ANNUAL REPORT OF THE

OFFICE OF THE CHIEF COMPLIANCE OFFICER

JULY 1, 2007 – JUNE 30, 2008
INTRODUCTION:

The Office of the Chief Compliance Officer was created by 2005 Public Act 225. Its mission is to assist the Michigan Strategic Fund board of directors, the Strategic Economic Investment and Commercialization Board, and their employees and agents in carrying out the duties specified in Chapters 8A and 8B of the Michigan Strategic Fund Act. Those duties include awarding grants, loans, and contracts and making investments for economic development as part of the 21st Century Jobs Fund Programs.

The Office of the Chief Compliance Officer has certain responsibilities established by statute, which primarily involve recommending policies and procedures to the MSF board of directors and the SEIC Board and ensuring that those policies and procedures and related laws are followed by the boards and their agents and employees. In carrying out those responsibilities, the Chief Compliance Officer works closely with staff of the Michigan Economic Development Corporation, the Michigan Department of Attorney General, and the Credit Suisse Customized Fund Investment Group, which was hired by the MSF Board to carry out certain investment activities. Newly included responsibilities of the Office of the Chief Compliance Officer this year include working with the Michigan Film Office and the MSF Board in the event funds are sought by production companies or film and digital media private equity funds under the MSF Board’s loan enhancement program; and providing guidance in the area of conflicts of interest during the awarding of contracts for the Michigan tourism promotion program.

This annual report is prepared pursuant to the Michigan Strategic Fund Act and its requirement that the Chief Compliance Officer “[p]repare a written annual report that evaluates compliance with internal policies and procedures and with applicable state and federal law, explains any compliance matters that arose during the previous year, and suggests revisions to agency policies and procedures.”

A great deal of activity took place during the past year with respect to the 21st Century Jobs Fund Programs, including investments by the MSF Board with several venture capital, private equity, and mezzanine financing funds; the completion of one competition and the initiation of a second for competitive edge technologies by the SEIC Board; and the development of new programs to help retain Pfizer Corporation employees and assets affected by the 2007 downsizing of Pfizer in the State of Michigan. The existence of the Office of the Chief Compliance Officer proved highly useful during the course of these activities, and the willingness of all involved parties to accept the advice and incorporate the recommendations of the Chief Compliance Officer ensured that all applicable laws, policies, and procedures were followed. The activities of the Office are discussed in more detail below.
ACTIVITIES OF THE OFFICE OF THE CHIEF COMPLIANCE OFFICER RELATED TO THE MICHIGAN STRATEGIC FUND:

The Office of the Chief Compliance Officer was involved in activities related to Credit Suisse Customized Fund Investment Group, which has been hired to find prominent private equity, venture capital, and mezzanine funds in which to invest $114 million of funds appropriated to the 21st Century Jobs Fund. Throughout the year, the Chief Compliance Officer performed several functions, including advising the Michigan Strategic Fund Board to assure the legality of its actions, analyzing documents to ascertain statutory compliance, and resolving questions related to requirements of Chapter 8A of the Michigan Strategic Fund Act. The Chief Compliance Officer received significant cooperation from legal staff at the Michigan Economic Development Corporation and the Michigan Department of Attorney General, and counsel for Credit Suisse, such that all compliance issues were successfully resolved.

Over the course of the year, the Chief Compliance Officer discussed and/or reviewed various agreements to be entered into between the Michigan 21st Century Investment Fund, L.P. and the private equity, venture capital, and mezzanine financing funds selected by the Michigan Strategic Fund Board. The funds selected for investments during the period covered by this report include:

1. Quad Partners, a private equity fund;
2. Relativity Fund, L.P., a private equity fund;
3. RPM Ventures, a venture capital fund; and
4. Midwest Mezzanine, a mezzanine financing fund.

In this regard, the Chief Compliance Officer discussed statutory requirements with legal counsel for Credit Suisse. In all cases, recommendations by the Chief Compliance Officer were implemented, including those for statutorily-required due diligence and incorporation of the following provisions of the Michigan Strategic Fund Act:

1. A prohibition against using the money for a stadium, arena, or casino;
2. A prohibition against providing money to persons convicted of certain crimes or held liable in certain civil proceedings, and in the other situations described in MCL 125.2088c(4); and
3. A requirement that the fund operate a business development office in Michigan staffed with a full-time equivalent employee, and fulfill the other requirements described in MCL 125.2088e; 125.2088f; and 125.2088g, which relate to private equity funds, venture capital funds, and mezzanine funds, respectively.

The Office of the Chief Compliance Officer performed similar duties with respect to the first co-investment in a company by the Michigan Strategic Fund Board. In this case, the Chief Compliance Officer reviewed and approved a number of documents pursuant to which the MSF Board directly purchased stock in Microposite, a Michigan-based
company which had previously received an investment from Nth Power, one of the venture capital funds with which the MSF Board has invested.

