

**Oregon Investment Council  
MINUTES  
December 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 (\*joined the meeting at 9:12 am), Mark Gardiner and Richard Solomon.

**PERS Board Members Present:** Mike Pittman, James Dalton, Eva Kripalani and Thomas Grimsley.

**Staff Present:** Tony Breault, Inga Deckert, 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  
Mike Moy, Pension Consulting Alliance (PCA)  
Allan Emkin, Pension Consulting Alliance

**Legal Counsel:** D. Kevin Carlson, Oregon Department of Justice

**I. 9:00 am: Review and Approval of Minutes – 10/25/2006**

**MOTION:** Harry Demorest moved approval of the October 25, 2006 OIC Minutes as amended. The motion was seconded by Katy Durant and passed by the Council.

- a. The October 30, 2006 Private Equity Committee meeting minutes were presented as an information item.

Harry Demorest requested a copy of Nori Lietz's timber paper referenced in the 10/25/2006 OIC minutes.

**II. 9:03 am: OPERF Asset/Liability Study – Phase I**

Ron Schmitz addressed the Council and the PERS Board and noted that approximately every five years, an asset liability study is performed. Mike Beasley and John Meier presented an "Introduction to Asset-Liability Analysis" including a discussion of OIC and PERS Board objectives and risk tolerance. Asset/Liability modeling was outlined and the importance of asset allocation was reviewed with the purpose in mind to select a total fund asset allocation

policy that has the best chance of achieving a desired outcome with the following benefits:

- Incorporates current plan circumstances
- Enhances Understanding
- Demonstrates Prudent fund management
- Communicates risk tolerance
- Provides benchmark information for performance measurement

The SIS asset allocation approach was outlined as follows:

- Understand the needs and objectives of the plan
  - What are the Investment Goals?
  - What are the Time Horizons?
  - What are the Risk Tolerances?
  - What is the Framework for Decision-Making?
- Define the Benchmarks to Proxy the Selected Asset Classes
- Capital Markets Expectations and Correlations
- Set Asset Class Constraints
- Project Cash Flow Requirements
- Review Preliminary Results
- Establish Decision Criteria
- Document Decisions

Discussion followed regarding capital markets assumptions and planning horizons as well as funding objectives. Several simulations were presented by Mr. Beasley and Mr. Meier for consideration and discussion.

Bill Hallmark of Mercer presented a “Risk Tolerance Parameter Discussion.” He outlined the structural background of Tier 1/Tier 2 Benefits, Oregon Public Service Retirement Plan and Individual Account Program actuarial liabilities. The cash flow regarding contributions, investment earnings and benefit payments was reviewed as well as the payroll to liability ratio. It was noted that the liability exceeds payroll by a factor of more than seven. Discussion followed regarding the potential impact on employer contribution rates.

The following PERS Board objectives were reviewed:

- Liability measurement issues – Liabilities are essentially projected cash flows discounted back to the valuation date at 8%.
- Higher expected returns mean 1) Lower cost today and 2) Greater risk in the future.
- Stable Contribution Rates
- Protect Funded Status

Mr. Hallmark answered questions from the PERS Board and OIC. A general asset/liability discussion followed including the PERS Board members, OIC members, staff and consultants.

The PERS Board members exited the meeting at 10:50 am.

### **III. 11:01 am: Sudan Divestiture Policy Recommendation – 4.01.15**

Ron Schmitz addressed the OIC regarding a proposed revision to the current Sudan divestment policy. Last year Oregon was one of the first states to address Sudan divestment legislation. The OIC drafted a policy and relied on work that Calpers and Stanford had done, and identified four initial companies that were widely considered to be doing business in Sudan.

Mr. Schmitz noted that there are some firms in the business of identifying companies that are doing business in Sudan, at different levels. He outlined the staff recommendation to move to a policy allowing the Treasurer to hire a third party firm, on an ongoing basis, to identify managers doing business in Sudan, under Oregon law.

Discussion followed regarding the selection process and timeframe. Allan Emkin discussed the Calpers process of defining a list of companies.

Mr. Schmitz and Mr. Mueller gave examples of other states and their criteria, using a third party to screen the universe of companies.

Mr. Solomon requested that staff share information regarding the list of companies with the OIC when available.

**MOTION:** Randall Edwards moved adoption of revisions to Policy 4.01.15 to allow staff to engage a third party research firm to develop a list of companies “doing business in Sudan” under Oregon law. The motion was seconded by Mark Gardiner and passed unanimously by the Council.

### **IV. 11:14 am: Relaxing the Long Only Constraint**

Kevin Nordhill, Jay Fewel and John Meier addressed the OIC regarding staff recommendation to implement public equity strategies whereby managers are authorized to employ equity shorting, up to 40%.

