State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Regular Meeting May 24, 2006

A State Investment Commission ("SIC") meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, May 24, 2006. The Treasurer called the meeting to order at 9:05 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Ms. Rosemary Booth Gallogly, Dr. Robert McKenna, Ms. Marcia Reback, Mr. John Treat, and General Treasurer Paul J. Tavares. Also present were: Ms. Joan M. Caine, Deputy Treasurer for Finance, Jayne Donegan, Esq., of Brown Rudnick Berlack Israels, Legal Counsel to the Commission, Mr. William G. Bensur of Wilshire Associates Incorporated, Consultant to the Commission, Ms. Tara Blackburn of Pacific Corporate Group, Alternative Investments Consultant to the Commission, and other members of the Treasurer's Staff. Mr. Jeffrey Britt was absent.

State Investment Commission Minutes. Ms. Reback moved, Dr. McKenna seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, Mr. Treat, and Treasurer Tavares.

VOTED: To approve the Minutes of the April 19, 2006 Regular Meeting and to approve and seal the Minutes of the April 19, 2006 Executive Session.

Proposed Investment in Centerbridge Partners, L.P. ("Centerbridge"). Ms. Tara Blackburn of Pacific Corporate Group ("PCG") gave a brief overview of Centerbridge. She noted that Centerbridge is being formed to make both private equity and distressed debt investments. This is the first fund for Centerbridge which was formed by Mark Gallogly, former Senior Managing Director and the Head of Private Equity at The Blackstone Group, and Jeffrey Aronson, former Partner at Angelo, Gordon & Co. Target size of the fund is $3 billion.

Mr. Aronson noted that Centerbridge will pursue a multi-stage strategy making private equity investments in leveraged buyouts, corporate partnerships, build-ups, or other opportunities using a value investment strategy. The fund will also pursue distressed debt investments in situations where Centerbridge believes it can influence the reorganization process and ultimately own the company. Centerbridge intends to make investments of $50 million to $300 million per portfolio company, investing primarily in North America. The general partner has made a minimum commitment of $50 million.

Centerbridge believes that there will be significant distressed investment opportunities as default rates climb from historically low levels and revert to historical averages. Centerbridge will invest in private companies and privately held instruments, the shares of which are not publicly traded.

Mr. Costello moved, Ms. Reback seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Dr. McKenna, Ms. Reback, Mr. Treat, and Treasurer Tavares. NOTE: Ms. Gallogly recused herself from this vote.

VOTED: To invest up to $15 million in Centerbridge Partners, L.P. contingent upon satisfactory review and negotiation of investment and other legal documents.

Investment Manager Review - Wellington Management Co. ("Wellington"). Mr. Bensur from Wilshire Associates Incorporated gave a brief overview of Wellington, which was retained in 2002 to provide a long-term, strategic exposure to the small stock, core-oriented segment of the US equity market. The market value of this portfolio as of March 31, 2006 was $436.1 million and comprises approximately 13.1% of the US equity composite and approximately 6.0% of the total fund.

Ms. Elizabeth O'Hara, Vice President and Relationship Manager and Mr. Kenneth Abrams, Senior Vice President and Portfolio Manager represented Wellington. Ms. O'Hara noted that there have been no material changes to the firm. Mr. Abrams noted that Wellington uses the Russell 2000 Index as a benchmark. Although markets have been volatile, Wellington's year-to-date performance through May 19, 2006 was 8.1% versus the benchmark's 7.7%.

Wellington's sector weights are as follows: 19.6% in information technology; 16.8% in consumer discretionary; 16.4% in healthcare; 14.5 % in financials; 14% in industrials; and 5.8% in energy. Wellington pursues a bottom-up, research intensive investment process with an opportunistic approach to style and sectors. Mr. Abrams also noted that Wellington has had seven years of outperformance. Wellington clients have received 17.6% annualized for seven years and the S&P has returned just 1.8%. Ms. Caine noted that while the total domestic equity portfolio was on target, Wellington's portfolio was approximately $25 million over-allocated at the end of May which will be drawn down to rebalance to target.

Mr. Abrams reported that one way to buy portfolio "insurance" is to sell calls on our more volatile stocks. It is not a derivative because Wellington has the underlying collateral. He noted that the portfolio could pick up 100 to 150 basis points and that the process is within their guidelines. He has not sold calls yet as he wanted the opportunity to explain the process and obtain permission to do so. There were no objections.

Investment Manager Review - The Boston Company Asset Management ("TBC"). Mr. Bensur gave a brief overview of TBC noting that it was retained in 2004 to provide a long-term, strategic exposure to the non-US, or international equity market. As of March 31, 2006 the portfolio's market value was $569.1 million, and comprises 33.6% of the non-US equity composite and 7.9% of the total fund.

