

State of Rhode Island and Providence Plantations

STATE INVESTMENT COMMISSION

Regular Meeting October 24, 2007

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, October 24, 2007. The Treasurer called the meeting to order at 9:15 a.m.

Membership Roll Call. Present were: Mr. Michael Costello, Ms. Rosemary Booth Gallogly, Mr. Robert Gaudreau, Mr. Robert Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. John Treat, and General Treasurer Frank T. Caprio. Mr. Andrew Reilly arrived fifteen minutes late. Also present were: Mr. Kenneth E. Goodreau, Deputy General Treasurer for Finance; Mr. Brian Gallogly, Esq., of Brown Rudnick Berlack Israels, Legal Counsel to the Commission; Mr. William Bensus, of Wilshire Associates Incorporated, General Consultant to the Commission; Ms. Lisa Tyrrell of the State Street Corporation; Mr. Sundeep Rana, Vice President of Pacific Corporate Group (PCG), Alternative Investments Consultant to the Commission; and other members of the Treasurer's staff.

State Investment Commission Minutes. Treasurer Caprio noted the omission of two words (of Iran) from a sentence on page five in the meeting minutes from September 26, 2007. The sentence should have read "There has also been discussion that California is getting

ready to pass a bill to prevent major corporate entities from having activity within the country of Iran". With this correction noted, the Treasurer entertained a motion for approval of the minutes. Dr. McKenna moved, Mr. Treat seconded and the following motion was passed. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Treat, and Treasurer Caprio. Mr. Reilly was absent for the vote.

VOTED: To approve the Minutes of the September 24, 2007 regular meeting.

Manager Continuation Policy Analysis & Review – The Boston Company. Mr. Bensusan of Wilshire gave a brief overview of the objectives of The Boston Company. He stated that although the performance history is insufficient for compliance measurement, the portfolio lags the benchmark by 669 basis points (6.69%), net of fees, since inception.

Treasurer Caprio asked the firm representatives to address the Commission. Mr. Matthew J. Bucci, Senior Relationship Manager represented The Boston Company along with Mr. D. Kirk Henry, CFA, Director of Non-U.S. Value Equity and Mr. Jeremiah K. Holly, Sr., Relationship Manager.

Mr. Bucci announced that there have been two organizational changes within The Boston Company. In early August one of the

International Core Teams left the company to start a similar venture, unrelated to the team that manages our portfolio. These individuals have been replaced by seasoned investment professionals. A lawsuit has been filed to protect the interests of The Boston Company's intellectual property, capital, employees, and clients. Secondly, David Cameron has been promoted to Chief Executive Officer, John Truschel has been promoted to Chief Investment Officer and Corey Griffin has been named Chairman.

Bill Bensusan asked Mr. Bucci if the loss of the team has affected the organizational structure or resources. Mr. Bucci responded that with the exception of this event, the employees in the international group have been with the company for a very long time with very little turnover. The Boston Company continues to be provided with all the resources necessary to focus 100% on their efforts regarding our portfolio.

Mr. Bucci stated that The Boston Company is very disappointed with the performance of the portfolio. There have been three years of under performance with 2007 being the fourth; they are 1998, 2005, 2006, into 2007. They have, however, outperformed very well in other market environments. During the three year period from 1999 to 2002 when the tech bubble burst, The Boston Company outperformed in a declining market. When a bull market exists stocks become overvalued, as is the case with China. The market today is focusing on fundamental earnings and price momentum. Mr. Bucci went on to

explain he felt there would be a broadening out of the market or a potentially down market.

In regard to China and emerging market exposure, Bill Bensusan asked Mr. Bucci to explain The Boston Company's position five years ago in relation to where they are today. Mr. Bucci stated that the emerging market weight in the portfolio over seven to eight years ranged from 20% to 12%. The index at that time was anywhere from 8% to 16%. The portfolio was significantly over weight in emerging markets for the first four or five years, but has since become more neutral. The portfolio currently has about 15% invested in emerging markets and they continue to look for opportunities from a stock selection standpoint to add to the portfolio.

