South Carolina Retirement System Investment Commission
Meeting Minutes

August 20, 2009

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

Commissioners Present:
Mr. James Powers, Chairman
Mr. Allen Gillespie, Vice Chairman
State Treasurer Converse Chellis
Mr. Blaine Ewing
Dr. Travis Pritchett

Others present for all or a portion of the meeting: Dunkin Allison, Curtis Barrineau, Geoff Berg, Bob Borden, Donald Brock, Jonathan Boyd, Dori Ditty, Brenda Gadson, Hershel Harper, Doug Lybrand, Heather Muller, Jared O'Connor, Kathy Rast, Nancy Shealy, Nicole Waites, Brian Wheeler, and Hilary Wiek from the South Carolina Retirement System Investment Commission; Mike Addy and Shakun Tahiliani from the State Treasurer's Office; Rhett Humphreys from New England Pension Consultants; Chris Anderson, Peggy Boykin, Sarah Corbett, Robyn Leadbitter, Tammy Nichols, John Page, Danielle Quattlebaum, Joni Redwine, and Faith Wright from the South Carolina Retirement Systems; Sandi Wilson from Womble, Carlyle, Sandridge & Rice; Lea Kerrison and Michael Molony from Young, Clement & Rivers, LLP; Michelle Cook from the Bank of New York Mellon; Wayne Pruitt from the State Retirees' Association; Jim Zelter and Barry Cohen from Apollo Capital Management; and Shaka Rasheed from J.P. Morgan Asset Management.

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

Chairman James Powers 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. Chairman Powers reported Reynolds Williams would not be in attendance due to a scheduling conflict.

Chairman Powers referred to the meeting agenda and advised that the Executive Session was unnecessary, so he proposed that the item be deleted. There being no other amendments, State Treasurer Converse Chellis made a motion, which was seconded by Allen Gillespie and passed unanimously, to adopt the agenda as amended.

Chairman Powers called for amendments to the minutes from the meeting on June 18-19, 2009. Nancy Shealy, General Counsel, reported that a few technical changes needed to be made to the minutes and stated that the content appeared to be consistent with the actions taken at the prior meeting. Upon motion of Mr. Chellis and second by Chairman Powers, the minutes were approved and staff was authorized to make any necessary technical corrections.

II. ADMINISTRATIVE ITEMS

Chairman Powers introduced Bob Borden, CEO/CIO, for the Strategic Plan Review. Mr. Borden referred to materials that were distributed to the Commission for review prior to the meeting. He indicated that the proposed Values and Sample Expressions that were discussed at the Retreat in June 2009 were vetted by Commission staff. Mr. Borden introduced Hershel Harper, Deputy CIO, for a presentation of the revised Value Statements. Mr. Harper reported that the Value Statements were rewritten based upon Commission comments at the Retreat. The Commission discussed the statements as presented and proposed several amendments. Upon motion of Mr. Chellis and second by Mr. Gillespie, the following Value Statements were adopted:

Value	**Sample Expression**
Integrity	The Commission will conduct itself with integrity by upholding the highest standards of fiduciary responsibility on behalf of the Retirement Systems, participants and beneficiaries.
Accountability	The Commission will be accountable to the Retirement Systems, participants, and beneficiaries for its ethical conduct and for compliance with its fiduciary responsibilities through a commitment to industry best practices of credibility, stewardship, and transparency.
Empowerment	The Commission will encourage constituents at all levels to make decisions consistent with the organization's policies, goals, and objectives.
Innovative	The Commission will use creative and independent thinking in its analyses, engagement processes, and decision making to develop evolving investment practices and strategies that integrate the values, goals, and mission of the organization.
Collaborative	The Commission will pursue the goals of openness, teamwork, equality, and relationship building to formulate strategies, increase performance, and maximize knowledge transfer for the benefit of the plan.
	Note: Commission is defined as the Commissioners and the Commission Staff.

