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

**January 19, 2012**

**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, January 19, 2012:**

Mike Addy, Geoff Berg, Jonathan Boyd, Brie Bramlett, Betsy Burn, Harris Chewning, Sarah Corbett, Dori Ditty, Robert Feinstein, Brenda Gadson, Rebecca Gunnlaugsson, Hershel Harper, Gary Li, Adam Jordan, David King (via telephone), David Klauka, Doug Lybrand, James Manning, Lorelei McKay, Heather Muller, Jared O'Connor (via telephone), David Phillips, Kathy Rast, Nancy Shealy, Nicole Waites, Brian Wheeler, and James Wingo from the South Carolina Retirement System Investment Commission; Bill Condon, Bill Leidinger, Mike McDermott, and Shakun Tahiliani from the State Treasurer's Office; David Barnes and Rhett Humphreys from New England Pension Consultants; Jim Holly from the Comptroller General's Office; William Blume and Tammy Nichols from the South Carolina Retirement Systems; Wayne Pruitt from the State Retirees Association; Andrea Taylor, Bob Borden, and Matt Iovanina.

## 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 10:00 a.m. and welcomed the Commission and guests.

Dr. Travis Pritchett made a motion, which was seconded by Mr. Reynolds Williams and passed unanimously, to approve the agenda as presented.

Chairman Gillespie stated that Mr. Bob Borden resigned on December 1, 2011, and his last day of employment was January 13, 2012, which was after he completed meetings with the strategic partnerships and Commission staff ("Staff"). Chairman Gillespie added that he was thankful for the team that Mr. Borden built during his tenure with the Commission. He stated that Mr. Hershel Harper, Acting Chief Investment Officer ("CIO"), and Staff had done an outstanding job, and that Mr. Borden was leaving the Commission in good hands. Chairman Gillespie asked Mr. Williams to speak about Mr. Borden on behalf of the Commission.

Mr. Williams stated that in April 2006, Robert L. Borden became the first CIO of the South Carolina Retirement System Investment Commission. He said that Mr. Borden proposed a strategic target of creating a world-class investment management team and protocol, and that the Commission would not be where they are today without the insight and leadership from Mr.

Borden. He added that Mr. Borden brought his vision, intelligence, creativity, unfailing work ethic and integrity to the Commission, and he set a shining example for the Commission, investment community, and Staff that he had crafted very well over the years. Mr. Williams stated that Mr. Borden's unqualified strategic success had laid a splendidly visionary foundation for the challenging work ahead. Mr. Williams added that on behalf of the Commission, he wanted to express to Mr. Borden the Commission's enduring gratitude for his leadership and the example that he set for everyone.

Mr. Williams presented Mr. Borden with a South Carolina State flag that had been flown over the State Capitol in honor of Mr. Borden on December 15, 2011. He also presented Mr. Borden with a certificate from the Speaker of the South Carolina House of Representatives certifying that the flag had been flown for the purpose of being presented to Robert L. Borden. Mr. Williams then read a letter written and signed by the Governor of South Carolina which stated:

> "*Dear Bob:*
>
> *I wanted to take a moment and thank you for your service to the people of our great state. You have made a tremendous impact as the first Chief Investment Officer of the South Carolina Retirement System Investment Commission. Through your patience and attention to detail, you have set a high standard for your colleagues and your contributions will certainly leave a lasting impression on the agency. We wish you all the best in your future endeavors. God bless you."*

Mr. Williams closed by reading one of his favorite quotations from Ralph Waldo Emerson. "*Do not go where the path may lead, go instead where there is no path and leave a trail"*. Mr. Williams told Mr. Borden that he had done that for the Commission, and he thanked him once again.

Mr. Borden thanked the Commission for their kind words and wished them good luck in taking care of the trust funds going forward. Mr. Borden added that his money and heart were still with the Commission and the trust fund, and that he would consider it his duty and a pleasure to assist the Commission if needed in the future.

## II. PORTFOLIO UPDATE

Mr. Hershel Harper, Acting CIO, stated that a couple of years ago the Commission Staff ("Staff") decided to take a much more conservative posture. He said that these decisions had resulted in a higher weight to fixed income and opportunistic credit strategies and a lower weight to equity strategies, which had lowered risk exposure. Mr. Harper advised the Commission that New England Pension Consultants ("NEPC") had completed their new forecast, which Staff would review over the next month and present the Commission with an update and recommendations for potential changes to asset allocations.

