

# **State of Rhode Island and Providence Plantations**

## **STATE INVESTMENT COMMISSION**

**Regular Meeting June 25, 2008**

**A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, June 25, 2008.**

**The Treasurer called the meeting to order at 9:11 a.m.**

**Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. Robert Gaudreau, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, and General Treasurer Frank T. Caprio. Also present were: Mr. Kenneth E. Goodreau, Deputy General Treasurer for Finance; Ms. Sarah Dowling, of Adler Pollock & Sheehan, Legal Counsel to the Commission; Mr. Joseph Pezza, of Rodio & Ursillo, Legal Counsel to the Commission; Ms. Michelle Davidson of the Pacific Corporate Group, Alternative Investments Consultant to the Commission; Ms. Lisa Tyrrell of the State Street Corporation; and other members of the Treasurer's staff. Mr. Costello and Mr. Treat were not present.**

**State Investment Commission Minutes. The Treasurer entertained a motion for approval of the minutes. Dr. McKenna moved, Ms. Reback seconded and the following motion was passed. The following members voted in favor: Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, and Treasurer Caprio.**

**VOTED: To approve the Minutes of the May 28, 2008 regular meeting.**

**Due to the request by one of the SIC Members for time consideration, the Treasurer began the Meeting with item #5 from the Agenda.**

**RFP Subcommittee Recommendation and Review-General Consultant Search. The Treasurer referred to the memo in the Consultant Presentations booklet, which summarizes that an RFP was published in December 2007 in national publications requesting proposals for consultants to ERSRI. The Commission received numerous responses, and the Subcommittee met on February 19 to determine which firms the Committee wished to interview. On April 9, 2008 and May 5, 2008, the Subcommittee met and heard presentations from the finalists. On June 12, 2008, the Subcommittee met, reviewed, and approved the recommendation outlined in this memo. All these meetings were posted as public meetings. The Committee and Staff recommended splitting the consultant's responsibilities into three roles: a General Policy Consultant, an Implementation Manager, and a Manager Search and Database Services Component.**

**To fill the General Policy Consultant role, the Subcommittee and Staff recommended Pension Consulting Alliance. PCA is the lead consultant to CALSTERS, which is the second largest U.S. pension fund along with other large funds. Industry polls and publications, including Pensions and Investments, have consistently ranked PCA**

**as one of the top ten Consulting Organizations. CEO and Founder Allen Emkin was a former Wilshire representative to R.I. in the 1980's and is familiar with ERSRI, having been part of the implementation of its current structure. He will personally handle our account, which will give the Commission and Staff the distinct advantage of an upper level relationship with the Firm. The Treasurer emphasized that although there may be three proposed consultants, the fees would remain the same or less than the fees currently paid to our Consultant. The General Policy Consultant will attend the SIC meetings consistent with current practice.**

**Improvement of the portfolio's efficiency is the primary function of the Implementation Manager. The group that was recommended for this role was the Russell Investment Group. Russell Investment Group is a top rated Pension Consultant in the category of assets under advisement and a pioneer in the pension universe, and is the industry standard in beta overlay and exposure management. The Firm was a clear choice for the Subcommittee given its consistently high performance, industry leadership, and low fee structure.**

**The third component, Manager Search and Database Services, is an assignment-based function. The Commission would not pay a monthly fee to the Firm, but will have access to their extensive database. Fees will be incurred only when the SIC Members request their services. The Firm that is recommended for this role is Brockhouse & Cooper, which is a Firm that currently provides these**

services to two of the largest funds in the world: Ontario Teachers Pension and ABP Investments. Their extensive databases, covering both domestic and international investment firms, will allow Staff to conduct far more in-depth manager searches in a user friendly format than is currently possible.

Mr. Goodreau added that although the Commission only meets once a month, he would like the Members to understand that this was a very painstaking, long due diligence process that the Treasurer, his Staff, and the Subcommittee went through over the past six months. The architecture and methodology behind what the Commission is trying to do started very specifically with the careful wording of the RFP under the Treasurer's direction. With the proposed structure, the consultants would constantly be testing each other, and would give the program a checks and balances framework that is not currently available. Mr. Goodreau then thanked the Subcommittee for their diligence and hard work.

