

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

## **STATE INVESTMENT COMMISSION**

**Regular Meeting September 24, 2008**

**A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, September 24, 2008. The Treasurer called the meeting to order at 9:16 a.m.**

**Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio.**

**Also present were: Mr. Kenneth E. Goodreau, Chief Investment Officer; Ms. Sarah Dowling, of Adler Pollock & Sheehan and Mr. Joseph Pezza, of Rodio & Ursillo, Legal Counsel to the Commission; Mr. John Burns of Pension Consulting Alliance, General Policy Consultant to the Commission; Ms. Michelle Davidson of the Pacific Corporate Group, Alternative Investments Consultant to the Commission; Ms. Laura Callahan of State Street Corporation, and other members of the Treasurer's staff. Mr. Robert Costello arrived at 9:30 a.m. Mr. Robert Gaudreau was 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. Giudici, Dr. McKenna, Ms.**

**Reback, Mr. Treat, and Treasurer Caprio.**

**VOTED: To approve the Minutes of the July 23, 2008 regular meeting.**

**Capital Market Trends – Pension Consulting Alliance. The Treasurer noted that Mr. Emkin and Mr. Burns will be attending each meeting. However, Mr. Emkin was not able to attend today due to a previous commitment. Both Mr. Emkin and Mr. Burns have spent a considerable amount of time with Mr. Goodreau during the last several weeks to get an understanding of ERSRI's policies and procedures.**

**Mr. Burns explained that PCA will be working with the SIC to determine goals and objectives. A work plan draft will then be established based on the Commission's recommendations and suggestions.**

**Mr. Burns began his review by stating that various asset classes perform differently through different economic and market environments. The equity risk premium is volatile and, at times, may not reward an investor for the risk taken. Long-term oriented Institutional Investors are continually searching for alternative market segments that are less dependent on, and diversify away from, the equity risk. Mr. Burns explained that the current ERSRI asset allocation is as follows: U.S. Equity 42.5%, Non-U.S. Equity 20%, Real Estate 5%, Private Equity 7.25%, Fixed Income 25%. He noted that**

**ERSRI's long term return target of 8.25% will be a challenge to achieve in this market environment.**

**Mr. Burns gave a brief historical perspective of capital market trends since 1970. He summarized by commenting that U.S. equity returns have been influenced more by inflation and economic growth than by interest rate performance. Slow economic growth is a primary concern today, while the issue in the 1970's was inflation. Over the last six decades, bonds rarely exceeded an 8% return and lagged inflation in two out of six decades. Real estate has produced the most consistent results across four decades. Private equity is the only asset class which had a negative decade, due largely to the 2000's bear market. Mr. Burns commented that fixed income, real estate, and hedge fund of funds, are the least non-volatile no-cash classes. Private equity has been the top long-term performer by a substantial annual margin, but with materially higher risk. Fixed income and hedge funds have produced solid returns during recessions and equity bear markets. Real estate produced strong returns when inflation has significantly exceeded its long-term average.**

**Mr. Burns went on to explain the benefits of an equal-weighted allocation of asset classes within a portfolio. Such an allocation strategy would have produced materially higher average returns, with only minimal additional risk. This type of strategy does well during recessionary periods. The equal-weighted strategy would have**

**created 50% more wealth than the 60/40 strategy over the past thirty years, after lagging somewhat during the 1970's. Mr. Burns cautioned that there is no strategy that will perform well during every market environment. Mr. Burns concluded by stating that all portfolios have unique characteristics, which will be a determining factor when choosing the most advantageous strategy.**

**The Treasurer thanked Mr. Burns for his presentation. He noted that asset allocation is the primary responsibility of the Commission, as allocation drives returns. He stressed the need for a sub-committee meeting to discuss a work plan strategy. He asked if there were any questions or comments.**

