1Q2009 IAC Meeting Materials

IAC Meeting – May 20, 2009

Additional Meeting Materials

MINNESOTA STATE BOARD OF INVESTMENT

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DATE: June 10, 2009

TO: Members, State Board of Investment

FROM: Howard Bicker
Teresa J. Richardson

SUBJECT: Recommendation to terminate the large-cap equity management with Voyageur Asset Management Inc.

Organization

The SBI hired Voyageur Asset Management (Voyageur) in June 2000 to manage a large-cap domestic equity portfolio. Voyageur lifted the large-cap growth team out of Chicago Trust Company in 1999 and the team remained in Chicago. The Voyageur Chicago investment office is a wholly owned division of Voyageur Asset Management Inc.

In July 2008, David Cox, co-portfolio manager and CIO of the Chicago Equity team, abruptly resigned. Nancy Scinto, David's co-portfolio manager, has continued to manage the account with a new co-portfolio manager, Gordon Telfer.

Voyageur notified SBI staff on June 4, 2009 that they are closing the large cap growth product. The product currently has $850 million in assets under management down from a peak of just under $7 billion during 2006.

The Chicago office will be open through October 2009 to allow clients time to move their portfolios.

RECOMMENDATION:

Staff recommends that the SBI immediately terminate its relationship with Voyageur Asset Management Inc. for investment management services related to large-cap domestic equities.

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DATE: May 20, 2009

TO: Members, Investment Advisory Council

FROM: Howard Bicker

SUBJECT: Proposed Fixed Income Investment

In March 2009, the U.S. Treasury Department announced the Public-Private Investment Program (PPIP) which is designed to purchase mortgage-backed securities and whole loans from the balance sheets of U.S. financial institutions. Staff talked with a number of fixed income managers to gather information about the program.

All the information related to this program, however, is not yet available. What is known is that at least five investment managers will be selected by the government in late May to run the program. The investment managers will then raise approximately $75 billion to $100 billion of capital from investors. This capital will be matched dollar for dollar by the government. The government will also provide additional capital to leverage the programs. It is anticipated that the program to purchase asset backed bonds, called the Legacy Securities Program, will be provided leverage up to a 1 to 1 basis. The program to purchase whole loans, called the Legacy Loan Program, will receive additional capital to leverage purchases up to a 6 to 1 basis.

These programs could provide the SBI with very attractive fixed income returns in the range of 15% to 20%. Any investment made by the Board would have no liquidity for at least three years. It is currently anticipated the SBI would get its money back in about 5 to 7 years.

Staff suggests the SBI consider investing in the Legacy Securities Program due to its lower level of risk. Staff recommends the SBI consider investing one percent of the Combined Funds, approximately $300 million, in the program with assets coming from the fixed income portfolio. The structure of the investment vehicle will be in the form of a limited partnership with monitoring and reporting conducted by the fixed income program. (See **Attachment A** for further background information.)

Staff has been informed by a number of organizations that the fund-raising for these investments will be completed by July or early August. Therefore, if the SBI would like to participate in these programs, the Board will need to approve action at the June meeting. However, staff does not have, at this time, all the information related to the programs. Staff suggests that if there is not sufficient time to bring the issue to the Board, a meeting of the Administrative Committee will be called to review and approve details of any recommendations.

RECOMMENDATION:

Staff requests that the Board approve an investment of up to one percent of the Combined Funds assets with one or more managers in the Legacy Securities Program of the U.S. Treasury Public-Private Investment Program. The assets would come from the current fixed income portfolio. After staff has completed its due diligence of the program and has determined if it is an appropriate investment for the SBI, if time allows, staff will bring a detailed recommendation to the Board in September for final approval. If there is not time to bring a recommendation to the Board, a meeting of the Administrative Committee will be called to review and approve staff recommendations.

ATTACHMENT A

Public-Private Investment Program (PPIP)

Program Overview

The Public-Private Investment Program (PPIP) was introduced by the U.S. Treasury Department in March 2009. The focus of this government-sponsored program is to attract investments of $75 billion to $100 billion and provide financing for investments up to $1 trillion in the loan and securities markets. Private investors will have the opportunity to receive a dollar-for-dollar match of government funds, in addition to term, non-recourse financing, toward the purchase of "legacy" loans and securities currently valued at distressed prices.

There are two separate programs in the PPIP:

- Legacy Loans Program
- Legacy Securities Program

The purpose of the Legacy Loans Program is to cleanse bank balance sheets of troubled legacy loans while providing attractive terms for investment to the private sector. Public-private investment funds will be set up to purchase asset pools on a discrete basis. The U.S. Treasury will match private capital dollar-for-dollar (1:1 ratio) in a separate investment vehicle which will acquire assets alongside the private capital funds on a pro-rata basis. Then, the Term Asset-Backed Loans Facility (TALF) will provide term, non-recourse financing to the fund for asset purchases to provide leverage up to a 6 to 1 ratio.

The purpose of the Legacy Securities Program is to fund purchases of distressed securities to take devalued securities off bank balance sheets and to jump-start the securitization market. Taxpayer money will be combined with capital raised by select asset managers to buy mortgage-related assets, including non-agency RMBS and CMBS. The Treasury will provide capital on a dollar-for-dollar (1:1) basis and invest in a separate investment vehicle which will acquire assets alongside the private capital funds on a pro-rata basis. This fund is also eligible for term, non-recourse financing provided by the TALF to provide leverage in the range of a 0.5:1 to 1:1 ratio. The Treasury will select five or more managers to operate a Legacy Securities fund.

The financing provided by the TALF will be on a 10 year term and will come with a 25 basis point fee. This financing will be repaid on a pro-rata basis as cash flows from the investments are received.

A Proposed Fund Set-up

One of SBI's fixed income managers submitted a proposal to the U.S. Government to operate a Legacy Securities fund. The fund would be a limited partnership fund with the following features:

- There would be an initial three year investment lockup period.
- The manager would look to raise about $7 billion of private capital and match it with taxpayer money. This $14-15 billion would be levered up to 1x for a total fund of $25-30 billion.
- The fund would target a return of 20%.
- A 25 basis point fee on the TALF financing would be passed on to investors in addition to a 25 basis point upfront management fee, resulting in a total 50 basis point fee. (Other managers may propose a different management fee.)
- Profit sharing will take place after the investors receive 100% of their principal back plus a 10% return. After that threshold has been achieved, additional returns will be split 80/20 with the manager taking 20%.