South Carolina Retirement System Investment Commission
Meeting Minutes

June 19, 2008

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

Commissioners Present:
Mr. Reynolds Williams, Chairman
Mr. James Powers, Vice Chairman
State Treasurer Converse Chellis
Mr. Blaine Ewing
Mr. Allen Gillespie
Dr. Travis Pritchett

Others present for all or a portion of the meeting: Dunkin Allison, Robert Borden, Donald Brock, Brenda Gadson, Hershel Harper, Douglas Lybrand, Heather Muller, Rick Patsy, Greg Putnam, Kathy Rast, Nancy Shealy, Nicole Waites, Brian Wheeler, Hilary Wiek, Dori Ditty, Jonathan Boyd, and Jared O'Connor from the South Carolina Retirement System Investment Commission; Mike Addy and Shakun Tahiliani from the State Treasurer's Office; Sam Wilkins, Joye Lang, and Stephanie Duncan from the Budget and Control Board Office of Human Resources; Rhett Humphreys and Sean Gill from New England Pension Consultants; Peggy Boykin, Sarah Corbett, Tammy Davis, Robyn Leadbitter, Ashley McAdoo, John Page, Danielle Quattlebaum, Joni Redwine, Travis Turner, and Faith Wright from the South Carolina Retirement Systems; Kelly Rainsford from the Budget and Control Board's Employee Insurance Program and Office of General Counsel; Wayne Pruitt from the State Retirees' Association; John Huffman, state retiree; and Arnold West from ING Investment Management.

I. CALL TO ORDER, CONSENT AGENDA, AND CHAIRMAN'S REPORT

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission (Commission) to order at 10:00 a.m. and welcomed the Commissioners and guests.

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

Chairman Williams referred to the draft of the minutes from the meeting on April 17, 2008. Ms. Shealy noted that per comments from Chairman Williams, she had drafted a proposed amendment to the draft to conform to the verbatim discussion of the Sudan legislation as presented by Chairman Williams during that meeting. Mr. Allen Gillespie said that he had not had an opportunity to review the minutes, so the Chairman carried the minutes over. The minutes from the meeting on May 15, 2008, were carried over also.

Chairman Williams advised that the Sudan Legislation (bill S.241) passed the South Carolina House of Representatives and the South Carolina Senate. Ms. Nancy Shealy, Administrative Director and General Counsel, noted that the law became effective on June 5, 2008, without the Governor's Signature. Chairman Williams also advised that the State Budget and Control Board (Board) increased the actuarial assumed rate of return from 7.5 percent to 8 percent. He also noted that the actuaries had based their recommendation on a five-year smoothing period but would use a 10-year smoothing period in the future.

Chairman Williams recognized State Treasurer Converse Chellis to provide an update on the search for an Investment Compliance Officer (CO). Mr. Chellis introduced staff from the Board's Office of Human Resources (OHR) and referred to information that had been provided to the Commission prior to the meeting, which included a draft position description prepared based on information from other states and various surveys and a list of proposed venues to post the job opening. He requested input from the Commission regarding additional posting venues, additional information to include in the position description and asked if a search committee should be formed or if another proposal was in order.

Mr. Allen Gillespie suggested following a similar format as the prior search for the Chief Investment Officer (CIO) whereby a committee would narrow qualified candidates to five or six finalists for the Commission to interview. Messrs. Gillespie and Ewing noted that they were quite impressed with the job description.

Mr. Gillespie mentioned that in addition to salary, any software needed by CO should be included in the Commission's operating budget. Mr. Chellis noted that the CO may be in a better position to decide what type of software would be required to perform his/her duties. Mr. Ewing added that the complexity and the duties described in the job description may create difficulty locating qualified candidates.

Mr. Chellis requested input regarding the salary range. Mr. Sam Wilkins, Director of the OHR, said that salary research was still being conducted. Mr. Ewing questioned if other states were contacted to determine if the salary range was in line with other government entities. Ms. Joye Lang of the OHR asked Mr. Robert Borden, CIO, for comments regarding the CO position. He discussed several different educational and employment backgrounds that would include the requirements or desired experience needed and noted that the CO would be responsible for creating and establishing many of the processes that the Investment Division would follow. Messrs. Ewing and Gillespie noted that private sector COs were highly compensated. After further discussion about recruiting and specific salary ranges, Ms. Shealy suggested deleting the specific salary range and posting the position with the salary being negotiable depending on education and qualifications. The OHR confirmed that the position could be so posted, and the Commission concurred with the broader language to attract a larger number of qualified candidates.