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

Mr. Borden referred to the Action Plans and the Action Plan Leader Assignment Schedule. He explained that the Leader Assignment Schedule provided a chart of Commissioners and Commission staff assigned to specific goals and an un-weighted overview of the progress on each goal. Mr. Harper reported that some aspects of each goal would be on-going and therefore, would never be completed technically. Chairman Powers and Mr. Chellis suggested the addition of *Initiative I.F. Implement internal auditing system*. The Commission unanimously agreed to add *Initiative I.F.* to Goal I: Execute Major Investment Portfolio Initiatives to the Action Plan.

Mr. Borden explained that since the Commission Retreat in June, the Action Plans were reviewed and improved by staff. He stated that he envisioned that the Commission would formally approve the Goals and Major Initiatives while the Action Plans would be more fluid. He stated further that the detailed Action Plans would be adjusted and reviewed throughout the year although they would still be related to the Commission's approved Major Initiatives. Mr. Borden provided the Commission with a line-by-line detail of the current progress towards completion of each Goal and Major Initiative listed in the Action Plans. Chairman Powers stated that he was impressed with the Action Plans and noted that the Commission had a focus of where it needs to be in the future. Mr. Gillespie made a motion, which was seconded by Blaine Ewing and passed unanimously, to approve the Goals and Major Initiatives as amended.

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

Mr. Borden referred to materials relating to the Fiscal Year (FY) 2010-2011 budget and the Strategic Plan Organizational Chart draft. He explained that the completion of the proposed Action Plans may require additional funding in future budgets. Mr. Borden stated that he sought preliminary approval by the Commission of the FY2010-2011 budget to initiate facilities exploration and to conform to legislative deadlines. He reported that the proposed budget increased gross operating expenses to $6.348 million. Mr. Borden indicated that the increase was a result of Contingent Compensation & Employer Contribution ($772 thousand), Bank of New York Mellon Custody Expenses ($311 thousand), and Potential Strategic Partnership Outsourcing ($311 thousand). He also stated that he planned to look three years ahead in regards to agency budgeting. Mr. Borden proposed the hiring of four new full time equivalent positions (FTEs) including a Chief Operating Officer, an Audit and Compliance Officer, a Staff Attorney, and a Strategic Partnership Analyst.

Mr. Borden also mentioned that an additional risk management person may be needed to perform risk modeling. Mr. Borden explained that the proposed budget reflected full payout of the Contingent Compensation & Employer Contribution. He further stated that since the Contingent Compensation & Employer Contribution would be based upon benchmark performance, all, some, or none of the expense may be incurred. Mr. Borden said that outperformance of the benchmarks would add significant value to the South Carolina Retirement Systems (Retirement System) portfolio. He indicated that the proposed budget included a two percent cost of living increase and a three percent performance increase for Commission staff. Mr. Borden noted that cost of living increases would occur only if the Legislature authorizes such increases for state employees. Dr. Pritchett questioned across the board performance increases. Mr. Borden proposed that the three percent performance increases be put into a pool and distributed to employees at his discretion based upon each employee's EPMS (Employee Performance Management System) performance. He also indicated that an increase of $607 thousand would be necessary in contractual services mainly due to the need for additional data processing equipment and software.

Mr. Borden explained that the increase in contractual services would not include all custody costs as some costs would be paid from securities lending income. Mr. Gillespie stated that he did not favor custody cost splits because they tied manpower costs to assets. Mr. Ewing concurred with Mr. Gillespie's comments. Mr. Borden responded that custody costs could be broken out in the budget, but including such costs would result in an additional $1.5-3.0 million budget increase. He referred to information relating to earnings from the Retirement System's securities lending program. Messrs. Borden and Harper and the Commission discussed the cost of custody and the inherent issues with splits.