Mr. Harper introduced Mr. Geoff Berg, Senior Equity Officer, for an update on the total portfolio ("Portfolio") of the South Carolina Retirement Systems ("Retirement System"). Mr. Berg discussed key differences between the performance of the Portfolio and the Policy Benchmark. He stated that the Portfolio was overweight to domestic equities and underweight to international equities. In response to a question, he said the Portfolio also included exposure to private Real Estate Investment Trusts (REITs), which served as a proxy for the underweight to real estate. Mr. Berg advised that half of the overweight to equities was attributable to the exposure to REITs, and the other half was due to performance of other positions.

Mr. Berg discussed private equity investments, stating that the Commission was approaching the five-year anniversary of the beginning of the private equity program and the point at which the commitment to private equity would be fully allocated.

Mr. Harper added that the Staff was focusing on the liquidity component of the Portfolio and reviewing the asset liability structure because the Retirement System was currently paying out 3.5 to 4 percent a year in net benefits and that number would likely increase in the future, possibly to 5 percent. Mr. Harper advised that the Staff continued to explore ways to enhance liquidity strategies and was working with NEPC and the Retirement System's staff and actuaries to determine necessary liquidity levels.

Mr. Berg focused on performance as of October 31, 2011, and reported that core bonds and commercial real estate were the top-performing asset classes, which demonstrated a challenging time for equities. Global equity markets were down sharply as the world acclimated to a slowing global gross domestic product (GDP) growth. Mr. Berg added that international and emerging markets were both down over 11 percent between June 30th and October 1st of 2011, and hedge strategies were down and continued to be down at this point. Mr. Berg noted that the Portfolio return for the month of October was up, but fiscal year-to-date returns were down 3.38 percent. Mr. Berg also noted that domestic equities had been performing well against the benchmarks, but emerging market equities were down considerably.

Mr. Berg noted that performance of each of the fixed income managers had been below their benchmarks for the fiscal year-to-date but that Staff had made some redemptions, and the contract with one manager in the global fixed income allocation had been terminated during the third quarter as authorized by the Commission. Mr. Harper noted that there had been a lot of "risk on, risk off" trading with the volatility in the markets. He explained that the fixed income managers had been either over-weighted in credit or they spread products in high yield, and the spreads in high yield had pulled out a thousand basis points in September 2011. Mr. Harper added that the Staff had seen some recovery through December for the fixed income portfolios, however.

Mr. Berg reported that while the absolute return for hedge funds had been negative, the performance against the benchmark had been quite positive. He also explained that all three GTAA and risk parity managers had been beating their benchmarks. Mr. Berg noted that Bridgewater was currently a thousand basis points over their benchmark and added that both Bridgewater and Putnam had outperformed their benchmarks over the last three- and five-year periods.

Mr. Berg noted that the opportunistic credit results had lagged the benchmark, but the distressed strategies were performing more in line with the benchmark. He reported that commodities were down about 8 percent for the last three months and down 5.45 percent for the fiscal year-to-date.

Mr. Berg concluded his discussion by stating that the Portfolio return for the year-to-date was negative 2.85 percent, and the policy benchmark was about negative 2.35 percent, so the gap of underperformance had closed to about 50 basis points.

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

## III. AUDIT COMMITTEE REPORT

Chairman Gillespie provided a report from the Commission's Audit Committee and stated that the Audit Committee continued to interview candidates for the Director of Audit position. Commissioner Curtis Loftis asked Chairman Gillespie if the Commission would continue to have ongoing audit consulting services provided by an external source after the Director of Audit position was filled. Chairman Gillespie replied that the initial thought was that the firm of Deloitte and Touche would assist the Commission with the first-year audit, but the estimated cost for the preliminary audit plan was approximately $750,000. Then, Chairman Gillespie explained that the question was whether the Commission should develop and proceed with a Request for Proposal ("RFP") for Audit Consulting Services, which would slow the audit process. Due to the complexity of audit issues, Mr. Loftis opined that the Commission should hire external services to assist the Director of Audit. Chairman Gillespie advised that the Audit Committee was meeting again at the conclusion of the Commission meeting, and he invited the other Commissioners to attend, but reminded the members that in accordance with Commission policies and requirements of the South Carolina Freedom of Information Act, Commissioners who were not members of the Audit Committee could not participate in the discussions.

