

DRAFT MINUTES

State of Rhode Island and Providence Plantations STATE INVESTMENT COMMISSION

Monthly Meeting December 16, 2009

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, December 16, 2009. The Treasurer called the meeting to order at 9:00 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Andrew Reilly, Mr. John Treat and General Treasurer Frank T. Caprio establishing a quorum. Ms. Rosemary Booth Gallogly arrived at 9:06 a. m.. Also present were Ms. Sally Dowling, of Adler, Pollock, and Sheehan and 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; Mr. Nick Katsikis and Ms Lisa Tyrell of State Street Corporation; Mr. Michael Bane of PCG, and members of the Treasurer's staff. Dr. Robert McKenna, Mr. Robert Giudici, and Ms. Marcia Reback were not present.

State Investment Commission Minutes. Treasurer Caprio entertained a motion for approval of the minutes for the meeting of November 18, 2009. Mr. Reilly moved, Mr. Gaudreau seconded, and the subsequent

motion passed. The following members voted in favor: Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Andrew Reilly, Mr. John Treat and General Treasurer Frank T. Caprio.

VOTED: To approve the Minutes of the November 18, 2009 monthly meeting.

General Consultant Report. Mr. Burns introduced Mr. David Saunders of K2 Advisors, a noted practitioner in the hedge fund field.

Mr. Goodreau noted K2 Advisors was highly recommended by the staff at Mass PRIM.

Mr. Saunders asked the board to refer to the presentation material, then told the board about his professional experience culminating with the founding of K2 Advisors in 1994. He gave an overview of K2 Advisors, its global regulatory registrations, and client list.

He stated a hedge fund is not solely an absolute return investment. Hedge funds have delivered significant performance over time, however, there have been losses. He defined hedge funds as nothing more than a fee structure agreement. He then detailed some of the reasons to invest in hedge funds, highlighting the key elements of: an attractive risk adjusted return and a vehicle that is meant to protect capital. The main reason is risk diversification because the exposure is uncorrelated to equity and fixed income portfolios.

He covered points to consider when investing in hedge funds, stressing transparency, ongoing due diligence, and access to good managers as the most important.

A discussion among the group followed.

Mr. Saunders then addressed the long/short strategies, the least risky in hedge funds, explaining there are levels of diversification. At Mr. Burns' request he covered an example of a long/short investment.

Mr. Treat asked what the duration of a long/short investment would be.

Mr. Saunders explained that just like there are different methodologies there are different timelines for these investments.

He then told the group that in the 1990s investment banks developed a system based on Value at Risk (VaR). VaR is based on the common sense fact that risk is the odds of losing money. This is the quantitative method used to measure risk in hedge fund investments.

Ms. Booth Gallogly asked if the VaR calculation would have shown a high risk of losing money for the hedge funds that failed.

Mr. Saunders replied there are three types of risk we consider with hedge funds, headline risk, operational short falls (fraud) and market risk.

Ms. Booth Gallogly asked if there is less government oversight on this type of investment than with others even after the recent scandals.

Mr. Saunders replied that it is difficult for the government to monitor the financial industry with the resources they have. Common sense and vigilant due diligence will keep the investor out of trouble with hedge fund investing. Transparency is essential. To illustrate the optimal level of transparency he reviewed numerous examples of reports on hedge fund portfolios.

Ms. Booth Gallogly asked if the VaR calculation takes into account the liquidity issue.

Mr. Saunders replied that it is a separate measurement, which allows you to calculate liquidity at the fund level. VaR is not a 100% measurement, a stress test is needed as well. He continued reviewing additional examples of methods and reports to measure risk. He noted we have addressed market exposure and the other risk element is skill. Once market exposure is backed out of the equation you are left with the skill function.

Mr. Costello asked for information on multi-strategy and fund to fund hedge fund management.

Mr. Saunders reviewed benefits and liabilities in both; however, in fund to fund you are getting exactly what you specify in your guidelines.

Mr. Costello asked in a managed low risk portfolio what the expected rates of return are.

Mr. Saunders replied that the market is dynamic and there are times when you want more risk and times you want less. Historically the goal was 8% but from 1990 to now the fluctuation has been remarkable. He thanked the group for their attention.

Performance Review.

Mr. Emkin mentioned that in reviewing performance material the underperformance of real estate relative to its benchmark stood out. He encouraged the board to bring in Townsend for information on performance in the real estate portfolio.

Treasurer Caprio commented the commission has taken a patient

approach to real estate and has invested very little over the past three years; most investments were made prior to 2007. The changes we made in other areas of the portfolio in the past year are producing meaningful results. We are looking to the future in exploring vehicles for additional return.

Mr. Saunders noted he applauds the action the board is taking.

Legal Counsel Report. Legal Counsel had no report.

Chief Investment Officer Report Mr. Goodreau thanked Mr. Saunders for the presentation. He asked the group to turn to the performance material and to note that the total plan was up 3.61% for the month, the total plan benchmark was up 3.32%. Additionally, fiscal year return to date is 16.43% with private equity and real estate markdowns. Non-private equity and real estate is up 23.68%. It is good to see the increase in the overall value of the program; we are at \$6.9 billion as of last night's close. We will continue to focus on risk management going forward.

Treasurer's Report. Treasurer Caprio stated that there are contractual matters to address; the first item is the State Street contract. He said the distributed spread sheet shows the SIC will be paying less for more services than was paid ten years ago. That translates into a 2009 fee that is about 60% of the 1999 fee. Based on the positive negotiations and the agreement we have reached, it is the staff's recommendation that we extend the contract eighteen months.

Treasurer Caprio asked if there were any questions for Treasury or State Street staff.

He then entertained a motion to extend the State Street contract for 18 months subject to final documents being negotiated and signed. Mr. Costello moved, Mr. Reilly and Mr. Treat seconded and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Andrew Reilly, Mr. John Treat and General Treasurer Frank T. Caprio.

VOTED: To extend the State Street contract for 18 months subject to final documents being negotiated and signed.

Treasurer Caprio told the board that the current legal representation of the board is Adler, Pollock and Sheehan for alternative investments and Rodio and Ursillo for day to day and open meeting issues. The contracts with Adler, Pollock and Sheehan and Rodio and Ursillo allow for an extension for one year.

He entertained a motion to extend those contracts pursuant to the original contracts negotiated after the RFP process. Mr. Costello moved, Mr. Reilly seconded and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Andrew Reilly, Mr. John Treat and General Treasurer Frank T. Caprio.

VOTED: To extend the contract with Adler, Pollock and Sheehan and

the contract with Rodio and Ursillo for one year.

Treasurer Caprio then stated there is a recommendation for a bond custody services RFP and asked Mr. Izzo to give the group details of the recommendation.

Mr. Izzo commented that insurance, construction companies and banks are required to post a bond in order to conduct business in RI. The custodian will monitor and manage these accounts.

Treasurer Caprio entertained a motion for the authority for a bond custody services RFP. Mr. Treat moved, Mr. Costello seconded and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Andrew Reilly, Mr. John Treat and General Treasurer Frank T. Caprio.

VOTED: To authorize a bond custody services RFP.

New Business. There was no new business.

There being no new business, the Treasurer entertained a motion to adjourn. Mr. Treat moved, Mr. Reilly seconded and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Gaudreau, Mr. Andrew Reilly, Mr. John Treat and General Treasurer Frank T. Caprio.

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:14AM.

Respectfully submitted,

**Frank T. Caprio
General Treasurer**