South Carolina Retirement System Investment Commission
Meeting Minutes

September 15, 2011

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

Commissioners Present:
Mr. Allen Gillespie, Chairman
Mr. Reynolds Williams, Vice Chairman
State Treasurer Curtis M. Loftis, Jr.
Mr. Edward Giobbe
Mr. James Powers
Dr. Travis Pritchett

Others present for all or a portion of the meeting on Thursday, September 15, 2011:

Mike Addy, Dunkin Allison, Geoff Berg, Bob Borden, Jonathan Boyd, Harris Chewning, Sarah Corbett, Dori Ditty, Robert Feinstein, Brenda Gadson, Rebecca Gunnlaugsson, Hershel Harper, Adam Jordan, David King, David Klauka, Doug Lybrand, James Manning, Lorelei McKay, Jared O'Connor, David Phillips, Nancy Shealy, Nicole Waites, Brian Wheeler, and James Wingo from the South Carolina Retirement System Investment Commission; Clarissa Adams, Brian DeRoy, Bill Leidinger, Mike McDermott, Justin Evans and Shakun Tahiliani from the State Treasurer's Office; Danny Varat from the South Carolina Senate; Ashli Aslin and Keith Stronkowsky from New England Pension Consultants; The Honorable Richard Eckstrom, State Comptroller General; Donald Brock, John Page, and Faith Wright from the South Carolina Retirement Systems; Robert Cook, John W. McIntosh, and Mark Plowden from the South Carolina Attorney General's Office; Wayne Pruitt and Sam Griswold from the State Retirees Association of South Carolina; Taylor Hall from the Governor's Office; Noelle Enoch from The South Carolina Education Association; Gina Smith from The State Newspaper; Jim Davenport, Associated Press; and Eric Ward from The Nerve.

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

Chairman Allen Gillespie called the meeting of the South Carolina Retirement System Investment Commission ("Commission") to order at 10:02 a.m. and welcomed the Commission and guests. Chairman Gillespie, State Treasurer Curtis Loftis, Mr. James Powers and Mr. Edward Giobbe were in attendance when the meeting convened. Chairman Gillespie reported that both Dr. Travis Pritchett and Vice Chairman Reynolds Williams would be arriving later in the meeting.

Mr. Powers made a motion, which was seconded by Mr. Giobbe and passed unanimously, to approve the agenda as presented.

Chairman Gillespie called for objections or amendments to the draft minutes from the Commission meeting held on June 16-17, 2011. Upon motion of Mr. Loftis and second by Mr. Powers, the minutes from the June 16-17, 2011 meeting were adopted as presented.

Chairman Gillespie called for objections or amendments to the minutes from the Commission meeting held on July 21, 2011. Mr. Powers made a motion, which was seconded by Mr. Loftis, to adopt the minutes of the July 21, 2011 meeting. Discussion of the July minutes ensued. Mr. Loftis made reference to the following motion which was approved by the Commission in the concluding open session of its July 21, 2011 meeting (hereafter, the "July motion"):

> *Mr. Powers made a motion, which was seconded by Dr. Pritchett and passed unanimously, to increase Mr. Borden's base salary effective June 30, 2011 to an amount to be determined by the Chairman after further discussions with Mr. Borden, and to adopt the PIC policy changes, including an increase in the maximum PIC payout for both the CEO/CIO and all other staff covered by the Commission's PIC policy from 50 percent to 100 percent of base salary effective for the fiscal year ending June 30, 2012.*

Mr. Loftis raised objections to the July motion. He stated that, in his opinion, the July motion did not accurately reflect the discussion which had taken place in executive session, and that, as presented, the July motion raised constitutional and statutory problems. Mr. Loftis also stated that, in his opinion, the July motion was not in keeping with the Commission's policies and fiduciary responsibility.

Mr. Loftis made a motion to amend the July motion, to reflect that (i) the Commission had granted Mr. Borden a raise of a specific amount in a specific year, and (ii) this adjustment to Mr. Borden's base salary did not include any retroactive pay for the fiscal year ended June 30, 2011.

The commissioners sought to clarify the procedural issues raised by the motion. The Chairman recommended that, prior to consideration of Mr. Loftis' motion to amend, the Commission should first vote on whether to table the motion to approve the minutes of the July 21, 2011 meeting. At the request of Mr. Loftis, discussion of the July motion continued.

Mr. Loftis stated that, in his opinion, during the executive session discussion at the Commission's July 21, 2011 meeting, the Commission had agreed to increase Mr. Borden's salary for the current fiscal year (i.e., the fiscal year commencing July 1, 2011), and that a retroactive adjustment in Mr. Borden's salary effective June 30, 2011 was not intended. Mr. Loftis noted that adjusting Mr. Borden's base salary effective June 30, 2011 made Mr. Borden eligible to receive a greater amount of performance incentive compensation ("PIC") for the prior fiscal year. Mr. Loftis also indicated that, in his opinion, the fact that this base salary adjustment would make Mr. Borden eligible to receive a greater amount of performance incentive compensation for the prior fiscal year had not been fully explained. Mr. Loftis reiterated his other objections to the July motion, and stated that, for these reasons, the minutes of the Commission's July 21, 2011 meeting should not be accepted as presented.

In the ensuing discussion, Mr. Powers indicated that the commissioners had been informed that the July motion entailed making a retroactive adjustment to Mr. Borden's base salary and had been duly apprised of the fact that this adjustment would make Mr. Borden eligible to receive a greater amount of performance incentive compensation for the prior fiscal year. Chairman Gillespie also noted that in the concluding open session of its July 21, 2011 meeting, the Commission directed the Commission's Compensation Committee to review the structure and mechanisms of the Commission's existing PIC plan.

A vote was taken on the motion to approve the minutes of the Commission's July 21, 2011 meeting. Mr. Powers voted in favor of the motion, Chairman Gillespie and Messrs. Loftis and Giobbe voted against the motion, and the motion failed.

Mr. Loftis made a motion to change the effective date of Mr. Borden's base salary increase from June 30, 2011 to July 1, 2011. After discussion of procedural issues, the foregoing motion was withdrawn, and in lieu thereof, Mr. Loftis made a motion to reconsider the portion of the July motion which authorized an increase in Mr. Borden's base salary effective June 30, 2011. Chairman Gillespie suggested that this matter be carried over until the full Commission was present, and Mr. Loftis said he preferred not to carry over the discussions.

Dr. Pritchett arrived at the meeting. Chairman Gillespie and Mr. Loftis provided Dr. Pritchett with a summary of the Commission's discussions regarding the July minutes, as well as Mr. Loftis' motion to reconsider.

Dr. Pritchett seconded Mr. Loftis' motion to reconsider. Dr. Pritchett stated that the Commission must consider what the Commission conveyed to Mr. Borden prior to and at the July 2011 meeting, because Mr. Borden was at that time weighing a competing offer of employment with another pension plan. He said that Mr. Borden could have relied on the additional performance incentive compensation figure in evaluating his employment options.

