

State of Rhode Island and Providence Plantations

STATE INVESTMENT COMMISSION

Regular Meeting January 24, 2007

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, January 24, 2007. The Treasurer called the meeting to order at 9:05 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Ms. Rosemary Booth Gallogly, Dr. Robert McKenna, Ms. Marcia Reback, and General Treasurer Frank T. Caprio. Also present were: Mr. Kenneth E. Goodreau, Deputy General Treasurer for Finance; Jayne Donegan, Esq., of Brown Rudnick Berlack Israels, Legal Counsel to the Commission; Mr. William Bensus, of Wilshire Associates Incorporated, General Consultant to the Commission; Ms. Michelle Davidson and Mr. David Fann of the Pacific Corporate Group, Alternative Investments Consultants to the Commission; and other members of the Treasurer's staff. Mr. John Treat was absent.

State Investment Commission Minutes. Ms. Reback moved, Dr. McKenna seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, and Treasurer Caprio.

VOTED: To approve the Minutes of the December 6, 2006 regular

meeting.

Treasurer Caprio announced that presentations for Alternative Investments were made at the previous meeting but not voted upon given that meeting failed to achieve a quorum. He introduced Ms. Davidson of PCG and asked her to summarize those presentations and to give a brief overview of subsequent changes or developments.

Treasurer Caprio noted for the record that detailed descriptions of the previous presentations are available in the Minutes from the December 2006 meeting, and that the SIC has already invested in previous funds formed by these particular entities in the past.

Providence Equity Partners Fund VI, L.P. (PEP Fund VI). Ms. Davidson gave a brief reintroduction to the fund, summarizing the presentations delivered in the December 2006 SIC meeting and introducing new developments since that meeting. Ms. Davidson noted that the global media and communications group, based in Providence, has been investing for about 17 years with the same strategy and extremely strong track record. Since 1993 the group has invested about \$7.3 billion with net returns of about 37%. Performance across all four funds in which Rhode Island has invested is in the top quartile with net returns of roughly 50%.

Ms. Davidson noted two changes to the fund since the previous SIC meeting: First, that former Managing Director Michael Angelakis has left Providence Equity Partners to become CFO of Comcast, which

leaves a remaining team of 14 managing directors. Second, there has been a favorable change to the terms of investment in the reduction of the carried interest to be received by the General Partner from 25% to 20%. Ms. Davidson recommended approval of the investment in the amount of \$25 million.

Ms. Reback inquired as to what “carried interest” means, and Ms. Davidson replied that it is the share of the fund’s profits that Providence Equity Partners receive.

Dr. McKenna moved, Ms. Reback seconded, and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, and Treasurer Caprio.

VOTED: To invest up to \$25 million in PEP Fund VI, L. P., contingent upon satisfactory review and negotiation of investment and other legal documents.

Green Equity Investors V, L.P. (GEI V). Ms. Davidson delivered a brief reintroduction to GEI V, stating that the real estate fund has a strong management team and has been investing for roughly 16 years with the same strategy and strong, consistent performance. Ms. Davidson noticed that the fund focuses on upper middle-market companies. Target size for the fund is approximately \$4 billion. Since 1989 the firm has invested roughly \$2.5 billion with net returns

of 28%. Based on this, Ms. Davidson recommended approval of the investment in GEI V in the amount of \$20 million.

Treasurer Caprio announced a vote on investment in GEI V in the amount of up to \$15 million, upon which Ms. Donegan observed a discrepancy in numbers and inquired to confirm the amount of investment. Treasurer Caprio noted that the amount was recorded in the previous Minutes and the current agenda as \$15 million rather than \$20 million. A discussion ensued with the resolution being that the SIC would vote to approve the investment of up to \$15 million, and the matter could be revisited in the future. Treasurer Caprio restated the amount of investment as up to \$15 million in GEI V.

Ms. Reback moved, Dr. McKenna seconded, and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, and Treasurer Caprio.

VOTED: To invest up to \$15 million in GEI V, L.P., contingent upon satisfactory review and negotiation of investment and other legal documents.

Lighthouse Capital Partners VI, L.P. (LCP VI). Ms. Davidson handed the presentation to her colleague, Mr. Fann, also of PCG. Mr. Fann presented LCP as having five funds focused exclusively on venture lending, with investments totaling approximately \$1.2 billion. Mr.

