State of Rhode Island and Providence Plantations

STATE INVESTMENT COMMISSION

Bi-Monthly Meeting April 7, 2009

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Tuesday, April 7, 2009. The Treasurer called the meeting to order at 9:17 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Ms. Rosemary Booth Gallogly, Mr. Andrew Reilly, Dr. Robert McKenna, Mr. John Treat, Mr. Robert Giudici, 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. Allan Emkin and Mr. John Burns of Pension Consulting Alliance (PCA), General Policy Consultants to the Commission; Ms. Lisa H. Tyrrell of State Street Corporation; and other members of the Treasurer's staff. Ms. Marcia Reback and Mr. Robert Gaudreau were not present.

State Investment Commission Minutes. Treasurer Caprio entertained a motion for approval of the minutes for the meeting of March 25, 2009. Mr. Costello moved, Dr. Robert McKenna seconded, and the subsequent motion passed. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Giudici, Mr. Reilly, Dr. McKenna, Mr.

Treat, and General Treasurer Caprio.

VOTED: To approve the Minutes of the March 25, 2009 monthly meeting with the following addition to Legal Counsel Report:

"The Treasurer entertained a motion to change our representation in the Securities Capital Assurance and RAIT cases from Bernstein, Liebhard to Grant & Eisenhofer. Ms. Gallogly moved, Mr. Reilly seconded and the subsequent motion passed. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Reilly, Mr. Gaudreau, and General Treasurer Caprio.

VOTED: To change legal representation in the Securities Capital Assurance and RAIT cases from Bernstein, Liebhard to Grant &Eisenhofer."

General Consultant Report. Mr. Emkin reported that current markets are positive; the S&P is up almost 11% and emerging markets up 15%. However, the downside is that the REIT's markets were off 11% for the month and over 40% on an annual basis.

Mr. Burns explained that over 70% of large public plans are heavily exposed to Real Return Asset Portfolio (RRAP). Characteristics of return and risk would be similar to a combination of private equity, hedge funds and real estate investments. RRAP would add diversification to public and private equity, generate positive returns

during negative periods for fixed income and provide additional beta, as well as inflation protection. Typical segments include Commodities, Infrastructure, Global TIPS, Timber, and Hedge funds. Collectively they represent $10 Trillion in investment opportunity. The Commission would construct the Portfolio from a menu of strategies and policies, which would be reviewed annually.

Several large Pension Plans have allocated varying percentages to this strategy based upon the size of total plan assets. For modeling purposes, PCA would review individual risk/return historical data, along with modeling assumptions, and suggest allocation percentages between equity and fixed income. PCA will provide the Commission with historical data on each of the components along with their recommendations.

Mr. Costello asked what percent of the total portfolio RRAP would represent. Using sample "Blueprints" Mr. Emkin explained that it varies from 5% to 40% of total assets depending on size and risk assumptions.

In addition, the Portfolio would be structured whereby we would invest in partnerships and hire a third party who would manage the portfolio. This would replace direct investment in large public companies, where we lack diversification and are highly sensitive to capital markets.

A discussion ensued regarding current managers that engage in this strategy. However, the group was advised to keep this issue separate and instead focus on our current exposure. The size, management and time restraints of the Real Return investments would all be factored into the structure of such a policy.

The Treasurer questioned the correlation, or the lack thereof, between TIPS and other potential categories in the Real Return class. TIPS, which are directly related to inflation, are the prototypical real return asset and would be the foundation for this type of portfolio.

Mr. Costello questioned last year's performance of institutional quality, absolute return hedge funds. Mr. Emkin stated that last year's average hedge was off approximately 18%, however, larger macro funds that shorted the equity market had returns in the positive 20-30% range.

As part of PCA's policy, they do not recommend individual hedge funds and would recommend the Commission choose a fund of funds strategy. If individual hedge funds were of interest, PCA would prefer that a consulting firm that concentrates on Hedge Funds market make these recommendations. If the Commission chooses a Hedge Fund fund of funds, PCA would present the commission with a variety of strategies along with performance information.

