

**State of Rhode Island and Providence Plantations  
STATE INVESTMENT COMMISSION**

**Regular Meeting December 1, 2004**

A State Investment Commission meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, December 1, 2004. There being a quorum present, Treasurer called the meeting to order at 9:10 a.m.

Membership Roll Call. Present were: Mr. J. Michael Costello, Senator Daniel DaPonte, Ms. Rosemary Booth Gallogly, Ms. Marcia Reback, Mr. James E. Thorsen, Mr. John R. Treat, and General Treasurer Paul J. Tavares. Dr. Robert J. McKenna arrived at 9:20 a.m. Also present were: Mr. George Carvalho, Chief of Staff, Ms. Joan M. Caine, Deputy Treasurer for Finance, Mr. William Bensus, of Wilshire Associates Incorporated, Consultant to the Commission, Jayne Donegan, Esq. and Kevin Nulton, Esq. of Brown Rudnick Berlack Israels, Legal Counsel to the Commission, Mr. Peter Martenson and Mr. Rick Freitas of Pacific Corporate Group, Alternative Investments Consultant to the Commission, Mr. Frank Blaschka of The Townsend Group, Real Estate Consultant to the Commission, and other members of the Treasurer's Staff.

State Investment Commission Minutes. Sen. DaPonte moved, Mr. Costello seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares. (Note: Dr. McKenna was not present for this vote.)

**VOTED: To approve the Minutes of the October 27, 2004 Regular Meeting.**

Proposed Alternative Investment – Kayne Anderson III, L.P. (“Kayne Anderson”). Mr. Martenson of Pacific Corporate Group (“PCG”) gave a brief overview of Kayne Anderson, which is being formed to make active private equity investments in well managed oil and gas exploration and production (“E&P”) companies with enterprise values ranging from \$25 to \$500 million. The Fund will focus on E&P companies that are undertaking lower risk development drilling activities, rather than on higher risk exploration activities. Investments will be concentrated in North America and will be in the range of \$10 to \$50 million. The Fund target size is \$550 million.

Mr. Kevin Welsh, Managing Director of Institutional Account Management and Mr. Daniel Weingeist, Partner and Managing Director of Energy Investments represented Kayne Anderson. Mr. Welsh noted that Kayne Anderson has \$2.5 billion in private equity and hedge funds under management. The principals have completed 39 investments with 22 energy companies since 1991. He stated that Kayne Anderson provides strategic equity capital to finance acquisition and development opportunities.

Mr. Weingeist stated that the Fund's strategy is to invest in strong management teams with the intent to exit within a relatively short time horizon (2 to 4 years). Kayne Anderson provides capital to well managed companies, establishes a high degree of involvement with companies post investment, and exits investments following realization of value. He noted that all companies are 50-80% hedged against fluctuations in oil prices. Kayne Anderson Fund I returned 29.1% and Fund II returned 55.0% as of 9/30/04.

Mr. Costello moved, Mr. Treat seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: To invest up to \$15 million in Kayne Anderson III, L.P., contingent upon satisfactory review and negotiation of investment and other legal documents.**

Treasurer Tavares requested that the Commission members approve a change in the order of items on the Agenda so that the presentations from Alliance Capital and Fidelity Management Trust Co. would precede the discussion on Gateway Eight. All were in favor of the change.

CollegeBoundfund – Alliance Capital (“Alliance”). Mr. Richard A. Davies, Executive Vice President and head of Retirement and College Savings Plans and Ms. Jennifer DeLong, Senior Vice President and Director of 529 Product Management represented Alliance. Mr. Davies updated the Commission on progress made since the settlement with the New York Attorney General and the SEC. A \$250 million fund has been set up to compensate shareholders with an independent distribution consultant. The SEC has approved the nominee and is still reviewing the methodology for determining payments. Alliance has since improved their governance procedures with the establishment of a Code of Ethics Oversight Committee, a Compliance Controls Committee and an Independent Compliance Consultant. Alliance has also reduced management fees which resulted in a positive impact on CollegeBoundfund participants.