## IV. COMPENSATION COMMITTEE REPORT

Chairman Gillespie provided a report of the Commission's Compensation Committee and advised that the Compensation Committee had voted to engage McLagan to conduct the compensation study as previously authorized by the Commission. Chairman Gillespie stated that the Compensation Committee was requiring McLagan to interview each Commissioner separately and then collectively by attendance at the February 2012 Commission meeting. Chairman Gillespie stated that one of the questions when McLagan conducted their study would be whether to combine the Chief Executive Officer ("CEO") and CIO positions during the candidate search.

Dr. Pritchett opined that there was a case to be made for separation of the investment functions and administrative functions. He stated that the Portfolio was complicated, and there were advantages to having a CIO concentrate strictly on investments. Dr. Pritchett suggested developing new job descriptions for the two positions. He also questioned whether the second title should be "CEO" if the CEO and CIO positions were separated. He explained that the title "CEO" might suggest that the CIO reported to that person and noted further that the title of "CEO" would not resolve the question of who would be designated as the agency head of the Commission.

In response to questions by the Commission, Mr. Robert Feinstein, Chief Legal Officer, explained that there were certain functions that had to be performed by an "agency head". Mr. Feinstein added that the legal team provided the Commission with a summary of some of the functions that an agency head would be responsible for discharging, which would need to be shared with the compensation consultant before they made their recommendations.

Ms. Nancy Shealy, General Counsel, added that the investment statute specifically provided for the CIO position. As a practical matter, there were certain functions, such as approving employees' leave through the South Carolina Enterprise Information System ("SCEIS"), which would naturally go through an Executive Director ("Director"). Ms. Shealy stated that she would envision the Director position as a "dotted line" to the Commission, with the CIO having a solid line directly to the Commission, not only by virtue of the nature of the CIO's position, but also because it was a statutorily created position.

Chairman Gillespie opined that there was a good pool of investment professionals who would be excited about the CIO position, but they would tend to get a lot less excited about the managerial and administrative duties. Mr. Harper concurred that focusing exclusively on the investments was critical, and most investment professionals would welcome that role. He explained that usually the CIO reported to an executive director over an entire pension plan, which typically included the pension benefit administration component. Given that the South Carolina Budget and Control Board served that function through its Division of Retirement Systems, the structure was somewhat bifurcated from the typical pension plan management perspective.

Discussion continued regarding the reporting lines for the CIO and Director. Mr. James Powers said that there needed to be a clear distinction of the authority for each position. Mr. Edward Giobbe stated that if the duties of the CIO and Director were split, the duties needed to be very specific so that they were not overlapping if they both reported directly to the Commission. Chairman Gillespie agreed and said that job descriptions for both positions should go through the Compensation Committee for approval.

After further discussion, Mr. Loftis made a motion to separate the functions of Mr. Borden's previous position into a Chief Investment Officer and another position, which could be known as the Chief Executive Officer; that the Staff and the Compensation Committee work over the next two weeks to develop job descriptions to present to the Compensation Committee and the Commission. Dr. Pritchett seconded the motion, which carried unanimously.

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

## V. CEO/CIO SEARCH

Discussions turned to the search for the former CEO/CIO's replacements. Dr. Pritchett asked Chairman Gillespie if the Commission was considered a public or private agency, or a combination of both? Dr. Pritchett opined that this was a significant factor in terms of compensation. He stated that the Commission had a lot of freedoms with respect to compensation that all or most other state agencies did not have in South Carolina, so perhaps the Commission as an agency was a "hybrid" between a public organization and a private organization. Dr. Pritchett also opined that compensation in the private sector should influence how the CIO of the Commission was compensated. Mr. Giobbe agreed with Dr. Pritchett, stating it would be a mistake to look only at the public sector because there was a wide variety of ways investment funds are managed and ways investment professionals are compensated. Mr. Giobbe suggested searching for the best candidate possible within reasonable compensation levels. Mr. Williams agreed with Dr. Pritchett's description of the Commission as a "hybrid" and stated that it was an important factor for the compensation consultant to know as well. Chairman Gillespie stated that one of the reasons for hiring a compensation consultant was to have access to a variety of databases so the Commission could determine the appropriate balance to be competitive in hiring staff. Mr. Adam Jordan, Acting CEO, stated that the methodology

McLagan prescribed in their RFP response included private sector and public sector data, so the Commission could use either, or a combination of both, at their discretion.

