South Carolina Retirement System Investment Commission
Meeting Minutes

July 15, 2010

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

Commissioners Present:
Mr. Allen Gillespie, Chairman
Mr. Blaine Ewing, Vice Chairman
State Treasurer Converse Chellis
Mr. James Powers
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, Andrea Chapman, Harris Chewning, Dori Ditty, Brenda Gadson, Hershel Harper, David King, Dave Klauka, Sarah Lohmann, Doug Lybrand, Jared O'Connor, Kathy Rast, Nancy Shealy, Nicole Waites, Brian Wheeler, Hilary Wiek, and James Wingo from the South Carolina Retirement System Investment Commission; Jim Holly from the State Comptroller General's Office; Mike McDermont, Frank Rainwater and Shakun Tahiliani from the State Treasurer's Office; Ashli Aslin and Rhett Humphreys from New England Pension Consultants; Chris Anderson, David Avant, Sarah Corbett, Robyn Leadbitter, Tammy Nichols, John Page, Danielle Quattlebaum, Joni Redwine, and Faith Wright from the South Carolina Retirement Systems; Hasan Ross-El from Northwestern Mutual Financial Network; David Rodarte and Linda Rodarte from Sopher-Rodarte & Associates; Broadus Jameson from the South Carolina State Employees Association; Gary Forte from UBS; Bruce Jackson from Arnall Golden Gregory, LLP; Torrey Rush from Ed Rush Development; Wayne Bell, Parker Evatt, Sam Griswold, Charley McDonald, and Wayne Pruitt from the State Retirees Association of South Carolina.

I. CALL TO ORDER AND CONSENT AGENDA

Chairman Allen Gillespie 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 Gillespie called for objections or amendments to the meeting's proposed agenda. There being none, and upon motion by Blaine Ewing and second by Reynolds Williams, the agenda was adopted.

Chairman Gillespie referred to the draft minutes from the meetings on May 20-21, 2010 and June 10, 2010, and asked if there were any amendments. Chairman Gillespie noted that there were several technical amendments, which could be made by staff upon approval of the Commission, and the Commission concurred. There being no substantive amendments and upon motion by Travis Pritchett and second by Mr. Ewing, the minutes from the meetings on May 20-21, 2010 and June 10, 2010 were adopted unanimously with technical amendments to be made by staff.

Chairman Gillespie reported that he had heard comments and accusations which he felt were unfair to former Chairman James Powers. He reminded the Commission that experts from the Center of Fiduciary Studies presented the SAFE (Self-Assessment of Fiduciary Excellence) standards to the Commission several years ago. Chairman Gillespie said that two of the best practices of fiduciary management included periodic review of organizational structure and review of external and internal fees. He expressed concerns about how recent Commission discussions had been misconstrued into some type of scheme while in fact, the discussions had been in accordance with best practices. He provided additional perspective on the discussions, stating that during a break at the November 2009 Wampee Strategic Planning Retreat, he and Mr. Powers were discussing primary dealerships. He said that this discussion spurred the idea to create a separate entity from the Commission because of the substantial decrease in the number of primary dealers. Mr. Gillespie opined that starting a primary dealership would cost approximately $250 million, including licenses. He said that the idea to create an entity was a result of a quick brainstorming session with Mr. Powers and that it lead to further exploration of ideas to implement part of the Commission's Strategic Plan that had been adopted previously.

Chairman Gillespie reported that all Commission Self Evaluation forms had been turned in and were available to any Commissioner for review.

Chairman Gillespie stated that he, as former Vice Chairman, and former Commission Chairman Powers had nominated Mr. Ewing to serve as the Commission Vice Chairman for a term of two years. He noted that there were two other Commissioners who met the nomination qualifications for Vice Chairman under the Commission's policy. State Treasurer Converse Chellis made a motion, which was seconded by Mr. Williams, to close nominations for the position of Commission Vice Chairman and to elect Mr. Ewing as Vice Chairman. The motion passed unanimously.

Chairman Gillespie introduced Bob Borden, Chief Executive Officer/Chief Investment Officer (CEO/CIO), for an update the Service Provider Selection Policy. He reported that the first draft was presented at the 2010 Strategic Planning Retreat and only minor changes had been made. After further discussion, Mr. Chellis made a motion, which was seconded by Dr. Pritchett and passed unanimously, to approve the Service Provider Selection Policy.

