

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

**May 17-18, 2012**

**Wampee Training and Conference Center  
1274 Wampee Plantation Road  
Pinopolis, South Carolina 29469**

**Commissioners Present:**

Mr. Allen Gillespie, Chairman  
Mr. Reynolds Williams, Vice Chairman (via Telephone)  
State Treasurer Curtis M. Loftis, Jr.  
Mr. Edward Giobbe  
Mr. James Powers  
Dr. Travis Pritchett

**Others present for all or a portion of the meeting on Thursday, May 17, 2012:**

Mike Addy, Geoff Berg, Jonathan Boyd, Betsy Burn, Sarah Corbett, Dori Ditty, Robert Feinstein, Rebecca Gunnlaugsson, Hershel Harper, Adam Jordan, David Klauka, Gary Li, Doug Lybrand, James Manning, Jared O'Connor, David Phillips, Kathy Rast, Eric Rovelli, Nancy Shealy, Nicole Waites, and Brian Wheeler, from the South Carolina Retirement System Investment Commission; Bill Leidinger, Bill Condon, and Shakun Tahiliani from the State Treasurer's Office; Bill Blume, Tammy Nichols, and Faith Wright from the South Carolina Retirement Systems; Rhett Humphreys and David Barnes from NEPC, LLC; Mel Carter, Lee Brashear, and Kelly Williams from Credit Suisse Asset Management, LLC; Sam Griswold and Wayne Pruitt from the SC State Retirees Association; Mitchell Willoughby from Willoughby and Hoefler; Mike Montgomery from Montgomery and Willard; and Alex Patrick from Creel Court Reporting.

**Others present for all or a portion of the meeting on Friday, May 18, 2012:**

Geoff Berg, Betsy Burn, Sarah Corbett, Robert Feinstein, Hershel Harper, Adam Jordan, David Klauka, Gary Li, James Manning, Jared O'Connor, David Phillips, Kathy Rast, Nancy Shealy, and Brian Wheeler, from the South Carolina Retirement System Investment Commission; Bill Leidinger, Bill Condon, and Shakun Tahiliani from the State Treasurer's Office; Rhett Humphreys and David Barnes from NEPC, LLC; Bill Blume, David Avant, and Tammy Nichols from the South Carolina Retirement Systems; Joe Newton from Gabriel, Roeder & Smith; Alan Bowser and Jeff Gardner from Bridgewater Associates; and Kelly Perkins, Sean McGould, and David Pollok from Lighthouse Partners.

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

Chairman Allen Gillespie called the meeting of the South Carolina Retirement System Investment Commission ("Commission") to order at 9:30 a.m. Mr. Reynolds Williams participated in the meeting via telephone conference call. Chairman Gillespie referred to the proposed meeting agenda and asked for a motion to approve. Mr. James Powers made a motion, which was seconded by Mr. Edward Giobbe and passed unanimously, to approve the agenda as presented.

Chairman Gillespie began the Chairman's report. He asked Mr. Giobbe to provide an update of the Chief Investment Officer ("CIO") search from the work team, which was comprised of Messrs. Giobbe and Williams and Dr. Travis Pritchett. Mr. Giobbe stated that Ms. Joye Lang with the

South Carolina Office of Human Resources (“OHR”) had provided a list of 32 applicants to the work team, which will review and recommend a list of the most qualified applicants to the Commission. Mr. Giobbe informed the Commission that they received a diverse pool of applicants from both the private sector and other state pension funds. Chairman Gillespie and Mr. Giobbe reiterated that the Commissioners were welcome to review all of the resumes and any additional information that was provided to the work team.

Chairman Gillespie provided an update from the Audit Committee and stated that the Audit Committee met and interviewed several candidates for positions within the internal audit and compliance areas. He said that the Audit Committee had extended an offer to one candidate who replied with a verbal acceptance, and they would hopefully receive a signed offer letter shortly. He noted that the Audit Committee was still in discussions with another candidate.

Chairman Gillespie announced that the Commission evaluation forms had been completed, and the primary items noted related to custody issues, the CIO search, and the review of current investment managers, investments, and associated fees.

