**South Carolina Retirement System Investment Commission**
**Meeting Minutes**

**January 20, 2011**

**15th Floor Conference Room**
**1201 Main Street**
**Columbia, South Carolina 29201**

**Commissioners Present:**
Mr. Allen Gillespie, Chairman
Mr. Blaine Ewing, III, Vice Chairman
State Treasurer Curtis M. Loftis, Jr.
Mr. James Powers
Dr. Travis Pritchett
Mr. Reynolds Williams, Chairman *Emeritus*

**Others present for all or a portion of the meeting:** Mike Addy, Dunkin Allison, Geoff Berg, Bob Borden, Jonathan Boyd, Harris Chewning, Dori Ditty, Brenda Gadson, Hershel Harper, David King, Doug Lybrand, Heather Muller, David Nelligan, Jared O'Connor, Kathy Rast, Nancy Shealy, Nicole Waites, Brian Wheeler, and James Wingo from the South Carolina Retirement System Investment Commission; Bill Leidinger, Mike McDermont, Frank Rainwater, and Shakun Tahiliani from the State Treasurer's Office; Rhett Humphreys from New England Pension Consultants; Peggy Boykin, Donald Brock, Tammy Nichols, Robyn Leadbitter, Greg Meetze, John Page, Danielle Quattlebaum, Joni Redwine, and Faith Wright from the South Carolina Retirement Systems; Wayne Pruitt from the State Retirees Association of South Carolina; Jim Holly from the Comptroller General's Office; Eric Ward from TheNerve.org; Shaka Rasheed from Citadel Asset Management; Noelle Enoch from the SCEA; Eric Kleppe from Turner Investment Partners; Craig Lenser from RBC Insurance; Aaron Montano from AllianceBernstein Institutional Investors; Bruce Jackson from Arnall Golden Gregory, LLP; Adam Jordan; and David Phillips.

## I. CALL TO ORDER AND CONSENT AGENDA

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

Chairman Gillespie asked if there were any amendments to the meeting's proposed agenda. There being none, the proposed agenda was adopted as presented.

Chairman Gillespie welcomed State Treasurer Curtis Loftis to the Commission. Mr. Loftis thanked the Commission and introduced his staff members who were in attendance.

Chairman Gillespie referred to draft minutes from previous meetings. He stated that the minutes for the meetings in September and November 2010 were still in rough draft form, noting that those meetings were particularly lengthy and complex so additional time was needed to vet the drafts. He said that he had reviewed the minutes from the meeting on July 15, 2010, and after vetting with staff, he confirmed that the minutes were consistent with the actions taken by the Commission and suggested that the Commission adopt those minutes. Blaine Ewing made a motion, which was seconded by Travis Pritchett, to approve the minutes from the meeting on

July 17, 2010, and to carry over the minutes from the meetings on September 23 and November 17-18, 2010. Commissioners Ewing, Gillespie, James Powers, and Reynolds Williams voted in favor of the motion, which passed, and Mr. Loftis did not vote on the motion as he was not a member of the Commission during those periods.

## II. INVESTMENT MATTERS

Chairman Gillespie recognized Bob Borden, Chief Executive Officer/Chief Investment Officer (CEO/CIO), for a review of portfolio performance and asset allocation. Mr. Borden stated that the Commission ended Fiscal Year 2010 with a 14.6 percent return versus the 8 percent actuarial assumed rate of return. He reported that the total portfolio (Portfolio) was ranked in the top quartile amongst its peers. Mr. Borden explained that performance for the current fiscal year had benefitted from strong performance in the equity markets. He indicated that Portfolio performance for the first six months of the current fiscal year was estimated at 12 percent.

Mr. Borden introduced Geoff Berg, Director of Investment and Asset Allocation, to review materials that had been provided to the Commission prior to the meeting. Mr. Berg said that current performance was ahead of the target allocation by approximately 74 basis points (bps). He reported that allocation decisions relating to equities had increased portfolio performance and that the Hedge Fund Program had been a tremendous source of alpha.

Mr. Berg introduced Rhett Humphreys from New England Pension Consultants, LLC (NEPC) to begin discussions regarding the Investment Performance Report for periods ending November 30, 2010. Mr. Humphreys explained that given the performance of the general equity markets, NEPC did not believe that its institutional public pension funds would be able to achieve their actuarial targets through beta alone. He reported that the equity Standard & Poor's (S&P) forecast for the next seven years was currently below 8 percent. Mr. Humphreys suggested allocating some investments to non-dollar emerging market local currency. He also stated that if the actuarial rate of return could not be met through traditional stocks and bonds, active management, or diversification, then reducing fees and active management of the hedge fund portfolio would be an appropriate course of action.

