

STATE OF DELAWARE
STATE BOARD OF PENSION TRUSTEES
AND
OFFICE OF PENSIONS
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BOARD OF PENSION TRUSTEES
MEETING MINUTES OF APRIL 29, 2005

The meeting of the Board of Pension Trustees was called to order by P. Reese at 9:00 a.m. in the Delaware Conference Room of the Office of Pensions in Dover.

Trustees Present

Philip S. Reese
Robert W. Allen
Jan King
Dana Jefferson
Nancy J. Shevock
Richard Cordrey

Trustees Absent

Helen Foster

Others Present

David Craik, Pension Office
Kim Vincent, Pension Office
Kathy Kunkle, Pension Office
Alice Simon, Pension Office
Terri Timmons, Pension Office
John McCartney, Pension Office
James Testerman, Pension Advisory Committee
Sheldon Hudson, Budget Office

1. OPENING COMMENTS

P. Reese thanked Robert Allen for taking the Chair at the March Board Meeting.

P. Reese also congratulated the committees assigned to the Best Practices review for their discussions. There will be a meeting in May to share information and recommendations will be made in advance of the May meeting.

An announcement was made by P. Reese that Barbara Graham would be resigning from the Investment Committee to pursue other opportunities. The Board will need recommendations for a replacement.

A discussion was held as to where the Pension Office will end up within the proposed Office of Management & Budget. A meeting will be held on June 1st with P. Reese and D. Craik to discuss this further with the Budget Director.

P. Reese discussed the option to purchase the McArdle Building and had asked Ashford Capital Management to prepare a cost benefit analysis. This analysis shows that there would be a minimal advantage to purchasing the building, but given the approval process that would have to be undertaken this does not warrant any further action from the Board.

A discussion was held in reference to a request from the union AFSCME to release the retiree address listing to prepare a mailer. P. Reese suggested to send the union the incremental difference of the new retirees since the last mailing on a one time basis and then let the State handle the issue going forward.

MOTION made by J. King, seconded by N. Shevock directing D. Craik to respond to the current request referencing 29 Del. C. 8308(d), which explains the confidentiality of all pension records. However, an update will be provided to the previously disclosed list for new retirees.

MOTION CARRIED

(D. Jefferson abstained from the vote due to potential conflict of interest).

2. APPROVAL OF THE MINUTES

The Trustees reviewed the minutes of the March 18, 2005 meeting.

MOTION made by J. King and seconded by N. Shevock to approve the minutes, as amended, of the Board of Pension Trustees' March 18, 2005 meeting.

MOTION ADOPTED UNANIMOUSLY

3. INVESTMENT COMMITTEE REPORT

Total assets in the fund at the end of March \$5,886 million. The Fund lost (1.6%) for the month compared to a benchmark of negative (1.2%) and a negative (1.5%) for a 60/35/5 benchmark.

During month of March fund experienced losses across all equity markets. The Russell 3000 stocks lost (1.7)%, Large Growth stocks lost (1.8)% and Large Value index returned a negative (1.4)%. Small cap stocks posted the largest loss in the equity market with the Russell 2000 returning a negative (2.9)%. The international markets followed the U.S. market with the unhedged EAFE returning a negative (2.5)%. The bond market continues to add little surprise with the Lehman LT Government/Corp Index losses at (1.4%). The short market was essentially flat.

The fiscal year returns year to date for the Fund will be reported at an 8.4% gain, compared positively to a 5.8% benchmark. This positive variance to benchmark is mainly due the high U.S. equity and International Equity position of the Mellon-TAA and GTAA during months that experienced strong equity returns and the strong performance of the NRIS tactical allocation. Year to date calendar returns are an overall negative (.8%) comparing favorably to a benchmark of loss of (1.1%).

A poll vote taken in last week needs to be ratified by the Board. The Investment Committee recommended, after a special telephonic meeting, the partial liquidation of our tactical allocation to the T. Rowe Price Natural Resources portfolio. Our current allocation was approximately \$560 million. The Committee recommended liquidation of \$200 million to be held in cash until a further recommendation is developed.

The manager had met with the Committee on April 12, 2005 and followed up with more information to support their view of lightening our allocation. They see a slowing of growth, specifically in China, the tightening policy by the Fed slowing U.S. and the rest of the worlds' economies, and some capacity coming on line coupled with strong oil and gas inventories. Their view is that lower returns may be the result of these pressures.

MOTION made by J. King, seconded by R. Allen to ratify Poll Vote of April 21, 2005 to approve partial liquidation of the T. Rowe Price Natural Resources portfolio.

MOTION ADOPTED UNANIMOUSLY

Given the challenging return outlooks for conventional assets and the difficulties most managers have in adding material value to benchmark returns, additional sources of return are increasingly required to help the Fund achieve its long term objectives. One area that many funds have turned to in recent years is that of absolute return strategies. That is, strategies that are intended to consistently generate positive return over Treasury Bills. The Fund currently employs two managers using absolute return. These are Oaktree Emerging Markets fund and the Mount Lucas account. The OEM strategy is capacity limited. The Mount Lucas approach to investing in 25 commodities or managed futures meets the tests we require for use in the Fund. Additionally, another strategy is now being recommended for use within the Fund. The Investment Committee recommends use of Mellon Capital as an Active Foreign Currency Manager.

