**South Carolina Retirement System Investment Commission**
**Meeting Minutes**

**June 10, 2010**

**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, Jonathan Boyd, Donald Brock, Harris Chewning, Dori Ditty, Brenda Gadson, Hershel Harper, Cindy Lau, Sarah Lohmann, Doug Lybrand, Jared O'Connor, Kathy Rast, Nancy Shealy, Nicole Waites, Brian Wheeler, and Hilary Wiek from the South Carolina Retirement System Investment Commission; Jim Holly from the State Comptroller General's Office; Shakun Tahiliani from the State Treasurer's Office; Ashli Aslin and Keth Stronkowsky from New England Pension Consultants; Peggy Boykin, Tammy Nichols, Robyn Leadbitter, John Page, Danielle Quattlebaum, and Faith Wright from the South Carolina Retirement Systems; R.D. Gubbs and K.D. Phelps from the South Carolina Highway Patrol; Wayne Bell, Parker Evatt, Sam Griswold, Charley McDonald, and Wayne Pruitt from the State Retirees Association of South Carolina; and Cathy Hazelwood from the South Carolina Ethics Commission.

## I. CALL TO ORDER AND CONSENT AGENDA

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 asked if there were any 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 March 18, 2010 and asked if there were any amendments. There being no amendments and upon motion by Travis Pritchett and second by Allen Gillespie, the minutes from the March 18, 2010 Commission meeting were adopted unanimously.

Chairman Powers stated that since this meeting was the last meeting of the fiscal year, he wanted to take a moment to discuss the Commission's progress. He reported that the Commission was formed in part to address the historically low returns of the South Carolina Retirement Systems' (Retirement System) total portfolio (Portfolio), which could result in a burden on taxpayers to fund the Retirement System's unfunded liability. He also said that the Portfolio had had consistent low peer group rankings compared to other large pension plans with diversified portfolios. Chairman Powers stated that there had been many legislative barriers keeping returns and peer group rankings in the bottom 5-10 percent of large public pension plans. He noted that Reynolds Williams was instrumental in efforts to educate voters prior to the referendum to amend the Constitution of South Carolina to allow full diversification of the Portfolio. Chairman Powers said that for the Fiscal Year-to-Date, the Portfolio was up 18.20 percent. He also noted that the Commission's decisions had added significant value to the Portfolio since 2005. Chairman Powers referred to the Rolling Peer Percentile Rank chart and explained how, under the Commission's leadership, the Portfolio returns had moved from the lowest rankings up to the 85th percentile (with 1 being the worst and 100 the best). He said that the goal of the Commission had always been to go from "worst to first", and he predicted that after final performance figures are computed at the end of the fiscal year, the Retirement System should be near the top of its peer group. Mr. Gillespie concurred with Chairman Powers' comments and projected that the Portfolio's performance was within the top 5 percent of its peers. Chairman Powers said that the Commission's actions had contributed hundreds of millions in revenue dollars to the Portfolio.

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

## II. STRATEGIC PLAN MATTERS

GOAL VII: PERFORM FEASIBILITY STUDY AND PREPARE RECOMMENDATIONS FOR LONG-TERM ORGANIZATIONAL STRUCTURE

Chairman Powers introduced Bob Borden, Chief Executive Officer/Chief Investment Officer (CEO/CIO), for an update on Goal VII of the Commission's Strategic Plan, "Perform Feasibility Study and Prepare Recommendations for Long-term Organizational Structure" (Goal VII). Mr. Borden stated the Commission had been successful in increasing returns and building a competent investment organization while operating on a very small budget. He noted that the Commission continued to add hundreds of millions in revenue to the Portfolio on a yearly basis, although the Commission faced significant challenges moving forward.

