

**State of Rhode Island and Providence Plantations**

**STATE INVESTMENT COMMISSION**

**Regular Meeting March 26, 2008**

**A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, March 26, 2008. The Treasurer called the meeting to order at 9:05 a.m.**

**Membership Roll Call. Present were: Mr. Michael Costello, Ms. Rosemary Booth Gallogly, Mr. Robert Gaudreau, Mr. Robert Giudici, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio. Dr. Robert McKenna arrived at 9:10 am. Also present were: Mr. Kenneth E. Goodreau, Deputy General Treasurer for Finance; Mr. Joseph Rodio of Rodio & Ursillo, Legal Counsel to the Commission; Mr. William Bensusan, General Consultant to the Commission; Ms. Michelle Davidson and Mr. Tom Bernhardt of the Pacific Corporate Group, Alternative Investments Consultants to the Commission; Ms. Lisa Tyrrell of the State Street Corporation; and other members of the Treasurer's staff.**

**State Investment Commission Minutes. The Treasurer entertained a motion for approval of the minutes. Mr. Treat moved, Mr. Giudici seconded and the following motion was passed. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Gaudreau, Mr. Giudici, Ms. Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio.**

**VOTED: To approve the Minutes of the February 27, 2008 regular meeting.**

**Capital Market Review – Wilshire Associates. Mr. Bensur began his review by stating that the Federal Reserve backed the Bear Sterns buyout by JP Morgan and initiated overnight lending to primary dealers. Consumer confidence is at a 16 year low and consumers are feeling tapped out. Volatility is expected to continue in U.S. equity throughout 2008. As of the close of business on March 25, 2008, U.S. equity was down 7.5%; non-U.S. equity was down 9%; emerging markets were down 10.5%; fixed income was up 1.8%; high yield markets were down about 2.4%. TIPS were up 4% and continue to perform well within fixed income.**

**A major concern is the lack of new money coming into the market. Value is outpacing growth and large caps are leading small caps. Emerging and developed markets have declined in 2008. Inflation remains more of a concern in Europe than in the U.S. The U.S. mortgage crisis is affecting international markets. Regarding fixed income, the current federal funds rate is 2.25% and the current federal discount rate is 2.50%. The Federal Reserve loaned \$200 billion in treasuries for mortgage related debt. The yield spread has compressed as flight to quality begins to reverse. The ten year treasury yield is now 3.49%.**

**Performance Attributions Fourth Quarter 2007 - Wilshire Associates.**  
U.S. equity performed against the benchmark as follows: NorthPointe was down 41 basis points; PIMCO added about 5 basis points; SSgA 1000 was up about 12 basis points; Wellington small cap lost about 33 basis points; Wellington Technical added about 13 basis points. The total loss in U.S. Equity for the quarter was 79 basis points.

Non-U.S. equity allocations within the portfolio performed against the benchmark as follows: The Boston Company was down 28 basis points and continues to struggle; Goldman Sachs was down 51 basis points; Mondrian did well, picking up about 27 basis points. Non-U.S. equity was under the benchmark by 52 basis points for the quarter.

Fixed income performed against the benchmark as follows: Brown Brothers was down about 26 basis points; Brown Brothers TIPS was up about 8 basis points; Pyramis was down about 38 basis points; MacKay was flat; Taplin was down about 28 basis points. In total, fixed income was down 66 basis points against the benchmark for the quarter.

Treasurer Caprio asked Mr. Bensur to include the Investment Manager Performance as a regular addition to his report in the future.

Alternative Investments Consultant PCG – Nordic Capital Partners Fund VII. Mr. Goodreau explained that the representatives from Nordic Capital Partners were unable to attend this meeting due to time constraints; they will be attending the April 23, 2008 meeting. Treasurer Caprio explained that Fund VII, L.P. will be closing soon

**and if the Commission waits until the April 23, 2008 meeting to invest it may be too late. The Treasurer stated that Nordic Capital Partners has been one of our outstanding Investment Managers. He recommended the Commission take action today by voting, with the understanding that the Commission can exit the Fund between now and the time of the presentation on April 23, 2008.**