Mr. Powers agreed, and asked Mr. Borden whether the actions taken by the Commission at its July 2011 meeting with regard to his compensation had played a role in his evaluation of his employment options. Mr. Borden responded affirmatively, noting that immediately after the Commission's July 2011 meeting, he withdrew from consideration of the other position. Chairman Gillespie noted that it had been reported that the person who subsequently accepted the position for which Mr. Borden was a finalist will receive base compensation of $385,000 and incentive compensation of up to 140% of base pay, resulting in a total potential annual compensation package of approximately $900,000. Chairman Gillespie confirmed that the Commission had been made aware of the details of this competing offer prior to its July 2011 meeting at which Mr. Borden's compensation was discussed.

Mr. Loftis questioned what Mr. Borden's total potential compensation could be for fiscal year 2012 (i.e., the fiscal year commencing July 1, 2011 and ending June 30, 2012). Chairman Gillespie answered that Mr. Borden's annual base pay had been increased to $485,000, with potential PIC of up to 100% of base pay commencing in FY 2012, but reiterated that the Commission has asked the Compensation Committee to review the structure of the Commission's current PIC policy. It was also noted that the potential PIC for the fiscal year ended June 30, 2011 had not been revised; it remained capped at up to 50% of base pay for Mr. Borden.

Mr. Loftis said that he did not know what had been communicated to Mr. Borden. Mr. Loftis reiterated that it was never made clear to him that the adjustment to Mr. Borden's base salary would make Mr. Borden eligible to receive a greater amount of performance incentive compensation for the fiscal year ended June 30, 2011. Mr. Giobbe opined that there was sufficient confusion to warrant additional review, and that in fairness to Mr. Borden, a quick resolution was needed.

In response to a question from Mr. Loftis, Dr. Pritchett indicated that he had understood that the July motion entailed making a retroactive adjustment to Mr. Borden's base salary and that this adjustment would make Mr. Borden eligible to receive a greater amount of performance incentive compensation for the prior fiscal year.

Mr. Borden asked to be heard. Mr. Borden stated that he did not want to receive any compensation as to which there were any issues of legality. He concurred with Mr. Giobbe's admonition that these questions be swiftly and thoughtfully resolved. Mr. Borden noted that this discussion could affect the FY 2011 PIC payout for all investment staff. Mr. Borden volunteered to make his prior base salary (i.e., his base salary prior to the action taken by the Commission at its July 2011 meeting) the basis for determining his FY 2011 PIC payout pending resolution of the questions which had been raised so that Commission approval of the FY 2011 PIC amount could be obtained and payments to other investment staff could be made. Mr. Powers concurred, stating that it would be inappropriate to hold up PIC payments for other members of the investment staff.

Chairman Gillespie called for the question of the pending motion to reconsider that portion of the July motion which authorized an increase in Mr. Borden's base salary effective June 30, 2011. The motion passed with Chairman Gillespie and Messrs. Giobbe and Loftis voting in favor of the motion and Mr. Powers voting against the motion.

Chairman Gillespie commenced the reconsideration discussion by noting that the actions taken by the Commission at its July meeting could be understood as an effort to reach a total compensation figure. Accordingly, the Chairman offered that there were two elements which could be addressed as part of reconsideration of the July action: (a) the effective date of the base salary adjustment and (b) the amount of the base salary adjustment.

Mr. Loftis made a motion, which was seconded by Mr. Giobbe, to amend the action taken by the Commission at its July 2011 meeting as follows [change shown in ***bold italics***]:

> ... to increase Mr. Borden's base salary effective ***July 1, 2011*** to an amount to be determined by the Chairman after further discussions with Mr. Borden, and to adopt the PIC policy changes, including an increase in the maximum PIC payout for both the CEO/CIO and all other staff covered by the Commission's PIC policy from 50 percent to 100 percent of base salary effective for the fiscal year ending June 30, 2012.

It was noted that the effect of this change would be to (i) remove one day of pay for Mr. Borden at the higher base salary and (ii) reduce by approximately $70,000[1] the PIC payment which Mr. Borden would be eligible to receive for the fiscal year ended June 30, 2011.

Mr. Giobbe seconded the motion, which passed with Chairman Gillespie and Messrs. Giobbe and Loftis voting in favor of the motion, and Mr. Powers voting against the motion.

Chairman Gillespie stated that he wanted to make a motion, so by unanimous consent of the voting members present, he temporarily relinquished the chair to Mr. Giobbe.

Mr. Gillespie made a motion to increase Mr. Borden's annual base salary from $485,000 to $555,000 effective July 1, 2011. Mr. Powers seconded the motion. Mr. Gillespie presented a

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[1] Note: The figure cited was incorrect. The effect of this change to the PIC payment which Mr. Borden would be eligible to receive for the FYE June 30, 2011 was approximately $65,000.

number of reasons for this proposal. The proposal would resolve confusion regarding current fiscal year versus prior fiscal year application; provide a method for beginning to redress a situation in which a key employee had turned down a competing employment offer based upon actions taken by the Commission at its July meeting; and incentivize the Commission to promptly and fully resolve this issue. Mr. Loftis questioned how this proposal was consistent with the Commission's desire to move towards a compensation structure which relied more heavily upon performance incentive compensation. Mr. Gillespie responded by noting that the burden should be on the Commission to address these compensation-related issues in a timely fashion.

Dr. Pritchett suggested that a decision be deferred with regard to adjusting the CEO/CIO's base salary until the PIC issue could be resolved. Mr. Loftis opined that increasing the base salary as per Mr. Gillespie's motion would place the CEO/CIO's base salary at the very top among state funds in the U.S.

Mr. Gillespie noted that he had spoken with Deloitte's compensation experts who said it was typical for incentive compensation plans in investment organizations to provide up to 200% of base pay, but be structured so that there was only a 20% probability of achieving the full amount of the incentive component, a 50% probability of achieving incentive compensation equivalent to 100% of base pay, and roughly 80% probability of achieving incentive compensation equivalent to 20% to 30% of base pay. Acting Chairman Giobbe opined that rather than considering this issue in a piecemeal approach, the Commission should direct its Compensation Committee to develop a unified, comprehensive plan. Mr. Borden suggested engaging a third-party professional consulting firm to provide the Commission with an expert, objective review.

Acting Chairman Giobbe called for a vote on Mr. Gillespie's motion to increase Mr. Borden's annual base salary from $485,000 to $555,000 effective July 1, 2011. The motion failed with Acting Chairman Giobbe and Messrs. Gillespie and Loftis voting against the motion and Mr. Powers voting in favor of the motion.

Mr. Gillespie resumed his responsibilities as Chairman. It was noted that the foregoing discussion had served to clarify that the minutes of the Commission's July 21, 2011 were an accurate record of the actions taken at that meeting. Accordingly, Mr. Loftis made a motion, which was seconded by Dr. Pritchett and passed unanimously, to approve the minutes from the Commission's July 21, 2011 meeting.

Mr. Loftis made a motion, which was seconded by Mr. Giobbe, to issue a Request for Proposals ("RFP") to engage a compensation consultant. Mr. Powers opined that, while he supported the engagement of a compensation consultant, the cost to retain a consultant will likely be considerably more than the $70,000 that was in question. Mr. Loftis replied that a compensation consultant was an expense well worth bearing. He averred that a consultant should provide benefit to the Commission over time and should have been retained a long time ago. Chairman Gillespie called for a vote on the motion, which passed unanimously. General Counsel Nancy Shealy noted that there may already be relevant consulting services agreements in place with one or more vendors under existing State contracts.

