VERMONT PENSION INVESTMENT COMMITTEE
April 20, 2010

VPIC Members Present:
STEPHEN RAUH, CHAIR, VMERS Governor's Delegate, term expiring June 30, 2010
JEB SPAULDING, VICE-CHAIR, VT State Treasurer
DICK JOHANNESEN, Governor's Delegate, term expiring June 30, 2010
JOSEPH MACKEY, VSTRS Representative, term expiring June 30, 2011 **– briefly via conference call**

VPIC Member(s) *Absent*:
VACANT, Governor's Delegate, term expiring June 30, 2012
WARREN WHITNEY, VSERS Representative, term expiring June 30, 2012

VPIC Alternate Members Present:
STEVEN JEFFREY, VMERS *Alternate*, term expiring June 30, 2010
VAUGHN ALTEMUS, *Alternate* Governor's Delegate, term expiring June 30, 2010
JON HARRIS, VSTRS *Alternate*, term expiring June 30, 2011
ROBERT HOOPER, VSERS *Alternate*, term expiring June 30, 2012 **– arrived later in the meeting**

VPIC *Alternate* Member(s) *Absent*:
None

Also attending:
Donna Holden, Clerk
Dick Charlton, Kevin Kondry and Chris Levell, NEPC
Neil Sheth, Director of Hedge Fund Research, NEPC
Bill Griffin, Chief Assistant Attorney General
Linda Deliduka, VSTRS Board Member
Kevin Gaffney, VSERS Board Member
Aaron X. Montaño, Institutional Investments – Alliance Bernstein

CALL TO ORDER:

The Chair, Steve Rauh, called the Tuesday, April 20, 2010, meeting to order at 8:30 a.m., which was held in the 4th Floor Conference Room, 109 State Street, Montpelier, VT.

ITEM 1: Agenda Approval/Announcements

Hearing no objections, the April 20th and 21st agendas were accepted.

ITEM 2: Minutes

- **Approve the Minutes of February 22, 2009 – Regular meeting**
- **Approve the Minutes of February 23, 2009 – Regular meeting**
- **Approve the Minutes of March 16, 2009 – Special Conference Call meeting**

On a motion by Mr. Altemus seconded by Mr. Johannesen, the Committee unanimously voted to approve the minutes of February 22, 2010, as submitted.

On a motion by Mr. Spaulding seconded by Mr. Altemus, the Committee unanimously voted to approve the minutes of February 23, 2010, as submitted.

On a motion by Mr. Altemus seconded by Mr. Johannesen, the Committee unanimously voted to approve the minutes of March 16, 2010, as submitted.

<u>ITEM 3:</u> **Discussion Items/Updates**

- **Contract Updates**

    - PIMCO Stocks Plus

Mr. Griffin reported that Ms. Pershing Johnson and PIMCO's lawyers had apparently reached an impasse regarding negotiating the possibility to transfer the portfolio to the Limited Partner commingled vehicle, which he described as a complicated structure involving three entities and required at least two separate contracts to transition to a commingled account.

The Committee acknowledged its reasons for moving to a commingled vehicle were primarily to reduce its liability exposure of up to 2x the investment to a limit of not more than 100% of the portfolio. The commingled structure also simplifies internal reconciliation and accounting issues for the Treasurer's office. The Committee reviewed a worksheet containing a comparison of the separately managed StockPlus investment to two commingled vehicles and discussed features of the three options including fee structures, which were higher in the commingled products (approximately 18 basis points) in exchange for the lower risk.

Upon further clarification from Mr. Griffin, **the Committee agreed** the LP option was no longer viable, considering the contracting issues discussed above.

On a motion by Mr. Spaulding seconded by Mr. Johannesen, the Committee unanimously voted to move out of the PIMCO StocksPlus separately managed account to the PIMCO StocksPlus Fund Institutional Class Shares commingled fund, as timely as possible and pending successful contract negotiations.

