

Oregon Investment Council
MINUTES
July 6, 2006

The Oregon Investment Council was called to order at 9:00 a.m. by Richard Solomon, Chair.

OIC Members Present: Paul Cleary, Harry Demorest, Katy Durant, Randall Edwards, Mark Gardiner and Richard Solomon.

Staff Present: Brad Child, Jay Fewel, Linda Haglund, Norma Harvey, Andy Hayes, Wei Huang, Perrin Lim, Mike Mueller, Kevin Nordhill, Jennifer Peet and Ron Schmitz.

Consultants Present: Mike Beasley, Strategic Investment Solutions (SIS)
John Meier, Strategic Investment Solutions
Tara Blackburn, Pacific Corporate Group (PCG)
Thomas Martin, Pacific Corporate Group
Allan Emkin, Pension Consulting Alliance (PCA)

Legal Counsel: Cynthia Byrnes, Oregon Department of Justice

Richard Solomon welcomed former OIC chair, Gerard Drummond to the meeting.

Mr. Solomon noted, with regret, that Roger Meier died on June 5, 2006 just five days after he attended our last OIC meeting. Mr. Meier had a keen interest in the OIC and frequently attended our meetings. He chaired the OIC from 1973 to 1986. Prompted by his vision and leadership the fund transitioned from a conservatively managed portfolio of primarily bonds, to domestic and foreign stocks, real estate and private equity. At the time those changes were widely criticized, but in the end they greatly benefited the state of Oregon and its employees. The Council extended its condolences to Mr. Meier's wife and family.

I. 9:02 am: Review and Approval of Minutes – 5/31/06

a. MOTION: Harry Demorest moved approval of the May 31, 2006 OIC Minutes. The motion was seconded by Randall Edwards and passed unanimously by the Council.

b. The May 30, 2006 Private Equity Committee meeting minutes were presented as an information item.

II. 9:03 am: First Reserve Fund XI, L.P. - Presentation & Recommendation

Jay Fewel outlined the proposed, follow-on investment in First Reserve Fund XI and introduced Ben Guill, Tom Sacorski and Kathleen Ellsworth. The OIC and OPERF have had a successful partnership with First Reserve, having made a \$75 million commitment in 2001 and a \$100 million commitment in 2004 to the General Partner's two prior funds, First Reserve Fund IX and First Reserve X, respectively. Since the firm first shifted towards an equity/buyout oriented investment strategy in 1992, First Reserve's funds have generated a combined net IRR of 25.3% and a net Total Value Multiple of 1.9x. Based on Venture Economics data, these results position the First Reserve funds consistently as first/second quartile performers in terms of returns and total value multiples. Specifically, both funds OPERF has invested in are top quartile performers, with First Reserve Fund IX generating a net IRR of 45.9% and a net multiple of 3.2x and First Reserve Fund X generating a net IRR of 99.0% and a net multiple of 1.8x, as of December 31, 2005.

Ms. Ellsworth reviewed the team, market conditions, consistent returns and investment strategy. Mr. Guill outlined changes in the oil, gas and power industries and reported on several emerging, developing companies. Mr. Sacorski outlined projects and trends in the European marketplace.

Tara Blackburn, Tom Martin and Jay Fewel answered questions from the Council regarding alternative energy sources, strategic relationships and deal-sourcing.

MOTION: Randall Edwards moved that the OIC authorize a \$300 million commitment to First Reserve Fund XI, L.P. Said commitment is subject to the satisfactory negotiation of the requisite legal documents by legal counsel working in concert with OST Staff and PCG. The motion was seconded by Katy Durant and passed unanimously by the Council.

III. 9:40 am: Hedge Fund Investing Overview

Ron Schmitz and Mike Beasley presented a discussion of the pros and cons regarding the possible use of hedge funds in the OPERF portfolio. It was noted that developments in the industry are always changing and the use of hedge funds in the OPERF portfolio could be a means of diversifying the sources of returns. Mr. Beasley outlined the nature of hedge funds, how they add value and the current market environment. Hedge fund categories were reviewed as well as risk and the challenges of hedge fund investing. Mr. Beasley presented an industry hedge fund performance chart and outlined fee structures and benchmarking.

David Kabiller and Gregor Andrade of AQR Capital addressed the Council and presented information regarding alternative hedge fund strategies and their philosophy. Mr. Kabiller and Mr. Gregor answered questions from the Council.

Allan Emkin joined the discussion regarding risk and implementation of hedge funds. Discussion followed regarding whether or not the Treasury has enough staff to implement a hedge fund program and what other large pension funds are doing.

After discussion, it was the consensus of the Council to direct staff and SIS to perform further analysis, taking into consideration staff capabilities, and return with recommendations within a few months.

IV. 11:55 am: OPERF International Equity Fund Recommendations

Kevin Nordhill, Jay Fewel and John Meier addressed the Council regarding proposed changes to the OPERF International Equity Fund, intended to improve expected excess return. Mr. Nordhill noted that nearly all institutional investors and consultants project a lower return environment over the next 20 years and staff believes it is prudent to seek additional excess return while accepting slight increases in risk.