In response to a question regarding the process for selecting the consultant, Chairman Gillespie noted that although the charter of the Compensation Committee had not been established, the Commission could delegate authorization and task the committee to review submissions and make a recommendation to the full Commission. Ms. Shealy noted that a subsequent item on the agenda would present proposed revisions to the Commission's Committees policy, and advised that during the discussion of that item, the Commission could entertain a motion to delegate certain tasks to the Compensation Committee. The importance of immediately commencing efforts to procure a consultant was stressed by members of the Commission. Mr. Borden concurred, indicated that staff would also commence work on the Compensation Committee's charter immediately and suggested that the scope of the work to be performed by the Compensation Committee could cover recruiting and other elements.

In response to a question from Mr. Giobbe regarding the scope of needed services, Mr. Borden noted that later in the meeting, he would present for the Commission's consideration two distinct engagements warranting the assistance of third parties. The first engagement would address the Commission's reporting and technology needs. The second engagement would assist the Commission in holistically addressing human resource issues, including training, recruiting, and retention of employees, as well as compensation.

II. INVESTMENT ITEMS

Mr. Borden introduced Keith Stronkowsky from New England Pension Consultants ("NEPC"), for the Investment Performance Review of the South Carolina Retirement Systems' ("Retirement System") total portfolio ("Portfolio") for the quarter ended June 30, 2011. Mr. Stronkowsky referred to the Market Environment Overview section of the report.

Vice Chairman Reynolds Williams arrived at the meeting.

Mr. Stronkowsky continued with his presentation and highlighted salient points about various market and economic environments, components of U.S. GDP, key economic indicators, U.S. stock market performance, and the interest rate environment. He provided additional information on fixed income performance and the commodities market environment. Mr. Stronkowsky stated that within the past few months following the end of the quarter, the market and performance had shifted, prompting many funds to increase allocations to traditional fixed income allocations in order to decrease risk. Mr. Stronkowsky stated that the performance results for the quarter, including 0.9% for the pension composite and 1.9% for the financial composite, were satisfactory in light of the relatively flat performance of the equity markets during this period.

Mr. Stronkowsky highlighted performance of specific managers within the large cap, small cap, small-mid cap, emerging market equity, global fixed income, emerging market debt ("EMD"), global asset allocation ("GAA"), core fixed income, and cash and short duration strategies. He noted there were opportunities in EMD, and he pointed out that the meeting agenda included investment items related to these opportunities for the Commission's consideration. He concluded that the majority of the asset classes' performance for the quarter was close to the respective benchmarks, but noted that the hedge funds composite performance for the quarter was 0.6%. He noted that the average hedge fund of funds performance for this period was negative 1.2%, thus, the Portfolio's hedge funds collectively added a significant amount of value.

Mr. Hershel Harper, Deputy Chief Investment Officer, referred to the Commission's Quarterly Report for the quarter ended June 30, 2011, which was distributed to the Commission prior to the meeting. He reported that for the fiscal year ended June 30, 2011, the Portfolio had outperformed the 17.12% Policy Benchmark with a return of 18.59%. Mr. Harper noted that the market value of the Portfolio for the fiscal year ended June 30, 2011 was approximately $26.29

billion. He also indicated that approximately $900 million was paid out of the Portfolio for retirement obligations/benefits during the fiscal year. Mr. Harper stated that the cumulative net cash expenditures for retirement obligations since the fiscal year ended 2002 totaled about $6.611 billion.

Mr. Harper referred to the monthly Performance Report for June 30, 2011, and noted that for the fiscal year ended June 30, 2011, the equity markets were up close to 30% and that global fixed income markets were up about 10%. He explained that four out of six of the Portfolio's equity managers had outperformed their benchmarks for the fiscal year and added several hundred basis points of value. Mr. Harper noted that 11 out of the 14 of the fixed income managers had outperformed their benchmarks for the fiscal year. With regard to private equity, Mr. Harper stated that the Portfolio was underweight in private equity exposure based on the Commission's 10% target and current 7% funded investment status, but noted that this type of investment exposure took more time to build than other asset classes. He advised that some investment recommendations would be made later in the meeting to increase the Portfolio's private equity exposure and eliminate the 3% deficit allocation.

Mr. Harper reviewed the performance of the Portfolio's hedge fund investments, noting that they had achieved significant growth and were up 11.6% for the fiscal year. He also reported that the GCM Palmetto Strategic Partnership, L.P. ("GCM") with Grosvenor Capital Management had closed and that GCM had submitted a redemption to Grosvenor Institutional Partners, L.P. ("Grosvenor"), to begin the transition of the Retirement System's hedge fund of funds relationship with Grosvenor to the new hedge fund structure with the GCM strategic partnership. He reported that the total commitment to GCM was approximately $750 million; however, pending investments with GCM required funding before the redemption proceeds from Grosvenor would be received. In order to manage cash flows pending receipt of the redemption proceeds, the Chairman, upon recommendation of the Commission's CIO, had approved a temporary increase in the commitment to GCM pursuant to the allocation level provisions of the Annual Investment Plan. Accordingly, Mr. Harper said that a bridge loan had been made to GCM for $100 million and that per the contractual obligations, the bridge loan would be paid back to the Portfolio when the redemption proceeds were received, which would be no later than the middle of November 2011. He noted that the commitment to GCM would revert to the initial amount when the bridge loan was satisfied.

Mr. Harper discussed the performance of the Portfolio's GAA, which yielded a return of 18.90% for the fiscal year. He reported that despite being 5% underweight to real estate, fiscal year performance was up approximately 17%. Mr. Powers questioned why one manager had negative performance for the quarter, and Messrs. Harper and Borden explained that the manager had not been fully funded and its fund had not closed yet, so the performance was negative due to the management fee that had been called.

After further discussion about performance and asset allocations, the Commission received all of the reports as information, which also included a memorandum relating to preliminary performance estimates for periods ended August 31, 2011, and the RSIC Weekly Portfolio-Level Dashboard as of September 14, 2011.

(Information relating to these matters has been retained in the Commission's files and is identified as Exhibits A-1 through A-4.)

Mr. Borden transitioned into a discussion of plans for the Portfolio. He explained that significant work had been completed with regard to diversifying the Portfolio and reducing the risk associated with public, long-equity exposure since the Commission's inception. He noted that when the Commission began managing the Portfolio, 95% of the Portfolio's risk was derived from the public U.S. equity markets. Mr. Borden reiterated that one of the Commission's goals was to balance the risk by diversifying the Portfolio and the types of risk exposure. He further elaborated on the risks and rewards associated with equity risk and reported that the Portfolio currently had a significantly lower long-equity component compared to the Retirement System's peers. He explained that in periods of high market growth, the Portfolio would lag the markets due to the relative lower exposure to equity markets, but during periods of slow to no growth, the Portfolio should perform better than its peers. Mr. Borden discussed the difficulties which sometimes arise in quickly implementing investments to attain exposure during periods of growth and the impact a lag in implementation might have on performance.

