

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

## **STATE INVESTMENT COMMISSION**

**Monthly Meeting February 25, 2009**

**A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, February 25, 2009. The Treasurer called the meeting to order at 9:13 a.m.**

**Membership Roll Call. Present were: Mr. Michael Costello, Mr. John Treat, Mr. Robert Giudici, Ms. Rosemary Booth Gallogly, Mr. Andrew Reilly, Mr. Robert Gaudreau, Dr. Robert McKenna, and General Treasurer Frank T. Caprio. Also present were: Mr. Kenneth E. Goodreau, Chief Investment Officer; Ms. Sarah Dowling, of Adler Pollock & Sheehan; Mr. David Ursillo, of Rodio & Ursillo, Legal Counsel to the Commission; Mr. John Burns of Pension Consulting Alliance (PCA), General Policy Consultants to the Commission; Lisa H. Tyrrell, of State Street Corporation; and other members of the Treasurer's staff. Ms. Marcia Reback was not present.**

**State Investment Commission Minutes. Treasurer Caprio entertained a motion for approval of the minutes for the meeting of January 28, 2009. Mr. Costello moved, Dr. McKenna seconded, and the subsequent motion was passed. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Giudici, Mr. Reilly, Mr. Gaudreau, Dr. McKenna, Mr. Treat, and General Treasurer Caprio.**

**VOTED: To approve the Minutes of the January 28, 2009 monthly meeting.**

**General Consultant Report. Mr. , Burns presented an overview of the investments policy review. PCA is working together with Mr. Dingley and Mr. Goodreau to develop a comprehensive Investments Policy Statement (IPS) to establish clear guidelines for policy and governance of the SIC and Employees Retirement System of Rhode Island (ERSRI).. The IPS will dictate (i) the SIC's philosophy regarding different asset classes, (ii) how the investments are to be managed, and (iii) the role of the Commission as it relates to various asset classes. The goal is to provide balanced, detailed documentation, which will accommodate new contingencies within asset classes without requiring changes to the documentation per se.**

**The first documents under draft are the investment policy statements for U.S. and non-U.S. equities . These documents each contain: a statement of purpose; investment philosophy and objectives; a definition of indices; directions for policy implementation; a list of prohibited transactions; documented correspondence; watch list procedures; and derivatives.**

**Ms. Gallogly asked whether the actively managed component of the portfolio would have separate mandates for managers with guidelines based upon specific benchmarks. Mr. Goodreau explained that**

currently we have policies for individual managers and that the IPS will pertain broadly to the full investment program.

Ms. Gallogly asked if any states prohibit specific transactions . Mr. Burns answered yes, explaining that many states have legal list requirements pertaining to investments.

Ms. Gallogly asked if the SIC has or should adopt a policy regarding cash investments. Mr. Burns responded that typically such a policy is included in the manager guidelines. For example, in U.S. equities the mandate for index fund managers would be 1% or less cash holdings, and 5% or less for active managers. He added that regardless of the guideline for equity managers, all cash is equalized ultimately by Russell Investments (Russell) through the implementation of notional overlay.

Ms. Gallogly inquired about the consideration of issues surrounding regulatory action. Currently the all issues of compliance are addressed internally by the Treasurer's staff and through the SIC's legal and investments consultants. Mr. Burns answered that statements regarding any issue, including regulatory action, can be included in the IPS at the SIC's discretion. Mr. Burns further noted that additional issues will be addressed, and appropriately recorded, during the course of developing and compiling documentation.

Treasurer Caprio entertained a motion to accept the investment

**policy review and implementation of policy statements for both U.S. equity and non-U.S. equity as presented. Dr. McKenna moved, Mr. Reilly seconded, and the subsequent motion was passed. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Giudici, Mr. Reilly, Mr. Gaudreau, Dr. McKenna, Mr. Treat, and General Treasurer Caprio.**

**VOTED: To approve policy statements for investments in U.S. and non-U.S. equities as presented.**

**The Treasurer introduced a report from BrockHouse Cooper, Consultant to the Commission, on the search for Passive Index Investment Management Services for U.S. and non-U.S. Equities. Treasurer Caprio presented a detailed report of responses to the Request for Proposals (RFP) and a summary of recommendations.**

**Mr. Goodreau clarified that ERSRI is looking to retain a passive manager for existing asset classes. Mr. Goodreau emphasized that the current asset allocation scheme will not change.**

**Mr. Goodreau reported that twelve (12) responses to the RFP were received, which BrockHouse Cooper has narrowed to three: Mellon, Barclays Global Investors (BGI), and State Street (SSgA). Mellon was disqualified due to insufficient data. Mr. Goodreau characterized both the remaining candidates as strong institutions, leaders in the field of passive management, and relatively equal in terms of capability and**

**risk. After comparing the candidates in depth, Mr. Goodreau expressed the Treasury staff's preference for SSgA. He enumerated the firm's advantages as follows: SSgA's wealth of expertise and experience as the world's largest passive manager; an existing, strong relationship with State Street; the ability to work with the firm's quantitative staff on a range of issues in addition to passive management; and the firm's geographic proximity.**

