APPROVED

STATE OF WASHINGTON
STATE INVESTMENT BOARD

Private Markets Committee Meeting
Minutes

July 10, 2003

The Private Markets Committee met in open public session at 9:01 A.M. in the boardroom at the Washington State Investment Board in Olympia, Washington.

Members Present:	George Masten, Chair Mike Colleran Charles Kaminski Jeff Seely Paul Trause
Members Absent:	John Charles John Magnuson
Others Present:	Joe Dear Gary Bruebaker Tom Ruggels Isabelle Fowler Linda Buchanan Paul Silver, Assistant Attorney General Karen Jakobi, Pathway Capital Management Terrence Melican, Pathway Capital Management Katherine Cattanach, Invesco Private Capital Mary Kelley, Invesco Private Capital Tara Blackburn, Pacific Corporate Group Eric Becker, Pacific Corporate Group Alison Bonaci, Pacific Corporate Group

[Names of other individuals attending the meeting are not included in the minutes, but are listed in the permanent record.]

The meeting convened at 9:01 A.M. with Chair Masten identifying members present.

REVIEW AND APPROVAL OF MINUTES – JUNE 5, 2003

Mr. Trause moved to adopt the June 5, 2003, minutes. Mr. Masten seconded, and the motion carried unanimously.

PRIVATE EQUITY – VENTURE CAPITAL MANAGER ANNUAL UPDATES

Ms. Fowler explained that as part of contract requirements, Pathway Capital Management (Pathway) and Invesco Private Capital (IPC) would present annual reviews to the Committee.

Pathway Capital Management

Ms. Fowler introduced Karen Jakobi and Terry Melican of Pathway. Pathway has managed a portfolio of venture capital funds for the WSIB since July 1996, and has had total discretion since July 2001. She explained that Pathway can invest up to $30 million in venture capital funds with a total targeted capitalization size up to $750 million. The Board has authorized a total of $575 million to Pathway. Pathway has committed $422 million of that amount to 24 funds.

Ms. Jakobi and Mr. Melican presented an annual update on the portfolio that they have invested on behalf of the WSIB, described Pathway's organizational stability, continuity, experience, and clients, announced four members of the senior investment team were invited to invest equity and become partners, bringing the firm to nine partners and owners, and discussed current market conditions, environment, and deal flow.

Mr. Colleran asked for clarification regarding when money was raised as opposed to when it was actually dispersed. Mr. Melican responded that the money that is raised in any given year is dispersed over a number of years, but the pace was accelerated during the 1999-2000 time period. Discussion ensued regarding lag effect, capacity, investment performance, returns, and pace of investments.

Ms. Jakobi described how post-money valuations of venture-backed companies have come down. This means that it cost less to buy the same percentage of a company compared with the 1999-2000 time period.

Discussion ensued regarding valuations, timing, and definitions of investment rounds.

Ms. Jakobi compared information technology and healthcare companies and stated that investments in healthcare companies had been more stable than in information technology companies. Ms. Jakobi stated that Pathway expects 2003 to remain slow in the fundraising environment and expects that to change in 2004. She stated that valuations have declined significantly; making this a good time to buy attractively priced companies. Ms. Jakobi explained that for the market to improve, large corporations would need to increase spending on technology.

Discussion ensued regarding valuations and ownership positions.

Mr. Melican presented an overview of the WSIB portfolio. He stated that Pathway has committed $422 million to 24 partnerships. He explained that 50 percent of the committed capital has been drawn down and that $171 million has been returned, which represents 81 percent of the money that has been drawn by the general partners. Mr. Melican stated that the last year has been a difficult environment.

Discussion ensued regarding the differences in numbers presented in the material provided in the packet and material handed out at the meeting. The numbers provided at the meeting are more current.

Mr. Melican discussed criteria used to select partners, including management teams, investment strategies, investment performance, and multi-cycle investment experience.

Discussion ensued regarding criteria used to evaluate partnerships returning to the market.

Mr. Colleran requested that a standard format be required from managers with standard data so that comparisons can be made. Mr. Bruebaker replied that staff will develop such a standard for consideration.

Mr. Melican described two investments made in the last 12 months.

Discussion ensued regarding the amount invested on behalf of multiple clients.

Ms. Jakobi discussed WSIB allocations, commitments, and realized proceeds back to the WSIB, and stated that $153 million is available to invest in new partnerships.

Discussion ensued regarding the definition of commitment, contribution, valuation, and the validity of valuations.

Ms. Jakobi and Mr. Melican described the diversification and activity of the portfolio. They discussed the 1999 high-valuation period.

Discussion ensued regarding committed capital that has not been drawn and the timing of contributions.

Mr. Melican discussed the experience of general partners, and the ratio between committed and contributed capital.

Ms. Jakobi described partnerships that have reduced fund size, reduced management fees, or are in clawback situations. She discussed the history of the WSIB returns since the inception of the program. Ms. Jakobi stated that this has been a difficult year for the portfolio on a one-year basis with a -36.6 percent return, but the five-year and since-inception returns continue to be strong performers.

Discussion ensued regarding when money was committed and contributed, the advantages and disadvantages of separating venture investments from buyout allocations in a separate asset class, the importance of diversification of the portfolio, and the best data series to use when looking at private equity.

Invesco Private Capital

Ms. Fowler stated that Katherine Cattanach and Mary Kelley, Invesco Private Capital, previously Sovereign Financial Services, would be speaking with the Committee. Ms. Fowler explained Sovereign's parent company was acquired by Amvescap in 2001, and in 2002, Sovereign's operation was integrated with another Amvescap company, Invesco Private Capital. Like Pathway, Invesco has managed a portfolio of small venture capital funds for the WSIB since July 1996, and has had total discretion since July 2001. Invesco can invest up to $20 million in venture capital funds with a total targeted capitalization size up to $750 million. The Board has committed a total of $325 million to Invesco. Invesco has committed $270 million of that amount to 28 funds.

