South Carolina Retirement System Investment Commission
Meeting Minutes

March 5, 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 Monday, March 5, 2012:

Mike Addy, Geoff Berg, Jonathan Boyd, Betsy Burn, Harris Chewning, Sarah Corbett, Dori Ditty, Robert Feinstein, Brenda Gadson, Rebecca Gunnlaugsson, Hershel Harper, Adam Jordan, David King, Lorrie King, David Klauka, Gary Li, Douglas Lybrand, James Manning, Heather Muller, Jared O'Connor, David Phillips, Kathy Rast, Nancy Shealy, Nicole Waites, Billy Wallace, Brian Wheeler, and James Wingo from the South Carolina Retirement System Investment Commission; Bill Leidinger, Bill Condon, Clarissa Adams, Dinah Raven, Brian DeRoy, Mike McDermott, and Shakun Tahiliani from the State Treasurer's Office; Rhett Humphreys from New England Pension Consultants; Jim Holly from the Comptroller General's Office; Steven Gilbert from Senator David Thomas's Office; Donald Brock from the South Carolina Retirement Systems; Joye Lang and Kevin Paul from the Office of Human Resources; Wayne Pruitt from the State Retirees Association; Adam Barnett from McLagan; and Andrea Taylor from Creel Court Reporting.

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 2:00 p.m. and welcomed the Commission and guests.

Mr. Reynolds Williams made a motion to amend the agenda by moving the Chief Investment Officer ("CIO") and Director of Operations Job Posting Discussion before the Asset Allocation Discussion and Approval and approve the agenda as amended. Chairman Gillespie seconded the motion and it passed unanimously.

Chairman Gillespie stated that during the last meeting Mr. Edward Giobbe was unofficially nominated as Commission Vice-Chairman. Chairman Gillespie asked if there were any other nominations. Hearing none, Chairman Gillespie advised that the Commission will formally vote on the selection of the Commission Vice-Chairman at the next regular Commission meeting.

II. COMPENSATION CONSULTANT – MCLAGAN

Mr. Adam Barnett from McLagan presented a review of the RSIC's Compensation Plan. He stated that McLagan's review focused on two main questions: (1) are the Retirement System Investment Commission ("RSIC") salaries and total cash compensation levels competitive; and (2) are the features of RSIC's Performance Incentive Compensation ("PIC") Policy reasonable, competitive, and appropriate? Mr. Barnett advised that the review had been guided by input received from all six Commissioners during one-on-one interviews. Mr. Barnett further stated that McLagan also reviewed the roles and responsibilities of RSIC's positions with Ms. Sarah Corbett, Deputy Chief of Staff, and Mr. Adam Jordan, Acting Chief Executive Officer. This process helped McLagan identify position matches for each incumbent within its database of information. Mr. Barnett explained that McLagan collects data regarding pay level information on a job-by-job basis from approximately 60 other public pension funds, and that he had worked with Ms. Corbett and Mr. Jordan to ensure that the RSIC positions were properly matched to comparable positions in other public funds. Mr. Barnett advised that the survey data included a select group of 21 comparable public funds, eight of which are in the southeast, and six of which have significant (approximately 25 percent) alternative allocations within their portfolio. Mr. Barnett further advised that McLagan also looked at survey data for over 250 private sector firms, which included investment advisory firms, banks, insurance companies, and corporate plan sponsors. These are all organizations that manage pension funds internally, so they have similar skill sets to those of RSIC staff.

Mr. Barnett reported that on an aggregate basis, RSIC's salary levels are competitive with the select group of other public pension funds. However, on a payroll-weighted basis, Mr. Barnett noted that RSIC's salaries were two percent below the median. Mr. Barnett also reported that RSIC's pay levels were uncompetitive versus the private sector, and that approximately 48% of RSIC staff base salaries and total cash compensation levels were in the bottom quartile relative to the select group of other public pension funds. In addition, relative to total cash compensation, all of RSIC's staff were compensated below the private sector market median. Mr. Barnett pointed out that the private sector data is focused on total cash compensation (salary and the cash portion of a bonus), and does not include stock options and restricted stock grants as part of total compensation. Mr. Barnett noted that in the public sector there are more generous pensions, and in the private sector there are more long-term incentives.

Discussion continued regarding compensation levels for the full-time employee ("FTE") positions that the RSIC currently has not filled. Mr. Curtis Loftis inquired if the additional FTE positions had been filled, whether it would alter the percentage of RSIC staff salaries in the bottom quartile of the selected public funds. Mr. Hershel Harper, Acting Chief Investment Officer, responded by noting that the salary levels for the FTE positions that are unfilled for the current budget year would be in the range of $120,000 for three senior level professionals, and between $80,000-$90,000 for an open investment analyst position. Mr. Harper added that the salary levels for the unfilled positions for the next budget year would be in the range of $70,000-$90,000.

