approve 2005 Election Rules & Regulation

On a motion by Mr. Harris seconded by Mr. Altemus, the Board unanimously voted to approve the 2005 election Rules and Regulations, as presented.

ITEM 12: Any Other Business to Come Before the Board

Next Meeting Dates:

The next quarterly investment meeting is scheduled for May 18, 2005.

Adjournment:

On a motion by Mr. Mackey seconded by Mr. Altemus, the Board unanimously voted to adjourn at 5:10 p.m.

Respectfully submitted,

Donna Holden, Board Coordinator
for
Cynthia Webster, Secretary to the Board