Mr. Humphreys stated that the blended net and gross return for November was 8.8 percent. He explained the benefits of moving away from traditional active large cap equity management. He also said that active management in the long-only large cap allocation had resulted in performance being up 8.2 percent versus the benchmark of 7 percent. With regards to total small-to-mid (SMid) cap managers, Mr. Humphreys indicated that year-to-date performance was 18.9 percent versus the benchmark of 17.7 percent. He reported that total physical fixed income performance was 9.5 percent, which was ahead of the benchmark by 1.5 percent, and that core fixed income performance was 8.7 percent versus the benchmark performance of 7.7 percent. He also reported that high yield bond performance was 14 percent and emerging market debt performance was 11.7 percent.

Mr. Humphreys said that with regard to hedge funds, 18 of the 20 percent target allocation had been invested. He reported that hedge funds returns were 6.76 percent net of fees, while the GAA/Risk Parity portfolio return was over 10 percent.

Chairman Gillespie asked if an additional search had been conducted for another GTAA manager, and Mr. Borden replied that no progress had been made but that he was looking for additional managers to increase depth of the asset class. He also indicated that Mr. Ewing had volunteered to assist with the search and due diligence processes.

Mr. Ewing asked Mr. Borden for comments about the investment strategy given current interest rates. Mr. Borden provided a summary of his assessment and noted that he was focusing on specific high-alpha opportunities given that many companies had absolute capacity for growth in this market environment. Mr. Borden provided the Commission with several examples of investments within the strategic partnerships and said that additional opportunities were available, but a flexible pool of capital, additional staff, and resources would be required to underwrite the investments. He noted that the Commission was inundated with opportunities and deal flows, but it did not have the resources to pursue every opportunity. Mr. Borden said that finding idiosyncratic alpha and reducing costs would increase return. Mr. Humphreys suggested creating an actively managed, long-only credit portfolio with an investment grade of AAA or BBB to protect against interest rate increases. The Commission discussed performance further and received the reports as information.

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

Mr. Borden asked Mr. Berg to provide a summary of issues and staff recommendations relating to allocations to emerging market equity (EME) managers. Mr. Berg referred to materials that had been provided to the Commission prior to the meeting. He stated that the Portfolio had a neutral weight to the target allocation for the equity asset class, but that within the equity asset allocation there was a small underweight to EME exposure. Mr. Berg said that when approved, the maximum allocations to the prospective EME managers were set at specific dollar amounts. He suggested that the Commission approve the maximum allocations as percentages of total plan assets rather than as dollar amounts, which would prevent future problems due to either the growth of the assets or to an unanticipated need to reallocate assets. After further discussion, Mr. Williams made a motion, which was seconded by Mr. Ewing and passed unanimously, to adopt the recommended allocation ranges expressed as maximum percentages of the Portfolio for each of the EME managers as set forth in the memo dated January 20, 2011.

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

Mr. Ewing asked for additional information regarding the core fixed income portfolios managed by PIMCO and BlackRock. In response, Mr. Borden stated that both managers had a lot of flexibility and noted that maintaining a conservative posture in the equity markets within the past year had been beneficial. Mr. Borden noted further that significant alpha generation had offset most negative aspects of following the conservative posture.

Mr. Ewing asked for additional information about the D.E. Shaw Composite Fund, LLC. Hershel Harper, Deputy Chief Investment Officer, provided additional information and noted that although there had been some issues in the past, the Commission had recently moved assets to a more liquid class of shares within the fund.

Mr. Borden referred to information presented to the Commission regarding GSO Capital Partners LP (GSO). He reported that three other relationships with GSO within the strategic partnerships had been profitable in the past, and he recommended entering into a strategic partnership with GSO to invest in other liquid and illiquid strategies. He introduced Dunkin Allison, Strategic Partnership Investment Officer, to provide additional information regarding the recommendations. Mr. Allison explained the relationship between GSO and the Morgan Stanley

SCRSIC Strategic Partnership Fund LP (MS Strategic Partnership). He said that if approved, $190 million of the allocation to the GSO strategic partnership would be funded from an in-kind transfer of investments in GSO from the MS Strategic Partnership, and $800 million of the GSO strategic partnership would be funded with new capital. Mr. Allison provided additional information about GSO and noted that they focused primarily on corporate credit. He also said that the Commission staff had negotiated significant fee concessions and had secured preferential co-investment rights if the Commission approved the investment.