The Commission discussed functions of the CO. Mr. Ewing reiterated the complexity of the position description and gave examples of tasks performed by a CO in the private sector, which he suggested for the CO for the Commission. Chairman Williams noted that he thought the nature of the compliance work would be different and not as comprehensive as someone in a private sector position. He also noted that he thought the Compliance Officer would focus primarily on monitoring compliance with state laws and Commission policies and reiterated that the law did not mandate hiring a CO to monitor compliance but that the Commission was doing so voluntarily to ensure its compliance. Mr. Chellis said that it seemed that the Commission sought someone to establish the compliance activities and guidelines and then to conduct compliance based upon said guidelines. He suggested that hiring a consultant to create the activities and guidelines may be in order. Mr. Gillespie suggested expanding the position description to include additional backgrounds such as legal expertise. Chairman Williams suggested that it occurred to him that instead of a financial expert someone with legal investigative experience could be a better choice as a compliance officer. Mr. Ewing concurred with Chairman Williams' comments and added that educational background should not be limited to only financial expertise in the position description. Mr. Chellis noted the differences between preferred and required qualifications on the position description and it was agreed that additional education experience would be added to the position description.

Chairman Williams questioned if the *Wall Street Journal* would be the appropriate place to advertise the compliance officer position. Mr. Borden suggested using *Pensions & Investments*. Ms. Shealy questioned if a posting in the *Wall Street Journal* would be noticed by potential applicants who also would see the posting in publications that were more in line with the Commission's investment focus. Mr. Gillespie suggested posting in the *Compliance Reporter*. Ms. Lang noted that the $3,300.00 quote for the *Wall Street Journal* posting was for the eastern seaboard and it would cost $6,936.00 for the entire country for one day. Both quotes included a website posting for thirty days. Mr. Gillespie suggested that the position not be posted in the print version of the *Wall Street Journal*, and Ms. Lang said that an online only posting for thirty days would cost $375.00.

After further discussion, Mr. Blaine Ewing made a motion that the Commission accept the proposals presented as amended. Mr. Allen Gillespie seconded the motion, which passed unanimously. Chairman Williams appointed Messrs. Chellis and Ewing and Ms. Shealy to serve on the CO search committee.

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

II. INVESTMENT MATTERS

Chairman Williams recognized Mr. Borden for the Chief Investment Officer's (CIO) report.

Mr. Borden referred to materials that had been provided to the Commission prior to the meeting regarding investment performance and amendments to the Annual Investment Plan (AIP) for FY2008-2009. Mr. Borden noted that the proposed amendments eliminated some of the redundancy in the current AIP. He noted further that, as listed in the updated AIP narrative, the Bank of New York Mellon custody platform change and their online compliance monitoring system would be part of a new proposed technology budget. Mr. Borden said that the compliance monitoring system would provide the CO with a valuable tool. Mr. Borden also discussed changes to ensure that the benchmarks were relevant, able to be invested, and reasonably available.

Mr. Borden outlined the major amendments to the AIP to ensure compliance with the statutory requirements. He recommended changing benchmark indices for public equities from Standard and Poor's Indices to Russell Indices, which were consistent with the indices currently used as benchmarks for equity managers currently, and using the HFRX Global Hedge Fund Index and the Venture Economics Database of venture funds. He explained the rationale for the recommendations. He noted that the proposed amendments also reduced redundancies

Mr. Ewing asked how the Commission would benchmark the strategic partnerships. Mr. Borden replied that the challenge was in determining the appropriate method to benchmark the total return of the partnerships when those included assets with different trading, pricing, duration, and benchmarks. He noted that the Commission needed to disaggregate the portfolios into component pieces, which could also then be aggregated depending on the type of report that is needed. In response to another question by Mr. Ewing about evaluating the decisions made by the strategic partnerships, Mr. Borden replied that decisions were made and evaluated through collaborative process. Chairman Williams reiterated that the partnerships did not free reign in asset allocation decisions within the partnerships. They were not making asset allocation decisions, but they were making the individual investments that implemented the Commission's asset allocation decisions for the portfolio. He explained that Mr. Borden would insure that the implementation was consistent with the Commission's decisions regarding investment guidelines and asset allocations. Mr. Borden added that the investment committees for the strategic partnerships would not have free reign and the Commission, through its committee representative, would ensure that the investments were made in compliance with the Commission's investment decisions.