The third quarter has been particularly challenging. The stocks that are in the portfolio having been lagging by approximately 8 to 10%; this was caused somewhat by the sub prime situation. The Boston Company's investment style is out of favor at the present time but it will eventually come back into favor. Attributions with Australia, Canada, and Japan have been disappointing. The stock selection has been very negative for the past couple of years but traditionally had been very positive during prior years.

Treasurer Caprio asked Mr. Bucci to refer to the non-U.S. value equity percentage of the portfolio. He noted that the years 1999 and 2000 are similar to the current lagging performance. Treasurer Caprio asked

how The Boston Company intended to turn this around to become a top quartile performer. Mr. Bucci responded that part of the cause for the falling values was due to the tech and telecom bubble. Stocks are in a commodity driven market and a bear market resulting in down value. The Boston Company stocks picked up 1000 basis points in 2000, 1200 basis points in 2001, and 600 basis points in 2002 to close that gap. That gap will narrow again because investors are focusing on fundamentals but are not paying attention to valuation.

Mr. Goodreau stated that in The Boston Company's defense, this has been one of the narrowest markets he has encountered. He stated his concern regarding the use of price to book because there can be value traps. Looking at the composition of the sector attribution, the portfolio is underweight in financials which are currently at 26.8%. The sector itself, despite being 28% exposed, is returning 8.2%. Therefore, we are losing money and it appears to be a stock selection issue. In theory we have a reversion to value; however The Boston Company is in the wrong areas of value. Mr. Goodreau expressed his concern regarding the ability of the team from The Boston Company to rectify this situation once the cycle comes back into favor.

Mr. Bucci explained that in addition to the problems already discussed, another area that has hurt the portfolio is Japanese domestic related companies, specifically financials. They have made some changes in the portfolio to correct this. They have a team that has been in place for fourteen years with a tremendous amount of

experience. Mr. Bucci apologized for the current situation and stated they are doing their best going forward. This concluded the review of The Boston Company.

Treasurer Caprio addressed the Commission regarding the performance of the portfolio in general. He stated returns have been very good on a month to month basis as the market has advanced. However, this last month the portfolio lagged against our policy index by about 30 basis points. He attributed this to the international portion of the portfolio which is managed by The Boston Company. Treasurer Caprio recommended to the Commission that they should be prepared to exit The Boston Company and move into an index investment if there is no improvement in performance in the next three months. The Commission will then decide whether to stay in the index investment or bring in a new investment manager. He also stated that The Boston Company's fees are the second highest in the portfolio.

Mr. Goodreau noted that the 900 basis points that were lost due to The Boston Company's poor performance equates to approximately \$59 million in total revenue, which is a significant drag on the portfolio. He also stated he agrees with The Boston Company regarding an eventual reversion in styles within the market. If and when this happens, Mr. Goodreau expressed concern regarding the ability of the management team of The Boston Company to rectify the situation once the cycle comes back into favor.

A discussion ensued among the Commission members and Mr. Bensur regarding the performance and viability of The Boston Company including the risks involved in exiting the investment. Treasurer Caprio reiterated that the 30 basis point lag in the portfolio is largely attributed to The Boston Company. Ms. Reback motioned to accept a recommendation by the Treasurer, staff, and consultant to provide flexibility with respect to a timely decision on whether or not to continue a relationship with The Boston Company.

Treasurer Caprio added that the Commission would abide by all applicable statutes in making the decision and entertained a motion based on Ms. Reback's suggestion. Dr. McKenna seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio.

VOTED: To allow the Treasurer and staff flexibility with respect to a timely decision on whether or not to exit The Boston Company abiding by all applicable statutes in the process.

Wilshire Associates Incorporated – Capital Market Review. Mr. Bensur began his overview with general market observations, stating that economic growth had been slower to date in 2007; Mr. Bensur expects this trend to continue. In terms of businesses, quarterly earnings growth is expected to be low in the third quarter; the service

sector remains healthy, but the factory sector is slow. Weekly unemployment claims are up; job growth is sluggish and payrolls dropped in August. In terms of the housing market, new home sales dropped 8.3% in August and foreclosures are at a record high; this has had a negative affect on consumer confidence.