## **II. ADMINISTRATIVE ITEMS**

Chairman Gillespie referred to the draft minutes from the March 23, 2012 meeting and asked for a motion to approve. In response to a question from Mr. Curtis Loftis, discussion ensued regarding the official Commission meeting minutes versus the unofficial transcripts and the process to amend minutes at subsequent meetings. Ms. Nancy Shealy, General Counsel, stated that the statute did not require a verbatim transcript for the minutes, only a summary of the discussions and actions. With regard to amending minutes after approval of the Commission, Ms. Shealy suggested that if there were inadvertent errors discovered after approval of the minutes, the Commission should address those issues at the next meeting. She explained that once the minutes are approved, they are considered the official, public record of the Commission with regard to the particular meeting. After further discussion about records retention, Ms. Shealy added that the unofficial transcripts and audio and video recordings were currently kept on file, but eventually, there could be storage space issues, and at this point, a protocol for storing or disposing of this information had not been determined by the Commission.

Dr. Pritchett made a motion, which was seconded by Mr. Powers and passed unanimously, to approve the minutes from the meeting on March 23, 2012.

Chairman Gillespie recognized Mr. Robert Feinstein, Chief Legal Officer, to present the draft Placement Agent Policy and the placement agent report. Mr. Feinstein provided background on the Placement Agent Policy, and stated that last year Commission staff (“Staff”) began working on a placement agent disclosure policy. Mr. Feinstein stated also that earlier in the year, Mr. Loftis requested that Staff provide a list of all placement agents used by both strategic partners and in conjunction with alternative investments. Mr. Feinstein reiterated that the Commission did not hire placement agents; however, placement agents were retained by some investment managers to perform sales and marketing services. Mr. Feinstein advised that several members of Staff and the Commission’s investment consultant, New England Pension Consultants, LLC (“NEPC”), worked together to canvas all of the investment management firms that had been engaged by the Commission since 2006. The result of the survey indicated that the vast majority of the managers did not use placement agents in conjunction with the Commission’s investments.

Mr. Feinstein stated that it was not the intent of the Placement Agent Policy to proscribe the utilization of placement agents by investment managers; rather, the policy’s purpose was to

provide the fiduciaries and stakeholders of the South Carolina Retirement Systems (“Retirement System”) trust funds with additional information regarding the Commission’s investment decision-making process. Mr. Feinstein added that Staff had determined that it was in the best interest of the Commission to require disclosure of the use of any placement agents.

Chairman Gillespie opined that the Placement Agent Policy should be modified for clarification purposes to include a placement and soliciting agent policy and to address the need for placement agents to be properly registered and follow the applicable securities laws regarding registration. Mr. Feinstein responded that Staff would welcome additional feedback from all of the Commissioners so that when it is presented at a future meeting, the policy would reflect the entire Commission’s input. Chairman Gillespie advised the Commission that the Placement Agent Policy was presented as information for review and input from Commissioners and that no action was needed at this time.

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

Chairman Gillespie turned the discussion to the approval of the Compensation Policy amendments, which had been presented at the last Commission meeting. Mr. Powers made a motion, which was seconded by Dr. Pritchett and passed unanimously, to approve the Compensation Policy amendments as presented.

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

### **III. ASSET ALLOCATION AND MANAGER SEARCHES**

Mr. Hershel Harper, Acting Chief Investment Officer, stated that Staff was proposing the reclassification of investments with four managers, which would become effective on July 1, 2012, with the inception of the Fiscal Year 2012-2013 Annual Investment Plan. Mr. Harper stated that the reclassifications would provide a better alignment of how these managers actually manage assets and how the investments should be reflected from an asset allocation perspective. Mr. Harper added that Staff continued to work on improving transparency relating to the strategic partnerships and had developed certain new categorizations of the different investments, which led to the creation of some additional composites that better reflect the characteristics of these investments. Mr. Harper advised that Staff recommended approval of the proposed reclassification of the following: (1) Jamison, Eaton and Wood, Inc. (“Jamison”), from Core Fixed Income to Investment Grade Credit; (2) Torchlight Debt Opportunity Fund III, LLC and Torchlight Debt Opportunity Fund IV, LLC (collectively, “Torchlight”) from Opportunistic Credit to Real Estate; (3) GS Mezzanine Partners V, L.P. (“GS Mezzanine”) from Private Equity to Private Debt/Opportunistic Credit; and (4) Northstar Mezzanine Partners V L.P. (“Northstar”) from Private Equity to Private Debt/Opportunistic Credit.

After further discussion, Mr. Giobbe made a motion, which was seconded by Mr. Powers and passed unanimously, to approve the proposed reclassification of the investments with Jamison, Torchlight, GS Mezzanine, and Northstar as proposed by Staff, and to authorize the Chairman to execute any necessary amendments, upon approval for legal sufficiency by the Commission’s legal counsel (“Legal Counsel”) to implement the Commission’s actions.

