

STATE OF DELAWARE

INVESTMENT COMMITTEE MEETING MINUTES

September 15, 2009

The Investment Committee met at Walker's Mill at 8:30 a.m. on September 15, 2009. Present were Committee members George Saxon, Chair, A. Dale Stratton, Clark Phippen, Jan M. King and Philip S. Reese and Board member Suzanne Grant. Also present were Robert D. Gooderham, Garry A. Musto, David Craik, Wade Sallings, Jeffrey Hoover, Cynthia L. Collins, Seth J. Yablonovitz and Linda M. Drew.

Minutes of the August 18, 2009 Investment Committee meeting were approved as presented.

Mr. Reese moved, Mr. Phippen seconded, and the Committee unanimously approved a motion to enter Executive Session at 8:32 a.m. to consider sensitive commercial information, proprietary business information, trade secrets and confidential financial information.

The Committee returned to public session at 12:40 p.m. by unanimous vote, on the motion of Ms. King, seconded by Mr. Reese.

On motion of Ms. Stratton, seconded by Mr. Reese, the Committee unanimously voted to recommend the following actions to the full Board:

1. Terminate the international equity manager Mercator Asset Management and liquidate the account using Northern Trust's transition management services as needed.
2. Invest the Mercator account proceeds to Sanderson Asset Management's commingled international equity fund, employing as needed Northern Trust's transition management services to try and minimize the buy-in costs of the Sanderson fund.
3. Transfer cash balances currently managed by Northern Trust in its GSTIF fund to the Northern Trust STIF fund.

Mr. Gooderham reported that Meritech Capital Partners has requested a two year extension to the Meritech Capital fund. On the motion of Ms. Stratton seconded by Ms. King, the Committee unanimously voted to approve the Extension.

There being no further business to come before the Committee, the meeting was, on the motion of Ms. King, seconded by Mr. Reese and unanimously approved, adjourned at 12:45 p.m.

Respectfully submitted,

/S/Robert D. Gooderham
Robert D. Gooderham
Executive Secretary

/S/George J. Saxon
George J. Saxon, Chairperson

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Mr. Gooderham reviewed preliminary fiscal and calendar year performance through 8/31/09 for individual managers and the total fund, noting that the Fund continued to benefit from positive markets. Although the Fund experienced a positive return, it lagged its benchmark due to the cash position and illiquid partnerships which are marked to market on a lagged basis.

Mr. Gooderham reported that when Mr. Musto recently visited OFI in their Bellefonte, PA office, he learned that six people had been terminated in July and ACG had not been informed of this personnel change. This violates the understanding and trust of the firm's relationship with both ACG and DPERS. Mr. Gooderham stated that, in his opinion, the terminations and lack of disclosure were due to revenue pressure from the parent company. Mr. Gooderham stated that ACG's recommendation is to delay termination of OFI until ACG can bring recommendations for new small cap managers to the Committee instead of going through an interim step, involving significant transaction costs, of investing any OFI proceeds temporarily in a small cap index fund.

Mr. Musto reviewed the topics he requested Northern Trust cover in their presentation to the Committee today stating the topics are custody, cash management, and securities lending.

At this point Ms. Pamela Newton of the Northern Trust Company (Northern) entered the meeting and distributed detailed materials in connection with the firm's custodial, securities lending and cash management capabilities.

Ms. Newton briefly reviewed the firm's 120 year history and founding principles of integrity and service which remain unchanged. Ms. Newton reviewed management changes which have been recently announced, noting that the firm's president and CEO will also assume responsibilities of Chairman as the current Chairman is retiring. Ms. Newton also reported that last fall Northern had been asked, along with other large banks, to take TARP funds which they did. All funds, including interest, have been returned to the Government by Northern.

Ms. Newton stated that Northern is in the process of rolling out enhanced reporting capabilities which they will be going over with Pension Office staff soon. The

new services offered will include additional analysis capabilities by the Risk and Performance group.

At this point Messrs. Peter Yi and George Trapp of Northern joined the meeting by conference call.

Mr. Yi introduced himself stating that he is the portfolio manager of short duration fixed income and cash management at Northern.

