

State of Rhode Island and Providence Plantations

STATE INVESTMENT COMMISSION

Monthly Meeting January 27, 2010

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, January 27, 2010. The Treasurer called the meeting to order at 9:00 a.m.

Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Mr. Robert Giudici, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat and General Treasurer Frank T. Caprio, establishing a quorum. Also present were Mr. Stephen Geanacopoulos, of Adler, Pollock, and Sheehan and 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; Ms Lisa Tyrrell of State Street Corporation; Mr. Michelle Davidson of PCG, and members of the Treasurer's staff. Dr. Robert McKenna 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 December 16, 2009. Mr. Reilly moved, Ms. Reback seconded, and the subsequent motion passed. The following members voted in favor: Ms. Gallogly, Mr. Costello, Mr. Giudici, Ms. Reback, Mr. Reilly, Mr. Treat and General Treasurer Caprio.

VOTED: To approve the Minutes of the December 16, 2009 monthly meeting.

Treasurer Caprio asked Gregg Hymowitz, Jill Zelenko & Jill Daschle of Entrust Capital to join the meeting to make their educational presentation on hedge fund investing.

Mr. Hymowitz asked the group to refer to the presentation book, and then told the board about Entrust and his professional background. He gave an overview of the recent history and current view of the market as well as the hedge fund sector. He explained that hedge funds are simply different ways of managing stocks and bonds.

He noted that over the past few years there has been a significant increased allocation to hedge funds by institutional investors. The increase is partly due to the fact that it has become more difficult to make the 7 to 10% return pension funds look for in other vehicles. Also, the reduced volatility and the increased risk adjusted rate of return have contributed to the increase.

He detailed strategies hedge fund managers use by comparing scenarios of traditional equity management and hedge fund management. He noted hedge fund managers are focused on the down side protection, this is why they generate significant out-performance over a period of time. This strategy allows for reduced volatility and provides a significant level of diversification and the ability to preserve capital in the difficult times.

He reviewed performance for various equity indices and hedge fund

strategies for the years 2000, 2008 and 2009 to illustrate the different rates of return and levels of diversification. He spoke about the issue of transparency and how the participation of institutional investors has spurred its increase. He stressed the importance of ongoing due diligence. Going forward the opportunities are significant because of debt incurred in the equity and commercial real estate markets over the past few years. He explained how a fund is set up and how it is diversified among managers. Addressing the issue of leverage, he said its excessive use contributed to the recent crisis more than any other factor, then elaborated on the 2008 market. He cautioned to avoid hedge funds that use significant amounts of leverage.

The presentation concluded and the Entrust team departed the meeting.

Treasurer Caprio told the group that the RI General Laws Section 35-10 provides for up to 5% in Economically Targeted investments; like other segments of the portfolio it is prudent to have an investment policy, he then called on Mr. Burns.

General Consultant Report. Mr. Burns asked the group to refer to the handout Statement of Investment Policy for Economically Targeted Investment Program (ETI). He stated that over the past fifteen years it has been common for state and large municipal funds to make these types of investments. The idea of an ETI is to use a portion of the assets to invest in the local economy that will earn a market rate of return commensurate with the risk criterion that would be used to judge any investment. The secondary benefit would be to promote the local economy. He went through several fact patterns to demonstrate

what an ETI would and would not be. He stressed this is not a mandate to invest, the policy is intended to focus on the board's fiduciary responsibility and to give direction to the staff. He then covered each section of the policy draft.

The group discussed various elements of the class, the draft policy and fact patterns that may arise.

Treasurer Caprio stated that we have been approached with ETI ideas for the fund; our philosophy has been if they were not already in the institutional investor world, with a track record - it was not an investment that we would consider. He said the policy should not be open to interpretation and that he would like Mr. Dingley to work with Mr. Burns to refine the policy.

Ms. Booth Gallogly asked for specific language to clarify that a state agency or quasi-agency could not guarantee an ETI.

Mr. Costello commented that this is a good approach for the board to take.

Treasurer Caprio introduced the topic of the alternative investment search. He asked for consideration for a request for proposals (RFP) in this area without a commitment to select a manager.

