

**State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION**

Monthly Meeting May 25, 2011

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, May 25, 2011. General Treasurer Raimondo called the meeting to order at 9:04 a.m.

Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Marcia Reback, Mr. Andrew Reilly and General Treasurer Gina Raimondo, establishing a quorum. Also present were: Ms. Sally Dowling, of Adler Pollock, & Sheehan, and Mr. Joe Rodio Jr., of Rodio & Ursillo, Legal Counsel to the Commission; Mr. John Burns and Mr. Alan Emkin of Pension Consulting Alliance (PCA), General Policy Consultant to the Commission; Mr. Robert McCrory, Executive Vice President of EFI Actuaries; Ms. Lisa Tyrell of State Street Corporation; Thomas Lynch of Cliffwater; Mr. Frank Karpinski, Executive Director of Employees' Retirement System of Rhode Island and members of the Treasurer's staff.

State Investment Commission Minutes. Treasurer Raimondo entertained a motion to approve the minutes for the meeting of April 27, 2011. Ms. Gallogly moved, Mr. Fay seconded, and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Marcia Reback, Mr. Andrew Reilly and General Treasurer Gina Raimondo

VOTED: To approve the Minutes of the April 27, 2011 monthly meeting.

Update on Asset Liability Study. Treasurer Raimondo called upon Mr. McCrory and Mr. Emkin to update the board on the asset liability study.

Mr. McCrory confronted the issue of Rhode Island's unique demographic and how that demographic plays a role in how to balance the state's assets and liabilities. Mr. McCrory pointed out that the employer's cost as well as funding risk will be increasing over the next couple of years. Mr. McCrory showed some projections from the actuaries for the expected benefit payouts and how the state's plans were not like most other plans because of the state's demographics.

Treasurer Raimondo asked if Mr. McCrory was referring to public sector plans in his comparison.

Mr. McCrory confirmed that he was comparing the state's plan to other public sector plans.

Mr. Fay asked if the difference in Rhode Island's projections was a function of the change in staffing and the fact that the number of employees goes up at a higher rate.

Mr. McCrory said the staffing issue comes down to when people were hired. Mr. McCrory continued to explain the assumptions were made to create the models in the presentation.

Ms. Gallogly asked why five year smoothing and capital market assumptions on the return were not used.

Mr. McCrory reassured that gains and losses are not the issue and that five year smoothing does not accomplish that much because the fact that the five year period moves over time and creates additional volatility.

Treasurer Raimondo asked if it was unusual to have such a high percentage of the liabilities be attributed to inactive members.

Mr. McCrory agreed that it is a very unusual circumstance. Mr. McCrory said the state is about 20% higher than the typical pattern for most plans. He said no money has been put aside for active members and the state is still working on completely funding the inactive members.

Ms. Reback pointed out the state is down several thousand members due to lay-offs and forced retirements.

Mr. Emkin said the problem with people retiring early is that it means those people will begin taking out of the system earlier and then if you don't replace them, this compounds the problem.

Ms. Gallogly asked how this solution of hiring young workers would affect the liability side under the current benefit structure.

Mr. McCrory said usually with younger employees, their entire cost is paid for by their own contributions. He also pointed out that these younger employees would be so far away from retirement that the chances of them making it to retirement, not being terminated or leaving, is very low so they become donors to this plan and expand the payroll base.

Treasurer Raimondo asked how long-term investment gains are accounted for when creating the number ratio of the rate benefits are going out to the amount coming in.

Mr. Emkin said that number comes from contribution minus benefit payments; it doesn't look at the investment side of the equation at all.

Mr. Fay asked why the numbers in the liability wouldn't dramatically drop in the 30 year projections when the older population generation passes on and no longer takes from it.

Mr. McCrory showed another chart showing 100 years out, that liabilities do go down significantly.

Mr. Emkin said that the reason the liability doesn't go down as rapidly as one might expect is because the state is so currently under funded.

Mr. McCrory said another problem is the schedule B benefits are so much lower than the schedule A benefits and as the amount funded goes up, the cost risk also increases. Mr. McCrory explained that the more assets you have the riskier the plan is in terms of employer's cost.

Mr. Emkin said as the state becomes better funded it must decide what level of risk it would like to take on and maintain to work best for the state in the future.

Mr. Costello asked what the current ratio was.

Mr. McCrory said the ratio was 3.3 times assets to payroll, but as the plan increases that ratio will increase and become closer to the normal ratio which is about 5 times.