**Prior to the discussion regarding Nordic Fund VII, Ms. Davidson introduced Tom Bernhardt as the new Head of Research for PCG. Tom went on to give a description of his qualifications and offered his assistance as a non-discretionary advisor to the Commission.**

**Since inception in 1990 Nordic Capital has achieved net returns of 46 % with no capital losses and 2.07 as an investment multiple. There have been 55 investments to date. Ms. Davidson stated ERSRI has a ten year investment history with Nordic Capital and they have performed extremely well during this period with no loss of capital. Commitments to the prior three funds have totaled about \$43 million with net returns of 31.6% which is more than two times the invested capital. Nordic will be raising €3.7 billion in commitments for Fund VII and has set a hard cap of €4.3 billion. As of March Fund VII has secured commitments of approximately €3.2 billion. The Fund will be over-subscribed due to the outstanding performance of the previous funds.**

**Nordic Capital Fund VII will make controlled investments in**

companies primarily located in Denmark, Finland, Norway and Sweden. They will target middle-market control buyout opportunities with enterprise values ranging from €200 million to €2.5 billion. The sectors they typically pursue are health care, industrials, and consumer discretionary industries. Fund VII will be slightly different than previous Funds because they will have the ability to invest 50% in greater Europe and 10% outside of Europe entirely. This change in mandate is simply to give the Fund more flexibility. Should Nordic Capital choose to invest in these geographical areas they will execute the same level of discipline demonstrated in the past. Commitment to the Fund is complementary to ERSRI's existing corporate finance commitments and provides the overall portfolio with a further degree of diversification. The Firm historically relies on Nordic Banks for debt funding and the banks remain interested in continuing to support Nordic's investments alleviating concerns of credit tightness.

The management team, consisting of thirty two investment professionals, is very stable. The remarkable stability of the senior management team, and the fact that Partners are typically "home grown" provide evidence of management's commitment to the Firm.

Mr. Costello noted that Fund V and Fund VI have a substantial amount of remaining money to be invested and monitored. He asked Ms. Davidson if this should be an area of concern. Ms. Davidson replied Nordic has added eight investment professionals to the team since Fund VI which gives them adequate staff to monitor both

**existing funds and new funds.**

**Fund VII's management fee will be 1.75% of committed capital during the investment period, and 1.75% of net invested capital with a 20% annual reduction thereafter. The terms include a 100% offset of all additive fees earned by the Firm, which helps to reduce management fees and preserves the alignment of interests between the Firm and Limited Partners.**

**Ms. Davidson suggested the Commission make a commitment of €15 million which translates to approximately \$23 million. The commitment should be made in Euros to avoid dollar fluctuation. Mr. Costello asked if the Commission should consider increasing the investment amount to make the process more manageable. He also asked if any of the existing clients have decided not to invest in Fund VII. Ms. Davidson replied that all existing clients have opted to invest in Fund VII. Regarding increasing the dollar amount of the investment, she explained that 7% of the portfolio is committed to private equity which translates to ten to twelve investments per year. On a per fund basis the target size ranges from \$10 to \$30 million. Ms. Davidson stated the Commission could consider increasing the percentage of private equity allocation within the portfolio to achieve larger commitments. Mr. Costello asked if the Commission could work on a strategy to address this issue and narrow the mix, as this has been an ongoing issue. Treasurer Caprio added that the amount of investments that come before the Commission each month are**

manageable in regard to the Commission's time, and although private equity is less than 10% of the portfolio, a fair amount of time is dedicated to this allocation.

Mr. Costello asked how the difference in exchange rate between the euro and the dollar will affect the Fund's performance. Michelle replied that PCG has monitored the affect of the exchange rates. It is 28% net on the U.S. dollar and is very strong. . Treasurer Caprio said he has been approached by companies that advise institutions on currency risks within private equity and actively manage equity portfolios. He felt it would be wise to request proposals in the future to see if this would benefit the portfolio.