Ms. Reback asked what the difference was between a General Consultant and an Implementation Manager. The Treasurer replied that the Implementation Manager would deal with day-to-day issues within the portfolio, such as moving asset allocations. Currently when implementing that strategy, there are certain time lags that affect the portfolio's performance. The Implementation Manager would assist in that process using strategies that will eliminate this two to three day lag. As the Commission conducts additional asset

allocation studies and investment guideline studies, the General Consultant will provide the guidance and oversight required as the fiduciary.

The Treasurer noted that the Firms had already given extensive presentations to the Subcommittee, and asked them to give an abbreviated version to introduce their Firm and their goals in partnering with the SIC going forward.

**General Consultant Presentation—Pension Consulting Alliance, Inc.** Mr. Allen Emkin, CEO of PCA, stated that he started PCA in 1988. Prior to that he was with Wilshire Associates, and was the first Wilshire Consultant to the SIC. PCA's only business is pension consulting; they do not manage assets or sell services to investment managers. Mr. Emkin stressed that consulting is a service rather than a commodity, so the advice PCA provides is unique to each client's circumstance and facts. They conduct a variety of services for clients: general consulting, private equity consulting, and real estate consulting. PCA is unique in that they like to work with other consulting Firms and have worked with every major specialist Firm in the country. They have worked with Russell Investments for years. They have an office in New York, and are in the process of expanding East Coast staffing. Most of the staff that works with clients have more than a decade of institutional consulting experience, and are highly motivated because their compensation is directly linked to

**client retention. They have only lost one staff member in twenty years. The Firm is also hired to do unique projects. They were retained by the State of New Jersey for an infrastructure project, and by the State of New York for a private equity program. They help clients with private equity searches and orchestrate consultant searches. In this role, they recuse themselves from being considered as a candidate, and only act as an independent resource.**

**PCA rates among the highest in the country's top consulting organizations, according to Pensions & Investments. The Firm does not have any small clients—the average client has over 30 billion dollars in assets. They have a long term relationship with many of their clients, and have lost very few clients over the years. This year, they have been retained by the State of New Jersey, State of Hawaii, and the City of Seattle, among others.**

**The Treasurer asked Mr. Emkin to highlight points he made during a panel discussion at Harvard Law School on the future of pensions and investment management. Mr. Emkin replied that he could guarantee two things: the only thing that works in the business is diversification, and that there will be change. There are opportunities that the institutional investing community typically doesn't look at and these opportunities can earn an excellent rate of return and foster economic development.**

**The Treasurer stated that the current portfolio is diverse and has a**

sophisticated model, but stressed the need to look toward the future. Mr. Emkin pointed to the recent green initiatives of large corporations as a supporting example. The consultant's role in this process is to provide the concepts and information that can help clients make the best decisions for their portfolio.

PCA is structured differently than other consulting Firms because it outsources analyst, data entry, and computer programming positions. Mr. Emkin highlighted that their clients involve them in governance. The Firm has a unique design for public pension plans, asset liability products, and a joint venture with an actuarial Firm. They provide practical approaches to key investment processes, including a new real return asset class, which is designed to grow with inflation, and portable alpha programs. They hire people and give them one mandate so they can become an expert in their area.

The Treasurer then asked the SIC Members to introduce themselves to Mr. Emkin. After a brief introduction, the Treasurer mentioned that Mr. Costello and Mr. Treat were also Members of the Commission, but were not present at this meeting. The Treasurer asked for questions, and hearing none, thanked Mr. Emkin for his presentation.

**Implementation Manager Presentation—Russell Investments.** Mr. Cameron Lochhead and Mr. Greg Nordquist were representing Russell Investments. Mr. Lochhead is the Regional Director of

**Russell Investments and Mr. Nordquist is the Senior Portfolio Manager. Mr. Lochhead stated that they were well-resourced with headquarters in Tacoma, Washington and 2,000 associates worldwide. They partner with the largest institutions, and do business with eighteen to twenty state funds, most of which are implementation relationships. They are one of the top one hundred money managers in the world, but are first and foremost an asset manager that hires managers and runs multi-asset class portfolios. Mr. Lochhead stated that they have discovered inefficiencies while fulfilling the role of fiduciary, and as a result they have become an expert in portfolio implementation techniques to reduce costs, take unintended risks out of the equation, and improve the efficiency of the portfolio. The Firm is client focused, which means they limit the amount of clients they service. Everything is customized to the specific needs of the staff and pension fund investment guidelines. Russell Investments has won many industry awards for its research and implementation techniques. They were ranked number thirty on the 2007 list of Fortune 100 Best Companies to Work for in America.**