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

II. ADMINISTRATIVE ITEMS

Chairman Gillespie asked Mr. Williams and Nancy Shealy, General Counsel, to comment on the process by which external legal counsel for the Commission is selected. Mr. Williams explained that by statute, the South Carolina Attorney General must approve the hiring of external counsel. He also noted that depending on the legal task to be performed, the Commission had identified a pool of qualified law firms to perform specialized legal review. He explained that typically, the firms within that pool were reviewed and, once selected for a particular assignment, a packet of information regarding the proposed firm was forwarded to the Attorney General for approval. Mr. Williams opined it was a cumbersome process that was not to his satisfaction. He suggested developing a plan to create a more efficient process to hire outside counsel. Mr. Williams expressed further concerns with the current legal selection process with regards to not being able to act quickly enough for current and potential investments. Ms. Shealy reported that the process had improved over the past few years due to the standardization of certain documents. She also reviewed the history of legal vendor selection

and explained that when the Commission first considered alternative investments, a Request for Information (RFI) had been issued to identify qualified outside counsel. Ms. Shealy reported that she still continued to receive proposals from law firms, which were vetted and considered for current and future selection. Ms. Shealy stated that the South Carolina Budget and Control Board had an exemption from the approval process of the Attorney General that allowed them to procure outside legal counsel without approval.

Mr. Borden introduced attorney Bruce Jackson from Arnall, Golden Gregory LLP, to discuss issues relating to "Goal VII: Perform Feasibility Study and Prepare Recommendations for Long-Term Organizational Structure" (Goal VII or Strategic Plan). Mr. Jackson noted that his firm had worked with the Commission on various investment matters over the past three years. He said that he attended the 2010 Strategic Planning Retreat at Wampee in May 2010 and that he had reviewed the Strategic Plan as prepared by Commission staff. Mr. Jackson said his firm was hired after the Retreat to provide legal advice as to whether the Commission had the authority to engage and/or implement certain aspects of Goal VII, especially issues related to the "hybrid model" (also referred to as "NewCo").

Mr. Jackson explained that Goal VII included three proposals: maintaining "status quo" with increased internal funding and staff, a plan for "complete outsourcing", and the "hybrid model". The "hybrid model" was a plan which would facilitate the formation of an asset management company to be based in South Carolina with a number of ancillary benefits. He noted that the "hybrid model" was designed to allow the Commission to move in a more efficient and timely manner in accessing a broader scope of opportunities and to dramatically reduce investment management fees and carried interest. Mr. Jackson noted that in terms of the Commission's authority, he used the word "facilitate" the asset management company because the legal result would not change whether the Commission facilitated and reached its goals contractually through an outside asset management company or whether the Commission arranged the South Carolina Retirement Systems (Retirement System) to own part or all of the proposed asset management company or whether the Commission implemented some other arrangement such as using convertible lending or other arrangements to facilitate the company.

He stated that the Commission was established in 2005, and S.C. Code Ann. §9-1-1310 was amended at that time to provide an extensive, representative list of permitted or allowed investments. Mr. Jackson said the statute notably included language that the list was an "included, but not limited to" list. He also stated that under the provisions of Art. X, §16 of the South Carolina Constitution, the Commission's authority in this regard was virtually unlimited. He stated that the Commission's authority was limited only by the governance statutes that provide how and in what manner the Commission could proceed. Mr. Jackson said that these governance statues applied to all prior, current, and future Commission investments and activities. Mr. Jackson explained that the ultimate authority to invest was with the Commission, so even if a proposed asset company was created, every investment vehicle that the Commission used must be approved by the Commission. He said that there would be no legal intent to, nor could the Commission turn all matters over to the proposed asset management company. Mr. Jackson stated that ultimate investment authority, by law, would continue to reside with the Commission.

With regards to the ancillary benefits outlined in the Strategic Plan, Mr. Jackson stated that the proposal included dramatic and revolutionary ideas that could create a whole new industry in South Carolina, including being a magnet for other financial services businesses. Mr. Jackson also explained that under the Strategic Plan, direct investments within South Carolina could range from mortgage origination for homeowners to mortgage rescue and venture capital, when

appropriate. Mr. Jackson noted that if a proposed investment had ancillary benefits, the Commission must first determine that the investment providing the benefits was prudent even without those ancillary benefits. Ms. Shealy noted that consideration of ancillary benefits was generally referred to as the "social investing statute".

With regards to the possibility of transferring employees of the Commission to the asset management company, Mr. Jackson stated that the decision to hire employees would be made by the asset management company because the amount of influence the Commission would have over the management company had yet to be seen. He noted that the mission of the asset management company would be aligned with the Commission. Mr. Jackson said legally, it would be important that the Commission retained some oversight as to how Commission employees would be transitioned to the asset management company. Mr. Jackson said he had identified no specific legal prohibitions against any Commission employee, including the CIO, from resigning employment with the Commission and becoming employed with another company, including the proposed asset management company. He noted the only restrictions regarding employment would be that a former Commission employee could not represent another company before the Commission for one year after resigning from the Commission. Mr. Jackson also said that unless waived, former employees were bound by confidentially relating to Commission matters. He indicated that according to the South Carolina Code of Laws, a former employee could not own or control another company in which the Retirement System had invested. Mr. Jackson said that neither salary nor whether the former employee was an executive employee would be a factor of control of the company. He explained that control was a very high standard characterized by voting control or the power to direct the affairs of a company. He suggested that appropriate controls be established to ensure any former Commission employee would not have control or ownership of the proposed asset management company.