Mr. Barnett stated that McLagan also compared the RSIC staff's salaries to three positions in the public funds peer group, as well as larger public funds. McLagan analyzed the positions of an executive director, a chief investment officer, and a senior-most investment officer, and found that the RSIC salaries were below the high quartile for both the peer group and larger public funds group in both base salary and total compensation. Mr. Barnett reported that at the median, the total compensation for 2010 in the peer group was approximately $240,000, compared to the public funds total compensation of approximately $413,000.

Mr. Barnett also discussed a 2012 competitive pay analysis based on data reported by Pension and Investments on tax exempt pension funds, and stated that only two of the top paid 50 chief investment officers worked for public pension funds, with many working for universities and other non-public funds. Dr. Travis Pritchett inquired into whether the RSIC functions like a public or private organization, or some combination of both. Dr. Pritchett illustrated an example where he assumed that the RSIC is 75 percent public and 25 percent private. Using the salary data provided in Exhibit 1, he weighted the RSIC salary by .75 from the high quartile of the public base CIO salary ($269,000) and the median base salary by .25 from the private sector ($1,092,000), and explained this calculation suggested the base salary for the open CIO position would be approximately $475,000 under this type of weighting.

Mr. Barnett began discussions related to the specific components of RSIC's PIC plan. He stated that the findings were based on a review of RSIC supplied background material, input provided by Commissioners during one-on-one interviews, and McLagan's extensive experience in evaluating, designing, and benchmarking compensation plans. Mr. Barnett explained that in preparing the review, McLagan summarized their understanding of RSIC's current PIC plan, completed a structured assessment of the current plan, and will present a modified PIC plan concept for consideration by the Commission at a later time. Mr. Barnett advised that McLagan evaluated the RSIC's eligible positions, performance incentive opportunities, performance incentive weightings, quantitative plan components, plan payouts, and plan administration.

Discussions ensued related to the percentage of base salary that RSIC's investment positions are eligible for under the current PIC plan. It was noted that the percentage previously had a 50 percent maximum for PIC opportunity of an eligible staff member's salary, and was increased to up to 100 percent for Mr. Robert Borden, former CIO. Chairman Gillespie stated that it was not communicated to RSIC Staff that the percentage had increased up to 100 percent for all eligible staff positions. Mr. Barnett then reviewed the performance standards currently in place for the PIC plan, including the strategy and policy benchmark components. Under the current components, there are six available pieces that total 200%, but because of the 100% of salary cap, it would be possible for a staff member to meet all six available components, but leave 100% of the available 200% bonus on the table because of the salary cap.

Mr. Barnett summarized that the RSIC's PIC plan could be improved by: (1) varying incentive opportunities by position, with greater incentives for more experienced staff, (2) restructuring the quantitative component by eliminating the strategy benchmark component and replacing "all or none" payouts with linear performance scales, (3) adding a modest qualitative component that would link a portion of PIC to Staff's achievements of strategic results (which could help address the challenges of evaluating RSIC's alternative investments as well as new employees), and (4) providing the Commission with the discretion to pay out incentives (or not pay out incentives) in years when absolute returns are negative.

Mr. Barnett then discussed the proposed modified PIC plan in more detail, suggesting that the proposed PIC plan would preserve the best features of the current PIC plan, address the weaknesses of the current PIC plan, and also reflect competitive market practice and McLagan's incentive plan design experience. Mr. Barnett explained that under the proposed PIC plan, maximum incentives (varied by position) would be identified at the beginning of each year and weighted to stand-alone performance. The next step would be establishing performance standards, and after the end of each year, performance should be measured to determine what percentage of maximum performance incentive opportunity each investment professional could earn. Mr. Barnett stated that under the modified PIC plan, if the total fund one-year absolute returns are positive, the payout would be up to 100 percent of the available compensation. If the total fund one-year absolute returns are negative, the Commission would have to determine if all or a portion of the compensation should be paid, or deferred until after the end of the first year of positive absolute returns. While deferred, compensation could accrue interest at the total fund's annual rate of return, positive or negative. Mr. Barnett advised that in order to proceed with the new PIC plan, the Commission would need to provide guidance related to defining quantitative performance standards, determining maximum PIC levels, deciding if a qualitative component should be implemented and applied, and deciding if giving the Commission the discretion on proposed payouts for years with negative absolute returns would be acceptable. The Commission and Mr. Barnett then discussed specific details regarding defining the quantitative standards, how to apply any qualitative standards and related matters. Additional discussions were held regarding salary levels and whether, in reviewing salary levels for staff, the Commission should use strictly the data for other public plans, or some ratio of private/public, as earlier suggested by Dr. Pritchett, to best capture the appropriate standard for RSIC staff salaries.