Mr. Joseph P. Gennaco, Director of Client Services and Mr. Kirk Henry, Director of International Value Equity and Portfolio Manager represented TBC. Mr. Gennaco noted that TBC has $64.2 billion of assets under management. He stated that Mr. David Cameron has recently become the new Chief Investment Officer at TBC. First quarter 2006, TBC returned 9.0%, slightly behind the MSCI ACWI ex-US benchmark at 9.8%. As of May 23, 2006, TBC is slightly ahead of the benchmark.

Mr. Henry noted that TBC has a bottom-up, value oriented, stock-picking process. The portfolio is well diversified by country and sector and has a fundamental, research driven process. TBC invests in a minimum of twelve countries with a maximum of 30% per economic sector, and normally has 120-160 holdings. Approximately 15% of the portfolio is in emerging markets. Sector weights are as follows: 24.8% in financials; 12.3% in consumer discretionary; 10.8% in materials; and 10.4% in consumer staples. The largest holdings in the portfolio are in France, United Kingdom, Japan, Singapore and Ireland.

Mr. Henry noted that the stocks that performed the best in 2004 were also the best performers in 2005 which is unusual. TBC will be selling those international stocks that outperformed as they get more expensive and will buy stocks that are lagging as they are the least expensive. The emerging markets have done well but the market has driven the large cap stocks up which is starting to make a correction. Therefore, TBC is shifting more holdings to the mid-cap sector because of better valuations and that will provide protection in the decline. He noted that the hardest hit emerging markets lately were Russia, Turkey and Brazil. The markets holding up are Malaysia and Thailand. He noted that in the long-term they are positive regarding China even though the market growth has slowed.

457 Plan - VALIC Fund Options. Ms. Caine reported that the 457 (Deferred Compensation) Plan has three providers: Fidelity, Aetna (ING), and VALIC. Each of those providers offers twenty options for a total of 60 options for participants. She noted that one of VALIC's options - the SunAmerica Core Bond Fund - will be closing on May 31, 2006 affecting approximately 131 plan participants representing approximately $46.5 million. The two replacement options provided by VALIC from which to choose are the PIMCO Total Return Fund and the Franklin Templeton Total Return Fund. Both funds have been top quartile performers and either one will be a better option for participants than the SunAmerica fund.

Ms. Caine noted that both proposed funds are rated three star funds by Morningstar. She noted that PIMCO has 85% of its assets under management in fixed income while Franklin Templeton has only 24% of its assets in fixed income, making the PIMCO fund more comparable to the fund which is closing. The majority of Franklin's assets are in international and domestic equities. PIMCO is an institutional, high-quality firm with an emphasis on fixed income and a firm with which the SIC already has a relationship. Ms. Caine recommended choosing the PIMCO fund to replace the SunAmerica fund that is closing.

Mr. Bensur also recommended the PIMCO fund noting that PIMCO also manages the StocksPlus program for the pension fund. He also noted that PIMCO is a much larger institution than Franklin Templeton.

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

VOTED: To approve the PIMCO Total Return Fund as the replacement for the SunAmerica Core Bond Fund as part of the 457 Deferred Compensation Plan that VALIC manages for the State.

457 Deferred Compensation Plan. Treasurer Tavares requested that the Minutes reflect the following concerns he has regarding the State's 457 Deferred Compensation Plan. He noted that the 457 Plan is offered to all state employees and is administered by the Department of Administration ("DOA"). By statute the SIC is responsible for selecting the investments offered in the deferred compensation plan. The SIC is also responsible for monitoring performance. Each of the three firms - Aetna (ING), Fidelity and VALIC offer 20 options each for a total of 60 options offered to employees.

Treasurer Tavares noted that the General Treasurer's Office does not have enough staff to professionally monitor 60 funds. He also expressed concerns that state employees may not be receiving appropriate advice and consultation with regard to these services/funds. He noted that the Investments Department headed by Joan Caine is funded by the retirement system and investment proceeds, and that the expenses of monitoring the 457 Plan legally cannot be borne by the SIC. The Treasurer reported that he has written letters to both Governor Carcieri and his predecessor Governor Almond expressing his concerns and recommending that the DOA hire a consultant solely for the monitoring of the 457 Plan. His letters noted that he felt there are exposures in this area that need to be addressed. He has also brought this issue to the attention of the respective Directors of Administration under the two governors.

Note: Dr. McKenna left the meeting at 10:25 a.m.

Ms. Caine reported that most state 457 Plans are employing a consultant. Mr. Bensur noted that Wilshire Associates Incorporated does have the capability to serve as a 457 Plan consultant. Ms. Caine noted that the levels of service from the three providers vary. Fidelity is highly automated with online services and toll free telephone numbers. Aetna (ING) is similar to Fidelity and VALIC operates on a more face-to-face basis with participants. VALIC regularly solicits new participants by attending the state's open enrollments.