Chairman Gillespie advised the Commission that there appeared to be two options available for conducting the CIO search. A private recruiter could be used, or the Commission could engage the Budget & Control Board's Office of Human Resources ("OHR") as the Commission did for the previous CIO search. Mr. Williams stated that OHR vetted the candidates very well when they coordinated the CIO search previously, and the Commission was pleased with the caliber of the candidates that were presented. Mr. Loftis made a motion to engage the Budget & Control Board's Office of Human Resources to coordinate the CIO search. Mr. Powers seconded the motion, which passed unanimously.

The Commissioners discussed the timeline for the CIO search and decided to initiate the search after receipt of a report and recommendations from the compensation consultant regarding salary ranges, which would be after the Commission's meeting in February 2012.

The Commission discussed whether to also use OHR to coordinate the CEO search. Ms. Shealy noted that Commission employees were exempt from the state classification and compensation system and were not subject to the state's grievance procedures as all were "at will" employees. She noted further that OHR had advised previously that the Commission was not subject to the same state laws with regard to job postings. Mr. Loftis made a motion to engage the Budget & Control Board's Office of Human Resources to coordinate the CEO search. Mr. Powers seconded the motion, which passed unanimously.

Ms. Shealy noted that when OHR coordinated the CIO search previously, the contract was for OHR's services, but the Commission reimbursed or paid for all actual expenses incurred in the search, such as travel expenses for interviews, advertising costs, etc. Ms. Sarah Corbett, Deputy Chief of Staff, advised the Commission that costs for OHR coordinating the CIO search were estimated at approximately $20,000 and that the Commission would be given a firm quote after OHR received a specific scope of services to be performed.

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

## VI. TRANSITION UPDATE

Mr. Harper advised that there were three key areas for the CIO transition update, which included day-to-day activities, strategic partnership activity updates, and staffing updates. Mr. Harper noted that the Commission adopted its Strategic Plan almost three years ago, and it continued to govern the day-to-day activities of Staff. Mr. Harper advised that Dr. Rebecca Gunnlaugsson, the Commission's Systems and Economic Specialist, would lead the strategic partnership initiatives component of the Strategic Plan and that she would focus on improving the reporting and transparency in line-item data and standardizing the operational protocol across all of the strategic partnerships.

Mr. Harper turned the discussion to strategic partnerships and said that there were 13 strategic partnerships with an approved capacity of $14 billion currently. He explained that previously, Mr. Borden and several members of Staff focused on strategic partnerships, while he and other members of Staff focused on the hedge funds and public market investments. Mr. Harper noted that currently, there was a much more focused approach to strategic partnerships. He explained that a cross-staff of primary and secondary coverage had been assigned, and for some partnerships, staff was assigned for tertiary coverage to continue to review, be in contact daily with partnerships and to manage the relationships. Mr. Harper advised the Commission that over the past several weeks, all of the strategic partnerships had met with Staff in the Commission's office, and all of the existing and perspective investments had been reviewed in detail. He advised that NEPC would be reviewing the strategic partnerships also, and he introduced Mr. Rhett Humphreys, Managing Partner, and Mr. David Barnes, Senior Consultant, from NEPC, to review NEPC's general scope and estimated timeline to complete their review and assessment of the strategic partnership investments.

Mr. Humphreys said that Mr. Barnes had spent two weeks in the Commission's office in Columbia working with Mr. Harper and that he had attended all 12 of the strategic partnership meetings held during that period. Mr. Humphreys turned the discussion about the meetings over to Mr. Barnes.

