

South Carolina Retirement System Investment Commission Meeting Minutes

June 8, 2006

**Second Floor Conference Room
202 Arbor Lake Drive
Columbia, South Carolina 29223**

Commissioners Present:

Mr. Reynolds Williams, Chairman
Mr. James Powers, Vice Chairman
Mr. Blaine Ewing
Mr. Allen Gillespie
Dr. Travis Pritchett

Others present for all or a portion of the meeting: Robert Borden, Nancy Shealy, Ashli Aslin, Tomas Jokl, and Justin Young from the South Carolina Retirement System Investment Commission; Rick Patsy, Frank Rainwater, and Shakun Tahiliani from the State Treasurer's Office; Jay Love and Jeff Schutes from Mercer Investment Consulting; Peggy Boykin, Faith Wright and Joni Redwine from the South Carolina Retirement Systems; Anne Macon Flynn from the Budget and Control Board Office of General Counsel; Todd Wren from Merrill Lynch Investment Managers; Robert Tovo and Ryan Neff from GNI Capital, Inc.; Danny Verat from the South Carolina State Senate; Wayne Pruitt, Crawford Clarkson, and Sam Griswold from the State Retirees Association; and Charley McDonald from the South Carolina Trooper's Association.

I. CALL TO ORDER AND CONSENT AGENDA

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission (Commission) to order at 10:05 a.m. and welcomed the Commissioners and guests. Treasurer Grady Patterson was unable to attend due to a scheduling conflict.

Chairman Williams called for objections or amendments to the meeting's proposed agenda. There being none, the agenda was adopted as presented.

Chairman Williams called for objections or amendments to the minutes from the Commission meeting on May 11, 2006. There being none, the minutes were adopted as presented.

II. ELECTION OF RETIREE REPRESENTATIVE

Chairman Williams reported that Dr. Travis Pritchett's term as retiree representative to the Commission would expire on June 30, 2006, and advised that, per statute, the retiree representative must be elected by unanimous consent of the Commission. After discussion and by unanimous acclamation of the Commission, Dr. Pritchett was

reelected to serve as retiree representative to the Commission from July 2006 through June 2011.

III. REPORTS

Chairman Williams reported that he and Mr. Robert Borden met with Mr. Van Newman, the retired Chairman and CEO of CNSG (formerly Newman, Saylor, and Gregory). He stated that they discussed strategies related to the public relations and educational presentations regarding the proposed Constitutional amendment that would allow for further diversification of the South Carolina Retirement Systems' (Retirement Systems) portfolio. Chairman Williams stated that Mr. Newman would assist the Commission by formulating discussion points, speech concepts, and presentation schedules. Chairman Williams reminded the Commission that Mr. Newman offered to lend his expertise pro bono.

Chairman Williams reported that he contacted the South Carolina Attorney General's office to request the Commission's involvement in drafting the explanation of the amendment's intent, which would be included on the ballot.

Chairman Williams reported on topics discussed and actions taken during the Executive Session of the May 11, 2006, Commission meeting. He noted that the Commission had the specific statutory authority to deliberate about, or make tentative or final decisions, on investments or other financial matters in executive session, if taking those actions in a public forum or disclosure of the deliberations or decisions would jeopardize the Commission's ability to implement a decision or to achieve investment objectives. Chairman Williams explained that after discussing all of the issues in executive session, the Commission determined that taking these actions in a public forum would jeopardize its ability to implement their decisions and to achieve investment objectives, which could potentially have a negative impact on the portfolio. Chairman Williams stated that since the approved actions had now been consummated, the actions should be stated for the public record. Chairman Williams reported that after receiving information and recommendations from Mr. Borden and Mercer Investment Consulting, Inc. (Mercer), a motion was made, seconded, and passed to authorize the Chairman or his designee to terminate the contractual relationship with Nicholas-Applegate Capital Management (NACM) for the quantitative Small Cap Growth strategy due to the loss of the entire portfolio management team and the Commission's lack of confidence in NACM's replacement team. Chairman Williams noted that due to the time-sensitive nature of this decision, a motion was made, seconded, and passed unanimously to suspend the remainder of the Commission's formal manager search process for the Small Cap Growth strategy. One rationale for doing so was that a majority of the replacement candidates had closed their products during the course of the Small Cap Growth search that had been in progress since March 2006, and Mercer and Mr. Borden determined that ClariVest Asset Management, LLC (ClariVest) was the appropriate candidate for the Retirement Systems' current portfolio structure. Chairman Williams reported that a third motion was made to authorize the Chairman or his designee to negotiate and execute a contract with ClariVest Asset Management, LLC (ClariVest), upon approval for legal sufficiency by General Counsel, to manage assets in the Small Cap Growth

