South Carolina Retirement System Investment Commission
Meeting Minutes

January 18, 2007

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

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

Others present for all or a portion of the meeting: Ashli Aslin, Bob Borden, Donald Brock, Douglas Lybrand, Nancy Shealy, and Hilary Wiek from the South Carolina Retirement System Investment Commission; Anne Macon Flynn from the Budget and Control Board Office of General Counsel; Ed Evans, Rick Harmon, Rick Patsy, and Shakun Tahiliani from the State Treasurer's Office; Rhett Humphreys from New England Pension Consultants; Ernie Cruikshank and Keith Wood from Jamison, Eaton & Wood, Inc.; Peggy Boykin, Alice Copeland, Tammy Davis, John Page, Dianne Poston, Danielle Quattlebaum, Joni Redwine, Travis Turner, and Faith Wright from the South Carolina Retirement Systems; Crawford Clarkson, Sam Griswold, and Wayne Pruitt from the State Retirees' Association; Charley McDonald from the South Carolina Trooper's Association; and Kevin Kibler from the South Carolina Office of the Governor.

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

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission (Commission) to order at 10:10 a.m. and welcomed the Commissioners and guests. Messrs. Blaine Ewing and Travis Pritchett arrived late due to traffic conditions caused by the inclement weather.

Chairman Williams called for objections or amendments to the meeting's proposed agenda and to the minutes from the Commission's Investment Retreat (Retreat), which was held at the Wampee Training and Conference Center on November 30-December 1, 2006. There being none, the proposed agenda and the minutes were adopted as presented.

Chairman Williams introduced and welcomed the newly inaugurated State Treasurer, Mr. Thomas Ravenel. Treasurer Ravenel expressed his excitement and dedication to service on the Commission.

Chairman Williams recognized Mr. Robert Borden, Chief Investment Officer (CIO), for an introduction of the Commission's newly hired staff members. Mr. Borden introduced Mr. Donald Brock, Research Analyst, Mr. Douglas Lybrand, Director of Research, and Ms. Hilary Wiek, Senior Equity Officer. Chairman Williams welcomed the new staff members on behalf of the Commission.

Chairman Williams reported that in order for Constitutional Amendments 3(a) and 3(b) to become law, they must be ratified by the Legislature. Chairman Williams described the process and stated that he expected the ratification to be completed within a month.

Chairman Williams reported that the Commission's Annual Report for the fiscal year ended June 30, 2006, was completed and distributed to the appropriate parties.

Chairman Williams reported that the South Carolina Retirement Systems' (Retirement System) Comprehensive Annual Financial Report for the fiscal year ended June 30, 2006, was included in the Commissioners' meeting materials as information.

Chairman Williams reported that the Senate Judiciary Committee had asked the Commission to comment on two pending bills, s.241 and s.242. S.241 would prohibit pension fund assets from being invested in companies with ties to Sudan, and s.242 would prohibit pension fund assets from being invested in entities or countries that sponsor or support terrorist activities. Chairman Williams reported that copies of the bills were included in the Commissioners' meeting materials. He asked each Commissioner to study the documents and provide comments to him.

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

II. CHIEF INVESTMENT OFFICER'S REPORT

Chairman Williams recognized Mr. Borden for the CIO report. Mr. Borden discussed the investment performance of the equity, fixed income, and total Retirement System's portfolio as of December 31, 2006, and highlighted contributing factors to that performance.

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

Mr. Borden suggested that the Commission engage a Beta overlay manager to transition the portfolio to the new target asset allocation that had been adopted at the Retreat, and he outlined a methodology and proposed timeline for a manager search process. Mr. Borden reported that representatives from Citigroup Inc. had been invited to the February Commission meeting to provide an educational framework on the mechanics of a Beta overlay program. In the interim, Mr. Borden advised that he and Mr. Rhett Humphreys from New England Pension Consultants (NEPC) would develop a Request for Information (RFI) for Beta overlay services from several multinational investment banking firms to evaluate the transition process between the current portfolio and target asset allocation. He said that if the mechanics of the proposed implementation strategies appear appropriate for the portfolio, he and NEPC would develop a recommendation for Commission. If approved by the Commission, Mr. Borden said he anticipated engaging a manager and beginning the transition during the fourth quarter. He said that if the Commission was not comfortable with the implementation strategy after the February meeting, they would develop a cash transition plan. Chairman Williams agreed to work with Mr. Borden throughout the process and asked that documents be provided to Ms. Shealy to ensure compliance with the Commission's policies.

