

STATE INVESTMENT COMMISSION

State of Rhode Island and Providence Plantations

Regular Meeting September 26, 2007

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, September 26, 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 Giudici, Dr. Robert McKenna, Ms. Marcia Reback, Mr. Andrew Reilly, Mr. John Treat, and General Treasurer Frank T. Caprio. Mr. Robert Gaudreau was absent. Also present were: Mr. Kenneth E. Goodreau, Deputy General Treasurer for Finance; Mr. William Bensus, of Wilshire Associates Incorporated, General Consultant to the Commission; Ms. Michelle Davidson Pacific Corporate Group (PCG), Alternative Investments Consultant to the Commission; and other members of the Treasurer's staff.

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

VOTED: To approve the Minutes of the August 29, 2007 regular meeting.

Manager Continuation Policy analysis – Wilshire Associates. Mr. Bensur stated he would dispense with the Capital Marker Review as everyone is tuned into how the market is performing. In general, he stated that July and August was a period of negative volatility; the market has since recovered. On the yearly, U.S. equity is up to about 8%; international exposures continue to outperform U.S. exposures and are now up 14.5%. Emerging markets are up about 32%. Fixed income has become slightly more normalized. The Lehman aggregate is up about 3.5 % on high yield bonds and spreads have widened out and are up about 3% on a year to date basis.

Mr. Bensur then moved on to the Manager Continuation Policy analysis by explaining why the policy was put in place and stating this is only one of many tools used for analyses of performance. He recommended the commission retain all of the U.S. equity managers. Mr. Bensur reminded the committee that the benchmark for State Street Global Advisors had been converted from Russell 1000 to S&P 500 as of December 31, 2006.

The non U.S. equity space has been a bit of a challenge. Mr. Bensur recommended we retain Goldman Sachs Asset Management and Mondrian Investment Partners Ltd.. However, he suggested we

monitor Boston Company Asset Management. They have gone through organizational and performance considerations. Mr. Bensus suggested we schedule The Boston Company to come before the committee for a review at the next SIC meeting. Treasurer Caprio concurred with Mr. Bensus's suggestion.

Fixed income managers have performed well, although MacKay Shields LLC personnel developments should be monitored. Treasurer Caprio stated we had exited Shankman earlier this year and Mr. Bensus concluded this was a positive decision. Mr. Bensus stated there would be a day when spreads and high yield space return to normality. He suggested the committee analyze, review, and shelf RFP names of high yield managers who are already vetted in the event yields curves migrate back to normal conditions, as there may be a great opportunity for excess returns. Treasurer Caprio concurred and suggested the staff discuss a strategy with Wilshire for RFP's in the high yield space. Mr. Giudici asked how often Wilshire reviews changes in personnel within the management groups and how this impacts their performance. Mr. Bensus stated they evaluate this on an ongoing basis. Mr. Goodreau stated that the Treasury staff has a fiduciary responsibility to take part in the review process along with Willshire Consulting.

Mr. Bensus went on to discuss asset allocation investment performance. He recommends maintaining the current exposures to US equity (42.5%), non-US equity (20.0%), and fixed income (25.0%).

Real estate has a target of 5% and the fund is currently at 3.5% and building. Private equity has a target of 7.5% and the fund is currently at 5.8%. RIRS currently has 5 to 5.5% cash and cash equivalents on hand.

Proposed Investment in Point Judith Venture Fund II, L.P. Michelle Davidson of PCG stated Point Judith Capital Venture Fund II will make early stage venture capital investments in the information technology and science sectors. Geographically, the fund will focus on investments in the Northeast region. The breakdown will be 60-70% IT and 30-40% life science investments

Treasurer Caprio noted that Point Judith is a local company and it is prudent that ERSRI support these types of world class entities to help grow our local economy. He asked Gina Raimondo, General Partner, to introduce the members of Point Judith Capital: Sean Marsh, General Partner, and David Matirano, General Partner.