Mr. Jackson said that the Commission had full legal authority to implement all or part of the Strategic Plan and in doing so, the Commission should continue operating, as it has done since inception, under the governance statutes. Mr. Ewing asked if ownership was in perpetuity. Mr. Jackson replied that ownership or control by a former employee or fiduciary meant that unless waived by the Commission, the Commission could not do business with that employee or fiduciary for three years. Mr. Chellis asked if there were penalties if a former employee or fiduciary benefited from a relationship that was associated with the Commission, and Mr. Jackson replied that the specific statute only considered ownership or control. He also explained, however, that there were other legal provisions that prohibited a state employee from making a decision for his own financial benefit or his family's financial benefit. Mr. Jackson explained further that if the person was the employee who approved the decision, then he could not make the decision. He indicated that as long as the employee did not control or have ownership in the company or gain any financial benefit, he could make decisions. Mr. Jackson said that even if the employee planned on working for the proposed asset management company, the ultimate decision as to whether the employee was hired resided with the asset management company. He suggested, as a matter of caution, a former employee should be recused from the decision making process. Mr. Jackson explained that the Commission's governance statutes also addressed issues with potential insider trading provisions; neither the Commission nor its employees could invest in something that they learned about while working with the Commission.

Chairman Gillespie noted that Federal securities laws outlined that control did not necessarily reside with ownership. He said that if the Commission established a separate entity, depending on the type of entity, there was a further set of securities laws that related to control. Mr.

Jackson added that the statutes used the terms “ownership” and “control”, but did not define those terms. He noted that he did not see any terminology in the Strategic Plan that would indicate that any one person, including the CIO, would be an owner or control the “hybrid” asset management company. Mr. Jackson noted further that South Carolina’s securities laws provided that controlling persons may be liable for certain violations of the securities laws as well.

Mr. Jackson said that the asset management company could be structured so that the parent company would be the administrator and it, in turn, would create subsidiaries that would be investment vehicles. He further stated that the Commission would be able to decide if the Retirement System invested in the investment vehicles. As to the establishment of the asset management company itself, if among the alternatives the Commission wished to consider owning a piece of the asset management company, then that was itself an investment which must be approved by the Commission. Mr. Jackson said that legally it would not be permissible, nor did the Strategic Plan suggest, that the Commission was simply going to turn money over to the proposed asset management company and allow it to decide where to invest the Retirement System’s assets. He said that the Commission would decide where to invest the Retirement System’s assets. Mr. Williams noted that this was the same relationship that the Commission had with all of its managers. Mr. Jackson concurred with Mr. Williams comments and indicated that the Commission had absolute control of all Retirement System’s investments.

Chairman Gillespie suggested that some of the current discussion topic would depend on how the asset management company was structured. He said that if a company was created with a full balance sheet, then it would be free to invest its balance sheet. Chairman Gillespie said that a primary dealer must have a balance sheet that was not derived from outside capital. Mr. Jackson said, as an example, if the Commission wished to initially capitalize the balance sheet, it should be done under conditions that the money be spent only in certain places and ways which were not considered investments such as office space, salary, purchasing computers, etc.

Mr. Jackson said a written summary of his legal review would be distributed to the Commission in the near future. Ms. Shealy noted that the legal summary would be subject to the attorney client privilege. She also suggested that the Commission should waive attorney client privilege only with consent of each individual Commissioner. The Commission discussed issues regarding the attorney client privilege and how it applied to the Commission. Ms. Shealy explained that each Commissioner had potential personal liability for breach of fiduciary responsibility. After further discussion, Mr. Ewing made a motion, which was seconded by Mr. Williams and passed unanimously, that the forthcoming legal memorandum from Arnall be distributed to the Commission members and General Counsel and be specifically designated as confidential information until the Commission, as the governing body, determined that the document could be made public.

III. INVESTMENT ITEMS

Mr. Borden reported that the Commission’s preliminary rate of return for Fiscal Year 2010 was approximately 14.37 percent. He also noted that this performance was achieved at one half of the equity exposure of the Commission’s peers. Mr. Borden said that the policy return was 10.42 percent and the strategy return was 10.64 percent, which indicated that portfolio rebalancing decisions had been correct and had added value. He also said that the portfolio had generated over 400 basis points (bps) of alpha during the current year. Mr. Powers requested that Mr. Borden provide the Commission with information regarding actuarial

assumed rates of return for the Commission's peers. Mr. Borden replied that the ability to earn an 8 percent rate of return would be very challenging in the current market environment. He also indicated that about a dozen states were in the process of lowering their actuarial assumed rates of return.