Credit-Suisse has certain reporting requirements contained in the agreements into which it has entered with the Michigan Strategic Fund, those being the 21st Century Investment Fund Manager Agreement and the Michigan 21st Century Investment Fund, L.P. Limited Partnership Agreement. This year the Chief Compliance Officer undertook a review of the materials submitted by Credit-Suisse to assure that it is in compliance with its reporting requirements and to make any necessary recommendations. The materials which Credit-Suisse is required to provide include monthly reports, quarterly reports, and an annual report. The review showed that Credit-Suisse is in compliance with its reporting requirements.

In another area, the Office of the Chief Compliance Officer was involved in the development of two programs arising from the Retention of Pfizer Assets Toward the Advancement of Life Sciences Technologies Request for Proposals. This RFP was issued in response to an announcement in January, 2007 by Pfizer Corporation of its intention to close research sites in Ann Arbor, Holland, Kalamazoo, Plymouth Township, and Portage. Its purpose was to solicit ideas from non-profit regional economic development organizations for programs to help retain in the State of Michigan Pfizer employees who may otherwise have left the state, and assets which otherwise may have been removed, demolished, or sold for purposes other than the life sciences industry.

The first program to result from the RFP is run by Ann Arbor SPARK. Designated the Michigan Innovation Equipment Depot, it took equipment donated by Pfizer and redistributes it to life sciences companies for a license fee equal to one percent of the fair market value of the equipment. For this program, the Office of the Chief Compliance Officer reviewed and approved the grant agreement pursuant to which Ann Arbor SPARK operates the MIED.

The second program is the Company Formation and Growth Fund. This program established an eight million dollar fund to lend money to companies either formed by ex-Pfizer employees or which hire ex-Pfizer employees who lost their jobs due to the 2007 downsizing of Pfizer in the State of Michigan. The Chief Compliance Officer reviewed and made recommendations with respect to the parameters of the program and the form of the loan documents, all of which were accepted and implemented. Permissible uses of the funds include hiring ex-Pfizer employees, purchasing Pfizer equipment, or leasing space in former Pfizer facilities. No matter how the money is used, there is a job-creation component to the loan.

Subsequent to the adoption of the program, recommendations for loans were received from Ann Arbor SPARK, Southwest Michigan First, and Lakeshore Advantage, which are located in Ann Arbor, Kalamazoo, and Holland, respectively. Thirty-four applicants were awarded funds by the Michigan Strategic Fund Board. The Chief Compliance Officer undertook due diligence on these 34 awardees and their personnel. As the awardees were all business entities, this due diligence included running background
checks on each business entity, and on its affiliates, subsidiaries, officers, directors, managerial employees, and any person who, directly or indirectly, held a pecuniary interest in the business entity of 20% or more, as required by the Michigan Strategic Fund Act.

The background checks were run for the purpose of ensuring that money expended was not used for:

1. Loans to a person who was convicted of a criminal offense incident to the application for or performance of a state contract or subcontract; and
2. Loans to a person who was convicted of a criminal offense, or held liable in a civil proceeding, that negatively reflected on the person’s business integrity, based upon a finding of embezzlement, theft, forgery, bribery, falsification or destruction of records, receiving stolen property, or violation of state or federal antitrust statutes.

A total of 374 background checks were completed. These were done using the Westlaw Locator database. A total of 24 loan agreements were thereafter reviewed and approved this year for awardees under this program, resulting in a commitment to create 122 jobs in the life sciences area.

Finally, the Chief Compliance Officer drafted a conflict of interest policy for the Michigan Strategic Fund Board. This was done in conjunction with the Department of Attorney General, which provides advice to the MSF Board in areas not related to the 21st Century Jobs Fund programs. The policy was adopted by the MSF Board in January 2008.

In sum, the Office of the Chief Compliance Officer reviewed four private equity, venture capital, and mezzanine funds that were chosen to receive investments by the Michigan Strategic Fund Board. The Office of the Chief Compliance Officer also reviewed two programs to retain Pfizer assets in the State of Michigan. Issues that arose during these processes generally involved questions of what the Michigan Strategic Fund Act requires and how that needs to be implemented. In all cases, recommendations by the Chief Compliance Officer were followed, and hence all parties involved were in compliance with all applicable laws, policies, and procedures during the period covered by this report.
The Office of the Chief Compliance Officer was again involved in activities related to a competition held by the Strategic Economic Investment and Commercialization Board for the selection and funding of awardees of funds appropriated to the 21st Century Jobs Fund. For the 2008 fiscal year, the SEIC Board chose to hold a commercialization competition for competitive edge technologies, seeking to find companies with products close to commercialization, rather than companies and organizations involved in applied or basic research. The amount of funds available for this competition was $30 million. The four competitive edge technologies for which funding was available are comprised of life sciences technology; advanced automotive, manufacturing, and materials technology; homeland security and defense technology; and alternative energy technology.

Throughout the year, the Chief Compliance Officer filled several roles, including giving advice and guidance to the SEIC Board and its members to assure the legality of its and their actions, and examining documents to ascertain statutory compliance.