Mr. Borden referred to the market environments and market uncertainties discussed by the Commission during its previous meeting, including the impending credit downgrade, re-pricing of high yield assets, and the pricing of U.S. Treasuries. Mr. Borden explained that the European banking situation had been at the forefront of market concerns and cited one estimate that suggested $1.5 trillion of recapitalization would be needed to stabilize the European banking system. Mr. Borden explained that the Commission's staff ("Staff") had discussed underweighting the Euro, although currently it had not been implemented. In light of the issues within the European banking system, Mr. Borden explained that Staff had been systematically reducing duration risk from the Portfolio by selling long bonds and directing all of the high yield cash flows and dispositions in the long-term high yield portfolio to the short-term high yield portfolio, and selling long bonds and buying a significant amount of senior secured bank loans. Mr. Borden summarized the Staff's efforts by stating that they had redeployed about $650 million from long duration and long credit assets into short duration bank loans and emerging market cash and cash equivalents.

Mr. Giobbe inquired about the length of the duration for assets considered "short-term" by the Commission and Staff. Mr. Borden responded that the short-term assets generally had a duration of three years or less; however bank loans were floating, so while they may have a maturity of three or four years, the duration may be a month. Mr. Borden noted that the broader themes in reacting to the European banking situation were to decrease the duration risk and the longer term, broad, public credit exposure and to take credit risk in a more targeted, idiosyncratic way.

Mr. Borden said that due to the current Portfolio's underweight to equity and the view that markets were in a long period of volatility, Staff was using a cashless equity replacement. Mr. Borden explained that the cashless equity replacement mitigated the risk of the Portfolio's underweight to equity and the potential risks associated with this type of trading. In short, Mr. Borden stated that this method allowed the Portfolio to access yield without duration risk, with manageable credit risk, and to use volatility to the Portfolio's advantage. Mr. Borden explained that Staff was implementing the cashless equity replacement in conjunction with the Beta Overlay Program managed by Russell Implementation Services ("Russell") and Goldman Sachs Palmetto State Partners with the Staff's internal investment committee directing the trades which Russell subsequently executed.

Mr. Borden noted that he anticipated a great deal of discussion regarding the Portfolio's actuarial assumed rate of return ("ARR") and the funded status of the Retirement System. He discussed the components of the ARR, the effect various factors could have on the rate, and the ability to achieve the rate. Mr. Borden stated that the cashless equity replacement was an example of creatively seeking solutions to the difficult economic environment to capture the best returns within appropriate risk confines. Mr. Borden emphasized that the Portfolio must be more creative and complex, and must have the human, technological, and budgetary resources needed to support those functions in order to earn a higher rate of return. He stressed that Staff needed budgetary support and flexibility to achieve the best risk adjusted return and cautioned that without the support, Staff would need to transition to another model without direct investments and creative investment strategies. He added that lowering the rate of return from 8% to 7.5% would be an extremely difficult adjustment for the state. Chairman Gillespie noted that he had spoken with Professor Carmen M. Reinhart, co-author of *This Time Is Different: Eight Centuries of Financial Folly*, who opined that the equity risk was currently attractive but highly volatile. Mr. Borden suggested moving some equity into a diversified large cap, dividend-focused pool of capital. The Commission and Mr. Borden discussed the challenges in the current environment and the obstacles faced in managing the Portfolio.

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

Mr. Borden introduced Mr. Mike Addy, Senior Fixed Income Officer, for a presentation regarding recommendations relating to investments with Mondrian Investment Partners Limited ("Mondrian"). Mr. Addy provided a brief overview of the recommendations and highlighted key investment considerations, history of Mondrian, the market opportunity, portfolio construction, and performance. Mr. Addy explained that the Portfolio was 1% underweight its target allocation of 3% to EMD and had only one EMD manager currently. He reviewed the due diligence process used to select Mondrian for this investment and the recommendation to invest in the Mondrian Emerging Markets Debt Fund, L.P. ("Mondrian EMD"). Mr. Borden explained that the Portfolio's current investment with Mondrian was in its Global Debt Opportunity Fund ("GDOF"), a portion of which was invested in emerging market debt, but in light of the previous discussion regarding emerging markets, Staff recommended reducing the allocation to the GDOF and adding more capacity to an investment in Mondrian EMD.

At this point in the meeting, Chairman Gillespie explained that he had a scheduling conflict and needed to be excused from the meeting temporarily, so he relinquished the Chairmanship to Vice Chairman Williams.

After further discussion about the Portfolio and Mondrian, Mr. Loftis made a motion, which was seconded by Mr. Giobbe and passed unanimously, to approve the recommendations presented, to invest an initial amount of $100 million in the Mondrian Emerging Markets Debt Fund, L.P., with the final allocation not to exceed 1.5% of the Portfolio, and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the investment upon approval for legal sufficiency by the Commission's legal counsel ("Legal Counsel").

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

Mr. Borden introduced Mr. Geoff Berg, Director of Investment and Asset Allocation, to report progress on the international equity manager search. Mr. Berg explained that in conjunction with Mr. Powers and Mr. Jared O'Connor, Investment Officer, they had narrowed an initial list of 14 international equity managers to a list of three managers of which on-site due diligence had been conducted. He noted that the Commission approved an investment with EARNEST Partners, LLC ("EARNEST"), in April 2011, and the search team was presenting recommendations regarding two additional managers: Tradewinds Global Investors, LLC ("Tradewinds"), and Johnston Investment Management Corporation ("Johnston").

Mr. Berg provided the Commission with a brief overview of Tradewinds and highlighted key investment considerations, the manager's history, the market opportunity, portfolio construction, and performance. He discussed the due diligence conducted on the recommended investment and described the role of the Chief Investment Officer of Tradewinds in its investment process. He provided additional information about the importance of risk management to Tradewinds and its approach with respect to currency analysis. Mr. Berg and the Commission discussed how the investment would complement the Portfolio's asset allocation.

After further discussion, Mr. Powers made a motion, which was seconded by Mr. Loftis and passed unanimously, to approve the recommendations presented, to invest an initial amount of 0.5% of the Portfolio in the Tradewinds Global Investors' International Value Equity strategy, with the final allocation not to exceed 1.5% of the Portfolio, and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the investments upon approval for legal sufficiency by Legal Counsel.

Mr. Berg provided the Commission with a brief overview of Johnston and presented the key investment considerations, the manager's history, the market opportunity, portfolio construction, and performance. He noted that while Tradewinds was geared toward a value discipline, Johnston more growth-oriented. He provided information about the due diligence conducted on the recommended investment and discussed the investment team and portfolio manager of the fund. Mr. Berg detailed Johnston's investment process and how the investment would complement the Portfolio's allocation.

After further discussion, Mr. Powers made a motion, which was seconded by Mr. Loftis and passed unanimously, to approve the recommendations presented, to invest an initial amount of 0.5% of the Portfolio in the Johnston Asset Management's International Growth Equity strategy, with the final allocation not to exceed 1.5% of the Portfolio, and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the investments upon approval for legal sufficiency by Legal Counsel.

