State Investment Commission

Monthly Meeting Minutes
Wednesday, April 24, 2013
9:00 a.m.
Room 135, State House

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:02 a.m., Wednesday, April 24, 2013 in Room 135, State House.

I. Roll Call of Members

The following members were present: Ms. Rosemary Booth Gallogly, Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Paula McNamara, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. Frank Karpinski, General Treasurer Gina Raimondo. Ms. Booth Gallogly arrived at 9:04. Also in attendance: Mr. Thomas Lynch, Mr. Steve Nesbitt and Mr. Mark Johnson of Cliffwater, alternative investment consultant to the Commission; Mr. Alan Emkin, Mr. John Burns, Ms. Judy Chambers, and Mr. David Glickman of Pension Consulting Alliance (PCA), general policy and real estate consultant; Ms. Sally Dowling, of Adler Pollock, legal counsel; Ms. Margie Vose and Mr. Jake Weinstein of Fidelity; Ms. Anne-Marie Fink, chief investment officer and members of the Treasurer's staff; Mr. James Alvarez from the office of Governor Lincoln Chafee and various local reporters. Treasurer Raimondo called the meeting to order at 9:02 a.m.

II. Approval of Minutes

On a motion by Mr. Reilly and seconded by Mr. Fay, it was unanimously
VOTED: To approve the draft of the minutes of the March 27, 2013 meeting of the State Investment Commission. Ms. Booth Gallogly was not present for the approval of the minutes.

III. Real Estate Secondary Sale Recommendation

Mr. Glickman provided an update on the sale of some non-core real estate limited partnerships. He said there are a number of prospective bidders who are willing and able to purchase the assets. He explained some bidders expressed interest in buying large portions of the portfolio and others had interest in buying only single partnerships. He said there are thirteen separate transactions that will hopefully be completed by the end of June. He talked about the advantages of the secondary sale. He asked for authorization from the board to move forward with the sale if they receive an appropriate discount price.
Ms. Fink noted this part of the portfolio hasn't worked out as planned when the SIC invested in them in 2005 through 2008. She said the fund has lost money on these positions and PCA believes there are better long-term real estate opportunities.
Ms. Fink outlined the advantages of redeploying the money to lower risk real estate funds and stated there would be an 8% expected return. She also asked the board for flexibility around the discounts so staff may negotiate as strongly as possible with the bidders.
Ms. Booth Gallogly asked about the process and if we are able to hold the cash. Ms. Fink explained the money committed to Heitman should be called about the same time as the proceeds come in. One bidder might give better pricing if they give us all the cash at the end

of September. Additionally, the cash won't likely be able to be redeployed until that time period.
Mr. Glickman added that the process of identifying new non-core investments is already under way. He also explained that if a commitment were to be made in the third or fourth quarter, the funds would likely be drawn in calendar years 2014 and 2015. The goal is to diversify by vintage year.
Ms. Fink talked about how the managers in some of these funds are not particularly motivated to work hard on the remaining assets because they know they won't earn an incentive fee, because the funds are so far from being profitable.
Ms. Booth Gallogly asked if the compensation structure needs to keep people interested up to the last dollar and if that wasn't previously the case.
Ms. Fink explained that because these funds were invested at the top of the market and are now under water, they most likely won't deliver positive returns.
Mr. Reilly reiterated these funds have already suffered loses. The board isn't making a decision to take further loses.
Mr. Glickman noted that this would not be a forced sale but rather a market opportunity.

On a motion by Ms. Reback and seconded by Mr. Fay, it was unanimously
VOTED: to give staff, with consultation from PCA, the authority to act upon the legacy portfolio secondary sale within 90 days and within a reasonable range of discount or to not continue if the discount level is not satisfactory.

