

STATE OF DELAWARE
STATE BOARD OF PENSION TRUSTEES
AND
OFFICE OF PENSIONS
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BOARD OF PENSION TRUSTEES
MEETING MINUTES OF OCTOBER 1, 2004

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 McArdle Building.

Trustees Present

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

Trustees Absent

Lisa Blunt-Bradley
Helen Foster

Others Present

Joel Poorman, Audit Committee
Harold Smith, Audit Committee
Ron Draper, Deputy State Auditor of Accounts
Candace Casto, State Auditor's Office
Lori Stoughton, State Auditor's Office
Jim Testerman, Pension Advisory Council
Charlotte Lister, Pension Advisory Council
David Craik, Pension Office
Marsha Kramarck, DAG
Alice Simon, Pension Office
Kathy Kunkle, Pension Office
Debbie Nicholson, Pension Office
Mike Buchheit, Siegfried Group
Barry Pelagatti, Siegfried Group

1. OPENING COMMENTS

The meeting of the Board of Pensions Trustees was called to order at 9:00 a.m.

2. APPROVAL OF THE MINUTES

The Trustees reviewed the minutes of the July 30, 2004 meeting.

MOTION made by J. King and seconded by R. Allen to approve the minutes of the Board of Pension Trustees' meeting.

MOTION ADOPTED UNANIMOUSLY

3. AUDIT REPORT

Presentation of the FY04 Comprehensive Annual Financial Report

The Audit Committee briefed the Board on the outcome of the annual audit and presented the Thirty-third Comprehensive Annual Financial Report. J. Poorman updated the Board on the logistics that evolved in selecting the auditors for the FY04 report, with the State Auditor's Office and the Siegfried Group completing the audit under co-signatures. M. Buchheit and B. Pelagatti from Siegfried Group reviewed the significant items in the audit report with the Board and discussed procedures used in their audit, with the Fund receiving a clean opinion. B. Pelagatti reviewed the Management Letter with the Board. There were seven items covered, two on information technology matters and five on procedures within the Pension Office.

Members of the Pension Office were excused so the Board could speak freely regarding the outcome of the annual audit. M. Kramarck recorded the following: No negative observations were noted regarding Pension Office performance. The staff was observed to be highly responsive to any requests and to correct failures of internal controls. The question of adequate safeguards against active fraud will be explored further to insure that redundancy systems serve to avoid fraud. There is some difficulty on the part of the Auditors for detection of fraud, since they do not conduct extensive internal testing. It was suggested that implementation of mandatory leave minimums for certain key positions would broaden the opportunity to detect fraud.

Members of the Pension Office returned and were commended for another good year.

Selection of Auditor for FY2005

A discussion was held concerning the audit contracts going forward for the next few years and the State's desire to have a single statewide audit contract. It was agreed that to coordinate the contract schedules, the pension audit would be awarded on a one-year contract for the next year. The Audit Committee recommended a one-year RFP to be sent to the "Big Four" accounting firms plus the Siegfried Group. R. Draper advised that he would discuss this matter with the State Auditor, Tom Wagner.

4. GOVERNANCE ISSUES

A list of Governance Issues had been distributed to Board members at an earlier date for further discussion. A discussion then followed on the following items.

- Board of Pension Trustees attendance policy; M. Kramarck will prepare a draft attendance policy for review by the Board. This policy will outline that both Board and Committee members are expected to attend 75% of their respective meetings.
- What personal liability are Board members exposed to? M. Kramarck reported that the statute creates immunity with the exception of willful misconduct. Therefore, both Board and Committee members are indemnified and personal assets would not be at risk.
- Creation of a formal nominating committee when vacancies exist for Board members. The Board can not supersede the current process in which the Governor's office is responsible for nominating new members, so it was decided that no further action was required on this topic.
- Should a member of the Board chair the Board's Committees? After a discussion it was agreed that the Audit and Medical Committees are better served by chairs independent of the Board. As for the Investment Committee it was felt that the Board is responsible for the investment decisions, thus should be chaired by a Board member.

