



Final Minutes
Endowment Fund Investment Special Board Meeting
October 6, 2008

A special meeting of the Endowment Fund Investment Board (Board) was held in the Board Conference Room at 816 W. Bannock Street, Ste. 301, Boise Idaho on October 6, 2008. Chairman M. Dean Buffington called the meeting to order at 2:00 p.m. and recognized that a quorum was present.

Member's Present:

M. Dean Buffington
Gavin Gee
Representative Max Black
Senator Brad Little
Sue Simmons
Richelle Sugiyama (*by telephone*)
John Taylor (*by telephone*)

Member's Absent:

Vaughn Heinrich
Tom Kealey

Staff Present:

Larry Johnson
Chris Halvorson
Andy Potter
Judy Shock

Legal Counsel:

Julie Weaver, Attorney General
Steve Olsen, Attorney General

Guests:

Bob Meinen, Parks & Rec (*by telephone*)
Janet Becker-Wold, Callan (*by telephone*)
Bo Abesamis, Callan (*by telephone*)

A meeting notice was posted on the door of the EFIB office beginning Wednesday, October 1, 2008.

Update on portfolio performance thru September

Mr. Johnson reviewed fund performance versus benchmark for the quarter ended September 30, 2008, for the Endowment Fund (-9.6%), the State Insurance Fund (-2.0%), the Judges' Retirement Fund (-8.1%), and the Ritter Island Endowment Fund (-6.2%).

Update on Mid-Cap Growth manager search

Staff indicated that work on the search had just begun, with finalists selected for review and approval by the Executive Committee by January.

Update on securities lending

Mr. Johnson presented an overview on securities lending procedures and reviewed current issues.

Mr. Johnson explained that during the recent turmoil in the fixed income markets, risk spreads suddenly increased and many money market and cash investment funds experienced significant negative returns for the first time in their history. Two of Northern Trust's cash investment funds, which invest collateral for stocks and bonds that EFIB clients have loaned out temporarily, have losses of approximately 1% (totaling \$2.7 million) as of the last valuation on 9/30. Staff expects modest additional losses will be revealed in future valuations since risk premiums have increased

since the 9/30 valuation. The State Insurance Fund has no collateral fund losses because they do not lend securities.

In securities lending, a fund earns additional revenue by temporarily loaning stocks or bonds to other investors through a program administered by Northern Trust. To secure the loan, cash is required to be deposited with Northern as collateral/security and the borrower is guaranteed a low interest rate or rebate (generally the fed funds rate) on the collateral. Until the stocks/bonds are returned, the cash collateral is invested in short term notes/commercial paper. Normally, each day a security is out on loan, a small premium is earned by EFIB, above the rate guaranteed to the borrower. However, the recent market stress has caused an extreme discount on short-term paper to arise, resulting in a mark down on the value of the securities held in our collateral funds (the first significant loss in the 27 years these collateral pools have been in existence).

About 15 basis points of the 1% loss (0.15%) is attributable to a sharp drop in the value of Lehman bonds/equities due to their bankruptcy filing, but Northern has voluntarily committed to make up that loss, plus a little more. The remainder of the loss is due to other securities that have been marked down in the current turmoil. None of these other securities are permanently impaired, so it is anticipated that these unrealized losses will be recovered in the near future, either when today's extreme risk discounts abate or when the securities mature at par over the next couple of years.

In normal times (i.e. for the last 27 years), a plan sponsor could withdraw from securities lending and remove funds from the multi-client collateral pool to repay the borrowers within a few days. However, with the recognition of unrealized losses in the fund, Northern has imposed temporary withdrawal limits on the program to ensure there is no mass exodus that would require Northern to sell any of the discounted securities in the pool. Instead, they can hold the bonds until they mature at full value. Fortunately, EFIB clients do not have an operational need to withdraw from the program, so this new limitation does not have a significant impact those clients. For the next year, Northern has announced it will modestly increase the share of lending income paid to lenders.

Mr. Johnson advised the EFIB that staff recommends remaining on the current course because it is superior to all other alternatives. This recommendation is based on three key assumptions:

- There will be no catastrophic failure of Northern Trust
- EFIB clients will not be disadvantaged by the withdrawal of others from the program
- There will be no further defaults on securities in the portfolio (they mature at par and EFIB clients earn back the deficiency)

Mr. Johnson described steps staff intends to take in the future:

- Continue to monitor the three key assumptions
- Develop contractual framework for a rapid shift to another index provider, if necessary
- Continue to examine the following options over next year to improve the risk/return of the program
 - Lower risk collateral pools
 - Eliminate loan low margin securities
- Provide a status update at each board meeting
- Reexamine overall risk/return of securities lending – Provide a recommendation to the board when withdrawal would no longer be punitive (May 2009?)

Mr. Abesamis and Ms. Becker-Wold provided additional information on securities lending and the actions of other institutional investors. They supported staff's recommendation to "stay the course".

During the discussion, the board asked numerous questions about the securities lending issue including options to terminate the securities lending program with Northern Trust, risks of remaining in the program, and the status of other funds. Some Board members expressed concerns about staying in the program and voiced interest in cutting client losses.

Executive Session

At 3:45 p.m., Senator Little made a motion that the board enter Executive Session pursuant to *Idaho Code* §67-2345 for the purpose of personnel/agent matters §67-2345 (1)(b) and consideration of records exempt from public disclosure §67-2345 (1 (d)). The motion was seconded by Mr. Gee and approved unanimously. The board went into Executive Session at 3:45 p.m.

Prior to the roll call vote, the teleconference connection was lost and Mr. Taylor and Ms. Sugiyama were not able to participate in Executive Session.

The roll call vote was as follows:
Chairman Dean Buffington – Aye
Gavin Gee – Aye
Representative Black – Aye
Senator Little – Aye
Susan Simmons - Aye

Guests present during Executive Session:
Julie Weaver, Deputy Attorney General
Larry Johnson
Andy Potter
Chris Halvorson
Judy Shock

At 3:52 p.m., a motion to return to regular session was made by Senator Little, seconded by Mr. Gee and approved unanimously.

No action was taken as a result of the Executive Session.

Mr. Johnson reviewed a list of upcoming issues.

Adjournment

There being no further business to come before the Board, Mr. Gee made a motion to adjourn, seconded by Representative Black, and passed unanimously. The meeting adjourned at 3:55 p.m.