

STATE OF DELAWARE
STATE BOARD OF PENSION TRUSTEES
AND
OFFICE OF PENSIONS
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BOARD OF PENSION TRUSTEES
MEETING MINUTES OF SEPTEMBER 29, 2006

The meeting of the Board of Pension Trustees was called to order by P. Reese at 9:02 a.m. in the Delaware Conference Room of the Office of Pensions in Dover.

Trustees Present

Philip S. Reese
Jan King
Nancy J. Shevock
Richard Cordrey
Jennifer Davis
Helen Foster

Trustees Absent

Robert Allen

Others Present

David Craik, Pension Office
Kim Vincent, Pension Office
Kathy Kunkle, Pension Office
Terri Timmons, Pension Office
Karen Field Rogers, OMB
Jim Testerman, PAC
Joel Poorman, Audit Committee
Rob Gooderham, Ashford Consulting Group
Gary Musto, Ashford Consulting Group
Linda Drew, Ashford Consulting Group
Bob Steen, KPMG
Evelyn Zerenner, KPMG

1. OPENING COMMENTS

The meeting of the Board of Pensions Trustees was called to order by P. Reese. Mr. Reese welcomed KPMG staff Bob Steen and Evelyn Zerenner and Ashford Consulting Group staff Rob Gooderham, Gary Musto and Linda Drew.

2. APPROVAL OF THE MINUTES

The Trustees reviewed the minutes of the July 28, 2006 meeting.

MOTION made by J. King and seconded by N. Shevock to approve the minutes of the Board of Pension Trustees' July 28, 2006 meeting.

MOTION ADOPTED UNANIMOUSLY

3. AUDIT COMMITTEE REPORT

Joel Poorman, Chair of Audit Committee, turned over the meeting to Bob Steen from KPMG. P. Reese asked B. Steen what branch office they were from and it was stated they were from the Philadelphia office.

B. Steen reported on the findings of the annual audit. He referred to the Independent Auditor's Report to review this year's audit. He called attention to the new AICPA guidelines KPMG follows and the emphasis paragraph disclosing assets held by the System. B. Steen also spoke of the Management Letter, a draft of which was reviewed by the Audit Committee.

It was stated that there were no difficulties in performing the audit. A draft of the Management Letter was presented to Management for their review and comments. J. Poorman suggests that the Management Letter be discussed with all the Board Members. P. Reese asked that the Management Letter be sent to any Board Member not present at this meeting so it can be reviewed and will then be discussed at the October Board meeting.

Joel Poorman hopes everyone reads the Comprehensive Annual Financial Report (CAFR). He spoke briefly about the current investment climate and the resulting need for greater internal controls. He commented on the impact of the audit report production schedules on getting the CAFR published by the self-imposed deadline. The State has a contract with KPMG for one more year of pension plan auditing.

J. Poorman also spoke of the new Custodian Bank, Northern Trust, and stated it was clearly a step up. The reporting capabilities are far better and we have fixed fees. He stated that the flowcharts may need to be updated and that we might need to be independent from KPMG for this. He also spoke of the recent personnel retirements within the Pension Office such as our attorney Marsha Kramarck who brought a lot of experience to the table and will be missed and Alice Simon, who was the Cash & Debt Manager. A. Simon's retirement creates a void and also adds additional

workload. J. Poorman spoke briefly about the Cash & Debt Manager and Management Analyst III vacancies. He went on to say that while R. Gooderham, G. Musto and L. Drew of Ashford's Consulting Group are very competent and have the expertise we still have a shortage in our own shop and that needs to be watched. It will take time to train new employees.

4. INVESTMENT COMMITTEE REPORT

R. Gooderham presented the Board Members with the Investment Committee Report for the Quarter Ending June 30, 2006. He reviewed the total fund performance asset allocation, the objectives and policies as of June 30, 2006. He further spoke of risk control and the rolling benchmark for the total fund. R. Gooderham explained the evolution of component weighting in the fund's benchmark ("DelBench"). He also discussed the increased emphasis on non-traditional investment opportunities to provide more diversified return drivers.