Mr. Borden reported on the status of the Global Fixed Income manager search, which was initiated in April 2006. Mr. Borden reminded the Commission that the finalists were Crédit Agricole Asset Management (Crédit Agricole), Franklin Templeton Institutional, LLC (Franklin Templeton), Goldman Sachs Asset Management, L.P. (Goldman Sachs), Loomis Sayles & Company, L.P. (Loomis Sayles), Mondrian Investment Partners Limited (Mondrian), and

Western Asset Management Company (WAMCO). Messrs. Borden and Humphreys provided an overview of each candidate and outlined the pros and cons of each.

Mr. Borden noted that he felt Crédit Agricole was the strongest candidate in terms of process and performance; however, they were not a registered US investment advisor, and it was uncertain as to whether audited AIMR compliant composite information would be available. Therefore, Mr. Borden recommended that the Commission hire Loomis Sayles and Mondrian for their commingled global fixed income products with an initial allocation of $750 million each. He stated that he and Mr. Humphreys would conduct further due diligence concerning Crédit Agricole and WAMCO and would make recommendations at a later time, if appropriate.

Mr. James Powers made a motion that the Chairman negotiate and execute agreements with Loomis Sayles and Mondrian for their global fixed income commingled products in the amount of $750 million each, subject to review and approval for legal sufficiency by General Counsel, and that the accounts be funded from assets transitioned from the cash or core fixed income portfolio. Mr. Ewing seconded the motion, which passed unanimously after thorough discussion. Chairman Williams noted that evaluation and legal review of Crédit Agricole would continue.

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

Mr. Humphreys presented information regarding an implementation strategy for the private equity asset allocation. He reviewed the target allocation that had been adopted at the Retreat, which was a five percent target allocation to private equity. He noted that many funds consider over-committing 130 to 150 percent of the desired allocation to ensure the desired level of exposure, which would take the Commission approximately four years to achieve. Mr. Humphreys explained the Core-Satellite approach, which NEPC recommended as an implementation strategy to build the private equity program. He explained that Core would use investments in funds of funds to provide broad exposure to the various private equity strategies and geographical diversification, while Satellite would use direct funds to complement the funds of funds exposure to private equity.

In response to a question posed by Chairman Williams relating to liquidity and the Asset-Liability Modeling Study, Mr. Borden stated that the long-term investment of funds in a private equity program would not cause a problem in providing liquidity for employee benefits anytime in the foreseeable future.

Mr. Borden reported that a draft policy providing the broad strategic framework for managing the private equity program was included in the Commissioners' meeting materials. Chairman Williams asked the Commissioners to review the document and provide critiques, comments, and suggestions. Mr. Ewing suggested that the Commission employ someone solely dedicated to the private equity program. At Mr. Powers' request, Mr. Borden agreed to provide a quarterly update on the capital calls and distributions as the Commission builds a private equity program.

After further discussion about funds of funds and their hybrid nature, Mr. Pritchett made a motion to authorize Mr. Borden to pursue fund of funds private equity opportunities, conduct due diligence, and make presentations to the Commission as appropriate. Mr. Powers seconded the motion, which passed unanimously.

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

Mr. Borden stated that while he and Mr. Humphreys were compiling a sample of the due diligence process that would be used to evaluate prospective funds, he had become aware of two investment opportunities in the private equity area. He noted that the closing date on both opportunities would be February 28, 2007. Mr. Borden outlined the process used for conducting due diligence on the two funds. He stated that he met with general partners and support staff in Columbia, coordinated meetings between representatives of the funds and all of the individual Commissioners, asked NEPC's private equity group to meet with the general partners both at their offices and at the general partners' offices and to provide written summaries about the funds, performed background checks of some of the other limited partners, and substantively reviewed each firm's process. He noted that as a result of the due diligence conducted in these cases, a summary sheet would be developed in the future to succinctly document the results of the due diligence process and recommendations.

Messrs. Borden and Humphreys stated that Aquiline Capital Partners, LLC. (Aquiline) was a New York-based private equity management firm that focused on investing in the global financial services industry. They explained that Aquiline intended to actively add value to its portfolio through investment in risk-bearing and services enterprises in sectors such as property & casualty insurance, finance, securities, asset management, life insurance, and transaction processing. Messrs. Borden and Humphreys outlined the advantages and issues associated with investment in the Aquiline fund in detail.

