South Carolina Retirement System Investment Commission
Meeting Minutes

October 15, 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
Mr. Reynolds Williams, Chairman Emeritus

Others present for all or a portion of the meeting: Mike Addy, Dunkin Allison, Geoff Berg, Bob Borden, Donald Brock, Jonathan Boyd, Dori Ditty, Brenda Gadson, Hershel Harper, David Klauka, 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; Rick Harmon and Shakun Tahiliani from the State Treasurer's Office; Rhett Humphreys from New England Pension Consultants; Chris Anderson, 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; Aaron Montano from Alliance Bernstein; and Kent Phillips, Wayne Pruitt, and Monroe Swearingen from the State Retirees' Association.

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 Commissioners and guests.

Chairman Powers called for objections or amendments to the meeting's proposed agenda. There being none, the proposed agenda was adopted as presented.

Chairman Powers referred to the draft minutes from the meeting on August 20, 2009, and asked if there were any amendments. There being no amendments and upon motion by Allen Gillespie and second by Travis Pritchett, the minutes from the August 20, 2009, Commission meeting were adopted.

II. ADMINISTRATIVE ITEMS

Chairman Powers introduced Bob Borden, Chief Executive Officer/Chief Investment Officer (CEO/CIO), for a review of the draft Agenda for the Investment Commission Retreat scheduled for November 18-19, 2009, in Pinopolis, South Carolina. Mr. Borden stated that the proposed agenda included macroeconomic overview presentations from some of the Commission's strategic partners and a review of the Commission's Detailed Action Plans. He also reported that the discussions should include Hedging Tail Risk and Risk Parity. Mr. Borden indicated that a significant portion of the agenda would be reserved to discuss amendments to the Incentive Compensation Policy.

Chairman Powers requested information regarding the result of Harvard University's Negative Alpha Fat Tail Risk program. Mr. Borden replied that the managing director of the Pacific Investment Management Company's (PIMCO) tail risk program was scheduled to be a speaker at the Commission's Investment Retreat, and Blaine Ewing provided an overview of several examples of PIMCO's Negative Alpha Fund. Mr. Gillespie suggested reserving time to discuss internal Commission operations and board governance policies and procedures.

Mr. Borden began the discussion of Securities Litigation by stating that Nancy Shealy, General Counsel, and Bank of New York Mellon had historically monitored securities litigation issues. He suggested that the Commission have several law firms on a no-cost retainer to assist in the monitoring of portfolio holdings and potential securities litigation actions. Mr. Borden said that it was his impression that this approach would greatly improve the integrity of monitoring. Ms. Shealy reported that the recruitment of any potential law firms would have to reviewed and approved by the South Carolina Attorney General's Office. She also stated that the Attorney General's office indicated that she and Mr. Borden would need to schedule a meeting to discuss securities litigation prior to the Commission taking any further action. State Treasurer Converse Chellis reported that he had been in contact with several litigation law firms and said that each firm had expertise in different areas. Mr. Chellis noted that several firms had advised that there may be potential issues if the Commission did not pursue a more active role in class action securities litigation cases.

Chairman Powers stated that the Commission had already recovered many millions of dollars as a result of filing claims in securities class action litigation. He reported that he wanted to make it clear that securities litigation had not been neglected and that Ms. Shealy had been very diligent in monitoring and pursuing claims administration. Chairman Powers indicated that the Commission should seek additional assistance to monitor securities litigation. Ms. Shealy explained that expanded focus on securities litigation would give the Commission a closer look at cases on the front end in order to make a determination of whether to vie for lead plaintiff to be in control of the class action lawsuit, to opt-out and bring separate action, or to participate as a passive class member. Mr. Gillespie expressed concerns regarding how potential securities litigation would change as a result of the Commission's strategic partnerships and noted that the securities litigation process could quickly become very complicated and was not always straightforward. Chairman Powers reported that he and Mr. Borden had met with the State Attorney General in January 2009 to discuss any instances in which the Commission, acting on behalf of the South Carolina Retirement Systems (Retirement System) could become lead plaintiff. Mr. Borden said that any litigation would depend on the date of the investment and the evidence. Dr. Pritchett made a motion, which was seconded by Reynolds Williams and passed unanimously, to authorize Mr. Borden and Ms. Shealy to pursue retaining law firms for a potential securities litigation team.