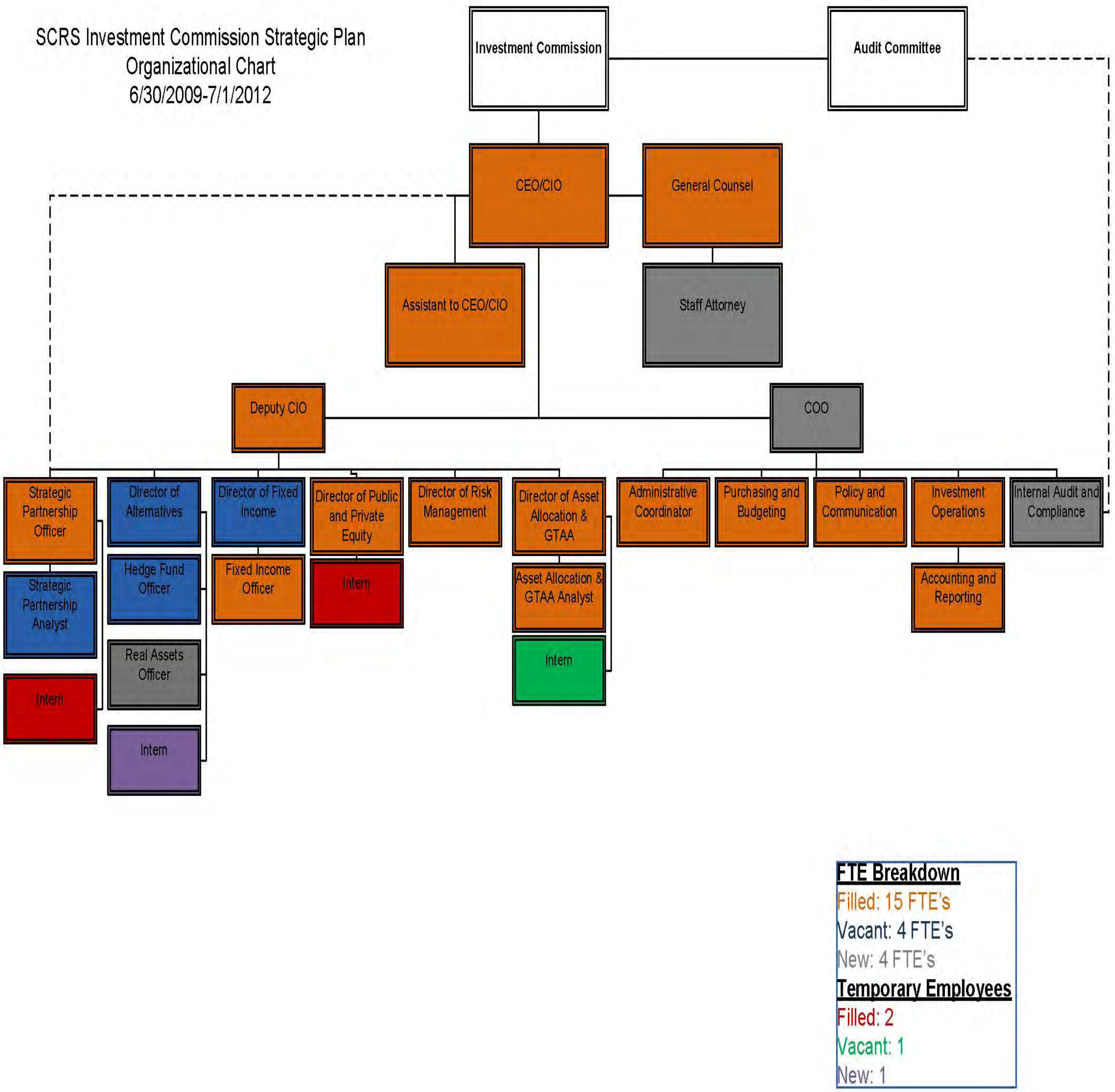
Mr. Ewing suggested listing all of the expenditures for all services, including investment management custody costs. Chairman Powers replied that the information would be included in the Annual Investment Report (AIR). Mr. Borden said that service expenditures were required to be reported in the AIR. He said that historically, asset management fees were not budgetary items. Peggy Boykin, Director of the Retirement System, explained that the Legislature examines the funding coming out of the trust fund, and for expenses that are netted against gross returns, it was not appropriate to show an expenditure from the trust fund as management fees because the fund will receive a net return from the manager. She also reported that fees varied among managers and that the best way to report overall return from a budgetary standpoint was to look at the net fees.