It was noted that the Senate Finance Committee has requested to receive RSIC's new PIC plan by March 30, 2012. Mr. Jordan also noted that he will be required to schedule a hearing with the Senate Finance Committee to discuss the proposed PIC plan prior to March 30, 2012. Mr. Williams further clarified that a Senate proviso was previously passed providing that the Senate's approval of the RSIC's 2013 fiscal year budget is somewhat contingent on its receipt of the PIC plan. Mr. Williams added that it would not be in good faith to present the current PIC plan to the Senate Finance Committee, and then alter the plan at the next Commission meeting. The Commission further discussed the merits of adding any qualitative component to the PIC plan. After further discussion, it was agreed that the Compensation Committee would meet and discuss the proposed PIC plan and present final recommendations to the full Commission, prior to the March 30, 2012 deadline. Chairman Gillespie noted that historically, changes made to the compensation policy have been linked to the Annual Investment Plan ("AIP"). It was agreed that any changes made to the current PIC plan would be effective as of July 1, 2011 and will coincide with the AIP for the current fiscal year.

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

III. CIO AND DIRECTOR OF OPERATIONS JOB POSTING

Ms. Joye Lang from the Office of Human Resources ("OHR") provided an update regarding the Chief Investment Officer ("CIO") and Director of Operations job postings. Ms. Lang discussed the draft postings for both positions, and advised that the most important part of the job postings relates to the training and experience minimum requirements. Ms. Lang stated that the experience requirements for the CIO posting will include the following language: "the successful candidate will possess a bachelor's degree in finance, economics, or a related advanced degree, and 10 years investment management experience, with 5 of those years experience in the management of multiple asset portfolios preferred. CFA or CFP designation preferred." Mr. Williams inquired why the CFA or CFP designation would be preferred and not required. Chairman Gillespie stated that there might be qualified candidates who would not have the CFA designation, but may have an MBA in Finance. Ms. Lang advised that the CIO job opening would be posted on or about March 6th for 30 days (with extensions if necessary) in Pensions & Investments, Bloomberg, CFA Institute, Wall Street Journal, E-Financial Careers, and the state job website. Mr. Edward Giobbe suggested posting on the Investor's Business Daily. All postings will be online with the exception of Pensions & Investments which will also be in the printed version for the CIO posting.

Chairman Gillespie asked if there were any additional comments on the proposed CIO job posting. Dr. Pritchett suggested several grammatical and style edits. It was agreed not to provide a salary range, but rather state that salary would depend upon experience with a competitive incentive package. It was the consensus of the body that the proposed CIO job posting should proceed, with the agreed-upon edits.

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

Ms. Lang began discussions related to the Director of Operations job posting. She advised the job posting would state "the successful candidate must possess a bachelor's degree in business, finance, accounting, or related field and 10 years' experience in management, administration and investments." Mr. Williams suggested adding public communications to the experience requirements. Dr. Pritchett suggested adding the sentence "the position reports directly to the Retirement System Investment Commission, and serves as an at will employee of the RSIC." It was agreed to not provide a salary range, but rather include that salary would be competitive and would be dependent upon experience. It was the consensus of the body that the proposed Director of Operations job posting should proceed, with the agreed-upon edits.

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

Ms. Lang concluded her discussion by reporting that the Director of Internal Audits position has closed, and there are approximately five strong candidates that OHR will review prior to sending to the Commission for interviews.