Mr. Berg began a discussion of the benefits of structuring the investments in the international equity strategy (i.e., Tradewinds, Johnston, and EARNEST) in separate accounts. Mr. Berg stated that separate account structures would allow for additional transparency and favorable economics, and he recommended that the Commission consider using the platform within the Lighthouse Palmetto Strategic Partnership, L.P. ("Lighthouse") to enable the use of separate account structures. Mr. Harper explained that Lighthouse was willing to take long-only mandates onto its platform and to create separate account structures for Retirement System's investments. He explained that implementation of these investments as separate accounts would otherwise be difficult and that using Lighthouse's platform would help facilitate improved transparency and oversight while simplifying the aggregation and monitoring of portfolio risk. Mr. Harper noted that in order to use Lighthouse's platform, the Commission would have to approve additional capacity to Lighthouse. He reiterated that this would be a platform function, not an additional investment management allocation to Lighthouse. Mr. Borden added that implementing the international equity investments though the Lighthouse platform would reduce fees. Ms. Shealy noted that it might be favorable to allow flexibility for the investments to be implemented either through Lighthouse to use the platform or within a commingled account structure, dependent upon Legal Counsels' review of the investment documents and an assessment by the Chairman and Staff.

After further discussion, Mr. Loftis made a motion, which was seconded by Mr. Powers and passed unanimously, to authorize the allocations to Tradewinds, Johnston, and EARNEST to be invested through either Lighthouse for use of the platform or through separately managed account structures as determined appropriate by the Chairman; to approve an increase in the allocation to Lighthouse by $550 million for the purpose of using the platform, if applicable; and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the investments upon approval for legal sufficiency by Legal Counsel.

(Information relating to these matters has been retained in the Commission's files and is identified as Exhibits D1-D7.)

Mr. Berg reported that Staff and Mr. Loftis were engaged in the small-mid cap ("SMID") manager search. He noted that Retirement System's current managers would be revisited along with prospective new managers during the search process.

Mr. Borden introduced Mr. David Klauka, Senior Alternatives Officer, to begin discussions about recommendations regarding real estate and private equity investments. Mr. Klauka began discussions about the proposed real estate investments and referred to materials about Brookfield Asset Management ("Brookfield") and Oaktree Capital Management ("Oaktree"). Mr. Klauka reported that the real estate portfolio was still being built out and noted that Mr. Giobbe was assigned to this asset class. He said that the real estate debt manager search had been completed and candidates had been narrowed from eight to four prospective managers. Mr. Klauka explained that he would present information and recommendations about two of the funds during the current meeting and anticipated two at the Commission's next meeting. He stated that $1.7 trillion in commercial real estate loans that would be due within the next three to five years had created a backlog of opportunity because banks were not addressing key issues. He noted that non-bank providers of capital would need to find a way to restructure investments. He explained that Brookfield's Real Estate Finance Fund III, L.P., provided financing for higher quality properties with mezzanine loans and B-notes, and Oaktree's Real Estate Opportunities Fund V, L.P., focused on restructuring more troubled properties.

Mr. Klauka provided the Commission with a brief overview of Brookfield and presented the key investment considerations, manager and fund histories, the market opportunity, portfolio construction, and performance. He noted that this was a low risk investment opportunity which fit well within the asset allocation in light of the current macroeconomic conditions. He provided information about the due diligence conducted on the prospective investment and the investment team.

After further discussion, Mr. Giobbe made a motion, which was seconded by Dr. Pritchett and passed unanimously, to approve the recommendations as presented, to invest an amount not to exceed $75 million in the Brookfield Real Estate Finance Fund III, L.P., and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the investment upon approval for legal sufficiency by Legal Counsel.

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

Mr. Klauka provided the Commission with a brief overview of Oaktree and its Real Estate Opportunities Fund V ("Oaktree Real Estate") and presented the key investment considerations, manager and fund histories, the market opportunity, portfolio construction, and performance. He noted that Oaktree's investment team had a very specialized skill set in distressed debt and debt restructuring. He added that Oaktree had filed a registration statement ("S-1 form") and planned to issue an initial public offering, however, it would focus on the concerns of its fund investors because these investors were the primary source of capital for the organization. Mr. Klauka provided information about the due diligence conducted on the proposed investment and the prudence exercised by the investment team during difficult times since 2005. Mr. Giobbe added that although Oaktree Real Estate seemed to have additional risk, their decisions to not make any investments between 2005 and 2007 and to liquidate some of their investments paired with their ability to take themselves out the market for a substantial period of time without the impetus of pressure to be in the market reflected positively on their business judgment.

After further discussion, Mr. Giobbe made a motion, which was seconded by Mr. Loftis and passed unanimously, approve the recommendations as presented, to invest an amount not to exceed $75 million in Oaktree Real Estate Opportunities Fund V, L.P., and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the investments upon approval for legal sufficiency by Legal Counsel.

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

Mr. Klauka referred to information regarding proposed investments in Oaktree European Principal Fund III, L.P. ("Oaktree European"), and Apax VIII, L.P. ("Apax VIII"). He stated that these funds were private equity opportunities, and in conjunction with Dr. Pritchett, due diligence was conducted on both funds.

Mr. Klauka provided the Commission with a brief overview of Oaktree European and presented the key investment considerations, manager and fund history, the market opportunity, portfolio construction, and performance. He stated that this was a higher risk investment opportunity but the risk would be mitigated by the expected returns. He noted the importance of having access to a firm with an understanding of the different countries' laws was key to making this type of investment. Mr. Klauka cautioned that the fund was currently oversubscribed, which might decrease Oaktree's flexibility in negotiating contractual terms.

The Commission and Mr. Klauka discussed the European Debt Crisis and its potential impact on Oaktree European. Mr. Borden stated that Oaktree was an outstanding firm with a lot of bandwidth. Mr. Giobbe asked whether the oversubscription issue was a result of limited supply, and Mr. Klauka responded negatively and indicated that it was a capacity issue. He also stated that since the banks were releasing the loans at a slower pace, the managers might create funds with a two-year investment period. Mr. Powers opined that these proposed investments were a great opportunity; the banks would not be able to sell what they wanted to sell and would then be forced to sell their higher quality investments. The Commission discussed the proposed allocation and the investment opportunities in this strategy.

After further discussion, Mr. Powers made a motion, which was seconded by Dr. Pritchett and passed unanimously, to invest an amount not to exceed €70 million (approximately $100 million) in Oaktree European Principal Fund III, L.P., and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the investments upon approval for legal sufficiency by Legal Counsel.

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

Mr. Klauka provided the Commission with a brief overview of Apax VIII and presented the key investment considerations, manager and fund history, the market opportunity, portfolio construction, and performance. He provided information about the due diligence conducted on the proposed investment and the investment team. Mr. Klauka explained that Apax Partners LLP ("Apax") drove value for their investors through improvement of operations, essentially from reducing costs and moderately increasing revenue growth. Dr. Pritchett added that the Retirement System was currently invested in another fund with Apax and that the firm and its track record were impressive.