Mr. Borden indicated that $250 thousand in the proposed budget was for risk management software, if risk management was not outsourced to a third party. He also stated that an additional FTE may be needed for the Risk Management Program but that he had not included the position in the proposed budget. Mr. Borden explained that risk management could be outsourced to Strategic Partnerships, but that arrangement may create issues if the partnership is subsequently dissolved. Doug Lybrand, Compliance and Risk Management Officer, reported that the proposed budget increase was needed to begin developing a risk metrics program. Mr. Ewing expressed concerns regarding the urgent need for risk management and concerns about placing a budgetary cap on risk management expenses. He also stated that spending to create a superior Risk Management Program would be worth the additional cost to protect the Retirement System's portfolio in the future.

Mr. Ewing referred to the Strategic Plan Organizational Chart for the Commission and said that he understood that all functions of Compliance and Risk Management would report directly to the Commission. Chairman Powers stated he recalled that the Commission decided previously that Risk Management and Compliance/Audit would be separate agency functions. He added further that he viewed risk management as an investment function and that compliance and audit should report to the Audit Committee. Mr. Ewing concurred that they were separate functions, but said that he thought both functions would report to the Compliance and Risk Management Officer, who in turn would report directly to the Commission. Messrs. Gillespie and Chellis reiterated that the Commission had previously decided that there were two separate agency functions: (1) Risk Management, and (2) Compliance/Audit. Mr. Gillespie noted that the issue with risk management was whether to outsource services or build a system internally and that the issue with audit was whether to hire an internal auditor or to use the services of the Retirement System. Mr. Chellis said that one of the functions of the Compliance/Audit Officer would be to audit the Risk Management Officer, and Chairman Powers and Mr. Gillespie concurred. Mr. Gillespie added that the audit would be to ensure that Risk Management was complying with its functions by performing tasks properly and submitting reports, etc., to the Commission. Mr. Ewing asked whether they thought the Risk Management Officer should report directly to the Commission, and Chairman Powers and Messrs. Chellis and Gillespie reiterated that the Compliance/Audit Officer would audit the Risk Management Officer and would report directly to the Audit Committee, which in turn would report to the Commission. Mr. Ewing reiterated concerns with the Risk Management Officer reporting within the Investment Division instead of directly to the Commission.

Chairman Powers restated the three major aspects of the proposed budget. Mr. Chellis requested information regarding how the Contingent Compensation figures were calculated. Chairman Powers responded that the topic would be reviewed at a future Commission meeting and suggested that it be addressed at the next Retreat. He suggested also that Contingent

Compensation be footnoted in the budget submitted to the Legislature. The Commission discussed the proposed budget and decided to remove the Bank of New York Mellon Custody Expenses ($311 thousand) and Potential Strategic Partnership Outsourcing ($311 thousand). Mr. Chellis made a motion, which was seconded by Mr. Gillespie and passed unanimously, to adopt the preliminary budget and the associated organizational chart as amended.



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

Mr. Borden presented the Governance Policies to the Commission. Chairman Powers indicated that he had read the proposed Governance Polices twice and was satisfied with them. Mr. Gillespie stated he was also pleased with the policies as drafted. Dr. Pritchett made a motion, which was seconded by Mr. Gillespie and passed unanimously, to adopt the Commission Roles and Responsibilities, the Chair/Vice Chair Roles and Responsibilities, and the CEO/CIO Roles and Responsibilities governance policies.