After further discussion, Chairman Williams noted that he had received the draft amendments the morning of the meeting and had not had an opportunity to review the document, and several other Commissioners concurred. He also noted that several issues in the AIP appeared to be attorney-client privilege and concerned legal matters that should not be included as public information and said that while not fatal, they should avoid including legal matters in draft documents in the future. After further discussion, Chairman Williams suggested accepting the AIP as information until it could more thoroughly reviewed by the Commissioners and Ms. Shealy. Mr. Gillespie noted that he had made some comments on his copy which would be submitted to Ms. Shealy for review. Mr. Gillespie also asked if documents such as the AIP conflicted with existing contracts. Ms. Shealy replied that proposed managers were provided with guidelines prior to the execution of any contract, pertinent provisions or exceptions were noted in the contracts with individual managers, and they were notified of any material changes that would affect the contract.

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

Chairman Williams asked Mr. Borden to present the Quarterly Investment Portfolio. Mr. Borden noted that the prior year's diversification strategy had had a profound positive impact on the South Carolina Retirement Systems' (Retirement System) peer ranking despite market downturns and absolute performance. He discussed fund performance for the month of April, noting that the portfolio was up 2.4 percent, which brought the fund back into positive figures for the fiscal year to date.

Mr. Borden discussed the portfolio performance for the fiscal year to date (FYTD). He noted that the large cap portfolio continued to suffer and that nationally, similar fund performance was down. He also discussed the small cap portfolio, noting that the five-year performance for the growth portfolio was down 10.9 percent and that the value portfolio had performed well within the same five-year period. Mr. Borden discussed the domestic fixed income portfolio and said that despite historically good performance, the credit dislocation had hampered performance. He also stated that with collaboration of the fixed income managers, he planned to recommend restructuring the current portfolio. Mr. Borden said that the manager's ability to reposition the portfolio during the credit dislocation was also impaired as a result of using the portfolio as a primary source of liquidity. Mr. Borden mentioned that global fixed income was up 2.7 percent due to the weak dollar value.

Mr. Borden reviewed the absolute return of the portfolios, managers, and the total portfolio. He noted that the Absolute Return (AR) and Global Tactical Asset Allocation (GTAA) portfolios had exceeded expectations overall and had added back a significant amount of value and the total portfolio was up one percent for the FYTD.

Mr. Rhett Humphreys of New England Pension Consultants (NEPC) noted that the allocation and reallocation of approximately $10 billion to new mangers over the past eighteen months had not been reflected yet in terms of performance, particularly in the private equity strategies. He noted that the AR portfolios were up 6.4 percent versus the remainder of the portfolio, which had a return of 1.0 percent. He said that the Global Bond portfolio was up 2.7 percent and the GTAA strategy was up 4.2 percent. He also noted that Putnam Fiduciary Trust Company had gone through several changes which may impact the GTAA strategy and that NEPC would monitor the company closely and advise the Commission of any areas of concern.

Mr. Borden reiterated that the changes that the Commission had made and the selection of managers had had a profound positive effect on the overall portfolio and noted that many other state retirement systems had suffered far worse performance. Mr. Ewing questioned if the total plan allocation index was weighted by the assets in each category and compared to the appropriate benchmark. Mr. Borden responded positively and noted that because the total allocation index exceeded the policy index, the balancing tactics employed by Commission staff had added value.

Mr. Chellis questioned when underperforming managers would be terminated and if moving allocations created increased loss. Mr. Powers stated that he had expressed that concern previously and the Commission had discussed tolerance levels, although terminations had been on an ad hoc basis thus far. Mr. Borden said that the impact of moving allocations had very little impact and noted that half of the prior managers were terminated last year. After further discussion, Mr. Powers asked Mr. Borden to have Ms. Hillary Wiek review current data and provide a report to the Commission regarding the long-only equity managers. Mr. Borden replied that Ms. Wiek was currently working on such a report for the next meeting. Mr. Gillespie noted that in addition to diversifying by asset class, active or passive should also be taken into consideration and a balance between them achieved.

Mr. Ewing noted during a recent conference he attended, a speaker presented an explanation of how Yale University developed its strategy, and he suggested inviting the presenter at the Commission's retreat in the Fall. He also noted that examining the process of how decisions are made would be of great benefit to the Commission. Mr. Powers replied that more retreat details would be discussed at the next meeting. Ms. Shealy stated that the available dates for the Wampee Training and Conference Center had been circulated to the Commissioners and requested that they select a definite date for the retreat. The Commission responded that December 4th and 5th would be suitable, so the retreat was set for those dates.

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

Mr. Borden presented and discussed the Overlay Performance report from Russell Implementation Services, Inc. Upon question by Mr. Gillespie, Mr. Borden discussed terms of collateral for swaps.

Mr. Borden discussed reports provided by the Morgan Stanley Alternative Investment Partners (Morgan Stanley) and Gottex regarding the Retirement System's portfolio risk analysis.

