South Carolina Retirement System Investment Commission
Meeting Minutes

April 17, 2008

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 Converse Chellis
Mr. Blaine Ewing
Mr. Allen Gillespie
Dr. Travis Pritchett

Others present for all or a portion of the meeting: Robert Borden, Donald Brock, Brenda Gadson, Douglas Lybrand, Heather Muller, Rick Patsy, Greg Putnam, Kathy Rast, Nancy Shealy, Nicole Waites, Brian Wheeler, and Hilary Wiek from the South Carolina Retirement System Investment Commission; Mike Addy, Delores Dacosta, and Rick Harmon from the State Treasurer's Office; Rhett Humphreys and Sean Gill from New England Pension Consultants; Sarah Corbett, Tammy Davis, Robyn Leadbitter, Danielle Quattlebaum, John Page, Kelly Rainsford, Joni Redwine, Travis Turner, and Faith Wright, from the South Carolina Retirement Systems; Ernest Cruikshank from Jamison, Eaton & Wood, Inc.; and John Huffman, a state retiree.

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 10:00 a.m. and welcomed the Commissioners and guests.

Chairman Williams called for objections or amendments to the meeting's proposed agenda. There being none, the proposed agenda was adopted as presented. Chairman Williams called for objections or amendments to the minutes from the meeting on November 19-20, 2007, and there being none, the minutes were approved. The minutes from the meeting on March 20, 2008, were carried over.

Chairman Williams provided an update on pending Sudan Divestment legislation. He said that he understood that the Sudan divestment legislation had not yet been presented to the full Committee and that the pending legislation was in fact the one that he redrafted for them, which basically said that the Commission is against divesting in Sudan and Commission, please do what you can not to invest in Sudan and report to the Legislature what the Commission is doing. He said it was the least intrusive legislation possible and his official position on it had been that the Commission was not endorsers of that legislation, but the Commission did not oppose that legislation. There was a committee hearing on it and the committee was prepared to amend the legislation and present it to the floor, but they had not actually done it yet and with the rush of other events, it may not even happen this year. Chairman Williams concluded his status report on the bill.

Chairman Williams reported that the nominating committee for the office of Vice Chairman of the Commission for Fiscal Year (FY) 2009 and FY2010 had met. The committee, which was comprised of Chairman Williams and Vice Chairman James Powers, presented Allen Gillespie as their nomination for the office. Chairman Williams noted that under the Commission's current policy, nominations would remain open until the next meeting. After further discussion, State Treasurer Converse Chellis made a motion to suspend the portion of the policy that required nominations to remain open until the next meeting, that the nominations be closed, and that the Commission elect Mr. Gillespie as Vice Chairman for FY2009 and FY2010. Mr. Blaine Ewing seconded the motion, which passed unanimously. The Commission congratulated Mr. Gillespie.

II. INVESTMENT MATTERS

Chairman Williams recognized Mr. Robert Borden for the Chief Investment Officer's (CIO) report. Mr. Borden outlined the topics he would present.

Mr. Borden referred to a summary report and commentary from Morgan Stanley (MS) Alternative Investment Partners, which had been provided to the Commission. The commentary discussed various events that had driven the markets and performance recently, such as the Bear Sterns and the J.P. Morgan/Federal Reserve buyout, continued volatility, and spike in commodity prices. He reviewed the performance report for periods ended February 29, 2008, and noted that while performance had been unsatisfactory in absolute terms, the Retirement System probably fared well compared to other pension systems that had significant long equity biases, particularly as the first quarter may have been the worst since around September 11, 2001, or the decline of the technology sector.

Mr. Borden reviewed the preliminary performance report for periods ended March 31, 2008, discussed performance of the various investment strategies, highlighted performance of individual managers, and discussed contributing factors to these performances. The Commission discussed hedge fund exposure and controlling volatility of the portfolio over long-term periods and methods to achieve the best risk-adjusted returns over a 30-year liability stream. Mr. Borden discussed risk and reviewed the processes that the Commission was developing and implementing to monitor and manage those risks. He reiterated that the assumption of risk was necessary to meet the actuarial targets while decreasing the unfunded accrued liability and that investment decisions should be made focusing on long-term goals rather than short-term or monthly performance data.