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

Messrs. Borden and Humphreys stated that The Aurora Funds, Inc. (Aurora) was a venture capital fund that provided capital, introductions, and strategic guidance to entrepreneurs with early-stage healthcare and information technology companies. They explained that Aurora Ventures V, LP (Aurora V) intended to generate significant capital appreciation by making seed, start-up, early stage, and follow-on investments principally in equity and equity-related securities of information technology and life sciences companies, primarily located in the mid-Atlantic and Southeastern United States. Messrs. Borden and Humphreys outlined the advantages and issues associated with investment in the Aurora V fund in detail.

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

After further discussion, Mr. Powers made a motion that the Commission commit $100 million to Aqualine, provided that Constitutional Amendment 3(a) was ratified by the Legislature before the February 28, 2007. After thorough discussion, during which the floor was open to questions from the public and additional details about the substance of due diligence discussions and meetings were provided, Mr. Gillespie seconded the motion, which passed unanimously. The Commissioners agreed to provide documentation relating to their due diligence process, which would be incorporated into the minutes when completed.

After further discussion, the Commission determined that additional due diligence regarding Aurora was required, and no action was taken.

Chairman Williams stated that contractual documents related to private equity investments would be incredibly complex and lengthy and would be difficult for the Commission's General Counsel to manage currently. He advised that state law required approval from the South

Carolina Attorney General (Attorney General) for a governmental entity to retain outside legal counsel. Mr. Ewing made a motion to authorize the Chairman, Vice Chairman, and General Counsel to identify law firms to provide legal services to the Commission to review, negotiate, and draft contracts and other necessary documents relating private equity and limited partnerships and to submit the request for outside counsel to the Attorney General for approval. Treasurer Ravenel seconded the motion, which passed unanimously.

III. ADMINISTRATIVE MATTERS

Chairman Williams recognized Ms. Nancy Shealy for the Administrative Director's report. Ms. Shealy provided the Commission with a budget status report for Fiscal Year (FY) 2007 and 2008. She noted that the budget authorization for FY 2007 was approximately $2.79 million. Ms. Shealy explained the budget process and noted that the Commission's budget for FY 2008 would be presented to the House Ways and Means subcommittee on January 24, 2007. Ms. Shealy noted that the FY 2008 budget included funding for two additional administrative positions that had been discussed with the Commission previously. Chairman Williams stated that additional work was being completed on the FY 2008 budget, and a draft would be distributed to the Commissioners for comment before the budget hearing on January 24, 2007.

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

Mr. Borden stated that the most current salary survey of other state retirement system investment positions had been included in the Commissioners' meeting materials. Mr. Borden proposed a salary structure corresponding to the median salary of other state retirement system investment programs. He noted that he also drafted a continuing education budget, which could be used at the Commission deemed appropriate. He noted further that a revised draft travel budget was included in the Commissioners' meeting materials.

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

Mr. Borden and Ms. Peggy Boykin suggested that the Commission consider joining the Council of Institutional Investors (CII), an association of 130 public, labor, and corporate pension funds. CII worked to educate members and the public about corporate governance and is an advocate for strong governance standards on issues ranging from executive compensation to the election of corporate directors.

Ms. Shealy stated that two of the Commission's new employees were recruited from out of state, and their offer letters included reimbursements for moving expenses. Mr. Powers made a motion that the Commission ratify approval of moving expenses up to $5,000 for Hillary Wiek and up to $1,500 for Donald Brock, contingent upon compliance with state law and approval from the Comptroller General's office. Mr. Allen Gillespie seconded the motion, which passed unanimously.

IV. OTHER BUSINESS

Mr. Powers stated that the issues related to the lease for the Commission's new office facilities had been resolved. Mr. Powers discussed the provisions of the lease and stated that he intended to sign it as soon as possible.

Chairman Williams reported on Opal Financial Group's Public Funds Summit (PFS), which he attended January 10-12, 2007, in Scottsdale, Arizona. Chairman Williams provided an overview of the conference and stated that the PFS was very relevant to issues the Commission faced. He stated that several investment opportunities he found particularly interesting included investment in timberland, bank loans, and oil and gas royalties.

Chairman Williams reported that Mr. Borden volunteered to organize and coordinate the agenda for the Commission's annual retreat. Ms. Ashli Aslin agreed to explore potential dates for the Commission's 2007 Retreat at Wampee Training and Conference Center.

Chairman Williams reported that the next Commission meeting was scheduled for February 22, 2007. Due to scheduling conflicts, the March meeting would be rescheduled as soon as possible.

V. ADJOURNMENT

Chairman Williams thanked everyone for attending, and the meeting adjourned at 2:10 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 2nd Floor Conference Room at 202 Arbor Lake Drive, Columbia, SC, on January 16, 2007.]