Mr. Goodreau told the members that after hearing the educational material over the past two months this search should be viewed as a continuation of exploration in this area. We want to look at institutions, fees and industry standards and are not making a commitment to engage.

The members discussed various aspects of the search, policy and allocation.

Mr. Burns clarified the policy for this class is 3% or about \$180 million which is part of the 10% real return allocation. As in any search, PCA will assist in crafting the scope of the search.

Treasurer Caprio entertained a motion to authorize a search as defined by PCA. Ms. Reback moved, and Mr. Costello, Mr. Giudici, and Mr. Treat seconded, and the subsequent motion passed. The following members voted in favor: Ms. Gallogly, Mr. Costello, Mr. Giudici, Ms. Reback, Mr. Reilly, Mr. Treat and General Treasurer Caprio.

VOTED: To authorize a search as defined by PCA

Mr. Burns turned to the topic of real estate investments. He noted that the quarterly report shows the real estate portfolio off 42.2% for the year. At the next meeting we will have Townsend come in for a review of the entire real estate portfolio.

Mr. Goodreau commented that this is an issue that is impacting a number of pension funds and he has been engaged in discussions with our peers from around the country exchanging information on how best to proceed.

Treasurer Caprio noted over the last 3 years we have made few investments. The allocation to real estate is always targeted at 5%, and although this seems small, it is having a major impact on overall performance.

Legal Counsel Report. Mr. Dingley asked the board to turn to the

Placement Agent Disclosure Certificate. He said the document is a collaborative effort of Treasury, PCG and Adler Pollock and Sheehan staff which represents the best practices in the industry to get as much transparency as possible. It requires the general partner of real estate or private equity firms certify there are no placement fees in connection with the RI investment. Additionally they must disclose any placement fees involved in the transaction with other investors. Staff recommends we require this certificate on all future transactions.

Treasurer Caprio entertained a motion to adopt the Placement Agent Disclosure Certificate and make it part of our due diligence package. Mr. Costello moved, Ms. Booth Gallogly and Ms. Reback seconded, and the subsequent motion passed. The following members voted in favor: Ms. Gallogly, Mr. Costello, Mr. Giudici, Ms. Reback, Mr. Reilly, Mr. Treat and General Treasurer Caprio.

VOTED: To adopt the Placement Agent Disclosure Certificate.

Chief Investment Officer Report Mr. Goodreau said calendar year 2009 was a very positive year for the fund. Total assets were up 18%, which is in line or out-performing our peers. Without private equity & real estate the total plan would be up 26%, beating benchmark by 4.98%. He explained how the increase in private equity from \$350 million to \$600 million during 2006 is producing the current drag on

performance. Regardless of the drag, the board's decisions have resulted in the fund being near the top quartile for the year.

Mr. Costello asked if we are using the S&P+300 and if there is a better benchmark?

The group discussed the benchmark types and options then agreed to get consultant guidance and to continue a more in depth discussion in the future.

Mr. Goodreau asked the group to turn to the money manager fee savings calculation document. He explained how the board's initiatives to reduce fees are becoming a reality. The fee savings through December 31, 2009 were \$4.4 million. The additional trading and market impact related cost savings are not included in this calculation.

Treasurer's Report. Treasurer Caprio reported, in addition to his previous comments, a good benchmark was recently released. CALPERS, the largest fund in the country, earned 12% for calendar year 2009. Our fund earned 18% last year. Your efforts to minimize fees, simplify our process and monitor liquidity is a large part of our success.

He turned the meeting over to Ms. Booth Gallogly and exited the meeting at 10:28.

New Business. There was no new business.

There being no new business, Ms. Rosemary Booth Gallogly

entertained a motion to adjourn. Mr. Costello moved, Ms. Reback seconded and the subsequent motion passed. The following members voted in favor: Ms. Booth Gallogly, Mr. Costello, Mr. Giudici, Ms. Reback, Mr. Reilly, and Mr. Treat.

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:44AM.

Respectfully submitted,

Frank T. Caprio

General Treasurer