    - SSB&T Securities Lending Agreement

Mr. Griffin referred the Committee to an April 16, 2010 memo from Ms. Pershing Johnson regarding the legal risks of the current securities lending program. **The Committee agreed** based on their contract with State Street Bank that ,if a security lending issue arose, the custodian bank would be held responsible.

Mr. Spaulding pointed out the current custodian contract did contain an attachment directly detailing the securities lending arrangement and noted he was not aware of any other public entity that had a separate securities lending investment management contract for the collateral pool, which was confirmed by NEPC, and acknowledged by Mr. Griffin through Ms. Pershing Johnson's National Association of Pension Plan Attorney (NAPPA) connection.

- **Real Estate Update**

Mr. Kondry briefed the Committee on the status of each of the real estate managers, mentioning the relative stability of the UBS and Morgan Stanley core investments; enhanced communication and a recently completed restructuring of the open-ended RREEF investment; and ongoing financial stresses in the closed-ended Transwestern portfolio, which would likely result in significant losses in the investment.

Mr. Levell explained that, like other consultants and investors, NEPC had concerns that there could be a downturn in real estate, but the resulting bursting of the credit market bubble was unexpected and harmful to real estate investments. He said, however, there were still opportunities in the real estate market as the economy recovers.

On a motion by Mr. Johannesen seconded by Mr. Altemus, the Committee unanimously voted to supported NEPC's recommendation to vote VPIC's proxy affirmatively (due April 21, 2010) to reappoint the RREEF Board of Directors and directed Mr. Wisloski to file the proxy.

- **Actuarial Assumed Rate of Return**

Mr. Rauh advised the Committee the purpose for the agenda item was to provide an opportunity to discuss developing a process, if desired, regarding potential changes to the assumed rate of return.

Mr. Spaulding reminded the VPIC that experience studies were conducted for each system on a five-year cycle and include examination of the rates of returns, along with other experience. He said the statute requires a combined effort between the VPIC and Retirement Boards to agree on any changes to the assumed rate of return. He said a lot of discussion was circulating, both locally and nationally, regarding the topic, however, there were ramifications associated with making significant changes. He advised one recommendation would be to make incremental decreases in the rate over the next 10 years to a 7.25% rate.

Mr. Levell confirmed that NEPC's investment recommendations would not differ if the rate of return was lowered, however, the recommendations would change for an upward revision in the assumption. As an actuary himself, Mr. Levell supported Mr. Spaulding's remarks and noted that lower rates indicated conservatism.

The Committee agreed initiation of process would begin at the VPIC level and involve communication and support from the Boards.

Mr. Mackey joined the meeting via conference call.

It was also agreed to move forward with further discussion of this matter at the May meeting.

- **Investment Guidelines**

    - Classification of Multi-Strategy Products
    - Guideline Language in Contracts

Mr. Rauh reminded the Committee of the October 2009 approval of the new *Investment Guidelines*, which included several incomplete sections that as authors of the document the AG's Office had agreed to complete. He explained, since that time the AG's Office proposed several major changes to the Guidelines, which included recategorizing investments within VPIC's traditional allocation format.

Mr. Griffin explained his and Ms. Pershing Johnson's position, including disclosure concerns of whether the information on the VPIC website contained enough transparency, and he proposed a reclassification of portable alpha investments to the "multi-strategy" asset class currently used for risk parity and global asset allocation strategies. A noted item of concern to Mr. Griffin was the labeling and classifying of PIMCO Stocks Plus as an equity investment when the majority of physical investments are in fixed income.

Further discussed were the complexities of transferring terms defined in contracts vs. as defined in the guidelines vs. how information was disseminated on the website. Some members shared thoughts of how the structure and asset allocation definitions could be categorized or identified, i.e. by benchmark, or by sector with more defined titles, etc.

