

STATE OF DELAWARE
STATE BOARD OF PENSION TRUSTEES
AND
OFFICE OF PENSIONS
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BOARD OF PENSION TRUSTEES
MEETING MINUTES OF JULY 30, 2004

The meeting of the Board of Pension Trustees was called to order by P. Reese at 9:05 a.m. in the Delaware Conference Room of the McArdle Building.

Trustees Present

Phillip Reese
Robert W. Allen
David W. Singleton
Nancy J. Shevock
Helen Foster
Jan King

Trustees Absent

Lisa Blunt-Bradley

Others Present

Charlotte Lister, Pension Advisory Council
David Craik, Pension Office
Alice Simon, Pension Office
Kathy Kunkle, Pension Office
Jill Floore, Budget Office
Kim Wells, Budget Office
Ron Draper, Auditors Office
Candace Casto, Auditors Office
Theresa Leatherbury, Milliman USA
John Muehl, Milliman USA

1. OPENING COMMENTS

The meeting of the Board of Pensions Trustees was called to order at 9:05 a.m.

2. APPROVAL OF THE MINUTES

The Trustees reviewed the minutes of the June 18, 2004 meeting.

MOTION was made by H. Foster and seconded by D. Singleton to approve the minutes of the Board of Pension Trustees' meeting.

MOTION ADOPTED UNANIMOUSLY

3. ACTUARIAL REPORT

Theresa Leatherbury from Milliman USA, who is the actuary assigned to the Delaware Public Employees Retirement System, presented a review of the actuarial experience of all of the plans administered by the Board. Below are the recommendations for each assumption:

- 1) Retiree Mortality Healthy Lives
 - Use different tables for different plans
 - Strengthen assumptions to be more in line with experience
 - Recognize general trends in mortality
 - Provide for expected mortality improvements
- 2) Retiree Mortality Disabled Lives
 - Use different tables for different plans
 - Use sex-distinct tables
 - Increase rates at younger ages, decrease rates at older ages
- 3) Active Mortality
 - Develop rates using a standard table
 - Adjust standard tables based on experience of healthy retirees
- 4) Early Retirement
 - Develop rates based on experience in each plan
 - Decrease rates at younger ages, increase rates at older ages
 - Different rates for first eligible and subsequent to first eligible
 - Different rates for males and females
- 5) Normal Retirement
 - For State Employees plan, increase rates prior to age 65 and decrease rates after age 65
 - For State Police, decrease rates prior to age 60
 - For Judges, increase rates when first eligible, reduce rates at later ages

- Sex distinct rates for the State Employees, County/Municipal General and Volunteer Fire plans
 - Unisex rates for all other plans
 - Different rates for first eligible and subsequent to first eligible
 - Extend rates to higher ages to anticipate members working longer
- 6) Withdrawal
- Vary rates by age and service for the first 10 years of service
 - Subsequently, vary rates by age only
 - No withdrawal assumption for Judges or Closed State Police Plan
- 7) Disability
- Slightly increase rates at younger ages, decrease rates at older ages
- 8) Marriage
- Build conservatism into assumption
 - Assume 90% marriage assumption for Judges and Police, 80% for other plans
- 9) Salary Increase
- Merit scale that varies by years of service for first 10 years and by age after that. Increase merit scale at younger ages, decrease at older ages. For Diamond Port, use flat merit scale
 - Wage inflation assumption of 3.75%
- 10) Plan Expenses as a percent of pay
- 0.40% for County/Municipal General
 - 0.35% for State Employees and Diamond Port
 - 0.30% for County/Municipal Police
 - 0.20% for New State Police
 - 0.15% for Judges
 - 1.50% for Closed State Police
 - Flat \$17,000 for Volunteer Fire

The Board proceeded to have a discussion on the Investment Return assumption and the impact on plan costs by using a 8.25% and 8.0% return. J. King reviewed the process that the Investment Committee uses to invest the assets using risk parameters versus targeting a specific rate. Using the conservative assumption of 8.0% would increase the State's cost for FY06, but is a realistic assumption for future valuations.