Ms. Raimondo went on to summarize her education and the history of the fund. She stated that there is one amendment to the overview as it was presented; the fund was closed in January of this year but was given an opportunity by the Limited Partners to reopen the fund and allow ERSRI to invest. Ms. Raimondo thanked the committee for considering a smaller investment which is atypical for ERSRI; however she is looking forward to a larger investment and greater commitment in Point Judith's next fund. The average investment size

will range from \$3 million to \$6 million in a total of 13 to 15 portfolio companies. The General Partner will seek board representation on all investments. The fund will leverage its newly established partnership with Tudor Asset Management. Tudor has chosen Point Judith exclusively to be their early stage partner. Through its relationship with Tudor and Tudor Ventures, Point Judith should be able to enhance its industry and deal flow network. The firm will have access to Tudor's proprietary research as well as analyses on industries, competitive landscapes, management teams, and market dynamics for potential financings, providing a competitive edge for Point Judith.

Mr. Marsh stated that the early stage venture investment business is more about working with entrepreneurs to build these companies rather than the financial, mechanical, and engineering aspects. The way they achieve alpha and achieve top quartile returns is by targeting specific industries within their area of expertise and optimizing their ability to add value to these companies. Mr. Martirano concluded with an overview of Fund II's current performance stating that the fund should be fully invested in about eighteen months.

Mr. Goodreau reiterated the importance of Tudor's commitment to Fund II and the huge advantage this affords the committee in regard to this investment.

Treasurer Caprio then entertained a motion for investment in Point Judith Fund II in the amount of \$5 million, pending satisfactory legal review. Mr. Reilly moved, Dr. McKenna seconded and the following motion was passed: The following members voted in favor: Ms. Gallogly, Mr. Giudici, Dr. McKenna, Ms.Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio. Mr. Costello recused himself from participating in the vote.

VOTED: To invest up to \$5 million in Point Judith Fund II contingent upon satisfactory review and negotiation of investment and other legal documents.

Proposed Investment in Perseus Partners VII, L.P. Ms. Davidson of PCG introduced Frank Pearl, Chairman & CEO, and Ray Newton III, Senior Managing Director. She went on to state that Perseus, L.L.C. is a private equity firm founded in 1995 that manages seven investment funds and capital commitments totaling \$2 billion. Perseus Partners VII, L.P. fund has a target of \$750 million and focuses on buyout and growth equity investments, biotechnology and medical device consolidations. They have a highly experienced team with the ability to identify companies and sectors with unrecognized value. Perseus VII, L.P intends to invest between \$25 and \$100 million in each of its portfolio companies. The average investment size of these companies is \$37 million. The strategy of Perseus VII, L.P. is to make growth equity and buyout investments in companies with strong management teams, rich intellectual property

assets, powerful consumer brands, and/or highly skilled work forces.

Ms. Reback asked why there was a high turnover in personnel at the firm. Mr. Pearl explained that turn over at the junior level is very common and Ms. Davidson of PCG concurred. Mr. Pearl explained that the five senior people have been together for many years and they are the core of the company.

Mr. Pearl went on to explain that this is the seventh fund. The investment sectors are broken as follows: 50% undervalued and distressed investments, 25% healthcare, and 25% energy and environmental. They have closed \$600 million and will have a final closing in a little over a month. The core of their investors has been with them through four or five funds. The reason for this is their return is very high (75%).

Ms. Gallogly asked Mr. Pearl to comment on why the closure dates for private equity holdings have dragged on. In regard to Perseus, Mr. Pearl explained that they create substantial companies through consolidation. In these transactions the firm is really a strategic owner building a business, not just a financial owner. These companies will typically be held for five to seven years. There will be a great deal of realization up front, and then a big slug of value will be generated some years later.

Mr. Giudici asked Mr. Pearl how personal bankruptcy impacts his

investment strategy. Mr. Pearl stated it does not have a direct impact on his strategy, but it does affect the economy negatively. There will be more bankruptcies which he considers to be an opportunity for Perseus.

Treasurer Caprio then entertained a motion for investment in Perseus Fund VII in the amount of \$15 million, pending satisfactory legal review. Ms. Reback moved, Mr. Costello seconded and the following motion was passed unanimously. The following members voted in favor: The following members voted in favor: Mr. Costello, Ms. Gallogly, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio.