Northern's cash management investment philosophy focuses on principal preservation, liquidity management and yield maximization. Of these, principal preservation is the most important. Comprehensive risk control and an extensive credit review process are fundamental in the implementation of the cash management strategy.

Mr. Yi stated that, in his opinion, markets will continue to be challenging and he is maintaining conservative positioning in the cash pools. Thirty-five percent of the \$27 billion Collective Short Term Investment Fund (STIF) has overnight liquidity and 60% has thirty day liquidity. The restructuring of the troubled SIV holding in the STIF fund has been finalized and there are no SIV's in the fund. The average quality of the fund is A1 with over 50% in repurchase agreements and certificates of deposit.

The Collective Government Short Term Investment Fund (GSTIF) is comprised of U.S. Government and Agency securities and A1 paper. The \$11 billion fund has an average maturity of 52 days with a 5% maximum limit to any one holding. The current yield of the GSTIF is 15 basis points lower than STIF.

At this point Mr. George Trapp turned to a review of Northern's securities lending program stating that securities lending activity promotes market efficiency and liquidity. Northern's program has 548 participating clients and \$586 billion in lendable securities with \$98 billion in outstanding loans. Northern's lendable base of securities is down approximately 50% from a year ago, largely due to market action.

In response to questions from the Committee regarding clients' ability to withdraw from the securities lending program over the last year, Mr. Trapp stated that a few have left and some who wanted out could not since, for fairness, Northern required departing clients to take their pro-rata share of troubled assets in the CORE collateral pool. Approximately 80-85% of Northern Trust clients have continued their securities lending program.

Mr. Trapp reviewed an estimate of DPERS potential earnings from securities lending activity of approximately \$1 million per year based on current holdings and spreads, with borrowers' cash collateral invested in the Basic collateral pool. Mr. Trapp stated that Northern offers a non-cash collateral option but this would reduce spreads and thus income from the program.

At this point Messrs. Yi and Trapp withdrew and terminated the conference call.

Ms. Collins noted DPERS problems in establishing international custody accounts in countries such as India and Taiwan and requested Ms. Newton explore the potential for Northern to establish omnibus custody accounts for these countries. The Committee also requested Ms. Newton determine the number of Northern's public fund clients who have established custody accounts in India. Ms. Newton agreed and will follow-up with the Committee.

Following further full discussion Ms. Newton withdrew from the meeting.

Mr. Musto reviewed ACG's recommendation, which had been circulated in advance, to terminate Mercator and use the account proceeds to fund an international equity account with Sanderson Asset Management. Sanderson has Mercator's value orientation, but adds a mid-cap bias and an improved analyst team. Sanderson offers only a commingled investment vehicle and DPERS would be one of the larger clients in this pool. Sanderson charges a 60 basis point transaction fee for new clients to implement. Mr. Musto recommends exploring the potential for Northern Trust to structure the new portfolio at a lower cost.

At this point Ms. Holly Harralson and Mr. Gavin Hall of Sanderson Asset Management (Sanderson) entered the meeting and distributed detailed materials in connection with the firm's international equity strategy.

Mr. Hall described the Sanderson investment philosophy which is based on the premise that (1) value investing exploits market inefficiencies which are more prevalent outside the USA and at the individual stock level and (2) international value investing outperforms international growth with less downside volatility. Sanderson seeks companies which are both undervalued and have high quality characteristics exhibited in strong franchises with a record of success. The firm looks at individual businesses rather than macro themes and thus stock selection is the basis of the firm's ability to add value.

The portfolio construction process begins with a database of approximately 1,500 international securities. This universe is then screened for value characteristics and growth measures. The companies in the cheapest quartile are then analyzed on fundamentals by sector specialists to produce a list of approximately 200 companies. Analysts seek companies with an ability to produce real returns of 4-5% and focus more on the dividend stream than appreciation for returns.

The process seeks to determine if a company is one the firm would like to own as well as invest in. Key factors evaluated in answering this question are underlying industry growth, competitive position, strong and stable cash flow, strong capitalization, past track record, and experienced and ethical management. Analysts each focus on specific industries and spend 25-35% of their time on the road meeting with managements. Risk is controlled by (1) intense company research and use of "worst

case” analysis and (2) very broad sector and country exposure ranges. This produces a portfolio which can be very different from the benchmark.