MOTION made by D. Singleton and seconded by N. Shevock, that the Chair of the Investment Committee shall be a member of the Board of Pension Trustees, effective the next occasion that the Chair position becomes vacant.

P. Reese – Yes
R. Allen – No
J. King – Yes
D. Singleton – Yes
N. Shevock – Yes

MOTION ADOPTED

- Should the daily fee and annual dollar limitation on Board member payments for services be increased? The daily fee was increased to \$150 in the FY05 Budget Act. On the advice of Counsel, the original Board action setting up an annual limit was beyond its authority, and the previous action is voided. There will be no annual cap on Board member payments.
- Discussion on whether a self-audit should be undertaken to evaluate best practices to be used. General Board consensus is to proceed with developing a self-audit of fiduciary and investment responsibilities. Pension Office staff will look for vendors and develop a scope document. As part of the annual review of the investment advisor, the Investment Committee is pursuing a non-competitive review of both investment advisor and investment practices.

5. INVESTMENT COMMITTEE REPORT

INVESTMENT PERFORMANCE – MONTH ENDING AUGUST 31, 2004

<u>Fund</u>	<u>Previous Month</u>	<u>Fiscal Year To Date</u>	<u>12-Month</u>
Total Fund	0.6%	(1.2)%	12.1%
S & P 500 Index	0.4%	(2.9)%	11.4%
60/35/5*	1.0%	(0.6)%	9.2%
Delaware Benchmark**	1.1%	(0.6)%	10.1%

*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 August totaled \$5.435 billion. The fund posted a month of fair performance with August gaining a 0.6% return during the month. This return was under the Delaware Benchmark of 1.1% and was also lower than the 60/35/5 benchmark of 1.0%.

The month of August was uneven across the equity markets. The Russell 3000 stocks gained 0.4%, Large Growth stocks lost 0.5% and Large Value index returned a positive 1.4%. Small cap stocks posted a loss with the Russell 2000 returning a negative 0.5% mainly due to the growth sector. The international markets kept pace with the U.S. market with the unhedged EAFE returning a positive 0.4%. The bond market, with the changing interest rates experienced positive returns for the month with the Lehman LT Government/Corp Index at 3.8% and the High Yield sector returned a positive 1.6% as spreads continue to widen and higher coupons.

The fiscal year returns for two months for the Fund will be reported at a negative 1.2%, compared to a negative 0.6% benchmark. This negative variance to benchmark is mainly due to the high U.S. equity and International Equity position of the Mellon-TAA and GTAA. Mellon's current allocation to equity is 90% in the TAA. Calendar year to date returns are 2.2% compared to 1.6% for the Delaware benchmark.

The Investment Committee met mid-month with OFI Institutional, formerly Trinity, a small cap equity manager and discussed their performance and quantitative process. Their short-term performance has fallen off but the firm performance remains strong against its peer group and when looking over a longer time horizon.

The meeting on Tuesday included a detailed presentation from Mercantile-Safe Deposit & Trust Company. Included in the meeting were several members from the Audit Committee. Mercantile's presentation included information on their changing reporting systems from AmTrust to Sunguard scheduled over the next month. An update on their move from State Street Bank to Bank of New York as International clearing agent was also included.

In addition, the Committee did its annual review of services provided by Ashford Capital Management. This review included discussion on meeting frequency, materials provided, new reporting formats, manager meetings, staffing and continuity of relationship. Several recommendations were forthcoming and will be discussed with Ashford Capital. This includes working on a best practices review within the next year, if practical.

The fund has an investment in OCM Emerging Markets that opens for possible liquidation in December 2004. It is recommended that the approximate balance of \$80 million remain with the manager and be scheduled for possible withdrawal over three years, 1/3 in each of 2, 3 and 4 years. This maturity schedule coupled with other staggered maturity investments will ladder the windows where withdrawals can be made. Total invested in OCM Emerging Markets is approximately \$200 million with opening dates in 2005, 2006 and 2007. Returns in this unique investment continue to be strong. While this investment is considered as part of our "illiquid" portion of the fund that includes private investments, it has liquidity on the dates the fund opens. When investing we commit the funds for three years or an average of three years. As a result these staggered windows, the Committee will also be considering at a later date, whether or not the cap we have on "illiquids" should be raised to allow higher investment in private partnerships.