Mr. Borden referred to materials that were distributed to the Commission for review prior to the meeting regarding the budget for Fiscal Year 2010-2011. He explained that the Commission had approved the amended budget during the last Commission meeting with three changes, including custody cost, risk management modeling system, and adjusted salary projections. Mr. Borden reported that these changes resulted in an 11.43% decrease ($725,752) to a proposed final budget of $5,622,587. Mr. Borden and the Commission discussed the proposal to relocate offices to the Capitol Center. Chairman Powers reported that Commission had been at or below budget every year since inception. Mr. Williams made a motion, which was seconded by Mr. Ewing and passed unanimously, to adopt the budget for Fiscal Year 2010-2011.

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

Mr. Borden referred to the first draft of the Commission's Operations Policy. He explained several highlights of the draft. Mr. Borden noted that the Operations Policy included a definition of a quorum. Chairman Powers and Mr. Gillespie requested policy and legal clarification regarding designating signatory authority and parameters of delegation of authority to the retiree representative member of the Commission.

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

III. INVESTMENT ITEMS

Mr. Borden referred to the revised Quarterly Report for periods ended June 30, 2009. Mr. Chellis and Dr. Pritchett requested information regarding the Cumulative Net Benefits calculation on the Quarterly Report. Geoff Berg, Director of Research and Analytics, stated that the calculation was designed to show the impact of benefit payments on the value of the Retirement System's total portfolio (Portfolio). Chairman Powers explained that benefit payments create a negative three percent market value loss to the Retirement System's Portfolio. He also indicated that like most mature state retirement plans, the Retirement System's Portfolio was in a net payable position. Mr. Borden stated that actuarial calculations were designed to account for the negative three percent market value loss.

Mr. Borden introduced Rhett Humphreys from New England Pension Consultants (NEPC) for a report on investment performance for periods ended August 31, 2009. Mr. Humphreys noted that performance of active management in domestic equity was up 20.9 percent for the year to date. Mr. Ewing stated that many managers had outperformed substantially. He also suggested that the Commission not focus on short term periods when evaluating managers because just a year ago, these managers were underperforming substantially. Mr. Ewing added that equities should be reviewed over a five year rolling basis. Mr. Humphreys reported that the total fixed income composite was up 13.2 percent and opportunistic credit was up 23.8 percent for the year to date. Mr. Borden explained that the decisions relating to opportunistic credit during December of 2008 had resulted in excellent performance.

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

Mr. Berg referred to the draft of the Annual Investment Report (AIR) and explained that the draft report featured a revised format. The Commission and Messrs. Berg and Borden discussed content in the report. Chairman Powers requested that once finalized and approved by the Commission, the report be posted on the Commission's website.

He also mentioned that a detailed list of the Commission's holdings was contained in the the report. The Commission received the draft AIR as information.

Mr. Borden reported that Dunkin Allison, Alternative Investment Officer, is in the process of creating annual strategic planning documents for all strategic partnerships. He also said that creating a standardized document for strategic partnerships would allow the Commission to take advantage of the best opportunities, identify benchmarks, and monitor individual and across the board strategic partnership performance. Mr. Borden explained that there were several elements by which to judge the strategic partners, including idea generation, benchmarking, economic benefits, and negotiated concessions.

Mr. Borden introduced Mr. Allison for a review of the proposed strategic planning documents for Mariner/Palmetto State Partners, L.P., and Goldman Sachs Palmetto State Funds A and B, L.P.. Chairman Powers explained that several of the Commission's strategic partnership managers had collaborated on ventures that would be mutually beneficial to each partner and the Commission. He noted the added value that the partnerships contribute to the Retirement System's Portfolio was a huge benefit. Mr. Borden replied that having several strategic partners willing to work with each other, when appropriate, created additional opportunities for the Commission and the Retirement System's portfolios. The Commission received the draft documents as information.