Ms. Gallogly asked if the state would need to achieve the higher percentages in order to achieve 100% funded status by the actuary's projected date.

Mr. Emkin confirmed this and he also stated this would not happen using the current portfolio.

Ms. Gallogly asked if the state would adopt a portfolio that could in fact hit these benchmarks.

Mr. Emkin said that would have to be decided after looking at the tradeoff of having more volatility and a wider range of outcomes.

Cliffwater Presentation: Mr. Lynch gave a quick overview on where the private equity portfolio stands today. He recommended that the state begin to make more commitments in order to maintain its target of 7.5%. Mr. Lynch pointed out biases in the portfolio such as large exposure to large corporate finance and its small exposure to small corporate finance as well as very little exposure to certain international markets specifically the Asia/Pacific area and maintain diversification He suggested the state moves toward medium to smaller sized corporate finance. Mr. Lynch said the state should be looking for a premium on its private equity of about 300 basis points. He showed the expectations and distributions for the maturity of the current portfolios and noted without making more commitments the portfolio will decline pretty quickly.

Mr. Reilly asked if the later years would also be less on these distributions.

Mr. Lynch confirmed and noted that the state's international exposure is mainly Europe and that the exposure in Asia is a very small percentage of the total.

Treasurer Raimondo asked what Mr. Lynch thought would be a good number of partners for the state's fund.

Mr. Lynch responded that the number would be somewhere between 20 and 30, ideally 25 partners.

Mr. Kenneth Goodreau, chief investment officer, asked if there are some portfolio managers the board is not going to re-up, so how should the state approach new secondary opportunities.

Mr. Lynch answered if there is an opportunity to sell then they should sell. Mr. Lynch showed a few models of the state's private equity budget with the assumptions that the total fund will grow by 4.5% per year. Mr. Lynch commented that he knows down the road the model will be wrong because it's just a simulation of what might happen to market values.

Mr. Lynch showed a chart of a recommended commitment schedule. Mr. Lynch provided a breakdown of the different sections that would be acquiring new partners and commitments.

Mr. Reilly expressed fear that in another financial crisis the cash flow would be much worse if the state had to deal with frozen private equity.

Mr. Emkin said that next month the board may know how much money may be put into this. Mr. Emkin commented that the lack of liquidity that existed in previous financial crises is better regulated today. Mr. Lynch said that Cliffwater updates their models frequently to adapt so that it is better prepared to foresee possible issues of illiquidity and minimize risk.

Treasurer Raimondo asked Mr. Lynch to bring a distribution of some newly invested commitments to his next presentation.

Mr. Lynch said he would bring the information and framework to his next presentation and would like to keep a forward looking approach, so he will bring short term as well as long term commitment recommendations.

OPEB. Treasurer Raimondo referred to the OPEB Trust Investment Policy handout.

Mr. Mark Dingley discussed the statute passed by the General Assembly that requires funding of the OPEB Trust with the actuarial assumption of 5% returns. He explained the SIC is responsible for the investment of the funds. It's members must make sure investments are made in accordance with the policies of the Trust. Mr. Dingley said the SIC could recommend different allocations for its policy in order to meet the expected value of return.

Treasurer Raimondo entertained a motion to approve the investment policy for the OPEB Trust. Ms. Gallogly moved, Mr. Costello seconded, and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Mr. Andrew Reilly and General Treasurer Gina Raimondo

VOTED: To approve the investment policy for the OPEB Trust.

Legal Counsel Report. Legal Counsel had no other report.

Chief Investment Officer Report. Mr. Goodreau had no other report.

Treasurer's Report. Treasurer Raimondo noted that next month is an important meeting that will require a decision on whether it's appropriate to make any changes to the state's investment policy in light of what is now known about the liabilities. Treasurer Raimondo brought up the possibility of entering hedge funds and that asset class sometime this year. Treasurer Raimondo mentioned her new website that was just launched called SecurePathwayRI.com and noted that they will continually be posting new educational information on that site in case anyone has questions.

New Business. There was no new business.

There being no new business, Ms. Gallogly moved to adjourn, Mr. Costello seconded and the subsequent motion passed. The following members voted in favor: Ms. Rosemary Booth Gallogly, Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Mr. Andrew Reilly and General Treasurer Gina Raimondo

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:50 a.m.

Respectfully submitted,



Gina M. Raimondo
General Treasurer