Mr. Borden briefly discussed a recent article in which Laurence Fink, Chairman and Chief Executive Officer of BlackRock Financial Management, Inc., opined that a 6 percent return over GDP would be difficult to achieve consistently over the next several years. Mr. Borden, noting that the South Carolina Budget and Control Board (B&C Board) had increased the assumed rate of return from 7.25 to 8.0 percent, said a higher rate of return assumption increased pressure on the Commission to find creative solutions to earn revenue. He reported that the economy was currently in a low growth era and opined that the reduction of Federal stimulus funding would continue to slow growth. Mr. Borden said that the ability to generate excess returns over the policy benchmarks was a function of selections and active risks in the market, and costs for those selections and risks were paid. He reported that New England Pension Consultants (NEPC) had estimated the Commission's future rate of return at 8 percent, which was down from 9.6 percent the previous year. Mr. Borden said that this reduction was a result of how the market had changed within the past year. He indicated that despite some market growth, valuations were down and were not as significantly cheap as before. Mr. Borden reported that low valuations, low interest rates, and low growth estimates conspired to produce a fairly muted set of returns going forward. He said in order to achieve higher alpha, the Commission must either assume more risk or reduce fees. Mr. Borden reported that involvement with Strategic Partnerships had provided the Commission with alpha generating opportunities that would not have been possible in the past. He also indicated that the Commission currently had a highly outsourced operations model. Mr. Borden reported that the returns from the outsourced model had been good, but they came at a cost. He estimated that the Commission paid over $150 million in management fees and hundreds of millions of dollars in carried interest annually. Mr. Borden said that the Commission could not expect higher returns at zero cost. He outlined a “buy versus build” analysis and indicated that a significant increase in the Commission’s operating budget would be needed to build an optimal internal management structure. Alternatively, Mr. Borden said that the Commission could build a management structure externally. He identified several possible roadblocks to building the structure internally, including the process to increase the Commission’s operating budget and the ability to attract experienced investment professionals within current salary constraints.

Mr. Borden reported that the Portfolio had enjoyed a period of significant recovery within the last year and noted that it was currently in a good position. He said that unless a catastrophic market event occurred, the Portfolio would end Fiscal Year 2010 with double digit returns. Mr. Borden cautioned, however, that achieving double digit returns would become increasingly difficult going forward, and it would be challenging to meet the actuarial rate of return over the next 5 to 7 years.

Chairman Powers summarized Mr. Borden’s comments and opined that the Commission could either pay managers outside of South Carolina millions of dollars or pay managers who work, pay taxes, buy houses, and raise children in South Carolina to do the same thing. He said that every member of the B&C Board had been contacted regarding the proposal for Goal VII. He also indicated that the proposal for Goal VII was only under consideration. Chairman Powers reiterated comments from the last Commission meeting by stating that as fiduciaries, the Commission must develop ideas to increase Portfolio returns at an acceptable level of risk. He said that the proposal for Goal VII was one way to increase Portfolio returns, while helping the state of South Carolina in the process. He reported that no decision or motion had been made to implement the proposal for Goal VII, and he opined that it would take several months before the Commission could make such a decision.

Chairman Powers noted that copies of Mr. Borden’s presentation had been made available. Mr. Borden confirmed that in addition to copies that were distributed during the meeting, copies of the presentation were available at the door of the meeting room.

Chairman Powers expressed concern about the inaccurate misinformation that had been circulated about Goal VII. He reiterated that all investments for the Retirement System had been discussed and voted upon in public session, and he stated that more detail about Goal VII had been discussed at the Wampee Strategic Planning Retreat, which was also a public meeting. He said that he concurred with Mr. Borden’s statement that the Commission could only do two things to enhance performance: either target greater returns at higher risk or reduce fees and costs. Chairman Powers opined that the Legislature could do three things; raise the retirement age, increase employee contributions, or decrease distributions.

Chairman Powers stated that rumors had circulated through the B&C Board and other groups that the Commission was considering taking an illegal course of action with regard to Goal VII. He reiterated that no member of the Commission had received any financial gain from the decisions of the Commission, and in fact, serving on the Commission had personally cost Commissioners approximately $5,000-$60,000 per year in lost work, personal time, and personal expenses. Chairman Powers stated that he was frustrated by the misconceptions and inaccurate information circulating about Goal VII and that he was disappointed to end his term as Chairman with accusations of Commission wrongdoing, especially after the hard work and dedication that each Commissioner had provided to the Retirement System. He reiterated his displeasure with the notion that a new idea that could help the state and earn revenue for the

Portfolio, while saving money, would be misconstrued as an illegal course of action before the issues were thoroughly explored and vetted by the Commission.