Mr. Rauh proposed the Committee return to the original path and complete the previously approved Guidelines in their original form, and once the Guidelines were completed and approval finalized, VPIC would address the concerns Mr. Griffin has raised and consider possible amendments to the guidelines.

Mr. Mackey left the meeting.

Mr. Griffin agreed to complete the current October 2009 approved Guidelines, work with the Treasurer's Office staff to identify areas of concern. Mr. Rauh agreed to include discussions on future agendas.

ITEM 4: **Review/Action: Hedge Fund-of-Funds Search Result**

Mr. Sheth from NEPC provided the history of the development of hedge fund-of-funds vs. direct hedge funds, referring to both as an "absolute return" investment. In short, he advised fund-of-funds investments for VPIC, which provided wider diversification and where the manager would serve as a "gate keeper" with due diligence, accounting functions, etc., for an additional layer of fees. He confirmed the talent of the industry was extremely deep and experienced and the potential to realize appropriate returns was still realistic

He said the key component for the Committee to consider regarding manager selection was to assure VPIC's investment strategy was well aligned with the individual manager's portfolio structure.

Mr. Hooper arrived at the meeting.

Along with the Committee, Mr. Sheth reviewed NEPC's *April 2010 Fund of Hedge Funds Manager Search* book. He recommended the Committee select more than one firm to manage the proposed initial 5% allocation, or approximately $150 million. Mr. Sheth also confirmed his level of comfort in a hedge fund stems from knowing that the key managers have substantial personal investment in the fund. Mr. Sheth reported in his experience contracting was "doable", and Mr. Levell said he was "cautiously optimistic".

The Committee discussed and NEPC agreed that adding hedge funds to a traditional 60/40 portfolio has historically provided higher returns with less volatility.

The Committee discussed the amount of administrative due diligence, internal controls, and other ongoing governance required when including a hedge fund or fund-of-funds investments in a portfolio. NEPC agreed that a fund-of-funds investment would require less staff time for oversight, however, would still allow for an appropriate level of due diligence, including on-site manager visits. Mr. Levell also stressed, however, that the Committee needed to understand all of the risks involved in this type of investment, including “headline” risk.

Mr. Spaulding acknowledged as fiduciaries the Committee’s responsibility was to the members and beneficiaries of the systems and the difficulty the VPIC faces with challenges to meet expected returns to pay current and future liabilities.

Mr. Sheth recommended a core/satellite concept, beginning with approximately two core managers with broad diversified exposures and later adding the one or two satellite managers once the Committee’s comfort level grows. He reiterated manager selection should be prefaced with clarifying the objective of the plan and how much risk you are willing to accept, as well as underlying strategy exposures.

The Committee requested and NEPC agreed to cull the list presented and bring three or four core managers forward, with preliminary legal/contracting issues vetted before the interviews.

ITEM 5: **Asset Allocation Implementation Plan (continued)**

- **Review Proposed Implementation Alternatives**
- **Create Mid-Cap Equity Category**
- **Maximum Allocation to a Single Manager**
- **Portfolio Risk Implications**
    - Analysis of Active Risk
    - Tail Risk Exposures
    - Risk Contribution of Portable Alpha Strategies
    - Risk Contribution of Securities Lending

Mr. Kondry and Mr. Levell reviewed NEPC’s proposal for achieving implementation of the adopted February 23, 2010 asset allocation. It was proposed as follows:

The asset allocation adopted is:

	OLD	NEW
Large Cap Equities	**18.5%**	**15%**
PIMCO StocksPlus	*7.4%*	*4.0%*
T. Rowe Price	*7.4%*	*5%*
S&P Index Fund (NEW)	*0%*	*3%*
S&P Equal Weighted Index	*3.7%*	*3%*
Mid Cap Equities	**2.5%**	**2%**
Champlain Partners	*.75%*	*2.0%*
SSgA Russell 2500 Index	*1.75%*	*0%*
Small/Mid Cap Equities	**5.5%**	**4%**
SSgA Russell 2000 Index	*2.75%*	*2%*
Wellington SCV	*2.75%*	*2%*