In response to a request by Mr. Powers, Mr. Borden provided an overview of the current credit market environment and the role of fixed income investments in the portfolio. Mr. Borden reviewed the transition of the portfolio during the last year, noting that because the equity investments had been transitioned close to the new target allocation, the core fixed income portfolio had been the primary source of funds to implement the new investment strategies. He discussed the current credit market environment and noted that Commission's caution in credit exposure last year had been beneficial given the profound opportunities in the credit markets currently. He discussed various credit opportunities, including residential mortgages, commercial mortgages, ABS securities, bank loans, credit arbitrage, etc.

Mr. Gillespie asked Mr. Borden to discuss management fees and the investment strategies. Mr. Borden reviewed the different strategies and styles, risk profiles, and the resulting impact on fees generated by performance and/or offered by managers on an asset-based rate.

The Commission discussed performance further. Mr. Rhett Humpreys of New England Pension Consultants, LLC (NEPC), noted that the Commission had reallocated or committed approximately $10 billion over the last 12-13 months, and as a result, returns were higher than the previous asset allocation would have produced. Mr. Borden explained that approximately

$500-600 million of preservation of capital had resulted from the changes and reallocations that had been implemented. He said that while the Retirement System had traditionally been in the bottom decile compared to other pension plans, its position had improved dramatically due to portfolio diversification.

Mr. Gillespie suggested that Mr. Borden include a list of investment vehicles and the amount of assets under management for each in future risk reports. He explained that a weighted average of the investments in separately managed accounts versus commingled trusts versus limited partnerships, etc., would assist in assessing the control and operational risks and the ability to react to market contingencies. Mr. Borden said that he would include the information in future reports and added that the information would provide another measure for leverage versus liquidity. For example, he explained that the particular investment might be liquid, but the particular investment vehicle might prohibit liquidation.

The Commission discussed other information that might be considered for future risk and performance reports, such as separate charts for similar investments in terms of volatility, duration, valuation periods, liquidity, peer group comparisons by asset allocations, etc. Chairman Williams asked Mr. Borden to include another column in the performance reports to capture the calendar year-to-date return. Chairman Williams explained that he is often asked for returns on a calendar year basis rather than fiscal year basis. Mr. Borden agreed to add the information, but noted that it would be a static number in each report until the end of the following calendar year.

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

Mr. Borden summarized the implementation of the Commission's adjustments to the asset allocation as adopted in February 2008. He reported that the opportunistic credit search team, which was comprised of NEPC, Messrs. Gillespie and Borden, and Mr. Rick Patsy, had received a list of potential candidates from NEPC that focused on investments across the full spectrum of credit investments, including residential and commercial mortgages, ABS securities, bank loans, etc. Mr. Borden detailed information about due diligence meetings and the firms that were considered. He summarized the firms' characteristics, investment strategies and focus, competitive edges, management team experience, investment vehicle structures. He explained how each would complement the portfolio, and he invited members of the search team to provide additional comments.

Mr. Gillespie noted that discussions with the different firms illustrated the remarkable disarray in the credit markets across the full spectrum and that each of the markets was at a different stage of recovery. He said that the meetings with the various firms demonstrated that there would be a rolling recovery, and that a strategic partnership or partnerships that could diversify among the different sets of credit markets would provide the most flexibility and value added within this strategy over time. Mr. Borden added his observations about economic factors and events that influenced these markets.

Mr. Borden referred to materials about Avenue Capital Group (Avenue) and Angelo Gordon (AG) that had been distributed to the Commission. He reviewed the firms' various distressed debt investment strategies and fund investment cycles, backgrounds, investment staff, and upcoming investment opportunities. Mr. Sean Gill with NEPC noted that they had performed extensive reviews of the firms and funds and that NEPC advocated the strategies highly.

Mr. Gill said that NEPC's other clients who invested with Avenue were pleased with the relationship. Mr. Borden noted that he and Mr. Patsy were familiar with the firm and its background and felt comfortable with its capabilities as a deep, broad credit organization. He explained further that currently, Avenue was in an investment period so it was between funding cycles. However, Avenue indicated that it may be able to accommodate a managed account that would allow the Retirement System to participate in various investment strategies. Mr. Borden said that the search team recommended that the Commission invest $250 million with Avenue in a global distressed multi-asset class strategy under a master partnership agreement. He added that the allocation would be a draw-down based on opportunities in the markets.