<u>Fund</u>	<u>Previous Month</u>	<u>Fiscal Year To Date</u>	<u>12-Month</u>
Total Fund	1.5%	1.4%	10.5%
S & P 500 Index	2.4%	3.0%	8.5%
60/35/5*	2.0%	2.9%	5.9%
Delaware	2.1%	2.9%	7.3%
Benchmark**			

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

**Benchmark mix of 37% Russell 3000, 1% NAREIT, 20% MSCIA, 38.5% Lehman Bond universal, 1.5% LBTIPS, 2% T-bills.

J. King stated that the total assets in the fund at the end of August were \$6.6 billion. The Fund gained 1.5% for the month which was less than the Delaware Benchmark of a positive 2.1% and was ahead of the 60/35/5 benchmark which was 2.0%. The slight under performance to the benchmark is mainly due to the large allocation to natural resources.

The month of August was a strong market with positive returns in most asset classes. The Russell 3000 Stocks gained 2.4% with Large Growth Stocks leading at a positive 3.3% gain for the month while the Large Value Index returned a positive 1.7%. Small Cap Stocks also had a positive return of 3.0%. The International Markets were also positive with unhedged EAFE returning 2.7%. The Bond Market with Lehman LT Government/Corp Index experienced gains of 2.9% with the remainder of the fixed income indices also yielding positive results. Natural Resources Index experienced large losses returning a negative 3.1% for the month.

The fiscal year 2007, for two months return for the Fund, will be reported at a 1.4% gain, compared negatively to a 2.9% benchmark. This negative variance to benchmark is mainly due to the

high NRIS tactical allocation. Calendar returns for 2006 are a positive 6.6% compared to a 5.2% benchmark.

At its meeting on September 12, 2006, the Investment Committee made the following investment recommendations which needs Board approval. Western Asset Management Company (WAMCO), located in Pasadena, CA, is one of the largest fixed income managers with over \$500 billion under management. The Investment Committee reviewed and recommends the use of WAMCO's Absolute Return Strategy.

This product utilizes all of the basic fixed income strategies plus high yield, non-U.S. Markets, bank loans and commodities. There are wide allocation limits and duration ranges to allow the manager maximum flexibility to achieve returns.

The Investment Committee recommended retaining Western Asset Management Company and upon satisfactory negotiation of a contract, funding up to \$225 million in its commingled Absolute Return Strategy. After a discussion of the merits the Board then voted.

MOTION was made by J. King and seconded by J. Davis to fund up to \$225 million in the Western Asset Management Company commingled Absolute Return Strategy upon satisfactory negotiation of a contract.

MOTION ADOPTED UNANIMOUSLY

In order to fund the above investment, the Investment Committee recommends the termination of Mt. Lucas Management (approx. \$157 million market value). In addition, the Committee recommends terminating the domestic convertible bond account managed by Frole, Revy (approx. \$132 million market value). After a discussion of the merits the Board then voted.

MOTION was made by P. Reese and seconded by J. King to terminate Mt. Lucas Management (approx. \$157 million market value) and to terminate the domestic convertible bond account managed by Frole, Revy (approx. \$132 million market value).

MOTION ADOPTED UNANIMOUSLY

The Investment Committee further recommends using an existing domestic convertible bond manager, Oaktree Capital Management, to liquidate the Frole, Revy account, keeping one-half of

the account (approx. \$66 million) in cash and/or in-kind assets; and transferring approximately \$66 million cash to DPERS to complete the funding of the WAMCO Absolute Return Strategy.

MOTION was made by J. King and seconded by J. Davis to use the services of Oaktree Capital Management, to liquidate Froley, Revy account, transfer approximately \$66 million cash to DPERS to complete the funding of the WAMCO Absolute Return Strategy, and use the remaining balance (approx. \$66 million) to fund an additional investment in the Oaktree Capital Domestic account.