The Investment Committee seeks the authority to rollover the existing investment of approximately \$80 million in the Oaktree Capital Management (OCM) fund when it opens for liquidation on December 31, 2004, into investments that will have future openings for one-third of the funds on December 31, 2006, 2007, and 2008.

MOTION made by P. Reese, seconded by D. Singleton to commit the proceeds from the December 31, 2004, liquidation of the OCM Emerging Markets fund to a new tranche for a three-year average investment period.

MOTION ADOPTED UNANIMOUSLY

In addition, the Committee recommends up to \$100 million be invested in Carlyle IV now in formation as part of our private investment program. Carlyle II and III have both been strong performers with strong cash flows even as committed capital is drawn down. The Committee will be meeting with some of the principals of the fund in October in a special Investment Committee meeting. This fund is expected to be over subscribed and we want to be a major player in this fund at an appropriate level.

MOTION made by D. Singleton and seconded by N. Shevock to approve an investment of up to \$100 million in the Carlyle IV fund.

MOTION ADOPTED UNANIMOUSLY

Jan King proposed the addition of Barbara Graham to the Investment Committee. Ms. Graham is a CPA and the former CFO of Connectiv and a career financial executive of the caliber that the Committee needs.

MOTION made by J. King and seconded by N. Shevock to approve the appointment of Barbara S. Graham to serve as a member of the Investment Committee.

MOTION ADOPTED UNANIMOUSLY

October will be a busy month for the Committee with a special meeting on October 5th, another October 12th and the 26th.

6. PENSION ADVISORY COUNCIL

J. Testerman advised that there was nothing to report from the Advisory Council and 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 months of August and September 2004.

Meeting Dates

A listing of all 2005 meeting dates was distributed, including all Board, Committee, Advisory Council, and appeal hearing dates for the year. D. Craik requested that each Board member sign up for three appeal dates in 2005 and forward those dates to him. D. Craik requested Board members to sign up for the remaining 2004 appeal dates. J. King will participate in the October hearing, P. Reese in November, and N. Shevock in December.

The Board reviewed a resolution thanking Lisa Blunt-Bradley for her service to the Board and the Office of Pensions.

MOTION made by R. Allen and seconded by P. Reese to approve the resolution thanking Lisa Blunt-Bradley for her service on the Board of Pension Trustees.

MOTION ADOPTED UNANIMOUSLY

8. PENDING ITEMS

D. Craik reported that the RFP for item #1, Disability Project, had closed on September 30 and there had been seven bids submitted.

9. DEPUTY ATTORNEY GENERAL REPORT

Appeal cases were deferred to Executive Session

10. EXECUTIVE SESSION

MOTION made by R. Allen and seconded by P. Reese to convene an Executive Session for the purpose of discussion of two appeal cases.

MOTION ADOPTED UNANIMOUSLY

MOTION made by D. Singleton and seconded by R. Allen to exit Executive Session.

MOTION ADOPTED UNANIMOUSLY

Following a discussion in Executive Session, the following motions were made:

MOTION was made by R. Allen and seconded by J. King to accept the decision of the hearing officer in the case of Lisa Feddiman to grant her application for disability benefits.

MOTION ADOPTED UNANIMOUSLY

MOTION was made by J. King and seconded by D. Singleton to accept the decision of the hearing officer in the case of Susan Bridgman to deny her request for retroactive benefits.

MOTION ADOPTED UNANIMOUSLY

12. ADJOURNMENT

The next Pension Board meeting will be held on October 26, 2004 at 1:30, in the Delaware Conference Room at Ashford Capital Management in Wilmington, Delaware.

At 12:30 p.m. there being no further business, MOTION was made by D. Singleton 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