**Mr. Nordquist then talked about the proposed assignment. As Implementation Manager, Russell would help develop a risk-return profile within the portfolio and maintain the broad asset allocation as determined by the SIC under the guidance of the General Policy Consultant. The goal is to maximize exposure to intended bets and minimize the unnecessary risk of exposures. He then spoke about the importance of cash flow management, and how they will work to**

ensure that the fund has enough cash available, yet have it exposed to the markets. This more opportunistic approach would lessen the Staff's administrative burdens. In regard to alternative investments, the Firm can help the Commission work through unpredictable cash flows and cash strikes. The Firm will also bring new research ideas and educational experiences as opportunities that the Commission can take advantage of. They have a gold-standard list of clients, and can cater to the size, needs, and staff to help accomplish each client's goals. Mr. Nordquist highlighted the Firm's focus on administrative alpha, or adding value to portfolios by improving implementation. This has added approximately 15 basis points per year to the average client's portfolio. He again emphasized the ability of the Firm to service large clients. Mr. Nordquist noted that sloppy implementation can add risk and take away return from a portfolio, while a well implemented strategy can be a competitive advantage in moving the portfolio forward and increasing returns. Their proposed platform is to be more nimble, "decide today, act today." Russell Investments offers flexibility for the Commission to get the desired risk-return profile.

The Treasurer then asked for questions. Mr. Goodreau emphasized that Russell Investments is not meant to be a replacement for the previous consulting service, but was an unexpected discovery that will help the Staff with day-to-day functions. With fast-moving markets and large sums of money, not being able to pay attention to details can cost a portfolio from 5 to 15 basis points over a year. This

**unintended risk results in inefficiencies in performance. Russell Investments has demonstrated the ability to help staff capitalize on the efficiencies of moving large sums of money.**

**Manager Search Consultant Presentation— Brockhouse & Cooper**  
**Mr. Ralph Loader, Chairman/CEO and Mr. Ryan Anderson, U.S. Global Broker, represented Brockhouse & Cooper. Mr. Loader explained the Firm was established in 1968 to serve institutional investors in all major world markets. Since 1987 the Firm has focused on the very specialized field of global investment manager structure and search, earning respected status as a leader in its field. They have developed and maintain a comprehensive database which includes detailed investment manager profiles and detailed performance reports across a wide variety of geographic and style-based mandates. Clients may access this information via the web to conduct their own research and evaluation of investment managers. Their clients incur no fees for this service and the investment managers are not charged to participate in the database. During the last four years Brockhouse & Cooper has completed 484 investment manager searches with a total of \$48.6 billion in assets placed in the U.S., Canada, and internationally.**

**Brockhouse & Cooper's manager search process begins with a multi-factor ranking model involving all qualified candidates. The list of managers is then narrowed to ten to fifteen of the most qualified**

managers. This is followed by another detailed analysis with recommendations for three to five managers. At this point, Mr. Loader suggests his clients have an on site meeting with the finalists.

During the final phase, Brockhouse & Cooper will negotiate implementation of contracts and fees, as required.

Treasurer Caprio asked if there were any questions. Ms. Reback asked about the fee structure and the contractual obligations of the proposed investment consultants. The Treasurer explained the cost will be no higher than the costs associated with our current consultant. The contracts are yet to be negotiated, but stipulations will be implemented within this motion to assure that the fees remain within the current fee structure. The length of the contracts will be two years, with a clause that allows exit from the contract with the appropriate notice, should the Commission find cause to end the relationship. There will also be an option to renew the contract without going through an additional RFP process. Mr. Giudici commended the Subcommittee for their time and effort and also for a job well done. He went on to state that during this complex economic environment, increasing our information and decision making resources is very important. He stated he would like to endorse the recommendation of the Subcommittee.