Use of Currency Strategies can be helpful to the Fund for four key reasons:

1. The world currency markets are inefficient due to the large presence of market participants such as central banks and corporate treasurers that are covering needs for trade flows or other non-economic objectives.
2. While currency global currency markets are inefficient they are the most liquid and deepest, indicating that there is room for huge volumes of assets to be managed without diminishing potential returns.
3. Currency returns are uncorrelated with traditional asset class returns.
4. The risk involved is rewarded appropriately based on the individual return levels.

Currency mandates typically involve short or long positions in a variety of currencies, depending on the manager's investment views. All currency trades take place in the forward or spot market.

A search was conducted and thirty or so firms that had products in currency were reviewed. Eight are considered the most prominent in the industry and three were reviewed in detail. Based on the strong actual and simulated results relative to the others and based on the solid underpinnings of their relative value process of allocating currency exposures, the Committee recommends Mellon Capital Management. Their currency process has run live money as part of their Global TAA process for 9 years. Mellon's process's main aspect is relative real interest rates adjusted using a purchasing price parity differential, between individual currencies and a trade-weighted basket. This is a simple process compared to other firms and has achieved impressive results over time.

The Investment Committee recommends the funding of this mandate, after successful negotiation of documentation, by the liquidation of \$100MM of the approximate \$250MM held by Mount Lucas in managed futures. The vehicle to be used is a Delaware-based LLC managed by Mellon Capital, with

assets held at Mellon Bank of New England, for which documentation will be reviewed by the Deputy Attorney General. This strategy involves leverage of approximately 4:1 – this was of great concern to the Investment Committee and was debated for some time as to how to approach this investment. Although risk modeling by the Manager and by Ashford indicates this investment has a high likelihood of a positive risk-return relationship, the LLC vehicle limits the Fund's liability to no more than the amount invested.

MOTION made by J. King and seconded by R. Allen to liquidate \$100 million from the Mt. Lucas Managed Index Fund and invest the proceeds with the Mellon Currency Opportunity Funds subject to successful contract negotiations.

MOTION ADOPTED UNANIMOUSLY

J. King reported that the Investment Committee is recommending a new allocation in a private equity program. A new fund is being initiated by Summit Partners with whom we have a long and successful relationship. The recommendation is up to a \$35 million commitment.

MOTION made by J. King and seconded by R. Allen to authorize Summit VII up to \$35 million funding commitment.

MOTION ADOPTED UNANIMOUSLY

The next meeting of the Investment Committee is May 12.

4. AUDIT COMMITTEE REPORT

R. Allen reported that the Audit Committee met with the new auditing firm, KPMG, to begin the Entrance Audit on April 26th. The Exit Audit has been scheduled for August 29th and the audit findings will be available for the September Board meeting.

R. Allen stated that the Audit Committee will be visiting and meeting with Mercantile on May 17th to look at their operation and review some of the changes and discuss bank systems conversions.

5. PENSION ADVISORY COUNCIL

J. Testerman praised D. Craik and K. Vincent for their participation with the Spring Pre-Retirement Pension Workshops. This years turn out was very successful in each County:

4/5 Delaware Tech Owens Campus – 60
4/12 Stanton Middle School – 55
4/19 Brandywine High School – 41
4/21 Stanton Middle School – 21
4/26 State Troopers Association - 61

J. Testerman indicated that retirees' are concerned about their medical benefits and that the Pension Advisory Council is concerned that pre-funding medical benefits would be a tremendous cost. R. Cordrey stated he discussed with the Governor the possibility of a new commission to study other Post Employee Benefits.

6. PENSION ADMINISTRATOR'S REPORT

Disability Project Update

After completing site reviews of potential vendors, the disability project team has a recommendation for the proposed State disability program. Once the Employee Benefits Committee adopts the recommendation, work can begin with the vendor. The committee will review the selection once legislation has passed establishing the new benefit.

D. Craik has been invited to attend the Joint Finance Committee retreat on May 9 to discuss the following legislative issues:

- 25 year retirement
- Disability program
- Post Retirement Increase

D. Craik mentioned an article that was in the Delaware State News on April 27th, which was included in the board packets. The article discusses the health care costs for retired state employees and the disclosures that the State will have to put in their financial statements regarding the liability for retiree health insurance.

Medical Committee Report

As of April 1, 2005, there were 33 new cases pending receipt of original medical information. There were 3 that are over 90 days old and 2 cases that were over 60 days old.

7. DEPUTY ATTORNEY GENERAL REPORT

In M. Kramarck's absence a discussion took place that addressed M. Kramarck's current workload. M. Kramarck's position is 100% funded by the Board of Pension Trustees' with only 60% of her time is

spent on Board business. P. Reese is proposing a meeting with the Attorney General and M. Kramarck to discuss other options.

8. PENDING ITEMS

The next Best Practices meeting will be held on May 6, 2005 at the Pension Office to discuss Goverances Issues. R. Allen will be attending this meeting along with the Consultants.

9. ADJOURNMENT

The next Pension Board meeting will be held on May 27, 2005, at 9:00, in the Delaware Conference Room of the Office of Pensions.

At 10:50 a.m., there being no further business,
MOTION was made by R. Cordrey and
seconded by R. Allen to adjourn the meeting.

MOTION ADOPTED UNANIMOUSLY

Respectfully submitted,

David C. Craik
Pension Administrator

Philip S. Reese
Board of Pension Trustees Chairman