State Investment Commission

Monthly Meeting Minutes
Wednesday, November 20, 2013
9:00 a.m.
Room 205, State House

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:05 a.m., Wednesday, November 20, 2013 in Room 205, State House.

I. Roll Call of Members

The following members were present: Mr. Thomas Fay, Mr. Robert Giudici, Ms. Paula McNamara, Mr. Thomas Mullaney, Ms. Marcia Reback, Mr. Frank Karpinski, and General Treasurer Gina Raimondo. Also in attendance:
Mr. Darren Lopes and Mr. Larry Brown of TIAA-CREF, administrator of the defined contribution plan; Mr. Mark Johnson of Cliffwater, alternative investment consultant to the Commission; Mr. John Burns and Mr. Alan Emkin of Pension Consulting Alliance (PCA), General Consultant; Mr. Mark Sullivan of Bank of New York Mellon, Custodian bank of the fund; Mr. Seth Magaziner, candidate for Rhode Island General Treasurer; Ms. Sally Dowling, of Adler Pollock & Sheehan P.C., legal counsel;
Ms. Anne-Marie Fink, chief investment officer and members of the Treasurer's staff; Members of the Senate fiscal staff and various local reporters.
Mr. J. Michael Costello and Mr. Andrew Riley were absent. Mr. Reilly listened by phone.
Treasurer Raimondo called the meeting to order at 9:05 a.m.

II. Approval of Minutes

On a motion by Mr. Fay and seconded by Mr. Giudici, it was unanimously
VOTED: to approve the draft of the minutes of the October 23, 2013 meeting of the State Investment Commission.

III. Defined Contribution Plan Quarterly Update & Socially Aware Lineup Addition Recommendation

Mr. Lopes reviewed the current demographics of the plan. He said the total assets were about $154 million through the end of September. Roughly 93% of the assets remain in target date funds. He noted that the mapping of assets from the Vanguard target date funds to the collective trust funds went smoothly and was effective as of October 31.
Mr. Lopes said participant online log-ins have increased and calls have decreased. This is common, as participants log in and don't see much volatility in the market. He said they are starting to gain traction with on-site visits and one-on-one counselling sessions.
Mr. Brown reviewed the performance of the plan through September 30. He said the plan has had very strong returns for the quarter and year-to-date and good exposure to asset classes.

Ms. Fink said that there are a number of participants that are not diversified and have exposures to only one or two asset classes. TIAA-CREF will send out a letter offering a free counseling session to those participants to help them avoid any unintended consequences.
Ms. Fink said that now that the plan is established, it is a good time to consider adding an additional option. Since there are a number of people concerned with social risk, she said staff would like to look for a fund that would meet their preference. This would be added as an option to the lineup and would not be a default option.
Ms. Fink said staff will work with PCA to examine the available socially aware funds. They will select one to bring before the board for a vote at a later meeting.

IV. Quarterly Private Equity Review

Mr. Johnson reviewed the market performance for Q2 of 2013. He said all U.S. private equity was up 3.43% versus the Wilshire 5000 which was up 2.88%. He noted that private equity has outperformed the public equity markets in the long term.
He reviewed the goals and strategies for the portfolio. The goal is to maintain a 7% allocation target. The performance goal target is 3% over public equities over the long term. Cliffwater targets top quartile managers for this portfolio.
He said the portfolio is well diversified. The near-term strategy is to reduce the number of managers, which they have been working on with staff and being selective in the types of new funds that they're allocating to. He noted that in the current market they are seeing managers being more selective in their choice of limited partners. A number of clients have had difficulty getting the full size allocations they would like. Funds similar to Rhode Island have been getting decent allocations. But it has been a challenge as managers are trying to keep their fund sizes reasonable and reward existing clients. Cliffwater will continue to work on achieving this.
Mr. Johnson said that going forward the goal is to target 5 to 8 new partnerships per year and $100 million to $120 million in total commitments per year.
Mr. Johnson gave a brief summary of the portfolio since inception. The portfolio has had 13.7% annualized returns since inception and 15.2% over ten years. Performance has been comparable to the benchmark.
He said the portfolio was up about 3% in value as of the quarter ending in June, which is in line with the rest of industry. In the second quarter they closed on one new partnership, Riverside Fund Appreciation Fund VI for a $20 million commitment.
Mr. Johnson reviewed the positive and negative drivers in the portfolio. He said 37% of the overall gains in the quarter came from the top five managers. Some of the detractors are 2005-2007 vintage year funds. The long-term positive performance drivers are funds from the 2000-2004 vintage period. He reviewed the return by vintage year and said the strongest returns in the last 10 years are 2003 and 2004. He also pointed out the private equity portfolio has good diversification across various sectors.
It has been a good year in terms of distributions and the equity markets have performed well. The challenge is to redeploy money into funds in order to maintain the 7.0%-7.5% allocation to Private Equity.
Mr. Johnson said 2013 looks to be a record year in distributions out of the private equity industry in terms of total dollars. The amount of investment overhang that has existed the last 4-5 years is coming down and distributions are going up. They predict it to be very strong the

next couple of years. In terms of new capital being deployed, more funds are coming to market to raise capital. Next year should also be a good year for raising capital as well. He sees ample opportunity for the State to make more investments.

V. Investment Policy Statement Phase I Adoption

Ms. Fink reminded the board that the plan is to create a more consolidated investment policy statement (IPS). The policy will be broken down in four parts: philosophy, roles and responsibilities, asset allocation and individual asset policies. Changes were made to the first draft of the policy brought before the board at the previous meeting. The revised version was distributed to members of the board.

Mr. Emkin expressed the importance of a clear IPS from a macro perspective.