Based on a one-year investment return of 15.9% for FY04, the contribution rate in the State Employees pension plan is expected to increase from 4.91% in FY05 to 5.44% for FY06 if no assumptions are changed. With the recommended assumption changes and an 8.0% investment return produces a total plan cost of 6.05%.

MOTION made by R. Allen and seconded by J. King to change the investment return assumption to 8% and

to adopt all other demographic and economic assumptions recommended by Milliman USA

MOTION ADOPTED UNANIMOUSLY

4. DEPUTY ATTORNEY GENERAL REPORT

M. Kramarck had no information to report.

5. INVESTMENT COMMITTEE REPORT

INVESTMENT PERFORMANCE – MONTH ENDING JUNE 30, 2004

<u>Fund</u>	<u>Previous Month</u>	<u>Fiscal Year To Date</u>	<u>12-Month</u>
Total Fund	1.6%	15.9%	15.9%
S & P 500 Index	1.9%	19.1%	19.1%
60/35/5*	1.3%	11.0%	11.0%
Delaware Benchmark**	1.4%	12.2%	12.2%

*Benchmark mix of 60% S&P500 Index, 35% Solomon Long Government and Corporate Bond Index and 5% T-bills.

**Benchmark mix of 45% Russell 3000, 10% EAFE (international), 43% Lehman Bond aggregate and 2% T-bills.

Total assets in the fund at the end of June totaled \$5.521 billion. The fund posted a month of very good performance with June gaining a 1.6% return during the month. This return exceeded the Delaware Benchmark of 1.4% and was also higher than the 60/35/5 benchmark of 1.3%.

The month of June was strong in all equity markets. The Russell 3000 stocks gained 2.0%. Large Growth stocks gained 1.3% and Large Value index returned 2.4%. Small Cap stocks posted the strongest positive gains with the Russell 2000 returning a 4.2%. The international markets were ahead of the U.S. market with the unhedged EAFE returning a positive 2.2%. The bond market, with changing interest rates, experienced positive returns for the month with Lehman LT Government/Corp Index at .8% and the High Yield sector returned a positive 1.5% as spreads continue to widen and higher coupons.

The fiscal year returns for the Fund will be reported at a 15.9% gain, compared to a 12.2% benchmark. This positive variance to benchmark is mainly due to the high U.S. equity and International equity position of the Mellon TAA and GTAA during months that experienced strong equity returns. This is paying the Fund back for the months where their heavy equity weighting cost us return versus the benchmark. While this is an outstanding year, the Fund is still recovering from three down years. The Fund will report a 3-year return of 3.9%, 5-year return of 4.4%, 7-year return of 7.2% and 10 year and longer returns in excess of 10%. Most of the high returns for FY04 were earned in calendar year 2003. The year to date calendar returns for 2004 is an overall 3.4% comparing favorably to a benchmark of 2.1%.

A Poll Vote was conducted on June 29, 2004 at the request of the Investment Committee. The Committee recommends a slight rebalancing of the U.S. equity exposure from small cap stocks to U.S. large cap stocks; and from a value tilt to a more neutral growth/value stance. The Committee recommends an allocation reduction of \$60 million from Trinity and \$40 million from Granahan small cap equity. The proceeds of \$100 million will be invested in the BGI Russell 1000 Growth Index. At a later date, the Committee may recommend an active large cap growth manager for these funds.

MOTION made by H. Foster and seconded by R. Allen to ratify the poll vote conducted on June 29, 2004 to reduce the small cap equity allocation and increase the investment in the Russell 1000 growth index.

MOTION ADOPTED UNANIMOUSLY

A second Poll Vote was conducted on June 29, 2004 at the request of the Investment Committee. The Committee recommends the Delaware Fund commit up to \$25 million each to two new private equity funds, Onset V and Accel IX. The original e-mail ballot erroneously noted a fund commitment limit of \$24 million each.

MOTION made by N. Shevock, seconded by H. Foster to ratify the June 29, 2004 poll vote as amended to commit up to \$25 million to each new private equity fund.