Dr. Pritchett expressed concerns about risk and asked how this potential investment would impact the Portfolio's asset allocation. Mr. Allison replied that the investment would be a combination of private equity in the mezzanine and opportunistic credit strategies, so benchmarking would be difficult given the nature of the investments. Mr. Allison opined that the default risk that was present in similar investments several years ago could be mitigated with high equity participation, meaningful covenant protection, and low-leveraged multiples. Chairman Gillespie opined that after meeting with several groups, the industry seemed to be more stable and cautious than it was in the past and that the covenants were currently more meaningful. Chairman Gillespie indicated that credit strategies such as these were similar to equity strategies, except that the credit strategies had more recourse and security, and he opined that the current team at GSO was credible. Mr. Allison provided a brief history of GSO and indicated that they had a superior track record. After further discussion, Mr. Williams made a motion, which was seconded by Dr. Pritchett, to authorize an investment commitment not to exceed $990 million in a strategic partnership with GSO Capital Partners, of which approximately $190 million would be funded from an in-kind transfer from the Morgan Stanley SCRSIC Strategic Partnership LP; to authorize the transfer of assets to fund the GSO strategic partnership; and to authorize the Chairman or his designee to negotiate and execute any necessary documents upon approval for legal sufficiency by General Counsel to implement the investments. Mr. Ewing stated that while he would receive no benefit from any of the investments, he worked for an affiliate of Morgan Stanley so out of an abundance of caution, he abstained from voting. There being no further discussion, the motion passed unanimously with Mr. Ewing abstaining from the vote.

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

Mr. Ewing asked Mr. Borden to provide him with prior notice of any actions to be taken in Commission meetings relating to Morgan Stanley in the future, and Mr. Borden agreed.

Mr. Borden provided background information about the hedge fund program transition. He said that within the past year, a plan to transition hedge fund of funds to managed accounts had been approved by the Commission. Mr. Borden noted that operating the entire hedge fund program internally would have required significant resources, including approximately 35 to 50 additional employees and a $35 million budget. He explained that through a strategic partnership with Lighthouse Investment Partners LLC (Lighthouse), the Commission should be able meet its goals, including diversification, risk aggregation, and transparency. Mr. Borden asked Mr. Harper to provide additional information.

Mr. Harper provided an overview of the hedge fund investment plan and recommendations for hedge fund strategic partnerships. He explained that approximately $5 billion was allocated to the hedge fund program, which was invested primarily in fund of funds structures currently. Mr. Harper, reiterating Mr. Borden's comments, indicated that meeting the necessary fiduciary standards using an internally managed structure exclusively would be very costly. He stated that the massive undertaking itself and the length of time required to internally manage the program necessitated the need for a skilled and experienced key partner and platform provider, which could be accomplished through a strategic partnership with Lighthouse. Mr. Harper explained the benefits of using the Lighthouse Hedge Fund Platform, including systems and tools built for hedge fund of funds structures; managed account framework; improved transparency, control, and risk management; lower overall cost; and Retirement System ownership participation. He also reported that the Lighthouse Hedge Fund Platform was already established, had a proven track record, and could deliver most services the Commission needed immediately to manage the hedge fund asset allocations. Mr. Borden added that moving out of the fund of funds structure would reduce hedge fund management fees and associated costs greatly. He noted, however, that while administrative and pricing costs could be minimized, they could not be eliminated entirely. Mr. Ewing asked who would select the hedge fund managers, and Mr. Borden replied that if the recommendations for the hedge fund program were approved, the Commission would select investments outside of the strategic partnerships on a case by case basis with input from NEPC and Commission staff. Investments within the Lighthouse, Grosvenor, Entrust, and Blackstone strategic partnerships would be approved by the investment committees in accordance with the investment guidelines previously approved by the Commission. Mr. Harper provided the Commission with copies of sample risk reports that Lighthouse could generate for any account. Mr. Borden referred to a recent investment in the Apollo Palmetto Strategic Partnership relating to Lighthouse and noted that the Retirement System may have an opportunity for an ownership interest in the Lighthouse Hedge Fund Platform. He indicated that if the Retirement System acquired an ownership interest in the platform, there may be additional opportunities for fee reductions and greater ability to maximize other aspects of the business relationship.