Ms. DeLong reported that the CollegeBoundfund has total assets of \$5.2 billion. There are 441,000 accounts in total, and 12,800 in Rhode Island. The average balance in a Rhode Island account is \$9,300. The majority of the accounts are in the age-based (4-6 year olds) portfolios. The CollegeBoundfund's portfolios have consistently outperformed its competitors (Putnam, John Hancock (Manulife), Fidelity Advisors, and Franklin/Templeton).

Mr. Davies discussed Alliance's proposal, as requested by General Treasurer Tavares, to add a Total Stock Market Index Option for participants. The option would be a broad market index managed by Vanguard that tracks the Wilshire 5000 index. It would have large, mid and small cap US equity exposure and be passively managed using index sampling. Direct investors will pay an annual fee of 45 basis points (Admiral shares of Vanguard Fund priced at 15 basis points, plus program management and shareholder servicing fees of 30 basis points). Ms. DeLong explained that the option would be available to participants as of 12/15/04.

Dr. McKenna moved, Mr. Thorsen seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: To direct Alliance Capital as Program Manager to add the Vanguard Total Stock Market Index Portfolio as an investment option available to Rhode Island residents (and other eligible accounts) purchasing directly from the program.**

Mr. Thorsen moved, Sen. DaPonte seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: To authorize Alliance Capital to (1) enter into an agreement with the Vanguard Group, Inc. to arrange for the purchase and redemption for the Rhode Island Higher Education Savings Trust of shares of the Vanguard Total Stock Market Index Fund in response to CollegeBoundfund participants' purchase and redemption directions; and (2) take any other actions that may be necessary in connection with the administration of the Vanguard Total Stock Market Index Portfolio.**

Investment Manager Review – Fidelity Management Trust Co. (“Fidelity”). Mr. Bensus gave a brief overview of Fidelity, which was retained in 1989 to provide a long-term, strategic allocation to the mortgage-oriented sector of the fixed income market. As of 9/30/04, the Fidelity portfolio represented approximately 25% of the fixed income composite and approximately 6% of the total fund. Market value as of 9/30/04 was \$391.8 million.

Mr. Arthur Greenwood, Relationship Manager, Mr. Thomas Silvia, Bond Group Leader and Mr. William Irving, Portfolio Manager represented Fidelity. Mr. Greenwood reported that Mr. David Murphy had been promoted to the Head of Fixed Income and that Mr. Silvia had been promoted to Bond Group Leader and has transitioned his portfolio management responsibilities to Mr. Irving. Mr. Irving has been a quantitative analyst at Fidelity since 1999. Mr. Silvia emphasized that he would still be very involved in the mortgage strategy and portfolio construction of the RIIERS portfolio.

Mr. Silvia reported that the portfolio returned 6.00% as of 10/31/04, which was 43 basis points above the benchmark, and the 3-year return is 5.94%, which is 108 basis points above the benchmark. Year-to-date the portfolio has returned 4.83%, which is 60 basis points above the benchmark. Contributing to performance in the last year was an out-of-benchmark exposure to securitized sectors – ABS, CMOs and CMBS. Fidelity has focused on Agency MBS with better prepayment characteristics. Commission members thanked Mr. Silvia for his many years of managing the RIIERS portfolio.

Mr. Irving noted that the FOMC has raised the federal funds target rate 100 basis points since June 2004. Contained inflation fears and strong foreign demand have kept longer maturity Treasury yields low. He noted that in response to those factors together with anticipated future Fed moves, the yield curve has flattened considerably over the past year. In spite of low mortgage rates, refinancing activity this year has been slow because most borrowers that are willing and able to refinance have already done so. Home prices have appreciated significantly faster than inflation. Fidelity intends to increase its focus on hybrid ARMs, continue to seek opportunities in the non-Agency residential sector, and maintain its CMBS positions.