Mr. Borden referred to materials related to the proposed Wilber L. Ross & Company (WL Ross) Investco Mortgage Recovery Fund that were distributed to the Commission for review prior to the meeting. Mr. Borden stated that WL Ross was a well know firm with a stellar reputation in distressed investing. He explained that the Commission had a significant ownership in one of the firm's pre-distressed funds. Mr. Borden said he challenged WL Ross to provide the panoply of what the firm could offer the Commission. He stated that they responded to his challenge by reserving capacity in WL Ross' over-subscribed distressed fund, a $200 million whole loan Public-Private Investment Program (P-PIP) opportunity, and possible investment in another highly distressed industry. Mr. Borden explained that the P-PIP opportunity was time-sensitive. Mr. Gillespie said that WL Ross was engaged in a capital structure arbitrage which would result in definitive negative equity beta. He also stated that when the original investment was made, he was under the impression that the fund would carry its position and it would go into a private equity piece in the event of bankruptcy. Mr. Gillespie added that WL Ross placed private equity into separate investment vehicles than the pre-distressed fund. He suggested expanding the relationship to capture and access the private equity. Mr. Gillespie reported that the size of the distressed market did not reflect the potential opportunities. He noted that WL Ross was well positioned to navigate the distressed markets and to generate significant returns. Mr. Borden stated that within the next five years, he wanted to reduce equity risk to a level lower than the current level. Mr. Gillespie reiterated his confidence in WL Ross, reiterating that their knowledge and expertise in dealing with the federal government would be a great benefit in P-PIP strategies, particularly since the government has more involvement in the economy. Mr. Borden noted that there were exceptional opportunities in the whole loan sector.

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

Mr. Borden referred to materials that were distributed to the Commission for review prior to the meeting regarding private equity recommendations. He reported that NEPC, Dr. Pritchett and several Commission staff members had conducted extensive due diligence review of these managers. Mr. Borden noted that Azalea Capital, L.L.C. (Azalea), was one of the only private equity firms in South Carolina. He reported that Azalea was creating a third fund and suggested an initial investment of $20 million not to exceed 20% of the fund, plus a $40 million co-investment sidecar. Mr. Borden indicated that Azalea had generated significant economics and would be an invaluable resource for the Commission in the South Carolina Private Equity Co-investment Program. Dr. Pritchett stated that he was in favor of the proposed investment. Mr. Chellis made a motion, which was seconded by Mr. Gillespie and passed unanimously, to invest an amount not to exceed $20 million or up to 20% of the fund total in the Azalea Fund III, L.P., to invest in a co-investment sidecar not to exceed $40 million, and to authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the investment upon approval for legal sufficiency by General Counsel.

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

Mr. Borden discussed recommendations relating to Lexington Partners, noting that the Lexington Capital Partners VII, L.P. (Lexington), was very attractive in the secondary markets. Hilary Wiek, Director of Public and Private Equity, noted that Lexington Partners was in the middle to small market size of private equity funds. Mr. Borden stated that Lexington was a secondary private equity fund, which was attractive currently due to distressed sellers and good pool transparency. Mr. Gillespie explained that Stanford had a similar fund that was selling a partial interest in its private equity pool that was almost a secondary, but not exactly. Ms. Wiek added that there were many similar situations, and several firms were examining creative strategies in the secondary markets. Mr. Borden said that he was in discussions with Stanford and explained that Stanford would still own part of the assets, so they would not be out of the picture. He also indicated that vintage year diversification and deal type issues would need to be examined before any recommendations were made. The Commission discussed the new standardized due diligence framework document that Ms. Wiek had created for all equity recommendations.

On a side note, Mr. Borden reported that the Apollo Palmetto Strategic Partnership, L.P., was able to acquire Lehman Brothers' stake in Apollo's Fund VII at 10% of what Lehman had invested. Mr. Allison stated that transaction had resulted in a $1.5 million instant gain for the Portfolio.

After further discussion, Mr. Gillespie made a motion, which was seconded by Mr. Williams and passed unanimously, to invest an amount not to exceed $100 million or up to 20% of the fund total in the Lexington Capital Partners VII, L.P., to invest in a co-investment sidecar not to exceed $50 million, and to authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the investment upon approval for legal sufficiency by General Counsel.