strategy and to transition the assets managed by NACM to ClariVest in the most efficient and cost effective manner. The motion was seconded and passed unanimously. Some key reasoning and justification for these actions was that the entire portfolio management team previously employed by NACM and engaged by the State Retirement System Investment Panel (Panel) was now working at the newly formed ClariVest, and this was deemed a prudent action that the Commission could take, given the circumstances. The Commission was also in a position to achieve significant cost reductions by acting swiftly.

Chairman Williams reported that he and Ms. Nancy Shealy were working on an allowable investments schematic specifying the Commission's statutory and constitutional authority for potential investments of the Retirement Systems' portfolio. Chairman Williams stated that the document would be distributed to Commissioners and staff upon completion. He noted that the allowable investment schematic would be of secondary importance to the duly diligent, prudent investor, and fiduciary processes used when making investment decisions for the Retirement Systems' assets.

Chairman Williams recognized Ms. Shealy for the Administrative Director's report. Ms. Shealy reported that the Commission had tentatively reserved the Wampee Training and Conference Center for a retreat on November 30-December 1, 2006. At Chairman Williams' request, Mr. Allen Gillespie and Mr. Borden agreed to begin organizing the agenda for the retreat.

Ms. Shealy reported on the status of the fiduciary insurance policy and stated that the Commission's portion of the premium for the policy was approximately \$376,000 for Fiscal Year 2007.

Ms. Shealy reminded the Commission that the Commission's budget allocation for the current fiscal year (FY2006) was transferred from the Retirement Systems to the Commission effective October 1, 2005, and noted that budget transactions had been processed under the direction of the Chairman by the Administrative Director. Ms. Shealy stated that the Office of Internal Operations (OIO) of the State Budget and Control Board (Board) maintained the Commission's accounting system with assistance, monitoring, and oversight by the Retirement Systems' staff. Ms. Shealy presented a budget report summarizing the Commission's FY2006 allocation through June 3, 2006.

Ms. Shealy advised that on October 17, 2005, and pursuant to the legislative budget process, the Commission submitted a budget authorization request for the upcoming fiscal year (FY2007) to the Board's State Budget Office. She reported that the budget request was included in the General Appropriations Bill (H.4810), approved by House of Representatives, amended by the Senate per the Commission's request, and subsequently adopted by the General Assembly. Ms. Shealy informed the Commission that H.4810 was ratified on June 7, 2006, and would become effective July 1, 2006. She noted that H.4810 authorized additional full-time equivalent (FTE) positions for FY2007,

subject to evaluation and approval by the Commission. Ms. Shealy presented a budget report summarizing the Commission's FY2007 allocation.

Ms. Shealy reported that H.4810 also included a provision authorizing each agency to provide general pay increases to unclassified employees, subject to certain guidelines. Mr. Blaine Ewing made a motion to authorize the Chairman to award a general pay increase for the Commission's unclassified full-time employees, at his discretion, effective June 2, 2006, subject to the applicable provisions in the 2006-2007 General Appropriations Act or the guidelines established by the Board. Mr. James Powers seconded the motion, which passed unanimously.

The Commission received the Budget Allotment Summaries for FY2006 and FY2007 as information.