Treasurer Caprio stated he would like Nordic Capital to attend the next SIC Meeting, but suggested it would be prudent to pass the motion to invest at this time. The motion would be subject to completion of legal documentation and satisfactory continuation and finalization of due diligence. Dr. McKenna entertained a motion to except PCG's recommendation to commit €15 million, approx \$23 million, to Nordic Capital Fund VII, L.P. Mr. Reilly moved and Ms. Gallogly 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 except PCG's recommendation that the SIC commit €15

million, approximately \$23 million, to Nordic Capital Fund VII, L.P. subject to terms 1-5 as outlined in the following excerpt from the PCG memo.

**Conclusion:**

The Fund offers RISIC an opportunity to participate in a differentiated portfolio of private equity investments. PCG's review of the General Partner and the proposed Fund indicates that the potential returns available justify the risks associated with an investment in the Fund. PCG recommends that RISIC commit €15 million<sup>1</sup> to the Fund. PCG's recommendation is contingent upon the following:

- (1) Satisfactory negotiation or clarification of certain terms of the investment;**
- (2) Satisfactory completion of legal documents;**
- (3) Satisfactory continuation and finalization of due diligence;**
- (4) No material changes to the investment opportunity as presented;**  
**and**
- (5) Confidentiality maintained regarding the commitment of the RISIC to the Partnership until such time as all the preceding conditions are met.**

**1 Equates to approximately \$23.0 million based on the 3/11/08 exchange rate of 1.5329 USD/EUR.**

**Short Term Investment – Addition of Suppliers.** Mr. Vincent Izzo, Cash Manager, explained that in order to mitigate risk the Short Term Investments Managers performance is continuously monitored. He

**suggested additional services be provided by Sovereign Bank, who currently is one of our Short Term Managers and Bank of New York Mellon, which is a new addition. He went on to inform the Commission of the criteria for performance and capital ratios which qualify both Banks as acceptable Managers. Mr. Izzo stated that each Short Term Investment Manager is evaluated on a monthly basis and results are published in the monthly SIC Book. Treasurer Caprio thanked Mr. Izzo and his team, as well as the Commission, for their continuing efforts to monitor the viability of short term investments and performance for each Short Term Investment Manager.**

**Treasurer Caprio entertained a motion to accept Sovereign Bank and Bank of New York Mellon as approved additions to the Short Term Investment Manager Vendor List. Ms. Reback moved, Ms. Gallogly and Dr. Mc Kenna 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 accept Sovereign Bank and Bank of New York Mellon as approved additions to the Short Term Investment Manager Vendor List.**

**Legal Counsel Report. Mr. Joseph Rodio from Rodio & Ursillo Ltd, Legal Counsel to the Commission, indicated there were no legal developments for the month.**

**Deputy Treasurer for Finance report. Mr. Goodreau had no comments for this month.**

**Treasurer's Report. Treasurer Caprio advised the Commission that ERSRI has a small cap investment with Security Capital Assurance through Wellington Management Group. The investment was approximately \$4 million. In June 2007 Security Capital Assurance undertook a stock offering at \$31.00 per share and failed to disclose significant exposure to the sub-prime market. It was later discovered that they had substantial exposure to sub-prime securities. The shares rapidly lost value and are now worth \$2.00 per share. A number of firms petitioned to be lead counsel in a class action suit against Security Capital Assurance. The court has not finalized their actions, but it appears ERSRI may be designated as lead plaintiff through our Counsel, Bernstien Liebhard & Lifshitz, LLP of New York. They will be bringing action in Federal Court in the Southern District of New York. This Law Firm is one of two approved firms who monitor our portfolio for securities violations through State Street Bank and Trust.**

**The Treasurer noted that it has been over two years since the Commission has entertained the possibility of adding new Security Litigation Firms to our list. Mr. Dingley will be placing a RFP in Pension Investments Magazine to see if adding or making changes to the present representation makes sense at this time. There is no fee**

**associated with this litigation service. Mr. Dingley will keep the Commission apprised of the situation.**

**New Business. There being no further new business, the Treasurer entertained a motion to adjourn.**

**Dr. McKenna moved, Ms. Reback seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Giudici, Mr. Gaudreau, 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 10:10 a.m.**

**Respectfully submitted,**

**Frank T. Caprio**

**General Treasurer**