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

Mr. Chellis recused himself from discussions and voting on matters related to Aquiline Capital Partners (Aquiline). Mr. Borden explained that Aquiline was the first private equity manager that was hired by the Commission and they are a specialist in the financial services sector. He also said that Aquiline had generated several co-investments for the Commission and indicated that they were in the process of starting a second fund. Chairman Powers reported that Aquiline was a very transparent and open manager. He stated that the returns were favorable and was impressed with the progress in Aquiline Financial Services Fund I L.P. Dr. Pritchett said that he was impressed with the high caliber of their personnel and their experience. Mr. Borden explained that Aquiline's employees were highly seasoned investment professionals that bring exceptional deal flow to the firm. After further discussion, Mr. Williams made a motion, which was seconded by Mr. Gillespie, to invest an amount not to exceed $50 million or up to 20% of the fund total in Aquiline Financial Services Fund II, L.P., to invest in a co-investment sidecar not to exceed $50 million, and to authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the investment upon approval for legal sufficiency by General Counsel. The motion passed with Messrs. Ewing, Gillespie, Powers, and Williams voting in favor of the motion. Mr. Chellis abstained from voting on the motion.

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

Mr. Ewing recused himself from discussions and voting on matters related to TrueBridge Capital Partners' (TrueBridge) CVE – Kauffman Fellows Endowment Fund II, L.P. Ms. Wiek reported that the Commission's performance in CVE – Kauffman Fellows Endowment Fund I, L.P. had been positive and had resulted in several sidecar opportunities. Dr. Pritchett noted that TrueBridge was a professional firm with highly educated leadership that had no trouble raising funds. After further discussion, Mr. Chellis made a motion, which was seconded by Mr. Gillespie, to invest an amount not to exceed the lesser of $50 million or up to 20% of the fund total with TrueBridge Capital Partners' (TrueBridge) in the CVE – Kauffman Fellows Endowment Fund II, L.P., to invest in a co-investment sidecar not to exceed $50 million, and to authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the investment upon approval for legal sufficiency by General Counsel. The motion passed with Messrs. Chellis, Gillespie, Powers, and Williams voting in favor of the motion. Mr. Ewing abstained from voting on the motion.

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

Ms. Wiek referred to documents that were distributed to the Commission for review prior to the meeting regarding public equity recommendations. She reported that she had conducted an in-depth performance analysis of the US Small Cap Growth Equity product managed by Batterymarch Financial Management, Inc. (Batterymarch), the Small Cap Value Equity product managed by Integrity Asset Management LLC (Integrity), and the Small Cap Growth Equity product managed by Turner Investment Partners, Inc. (Turner). Ms. Wiek reported that both Integrity and Turner had been above their benchmarks cumulatively, while Batterymarch's performance was not cumulatively above their benchmark within the last five years. Mr. Borden recommended terminating the Commission's contract with Batterymarch. After further discussion, Mr. Williams made a motion, which was seconded by Mr. Gillespie and passed unanimously, to terminate the Commission's contract with Batterymarch Financial Management, Inc., for management of assets in the Small Cap Growth Equity investment strategy, to engage Russell Implementation Services, Inc., as a transition manager to transition the assets into cash to be invested in the Beta Overlay Program, and to authorize the Chairman or his designee to negotiate and to execute any necessary documents to implement the Commission's actions.

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

Mr. Borden referred to a memorandum that was distributed to the Commission for review prior to the meeting relating to proposed benchmark changes. He said that recent changes in asset allocation targets highlighted issues regarding whether the Commission was using the appropriate performance benchmarks. He explained proposed changes to cash, opportunistic credit, and commodities benchmarks. Chairman Powers questioned if backdating proposed benchmark changes to January 1, 2009 would trigger incentive compensation. Mr. Borden replied that the proposed changes would not result in the accrual of any incentive compensation. Mr. Williams made a motion, which was seconded by Mr. Ewing and passed unanimously, to change the cash benchmark from 3 Month LIBOR to 3 Month T-Bills; to change the opportunistic credit benchmark from the BarCap High Yield to 1/3 BarCap High Yield, 1/3 S&P Levered Loan Index, and 1/3 BarCap MBS Index; and to change the commodities benchmark from the Goldman Sachs Commodity Index to the Dow Jones/UBS Commodity Index.

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

IV. OTHER BUSINESS

Mr. Borden introduced David Klauka, Senior Alternatives Officer, Mike Addy, Senior Fixed Income Officer and J.P. Boyd, Alternatives Officer. Chairman Powers and the Commission welcomed them to the staff.

V. ADJOURNMENT

There being no further business, Chairman Powers thanked everyone for attending, and the meeting adjourned at 12:16 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 October 13, 2009.]