Mr. Williams said that under Chairman Power's leadership, Mr. Borden had developed a strategy and a goal which stood a strong chance of gaining $500 million to $1 billion for the Retirement Systems. He reiterated that the proposal was currently only an idea under consideration. Mr. Williams also said that as a fiduciary, if a strategy could legally, ethically, and morally add significant value to the Portfolio, then it must be considered – otherwise the Commission could be breaching its fiduciary responsibility. Dr. Pritchett, who stated he invited several retirees to the meeting, said that any decision regarding any proposal should be made with retirees having full knowledge of the discussions. Chairman Powers concurred with Dr. Pritchett. Dr. Pritchett noted that he was concerned with the speed of the Goal VII proposal review process and that an alternative of setting up an internal program had not been fully vetted.

Mr. Gillespie said that setting up an internal program was possible, but would require significant changes to the Commission's operating budget. He indicated it had been difficult to raise the operating budget from $4.7 million to $6.2 million, so an increase between $25 & $50 million would be very difficult to achieve. Mr. Gillespie said he did not disagree that an internal program should be considered. He noted that an internal program would have many of the same constraints and impediments that the Commission currently suffers. Mr. Gillespie said that people would have to understand that an internal program would cost approximately $50 million. He also noted that bank deleveraging opportunities would not last forever, so a decision must be made in a timely manner. Mr. Chellis said that a $24 billion portfolio investment operation required a budget larger than $5 million. He opined that an internal program should be created. Mr. Williams stated that it was the quality of time devoted to reviewing the Goal VII proposal, not the just the lapsing of time. He also said that current opportunities were not going to be available in the future. Mr. Ewing added that he had recommended expansion of operations and additional staff since the Commission was created. He said that the Commission should build out to become the best investment organization possible over a long term perspective. Mr. Ewing opined that a $5 million operating budget was wholly inadequate to effectively manage a $24 billion portfolio.

After further discussion, Chairman Powers summarized that the general consensus of the Commission suggested some changes needed to be made. He said that the Commission could examine Mr. Borden's proposal for Goal VII or take no action, which would itself be a decision.

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

GOAL I.C.3: EXECUTE MAJOR INVESTMENT PORTFOLIO INITIATIVES

Mr. Borden introduced Hershel Harper, Deputy Chief Investment Officer, for an update on the Hedge Fund Transition Plan (HF Plan). Mr. Harper explained that while the Commission had previously approved the overall HF Plan, he sought Commission approval to transfer hedge fund interests from the Portfolio's Strategic Partnerships and any existing hedge fund of funds to the Retirement System at the discretion of the CEO/CIO as part of the implementation of the HF Plan. He said that the Retirement System's direct ownership of the hedge funds would result in the elimination of redundant hedge fund of fund management fees. Mr. Borden explained that the funds were currently in accounts that incurred an additional layer of fees, and they wanted authority to move the funds out of these types of accounts. Mr. Gillespie questioned the

Commission taking direct ownership of the funds with regards to underwriting. Mr. Harper replied that working in conjunction with NEPC, existing Strategic Partners would continue to underwrite the funds. Chairman Powers indicated that Mr. Borden performed similar tasks for the Commission on a daily basis, and he had no objection to delegating authority to Mr. Borden to use his discretion to transition these funds. Chairman Powers said the Commission would save approximately 75 basis points (bps) per $250 million of these investments. After further discussion, Mr. Williams made a motion, which was seconded by Mr. Ewing and passed unanimously, to authorize the CEO/CIO to transfer hedge fund interests from the Strategic Partnerships and any existing hedge fund of funds at his discretion and within the targets previously approved by the Commission and to authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the transfers.