Mr. Borden introduced Geoff Berg, Director of Research and Analytics, for an update on the portfolio-level allocation dashboard. He reported that the Commission had not been bullish in large cap investments. Mr. Berg also noted that the Commission had voted to terminate contracts with two active equity managers during the last meeting. He indicated that the current portfolio allocation was underweight in the developed international world due to global growth concerns. Mr. Berg also stated that the current allocations were overweight in core fixed income. He indicated that private equity allocations had increased from approximately $538 million last year to close to $1 billion currently, with commitments equaling $2.5 billion. Mr. Berg opined that as the Commission continued to allocate to emerging markets, the robust cash position would become helpful. Dr. Pritchett expressed concerns with allocations to cash and short duration funds for emerging markets and real estate due to low returns of those asset classes. Mr. Berg replied that the current cash allocations were not optimal and staff was in the process of directing the cash allocation to other investments. Chairman Gillespie asked Hilary Wiek, Director of Public and Private Equities, to explain the recent increase in private equity capital calls. Ms. Wiek indicated that tracking trends was difficult due to the program's infancy, but she said that draw downs and distributions had increased during the past year. Mr. Borden said that the current progression of the private equity capital calls was within normal ranges and were neither fast nor slow. Mr. Borden highlighted being $1 billion underweight in real estate and noted that it was time to be more opportunistic in all underweight asset classes.

Hershel Harper, Deputy Chief Investment Officer, referred to the performance report for the period ended May 31, 2010, and noted that equity markets were down 7 percent. He reported that the large cap growth managers had struggled against their policy benchmarks while small cap managers had added significant value against their benchmarks. Mr. Harper explained that the credit markets had performed very well. He also stated that the Portfolio had recently had equity-like returns from the credit strategies. With regards to hedge funds, Mr. Harper said that performance was up 10 percent for the Fiscal Year to date.

Rhett Humphreys from New England Pension Consultants (NEPC) referred to the May 2010 performance report and noted that performance for total core fixed income had been "a home run". He reported that the outlook for global fixed income was in the low to mid 3 percent range, but indicated that within the last year, the Portfolio had returns in the 16 percent range. With regards to high yield, Mr. Humphrey said that despite the Commission being late in funding high yield investments, the Portfolio performed equivalent to the benchmark of 25 percent. Mr. Borden noted that this Portfolio performance exceeded the Russell 1000 benchmark. Mr. Humphreys explained that the Portfolio had earned 7-8 percent alpha for the Fiscal Year to date. He also said that the global allocation component of the Portfolio earned 13.68 percent despite the benchmark performance of only 7.86 percent.

Mr. Borden noted that two years ago, the Commission decided that opportunistic credit would be a good place to take advantage of market dislocation. He reported that the allocation to opportunistic credit was up 25.86 percent versus the blended benchmark of 16.6 percent, resulting in 900 bps of alpha on top of the high absolute return. The Commission discussed benchmarks, and Mr. Ewing opined that evaluating a manager on a one- to two- year basis was not fair to the manager. He stated that the Commission should be looking at rolling 3- to 5-year performance relative to applicable benchmarks. Mr. Humphreys, while examining policy and

actual allocations, opined that certain changes needed to take place, including moving away from 3 percent bond yields and considering private equity and private debt.

Ms. Wiek reported that there had been several personnel departures at Wells Capital Management – Benson Value Team (Wells), and that as a result, Commission staff had lost confidence in the remaining investment team. She recommended that the Commission terminate its contract with Wells for management of assets in Wells' small cap value product. After further discussion, Mr. Powers made a motion, which was seconded by Mr. Ewing and passed unanimously, to terminate the contract with Wells Capital Management – Benson Value Team and to authorize the Chairman to execute any necessary documents to implement the Commission's actions.

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

Ms. Wiek and Mr. Williams provided information relating to the search team's emerging market equity (EME) recommendations, noting that information about the recommendations had been provided to the Commissioners prior to the meeting. The recommendations were to invest in Aberdeen Asset Management PLC, Capital International, Inc., Dimensional Fund Advisors, LSV Asset Management, Schroders Capital Management, and William Blair & Company.

Ms. Wiek discussed the due diligence meetings conducted with each potential manager. She provided information about the diversification that these investments would provide for the Portfolio and reviewed information about each of the recommended managers and funds, including a description of the firm, investment strategy, recommended allocations, and track record. Ms. Wiek and Mr. Williams discussed the differences in the managers and funds, benchmark rating, the competitive advantages, and the resulting diversification of the Portfolio.