Chairman Williams mentioned the timeline for distribution of quarterly reports and there was a brief discussion of the first quarterly report and its distribution.

Chairman Williams noted that the Morgan Stanley and Gottex reports contained confidential and proprietary information were inadvertently included in the general meeting materials in error. He stated that risk reports should be reserved for executive session in the future as public disclosure of the information could jeopardize achieving the Commission's investment objectives or implementation of the AIP, and the Commission concurred.

Chairman Williams requested that Mr. Borden report on international equities. Mr. Borden asked Ms. Wiek to present the international equity report. Ms. Wiek stated that the current target allocation was 15 percent to developed market international equities (EAFE) and 5 percent to emerging market international equities (EME). She noted that the most efficient markets would be large cap outside of the United States. Prior to further equity discussion, Ms. Wiek discussed volatility issues and stated that emerging markets were up despite poor performance in the early part of the decade. She discussed the overall strategy for implementing the target allocations and various aspects of and considerations for EAFE and EME markets. Mr. Humphreys noted that international development large cap was selected because eighteen months ago, small cap was not performing to expectations. Mr. Borden added that most emerging market equity investments would include a large percentage of infrastructure improvements. Mr. Humphreys noted further that implementation and separating active verses traditional portable alpha and strategy moving away from synthetics would be issues for the Commission to consider in the future. After further discussion, Mr. Borden requested that Commission members with a background in international equities be selected to work with staff on this endeavor and conduct due diligence to select approximately 10-12 managers in the future. Chairman Williams volunteered to work with staff in the international equities search and due diligence in the manager selection process.

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

Mr. Borden referred to materials that had been provided to the Commission relating to the recommendation of the search team, which was comprised of Messrs. Gillespie, Borden and Rick Patsy, to invest $100 million in the ING Clarion Debt Opportunity Fund III (ING). Mr. Borden stated that the fund purchased commercial real estate mortgage debt and provided background information about the manager, performance, and terms of the fund. He noted that the current market provides an excellent opportunity for return in this strategy and highlighted the diversification the fund would provide for the portfolio. Mr. Chellis questioned the use of collateralized debt obligations (CDO) given the State of Florida's recent problems. Mr. Gillespie noted that buying CDOs created an opportunity, but they must be carefully managed. He also noted that the management staff of ING had acquired a great deal of knowledge and experience from involvement in CDOs, and Mr. Patsy stated that this firm was the best qualified for this type of investment. Mr. Borden added that Florida had used funds to create a money market vehicle, but ING used CDOs for opportunistic credit. Messrs. Ewing and Gillespie noted that more due diligence and credit work and the fact that funds are not going into money market funds emphasized the difference between ING's investments in CDOs and the CDOs that negatively impacted Florida. Mr. Humphreys noted that other organizations incorrectly used CDOs as an investment tool in a money market fund, overvalued them, and did not perform the extensive due diligence necessary for success. Mr. Sean Gill from NEPC commented on their opinions of ING and concurred with the search team's recommendation. Mr. Chellis questioned if there were actual assets which the Commission would possess, not just a piece of paper stating the asset. Messrs. Borden, Humphreys, Gill responded positively.

After further discussion, Mr. Gillespie made a motion to invest an amount not to exceed $100 million in the ING Clarion Debt Opportunity Fund III, to authorize the Chairman or his designee to negotiate fees not to exceed those presented by the search team, and to authorize the Chairman to negotiate and execute any necessary documents to invest in the fund. Mr. Powers seconded the motion, which passed unanimously.

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

Mr. Borden advised that an issue had arisen the day before the meeting relating to the TCW /Palmetto State Partners, LLC (TCW/Palmetto State Fund). He explained that an investment opportunity had arisen in the TCW Energy Partners, L.P., but that the TCW/Palmetto State Fund with the Retirement System had not closed. He said that the TCW Energy Partners, L.P., was closing the following day and that if the Retirement System invested in the fund, it could receive a favorable valuation given the current markets. Mr. Borden recommended that the Commission invest $40 million in the TCW Energy Partners Fund, which would be rolled into the TCW/Palmetto State Fund when that fund closed with the Retirement System.

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

Ms. Shealy advised that while the Commission had approved negotiations with TCW and Mariner Partners for strategic partnerships in the April meeting and concurred with the negotiated terms of partnerships presented in the May meeting, there had been no formal motion approving the execution of contracts. Mr. Powers made a motion to reaffirm investment of an amount not to exceed $750 million in the TCW/Palmetto State Partners, LLC (which includes the existing $240 million commitment in TCW funds), and investment of an amount not to exceed $750 million in a strategic partnership with Mariner Partners (which includes the existing $350 million invested in Mariner Partners, L.P.) as previously presented to the Commission, to authorize the Chairman to negotiate and execute any necessary documents to invest in the strategic partnerships. Mr. Ewing seconded the motion, which passed unanimously.