Companies are sold if their price reaches its pre-determined fair value, if there is an unanticipated change in the fundamentals or if more attractive alternatives are available.

Mr. Hall reviewed characteristics of the Sanderson portfolio relative to the EAFE benchmark. At 8/31/2009 the Sanderson portfolio presented had a dividend yield, P/E ratio, and return on equity of 2.9%, 13.3x, and 11.3% versus those for the EAFE Index of 3.2%, 20.8x, and 7.7% respectively. The weighted average market capitalization of the Sanderson portfolio was \$17.7 billion versus \$42.6 billion for EAFE.

In response to a question from the Committee regarding Sanderson’s 2007 relative underperformance of the EAFE index, Ms. Harralson stated that 2007 was a year when both the growth and small cap sectors outperformed the value and large cap sectors. The annualized return of the Sanderson international equity strategy for the five years ended 8/31/09 was +9.8% compared with +5.8% for the MSCI EAFE index.

Following further full discussion the Sanderson group withdrew from the meeting.

The Committee reviewed the Sanderson presentation, concurring with ACG that Sanderson is a good international manager to replace Mercator. The Committee authorized Mr. Musto to pursue discussions with Northern Trust regarding the cost of a transition of Mercator’s holdings to the Sanderson portfolio holdings.

The Committee reviewed the Northern Trust presentation. Mr. Musto stated that he is reviewing all of Northern’s cash collateral pool options. Following discussion the Committee unanimously determined to continue suspension of DPERS securities lending activities. In light of improved conditions in the Northern STIF pool and the STIF’s increased yield and lower fees, the Committee unanimously agreed to recommend DPERS cash holdings be transferred from the GSTIF to the STIF pool.

Mr. Gooderham updated the Committee on Liquid Realty Partners (LRP) stating that the Advisory Committee has had numerous calls over the past month and that the General Partner has agreed to termination of the investment period and plans to circulate an amendment to the Limited Partnership Agreement to this effect.

Mr. Gooderham reviewed the Mellon Bond Holding account and distributed several tables detailing monthly returns, cash flows and pricing. Mr. Gooderham noted that it has been approximately one year since Mellon was hired to monitor the illiquid holdings in DPERS terminated Lehman Asset Management account. In that time, the average price as a percent of par value has increased from a low of 64.5% to 73.4%. In addition, DPERS has received distributions totaling over \$14 million during this period. There have been no security sales to date, but the portfolio manager has indicated that we

are now in a market environment when sales of these troubled securities are possible. The Committee requested Mr. Gooderham remind the portfolio manager of its mandate for the portfolio of liquidating all holdings in a prudent manner.

Mr. Sallings updated the Committee on the status of the audit stating that despite some initial concerns regarding the First State Independence Fund, the issues are resolved and the audit is proceeding. Mr. Musto reported that he and Mr. Yablonovitz and the auditors met with Barlow Partners in their office in New York on 9/8/09. The mechanics and flow of information was clarified and the auditors expressed confidence in Barlow's process and internal controls.

Mr. Yablonovitz updated the Committee on Barlow Partners stating that senior analyst Trevor Hallstein has left the firm and that Mr. Hambrecht has added a portfolio manager to the team. While Mr. Hambrecht previously stated he would liquidate the firm at his retirement, it now appears that he may be transitioning to this individual. Mr. Yablonovitz stated that ACG has concerns regarding this individual's ability to take over for Mr. Hambrecht in the event of his retirement.

In response to a question from the Committee regarding its original plan to transfer some funds from Barlow management over time to ACG oversight, Mr. Yablonovitz stated that ACG is still comfortable with this plan. The Committee requested, and ACG agreed to supply, an action plan and timeline for such a transfer.

The Committee reviewed proposed meeting dates for 2010 and approved the dates as proposed.

Respectfully submitted,

/S/Robert D. Gooderham
Robert D. Gooderham
Executive Secretary

/S/George J. Saxon
George J. Saxon, Chairperson