IV. ASSET ALLOCATION DISCUSSION AND APPROVAL

Mr. Harper advised that at the last Commission meeting, the proposed asset allocation was discussed in-depth, and the Commission decided to defer a decision to permit further review. Mr. Harper noted that the proposed asset allocation is now being presented for final approval. Mr. Harper stated that during the last Commission meeting, Mr. Rhett Humphreys, Managing Partner, of New England Pension Consultants ("NEPC"), presented an asset allocation review, discussed market observations, and described how NEPC develops assumptions for the asset allocation and asset class level returns, as well as risk assumptions. It was noted that Mr. Humphreys also had discussed three alternative scenarios to increase the current target and current allocation, and showed the projected outcomes based on newly revised return and risk projections. Mr. Harper also noted that these various scenarios had been compared to both the current asset allocation and a recommended new asset allocation, so as to assist the Commission in seeing how the asset allocation would look if there were no or much reduced commitments to alternatives at this time. Mr. Harper stated that one of the scenarios was more conservative, having 40 percent dedicated to equities and 60 percent dedicated to bonds. The second scenario presented was more aggressive with 60 percent committed to equities and 40 percent committed to bonds. However, neither of these scenarios had been recommended, in part, because they would not provide the 7.5 percent actuarial rate of return and had higher risk. Mr. Harper discussed the third scenario which lowered alternative investment exposure by taking the current target allocation of 24 percent to private markets and cutting that by 50 percent. This scenario would raise the risk slightly from the current allocation, but the rate of return dropped to 7.3 percent, below the targeted 7.5 percent return. Mr. Harper stated that the materials before the Commission also included an alternative recommendation put together by RSIC staff and NEPC based on NEPC's recommendations and the Commission's expressed ideas of increasing exposure to U.S. equity and lowering exposure to U.S. core bonds, in response to feedback received regarding risk from sovereign debt. Mr. Harper noted that this updated alternative recommendation was to increase exposure to U.S. equities by 5% and decrease exposure to U.S. core bonds from 10% to 5%. This recommended allocation would result in an increase in the expected rate of return, but also resulted in an increase in risk. Mr. Harper further explained that the core fixed income managers do have the ability to rotate from sovereigns to certain types of credit exposures, and have done so, with the result that only about 25% of the current allocation is invested in treasuries and agency debt. Therefore, RSIC does not recommend the amended recommendation to reduce exposure to sovereign debt.

Dr. Pritchett distributed a handout regarding pending legislation on changes to the Retirement Systems. Dr. Pritchett explained that House Bill 4898 may have some implications on RSIC's investment policy, and provided background information on previously passed bills that impacted the Retirement Systems. Dr. Pritchett stated that the current pending House legislation proposes replacing the guaranteed one percent Cost of Living Adjustment ("COLA") with an annual benefit adjustment. Dr. Pritchett explained that the annual benefit adjustment as proposed would be a moving five year average rate of return on the Portfolio, minus the assumed rate of return of 7.5 percent. Retirees would receive an adjustment only when the Portfolio's moving average exceeds the 7.5 percent, with any adjustments capped at 2.5 percent.

The discussion then turned back to asset allocation. Mr. Giobbe inquired why the proposed 2012 asset allocation has real estate allocations decreasing from the current allocation of 6 percent to a recommended target of 3 percent. Mr. Harper explained that it is going to take time to allocate the call down structure before 6 percent can be fully invested, so it is reasonable to scale back the target and continue to make real estate commitments until a more developed real estate program can be achieved. Once that is achieved the Commission may revisit the target allocation and increase it as necessary.

After further discussions regarding additional allocation questions pertaining to cash and other allocations, Mr. Williams made a motion to approve the column in the asset allocation presentation entitled "Recommended Target" which will be included in the Annual Investment Plan for FYE 2013. Mr. Loftis expressed his appreciation to the Commission for taking the extra time to review the suggested asset allocation changes. Mr. Loftis also expressed his concern that the Treasurer's office has not been given enough information to make the decision on the proposed asset allocation. Mr. Loftis reiterated the fact that he didn't realize that NEPC was not involved in most of the Strategic Partnerships and some of the alternative investments. Mr. Loftis also stated that in checking due diligence, there was one item his office had specifically requested be done, and it had not been done and the due diligence was not available. Mr. Loftis noted his concerns regarding the risks posed by the proposed asset allocation, as well as other risk management issues and the need to continue heading in the right direction, as the Commission is now doing, with improved analysis and audit.

Further discussions ensued. Chairman Gillespie called the question of the motion to approve the column in the asset allocation presentation entitled "Recommended Target", which will be included in the Annual Investment Plan for FYE 2013. Mr. Giobbe seconded the motion. The motion passed with Messrs. Giobbe, Powers, Williams, and Chairman Gillespie voting in favor of the motion, and Mr. Loftis voted against the motion.

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

V. ADJOURNMENT

There being no further business, the meeting adjourned at 4:45 p.m.

[Staff Note: In compliance with S.C. Code Ann. §30-4-80, public notice of and the agenda for this meeting were delivered to the press and to parties who requested notice and were posted at the entrance, in the lobbies, and near the 15th Floor Conference Room at 1201 Main Street, Columbia, SC, at 2:50 p.m. on March 1, 2012.]