Ms. Caine suggested that she conduct a survey amongst other Chief Investment Officers nationwide to see what other states do. Ms. Caine also noted that most participants use only one provider and that each provider is well diversified in their fund offerings. Ms. Caine also noted that VALIC's parent, AIG, has been in litigation with regulators since June, 2005 and is now in settlement discussions regarding misstatement of financial results. A settlement has been reached with three regulators: the Securities and Exchange Commission, the New York Attorney General's Office, and the New York Insurance Commissioner whereby AIG is providing $300 million to a trust to make restitution to various entities.

She explained that prior to the establishment of Beacon Mutual and between 1985 to 1991, anyone who provided workers' compensation insurance in Rhode Island had to deposit a portion of the premiums into a residual market pool. AIG had misclassified its workers' compensation premiums in Rhode Island and did not put enough money in the pool. Ms. Caine has spoken to the Attorney General's office and the Insurance Commissioner at the Department of Regulation ("DBR"), Joseph Torti, who is spearheading the state's effort to seek restitution. Approximately $100 million of that $300 million is coming to Rhode Island and will go to those insurers who overpaid into the residual pool. Mr. Torti indicated that DBR is in discussions with AIG for additional restitution for the state and that while AIG has been cooperating, he expects it will take a long time to reach an agreement.

Wilshire Associates Incorporated - Capital Market Review. Mr. Bensur noted that small stocks rallied to start the year outperforming large cap stocks. Emerging markets continue to outperform. Through May 22, 2006, the S&P 500 is up 1.4%, small cap stocks are up 5% and the total market is up 1.8%. The non-US equity market is up 9.8% and emerging markets were up 22.5% and are now up 8%. The market has fallen off quite a bit in just the last ten days.

Deputy Treasurer for Finance Report. Ms. Caine reported that as of April 30, 2006 the fund was up 14.3% which was 40 basis points ahead of the benchmark. She also reported that a Purchase and Sales Agreement has been signed on the Gateway Eight building. The due diligence period will end on June 2nd and she expects to close by June 28th. Ms. Caine noted that the Commission members will be kept up-to-date on this matter.

General Treasurer's Report. The Treasurer distributed copies of an article from The Providence Journal regarding legislation in both the House and Senate concerning divestiture of holdings of companies who do business in Sudan. The movement in Rhode Island is being led by and he has met with a Brown University group called Students Taking Action Now. He noted that although he is extremely sympathetic and the situation in Sudan is horrific, he has concerns with the legislation as presented. There was a hearing at the State House regarding the proposed legislation.

He reported to Commission members that prior to his term as Treasurer, legislation was passed regarding divestiture of holdings in South Africa which was very successful. That legislation employed the “Sullivan Principles” where the US State Department spelled out how divestment should occur. There was a four year period in which to divest and there was a “hold harmless” clause where no one was required to sell any security at a loss. The legislation today is very different. The US State Department has not created an official list of holdings for divestiture. Representative Langevin has written to Secretary of State Condoleeza Rice to ask that the State Dept. prepare an official list of companies whose holdings should be divested.

The legislation before the House and Senate now is unique in that it is mandating that groups hire a private vendor to supply the list of companies to divest from and is also suggesting certain vendors to use. Also the legislation designates the divestiture period to be 50% of the portfolio within six months and 100% within twelve months. Based on an unofficial list obtained, the Treasurer believes the pension fund has approximately $44 million in targeted companies.

Treasurer Tavares reported that the California State Treasurer has asked that CALSTERS develop a policy that would be consistent with the ultimate goal. The Treasurer suggested to the sponsors of the legislation that rather than manage the situation by legislation, that perhaps a resolution would be appropriate requesting that the SIC research the matter and take appropriate action.

That was not acceptable to the Brown student group as they did not trust the SIC to do the right thing and wanted it mandated. The Treasurer noted that this is an extremely emotional issue, and he is very sympathetic to Sudan’s situation. However, he has informed the legislators that the proposed legislation is not prudent and is not in the best interests of the pension plan recipients.

Ms. Caine stated that a review of the pension fund portfolio indicates holdings in three companies known to do business in Sudan - Siemens, Total SA and Royal Dutch Shell. She noted that those positions are in separately managed accounts and the commingled funds do not include any of those investments. She expressed concerns related to the private equity portfolio where assets are illiquid and a forced liquidation would result in substantial losses. Divestiture would also diminish the fund’s ability to continue to broadly participate in the private equity marketplace in the future.

Mr. Bensur stated that he would present the Asset Liability Study at the June 28th meeting.

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

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:50 a.m.

Respectfully submitted,

Paul J. Tavares
General Treasurer