(Information relating to these budget matters has been retained in the Commission's files and is identified as Exhibit A)

Ms. Shealy stated that the model contract used by the Board for investment consulting services was reviewed by a team of attorneys, the Panel, members of the Board and staff in 1998, and by the Board's Office of General Counsel again in 2004. She reported that she reviewed the current consulting contract and updated the prototype to reflect current South Carolina law and practice, to clarify provisions, and to amend other provisions beneficial to the Commission and/or the Retirement Systems. She stated that the resulting prototype was vetted by the Chairman and incorporated into the Request for Proposals (RFP) for General Consulting Services, although the RFP reserved the Commission's right to modify any provision or negotiate with successful bidders.

Ms. Shealy advised that although the prototype may be amended during negotiations with individual consultants or for clarification of provisions, the prototype would provide notice to prospective consultants as to the Commission's general contractual expectations and provide the Commission or its designee(s) with a base document from which to negotiate.

Mr. Gillespie made a motion to approve the Consultant Contract Prototype to be used as the base document for negotiating consulting contracts. Mr. Ewing seconded the motion, which passed unanimously.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit B)

Ms. Shealy stated that the standard investment manager contract used by the Board was developed by a team of attorneys, the Panel, and members of the Board in 1999-2000 and was updated from time to time to reflect changes in laws and industry standards, to clarify provisions in response to issues raised during negotiations, and to streamline the documents for contract administration purposes. Ms. Shealy reported that she reviewed the current standard investment manager contract and updated the

prototype to reflect current South Carolina law and practice. She stated that she also compared provisions in approximately 20 of the Commission's current and/or recent manager contracts relating to the equity portfolio, and based on commonality, clarity, or provisions either required by law or opined to be in the best interests of the Commission and/or the Retirement Systems, she developed a new Standard Investment Manager Contract prototype, which had been thoroughly vetted by the Chairman.

Ms. Shealy advised that although the prototype may be amended during negotiations with individual managers or for applicability to a particular investment strategy or manager (e.g. commingled vs. separately managed account, active vs. passive, investment advisor vs. bank, fees, asset class, etc.), the prototype would provide notice to prospective managers as to the Commission's general contractual expectations, provide the Commission or its designee(s) with a base document from which to negotiate, and promote more efficient contract administration for the Commission.

Mr. Gillespie made a motion to approve the Standard Investment Manager Prototype to be used as the base document for negotiating investment manager contracts. Mr. Ewing seconded the motion, which passed unanimously.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit C)

Chairman Williams recognized Mr. Borden for the Chief Investment Officer's report. Mr. Borden stated that due to the special nature of a retirement trust and the long term nature of its investments, the concept of a legal list of investments schematic may not follow best practices and suggested that the Chairman consider pursuing legislative changes to simplify the guiding statutes to follow the "Prudent Expert Rule". Chairman Williams agreed that the Prudent Expert rule is desirable, but stated that it is explicit in the governing statutes and that efforts to amend them simply for clarification were of low priority given the amount of significant implementation projects that were of high priority for completion.

Mr. Borden stated that he and Chairman Williams met with C.H. Maguire, the Governor's Senior Advisor and Director of Cabinet Affairs, and attended a Board staff meeting regarding the operations of and future plans for the Commission. He stated that, in conjunction with those meetings, there was a discussion about the assumed rate of return of the portfolio. Mr. Borden stated the meeting successfully conveyed that the rate of return assumption should be driven exclusively by capital market expectations and not based the desire to fund any future benefits, including Cost of Living Adjustments (COLAs).

Mr. Borden suggested that the Commission consider rescheduling meetings for the third Thursday of each month, so reports could be prepared using the most current data. After discussion, it was determined that the July meeting would be held as previously scheduled, but subsequent Commission meetings would be rescheduled for the third Thursday of each month, if the Commissioners' schedules permitted.

Mr. Borden presented the Investment Performance Summary report for the Retirement Systems' portfolio. Mr. Borden and the Commission discussed potential changes to format and content for future reports. The Commission received the Investment Performance Summary report as information.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit D)

Mr. Borden recognized Mr. Jay Love from Mercer Investment Consulting (Mercer) to discuss the May performance results for the equity portfolio. Mr. Love discussed the broad economic factors that contributed to the unfavorable performance of the equity portfolio during May 2006. Mr. Love opined that market volatility would continue into June 2006, and, if so, the performance of the equity portfolio would reflect that volatility.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit E)

Mr. Borden updated the Commission on the Investment Consultant Search. He noted that progress, to date, had followed the schedule presented at the previous Commission meeting and that he and Mr. Gillespie plan to present a recommendation to the Commission during the August or September Commission meeting.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit F)

Mr. Borden provided the Commission with an update on the Global Fixed Income manager search. He discussed the process involved and the progress that had been made, to date. He stated that he would continue to work with Messrs. Love, Powers, and Ewing and would keep the Commission updated as to the progress.