Mr. Harper reiterated that the recommendation was to invest in a strategic partnership with Lighthouse to provide the platform for the infrastructure for the Retirement System's hedge fund program and to provide investment advisory services relating to investments made directly by the partnership. After further discussion, Mr. Ewing made a motion, which was seconded by Mr. Williams and passed unanimously, to approve the recommendations presented and to invest in a strategic partnership with Lighthouse Investment Partners LLC to provide a platform services and advisory services for the Retirement System's absolute return asset allocations not to exceed $3 billion on the platform, and to authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the investment upon approval for legal sufficiency by General Counsel.

Chairman Gillespie recognized Nancy Shealy, General Counsel to the Commission. She said that since Mr. Loftis was new to the Commission, she wanted him to know that in order to streamline the meeting process, the Commission had approved standing language to be added to all motions relating to contractual engagements. The language authorized the Chairman or his designee to negotiate and execute documents on behalf of the Commission upon approval for legal sufficiency by General Counsel.

Mr. Harper referred to materials relating to Blackstone Alternative Asset Management (Blackstone) and provided an overview of the recommended investment. He explained that Blackstone was identified as a prospective strategic partner following initial due diligence and a comparative analysis of at least six other hedge fund managers. Mr. Harper reported that Blackstone had been investing hedge fund of funds for over 20 years and that Blackstone had similar investment philosophies to the Commission. Mr. Harper stated that he was impressed with their seeding abilities and performance relative to their peers. He reviewed the recommendations outlined in the materials presented to the Commission, noting that the MS

Strategic Partnership had invested approximately $200 million with Blackstone, which would be transferred and included in the total allocation to the Blackstone strategic partnership if approved by the Commission. After further discussion, Mr. Powers made a motion, which was seconded by Mr. Williams, to approve the recommendations presented and to invest an amount not to exceed $750 million, of which approximately $200 million would be funded from assets transferred from the Morgan Stanley SCRSIC Strategic Partnership LP, in a strategic partnership with Blackstone Alternative Asset Management to invest in hedge funds and to provide investment advisory services for the core hedge fund program; to authorize the transfer of assets to fund the Blackstone strategic partnership; and to authorize the Chairman or his designee to negotiate and execute any necessary documents upon approval for legal sufficiency by General Counsel to implement the investment. Mr. Ewing stated that while he would receive no benefit from any of the investments, he worked for an affiliate of Morgan Stanley so out of an abundance of caution, he abstained from voting. There being no further discussion, the motion passed unanimously with Mr. Ewing abstaining from the vote.

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

## III. OTHER MATTERS

Mr. Borden referred to materials relating to Deloitte & Touche LLP (Deloitte) that had been provided to the Commission. He stated that Deloitte was selected to provide the Commission assistance with governance structure, audit planning, and a risk assessment. Mr. Borden reported that Deloitte offered to serve as an out-sourced internal audit team until the Commission established its internal audit team. He estimated that the process would take approximately 12-24 months. Mr. Borden also discussed issues relating to the Commission and its budget and personnel constraints. He added that the proposed budget request included at least 3 employees to be dedicated to audit, compliance, and risk management functions. Mr. Borden stated that hiring Deloitte would provide immediate, definitive guidance and expertise to develop the Commission's internal audit functions. After further discussion, Mr. Ewing made a motion, which was seconded by Dr. Pritchett and passed unanimously, to engage Deloitte to provide services as outlined in the materials and to authorize the Chairman or his designee to negotiate and execute any necessary documents upon approval for legal sufficiency by General Counsel to engage the firm.

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

Mr. Borden referred to draft documents that had been provided to the Commission, including the Statement of Investment Objectives and Policies (SIOP) and the Annual Investment Plan for Fiscal Year 2011-2012. Mr. Harper explained that the Statement of Investment Objectives (SIO) and the Statement of Investment Policies (SIP) had been combined into one document. He indicated that changes would be made before finalized documents were presented to the Commission for approval. The Commission received the drafts as information.

