

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

## **STATE INVESTMENT COMMISSION**

**Monthly Meeting June 24, 2009**

**A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, June 24, 2009. The Treasurer called the meeting to order at 9:03 a.m.**

**Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. Robert Gaudreau, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. John Treat, and General Treasurer Frank T. Caprio. Also present were Ms. Sally Dowling, of Adler, Pollock, and 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 Tyrrell of State Street Corporation; and Mr. Mark Dingley and other members of the Treasurer's staff. Mr. Michael Costello and Mr. Andrew Reilly were not present.**

**State Investment Commission Minutes. Treasurer Caprio entertained a motion for approval of the minutes for the meeting of May 27, 2009. Ms. Gallogly moved, Mr. Giudici and Mr. Treat seconded, and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Robert Gaudreau, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. John Treat, and**

**General Treasurer Frank T. Caprio.**

**VOTED: To approve the Minutes of the May 27, 2009 monthly meeting.**

**General Consultant Report. Mr. Burns proceeded with information regarding asset allocation as detailed in the Real Return Asset Class material. This material highlights the overall characteristics and goals of real return asset class investments. The goal is to have a bucket of assets that return more over the long run than fixed income without the volatility of equity.**

**Last meeting, Mr. Burns was asked what other funds are using this type of asset allocation. At that time, Mr. Burns said he would get back to the Commission at the next meeting once he had researched the correct answer. He told the group that he now had the answer to the aforementioned question and pointed out that Kansas, Los Angeles, Washington and California have implored similar investment tactics, with the goal of trying to have another source of return in the portfolio. For example, the funds will select a source that is different from publicly traded equity that increases the diversification and will help dampen the down side without giving up much on the return.**

**It was then suggested that in order to address all the questions that commission members have regarding the abovementioned practices, the Commission should invite practitioners of these tactics to a meeting to answer questions so as to give members a better understanding of the new asset class and its investments. Mr. Burns**

reminded the group that the end result would be a detailed implementation plan regarding this investment strategy.

Mr. Treat stated it would be valuable to hear such presentations; he noted the real assets proposed, such as agriculture, oil and gas, timber, are products local to the Midwest and West Coast regions and questioned if this would be a good fit for an East Coast state like Rhode Island.

Mr. Emkin stated the application does not have linkage to geography. He further explained the reason why they are strongly encouraging the fund to choose these real assets is because in the last ten years two events have occurred, each of which, would not be expected to happen once, so he is urging clients to have part of their portfolio hedge the risks of another such occurrence.

Ms. Gallogly asked if practitioners or PCA would give us historical trends.

Mr. Emkin replied that PCA will provide a background paper and that the practitioners will be available to address any concerns.

Ms. Reback asked if we are only talking about commodities like gas, oil and timber.

Mr. Emkin responded that the decision would be up to the Commission. He suggested that the first would be commodities, timber and infrastructure.

Ms. Reback asked for a definition of “op-oriented,” as listed on page 12 of the presentation booklet.

Mr. Burns answered that it is an allocation tactic which provides the Commission with the flexibility to invest in time-sensitive

opportunities, such as investment grade credit. These are temporary investments of one to three years and provide an exit strategy at initiation; he noted that the Commission does not have to use this category, but he is currently working on a policy for such structure.

Ms. Reback asked if the suggestion is to trade off a large portion of U. S. equity against a real return.

Mr. Emkin replied that is the decision the Commission must make; the goal is to find other investment vehicles that will diversify against periods when there is a high correlation among the asset classes.

Ms. Reback asked for a definition of “commodities”.

Mr. Emkin responded that most are dominated by energy, such as oil and natural gas, but it could also include agriculture or metals; commodities include a whole basket of assets that are “real” and therefore physical. Mr. Emkin stated that he would bring in a specialist to explain the different vehicles, as well as their portfolio structure and possible returns. However, the ultimate decision is up to the Commission and Mr. Emkin said that is the direction which will be followed.

Dr. McKenna commented that the current discussion deals with oil and gas, two areas from which he believed the Commission was trying to exit. He inquired if the Commission could do anything to encourage wind power and if any other state had done anything regarding such power?

Mr. Emkin answered that a number of their clients have included energy related clean technology or green technology investments in their private equity; he said he would get a briefing on it.