**Mr. Costello expressed a concern with locating managerial and custodial duties within the same institution.. Were SSgA to be retained for passive management services in addition to their custodial role, the firm must brief the SIC in detail on the matter of full legal separation and other attendant issues.**

**Mr. Goodreau responded that State Street and SSgA are separate entities; State Street has confirmed that our assets held with the institution as custodian are protected from default in its managerial role. Additionally, Ms. Tyrrell confirmed that SSgA and State Street are essentially separate entities, and will bring a representative from State Street to address all relevant issues with the SIC. She further noted that SSgA and State Street have experience in addressing such concerns with clients.**

**Mr. Costello requested written confirmation of the regulatory structure at SSgA and State Street, as well as the legal separation of**

**these entities.**

**There was some discussion regarding fee structure. Mr. Goodreau noted that SSgA's RFP response proposes a rate of 1 basis point. Rates proposed by other firms were more aggressive. Two separate fee structures and contracts would be adopted for the S&P 500 (at 1 basis point) and the Russell 3000 (at 3 basis points).**

**Treasurer Caprio entertained a motion to approve SSgA as the passive manager for the Russell and International Portfolios, subject to requested documentation with review and approval by legal counsel and staff. Mr. Treat moved, Mr. Giudici seconded, and the subsequent motion was passed. The following members voted in favor: Mr. Treat, Mr. Giudici, Mr. Costello, Ms. Gallogly, Dr. McKenna, Mr. Reilly, Mr. Gaudreau, and General Treasurer Caprio.**

**VOTED: To approve State Street subject to proper review and legal documentation regarding the separation of custodian and money manager functions, and further subject to legal review and satisfactory negotiation of contractual documentation.**

**Treasurer Caprio introduced a presentation on Cash Management from Mr. Patrick Marr, Fiscal Manager. Mr. Marr recommended the addition of BlackRock Investments as a Money Market Fund provider. Mr. Marr indicated that Treasury would invest in FedFund, BlackRock's Government Money Market Fund. Mr. Marr further**

**indicated that this fund's risk profile is similar to current investments in the Fidelity, Wells Fargo, and Federated funds. He added that BlackRock meets all the SIC criteria for investment providers.**

**There being no further discussion, the Treasurer entertained a motion to approve BlackRock as a short-term Cash Management vendor. Ms. Gallogly moved, Dr. McKenna Seconded, and the subsequent motion was passed. The following members voted in favor: Ms. Gallogly, Dr. McKenna, Mr. Costello, Mr. Reilly, Mr. Gaudreau, Mr. Giudici, and General Treasurer Caprio.**

**VOTED: To approve BlackRock Investments as a short-term Cash Management vendor.**

**Legal Counsel Report. Legal Counsel had no report.**

**Chief Investment Officer Report. Mr. Goodreau addressed fund performance, noting that from a policy standpoint we are picking up alpha. Mr. Goodreau stated further that no forced liquidations have occurred, and that the overall results show positive movement.**

**Treasurer's Report.. Treasurer Caprio commented on a recent focus in trade publications on securities lending, much of which has been negative coverage. The high risk associated with securities lending is exemplified by ERSRI's experience in 2008 with cash assets tied to**

**The Reserve. The Reserve, a money-market instrument, is a government-backed pool of assets in which the ERSRI formerly invested; certain market conditions in 2008 culminated in an inability to access these invested funds. Currently ERSRI's securities lending program has over \$1 billion invested in a money-market instrument, mostly government backed, with funds available upon maturity. The SIC must consider risk versus reward when determining whether to continue in securities lending given current market conditions. A scenario could arise in which ERSRI would be unable to gain access to the collateral pool of money in times of critical need, which is a pressing concern for a pension fund such as ERSRI.**

**The Treasurer noted that Ms. Gallogly addressed the issue of securities lending in the January 2009 SIC meeting, which engendered some discussion as to the means of exit from ERSRI's pertinent investments. Information provided subsequently by State Street on potential means of exit and other associated conditions indicate the necessity of a gradual exit dependent upon the maturity of underlying collateral. Additionally, there is a risk of impairment to collateral in the course of exit completion. ERSRI has made such an exit from securities lending in the past and has re-entered investments under appropriate conditions. An exit from securities lending in the present environment is a proactive measure to protect the fund from associated risks.**

**The Treasurer informed the group that currently he is overseeing a**

gradual exit from the securities lending program, noting that he has been advised that an SIC vote on this matter is unnecessary at present. Treasurer Caprio directed counsel to begin the process working with Treasury staff, and to be prepared for a vote at the appropriate time.

**New Business.** Treasurer Caprio opened the floor to new business. There being no further discussion, the Treasurer entertained a motion to adjourn. Dr. McKenna moved, Mr. Gaudreau seconded, and the subsequent motion was passed. The following members voted in favor: Ms. Reback, Ms. Gallogly, Mr. Costello, Mr. Giudici, Mr. Treat, and General Treasurer Caprio.

**VOTED:** To adjourn the meeting.

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

Respectfully submitted,

Frank T. Caprio

General Treasurer