MOTION ADOPTED UNANIMOUSLY

The Investment Committee this month continued its discussions with our convertible bond managers, meeting with Advent on July 13. All the convertible managers are struggling with rising interest rates and the portion of a convertible that acts like a bond will decline in value as rates rise. No recommendations are being brought forth at this time. Mercantile also presented their need to move from State Street Bank as sub-custodian to Bank of New York. The Investment Committee has no issue with this move, as the terms of the contract would be favorable to the system. The next Investment Committee meeting is August 17.

P. Reese reviewed the qualifications of Clark Phippen, a potential new member for the Investment Committee. The committee is currently at four members and would like to be up to six. Questions were raised about Mr. Phippen's current employment, but it was felt that this employment would not present any conflict of interest problems and had been discussed with Ted Ashford.

MOTION made by P. Reese and seconded by J. King to add Clark Phippen as a member of the Investment Committee.

MOTION ADOPTED UNANIMOUSLY

6. PENSION ADVISORY COUNCIL

C. Lister reported that a member of the Advisory Council, Robert Coleman, had passed away since the Board's last meeting. Mr. Coleman represented the Delaware Retired School Personnel on the council. The Pension Advisory Council will not have its next meeting until later this fall.

7. PENSION ADMINISTRATOR'S REPORT

Medical Report

Comprehensive monthly reports were distributed and discussed covering disability applications and pensions reviewed by the Medical Committee for the month July 2004. There were 13 new cases processed in July. Only one employee is in the over 90 days category, but will be resolved shortly.

Legislation

There were only three pension bills that passed during June:

SB 356, grants a 2% increase for all retirees effective 1/1/76 through 5/1/04 and a 2% or \$35, whichever is greater, to retirees effective prior to 1/1/76. There is an increase to 2.43% of employer contributions into the PRI fund to sustain the cost associated with this bill.

HB 462 affects the New State Police Plan. Currently, there is mandated retirement at age 55. This bill allows employees age 55 with 10 years of service to collect immediately upon termination.

HB 541 is for Samantha Fuller who is a New State Police survivor. She is currently paying for her health insurance coverage with zero percent of the premium paid by the State. The bill will provide 100% of the State share for her. Since then there has been another trooper killed in the line of duty and the Governor's office has requested that a generic bill be prepared to cover all survivors of troopers who are killed in the line of duty and also include members of the State Employees Plan who might be in hazardous situations.

8. AUDIT COMMITTEE REPORT

R. Allen and A. Simon reported to the Board the current situation regarding Ernst & Young (E&Y) and the audit staff that is scheduled to be on site as of 8/2. Due to recent legal problems, E&Y has decided to terminate all sub-contracts with other auditing firms that perform audit work for E&Y. This includes the Siegfried Group, which was scheduled to do the field work for the FY04 audit. R. Draper and C. Casto discussed the options that are open to the Board and the Auditor's office at this time.

MOTION made by R. Allen, seconded by N. Shevock that the Auditor's Office contract with KPMG, with Siegfried Group as sub-contractors, to conduct the annual Pension System audit, subject to the Auditor's Office fee negotiation and legal review of the contract. (J. King abstained from the vote due to a potential conflict of interest.)

MOTION CARRIED

9. PENDING ITEMS

D. Craik reported that the RFP for item #1, Disability Project, would be distributed in August.

10. GOVERNANCE ISSUES

Discussion of governance issues was tabled due to time constraints.

11. EXECUTIVE SESSION

There was no executive session

12. ADJOURNMENT

The next Pension Board meeting will be held on October 1, 2004 in the McArdle Building, Delaware Conference Room in Dover, Delaware.

At 11:10 a.m. there being no further business, MOTION was made by D. Singleton and seconded by H. Foster to adjourn the meeting.

MOTION ADOPTED UNANIMOUSLY

Respectfully submitted,

David C. Craik
Pension Administrator

Philip S. Reese
Board of Pension Trustees Chairman