Mr. Borden asked Messrs. Love and Jeff Schutes from Mercer for an update on the progress of the Asset Liability Modeling Study (ALM). Mr. Schutes stated that Mercer was waiting on data from Milliman Consultants and Actuaries (Milliman), the actuary for the Retirement Systems and Board. Mr. Borden agreed to check with Mrs. Peggy Boykin and representatives from Milliman on the status of the data.

Mr. Borden stated that the Commission was legally required to present a quarterly report to present to a variety of legislative entities. He updated the Commission on the progress of that report and stated his intent to present the Commission with a draft, in a format of reasonable permanence, at the July meeting.

IV. INVESTMENT MATTERS

Chairman Williams referred to the draft Statement of Investment Objectives (SIO) and amendment document, which were included in the Commissioner's meeting materials. The Commission and staff thoroughly reviewed and discussed various aspects of the

document and offered comments, suggestions and modifications. Chairman Williams stated that amendments consistent with the discussion would be integrated into the document and a new draft would be presented for possible adoption at the July meeting.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit G)

Chairman Williams referred to the draft Statement of Investment Policies (SIP) and amendment document, which were included in the Commissioner's meeting materials. Chairman Williams noted that the Board's Office of Human Resources and the State Personnel Office had reviewed pertinent provisions in the document and offered several amendments, which were included in the amendment document. The Commission and staff thoroughly reviewed and discussed various aspects of the document and offered comments, suggestions, and modifications. Chairman Williams stated that amendments consistent with the discussion would be integrated into the document and a new draft would be presented for possible adoption at the July meeting.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit H)

Mr. Borden referred to the draft Statement Annual Investment Plan (AIP), which was included in the Commissioner's meeting materials. Mr. Borden provided an overview and analysis of the draft document. Mr. Borden and the Commission thoroughly reviewed and discussed various aspects of the document and offered comments, suggestions, and modifications. Chairman Williams stated that amendments consistent with the discussion would be integrated into the document and a new draft would be presented for possible adoption at the July meeting.

(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit I)

Mr. Borden discussed the Commission's short-term staff development needs. After discussion, Mr. Ewing made a motion to authorize Mr. Borden to begin the recruitment process for a Director of Research and/or a Research Analyst and an Equity Analyst. Mr. Gillespie seconded the motion, which passed unanimously.

V. ADMINISTRATIVE MATTERS

Mr. Borden recognized Mr. Justin Young for a presentation on and demonstration of the Commission's draft website. Mr. Young discussed potential content for the Commission's website, to which the Commission offered comments, suggestions, and modifications. Mr. Borden stated that the suggested content was based on Commission's desire to strive for public transparency of all matters related to the Commission's operations, strategies, and investment performance. Mr. Borden suggested that the Commission consider employing a distribution list on the website,

whereby people may elect to be included in a mass distribution of certain reports, articles, and other information.

Mr. Young stated that the Commission must determine the website's domain name and offered several suggestions. After discussion, Mr. Powers made a motion to register all suggested domain names and approve the cost involved. Mr. Gillespie seconded the motion, which passed unanimously.

Mr. Borden commended Mr. Don Sears from the Retirement Systems for his technical assistance with the project.

VI. ADJOURNMENT

Chairman Williams thanked everyone for attending and adjourned the meeting at 2:30 p.m.

[Staff Note: In compliance with S.C. Code Ann. §30-4-80, public notice of and the agenda for this meeting were delivered to the press and to parties who requested notice and were posted at the entrance, in the lobbies, and near the 2nd Floor Conference Room at 202 Arbor Lake Drive, Columbia, SC, on June 6, 2006.]