**Dr. McKenna expressed interest in the possibility of interaction between the SIC and Economic Development. He stated that the policies affecting the three largest employment segments in Rhode Island (healthcare, tourism, and higher education) are also affected by national and state government.**

**Alternative Investments Consultant PCG – Secondary Markets Review. Ms. Davidson commented that PCG is assisting ERSRI with the sale of certain private equity interests. Approval was granted at the June 25, 2008 SIC Meeting to sell eleven private equity funds based on two bids received, which represented 88.4% of market value. PCG was able to negotiate slightly higher pricing for ten of the eleven interests, resulting in a bid price of 90.2% of March 31, 2008**

market values. The eleventh fund was sold above par value. As of September 24, 2008, four funds have been legally transferred, including two large interests. ERSRI has received total net proceeds of \$22 million from the transfer of these interests. An additional six funds will be transferred on September 30, 2008, and the final interest will be transferred on or about October 1, 2008. Additional proceeds will be just under \$10 million, for a total of \$32 million, net of fees and expenses. ERSRI's unfunded liability for these funds of \$3.9 million will also be eliminated, for a total net benefit of \$35.9 million.

Mr. Goodreau stated that due to the current market environment, the request for cap calls has increased. The sale of these funds will provide the portfolio with much needed liquidity.

The Treasurer thanked Ms. Davidson and Mr. Reilly for their assistance in the negotiation and sale of these funds. He went on to announce the next agenda item.

**Short Term Investments Vendor Consideration – Independence Bank (CDARS Program).** Treasurer Caprio explained the specifics of the CDARS (Certificate of Deposit Account Registry Service) Program. Banks that offer CDARS are members of a special network. When a public fund places a large deposit with a network member, that bank uses the CEDARS service to place the funds into CDs issued by other members of the network. This occurs in increments of less than \$100,000 to ensure that both the principle and interest are eligible for

full FDIC protection. One rate is negotiated for all CD investments and the funds can be reinvested through a simple process. The Treasurer asked Mr. Izzo, Cash Manager, to continue the discussion.

Mr. Izzo noted that the Treasurer's primary mandate to the Investment Staff is preservation of capital. This program is a safe investment, but will yield a greater return than the current Government Money Market investment by about 100-200 basis points. Treasurer Caprio interjected that the increase in yield was primarily the determining factor in this decision. Mr. Izzo explained that Independence Bank is one of two banks in R.I. that offers the CDARS Program. Although there are multiple banks involved, we will have the convenience of dealing only with Independence Bank.

Mr. Costello asked if all the banks who are part of the CDARS Program will meet ERSRI's investment criteria for short term investments. Treasurer Caprio explained that ERSRI will have the ability to exclude any institution that is part of the network that does not meet our guidelines. Mr. Izzo went on to explain that there will be an addendum to the contract with Independence Bank stating they cannot invest in a CD with any institution that does not meet our guidelines. Ms. Reback asked what the duration of the investment would be in the CDs. Mr. Izzo replied the terms are a minimum of 4 weeks up to 260 days, with a minimum deposit of \$10,000 up to \$50,000,000.

**In conclusion, Mr. Izzo advised the Commission that quotations are received on a daily basis regarding the yield on short term investments. When CDARS is no longer an attractive investment, the funds will be transferred into another short term investment.**

**The Treasurer entertained a motion to approve Independence Bank CDARS Program as an approved short term investment vendor. Mr. Costello moved, Ms. Gallogly seconded and the following motion was passed. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Treat, and Treasurer Caprio.**

**VOTED: To approve Independence Bank CDARS Program as an approved short term investment vendor, with specific instructions not to allow investment with any institution within the network who does not meet ERSRI's specific guidelines.**

**Legal Counsel Report. There were no legal developments for Counsel to report for the month of July or August.**

**Chief Investment Officer Report. Mr. Goodreau noted that this was an opportune time to have the additional guidance of Russell Investment Group in the role of Implementation Manager. With the current volatility in market conditions it is very difficult to maintain**

asset allocations and rebalance the portfolio. Russell has developed a program to keep allocations at policy levels and reduce volatility. Representatives from Russell Investment Group will soon be addressing the Commission to explain how the program works.