Mr. Bensus noted that the U.S. equity market has been volatile worldwide in 2007. Although private equity has been active in the public market, financing may be drying up. In terms of international markets, Mr. Bensus observed that emerging markets have outperformed developed markets by three times. European returns have been stronger than Japan and the U.S. in 2007. The U.S. dollar continues to fall versus the Euro and Yen. Mr. Bensus noted concern over the safety of Chinese imports which has cautioned investors toward that market area.

The Federal Reserve has cut rates by 50 basis points due to sub prime credit concerns. The federal funds rate is now 4.75%. Ten-year Treasury yields are near 4.40%. The sub prime mortgage issue is expected to continue to be a major concern for the capital markets.

Manager Review – Bain Capital Private Equity. Mr. Sundeep Rana, Vice President, Pacific Corporate Group gave a brief overview of Bain Capital prior to introducing firm representative Mr. Benjamin Thorndike. Mr. Thorndike stated that Bain Capital was started in 1984 and since inception has been one of the largest investors in all

private equity sectors. They have a tenured investment team globally based with deep industry knowledge. Bain Capital funds have had consistent top-quartile performance across all economic cycles.

Mr. Thorndike remarked that their fund structure is different than many of the firms they compete with. They raise smaller funds with a regional focus. Their cascading fund structure allows pursuit of large global deals without the pressure of investing in a large regional fund. They have a flexible structure which allows their European and Asian team to work together with their North American team to find the best deals.

Mr. Thorndike stated that Bain Capital has delivered gross multiple returns ranging from 2.2 up to 5+ times for each year of investment. They have delivered consistently superior returns in both favorable and challenging conditions. Mr. Thorndike concluded by remarking that they have a great culture, they generate terrific returns and the operating focus is really well situated in the environment expected during the next few years.

Treasurer Caprio thanked Mr. Thorndike and asked if anyone had questions. Ms. Gallogly asked if all the return numbers are net of operating expenses. Mr. Thorndike replied they are net of all fees that the investors pay including management fees. Treasurer Caprio then entertained a motion for investment in Bain Capital Fund X. Ms.

Reback motioned, Dr. McKenna and Mr. Guidici seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms.Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio.

VOTED: To invest \$25 million in Bain Capital Fund X, contingent upon satisfactory review and negotiation of investment and legal documents.

Legal Counsel Report. Mr. Brian Gallogly from Brown, Rudnick, Berlack Israels, LLP, legal counsel to the Commission, indicated there were no legal developments for the month.

Deputy Treasurer for Finance Report. Mr. Goodreau stated that the Commission has been exposed to some investments with potential adverse consequences as a result of the sub prime situation, but that there have been some successes over the last six to nine months which have resulted in positive changes. He thanked the Commission for “thinking outside the box” in regard to the Wellington commitment which was made a couple of months ago. As decisions are made, Mr. Goodreau intends to keep the Commission apprised of the affect these decisions have on the portfolio.

Treasurer’s Report. Treasurer Caprio first remarked that the Wellington Technical Equity Manager hired with a commitment of \$50 million has resulted in an 800 basis point advantage versus the

benchmark. Mr. Goodreau interjected that he feels this investment will do well in up markets as well as down markets. The market is down 50 to 60 basis points with small caps down more significantly this month. The Wellington portfolio is up 5.5% exceeding the benchmark by almost 200 basis points in September; this month it is up 4.5%.

Treasurer Caprio remarked that State Street Security Lending Plan has not changed materially at all from the revenue it produced, despite the switch from the Quality D Fund to the Quality A Fund. Due to the market environment the return in A Fund has kept up with the return in D Fund.

The Treasurer advised the Commission there will be no meeting in November due to the Thanksgiving Holiday.

New Business. The Treasurer stated the next SIC meeting will be on Wednesday, December 5, 2007 at 9:00 am. The meeting was subsequently re-scheduled to Thursday, December 6, 2007 at 9:00 am. There being no questions and no new business, Treasurer Caprio entertained a motion to adjourn the meeting. Ms. Reback moved, Dr. McKenna seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio.

VOTED: To adjourn the meeting

There being no further business, the meeting was adjourned at 11:00 a.m.

Respectfully submitted,

**Frank T. Caprio
General Treasurer**