Mr. Barnes stated that the meetings focused primarily on administrative and investment aspects of each strategic partnership. The administrative portions of the meetings focused on ensuring that there was proper documentation of various functions and the transfer of the Commission's appointment to membership on the investment committees from Mr. Borden to Mr. Harper. Mr. Barnes explained that a liaison from Staff, a liaison from the general partner, and a secretary had been assigned for each strategic partnership. He advised that the next priority for NEPC was to review the strategic partnership agreements, which would include a review of the key terms, processes, procedures, protocols, etc., as well as an organizational review of the general partner. Mr. Barnes detailed the next priority, which was to review the private market fund investments within each of the strategic partnerships. He noted that NEPC would develop a summary report, which would include information about the strategic partnership's organizational structure, general partner, fund investment team, and summary term sheet. The report would also identify significant risk, where investments were in the market cycle, a peer group comparison, and a summary of strengths and issues related to each of the investments.

Mr. Loftis asked Mr. Humphreys how NEPC was compensated by the Commission, and Mr. Humphreys replied that NEPC was on a full retainer contract with the Commission; NEPC was paid a flat fee to conduct all of the services under the guidelines of that contract. Mr. Loftis asked Mr. Humphreys about NEPC's independence in performing reviews and inquired whether a partner from NEPC would sign the report summarizing its findings relating to the investments. Mr. Humphreys replied that NEPC was compensated solely by clients such as the Commission and did not receive any revenue from investment management firms. He stated further that NEPC's name had been on every page of reports provided to the Commission and that his and Mr. Barnes' names would appear on the reports.

Mr. Barnes said that NEPC's next priority would be to review the hedge fund investments within the strategic partnerships. He added that Staff had asked NEPC to enhance the quarterly reporting provided for the hedge fund investments within the strategic partnerships.

Mr. Harper noted that strategic partnerships had been very functional and had enabled the Staff to be opportunistic and to move very quickly and decisively to take advantage of dislocations in the markets with regard to short-term investments. Mr. Harper explained that each of the investment committees of the strategic partnership was comprised of a combination of himself and one or two partners who represented the general partner. He added that the investment committee determined the investments made by the strategic partnership and that the decisions had to be unanimous, so by default, the Commission's representative could veto any investment. Mr. Harper noted that each strategic partnership provided an annual investment plan which served as a general guideline for selecting investments. Mr. Harper added that each partnership implemented a unique skill set in focusing and developing its strategic plan.

Mr. Harper advised that Staff was integrating information about strategic partnership investments into the Commission's flash reports. For example, the flash reports would specify "Apollo Opportunistic Credit" or "Morgan Stanley Opportunistic Credit", which represented the allocation of the strategic partnership to the respective investment strategy. Mr. Harper advised the Commission that reporting would be enhanced by aggregating the strategic partnerships individually so Staff could examine individual performance. Mr. Harper advised that he wanted to develop a more concise and defined governance structure with respect to how strategic partnerships operated on a daily basis to make sure each partnership followed the same protocol.

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

Mr. Harper provided the Commission with an update about Staff. He stated that two of the three open director-level positions that were posted in the Fall of 2011 had been filled. He introduced Dr. Gary Li as the new Director of Risk Management and noted that Dr. Li had earned a Ph.D. in finance and a Ph.D. in statistics and had been in the investment industry since 1996, formerly working at Wells Wachovia as Director of Asset Allocation. Dr. Pritchett stated that since the Commission had Dr. Li and NEPC on board, he would suggest that incentive compensation for investment Staff include a Sharpe ratio or some other ratio that recognized returns per unit of risk rather than returns exclusively. Mr. Giobbe added that measuring individual risk consistently and continually was extremely important, and it would be one of the most important parts of the investment function given the nature of rapidly changing markets.

Mr. Harper announced that the search for a Director of Private Markets resulted in Dave Klauka being promoted to that position. Prior to joining the Staff in October 2009, Mr. Klauka worked in the private equity department of the Michigan Retirement System and in commercial real estate banking. Messrs. Li and Klauka were welcomed to their new roles with the Staff.

Mr. Harper advised the Commission that he was in the process of reviewing resumes for the Director of Public Markets and that he expected to schedule interviews within the next few weeks. Chairman Gillespie asked Mr. Harper to clarify all of the unfilled full-time equivalent ("FTE") investment positions remaining. Mr. Harper replied that with Dunkin Allison's departure, there was an open FTE position for a strategic partnership officer. Additionally, he advised that FTE positions for a senior fixed income officer, real estate officer, and hedge fund analyst remained open.

## VII. ADJOURNMENT

There being no further business, the meeting adjourned by unanimous consent at 11:44 a.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, prior to 3:00 p.m. on January 17, 2012.]