IV. Corporate Governance Policy

Ms. Fink gave an update on the Corporate Governance Policy. She talked about the responsibility of the SIC in exercising corporate governance. She said since the equities held are in commingled funds, there is a third party that votes. The responsibility of the SIC is to oversee that everything is being done to maximize value in the portfolio. She talked about key principles which have been identified. She said she will be in further discussion with other states and look at the cost-benefit analysis of hiring a firm to exercise corporate governance.
Ms. Reback suggested that social responsibility be added as a key principle to the policy. The board determined that further work would need to be done as far as the social responsibility principle of the policy.
Ms. Fink added state plans with more corporate governance experience will talk to ERSRI for free and share best practices and procedures that might benefit the plan's corporate governance policy.
No vote was taken.

V. Infrastructure Update

Ms. Chambers provided a brief update of the infrastructure RFI. She said the potential managers have initially been narrowed down to eight, with on-site due diligence scheduled for four of these managers.
Mr. Reilly asked if the eight managers represented a diversified pool.
Ms. Chambers explained that the responses were diversified across the board with many of them in the energy sector. She pointed out that the managers have core or core plus strategies. She explained risk and return as well as how they meet overall standards, will determine how many managers will be selected.

VI. OSIP Review

Ms. Vose briefly reviewed Fidelity's distribution efforts in Rhode Island. She said OSIP has seven more participants other than the state and has about $530 million currently invested.

Mr. Weinstein reviewed current market conditions and their effect on OSIP's yield. He outlined the objectives of the pool and explained the parameters for management of the pool.

Mr. Izzo added that municipalities and quasi-state agencies have benefited from both direct participation and outreach from Fidelity which has generated competition from current vendors.

VII. Legal Counsel Report

There was no legal update.

VIII. CIO Report

Ms. Fink introduced Mr. Nesbitt to review the plan's current asset allocation and risk.

Mr. Nesbitt reviewed the alternative investment allocation for the State of Rhode Island in comparison with other states for fiscal year 2012. He said the ERSRI's current allocation is 26% which is around average when compared to other state plans. He went on to compare ERSRI's expense ratio to other state plans that publish their fees. He stated ERSRI's expense ratio is 0.36% and that it is slightly below the average of 0.40% among 38 pension plans. He also reviewed expense ratios including performance fees and compared them to the other five other plans which publish these fees. He stated that ERSRI's is on the lower end at 0.58%.

Ms. Reback asked how fees this year compare versus fees four years ago and how much alternative investments have impacted the overall fee structure.

Mr. Nesbitt noted that those numbers are not readily available.

Mr. Emkin added the information can be obtained and followed up on.

Mr. Costello noted the returns have become far less volatile. Since the plan must continually pay benefits, the net return of the hedge funds is worth the increase in fees.

Mr. Emkin said the plan's strategic objective was to get a higher rate of return with lower risk and to accomplish that, higher fees must be paid.

Ms. Reback expressed concern over three hedge funds whose managers are involved on a personal basis in organizations that she saw as having anti-teacher-union agendas. She asked if the plan could divest from these funds.

The board discussed issues around incorporating individuals' personal activities into the evaluation of fund investments as well as the obstacles related to divesting from these funds.

Mr. Costello suggested looking further into the three funds to determine if investments are being made directly into securities that are anti-teacher union. He then explained the challenges of monitoring individual's political leanings and said that is not how investment decisions should be made.

Ms. Fink briefly reviewed hedge fund performance to date.

Ms. Fink gave an update on the change of allocation for the OPEB fund and said that it is complete.

Ms. Fink said the banking transition for the disbursement account went smoothly and is now complete.

Ms. Fink updated the board on the Collegebound Fund review. She said she negotiated pricing with PCA to assist reviewing the investment lineup.

Ms. Fink stated Wellspring has not made any further progress in selling their holdings of United Sporting Companies, which is a distributor of firearms. The SIC is allowing until the end of June. If no progress is made, the board will consider a secondary sale of the partnership.

Ms. Fink reviewed the portfolio's performance for last month and reviewed each asset class.

IX. Treasurer Report

Treasurer Raimondo thanked the board for their continued work.

There being no other business to come before the Board, on a motion by Ms. Reback and seconded by Mr. Giudici, the meeting adjourned at 11:31 a.m.

Respectfully submitted,

Gina M. Raimondo
General Treasurer