Mr. Goodreau noted that there was an error in the data for the month of August under Section B. The Summary Performance Rate of Returns chart indicates that Goldman Sachs was flat for the year. They were actually in-line with the benchmark, which is down to -16%.

The portfolio achieved positive alpha for the month of August, picking up about 38-40 basis points. The portfolio is 40 basis points over the performance benchmark for the year, which was partially due to over allocation in cash.

Ms. Gallogly asked what the \$50 million in Russell Overlay represented. Mr. Goodreau explained that these funds will be used to keep allocations within the portfolio's asset allocation benchmarks. When the report was generated the funds were in a cash account, and had not yet been invested. Going forward, the \$50 million will be invested in the appropriate asset classes to keep the allocations within the benchmark targets. Next month there will be a supplemental report showing specifically where the funds have been invested.

Mr. Reilly asked how often the portfolio will be rebalanced. Mr. Goodreau responded that +/- 1% within an asset class will trigger a

rebalance. There was a discussion regarding how often a rebalance may occur and how the fee associated with this service may impact the profitability of the portfolio. Mr. Goodreau responded that the efficiency of the program will be apparent after two to three months. He also noted that the portfolio only had one rebalance this month, in spite of the unusually extreme volatility.

Mr. Goodreau assured the Commission that Russell Investments will be attending an SIC Meeting in the near future. Representatives will give a very detailed explanation regarding how the program works and how the efficiencies can be measured during this meeting.

**Treasurer's Report.** Treasurer Caprio expressed the importance of taking innovative actions to protect the profitability of the portfolio during this volatile environment. These actions include proper asset allocation, strong managerial skills, and the addition of Pension Consulting Alliance and Russell Investment Group. He reiterated the need for participation from the Commission Members in interim meetings to discuss investment strategy.

Treasurer Caprio announced that after thirty years of service, Mr. Stephen Iafrate, Fiscal Manager, will be retiring on September 26, 2008. He thanked Mr. Iafrate for his dedication through the years and expressed how much the entire Treasury Staff will miss him.

**New Business.** Mr. Mark Dingley, Chief of Staff, addressed the

**Commission regarding the 457 Plan, which is a State Deferred Compensation Plan. It is administered by the Department of Administration, but the SIC has discretion over the investments. There are currently three Investment Managers: AIG, ING, and Fidelity. An RFP for an Investment Manager has not been issued since 1996. While in discussions with Jerome Williams and Susan Rodriguez from the DOA, it was decided that this is an appropriate time to start the RFP process for an Investment Manager. Since the landscape of the Plan has changed dramatically in the last ten years, Mr. Dingley is proposing that the SIC retain a consultant who is familiar with 457 Plans, for guidance through this RFP process.**

**The Treasurer entertained a motion to issue an RFP for a consultant to assist the SIC through the RFP process for an Investment Manager for the 457 Plan. Mr. Giudici moved, Mr. Treat seconded and the following motion was passed. The following members voted in favor:**

**Ms. Gallogly, Mr. Giudici, Ms. Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio. Dr McKenna left the meeting at 10:25 a.m. and Mr. Costello left the meeting at 10:50 a.m. Neither was present for this vote, or the vote to adjourn.**

**VOTED: To issue an RFP for a consultant to assist the SIC through the process of hiring an Investment Manager for the 457 Plan.**

**The Treasurer entertained a motion to adjourn. Mr. Reilly moved, Ms. Gallogly seconded and the following motion was passed. The**

**following members voted in favor: Ms. Gallogly, Mr. Giudici, Ms. Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio.**

**VOTED: To adjourn the meeting.**

**There being no further business, the meeting was adjourned at 11:04 a.m.**

**Respectfully submitted,**