MOTION ADOPTED UNANIMOUSLY

A PowerPoint presentation was made to the Board Members in reference to the 2005 CEM Benchmark Study on the DPERS Results Summary. An overview was presented on the primary purpose of the survey, the underlying CEM premise, concerns for applicability of the data and the overall results.

The Investment Committee recommends the following:

- The relationship with CEM be discontinued as it relates to the investment survey.
- The Investment Committee tracks investment return against the TUCS peers and finds these results more meaningful because it ranks total performance.
- Comparison to averages is not “best practices.”

According to J. King during the Custodial Bank transition there were problems getting the July and August reports and there are still some transition items between Mercantile and Northern Trust.

The next Investment Committee meeting will be held on October 17th.

5. PENSION ADVISORY COUNCIL

J. Testerman stated that the Advisory Council was pleased with the recent Disability Insurance Program legislation.

He also thanked the staff for their work in scheduling and preparation for the November 4th DSEA workshop.

6. PENSION ADMINISTRATOR'S REPORT

Disability Pension Report

D. Craik reported that there was a low number of three new cases for September. There were two cases in the sixty day category and twenty-two continuance cases for the month.

Resolutions

D. Craik stated that resolutions had been written for Marsha Kramarck, Alice Simon and Dr. Tikellis. He asked Board Members to review and make any comments. J. Davis stated she would like to sign the resolutions along with P. Reese.

MOTION was made by J. King and seconded by N. Shevock to approve all three Resolutions.

MOTION ADOPTED UNANIMOUSLY

1st Quarter FY07 Activities

D. Craik stated that from this point forward he will report to the Board, on a monthly basis, the Pension Office statistics.

- 600 New Pension applications processed
- 200 Deletes (deaths, return to work)
- 1,900 Additions into Healthcare
- 700 Changes in Healthcare
- 250 Estimates
- 140 Individual counseling sessions
- 30 Walk-in customers (Ave per day)
- 5,000 Phone calls per month
- 16,000 Phone calls per quarter
- 250 Refunds processed
- 222 Group Life Benefits processed
- 30 Audits completed
- 3 Employee workshops this quarter
- Upcoming Disability Insurance Program workshops

Request for Repayment Schedule

D. Craik led a discussion on the repayment schedule to allow Mary E. Phillips 24 months to repay the Leave of Absence buy-in cost of \$4,553.93 based on her second retirement and the lack of information provided by the Pension Office.

MOTION was made by J. King and seconded by J. Davis to allow Mary E. Phillips 24 months to repay the Leave of Absence buy-in cost of \$4,553.93.

MOTION ADOPTED UNANIMOUSLY

County Municipal Report

D. Craik stated that the Mid-Sussex Rescue Squad is requesting to join the County Municipal Pension Plan with an effective date of January 1, 2006.

MOTION was made by R. Cordrey and seconded by J. King to allow the participation of the Mid-Sussex Rescue Squad in the County Municipal Pension Plan as of January 1, 2006.

MOTION ADOPTED UNANIMOUSLY

Personnel Issues

MOTION was made by J. King and seconded by R. Cordrey that the Board goes into Executive Session to consider pending personnel and confidential matters.

MOTION ADOPTED UNANIMOUSLY

The Board then moved into Executive Session to discuss pending personnel and confidential matters.

MOTION was made by J. King and seconded by N. Shevock to exit Executive Session.

MOTION ADOPTED UNANIMOUSLY

7. DEPUTY ATTORNEY GENERAL REPORT

There was no Deputy Attorney General Report due to the absence of M. Kramarck.

8. PENDING ITEMS

D. Craik stated that there were no updates on the Pending Items List.

9. NEW BUSINESS

There was no new business to discuss.

10. ADJOURNMENT

The next Pension Board meeting will be held on October 27, 2006, at 9:00 a.m., in the Delaware Conference Room of the Office of Pensions.

At 11:50 p.m., there being no further business, MOTION was made by R. Cordrey and seconded by N. Shevock to adjourn the meeting.

MOTION ADOPTED UNANIMOUSLY

Respectfully submitted,

David C. Craik
Pension Administrator

Philip S. Reese
Board of Pension Trustees Chairman