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

Proposed Investment in Fenway Partners Capital Fund III, L.P. Ms. Davidson introduced Mr. Richard Dresdale, President, and Mr. Gregg Smart, Senior Managing Director. She explained that Fenway was founded in 1994 to acquire underperforming but profitable middle market companies with significant opportunities for earnings growth. They are focused on consumer branded products and the transportation / logistics sector. Treasurer Caprio interjected that we are currently vested in Fenway Fund II. Ms. Davidson stated they have a very experienced management team. Transportation /

logistics are not currently represented in our portfolio and there is less competition in this type of investment. Ms. Davidson commented that it is worth continuing the relationship.

Mr. Dresdale went over the history of the firm. He noted the transaction size is \$100 to \$500 million. To date the fund has closed on four investments representing \$276.6 million of invested capital. He noted that Fund I's performance was poor. There was one large loss where fraud was identified, but the issues were addressed and the team was rebuilt, they tightened their investment screen and focused on the areas that are most familiar to them. They have not lost capital since 2000.

Mr. Reilly asked why the fees charged to the portfolio companies are larger than those charged by other managers of similar size companies. Mr. Smart stated this helps to pay overhead. They have had no turnover in their management team. In order to retain their team, they were more aggressive at the portfolio company level during the period of time at the back end of Fund II. Fund III has a split of 80/20 which is the industry norm. The fees will be slightly lower as the fund moves ahead. Mr. Reilly asked if there was a formula or matrix to determine fees. Mr. Dresdale responded that the fees were not formulaic, but rather they are based on a bandwidth related to the size of the company and the resources being allocated.

Treasurer Caprio then entertained a motion for investment in Fenway

Fund III in the amount of \$15 million, pending satisfactory legal review. Ms. Reback moved, Mr. Treat seconded and the following motion was passed: The following members voted in favor: Ms. Gallogly, Mr. Giudici, Dr. McKenna, Ms.Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio. Mr. Costello recused himself from participating in the vote.

VOTED: To invest up to \$15 million in Fenway Partners Capital Fund III, L.P. contingent upon satisfactory review and negotiation of investment and other legal documents.

Legal Counsel Report. Treasurer Caprio stated that there was no legal counsel report for the month. Mr. Edward Pare of Brown, Rudnick, Berlack Israels, LLP, legal counsel to the Commission, indicated that there were no legal developments for the month.

Deputy Treasurer for Finance Report. Mr. Goodreau asked Mr. Izzo, Cash Manager, to speak to the commission regarding short term cash management within the portfolio. Mr. Izzo asked the commission to approve an increase in the cap on money market funds from 50% to 75%, as we are consistently near our cap. Recently money market funds have been out performing the other investment instruments we have by 25 basis points on average. These funds have liquidity and are available on a daily basis which allows us to meet unexpected obligations. Treasurer Caprio remarked that the guidelines currently allow 75% allocation to the US

Agency discount. Treasurer Caprio thanked Mr. Izzo for bringing this to the committee's attention.

Treasurer Caprio then entertained a motion to increase allocation for money market funds from 50% to 75%. Mr. Costello moved, Ms. Reback seconded and the following motion was passed unanimously.

The following members voted in favor:

Mr. Costello, Ms. Gallogly, Mr. Giudici, Dr. McKenna, Ms. Reback, Mr. Reilly, Mr. Treat, and Treasurer Caprio.

VOTED: To increase the allocation for money market funds for short term investments from 50% to 75%.

Treasurer's Report. Treasurer Caprio first announced that the Sudan divesture legislation has passed. One of the targeted companies was Rolls Royce PLC who is currently providing aircraft engines and aircraft to the Sudanese government which are being used to bomb the villages. During the push for legislation, Rolls Royce PLC withdrew all activity from the Sudan government. There was also a major development with Berkshire Hathaway this week. Although not directly involved in Sudan, they are a major shareholder of the Malaysian oil company Petronus which is fueling Sudanese aircraft. Pressure was put on Berkshire Hathaway last week during their annual meeting. They have since announced the beginning of divestment of these holdings. 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. This is being closely monitored and may result in legislation here in Rhode Island.

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

Ms. Reback moved, Mr. Giudici seconded and the following motion was passed unanimously. The following members voted in favor: Mr. Costello, Ms. Gallogly, 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 11:30 a.m.

Respectfully submitted,

**Frank T. Caprio
General Treasurer**