**Mr. Emkin then noted that the world has changed in the last two months; at the end of the 1st quarter, the equity markets were down, as was the portfolio, and the spreads were still wide. Since then, there has been a huge rally globally and emerging markets are up almost 40% on a year-to-date basis. Stocks have gone from the negative mid-teens to flat, due in part to the support from Washington, D.C. in helping banks create liquidity.**

**Ms. Reback asked about the impact of the stimulus money from Washington.**

**Mr. Emkin replied that it is having an impact with regard to the credit markets and some regions have seen more home sales; however, he was not sure about the impact in the area of public works.**

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

**Chief Investment Officer Report. Mr. Dingley provided a summary of the presentation by Ryan Asset Liability Management, which focused on the fixed income part of the portfolio. Ryan's view is that our fixed income investing should be targeted toward our liabilities, like lotteries and insurance companies, as opposed to a benchmark that is not related to liabilities. Ryan can provide a custom liability driven target, with the essence of such being that fixed income investments do not offer alpha.**

**Ryan also recommended a structured method when we beat our target (8.25%) return, whereby we would take a portion for a fixed income investment, which would provide protection against a**

downturn in the market. Mr. Dingley stated that he thinks there is validity in looking at our liabilities and addressing them, especially given the current market conditions and our potential cash flow issues.

Mr. Dingley told the Commission that a copy of the presentation was provided for their review and/or possible discussion. Mr. Dingley noted that if the Commission decides to consider this, the Commission would turn things over to our advisors and subsequently issue an RFP.

**Treasurer's Report.** Treasurer Caprio stated the meeting book has a summary of the May fund performance; he noted since the transition to passive investments in equity, we have returned 6.14%. The policy benchmark ex-PE and RE said we should return 5.91%; the May return validates the Commission's assumption that we can meet our benchmark and pick up some alpha because of the small portion which is actively managed.

The Treasurer also thanked Mr. Gaudreau, Ms. Gallogly and the staff for attending the ALM presentation that Mr. Dingley mentioned. He stated that as soon as the legislature decides which changes will be made to the pension system, focusing on the future liabilities of the fund might be a worthwhile task.

Regarding jobs and the local economy, the Treasurer stated that we have been approached with economically targeted investment strategies. Because of the new policies out of Washington regarding the use of municipal bonds for projects by for-profit and non-profit

organizations, as well as the government sector, there is a potential to make investments in such bonds through a national bond fund. If Rhode Island invests in such a fund, the firm will invest the same amount in Rhode Island bonds. The Treasurer noted that this is a fixed income strategy that has the extra benefit of creating economic activity in our state. Examples of such bonds would likely be housing bonds or Build America Bonds. Additionally, the Treasurer informed the Commission that he has requested that staff put together a policy regarding the above-referenced policy to see how it could benefit both the local economy and the return in our portfolio.

The Treasurer next stated that a voluntary response has been submitted to the SEC regarding an inquiry they sent to most state pension funds. The Treasurer noted that in answering the SEC's questions, data was received from money managers, private equity managers and real estate managers. The most common fee structure for private equity managers, which the Commission uses, has the State, acting as a limited partner, paying 1.5% per year of our investment to the general partner in the form of an annual management fee. How the contracted money management firms allocated their expenses have been outside the review of the Commission. The focus previously was on the fee amount.

The Treasurer stated that at the next meeting, a policy will be proposed which would require all money managers, from any type of firm, to give the SIC a break down of fee dollars that they spend. The Treasurer noted that best practices will be used and the policy will be drafted with the assistance and consultation of Mr. Emkin and his

team, as well as the Treasurer's legal staff. He stated the Commission must have full transparency with any outside firm as to how they spend management fees we pay them.

Changing gears, Mr. Giudici asked if the Commission has any guidelines regarding minimum bond ratings for potential municipal bond investments.

Treasurer Caprio stated that right now we have an allocation to low credit bond investments and we are not adverse to risk in all parts of the portfolio; the Commission adopted an Economically Targeted Investment policy for municipal bonds, the allocation of risk would be carefully crafted.

Mr. Dingley commented that in regard to Build America Bond statistics, state pension funds are buying a large portion of the offering.

Mr. Treat observed that, as he understands it, this is a safer and more diversified way to participate.

Treasurer Caprio mentioned the state's credit rating was affirmed two weeks ago for the two bond issuances which were completed in the last month. The ratings agencies held us where we were, which is largely due to the financial management practices of the Governor's Budget Office and Ms. Booth Gallogly, as well as the Treasury Department and the legislative response in this area.

**New Business.** There was no new business.

There being no new business, the Treasurer entertained a motion to

**adjourn. Dr. McKenna moved, Ms. Gallogly seconded and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Robert Gaudreau, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. John Treat, and General Treasurer Frank T. Caprio.**

**VOTED: To adjourn the meeting.**

**There being no further business, the meeting was adjourned at 9:54AM.**

**Respectfully submitted,**

**Frank T. Caprio**

**General Treasurer**