After further discussion, Dr. Pritchett made a motion, which was seconded by Mr. Loftis and passed unanimously, to approve the recommendations as presented, to invest an amount not to exceed €50 million (approximately $75 million) in Apax VIII, L.P., and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the investments upon approval for legal sufficiency by Legal Counsel.

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

Mr. Borden referred to information regarding the strategic partnership with TCW/Palmetto State Partners, LLC (TCW-SP) that had been provided to the Commission. He introduced Mr. Dunkin Allison, Strategic Partnership Officer, to provide an overview of the TCW-SP. Mr. Allison stated that the Retirement System's original investments with TCW from 2007 were transferred into the TCW-SP in 2008. He noted that in 2009, key man provisions took effect across several strategies with the departure of Mr. Jeffery Gundlach and other employees. He said that the existing investments in the TCW-SP were sub-advised by an agreement between Crescent Capital Group L.P. ("Crescent"), the TCW Energy & Infrastructure Group, and the mortgage team brought from Metropolitan West. Mr. Allison reported that the TCW-SP did not allow for investments in non-TCW managed funds or portfolios, which restricted it from investing in new products launched by Crescent. He said that the Commission was currently unable to take advantage of many of the high quality and high yielding Crescent investment opportunities and suggested reconstituting the TCW-SP. Mr. Powers summarized that Mr. Allison was basically proposing to change the name of the partnership and to reallocate some of the assets.

After further discussion, Mr. Powers made a motion, which was seconded by Mr. Loftis and passed unanimously, to approve the recommendations as presented, to invest an amount not to exceed $750 million (which would include approximately $245 million in existing investments to be transferred and approximately $505 million in new allocations) in a strategic partnership with Crescent Capital Group; to transfer the Crescent sub-advised funds from the TCW/Palmetto State Partners, LLC, to the new Crescent strategic partnership; to transfer the interests in the TCW Energy Partners sub-advised fund from the TCW/Palmetto State Partners, LLC, to the Retirement System; and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the investments upon approval for legal sufficiency by Legal Counsel.

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

Mr. Borden reported that as of August 2011, the exposure to Amundi Asset Management ("Amundi"), which was formerly known as Credit Agricole Asset Management "CAAM" Oblig Internationales, had been reduced to zero. He reviewed the history of the relationship and the deterioration of the investment team as several groups of key investment professionals left the organization. Mr. Borden recommended that the Commission formally terminate its contractual relationship with Amundi. After further discussion, Mr. Powers made a motion, which was seconded by Mr. Giobbe and passed unanimously, to authorize the Chairman or Mr. Borden as CEO/CIO to execute any necessary documents to terminate the contractual relationship with Amundi Asset Management.

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

The Commission recessed for ten minutes for lunch.

III. ADMINISTRATIVE ITEMS

Chairman Gillespie returned to the meeting but asked that Mr. Williams continue to preside over the meeting as Chairman Gillespie presented information from the Audit Committee.

Mr. Williams, acting as Chairman, asked for a report from the Audit Committee regarding the Investment Risk Assessment ("Risk Assessment") conducted by Deloitte and Touche ("Deloitte"). Mr. Borden prefaced Deloitte's presentation of the Risk Assessment, noting that within the Commission's Strategic Plan there was an initiative to improve internal controls which included the creation of an internal audit position and audit plan and would be covered in the Risk Assessment. Ms. Corbett explained that Deloitte had been engaged to perform the Risk Assessment and to set up the internal audit function for the Commission. She stated that the Risk Assessment had been completed and work on the audit plan had commenced. She also reported that the Audit Committee had met and approved a committee charter, which was included within the meeting materials for the Commission's consideration. She noted that the charter would empower the Audit Committee to recruit, hire and fire the Director of Internal Audit. She also noted that a draft position description for the internal audit position was included in the meeting materials. Ms. Corbett asked the Commission to approve the Audit Committee Charter and the internal audit position description.

Ms. Corbett introduced Mr. Michael Chung from Deloitte, who summarized Deloitte's approach in conducting the Risk Assessment. Mr. Chung summarized the scope of Deloitte's engagement and stated that his presentation would focus on the Risk Assessment report that had been distributed prior to the meeting. He explained that Deloitte's analysis looked at seven operational functions, some of which had not yet been fully created. Those seven key areas were then evaluated in light of three components: People, Processes, and Technology.

Mr. Borden added that many of Deloitte's findings should not come as a surprise to the Commission; while the Commission was no longer in the startup stage, there was still build-out occurring. He stated that when the Commission was formed in 2005, the main priority was diversifying the Portfolio. The Commission was now seeking to build out its capabilities and infrastructure in a number of areas.

Mr. Chung explained the three-tier risk ratings that Deloitte used to define the risk within certain areas. He explained that there were no low risk areas, noted the very short period of time (2005 to present) during which the Commission had been in existence, commended the improvements that had been made since the Commission's inception, and stated that Deloitte's assessment focused on areas that remained to be enhanced or developed.

Mr. Chung explained that Deloitte had outlined 11 inherent risk areas within the Commission. There were also a total of 26 different recommendations for the Commission to consider, with five recommendations ranked as highest priority. Top risk areas focused on the following: establishing an internal technology function, as well as enhancing the Commission's reporting capabilities; improving cross-functional communications and organizational structure; developing a succession and talent management plan; developing a more rigorous due diligence process across all asset classes; and developing a compliance function. For each of these areas, Deloitte had created a list of related recommendations, an implementation plan, and a list of affected functional areas.

Mr. Chung discussed specific details regarding the technology infrastructure of the Commission, noting that it was a fundamental area that affected the entire agency. Mr. Chung explained some specific details and resources needed to complete each of the identified risk areas. Mr. Chung stated that, if there were no budgetary constraints on resourcing of the organization, Deloitte estimated the Commission needed a total of 55-60 FTE's. Mr. Chung mentioned that the Commission was seeking to fill one new position, the Director of Internal Audit and Compliance, which would address the compliance function risk area. He noted that at a later date the audit and compliance functions should be separated.

Mr. Williams asked if there were any further questions for Mr. Chung. Mr. Gillespie, Chairman of the Audit Committee, said that there were two objectives for the Commission on this matter: to accept the Deloitte Risk Assessment, and to approve the Audit Committee Charter, which would give the Audit Committee the authority to hire and fire a Director of Internal Audit. Mr. Gillespie added that, as noted on the agenda, a separate amendment would need to be made to the Commission's governance policies in order to delegate authority to the Audit Committee to recruit, retain, and hire the Director of Internal Audit.

As Chairman of the Audit Committee, Mr. Gillespie made a motion that the Commission approve the Audit Committee Charter as written, which included the authority to hire and fire a Director of Internal Audit, and to amend the governance policies as necessary to reflect this delegation of authority. The Acting Chairman ruled that the motion did not require a second. The question was called, and the motion was adopted unanimously.

Mr. Gillespie referred to the position description for the Director of Internal Audit, which had been drafted and reviewed by Deloitte and Staff, and approved by the Audit Committee.