Fann stated that the performance of the first two Lighthouse funds has been extremely strong (with returns of 37.5%), but the last three have been more challenging, which he characterized as reflective of venture capital overall. Mr. Fann noted that 3 of 5 managing directors of LCP's previous fund had departed due to a combination of personal career advancement and/or wealth of the directors, leaving a fairly new team. Mr. Fann asserted, however, that the legal structure has been consistent despite these changes. Mr. Fann thus recommended approval of the investment in LCP VI in the amount of \$15 million.

Treasurer Caprio inquired as to whether the aforementioned changes were very recent. Mr. Fann replied that they were not, and had occurred over the course of the last 18 months. Treasurer Caprio asked him to clarify the state of the current management team, and Mr. Fann replied that there remained 5 managing directors in total, and that the former directors had been replaced.

A motion was subsequently taken. Ms. Reback moved, Mr. Costello seconded, and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Dr. McKenna, Ms. Reback, and Treasurer Caprio.

VOTED: To invest up to \$15 million in LCP VI, L.P., contingent upon satisfactory review and negotiation of investment and other legal documents.

Treasurer Caprio interjected to excuse those members with time constraints and thanked them for their efforts to attend the meeting so that the group could achieve its quorum. Ms. Gallogly thanked the Treasurer and exited at 9:25 a.m to attend a budget meeting with Governor Carcieri. Ms. Reback stated that she could allow further time in the meeting and would stay. The group proceeded with the rest of the agenda.

Wilshire Associates Incorporated – Capital Market Review. Mr. Bensusur thanked Treasurer Caprio for his introduction and distributed materials to the group. He began by stating that the month of December [2006] saw a rather strong marketplace in terms of both U.S. stocks and non-U.S. equities, reflective of the overall economy created by such factors as reduced oil costs (from \$70 to around \$52-\$53 per barrel), the rebound of homebuilders, reasonable inflation rates of 2-2.5%, and increased buyer and investor confidence. The marketplace had improved stability and earnings growth rates for many U.S. corporations have been in line or above expectations.

Mr. Bensusur stressed that the major story of the past year was that of the emerging markets, especially China and India, both of which enjoyed double-digit growth rates of approximately 9-10%. Mr. Bensusur explained that as an asset class these markets have the goods and services desired by the rest of the world, such as inexpensive and relatively well-educated labor forces, and

commodity-driven economies. There is strong international investment participation as a result.

Mr. Bensus stated that in 2006 fixed income markets behaved roughly in line with expectations. He observed there was a strange event in May when risk preferences were turned upside-down, with stock prices falling as bond yields rose. However, the late 3rd and 4th quarters saw fairly strong markets across the board.

Mr. Bensus stated that in general the Dow Jones Wilshire 5000 (indicative of the total U.S. equity market) in 2006 was up 15.8%; small cap stocks were up aggressively about 18.4%, and large cap stocks performed identically to the total market. In general the 4th quarter was very strong, with small cap stocks in particular up about 9%. In terms of non-U.S. equities, continuing a trend of the past 4-5 years, non-U.S. markets outperformed the U.S. market in 2006. Mr. Bensus observed that the Rhode Island Treasury's money managers have been participating in these markets to the benefit of the retirement system; state investments have targeted about 20% foreign equities, and are now slightly above that.

The year to date in 2007 has seen a relatively flat market overall, with U.S. stocks up about 1%. So far this year bond markets and fixed income markets have also been flat. Lastly, high yield spreads to Treasuries were fairly tight going into last year and tightened more during the year, with a particularly strong increase of 4.5% in the 4th

quarter. They also remain mostly flat in the YTD, up about 1%.

Mr. Bensur opened for questions, and Mr. Costello asked what Wilshire's expectations of the various markets are for the upcoming year. Mr. Bensur stated that the group is completing its asset allocation recommendations for the year, which haven't changed substantially, but the preview predicts about 8.25% for U.S. and non-U.S. equities, and 5.25% for fixed income.

Treasurer Caprio asked how 2007's flat January correlates to other years and what it bodes for the next 11 months. Mr. Bensur replied that the rules of the current market have changed dramatically, making such correlations and advanced predictions difficult. In general, however, Mr. Bensur believes that current asset allocation policy and investment structure policy are sound and do not require revision barring major changes in the market. Mr. Bensur pointed out that for the past three years, Rhode Island has been in the 14th percentile ranking among public retirement systems, and in the 27th percentile over five years.