Mr. Humphreys explained that NEPC's chief goal was to help the Commission choose 6 managers with a well constructed portfolio of EME exposure. He referred to NEPC's Historical Alpha Risk and Return chart which provided information regarding all 6 potential manager's alpha and tracking error performance. Mr. Humphreys opined that selecting managers with different approaches was in the best interest of the Portfolio because the composite benchmark would be less risky than each manager on an individual basis.

Mr. Powers, noting that approximately $1.225 billion would be invested in emerging equity markets, said that management fees for these 6 managers would be several million dollars. He also noted that there would be no way to avoid management fees, but he said the "hybrid model", as proposed, would greatly reduce fees. After further discussion, Mr. Ewing made a motion, which was seconded by Mr. Williams and passed unanimously, to approve the recommendations of the search team and to invest an amount not to exceed $225 million in Aberdeen Asset Management PLC Global Emerging Markets Equity strategy; to invest an amount not to exceed $300 million in Capital International, Inc. Emerging Markets Growth Fund; to invest an amount not to exceed $300 million in Dimensional Fund Advisors Emerging Markets Value strategy; to invest an amount not to exceed $300 million in LSV Asset Management Emerging Market strategy; to invest an amount not to exceed $425 million in the Schroders Capital Management Emerging Markets strategy; to invest an amount not to exceed $225 million in the William Blair & Company Emerging Markets Growth strategy; to authorize the Chairman or his designee to negotiate terms consistent with the recommendations presented; and to authorize the Chairman to execute any necessary documents to implement the investments upon approval for legal sufficiency by General Counsel.

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

Mr. Borden indicated that a Commissioner had not been designated to participate in the GTAA/Risk Parity manager search, and Mr. Ewing volunteered to be assigned as the Commissioner on the search team.

IV. STRATEGIC PLANNING AND BUDGET DISCUSSION/UPDATE

Mr. Borden reported that staff was in the process of constructing budget documents for the next fiscal year, and he requested input from the Commission. He said that the Commission had asked him to present information regarding how the Commission could increase internal functionality given the current public sector restraints.

Mr. Borden referred to the Long-term Organizational chart that outlined benefits and constraints of the current Commission structure, a properly resourced structure proposal, and a "hybrid model" structure proposal. With regards to the current structure, Mr. Borden noted potential issues with the probability of exceeding the actuarial rate of return and the ability to properly discharge fiduciary responsibilities. He also noted that timely execution of potential investments was severely hampered in the current structure. Mr. Borden provided examples in which alpha had been lost due to the inability to execute investments in a timely manner. He opined that with either a better resourced public framework or in a public/private "hybrid model" framework, the loss of alpha due to delay in execution should be eliminated. He noted further that access to a pool of capital was needed in order to take advantage of current market disgorging, including being at the bottom of a business cycle, and the rewriting of financial rules at a rate which had been unprecedented since the Great Depression.

He reiterated comments made by Mr. Powers during the May 2010 Strategic Planning Retreat, stating that the Retirement System paid fees to companies in New York and California. He added that the California Public Employees' Retirement System owned 20 percent of one of the Commission's strategic partners, and the Florida Retirement System owned a portion of management companies of one of the Retirement System's private equity funds. Mr. Borden stated that in effect, the Retirement System was paying fees to two other retirement systems. He said that it was in the Retirement System's best interest for the Commission to consider new and creative ideas to capture ownership interests in underlining investment management firms.

Mr. Borden reported that the most recent due diligence search had been one of the most thorough to date, but he noted that with additional resources, the quality of searches would continue to improve. He said that current constraints regarding salaries and the hiring process made the ability to attract and retain talent difficult. Mr. Borden indicated that the pool of potential talent had never been better and opined that the "hybrid model" would dramatically increase the level and quantity of talent available to the Commission. Mr. Borden estimated that 100bps to 200 bps of additional return could be generated under the "hybrid model" by creating economic value and revenue sharing through third party asset management. He explained that under the "hybrid model" instead of South Carolina or another state's money going to Florida or California, the money could be profiting South Carolina in the form of management fees. Mr. Borden also said that the implementation of the South Carolina Private Markets Program would require additional staff and there were currently opportunities to hire entire teams of highly qualified investment professionals. He indicated that current limitations could only take internal

improvement so far and suggested the current staff structure could be classified as "good"; the properly resourced structure proposal could be classified as "better": and the "hybrid model" structure proposal could be classified as "best."