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

## III. INVESTMENT MATTERS

Mr. Borden stated that several managers had not added consistent value to the Portfolio. He described issues with performance and recommended that the Commission terminate investment management contracts with Legg Mason Capital Management, Inc., WCM Investment Management, ClariVest Asset Management LLC, and Aronson, Johnson & Ortiz, LP (AJO). Mr. Borden reported that AJO had added 30 bps of value, but indicated that the Commission's portable alpha allocation had added 60-90 bps of value during the same periods. He stated that Russell Implementation Services could manage the transitions and noted that monies would be redeployed to the S&P 500 Index allocation or existing small cap managers. Mr. Borden noted that with the exception of ClariVest, these contracts were due to expire in August 2010. He noted further that he had a long term goal of revaluating small cap managers and may consider recommending additional managers in the future. Mr. Gillespie suggested renewing the contract with AJO, particularly as there was a favorable performance-based fee schedule so the Retirement System did not incur fees if the portfolio underperformed its benchmarks. Mr. Ewing concurred with Mr. Gillespie's comments. After further discussion, Dr. Pritchett made a motion, which was seconded by Mr. Ewing and passed unanimously, to terminate the contracts with Legg Mason Capital Management, Inc., WCM Investment Management, and ClariVest Asset Management LLC, with timing of the terminations at the CEO/CIO's discretion, to authorize the Chairman to execute any necessary documents to implement the terminations, to renew the contract with Aronson, Johnson & Ortiz, LP prior to the expiration of the current contract, and to authorize the Chairman or his designee to negotiate and execute the new contract and any necessary documents to implement the Commission's decisions regarding AJO.

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

Mr. Borden referred to materials relating to a proposed investment with Ranieri Partners LLC (Ranieri), an affiliate of the Selene investment management firms. He explained that the investment would be in the form of a secured convertible note with a newly formed company, R-SC Financing Conduit LLC, and the investment would provide an opportunity to invest in several Selene ventures, including a commercial loan origination bank, a mortgage origination company, and a commercial and industrial lending company. He opined that it would be in the Retirement System's best interest to seek equity ownership interest in the underlining enterprises. After further discussion, Mr. Ewing made a motion, which was seconded by Mr.

Chellis and passed unanimously, to invest an amount not to exceed $25 million with Ranieri through a secured convertible note with R-SC Financing Conduit LLC, to authorize the CEO/CIO to execute the conversion right at his discretion, and to authorize the Chairman or his designee to negotiate terms and 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 E).

## IV. OTHER BUSINESS

Mr. Borden reported that the lease of the Commission's new office space at 1201 Main Street was close to being finalized by all parties. He also indicated that the Commission planned to move into the new space during the last week of July or the first week in August 2010.

Mr. Williams said that speaking from his own experience, Chairman Powers' term had been considerably more difficult than his term as Chairman of the Commission and thanked Chairman Powers for his dedicated and diligent work. Mr. Ewing echoed Mr. Williams' comments. Chairman Powers reiterated that within the last 5 years, the Commission had moved the Portfolio from one of the worst performing plans in the country to one of the best.

Chairman Powers noted that his term as Chairman would end June 30, 2010, and that Mr. Gillespie would become the new Chairman effective July 1, 2010. He stated that the Commission would affirm Mr. Ewing as the Vice Chairman of the Commission at the next meeting.

## V. EXECUTIVE SESSION

Mr. Gillespie made a motion for the Commission to recede to executive session to receive legal advice and discuss pending contractual matters relating to Lehman Brothers. Mr. Ewing seconded the motion, which passed unanimously. Chairman Powers announced that the Commission would meet in executive session to receive legal advice and discuss pending contractual matters relating to Lehman Brothers, and he asked Mr. Borden and Ms. Shealy to remain in the meeting.

The Commission reconvened in open session and Mr. Chellis made a motion, which was seconded by Mr. Williams and passed unanimously, to authorize the Chairman and staff to take the course of action discussed in executive session regarding Lehman Brothers.

## VI. ADJOURNMENT

There being no further business, the meeting adjourned at 12:05 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 entrance, in the lobbies, and near the 2nd Floor Conference Room at 202 Arbor Lake Drive, Columbia, SC, and at the Commission's office at 200 Arbor Lake Drive, Columbia, SC, prior to 9:00 a.m. on June 9, 2010.]