Ms. Cattanach and Ms. Kelley, Invesco, introduced themselves. They described Invesco's experience, access to top-tier partnerships, investment process, commitment to the WSIB, resources, focus,

expertise, client list, market awareness, diversification, monitoring process, and reporting process. They stated that they participate on advisory boards and committees and maintain constant contact with general partners. They stated that of the WSIB's $325 million authorization, $55 million remains to be invested, and $109 million has been returned. They discussed the diversification of the portfolio by industry, investment stage, and geography.

Mr. Colleran requested that the Committee receive at least one-year, three-year, and five-year returns on a consistent basis.

Mr. Seely requested information regarding actual contributions of commitments and timing of the calls. Ms. Cattanach stated that the data is not in this material, but they would provide a chart they have that does show the timing of the calls. A copy of this information was provided to members later in the meeting.

Ms. Cattanach discussed valuations, typical write-offs, and gains. She stated that in this portfolio the commitments are well diversified. Ms. Cattanach described write-downs and opportunities for growth and enhanced returns within the portfolio. She discussed historical returns in the portfolio, reasons for the volatility, and stated that the funds are well positioned to move forward.

Mr. Colleran requested WSIB returns for the fourth quarter 2002, one-year, three-year, and five-year. Ms. Cattanach stated that they do not have the information with them today but will provide it.

Discussion ensued regarding potential changes in the next five years. Ms. Cattanach stated that technology would continue to be the primary focus with life science a secondary focus, and then other sectors opportunistically.

Mr. Trause requested the amount of contributions by calendar or fiscal year, and distributions as a percentage of total contributions by vintage year. Ms. Cattanach replied that the information would be provided.

Mr. Masten requested that the information for both IPC and Pathway be presented at the next Private Markets Committee meeting. Staff will work with IPC and Pathway for the format.

Discussion ensued regarding the breakdown of funds dominated by investments made between 1996 and the first half of 2000, and what effect the results of the 2000-2001-2002 time frame will have on diversification by sector going forward.

PRIVATE EQUITY CONSULTANT CONTRACT EXTENSION AND AMENDMENT

Mr. Bruebaker explained that the Pacific Corporate Group (PCG) contract is due to expire December 31, 2003, and that the contract was structured for a three-year period with two one-year extensions. He stated that staff believes PCG's performance to date has been satisfactory and recommends the execution of the first one-year extension through December 31, 2004. Mr. Bruebaker explained that in March 2002 the Board granted the staff limited discretion for making investments in secondary partnerships up to $100 million per year with some limitations imposed in policy 2.10.700. The delegated authority is subject to a favorable due diligence determination by the WSIB's private equity investment consultant. The work on PCG's part is beyond what was anticipated at the time of the negotiation of the contract, and for that reason, there is not adequate compensation for PCG to absorb the extra work. Mr. Bruebaker stated that staff has negotiated favorable terms for the extra

work at below market rates. He stated that PCG has agreed to do the first two deals (up to $25 million commitments) without charge, with a one percent one-time transaction fee on deals that are successfully closed, thereafter.

Mr. Trause moved that the Private Markets Committee recommend that the Board authorize the Executive Director to extend the contract through December 31, 2004, as provided in the existing contract terms. Mr. Colleran seconded, and the motion carried unanimously.

Mr. Masten moved that the Private Markets Committee recommend that the Board approve Amendment No. 1 to Pacific Corporate Group's Contract No. 00-005, and authorize the Executive Director to extend the contract through December 31, 2004, as provided in the existing contract terms, and Mr. Trause seconded.

Discussion ensued regarding the extra due diligence and work required for the secondaries. Ms. Blackburn described the effort required, including valuation, negotiation, and legal due diligence.

Discussion ensued regarding the potential conflict of interest when compensation is only for deals that are completed, other possible ways to structure investments in secondaries, and the fact that the Senior Investment Officer – Private Equity and the Chief Investment Officer must also agree to the deal.

The motion carried with Mr. Colleran voting no.

PRIVATE EQUITY – BENCHMARK UPDATE

Mr. Bruebaker stated that staff is continuing to proceed with the benchmark issue and that State Street Bank is looking at the same issue. He said that he had discussions with CalSTRS and CalPERS and that they are enthusiastic about the project. Mr. Bruebaker stated that he would be having conversations with Oregon and other funds.

[A recess was called at 11:00 A.M. and the regular session reconvened at 11:08 A.M.]

PRIVATE EQUITY – ANNUAL INVESTMENT PLAN

Chair Masten announced that the Committee would go into executive session under the provisions of RCW 42.30.110(k) to discuss the Board's staff's recommended strategy addressing possible private equity investments expected to be presented to the Committee this year. Public knowledge of that strategy, and information underlying this discussion, would result in loss to the funds which the WSIB invests and, with respect to some of the information, competitive disadvantage and loss to persons furnishing such information to the Board.

The Committee expected the executive session to last 50 minutes.

[Mr. Masten was no longer in attendance at 11:50 A.M.]

[Mr. Seely was no longer in attendance at 12:00 P.M.]

At the end of the executive session, the Committee resumed its regular open session. The Committee did not expect to take any final action regarding the topic discussed in the executive session.

[The regular open session reconvened at 12:03 P.M.]

PRIVATE MARKETS CLOSING LOG

The Private Markets Closing Log was presented for informational purposes.

OTHER ITEMS

There being no further business to come before the Committee, the meeting adjourned at 12:04 P.M.