Ms. Reback expressed concern over the emphasis on risk in the statement and on the purpose of a policy statement. Ms. Fink explained that the investment policy statement includes voting proxies, but also provides the macro framework Mr. Emkin stressed.

Mr. Emkin explained the challenge for institutional investors is that returns are geometric not arithmetic. Because of this compounding effect, managing risk and volatility is imperative. He pointed out that ERSRI's fund has negative cash flow due to its large pension payments, therefore negative returns have an even greater impact. He stressed that preserving capital in this financial environment is crucial. He said the fund does need to take risk, and does, but it is a question of how much risk and how diversified that risk is. He pointed out the largest mistake institutional investors made before the financial crisis is that they only were concerned about returns and didn't spend enough time on risk. Mr. Emkin then explained the volatility penalty and how volatility and negative returns have a bigger impact on long-term performance. Ms. Fink then pointed out the hedge fund's collective net returns are above our statutory rate of return.

The vote on the draft was moved to a later meeting to allow for further discussion.

Treasurer Raimondo noted that an off-site meeting is being planned for January. This meeting will be longer than usual and will be scheduled pending member availability. PCA will be presenting their asset allocation study at this time as well.

VI. Fidelity 457 Plan Share Class Recommendation

Ms. Fink noted that currently there are three providers for the 457 plan, one of them being Fidelity. As of September 30, the plan has $5.5 million in the Fidelity Spartan 500 Index Fund. This size makes the plan eligible to move from the Fidelity Advantage Mutual Fund Share Class to the Institutional Share Class. This change will reduce fees from 0.05% to 0.04%.

Ms. Fink said it's prudent to make this switch as this is the same strategy with lower fees.

On a motion by Ms. Reback and seconded by Mr. Mullaney, it was unanimously

VOTED: to approve the 457 Plan change from the Fidelity Advantage Spartan 500 Fund Share Class to the Institutional Share Class.

VII. FICA Alternative Retirement Plan

Mr. Dingley said the role of the SIC in the FICA Alternative Retirement Plan is advisory. The Department of Administration has not yet reached agreement on all aspects of the plan with the provider. Once it's finalized, it will be brought before the board for review.

VIII. Non-Contributory Judges Plan Asset Allocation Recommendation.

Ms. Fink explained that this relates to a group of judges who had historically not contributed to the retirement plan. Following implementation of the Retirement Security Act of 2011 they are now contributing. A decision should be made on how to invest these contributions. The retirement board voted to fund the accrued liability associated with these judges with an annual required contribution (ARC) similar to that of the rest of the pension plan.

Ms. Fink said that with the ARC and the expected rate of return of 7.5%, this plan is very similar to the rest of the plans that the SIC administers. The advantage is that these assets can now be commingled with the rest of the defined benefit plan.

Mr. Mullaney noted that the Retirement Board adopted the option which will require the state to appropriate $1.3million yearly. There is no law that requires the State to do so. Given the budget constraints, Governor Chafee would have to decide on whether to include the appropriation in his budget proposal or not.

Mr. Dingley noted that it would not have to be taken out of the commingled fund. If the appropriation is not funded, the only difference would be the assumed rate of return would be 4.5% instead of 7.5%. The best decision for the amount of money would be to leave it in a fund where the management expenses are reasonable.

On a motion by Ms. McNamara and Seconded by Ms. Reback, it was unanimously
VOTED: to commingle the assets of the Non-Contributory Judges plan with the rest of the pool and give them the diversification and strategy of the overall plan.

IX. Legal Counsel Report

There was no legal counsel report.

X. CIO Report

Ms. Fink reviewed the portfolio's performance for October. She said October was a very strong month in the markets. The portfolio rose 2.5%, ahead of the bottom-up benchmark which was up 2.3%, and a bit behind the 60/40 plan, which was up 2.7%. With global equities up 4% and bonds up 0.8%, the portfolio performed as expected. Year-to-date the portfolio is up 7.4% with 7.5% risk. The portfolio is continuing to get better returns with less risk. She added that risk and return are connected over the long-term: as risk goes down you compound faster and end up with better returns over time. Comparatively, the benchmark, year-to-date, is up 7.1% with 8.2% risk and the 60/40 up 7.8% with 8.6% risk.

Ms. Fink noted that the expected rate of return is 7.5% and in four months the portfolio is up 7.4%, giving a sense of how strong the markets are. It has been a very strong period, but it would not be surprising if there is more volatility in the future.
Ms. Fink said that on a two-year basis, the portfolio continues to benefit from the hedge fund allocation. Over that period, the portfolio annualized 11.5% compared to 10.6% for the 60/40. Part of the reason for that is the asymmetric return in which the portfolio captures 95% of the upside during up months and only 65% of the market move in the down months. She added that in the past twenty-four months, only seven have been down months, which is unusually few.
Ms. Fink said it is a good time for PCA's asset allocation review to guide the next step of the portfolio as assets are becoming more richly priced.
Ms. Fink noted markets have remained strong in November. As of the end of day on Monday, November 18, the portfolio topped $8 billion for the first time since the financial crisis.
Ms. Fink gave an update on the secondary sale of the Wellspring interests. More than a dozen groups have indicated interest. They are currently in the process of signing non-disclosure agreements and getting information out to the bidders. The timetable is moving forward as expected and she will have more information at the December meeting.

XI. Treasurer Report

Treasurer Raimondo commended the efforts of the board and thanked them for their continued work.

There being no other business to come before the Board, on a motion by Ms. Reback and seconded by Mr. Fay the meeting adjourned at 10:45 a.m.

Respectfully submitted,

Gina Raimondo

Gina M. Raimondo
General Treasurer