Treasurer Caprio entertained a motion to accept the recommendation of the Subcommittee with the following directive: the fee structure will be no higher than the fee structure with the existing consultant;

**the term of the agreement shall be for two years, with a stipulation that allows for exit from the contract with appropriate notice, should the Commission find cause to end the relationship; there will be an option to renew the contract without going through an additional RFP process. Dr. McKenna moved, Ms. Reback and Mr. Giudici seconded and the following motion was passed. The following members voted in favor: Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, and Treasurer Caprio.**

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VOTED: To accept the recommendation of the Subcommittee with the following directive: the fee structure will be no higher than the fee structure in place with the existing consultant; the term of the agreement shall be for two years, with a stipulation that allows for exit from the contract with appropriate notice, should the Commission find cause to end the relationship; and the contract shall provide an option to renew without going through an additional RFP process.**

**Alternative Investments Consultant PCG – CVC European Equity Partners V. Ms. Davidson explained that CVC European Equity Partners is forming Fund V to pursue large and mega-market European buyouts. This is an existing relationship, as the SIC has invested in Funds II, III, and IV. The return on these Funds since inception has been 28%, with a multiple of more than 2 x's. They are currently one of our top performers. Fund V will primarily target**

companies headquartered in Western Europe but will have the ability to invest a limited amount of capital in the Asia Pacific region and the U.S. The fund will make investments in companies with enterprise values between €300 million and €10 billion. CVC Europe is managed by twelve Managing Partners and fifty five supporting investment professionals located in twelve offices throughout Europe, with one office in New York. The fund will make approximately twenty to thirty investments in a broad range of sectors including industrials, consumer discretionary, and materials. The first closing was held in April 2008 securing €8.4 billion in commitments with an expected total commitment of €11 billion. A hard cap has not yet been determined. A final close will be held near the end of the second quarter. Ms. Davidson stated that Fund V is complimentary to ERSRI's existing Corporate Finance commitments and recommended investment in Fund V.

Mark St. John represented CVC European Equity Partners. He is a Partner and has been with the Firm for ten years. He spoke of the large network and geographic diversification which enables their investment professionals to actively generate and pursue opportunities in local European and Asian markets, as well as provide constructive support to portfolio companies. They have nineteen offices across three continents. CVC has eight advisory boards located in Germany, Holland, Austria, Belgium, the Nordic Region, Italy, Spain, and the United Kingdom. The boards are comprised of successful European businessmen whose time commitments and

**involvement varies. The most active members assist in everything from sourcing investments to providing support and management advice to portfolio companies. There is a consistency of high returns in all four prior European funds, indicating strong investing discipline and good risk management. They are not a mega fund in terms of transaction size, but typically invest in the upper end of the middle market in Europe and Asia. When making investments, they are very aware of the down side and take steps to protect the investment.**

**Mr. St. John went on to explain the compensation structure within CVC. It is transparent and aligned so those individuals who have successful investments are rewarded. This means that a Junior Partner could conceivably make more money than a Partner. As a result, the Investment Team is very driven and they work very hard at making their investments successful. This is an important element of their business principles, as it drives performance and keeps losses down.**

**Mr. St. John explained that he believes this is one of the best times for making investments. Asset prices are coming down which allows CVC to buy companies with real value rather than buying and financing at a high level. Their current research has identified thousands of potential opportunities throughout Europe. Financing is more difficult, but it is still available.**

**Treasurer Caprio thanked Mr. St. John for his presentation. Ms.**

**Reback remarked that €20 million is larger than commitments made in the past. Treasurer Caprio asked Ms. Davidson to comment on this remark. Ms. Davidson explained that when renewing existing relationships, particularly those that have been very successful, it is advantageous to take a larger, more concentrated position. Treasurer Caprio added that the mandate states investments may be no more than 10% of any limited partnership; this investment currently is not even near 1%. He then entertained a motion for investment in CVC European Equity Partners Fund V. Ms. Gallogly moved, Ms. Reback seconded and the following motion was passed. The following members voted in favor: Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, and Treasurer Caprio.**