A few equity managers have been running products that relax the long only constraint for many years. For lack of a better name, “130/30” describes these products that may actually range from 120 percent long and 20 percent short to 140 percent long and 40 percent short. Recently, there has been a strong

movement by equity managers (particularly those who employ a quantitative investment approach) to implement 130/30 products.

These strategies seek to ensure leverage is not used, that is, the longs minus the shorts equals 100 percent of the money managed. The investment restrictions typically allow the manager to net 5 percent long, or short, since market movements make this flexibility a necessity.

Mr. Nordhill reviewed the recommended structural change to the portfolio and discussed implementation.

John Meier reviewed highlights of the SIS white paper included in the OIC materials entitled, "Relaxing the Long-Only Constraint: A Review and Summary of Academic Research."

Jay Fewel discussed the costs of transitioning the portfolio.

**MOTION:** Harry Demorest moved approval of staff recommendation to Authorize staff to implement public equity strategies whereby managers are authorized to employ equity shorting, up to 40%. Where staff and SIS agree that existing OPERF equity managers should be provided the ability to implement this strategy, and it does not change the managers' role within the Domestic Equity Fund (DEF) or International Equity Fund (IEF), staff is authorized to initiate such changes. Where any manager's mandate might change as a result of shorting (i.e., an enhanced manager's tracking error increases to full active manager level) or any new manager hire recommendations employing this strategy, must be approved by the Council. The motion was seconded by Randall Edwards and passed unanimously by the Council.

#### **V. 11:33 am: OIC General Consultants**

Ron Schmitz addressed the OIC regarding the two general consultants: Strategic Investment Solutions (SIS) and Pension Consulting Alliance (PCA) Emkin. He outlined staff recommendation to amend the contracts for a two-year period in accordance with Treasury policy, whereby both contracts would expire on 12/31/2008.

**MOTION:** Harry Demorest moved that the OIC direct staff to amend the contracts for SIS and PCA (Emkin) for a two-year period in accordance with Treasury policy. The new contracts would expire on December 31, 2008. The motion was seconded by Randall Edwards and passed unanimously by the Council.

#### **VI. 11:35 am: Discussion of Private Equity Terms & Disclosure Issues**

Jay Fewel noted that, several months back, the OIC requested a discussion of key private equity terms and the ability of limited partners to demand certain provisions in the partnership agreements. Additionally, the issue of public disclosure of private equity information has been a hot topic around the country and in various statehouses.

Mr. Fewel introduced Louis Singer, a senior partner at Morgan Lewis, a firm often used by the Department of Justice when helping OPERF negotiate partnership documents, and Jose Fernandez, a senior vice-president and general counsel for Pacific Corporate Group, to address these topics.

Mr. Singer commented on terms and conditions in the private equity market and how those factors in the market affect negotiations. He noted that the private equity fund market is differentiated, ranging from elite funds that are oversubscribed to funds that may not meet their fundraising targets. He further noted that the market is currently undergoing very rapid changes. Discussion followed regarding how OPERF should negotiate its investments given the current market. The market is currently undergoing rapid changes whereby elite funds are harder to negotiate with. The Most Favored Nation provision was reviewed as well as co-investment rights.

Mr. Fernandez discussed the filtering process for bringing in new funds and the public records act or Freedom of Information Act. Public records requests and the need for top-line information only in the disclosure process was reviewed. Financial records, side letters and other confidential information were outlined as valid concerns for many general partners.

D. Kevin Carlson and Ted Falk commented on disclosure and public records requests.

Mr. Singer and Mr. Fernandez answered questions from staff and the Council.

Mark Gardiner expressed concern regarding fees and the affect on alignment of interest in the private equity market.

## **VII. 12:43 pm: OPERF 3<sup>rd</sup> Quarter Performance Review**

Mike Beasley and Mike Mueller presented the *SIS Third Quarter Review*. The following topics were discussed:

- ❖ Economic Overview
- ❖ Securities Markets
- ❖ Market Indices Review
- ❖ Interest Rates
- ❖ US & Non-US Equity
- ❖ Private Equity

- ❖ Buyout Funds
- ❖ Real Estate Trends
- ❖ Fixed Income

Mr. Beasley presented the OPERF Third Quarter 2006 performance report for review and discussion. The OIC Regular Account performance report was reviewed as well as asset allocation.

Mike Mueller reviewed the OPERF asset allocation in comparison to other funds.

**VIII. 1:06 pm: Asset Allocation & NAV Updates**

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

**IX. 1:11 pm: Calendar – Future Agenda Items**

Ron Schmitz presented future agenda items for consideration and discussion.

**X. 1:13 pm: Other Items**

Paul Cleary distributed and updated version of “PERS by the Numbers” to OIC and staff.

**XI. 1:14 pm: Public Comment**

There were no comments from the public.

The meeting adjourned at 1:15 p.m.

Respectfully submitted,

Norma Harvey  
Investment Coordinator