Mr. Borden recognized Mr. Berg to discuss matters relating to Integrity Asset Management, LLC (Integrity), one of the Portfolio's small cap value managers. He reported that the value added to the allocation managed by Integrity had been significant. Mr. Berg stated that Integrity had been sold to Munder Capital Holdings, LLC (Munder). He said the new structure would provide Integrity with a more robust internal legal and compliance team in lieu of outsourcing these functions. He also indicated that Integrity's investment team would remain intact under the

Munder merger. Ms. Shealy added that per federal law and the terms of the investment management agreement (IMA) between the Commission and Integrity, Integrity could not assign the IMA to Munder without Commission approval. She said that given the deadlines for the Integrity/Munder merger, the Commission Chairman had consented to the assignment of the IMA with the understanding that the IMA would be terminated if the full Commission did not ratify the consent. After further discussion, Mr. Powers made a motion, which was seconded by Mr. Williams and passed unanimously, to ratify the consent to assignment of the investment management agreement with Integrity Asset Management, LLC, to Munder Capital Holdings, LLC, under the same terms and conditions as the current agreement with Integrity.

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

Mr. Border explained that prospective managers and funds routinely requested that the Commission sign non-disclosure or confidentiality agreements (NDAs) so the Commission could obtain confidential, proprietary, or trade secret information regarding investments. He explained that the agreements vary in complexity and negotiations, but that they were critical in obtaining necessary information for due diligence and investment purposes. Mr. Borden recommended that the Commission authorize Commission staff to execute NDAs when both the CEO/CIO and General Counsel concurred. Ms. Shealy added that the information contained in NDAs would more than likely be exempt from disclosure under the Freedom of Information Act (FOIA), but managers still insisted on having an executed NDA. After further discussion, Mr. Ewing made a motion, which was seconded by Mr. Williams and passed unanimously, to authorize the CEO/CIO or his designee to execute nondisclosure and confidentiality agreements relating to due diligence and investment materials upon approval for legal sufficiency by General Counsel.

Mr. Borden advised that there had been no further action with regard to the Commission's budget request for authorization for additional funds during the current fiscal year.

Chairman Gillespie advised that there were several other business items to address, so he asked for unanimous consent to address those items before the execute session, and there being no objections, he asked Mr. Borden to review the items.

Mr. Borden stated that the Commission previously approved an investment with Credit Research and Trading (CRT), a primary broker-dealer. He indicated that a seat on the CRT board of directors was part of the investment and that several at-large seats were available. Mr. Borden noted that having a seat on the board of directors would improve the Commission's oversight of the Retirement System's investment, and he suggested that Mr. Powers be designated as the Commission's representative for nominee as an at-large board member given his background and expertise. He added that the at-large board position was uncompensated. Ms. Shealy confirmed with Mr. Borden that this matter was not listed on the proposed agenda because information was obtained after the agenda had been distributed. After discussion, Mr. Ewing made a motion, which was seconded by Dr. Pritchett and passed unanimously, to designate Mr. Powers as the Commission's representative as a nominee for an at-large seat on the board of directors of CRT.

Mr. Borden advised that due to scheduling conflicts, he recommended changing the Commission's meeting dates over the next several months. After further discussion, Mr. Powers made a motion, which was seconded by Mr. Williams and passed unanimously, to cancel the meetings scheduled for March 17 and May 19, 2011, to schedule a Commission meeting for April 21, 2011, to schedule the Commission's Retreat at the Wampee Training and

Conference Center for June 16-17, 2011, and for the Commissioners to coordinate with Mr. Borden to schedule a meeting during February 2011 if a meeting was necessary.

Mr. Harper introduced David Phillips, who had been hired as a Senior Investment Officer for the Commission. He said that Mr. Phillips' first day of employment with the Commission would be January 24, 2011, and that he would work with hedge funds primarily. Mr. Harper provided some background information about Mr. Phillips' credentials, noting that he had over 15 years of experience in investment management, including underwriting and portfolio management experience.

Mr. Powers requested that at the next meeting, Mr. Borden provide the Commission with a summary list of the current strategic partnerships, including information about assets that had been allocated and invested and the current representatives on the investment committees of each. Mr. Borden said that staff would compile the information for the Commission.

## IV. EXECUTIVE SESSION

Mr. Ewing made a motion for the Commission to recede to executive session to discuss a personnel matter involving the CEO/CIO's performance evaluation. Mr. Williams seconded the motion, which passed unanimously. Chairman Gillespie announced that the Commission would meet in executive session to discuss a personnel matter involving the CEO/CIO's performance evaluation and asked that only Commission members remain in the meeting.

The Commission reconvened in open session and Chairman Gillespie reported that the Commission took no action in executive session.

## V. ADJOURNMENT

There being no further business, the meeting adjourned at 1:02 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 15th Floor Conference Room at 1201 Main Street, Columbia, SC, on January 18, 2011.]