The selection process began in October 2007 and initially involved the issuance of two requests for proposals: one to solicit business plans and other information from applicants seeking loans to fund their commercialization activities, and the other to solicit applications from which the SEIC Board would choose the independent peer review agency which would oversee the review and scoring of the commercialization proposals. The use of an independent peer review process is mandated by statute. Work in this area included reviewing, recommending changes to, and approving the requests for proposals. These RFPs were submitted to and approved by the SEIC Board at its February 2008 meeting.

The National Center for Manufacturing Sciences was chosen as the independent peer review agency to identify and recommend applicants who met thresholds for scientific and technical merit, personnel expertise, commercial merit, and the ability to leverage additional funding. Thereafter, the Office of the Chief Compliance Officer was involved in the review and approval of the contract with NCMS. Meetings were also held with NCMS and Michigan Economic Development Corporation personnel to develop a process to avoid conflicts of interest involving the peer review experts who would review the applications. Additional work arose when NCMS discovered that it had conflicts of interest with respect to six applicants, which resulted in the hiring of Business Engines as a second independent peer review agency to handle those matters.

The Chief Compliance Officer also reviewed and recommended changes to the template for the loan agreements to be entered into between the SEIC Board, the Michigan Strategic Fund Board, and the awardees to assure compliance with applicable laws and the incorporation of the following provisions of the Michigan Strategic Fund Act:
1. A prohibition against using the money for a stadium, arena, or casino; and
2. A prohibition against providing money to persons convicted of certain crimes or held liable in certain civil proceedings, and in the other situations described in MCL 125.2088k(6).

This year also saw the conclusion of the 2006 competitive process by which the Strategic Economic Investment and Commercialization Board awarded $126 million of funds appropriated to the 21st Century Jobs Fund to 78 awardees in the form of grants and loans. In particular, the Office of the Chief Compliance Officer was involved in the review and modification of procedures to monitor the awards and awardees to assure that awardees will be in compliance with the terms of their grants and loans. To this end, the Chief Compliance Officer reviewed files and online information related to the 78 awardees to determine whether semi-annual and annual reporting requirements were being met. Recommendations on how to standardize and improve this process were provided to the Michigan Economic Development Corporation. Annual reviews will continue to monitor the awards and awardees during the life of the program.

Following the completion of the first competitive process, the Office of the Chief Compliance Officer addressed concerns raised by a Board member concerning potential conflicts of interest related to Board members employed by large organizations. These concerns included:

1. Common employment of a Board member and an applicant for an award;
2. A contract between the employer of a Board member and an applicant for an award or a collaborating organization;
3. A licensing agreement between the employer of a Board member and an applicant for an award or a collaborating organization; and
4. An equity interest held by the employer of a Board member in an applicant for an award or a collaborating organization.

The general tenor of the questions centered on the difficulty in a large employer situation to uncover every potential conflict of interest, how much effort was required to uncover them, and what would be the effect of an undiscovered conflict. Answers to these questions were prepared by the Chief Compliance Officer and in general concluded that a reasonable effort was required based upon the information that was available to the Board member at the time the effort was made, after which an undiscovered conflict would not constitute a violation of the SEIC Board conflict of interest policy by the Board member. These answers were incorporated as part of the SEIC Board conflict of interest policy addendum to give guidance to Board members on how to handle these issues in the future, and a copy of the addendum was distributed to Board members.

In another area, the Chief Compliance Officer drafted an investment policy, which was adopted by Strategic Economic Investment and Commercialization Board in January 2008.
In sum, the Strategic Economic Investment and Commercialization Board completed its first competition which covered basic research, applied research, and commercialization projects, and which awarded grants or loans to 78 awardees totaling approximately $126 million, and began its second competition, which focused exclusively on commercialization projects. Issues that arose during this process involved conflict of interest questions and the requirements of the Michigan Strategic Fund Act. In all cases, recommendations by the Chief Compliance Officer were followed, and hence all parties involved were in compliance with all applicable laws, policies, and procedures during the period covered by this report.
EFFECTIVENESS OF POLICIES AND PROCEDURES:

The policies and procedures employed by the Michigan Strategic Fund Board, the Strategic Economic Investment and Commercialization Board, and the Michigan Economic Development Corporation, and monitored by the Office of the Chief Compliance Officer, worked extremely well during the past year. The Office of the Chief Compliance Officer neither received, nor is aware of, any complaints concerning compliance with the requirements of the Michigan Strategic Fund Act by any of these entities. To the extent that issues arose during the course of the year, these were addressed and resolved in accordance with the guidance and recommendations of the Office of the Chief Compliance Officer.

Consequently, no substantive changes are recommended to existing policies and procedures. The Office of the Chief Compliance Officer will continue to monitor the policies and procedures employed by the Michigan Strategic Fund Board, the Strategic Economic Investment and Commercialization Board, and the Michigan Economic Development Corporation to assure continued compliance with the law by all parties, both for new and existing programs and investments.

Respectfully submitted,

John D. Walter
Chief Compliance Officer
Office of the Chief Compliance Officer