Mr. Borden referred to the materials about Angelo, Gordon & Co., L.P. (AG) and noted that while Chairman Williams was not on the search team for opportunistic credit strategies, he had met with AG instead of Mr. Gillespie as he was in New York for other meetings. Mr. Borden explained that they understood that AG had closed its sixth distressed debt fund, although they learned subsequently that there was a $40 million capacity remaining. Mr. Borden said that they were very impressed with the firm and its performance, and that the search team recommended an investment of $40 million in the AG Capital Recovery Partners VI, L.P. He noted that the investment was limited to $40 million due to capacity of this particular fund, but that the recommendation presented in the materials included a framework for developing a broader strategic alliance with the firm in the future.

Mr. Borden advised the Commission that the search team would continue with due diligence of opportunistic credit investment strategies and report to the Commission. He noted that the firms that had been identified were the premier credit organizations for this mandate.

Mr. Borden provided an overview of the strategic partnerships that had been considered by the search team. He said that Chairman Williams and he had focused primarily on identifying two additional strategic partnerships that would be similar to the global multi-asset class structure of the Morgan Stanley SCRSIC Strategic Partnership. He said that they met with Goldman Sachs (Goldman), J.P. Morgan (JPM), and Credit Suisse to discuss investment opportunities. Mr. Borden provided information about the firms, structure, available investment strategies, and he provided an analysis of how each would complement the portfolio and add value.

Mr. Borden reported that the search team eliminated Credit Suisse from consideration because the firm was not yet geared for this type of strategic partnership. He explained that while Credit Suisse had many talented managers, they focused on credit primarily. He said that Goldman presented a structure similar to Morgan Stanley, and the search team would continue discussions with the firm about opportunities for a multi-asset class strategic partnership. Mr. Borden said that JPM offered a very robust investment committee structure that would include the leaders of the various strategies in the partnership. He said they also emphasized the risk controls and asset allocation models that would be used. He referred to a copy of the presentation materials that had been provided to the Commission, and the search team recommended that JPM present its proposal at the next meeting.

Mr. Borden said that as a result of meeting with the various firms to discuss opportunistic credit investments and multi-asset class strategic partnerships, the search teams recognized the benefit of establishing smaller, focused strategic alliances in credit strategies. He noted that while they were on due diligence visits, the teams also met with several other firms, including TCW, Mariner Partners, and Apollo, to discuss the viability of structuring strategic alliances. He said that at this point, the focus had been on TCW and Mariner with whom the Commission had current relationships, although the search team would continue exploring opportunities with Apollo. He referred to presentation materials that had been provided by TCW and Mariner and discussed various aspects of each. The search teams recommended that the Commission create master partnerships or managed accounts with Mariner and TCW, transfer the existing investments into the partnerships, and call down additional capital as opportunities arise within credit and fixed income markets. Mr. Borden reiterated that this structure could allow additional co-investment opportunities, reduce costs, and provide better tactical management of the portfolio. The search teams concurred.

Mr. Gillespie reiterated the importance of continued visits with firms after formation of partnerships due to constant changes in structure and assets over various strategies. He said that he concurred with the concept of strategic partnerships, although continued monitoring and tight risk controls were essential.

After further discussion, Mr. Powers made a motion to adopt the search team's recommendations to invest $40 million in the AG Capital Recovery Partners VI, L.P. with Angelo, Gordon & Co., LP, to invest $250 million in the Master Partnership of Avenue Capital Group, and to authorize the Chairman to negotiate and to execute any necessary documents to implement the investments upon approval for legal sufficiency by General Counsel. Mr. Chellis seconded the motion, which passed unanimously.

After further discussion, Mr. Powers made a motion to pursue strategic partnerships with TCW and Mariner Partners as recommended by the search teams. Mr. Gillespie seconded the motion, which passed unanimously. Mr. Borden said that he would provide term sheets for the investments at the next meeting.