Chairman Williams advised that when the Commission receded to executive session, they would discuss two investment opportunities involving the TCW Energy Partners, L.P. and a proposal involving Goldman Sachs. He stated that to discuss those matters in public session could compromise the integrity of the investments. Mr. Borden also requested that the Commission discuss a matter relating to Selene Residential Mortgage Opportunity Fund, L.P., and Chairman Williams said that the matter would be included for discussion.

III. ADMINISTRATIVE MATTERS

Chairman Williams recognized Ms. Shealy for the Administrative Director/General Counsel's report. Ms. Shealy advised that Ms. Dori Ditty had been hired as a law clerk for the Commission and discussed various projects that would be assigned to her, including legal research relating to the agency's records retention schedule. Mr. Chellis inquired if old materials could be scanned into computer files. Ms. Shealy noted that before anything could be scanned or imaged, it was important to determine the types of records that would be generated by the Commission and how long each should be retained as electronic files would also be subject to retention schedules. After further discussion, Ms. Shealy reiterated that the South Carolina Department of Archives and History (SCDAH) would have to approve the retention schedules regardless of the method of archival and that the Commission would have to identify records to determine the appropriate retention schedules to present to the SCDAH.

Ms. Shealy advised that only one firm responded to the request for proposal for a fiduciary liability insurance policy and details were being vetted by the Board. She noted that the policy was similar to the current policy and would cover $15 million primary and $10 million excess for a yearly premium of $422,200. She also said that this policy would specifically cover the Commission's operation. Ms. Peggy Boykin remarked that this new policy would be an improvement over the polices offered in the past, which had been generally drafted for ERISA plans.

Ms. Shealy also mentioned the ongoing audit by the State Auditor's Office and noted that the auditors had not contacted her since the last Commission meeting.

Ms. Shealy also reported that the investment with Angelo Gordon had closed and that the investment management agreement relating to the Morgan Stanley SCRSIC Strategic Partnership Fund, L.P. had been completed. She also provided an update on the status of pending investment matters.

IV. OTHER BUSINESS

Mr. Borden introduced Mr. Hershel Harper as the new Director of Alternative Investments for the Commission. Ms. Wiek introduced her new intern, Mr. Jonathan Boyd, the first recipient of the Dr. Travis Pritchett Scholarship. Mr. Douglas Lybrand introduced his new intern, Mr. Jared O'Connor.

V. EXECUTIVE SESSION

Treasurer Chellis made a motion to recede into executive session, which was seconded by Mr. Gillespie and passed unanimously. Chairman Williams announced that the Commission would meet in executive session for the purpose of discussing investment matters pursuant to S.C. Code Ann. §§9-16-80 and 9-16-320.

The Commission reconvened in open session. Chairman Williams reported that the Commission discussed several investment items in executive session.

Mr. Powers made a motion to invest an amount not to exceed $40 million in the TCW Energy Partners, L.P. as discussed, and to authorize the Chairman to negotiate and execute any necessary documents to invest in the fund. Mr. Ewing seconded the motion, which passed unanimously.

While the previous actions of the Commission allowed flexibility in the amounts allocated to the investment in the Selene Residential Mortgage Opportunity Funds, L.P. (Selene), in the interest of transparency and disclosure Mr. Powers made a motion to reduce the investment allocation to Selene previously approved by the Commission from an amount not to exceed $200 million to an amount not to exceed $100 million, to reaffirm authorization for the Chairman to negotiate and execute any necessary documents to invest in the fund. Mr. Ewing seconded the motion, which passed unanimously.

Mr. Powers made a motion to enter into a strategic partnership with Goldman Sachs and invest an amount not to exceed $1.5 billion in the fund, to authorize the Chairman or his designee to negotiate fees, and to authorize the Chairman to negotiate and execute any necessary documents, subject to satisfactory negotiations and approval for legal sufficiency by General Counsel, to invest in the fund. Mr. Ewing seconded the motion, which passed unanimously.

VI. ADJOURNMENT

There being no further business, Chairman Williams adjourned the meeting at 12:50 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 main entrance of the Commission's Office and at the entrance, in the lobbies, and near the 2nd Floor Conference Room at 202 Arbor Lake Drive, Columbia, SC, on June 17, 2008.]