Executive Session. General Treasurer Tavares, by open call, requested a motion to convene in Executive Session, pursuant to R.I.G.L. § 42-46-5(2) and R.I.G.L. § 42-46-5(7), to discuss potential litigation regarding the Gateway Eight lease and to discuss the investment of public funds regarding Gateway Eight. Mr. Thorsen moved, Ms. Reback seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: Pursuant to R.I.G.L. § 42-46-5(2) and R.I.G.L. § 42-46-5(7) the Commission voted to close the meeting to the public to discuss potential litigation regarding the Gateway Eight lease; and to discuss the investment of public funds regarding the Gateway Eight lease.**

The Commission went into Executive Session at 10:22 a.m.

Open Session. Mr. Costello moved, Ms. Gallogly seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: To reconvene the meeting into Open Session.**

The Commission reconvened into Open Session at 11:00 a.m.

Mr. Thorsen moved, Ms. Gallogly seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: That the Commission, on behalf of the Employees' Retirement System of Rhode Island, having reviewed in detail the proposal (the "Proposal") of Gateway Eight Limited Partnership (the "Developer") for an extension, suspension of debt payments and ultimate refinancing transaction with respect to the Developer's building located at One American Express Plaza, Providence, Rhode Island, as such Proposal has been outlined by legal counsel to the Commission, reject the Proposal and exercise its legal rights and remedies against the Developer, including but not limited to, foreclosure of the Developer's interest in such building, all in accordance with advice of counsel; and**

**VOTED: that the General Treasurer be, and he hereby is authorized, empowered and directed to execute, acknowledge and deliver any and all certificates, agreements and other documents, take any and all steps and to do any and all things as he may deem necessary or advisable, in his sole discretion, in order to effect the purposes of the foregoing vote.**

Wilshire Associates Incorporated – Manager Continuation Policy Analysis. Mr. Bensus briefly reviewed the investment managers noting that it is Wilshire's recommendation to continue to retain all of the following US Equity Managers for their current assignments: NorthPointe Capital, PIMCO StocksPlus, State Street Global Advisors, Wasatch Advisors, Inc. and Wellington Management Co. Wilshire also recommends continuing to retain The Boston Company Asset Management, Goldman Sachs Asset Management and Mondrian Investment Partners Ltd. for their Non-US Equity assignments.

Of the five fixed income managers, Wilshire recommends continuing to retain the following: Brown Brothers Harriman & Co., Fidelity Management Trust Co., MacKay Shields, and Taplin, Canida & Habacht. With regard to Shenkman Capital Management's high-yield, fixed income portfolio, it is Wilshire's recommendation to formally put them on the "Watch List" for possible termination based on the portfolio's underperformance. Mr. Bensus distributed his Capital Market Review.

Ms. Reback moved, Mr. Thorsen seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: To accept Wilshire Associates' recommendations in the Manager Continuation Policy Analysis presented at the December 1, 2004 meeting.**

Citation for Senator Daniel DaPonte. The Treasurer stated that since the approval of the Separation of Powers issue in November, 2004, that today's meeting would be the last for Senator Daniel DaPonte. He thanked Sen. DaPonte for his loyal and diligent service to the Commission and presented him with a Citation of Appreciation. Sen. DaPonte stated that it was his privilege to have served on the Commission with the Treasurer, Ms. Caine and staff.

Treasurer Tavares stated that with respect to the Separation of Powers amendment he had proposed to the General Assembly, that the State Investment Commission remain a nine member board, with two public members replacing the legislators. No decision has been made on that as of yet.

Deputy Treasurer for Finance Report. Ms. Caine distributed a list of proposed 2005 meeting dates and times to Commission members.

Ms. Reback moved, Dr. McKenna seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: To accept the proposed list of 2005 meeting dates and times as recommended.**

Ms. Reback moved, Sen. DaPonte seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Sen. DaPonte, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Thorsen, Mr. Treat, and Treasurer Tavares.

**VOTED: To adjourn the meeting.**

There being no further business, the meeting was adjourned at 11:20 a.m.

Respectfully submitted,

Paul J. Tavares  
General Treasurer