**VOTED: To accept PCG's recommendation that the SIC commit up to €20 million in CVC European Equity Partners Fund V, contingent upon the conditions documented in PCG's Investment Memorandum dated May 13, 2008, and upon satisfactory review and negotiation of investment and legal documents with no material changes to the opportunity as presented.**

**Legal Counsel Report. Ms. Sarah Dowling, of Adler Pollock & Sheehan, Legal Counsel to the Commission, asked the Commission to pass a resolution that the General Treasurer be authorized, empowered and directed, signing singly, to execute the Subscription Agreement, any Side Letter and any other ancillary documents related to investments made by ERSRI in private equity or real estate funds,**

**the execution thereof by the General Treasurer to be conclusive evidence that the same are hereby authorized. Dr. McKenna moved, Ms. Reback seconded, and the following motion was passed. The following members voted in favor: Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, and Treasurer Caprio.**

**VOTED: That the General Treasurer be authorized, empowered and directed, signing singly, to execute the Subscription Agreement, any Side Letter and any other ancillary documents related to investments made by ERSRI in private equity or real estate funds, the execution thereof by the General Treasurer to be conclusive evidence that the same are hereby authorized.**

**PCG Secondary Market Update. Ms Davidson stated that in 2007 ERSRI conducted a strategic review of its private equity program. She explained that older funds have high administration fees and tend to become a burden within the portfolio. Selling these interests would free up capital to make new investments in higher performing funds. As a result, PCG has been reviewing various options relating to the sale of interests in sixteen funds. After filtering potential buyers based on size, strategy, and market reputation, PCG held discussion with fifteen institutions about the offering, with six Firms ultimately targeted. Pantheon Ventures and Fondinvest yielded the highest overall bids for specific interests. Pantheon submitted two different portfolio bids (Option A & Option B), as outlined on page 4 of PCG's report. Fondinvest submitted a single bid for CVC European**

**Equity Partners II. By combining Pantheon's Option B bid with Fondinvest's offer, ERSRI would have the opportunity to optimize its portfolio sale value for selected interests. This sale will generate a cash distribution of about \$31 million. Capital calls would not be funded after the sale, which would reduce the amount of unfunded liability by \$5 million. The two bidders are strong secondary players and have cash in hand, so the ability to close is extremely high.**

**Mr. Reilly asked if there was an expiration date related to the bids. Ms. Davidson replied that typically the bids expire in thirty days. Ms. Reback suggested the SIC take a vote now regarding the acceptance of the two bids. Ms. Reback moved, Mr. Reilly seconded, and the following motion was passed. The following members voted in favor: Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, and Treasurer Caprio.**

**VOTED: To allow negotiation of contracts where the cash bid is a percent of market value as presented on page 6 of the PCG confidential memo "Sale of Interests in Private Equity Funds" dated June 25, 2008. If that percentage equals 85% or above, the Commission would allow the commencement of those negotiations and finalization of legal documents for approval.**

**Capital Market Review. Deputy Treasurer Goodreau stated May was a good month. The S&P was up about 1.3%. The portfolio outperformed in the equity space; the Wilshire Index was up about 2%,**

**Wilshire 5000 was up about 2.3%, Wellington Technical Equity outperformed the benchmark by almost 4%, SSgA Core was up about 50 basis points over the market, the Fixed Income portfolio was down about 30 basis points, the Lehman Aggregate was down about 75 basis points, the international portfolio was up 1.3%, and the MSCI Index was up 1.7%.**

**Treasurer's Report. The Treasurer stated that the changes that were made during this meeting will bring new relationships to the Commission. The decision was made over a long period of time with many discussions. He feels very positive regarding future accomplishments with the addition of the new consultants and intends to have more open dialogue between the SIC Members and consultants. He thanked the Commission for being open minded and adopting the changes that the Subcommittee and Staff suggested.**

**New Business. There being no further new business, the Treasurer entertained a motion to adjourn. Ms. Reback moved, Mr. Reilly seconded and the following motion was passed. The following members voted in favor: Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Ms. Reback, Mr. Reilly, and Treasurer Caprio.**

**VOTED: To adjourn the meeting.**

**There being no further business, the meeting was adjourned at 11:12  
a.m.**

**Respectfully submitted,**

**Frank T. Caprio**

**General Treasurer**