Summary of Proposed Recommendations

- Authorize staff to conduct a search for an additional international enhanced index manager. Change OIC Policy 4.05.12 to eliminate the 10 percent target allocation to the passive category and raise the enhanced index category from 20 percent to 30 percent. Active managers will remain at 70 percent.
- Hire Arrowstreet International for an Emerging Markets mandate. Assign a one percent target allocation from the International Equity Fund. Reduce the target allocation to Genesis Asset Management from 4.0 percent to 3.0 percent.
- Change the benchmark for TT International from the ACWI ex-US Growth index to the World ex-US Growth index.

MOTION: Randall Edwards moved approval of staff recommendations. The motion was seconded by Harry Demorest and passed unanimously by the Council.

V. 12:10 pm: OIC Policy Updates

Mike Mueller introduced Jennifer Peet, Contracts & Corporate Governance Officer and noted that she would be an added resource to the Treasurer's staff.

Mr. Mueller outlined "housekeeping" policy changes and updates as follows:

1. Statement of Investment Objectives and Policy Framework for OPERF: Section 3.5 & 3.6: Revise expected rates of return based on the most recent SIS return assumptions. Revise section 6.2 to conform with proposed changes to the international equity policy.
2. Policy 4.00.01: Conforms OIC agenda setting policy with OIC current and historical practice.
3. Policy 4.00.02: Updates policy on legal composition of the OIC and reference to the number of annual meetings.
4. Policy 4.01.01: Removes constraint that the Treasurer's office cannot directly invest in equity securities (a change made during the 2005 Legislative session); Clarifies use of Treasury investment division staff titles; eliminates old security type descriptions attachment, which is more appropriate for an accounting policy, not an investment policy.
5. Policy 4.01.02: Clarifies use of Treasury investment division staff titles; removes constraint on directly investing in equity securities, but acknowledges that the OIC has not approved direct investing by staff.
6. Policy 4.01.03: Delete policy in its entirety. Investment dollar limitations are defined in policy at the asset class level.
7. Policy 4.01.04: Delete policy in its entirety. As a practical matter, this policy has become too onerous given the size of the funds. For internally managed fixed income, all transactions are reviewed by a senior member of the investment division staff, as stated in the fixed income investment policy. Capital calls for private equity and real estate transactions require two investment division staff signatures, among other controls already in policy. Additionally, in accordance with ORS 293.761 "If requested by the officer or body, the investment officer shall furnish to the officer or body the details on the investment transactions for any fund." Detailed trading information is retained by the Treasury's custody bank.
8. Policy 4.01.05: Clarification of the sources and distribution of various performance reports. Broadened to include annual reporting as well.
9. Policy 4.01.06: Deleted in its entirety, given the changes made to Policy 4.01.05.
10. Policy 4.01.08: Deleted in its entirety. Treasury staff works directly with state agencies on a regular basis to manage liquidity needs. Additionally, Treasury's Finance Division manages the notification requirements for deposits and withdrawals from agency cash accounts.
11. Policy 4.01.10: Conforms policy to the form of motion used by the OIC in approving investments and the signature authority approved by the State Treasurer as investment officer for the state. Deletes language indicating that the Council approves contracts.
12. Policy 4.01.11: Deleted in its entirety, and consolidated into Policy 4.01.10 above.
13. Policy 4.01.13: Deletes reference to Policy 4.01.11 which is deleted above.
14. Policy 4.01.20: This is a new policy that consolidates two existing policies on securities lending, which are deleted, below.

15. Policy 4.02.04 and 4.03.05: Deleted in their entirety. Content is consolidated in Policy 4.01.20.
16. Policy 4.03.03: Deletes reference to AIMR Performance Standards which have been superseded by the Global Investment Performance Standards (GIPS).
17. Policy 4.05.05: Deleted in its entirety, since the law was changed in 2005.
18. Policy 4.09.02: Deletes asset class (convertible bonds) no longer relevant to the asset allocation of the SAIF portfolio.
19. Policy 4.09.04: Deleted in its entirety, SAIF policy on convertible bonds, which is no longer an asset class used by SAIF.

MOTION: Harry Demorest moved approval of staff proposed changes outlined above. The motion was seconded by Katy Durant and passed unanimously by the Council.

VI. 12:22 pm: Asset Allocations & NAV Updates

Ron Schmitz reported that asset allocation and NAV updates are all within policy parameters.

VII. 12:24 pm: Calendar – Future Agenda Items

Ron Schmitz discussed future agenda items. He noted that several Real Estate deals were in the works that were over the policy amount for the Real Estate Committee. He requested OIC approval to have the investments approved through the Real Estate Committee and brought to the OIC for ratification at a future meeting. It was the consensus of the Council to allow this exception.

Linda Haglund noted that an outside advisor is working on a “code of ethics” document. She asked the Council to forward any comments to Ron Schmitz.

VIII. 12:32 Public Comment

There were no comments from the public.

The meeting adjourned at 12:33 p.m.

Respectfully submitted,

Norma Harvey
Investment Coordinator