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

Mr. Borden presented an amended Meeting Schedule for FY2009-2010 and suggested moving to a bi-monthly meeting schedule. Chairman Powers suggested scheduling a June meeting to discuss any possible items of interest before the end of the fiscal year. Mr. Chellis made a motion, which was seconded by Mr. Gillespie and passed unanimously, to adopt the Proposed Investment Commission Meeting Schedule as amended.

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

III. INVESTMENT ITEMS

Mr. Borden referred to the Bank of New York Mellon (BNY Mellon) Securities Lending Collateral Pool Update memo, which had been provided to the Commission prior to the meeting. He suggested moving collateral that is backed by subprime and Alt-A mortgages to a third party manager and replacing those assets with cash, which would restore liquidity to the pool. Mr. Borden reported that he had identified three qualified managers for this move and provided the Commission with the positive and negative aspects of each manager. He also explained that the State Treasurer's Office had committed to work very closely with the Commission to address and review all aspects of the BNY Mellon contracts. Mr. Chellis added that as the statutory custodian who contracted with the BNY Mellon for both the Commission/Retirement System and the State Treasurer's Office, additional counsel may be necessary but that he would explore the issues. Mr. Borden indicated that the collateral move was time-sensitive and suggested selecting a primary manager and a back-up manager in case additional issues arose or a contract could not be negotiated satisfactorily.

After the Commission discussed the proposal and aspects relating to the prospective managers, including fee proposals, Mr. Gillespie made a motion, which was seconded by Mr. Chellis and passed unanimously, to segregate the subprime collateral assets with BNY Mellon and substitute collateral for those assets, to approve Strategos Capital Management LLC (Strategos) to manage the segregated subprime collateral assets, and the TCW Group, Inc., as an alternate if the Chairman determines that a contract with Strategos cannot be executed; to authorize Chairman Powers and Vice Chairman Gillespie to negotiate and approve fees relating to the management of the segregated subprime collateral assets, and to authorize the Chairman to negotiate and execute a contract and any necessary documents, upon approval for legal sufficiency by General Counsel, to implement the Commission's actions.

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

Mr. Borden referred to the Update on Retirement System Investment Commission Fixed Income Portfolio memo that had been provided to the Commission. He explained that a third party review of the Fixed Income Portfolio was conducted, and he reported that while there were a few distressed securities in the portfolio, the valuation of the whole portfolio seemed reasonable as of June 30, 2009. Mr. Harper provided the Commission with an update of the progress in outsourcing the Fixed Income Portfolio. Mr. Borden added that the decision to outsource the portfolio was the correct move due to lack of ability to underwrite credits without additional resources. Chairman Powers and Mr. Harper commended Nicole Waites, Fixed Income Officer, for all of her hard work and for assisting with the review.

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

Mr. Borden introduced Geoff Berg, Director of Research and Analytics, for an investment performance update. Mr. Berg presented the Commission with an SCRSIC Weekly Plan-Level Dashboard report. Mr. Ewing said that he was very impressed with the Dashboard report and mentioned that he had wanted a similar report for some time. Mr. Berg explained that the report included a detailed asset allocation and exposure report and said that his team was open to ideas for improvement.

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

Mr. Berg provided the Commission with a review of the revised Quarterly Report format. Mr. Borden referred to the graph on the Quarterly Report ending June 30, 2009, indicating the one-year rolling peer group average. He explained how the credit crisis had a detrimental impact on performance on all peer group portfolios and how removing equity risk had pushed the Retirement System's portfolio into the top decile among its peers in March 2009. Chairman Powers, noting that the net benefit payment is included in the Retirement System's portfolio performance figures, explained how the increase in benefit payments affects the overall market value ranking. He estimated that on a yearly basis, the Retirement System's portfolio suffers a negative three percent market value loss as a result of benefit payments. Mr. Borden replied that that trend would continue to grow as more of the baby boomer demographic begins to receive benefit payments. Mr. Chellis asked if payments into the Retirement System had increased from current participants. Mr. Berg estimated that payments into the Retirement System were currently projected to increase at a rate of six percent every year. Mr. Ewing asked if there was a way to compare the policy benchmarks and composites of the Retirement System's portfolio to actual and composite policy benchmarks relative to other plans. He also mentioned that current comparisons to other plans may be inappropriate due to different asset mixes. Mr. Ewing stated that he would like to have figures regarding performance versus the policy benchmark. Rhett Humphreys from New England Pension Consultants (NEPC) replied that NEPC runs several universes for peer ranking data. He also mentioned that a report showing a ranking of alpha could be created. Mr. Borden added that additional resources were available to produce the ranking that Mr. Ewing requested by going fund by fund and creating a custom peer group structure.