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

Mr. Borden recognized Ms. Hilary Wiek and Mr. Gill to review the private equity portfolio. Ms. Wiek referred to materials that had been provided to the Commission and provided an overview of the asset allocation goals and diversification. She noted that currently the target allocation was 6 percent or about $1.7 billion for private equity commitments. She reviewed the portfolio by cash flows through March 2008, fund diversification such as mezzanine, buyout, fund of funds, international, secondary, sector focused, and venture capital funds. She also noted the geographical diversification, vintage year diversification, and J-curve mitigation. She highlighted information about individual funds, including fees and various companies that were in the fund portfolios. Mr. Gill reviewed NEPC's recommendations and the strategic and tactical allocation targets from 2007. He reviewed the commitments and vintage years of private equity funds since inception and provided projected target net cash flows and commitment schedules for 6 percent and 8 percent allocations to private equities. Mr. Gill also discussed private equity strategies in general, provided historical performance data, and provided NEPC's outlook for the private equity markets. After further discussion, the Commission received the reports as information.

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

Mr. Borden referred to several search books from NEPC relating to high yield fixed income and emerging markets debt manager searches. He noted that Mr. Patsy would coordinate the search teams, which would include Messrs. Ewing and Powers, respectively. Mr. Borden asked Mr. Humphreys to review the search process and materials. Mr. Humphreys discussed the current exposures and target allocations to these strategies and reviewed information about some of the key managers that had been identified in the preliminary search process. The

Commission discussed several of the firms, overall investment strategies for the portfolio, and considerations for providing flexibility in responding to market contingencies. The Commission received the reports as information.

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

Mr. Borden recognized Mr. Greg Putnam to provide an update on the progress of the conversion from the Bank of New York Inform custody platform to the Mellon Workbench platform. Mr. Putnam reported that setting up accounts and other operations had been ongoing since January 2008, and the training process continued. He said that the goal was to have one cohesive platform for all staff by the end of the fiscal year. He noted that the new platform would provide policy compliance reports, performance monitoring and a number of other features.

Mr. Borden recognized Mr. Doug Lybrand for a review of the risk reports. Mr. Lybrand outlined some of the changes to the report format and provided an overview of Morgan Stanley's analysis of the portfolio. He reviewed the liquidity leverage report and provided a sample of a report from a fund of funds manager that illustrated the information that may be provided to identify managers who should be on a "watch" or "focus list". The Commission discussed various components of the report.

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

Mr. Borden advised that recruiting qualified candidates for the Director of Alternatives position had been difficult. He said he had received approximately 100 resumes, and of the initial finalists, several had been hired by other employers and several withdrew from consideration for other reasons. He advised that compensation had been an issue and that the position may need to be reposted. The Commission discussed hiring a private firm to assist in recruiting in this specialized field if the position was not filled in the near future. Mr. Borden also said that he anticipated needing additional resources in the research and alternatives areas.

Chairman Williams referred to a revised draft of the Annual Investment Plan for Fiscal Year 2008-2009 (AIP). He noted that the Commission had not had enough time to study the proposed plan and asked Mr. Borden to provide a summary of the changes from the current AIP. Mr. Borden said that most of the changes were to update the document to conform to actions recently taken and to address benchmarking. The Commission discussed problems with the statutory deadlines for drafting and adopting the AIP, implementation issues, and managing three separate documents that included the AIP, Statement of Investment Objectives (SIO), and Statement of Investment Policies (SIP). The Commission discussed various ways to consolidate the information to provide more flexibility and cohesion. Ms. Nancy Shealy advised that certain type of information was required by state law to be included in the AIP. She reviewed the statutory timelines relating to the AIP, SIO/SIP, State Budget and Control Board actuarial assumptions, and the CIO deadlines. She suggested that the Commission target October or the annual Retreat in November for an annual review of the SIO and SIP to allow the CIO sufficient time to develop the AIP. She said that currently the SIO was due for annual review in July, while the SIP was due for an annual review in August.

After further discussions, Mr. Ewing made a motion, which was seconded by Mr. Powers, to adopt the current AIP as the AIP for FY2009 with the understanding that amendments were anticipated. After further discussion, Mr. Ewing amended the motion to delete the mission and vision statements from the AIP as the statements were also included in the SIO and SIP. After further discussion, the motion passed unanimously.

Chairman Williams directed Ms. Shealy to provide Mr. Borden with a copy of the relevant statutes to use as a guide to draft amendments to the AIP. Mr. Borden was directed to draft amendments and provide a copy to Ms. Shealy to vet for compliance with the statutory requirements prior to submission to the Commission for consideration.