Ms. Gallogly questioned the benefit of individual partnerships versus

private equities that focus on real return. Mr. Emkin explained that the structure of the investment is the major difference. Individual partnerships engage in un-levered transactions, purchasing hard assets and are commodities driven. Private Equity fund management would make decisions and transactions that are levered in order to provide the required return. A further determining factor relates to strategies, where the partnership is income driven, with profits flowing directly to the investor, whereas with private equity investments the investor waits for distributions.

In conclusion, if the commission adds Real Return to the Portfolio, it will need to establish allocation levels, investment policies and guidelines. To ensure efficiencies and return, minimum and maximum ranges should be part of the design.

Mr. Emkin moved on to explain the goals of Opportunistic funds, which add value without the constraints of traditional fixed income or equity investments. The TALF program, which has not yet been finalized, and investment grade credits would be examples of these opportunities.

Mr. Emkin advised that prior to executing an Opportunistic strategy, the Commission would need to address policies and guidelines including issues of investment philosophy, required resources, accountability, due diligence processes, monitoring and reporting.

Mr. Costello expressed his concern regarding complexity of policy and implementation. Mr. Emkin explained that PCA would provide the Commission with specific policies for approval as well as recommend vehicles with institutional acceptability and large co-investors.

Ms. Gallogly questioned if the bulk of investment strategies in this area were real or options based. Mr. Emkin explained that we would be buying fixed income assets with known collateral and guarantees. Investments tied to equity would be real assets and not derivatives.

The presentation continued to the Asset Allocation review. Mr. Burns explained that the asset allocation process should reflect ERSRI's tolerance for risk, time horizon, legal constraints, and asset class preferences. PCA recommended reducing exposure to public equity return premiums and focus on meeting the funds 8.25% performance target. This may be enhanced through Opportunistic and Real Return Portfolios.

In creating the asset allocation model, factors to consider are correlation among asset classes, expected risk and returns, investment advisors, investment horizons, short-term liquidity, cash needs, constraints and preferences.

Additionally, portfolio constraints needing definition include legal, defined minimum and maximum participation, liquidity and income needs, minimum return rates, and maximum risk tolerance. Future

discussions should include adding ranges around asset classes, rebalancing policy, and risk management protocol.

As part of an initial exercise, PCA created two optimizations, one with steady risk and the other with steady return. There were four different portfolio models used integrating allocations in Real Return and Opportunistic strategies. The steady risk model resulted in increased return as Real Return and Opportunistic strategies were added. As Real Return and Opportunistic strategies were added to the steady return model, there was reduced risk volatility.

PCA would create a portfolio model for the Commission using assumptions that included historical data, examination of fundamental variables, expectations based on consensus views and outlook opinions from investment and banks advisors. Additional information included correlations assumptions, return, and risk. Mr. Emkin stressed that the relationship of the assets is of key importance.

PCA suggested they use this set of assumptions in presenting the Commission with possible portfolios to review. At that point, the Commission can discuss the models and provide additional direction.

There was a discussion regarding TIPS being represented as its own category. Mr. Emkin stated that going forward, TIPS will be modeled as part of RRAP.

Mr. Dingley questioned if Real Return and Opportunistic strategies could be added as a percentage of current asset classes. Mr. Emkin agreed this could be done; however, it changes the risk return characteristics of the fixed income class.

Ms. Gallogly questioned if under the current mandate some of our current fixed income managers might have these new strategies in their current portfolio. Mr. Emkin suggested looking at individual portfolios; however, these strategies would not be covered in most fixed income mandates.

Legal Counsel Report. Legal Counsel had no report.

Cash Manager Report. Mr. Izzo reported that our CDARS program is currently $40 million invested with a return approximately 100 bps greater than our average rate.

In addition, the investment department's new software is prepared to go live which will afford us more in-depth reporting on portfolio performance.

Chief Investment Officer Report. Mr. Goodreau noted that our goal is to increase return while reducing risk. Currently our portfolio does not have exposures in hedge funds, REITs, or commodities, which has helped us to this point. We have de-leveraged from securities lending and our current structure is predominately passive, which is

very cost efficient.

Treasurer's Report. The Treasurer reported that having provided PCA with information from State Street and Russell regarding transition management, PCA would issue a letter confirming their recommendation that State Street is the low cost provider for the professional execution of transitioning from active to passive management.

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

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:48AM.

Respectfully submitted,

Frank T. Caprio

General Treasurer