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

Mr. Humphreys referred to NEPC's Second Quarter 2009 Investment Performance Analysis and said that despite year-to-date world equities being up 20.8 percent, NEPC expected ongoing and greater volatility in the future. He also reported that the Commission moving into credit had been a good decision and noted that high yield was up 30.4 percent year-to-date. Mr. Humphreys suggested acquiring real assets and liquid commodities. He explained that although hedge fund performance was negative, had the Commission not moved equities into hedge funds, additional losses would have occurred. Mr. Gillespie asked if NEPC tracks the Taylor Rule. Mr. Humphreys indicated that the Taylor Rule could be examined at the request of the Commission. He also suggested that NEPC and Commission staff work together to perform a review of active managers. Messrs. Humphreys, Borden, and Harper and the Commission discussed the materials provided for the quarter ended June 30, 2009, which included information about portfolio performance, managers, the market environment, investment strategies, and asset allocations.

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

Mr. Borden introduced Mr. Lybrand for a Risk Analyses update. Mr. Lybrand reported that within the past few months, the Commission's managers and Strategic Partners were contacted to provide feedback regarding rebalancing the asset allocation to include risk budgeting and risk parity. He referred to the Asset Class Risk Evaluation that was conducted by FrontPoint Partners LLC, and said that their findings were similar to prior reports from NEPC and Bridgewater Associates. Mr. Lybrand explained that rebalancing the asset allocation may reduce risk. Mr. Lybrand also provided information from J.P. Morgan Asset Management relating to the calculation of non-normal return distributions for use in asset allocation, and he said that he would provide copies of the report to the Commissioners when it was available.

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

Mr. Borden introduced Dunkin Allison, Alternative Investment Officer, for an overview of the investment in the Apollo Palmetto Strategic Partnership, L.P. (Apollo Strategic Partnership). Mr. Allison explained that an annual investment plan would be created for each of the strategic partnerships that would outline the plan and provide the Commission with information regarding the partnership and investments. He also reported that due to the nature of strategic partnerships, indicating a specific benchmark would be difficult. Mr. Allison suggested establishing benchmarks for all public and private investments within each partnership to create a bottom-up allocation benchmark for each partnership. He also reported that a standardized risk assessment would be conducted on a yearly basis. Mr. Allison stated that the partnerships would be graded and evaluated based on the following criteria: 1) whether the ideas of the investment committee were the best possible ideas; 2) whether performance exceeded the selected benchmarks; and 3) whether the overall partnership economics were compelling. Mr. Allison introduced Jim Zelter, Managing Partner of Apollo Capital Management, L.P. (Apollo) and member of the Investment Committee of the Apollo Strategic Partnership. Mr. Zelter said that he welcomed the opportunity to work with the Commission and provided an overview of how the Apollo Strategic Partnership had progressed within the past year. Chairman Powers said that he was very pleased and impressed with Apollo's transparency, helpfulness, and enthusiasm in working with the Commission. Mr. Borden said that the Apollo Strategic Partnership is the optimal model for what the Commission wants to accomplish with strategic partners. He also explained that having a partner like Apollo, which has a global bandwidth over numerous asset classes and provides the Commission with its best ideas from its top executives, is very unique among the Commission's peers. Mr. Borden recommended reaffirming the Commission's July 2008 original approval to commit $750 million to Apollo, which had been decreased to a $200 million commitment during the recent credit crisis.