Mr. Costello asked about the 8.25% investment benchmark of the retirement system, and Mr. Bensur replied that to achieve over that would reduce the unfunded liability, and to achieve less would add to it. Mr. Costello pointed out this might be difficult to achieve, and Mr. Bensur answered that the Rhode Island Employees' Retirement System (RIERS) has migrated out into Alternative Investments, such

as by systematically building a real estate program through the Townsend Group, to improve expected return and diversify the asset base.

Treasurer Caprio clarified that there is a difference in the numbers projected by Wilshire of a benchmark of low 8% returns, and the retirement system's statement of a necessity of 8.25%. Mr. Bensus answered that this stems from a market disconnect. He referenced changes in estimates and goals that occurred in the 1990s which may have contributed to this disconnect. On average, Wilshire's surveys show that Rhode Island's public fund peers have benchmarks of 8.0% return. Mr. Bensus acknowledged that 8.25% is high but not unusual, as Wilshire has clients in the 8.5% range; it is, however, a struggle to reach a benchmark higher than the typical public fund average. Mr. Costello inquired as to the corporate world's numbers, and Mr. Bensus replied that corporate numbers are different because of accounting rules.

Treasurer Caprio asked what the genesis of the Universe Comparison chart is, and how the funds represented were chosen for inclusion. Mr. Bensus answered that all funds included in the survey are related to Wilshire in some way, whether as direct clients or as participants within larger funds. Treasurer Caprio clarified that the comparison does not include entities directly represented by any of Wilshire's competitors per se.

Treasurer Caprio thanked Mr. Bensus for his report, and announced the Legal Counsel Report.

Legal Counsel Report. Ms. Donegan stated that there was no report for this month. Treasurer Caprio thanked Ms. Donegan and requested that she include the Treasury in the process as she receives legal documents from the equity firms, specifically requesting copies for himself and Mr. Dingley. Ms. Donegan acceded.

No further discussion ensued, and Treasurer Caprio introduced his Deputy Treasurer, Mr. Goodreau.

Deputy Treasurer for Finance Report. Mr. Goodreau took a moment to address the SIC members and others present for the meeting, commenting that he looks forward to his role in the Treasury and with the SIC. He hopes to make himself as accessible and helpful as possible to the group, and thanked them for the opportunity to work with them.

Treasurer's Report. Treasurer Caprio began by thanking the remaining SIC members for all of their hard work, with special thanks to Ms. Gallogly for rearranging her schedule with Governor Carcieri to help achieve a quorum.

Treasurer Caprio announced as per the State Senate rostrum, which

he noted is public information at this point, he has reappointed Ms. Reback to the SIC for another term. Treasurer Caprio further announced that he has nominated, and submitted to the Senate for approval, Robert Giudici and Andrew Reilly to fill two of the remaining vacancies on the SIC, pending approval by the State Senate. Mr. Giudici is a CPA with a corporate background, and Mr. Reilly has a strong background in investments.

Finally, Treasurer Caprio alerted the group to the fact that Wilshire Associates are completing their evaluation of the investment managers of the System in accordance with the SIC's Investment Manager Continuation Policy. Treasurer Caprio stated that his administration plans to examine all investment managers with which the Treasury works, and that changes will be entertained regarding at least one manager that has remained on the watch list for an extensive period of time. Mr. Bensus commented that the report will be ready for the February meeting, and the Treasurer returned that they eagerly await it.

Treasurer Caprio then introduced two other members of his staff to the group: Mr. Dingley, Chief of Staff, and Ms. Dietsch, Aide to the Deputy General Treasurer. He thanked them for their work in the past month of transition. Finally, he asked for suggestions and input as to the structure and scheduling of the SIC meetings henceforth. Some discussion of previous SIC meeting schedules followed, but there was no formal decision taken.

Mr. Costello inquired to clarify the total number of members on the SIC, and whether there would be additional appointments or changes to the group. Treasurer Caprio answered that the SIC is a nine member commission, and that Mr. Jeff Britt, who formerly held a position appointed by the Governor, had submitted a letter of resignation. The group will await a new appointment by the Governor to fill that seat.

There being no new business, the meeting was adjourned at 10:10 a.m.

Respectfully submitted,

**Frank T. Caprio
General Treasurer**