Mr. Borden reported that the California State Teachers' Retirement System approved a 10-year plan to move even more of its asset management internally. He said that he was stunned that they were upset because their management fees are $130 million on a $125 billion plan. Mr. Borden noted that their portfolio was 5 times the size of the South Carolina Retirement System's Portfolio, yet they paid less management fees. Mr. Borden said that the budgetary increase needed to expand the Commission was significant and estimated that the Commission was understaffed 4-6 people per silo. He said that even with a $20 million budget, the Commission might still struggle to adhere to best fiduciary and investment practices. Mr. Borden said that the nexus of the "hybrid model" proposal was to dramatically reduce income lost to fees and carried interest. Mr. Powers noted that fees and carried interest were reported in the Commission's Annual Report.

Mr. Borden said that the Commission was preparing the future budget currently, and despite the possible structural changes, he needed a sense of how to direct staff in preparing the budget documents. Mr. Chellis noted that the Commission would need approval to increase the budget even though the funds come from the Retirement System trust funds, not out of the state's General Fund. Mr. Borden indicated that even if the Commission was able to increase its budget, the changes would not take effect for another year. Ms. Shealy opined that it might be difficult for the Commission to increase the budget significantly on an interim basis. Mr. Williams stated that it would be helpful to staff if the Commission would provide guidance for budget preparations.

Mr. Chellis stated that if the Commission established a private entity to which some of the Commission staff migrated, the perception may be that the Commission was assisting the migrating staff. He said that there were more perception issues to the private entity proposal than just setting up a budget. Chairman Gillespie stated that the private entity idea originated from the notion to create a primary dealer. He said that this would be different than purchasing a piece of an existing manager such as a strategic partner. Chairman Gillespie noted that the Commission had a similar revenue sharing deal in place with Jamison, Eaton & Wood, Inc. (Jameson) He indicated that the primary dealer concept needed a specialized legal structure that could make an application to Federal regulatory agencies without legacy liability issues. Mr. Powers added that during the primary dealer conversation, the idea just to purchase a primary dealer was considered. Mr. Chellis noted that the revenue sharing example was not a "spin-off" of the Commission staff, but the staffing for the "hybrid model" structure would originate from the Commission. Mr. Williams pointed out that any company, including Jamison, could hire Commission employees.

Chairman Gillespie expressed concern about being a Commissioner with potential personal liability for breach of fiduciary responsibility if the Commission requested additional funding and the request was denied. He explained the challenges and personal risk for Commissioners in properly discharging fiduciary responsibility in managing a portfolio with the complexity of the Retirement System's Portfolio when the investment program was not properly resourced. He added that no large company would run its budget on a year-by-year basis, noting that a 3- to 7-year budget would be more appropriate for an enterprise such as the Commission. He recommended that the Commission present a detailed budget extending several years. Mr. Ewing, concurring with Chairman Gillespie, added that he did not want the Commission to

compress a budget request due to concerns about getting it approved; he suggested requesting the resources that the Commission would need to manage the Portfolio to be the "best."

Mr. Chellis said he thought that the proposed structures should focus on what is best for the Retirement System. Mr. Powers replied that the proposed structures had been misconstrued, contorted, and misrepresented as a scheme to make the Commissioners and Mr. Borden more money. He stated that he was disappointed to learn how people had labeled ideas that could save money for the Retirement System while potentially resulting in third party revenues for the Portfolio, which would be in the best interest of the Retirement System.

Mr. Williams opined that at least $25 million would be needed and stated that he was in favor of the "hybrid model" because it would eliminate the need for a larger operating budget for the Commission and result in overall savings for the Portfolio. Mr. Chellis suggested presenting both the properly resourced structure and the "hybrid model" structure. Mr. Williams stated that they both had been on the table for a long time and continuing with both ideas would cause Commission staff issues with working in two different directions. Mr. Chellis opined that a proposal for a properly resourced public structure and a "hybrid model" structure should be developed with a detailed report explaining the benefits and cost savings of each structure. Mr. Powers suggested that Mr. Borden and Mr. Chellis work in conjunction to create a detailed proposal for both structures. Mr. Williams noted that the Commission could create the "hybrid model" structure with or without putting money into it.

Mr. Powers reiterated that the idea about primary dealers came from a brief conversation with Chairman Gillespie last year. He noted that he was once chairman of a primary dealer, so he knew how they operated. Mr. Powers also stated that there were once 46, and today there were only 17 primary dealers. He opined that U.S. Government debt would continue to grow for the next several years, and a primary dealership would provide the Portfolio with significant income.

Chairman Gillespie indicated that there may be legal issues with the "hybrid model" structure proposal regarding majority ownership versus a minority ownership. He also added that the new entity would need to have licensed individuals running a primary dealer. Chairman Gillespie hypothetically asked, if for instance, the Commission wanted to establish a primary dealer, would it be better to have someone the Commission knows and works with or a totally new person running the entity. Mr. Borden replied that there would be risk anytime an entity was created. He also said that to mitigate the risk, an entity would look to hire companies with long track records and stable teams. Mr. Borden noted that this was not always the best choice because even long-standing companies could have key man issues and other legacy issues.

