EXECUTIVE CHAMBERS

HONOLULU

LINDA LINGLE
GOVERNOR

March 28, 2008

The Honorable Calvin Say
Speaker, House of Representatives
Twenty-Fourth State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear Speaker Say:

Subject: Act 260, SLH 2007 - Relating to the Employees' Retirement System

Act 260, SLH 2007, "Innovation Economy," requires the Employees' Retirement System (ERS) to develop criteria to determine the level of funds that may be invested in Hawaii venture capital private placement investments. I am enclosing a copy of the criteria which was adopted by the Board of Trustees at the meeting of March 10, 2008. You may electronically view the report at http://hawaii.gov/budget/LegReports/ pursuant to Act 231, Session Laws of Hawaii 2001.

If you have any questions, please contact Mr. Rod June, Retirement System Chief Investment Officer, at 586-1796.

Sincerely,

/s/

LINDA LINGLE

Enclosure

EXECUTIVE CHAMBERS

HONOLULU

LINDA LINGLE
GOVERNOR

March 28, 2008

The Honorable Colleen Hanabusa
Senate President
Twenty-Fourth State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

Dear President Hanabusa:

Subject: Act 260, SLH 2007 - Relating to the Employees' Retirement System

Act 260, SLH 2007, "Innovation Economy," requires the Employees' Retirement System (ERS) to develop criteria to determine the level of funds that may be invested in Hawaii venture capital private placement investments. I am enclosing a copy of the criteria which was adopted by the Board of Trustees at the meeting of March 10, 2008. You may electronically view the report at http://hawaii.gov/budget/LegReports/ pursuant to Act 231, Session Laws of Hawaii 2001.

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Sincerely,

/s/

LINDA LINGLE

Enclosure

EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII
INNOVATION ECONOMY – DEVELOPMENT OF CRITERIA
TO DETERMINE THE FUNDING LEVEL OF
HAWAII PRIVATE PLACEMENT INVESTMENTS *

Act 260, which became effective July 1, 2007, directed the Board to "...develop the criteria to determine the amount of funds that may be prudently invested in Hawaii private placement investments."

In developing the criteria, the Board relied on several sources of information. One source was the non-partisan report titled *Venture Capital in Hawai'i – An Assessment of Market Opportunities* prepared by the Hawaii Institute of Public Affairs (HIPA). This research report, prepared in 2007 and released in January 2008, is the most current and definitive source of information available on the current state of private equity investments in Hawai'i, and addresses both supply side opportunities and demand side capital needs. Another source of information was a preliminary findings report (based on the content of the HIPA report) prepared by the ERS' general investment consultant, Pension Consulting Alliance (PCA).

Based on these two sources of information, the Board believes the funding gap may range from $20 million to $130 million over the next three to five years. Within that gap there exists venture capital investment opportunities with varying degrees of risk/return characteristics. To increase the probability of achieving ERS return objectives, the general consultant has recommended funding (through a discretionary fund-of-fund's manager) only a portion of the estimated gap to ensure that ERS commits capital to only the most attractive Hawai'i venture capital opportunities.

Accordingly, the Board adopted funding level criteria as follows: 1) a maximum of 50% of the estimated Hawai'i venture capital funding gap to bring more flexibility and higher returns to the targeted investment program; and, 2) a minimum of 25% of the estimated Hawai'i venture capital funding gap to attract a sufficient number of venture capital program fund-of-fund's managers from which to choose the most qualified manager candidate.

The specific funding level will be determined soon after the pool of Request for Information (RFI) responses from fund-of-fund's managers are reviewed by the Board's search committee; we anticipate this review to occur in June 2008. These RFI responses are expected to yield additional information about funding gap levels within the Hawai'i venture capital community.

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* Reference Act 260, Section 1.