As Chairman of the Audit Committee, Mr. Gillespie presented a motion that the Commission approve the job description for a Director of Internal Audit as written. The question was called by the Acting Chairman, and the motion was adopted unanimously.

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

Budget Committee Report

Mr. Gillespie, Chairman of the Budget Committee, said there were no pending actions from the Committee's last meeting. Mr. Borden noted that the budgeting process was based on the current Strategic Plan of the Commission and Deloitte's Risk Assessment. Mr. Borden stated that the proposed budget requests an increase in full time employees ("FTEs") from 35 to 47, including mainly lower level reporting and investment staff. He explained that the purpose of the additional FTEs was to bolster the reporting, due diligence, audit and IT functions, in line with Deloitte's assessment. Mr. Borden also noted that over the past five years, the Commission had expended more than 20% less than its approved budget, showing the fiscal discipline of the Commission. Mr. Borden identified challenges in recruiting and retaining high quality, specialized employees as the principal reason for the gap between the approved budget and actual spending.

Mr. Giobbe asked what happened to funds not spent, but included within the annual budget. Mr. Borden explained that the trust funds were the source of funds for the Commission's operational budget. Any surplus was left within the trust funds and would not be carried over to the next fiscal year's budget. Mr. Gillespie mentioned that the Governor's Office had requested that the Commission's budget proposal be submitted by September 30, 2011. He noted that the Commission had not yet submitted a budget because the Budget Committee was still determining how much of the cost of building out the reporting/IT infrastructure would be included in the budget proposal.

Mr. Borden went on to note that, given the complexity of the Retirement System's Portfolio, the staffing levels of comparable investment organizations, and Deloitte's independent assessment, it was entirely reasonable for the Commission to request 47 FTEs. Mr. Borden provided a breakdown of costs in the proposed budget for the fiscal year commencing July 1, 2012, noting that Staff was recommending a $7.8 million increase compared to last year's budget, largely due to costs associated with the build out of reporting/IT infrastructure. Mr. Borden reviewed the new organizational chart and briefly discussed the open FTE's within the current fiscal year budget, including a Director of Public Markets, Director of Private Markets, and Director of Risk Management – all critical positions to the Commission.

Mr. Giobbe asked for additional information regarding the job duties of the Directors of Public Markets and Private Markets. Mr. Borden explained that these senior-level professionals would be macro experts regarding the entire Portfolio; they would be expected to help with asset allocation as well as improving the Commission's sourcing efforts.

Mr. Borden provided an overview of the "outsourced data processing" segment of the proposed budget, the segment of the budget containing the bulk of the costs associated with build out of the reporting/IT infrastructure. Mr. Borden reviewed the current state of the reporting function and summarized the "buy versus build" decision facing the Commission. Building this infrastructure would take a significant amount of time and FTE's. Buying such services would accomplish the initiatives more quickly and should more effectively reduce risk. Mr. Borden indicated that the estimated cost for outsourcing this work was about seven and a half basis points. Fifty percent of the Portfolio's assets are in strategic partnerships, which are designed to absorb the costs of reporting, auditing, and other functions. Mr. Borden explained that approximately two-thirds of the cost of building the reporting/technology infrastructure could be absorbed indirectly through these partnerships, leaving approximately $6.8 million of direct expense. Mr. Borden stated that if the direct expense was not approved, the only options would be to (a) figure a way to make it an indirect expense, or (b) not address this critical risk. Mr.

Borden dismissed the second option as unacceptable for the fiduciaries of the Commission, as well as other stakeholders.

Mr. Borden noted that there was already approximately $312 million in indirect expenses, which was comprised largely of management fees, which contain a 50% profit margin. Thus, Mr. Borden indicated, approximately $75 million a year was spent on compensation to external investment firms managing the Retirement System's investments and additional carried interested of $112 million also paid. In sum, Mr. Borden noted that about $200 million per year was taken out of the trust funds to compensate the personnel of external investment firms which managed the investments of the Retirement System. If the Commission's proposed budget is approved, the trust funds would incur $19 million a year in expenses. In conclusion, Mr. Borden summarized the benefits of outsourcing. Over time, an outsourcing arrangement should result in economies of scale, provide a platform that would enable the Commission to flexibly adapt to changing requirements, and assist the Commission in meaningfully addressing this critical risk.

As Chairman of the Budget Committee, Mr. Gillespie presented a motion that the Budget Committee be authorized to approve submission of a budget proposal for the fiscal year commencing July 1, 2012 consistent with the information that Staff presented to the Commission. The question was called by the Acting Chairman, and the motion was adopted unanimously.

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

Mr. Gillespie resumed his responsibilities as Chairman of the Commission.

Performance Incentive Compensation Approval for the Fiscal Year Ended June 30, 2011

Mr. Borden stated that pursuant to the Commission's Performance Incentive Compensation (PIC) Policy, there were two elements that must be provided to the Commission for approval of PIC payments to investment staff for the fiscal year ended June 30, 2011 (FYE 2011). He stated that these two elements were (i) an independent FY 2011 compliance report (2011 Compliance Report) and (ii) an independent certification of the FYE 2011 net-of-fees performance results by NEPC. Mr. Stronkowsky reviewed NEPC's process and findings. Mr. Borden stated that under the terms of the PIC policy, performance had exceeded both the strategy and policy indices over five of the six specified timeframes, which made Commission investment staff eligible to receive the full PIC allocation. Mr. Borden noted that for FYE 2011, $320 million was the total amount of value added to the Portfolio, over and above all benchmarks and after all costs. Mr. Borden indicated that he was asking the Commission for the authorization to disburse $499,031 for Performance Incentive Compensation payments to members of the Commission's investment staff other than the CEO/CIO for FYE 2011.

Mr. Williams made a motion, which was seconded by Mr. Powers and passed unanimously, to (i) approve and deem NEPC's 2011 Compliance Report and the supporting documentation as acceptable for the purposes of the Commission's Compensation Policy and (ii) approve the CEO/CIO's request to disburse $499,031 for PIC payments to members of the Commission's investment staff other than the CEO/CIO for FYE 2011.

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

Governance Policies

Committees Policy Amendment: Mr. Robert Feinstein explained that the Commission now had three standing committees: Budget, Audit, and Compensation. He summarized three proposed amendments to the Commission's Committees Policy: clarification of the voting rights of the Retiree Member Representative when serving on a Commission committee, revision to the committee composition provisions, and clarification of the process by which the chairman of a committee would be selected. After additional discussion of the proposed amendments by the commissioners, Mr. Williams made a motion to approve the amendments as presented. Chairman Gillespie seconded the motion, and the motion was adopted unanimously.

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

CEO/CIO Roles and Responsibilities Amendment: Mr. Feinstein presented a limited set of proposed amendments to the Commission governance policy entitled, "CEO/CIO Roles and Responsibilities". Mr. Feinstein noted that the proposed amendments were prompted by the development of the Audit Committee Charter and were intended to align the Commission's existing governance policies with the newly adopted Audit Committee Charter.