International Equities	**12%**	**12%**
Acadian	*6%*	*5%*
Mondrian	*6%*	*5%*
ACWI ex. US Index (NEW)	*0%*	*2%*
Emerging International Equities	**4%**	**6%**
Aberdeen	*4%*	*6%*
Total Equity	**42.5%**	**39%**
Bonds	**18%**	**20%**
PIMCO Core Plus	*13%*	*15%*
OpCap Structured Alpha	*2.5%*	*2.5%*
Wellington DAS	*2.5%*	*2.5%*
High Yield Bonds	**5%**	**5%**
Post Advisory	*4.25%*	*4.25%*
KDP Asset Management	*.75%*	*.75%*
Global Bonds	**8%**	**8%**
Brandywine	*4%*	*4%*
Mondrian GFI	*4%*	*4%*
Emerging Market Debt	**2%**	**3%**
Wellington EMD	*2%*	*3%*
TIPS	**3%**	**3%**
Barclays TIPS	*3%*	*3%*
Total Fixed Income	**36%**	**39%**
Real Estate	**7%**	**5%**
Private Equity	0	0
Private Debt	0	0
Hedge Funds – Low Vol	0	0
Hedge Funds – Mod Vol	0	0
Commodities	**2%**	**2%**
Schroders	*2%*	*2%*
Total Alternatives	**9%**	**7%**
Risk Parity	**2.5%**	**5.0%**
AQR	*2.5%*	*5.0% (subject to May meeting review)*
Global Asset Allocation	**10%**	**10%**
PIMCO All Asset	*5%*	*5%*
Wellington GAA	*2.5%*	*2.5%*
Melon GAA	*2.5%*	*2.5%*
Total Other	**12.5%**	**15%**

Mr. Griffin confirmed that to implement a new SSgA S&P 500 Index Fund contract could be achieved through a memo from NEPC solidifying that SSgA was the preferred vendor, based on competitive fees (compared to two or three other vendors) including fee information with and without securities lending and that the ACWI ex US Index Fund manager process would require an NEPC database search.

On a motion by Mr. Spaulding seconded by Mr. Altemus, the Committee unanimously voted to adopt the *NEPC implementation plan for new target* recommendation, as presented, with a delay in implementing the AQR change until after their May presentation, and to authorize NEPC to initiate an ACWI database manager search.

NEPC confirmed the expected rate of return for the mix would remain at 7.2% with a 9.8% standard deviation.

The committee agreed to look at issues about Brandywine, real estate, and hedge funds at a later date.

<u>ITEM 6:</u> **Director of Investment and Debt Management Report**

- **Securities Lending Update**
- **State Street DeskTop**

Mr. Wisloski reviewed his written report.

Mr. Charlton supported continued participation in a securities lending program as an alpha source for the portfolio and recommended measurement of its performance against other like exposures based on risk/return and rather than as a way to reducer custodial fees.

Mr. Levell also noted the decision of which program, Quality A or Quality D would be a factor when considering the amount of risk the Committee was comfortable with.

Mr. Rauh reminded NEPC the Committee's desire to see the performance reflected in the Flash Reports and quarterly reports.

<u>ITEM 7:</u> **Executive Session**

At 3:25 p.m. on a motion by Mr. Altemus seconded by Mr. Johannesen, the Committee unanimously voted to enter into executive session pursuant to Title 1 § 313, to discuss contractual matters.

Mr. Griffin, Mr. Wisloski, and Mrs. Holden were invited into the executive session.

At 3:52 p.m. the Committee exited the executive session.

<u>ITEM 8:</u> **Recess**

At 3:58 p.m., hearing no objection, the Chair declared the meeting recessed until 8:30 a.m., Wednesday, April 21, 2010.

Respectfully submitted,

Donna Holden, Clerk