Mr. Borden said that he saw a lot of opportunities which could be pursued if the Commission had a more flexible pool of capital. He opined that reducing costs for the Commission could also lead to third party investment opportunities that could bring more income to the Portfolio. Mr. Borden suggested that the Commission would be remiss not to properly staff the investment program.

Dr. Pritchett requested information regarding the budget preparation timeline. Mr. Borden replied that budgets were typically drafted in the summer, submitted in October, and usually submitted to the Legislature in January. He said the process would usually take one year and noted that the Commission's budget increased by $800,000 for Fiscal Year 2011. Mr. Chellis indicated that the Governor would begin his Executive budget process in November generally and suggested that the Commission staff prepare proposed budgets for a September/October deadline. Mr. Williams opined that if the Commission waited until October to submit the budget

and then had to wait until early to mid-2011 for possible approval, the Commission should not even pursue a fully resourced public structure or a public/private "hybrid" structure. He explained that the generational opportunity would disappear within the next six months. Mr. Chellis replied that he did not see any way around the budget process and even if the Commission was able to increase the speed of the timetable, everything must still be presented to the Office of State Budget. Mr. Powers, concurring with Mr. Williams, stated that one of the Commission's former managers with 25 years of experience indicated that current opportunities would not last much longer.

Mr. Chellis opined that the "hybrid model" would not require Office of State Budget approval because the operating budget of the Commission would not change. Mr. Williams and Mr. Powers indicated that they believed the Commission had the authority to invest in an entity, but it would not be required to invest in an entity. Mr. Williams said he was not committed to investing in a "hybrid" company, but at a very minimum, the Commission could tell a company if they happen to start a new company, the Commission might allocate Portfolio funds for it to invest. Mr. Powers added that that was exactly what the Commission had done with other managers since inception.

Mr. Borden said that ring-fencing investments into fund structures would serve as a way to build the "NewCo" idea, and if "NewCo" was not pursued, the structures would serve as a way to have a fenced pool of capital for better implementation. He opined that even if the process were started immediately, it would take 3 to 4 months to complete the necessary steps to implement any investments.

Chairman Gillespie suggested that the Commission take incremental steps towards expanding Commission operations. Hypothetically, he asked Mr. Borden if he had a business plan for $5 million, knowing that by the time the new year started the plan would be more robust with a possible $25 million requirement, whether the Commission could begin engaging other firms or people that might meet the business plan's needs. Mr. Chellis opined that the issue was not the dollars, but whether the Commission should seed an entity with Commission staff and outside talent. He asked if it would be prudent for the Commission to invest in an entity without a history. Mr. Borden replied that the strategic partnerships had generated $1.1 billion in value added returns over benchmarks. Mr. Powers explained that the Commission had invested in management companies without history because the people running the companies had good histories. Dr. Pritchett expressed concerns with the amount of money that might be required to fund an entity. Mr. Powers responded that no final amounts had been suggested; only several estimates had been discussed at this point.

After further discussions about projected costs and factors to consider in developing an investment entity, Mr. Borden said that in summary, the Commission could continue to perform its duties within a framework that included many other firms at a cost of 2 percent carry and 20 bps, or the Commission could seed one company to perform the same functions at a lower cost and with many ancillary benefits. Mr. Chellis asked Mr. Borden to explain the differences if the Commission was able to implement all aspects of the "hybrid" model with internal Commission staff in lieu of forming a separate entity. Mr. Borden replied that the Commission would be able to reduce investment fees by one half, but it would still be hampered by the ability to attract and retain sufficient qualified staff. Mr. Chellis noted that the Commission had no salary restrictions with regards to recruitment, and Mr. Borden replied that while there were no restrictions as to salaries by law, there were practical issues with implementation. Mr. Chellis suggested that the Commission provide data about both the properly resourced model structure and the "hybrid" model structure to illustrate why it could or could not function under each model.

Mr. Williams suggested that a 3- to 7-year budget for "NewCo" be created and reviewed by Mr. Chellis to see if the budget would have any chance of being approved. Mr. Powers added that the budget should contain figures indicating the fee cost or fee savings of the properly resourced structure and the "hybrid model" structure. Dr. Pritchett said that the "hybrid" model would always have a higher expected rate of return. Mr. Borden explained that access to deal flow that was only available under the "hybrid" model structure. He also reported that each of the Commission's strategic partners had reviewed the "NewCo" proposal and believed it would work. The Commission and Mr. Borden briefly discussed co-investment dynamics. Mr. Chellis suggested that if the Commission could pay enough to attract qualified talent, it would not need to consider the "hybrid" model. Mr. Borden said that he asked potential talent if they would be willing to move to South Carolina and work for the "NewCo" structure or if they were willing to become employees of the state. He said their response was positive that they were willing to be a part of "NewCo", but nobody said they would be willing to be a state employee due to privacy concerns. Mr. Williams said he felt that would always be the case. He also added that the internal structure would not allow the Commission to manage third party investments, which would be a loss of potential revenue.