Mr. Borden inquired about the proposed amendment which would make the Audit Committee, rather than the CEO/CIO, responsible for ensuring that the audit function was not impeded by Staff. Mr. Borden stated that, based on his experience, the CEO/CIO should be held accountable for ensuring that appropriate resources were allocated to the audit function. After discussion, Mr. Williams made a motion to adopt the amendments as presented. The motion was seconded by Mr. Loftis and adopted unanimously.

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

Proposed Securities Litigation Policy

Mr. Williams introduced this item by referring to excerpts from a memorandum which the law firm of Arnall Golden Gregory had provided to the Commission in September 2010 regarding the authority of the Commission. Mr. Borden then provided a history of the Commission's Securities Litigation Policy and a summary of the processes which had been followed by the Commission in its management of securities litigation claims. Mr. Borden stated that the Commission adopted a securities litigation policy several years ago, which was housed in the Commission's Statement of Investment Policies ("SIP"). Mr. Borden noted that in April 2009, as part of revisions to the SIP, the Commission approved a Staff recommendation to extract the securities litigation policy from the SIP, but maintain the securities litigation policy in full force and effect pending the Commission's adoption of governance policies. Commission Staff had continued to manage securities litigation claims pursuant to this policy with the assistance of the Bank of New York Mellon, and certain limited proposed revisions to the policy were now being brought before the Commission for its consideration.

Mr. Williams reviewed the three main proposed changes to the policy which were identified in a Staff memo to the Commission included in the meeting materials. The first proposed change would clarify that the filing of claims was a function which was required to be performed as part of the process of prudently monitoring claims. The second main proposed revision called for submission of quarterly reports to the Commission regarding the status of new claims and recoveries collected. The third main change would clarify that any list of qualified securities/litigation counsel would be maintained by the Commission, in consultation with the Attorney General.

Mr. Powers made a motion, which was seconded by Mr. Williams and passed unanimously, to carry over consideration of the Securities Litigation Policy to the Commission's next meeting.

It was noted that representatives of the Attorney General's Office were in attendance. The Attorney General's representatives were provided with an opportunity to address the Commission. Mr. John McIntosh, Chief Deputy Attorney General, provided background as to the events which prompted the Attorney General to send a letter to the Commissioners in August 2011 relating to securities litigation. Over the last few years, two law firms, Motley Rice (headquartered in South Carolina) and Labaton Sucharow (based in New York), had approached the Attorney General's Office and offered a free "portfolio monitoring" service. Mr. McIntosh noted that the purpose of such monitoring was to prevent fraud -- that is, if the monitoring firm's research suggested that a company whose securities were owned by the Retirement Systems engaged in fraudulent activity, the monitoring firm would present its research to the Commission, and the Commission would decide what action, if any, it would take. Mr. McIntosh clarified that Attorney General Alan Wilson intended only to offer these firms' services to the Commission.

Mr. Loftis took issue with several aspects of Mr. McIntosh's account. Mr. Loftis stated that the August 2011 letter led him to believe that the Attorney General had retained these two law firms as counsel. In response, Mr. McIntosh unequivocally stated that no firms were under contract or had been employed by the Attorney General for this purpose. Mr. Loftis also expressed concerns regarding the Labaton firm, as well as the scope of the due diligence performed by the Attorney General's Office prior to presenting this recommendation.

In the ensuing discussion, Chairman Gillespie and Mr. Williams stated that, in their opinion, the Commission had the authority to select outside counsel, in conjunction with the Attorney General, to represent the Commission in securities litigation. Mr. Williams noted that the Commission had not, to date, selected counsel to represent the Commission in a securities class action lawsuit. The Commission had instead pursued claims by participating as a member of the class in these class actions. Mr. Williams noted that, after he received the Attorney General's August letter, he had a conversation with Attorney General Wilson. Mr. Williams indicated that he had reviewed with Attorney General Wilson the process which would be used to select and retain outside counsel (i.e., the Commission would vote on a firm and present that firm to the Attorney General for approval, as state law requires), and Attorney General Wilson had agreed with Mr. Williams' summary of this process. Accordingly, Mr. Williams reiterated that, in his view, only the Commission had the authority to recommend and hire counsel for the Commission with the Attorney General's approval, and that no third party could create an attorney-client relationship for the Commission.

Mr. Loftis explained that, as custodian of the State's funds, his office had interviewed law firms in order to determine the best way to monitor such pools of capital. A question arose as to the Budget & Control Board's role in this area. Chairman Gillespie and Mr. Williams acknowledged the Budget & Control Board's role as trustee, but stated that they did not believe the Budget & Control Board had the authority to hire attorneys to represent the Commission in securities litigation.

Mr. Robert Cook, Deputy Attorney General, stated that, based on his initial review of the statutes, the changes in law which created the Commission dramatically changed the legal landscape with respect to the Retirement System's funds and assets. Mr. Cook opined that the Commission had exclusive authority to manage and invest the assets of the Retirement System, while the Budget & Control Board, as the trustee, had the legal title to the funds, and the Treasurer, as custodian of the funds, was in a different category from the authority to invest and manage trust funds. Mr. Cook continued that, based on his initial review, he believed the Commission did have the right to hire its own attorneys with the approval of the Attorney General, but he indicated that he would want to look into the matter further. Mr. Cook also stated that if the Commission wanted it to review the issue, the Attorney General's Office would be happy to do so.

Mr. Williams said that he felt that the statutes were clear, and expressed agreement with Mr. Cook's assessment. Mr. Williams stated that he would welcome the Attorney General's opinion on these issues as it was essential to eliminate any doubt about the scope of the Commission's powers to invest and manage the Retirement System's funds and assets. Mr. Williams noted that, in his opinion, the decision as to whether to pursue litigation and hire legal counsel was a fundamental aspect of the management of any business enterprise, and directly impacted the Commission's performance of its fiduciary responsibility.

Further discussion ensued. Mr. Loftis stated that a holistic vision of these issues was needed, including whether other parties, such as the South Carolina Retirement Systems, the Comptroller General or other members of the Budget & Control Board, had a role regarding these matters. Mr. Giobbe stated that it was very important to get a clear definition of the responsibilities of the Commission, the Treasurer, and the Attorney General, and urged that in discussions of this topic, there be absolutely no implication or insinuation of any wrongdoing on the part of the Commission. Dr. Pritchett noted that since he joined the Commission in 2006, it was his understanding that the Commission had been managing securities litigation claims as Mr. Williams had described, and explained why he favored the Commission having the responsibility for retaining its own legal counsel, with approval by the Attorney General. Mr. Borden sought clarification from the Attorney General's Office that any recommendation to hire a law firm for monitoring services was not due to suspected fraud by the Retirement System or the Commission. Rather, the impetus would be the possibility that, unbeknownst to the Commission, fraudulent activities might have been engaged in by a company or other entities involved in issuing securities owned by the trust funds. Mr. McIntosh agreed, and stated that there was no intention by the Attorney General's Office to suggest anything to the contrary.

IV. OTHER BUSINESS AND ADJOURNMENT

Chairman Gillespie asked if there were any other discussion items. There being none, Mr. Giobbe made a motion to adjourn, seconded by Mr. Powers, and adopted unanimously. The meeting adjourned at 3:00 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 Commission's office, in the lobby, and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, South Carolina on September 13, 2011.]