After further discussion, Mr. Chellis made a motion, which was seconded by Mr. Ewing and passed unanimously, to increase the investment commitment to the Apollo Palmetto Strategic Partnership, L.P., from $200 million to an amount not to exceed $750 million and to authorize the Chairman to execute any necessary documents to implement the Commission's actions relating to the investment.

Mr. Borden presented a memo from the Morgan Stanley SCRSIC Strategic Partnership Fund LP (MS Partnership), and explained that the Commission's approval was needed to change the limited partners. He reviewed the background of the MS Partnership, noting that when the MS Partnership was formed, Morgan Stanley's members of the MS Partnership Investment Committee (MS-IC), Jack Coates and Gil Caffray, were required by the Commission to make personal investments into the MS Partnership as limited partners to align the interests of the MS-IC with the goals of the Commission. Mr. Borden reported that Dr. Coates planned to retire at the end of September 2009, and that Mr. Caffray had left employment with Morgan Stanley as reported to the Commission previously. Mr. Borden advised that Morgan Stanley had proposed to purchase Dr. Coates' and Mr. Caffray's interest in the MS Strategic Partnership and to create a deferred compensation pool for their eligible employees to provide a more standardized mechanism to align the interests of the MS-IC members with the Commission's goals. He noted that this proposed move would not change the Retirement System's ownership percentage of the MS Strategic Partnership. Mr. Borden added that Dr. Coates and Mr. Caffray had expressed an interest to remain on the Investment Committee, pending the Commission's approval. Chairman Powers asked if they should remain on the Investment Committee if they did not have a stake in the MS Partnership's performance. After discussion, Mr. Ewing, Chairman Powers, and Mr. Borden indicated that Dr. Coates' and Mr. Caffray's intellectual capital would be of great benefit to the partnership.

After further discussion, Mr. Gillespie made a motion, which was seconded by Mr. Ewing and passed unanimously, to waive the Retirement System's right to purchase Dr. Coates' and Mr. Caffray's limited partnership interests in the MS Partnership, to consent to the transfer of Dr. Coates' and Mr. Caffray's limited partnership interests to the Morgan Stanley AIP Funding Inc. (MS AIP), to consent to the admission of MS AIP as a limited partner of the MS Partnership, to approve Dr. Coates' and Mr. Caffray's continued service on the Investment Committee of the Morgan Stanley SCRSIC Strategic Partnership Fund LP as feasible, and to authorize the Chairman to execute any necessary documents to implement and to conform documents to the actions of the Commission.

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

Mr. Borden presented information regarding the investment with Reservoir Capital Group (Reservoir). He indicated that Craig Huff, Co-Chief Executive Officer of Reservoir, had provided the Commission with the compensation arrangement disclosure for third party placement agents as requested. With regard to Reservoir's Overseas Private Investment Corporation (OPIC) insurance policy from the United States Government, Mr. Borden said that if an infrastructure asset in the portfolio was seized by terrorists or if the country's government was overthrown, the investment would be covered. He also reported that if a country in which the infrastructure asset is located is added to the United States Department of State terrorist list or prohibited nation list, the insurance would cover the equity and rate of return against loss. Mr. Borden explained that less than one percent of the Retirement System's portfolio would be invested in similar opportunities. Mr. Chellis asked questions about NEPC's due diligence report on Reservoir. Mr. Humphreys indicated that NEPC did not recommend investment with Reservoir and explained their analysis. Mr. Humphreys, Mr. Borden, Mr. Harper, and the Commission discussed various aspects of the Reservoir investment. There were no objections by the Commission to proceeding with the investment with Reservoir as previously approved.

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

IV. ADJOURNMENT

There being no further business, Chairman Powers thanked everyone for attending, and the meeting adjourned at 1:35 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, South Carolina, on August 18, 2009.]