Mr. Ewing, referring to the "hybrid model" structure, asked how the Commission would evaluate "NewCo" performance. Mr. Borden responded that "NewCo", would be held to the same standards as any other manager for the Commission. He said that managers were benchmarked the same way, were expected to have the same level of reporting and due diligence, and in this case, the company would be affiliated with the Commission. Mr. Powers reiterated Mr. Jackson's comments by stating that the Commission would still be in control of Retirement System investments. He added that the investment process would not change, just the investment vehicle. Ms. Shealy summarized that it appeared as with other managers, the "hybrid model" structure would implement decisions of the Commission. Mr. Powers and Mr. Williams replied that that was their understanding, and Mr. Williams also noted that "NewCo" could be terminated just like other managers.

Mr. Ewing asked if the Commission could remove "NewCo" staff at their discretion, and Mr. Borden indicated that "NewCo" would be modeled after a private equity firm. Mr. Chellis expressed concerns with not being able to hire or terminate "NewCo" staff. Mr. Williams responded that the Commission was not able to hire or terminate employees of any of its managers currently. Mr. Chellis opined that if the Retirement System funded "NewCo", then the Commission should be able to control hiring and terminating employees. Mr. Williams replied that he was not suggesting that the Commission fund "NewCo", and Mr. Chellis requested information regarding how "NewCo" would be funded. Mr. Borden replied that the start-up cost for "NewCo" was being confused with the managed assets. Mr. Chellis indicated that "NewCo" would be paid through management fees, and Mr. Powers explained that all Commission managers were paid through fees, but the Commission had no control over their operational structure. Mr. Williams stated that "NewCo" would operate on fee income and if the Commission elected for the Retirement System to become an owner of "NewCo" and place people on their boards, then the Commission would have some control in "NewCo's" internal operations. In the alternative, Mr. Williams stated that contractual agreements could be made with "NewCo" that would allow the Commission to have control in their daily operations.

Mr. Chellis expressed concerns if in the future "NewCo" became a public company and generated a huge amount of revenue, the Portfolio would not benefit. Mr. Powers replied that covenants could be written to direct that a certain percentage of any income from "NewCo" be directed to the Portfolio. Mr. Williams reiterated that in a properly resourced structure, there

would be no possibility to earn additional revenue. Mr. Borden replied that the only way to increase the enterprise value of "NewCo" would be to obtain third party assets.

Mr. Chellis opined that a committee should be formed to review proposed budgets for the properly resourced structure and the "hybrid model" structure. Chairman Gillespie opined that Dr. Pritchett, Chairman Gillespie, and Mr. Borden should be on the committee. Mr. Powers said that the committee should generate something Chairman Gillespie can present to the Budget and Control Board. Chairman Gillespie stated that regardless of the legal structure and given the task at hand, the Commission needed a larger budget. He stated that he felt very strongly as a fiduciary that he could make the argument for increasing the budget. Chairman Gillespie also noted that there would be risks associated with either structure. After further discussion, Mr. Powers made a motion to create an exploratory budget committee chaired by Chairman Gillespie, with Dr. Pritchett Mr. Chellis to serve as members and Mr. Borden to staff and provide resources to the committee. The motion was seconded by Mr. Ewing and passed unanimously.

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

V. OTHER BUSINESS

Mr. Borden reported that the Commission was on schedule to relocate into its new office space during the first week of August 2010. He noted that Brenda Gadson, Operations Manager and Chairman of the Facilities Relocation Committee, had done an excellent job preparing for the move.

Mr. Borden presented a revised 2011 Commission Meeting Schedule and noted that one date from the pre-approved schedule had changed. Mr. Ewing made a motion, which was seconded by Mr. Williams and passed unanimously, to approve the revised 2011 Commission Meeting Schedule.

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

Mr. Ewing made a motion, which was seconded by Mr. Powers and passed unanimously, to grant Commission staff permission to compile the adopted governance policies into one document and permission to correct any typographical or other errors not substantive in nature, including but not limited to renumbering the policies and moving the Compensation Policy to personnel policies.

VI. ADJOURNMENT

There being no further business, Chairman Gillespie thanked everyone for attending, and the meeting adjourned at 1:55 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, prior to 9:00 a.m. on July 14, 2010.]