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

III. ADMINISTRATIVE MATTERS

Chairman Williams recognized Ms. Shealy for the Administrative Director and General Counsel's report. Ms. Shealy reported that with regard to administrative matters, staff continued drafting internal policies and refining the draft personnel policies and updating various internal reports. She noted that staff was also training on the new statewide accounting system, although a target date for implementation for the Commission had not been determined. She reported that the Commissioners and she had filed Statement of Economic Interest Forms with the State Ethics Commission within the statutory deadline.

Ms. Shealy highlighted the legal matters that had been addressed since the last meeting, which included closings with the following limited partnerships or fund: Lexington Middle Market Investors II, TCW Special Mortgage Credits Fund transfer, Morgan Stanley SCRSIC Strategic Partnership, Apax Europe VII-B, and Square 1 Venture 1. She also advised that the amendments to the contract with State Street Global Advisors relating to fees and other matters to conform to current law would be executed after the meeting. She reported that additional subscriptions to the Putnam Fiduciary Trust, D.E. Shaw Composite Fund, LLC, Mariner Partners, L.P., Bridgewater Pure Alpha Fund II, Ltd., and FrontPoint Multi-Strategy Fund Series A, L.P. had been completed. Ms. Shealy also reported that she had addressed several tax matters, coordinated fee reconciliations, prepared custody documents, addressed issues with a claims filing related to a securities class action lawsuit involving Tyco, etc. She advised that the fees for the GMO investment had been reduced effective January 1, 2008, and that the contract amendment had been executed.

Ms. Shealy advised that the Commission's financial records would be audited by the State Auditor's Office beginning the following week. She summarized the various documents that would be subject to the audit and the general process. Ms. Shealy noted that the State Auditor's Office would conduct annual audits of the Commission's records in the future. She reiterated that the audit related to the financial records of the Commission as an agency and would not include investment accounting.

Chairman Williams asked Ms. Shealy to review information about the Compliance Officer position. She provided a report that contained a list of various job responsibilities, reporting lines, and observations that had been compiled from a survey of public pension plans and other sources. She provided examples of position descriptions and noted that some of the items overlapped with functions performed by the Investment Division. The Commission discussed several approaches to develop a position description and to recruit appropriate candidates. They also discussed corporate governance and policies to address various functions of the agency. After further discussion, Mr. Chellis volunteered to coordinate the process and information for the Compliance Officer search and to begin drafting a control document. Mr. Ewing agreed to assist Mr. Chellis.

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

IV. EXECUTIVE SESSION

Mr. Chellis made a motion to in executive session to discuss personnel matters involving performance evaluations and compensation. The motion was seconded by Mr. Gillespie, passed unanimously, and Chairman Williams announced that the Commission would convene in execute session for those purposes. The Commission asked Ms. Shealy and Mr. Borden to remain for the beginning of the executive session.

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

Mr. Powers made a motion to approve adjustments to Mr. Borden's salary as discussed in executive session and to accelerate the incentive pay plan with regard to Mr. Borden to commence after two years instead of three years. Mr. Gillespie seconded the motion, which passed unanimously. Mr. Powers noted that the reasons for the increase were that of 70-80 funds in the United States, the Retirement System ranked second nationally in improved funds. Also, NEPC estimated that there was approximately $500 million in increased revenues that the Retirement System would have foregone had the Commission not adopted the new investment strategies that Mr. Borden implemented, and the Retirement System was in the top eight percentile after having been in the bottom quartile since inception of the plan.

Mr. Powers recognized the excellent work of Ms. Shealy and made a motion to approve adjustments to her salary as discussed in executive session. Mr. Gillespie seconded the motion, which passed unanimously.

Chairman Williams noted that the salary adjustments would be effective April 17, 2008.

Mr. Powers made a motion to endorse the incentive plan presented by Mr. Borden for all employees, including administrative staff, as discussed in executive session, subject to any restrictions that may be imposed by South Carolina law. Mr. Gillespie seconded the motion, which passed unanimously. Chairman Williams directed Ms. Shealy to develop a method to tailor the incentive pay plan to administrative staff.

V. ADJOURNMENT

There being no further business, Chairman Williams thanked everyone for attending, and the meeting adjourned at 2:05 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 and at the entrance, in the lobbies, and near the 2nd Floor Conference Room at 202 Arbor Lake Drive, Columbia, SC, on April 15, 2008.]