Mr. Loftis stated that several members of the South Carolina State Senate had inquired about the Commission’s involvement in the investments of the other post-employment benefits (“OPEB”)

trust funds that were managed by the State Treasurer's Office. He said that Senator Greg Ryberg indicated that a member of the Commission had suggested that the Commission become involved in the OPEB investments, and Senator David Thomas wanted to know the identity of the Commissioner. The Commissioners indicated that they were unaware of Mr. Loftis' inquiry. Mr. Powers said that he recalled that the Commission stayed away from the OPEB issues generally when the legislation passed several years ago. Mr. Williams said that the Commission had discussed several years ago when the OPEB trust funds were created that if certain constitutional amendments were made, then the Commission could manage the assets. Chairman Gillespie concurred and added that the Commission figured that it did not have any legislative authority to be involved with the OPEB investments, and he did not recall any discussions about the issues since that time.

Mr. Harper provided an overview of the asset class plan since the new asset allocation would become effective July 1, 2012, and reviewed a summary of the search activity anticipated during the new fiscal year as a result of the new asset allocation structure. Mr. Harper stated that Staff would be resuming the small to mid-cap manager search, locating a replacement candidate for an international equity manager because the proposed investment with Tradewinds Global Investors had been rescinded, conducting due diligence to potentially find another fixed income manager, adding an additional manager for emerging market debt investments, and lowering the allocation to global fixed income from three to one percent.

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

Mr. Harper reviewed the current asset allocation as of May 9, 2012, and the returns for March 2012. Mr. Harper stated that the total portfolio ("Portfolio") was up approximately 1.79 percent through March 2012 which was in line with the benchmark of 1.76 percent. April was a fairly flat month, and May had experienced significant volatility causing a decline of 2.5 percent. Fiscal year-to-date returns through mid-May were approximately negative 90 basis points, which was in line with the benchmark. Mr. Harper reported that hedge funds continued to perform well. GTAA multi-asset portfolios and risk parity were up 8 percent fiscal-year-to date, versus the benchmark of 1.30 percent. Bridgewater continued to be the top performer in this group, outperforming their benchmark by 1,200 basis points. Opportunistic credit returns were slightly negative for fiscal year-to-date. Mr. Harper stated that key areas in the Portfolio that Staff continued to watch closely would be in the emerging markets equity space, high yield managers, and private equity managers. Commissioners asked questions and discussed various aspects of the Portfolio throughout Mr. Harper's presentation.

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

#### **IV. INVESTMENT CONTRACT EXPIRATIONS**

Mr. Harper advised the Commission that the investment management contracts with the following three managers would expire during the Summer of 2012: (1) Western Asset Management Company ("WAMCO"), in the global fixed income investment strategy; (2) TimesSquare Capital Management, LLC ("TimesSquare"), in the small-mid cap growth investment strategy; and (3) Grantham, Mayo, Van Otterloo & Co ("GMO"), in the global asset allocation investment strategy. Mr. Harper added that all managers were in good standing and Staff and NEPC recommended renewing these contracts.

After further discussions about custody of the assets, contract termination provisions, and liquidity, Mr. Powers made a motion, which was seconded by Mr. Giobbe, to renew the contracts of WAMCO, TimesSquare, and GMO and to authorize the Chairman to execute the contracts upon approval for legal sufficiency by Legal Counsel. Further discussion ensued. Mr. Harper clarified for the Commission that TimesSquare investment was through a separately managed account structure and the assets were custodied at Bank of New York Mellon.

Mr. Powers amended his original motion, which was seconded by Mr. Giobbe, to renew the contracts with WAMCO and GMO and to authorize the Chairman to execute the contracts upon approval for legal sufficiency by Legal Counsel. The motion passed with Messrs. Giobbe, Powers, Williams, and Chairman Gillespie voting in favor of the motion, and Mr. Loftis voting against the motion due to custody of the funds not being with the Bank of New York Mellon.

Mr. Powers made a motion, which was seconded by Mr. Giobbe and passed unanimously, to renew the contract with TimesSquare and to authorize the Chairman to execute the contract upon approval for legal sufficiency by Legal Counsel.

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

#### **V. SELENE II – FUND SIZE CLARIFICATION**

Mr. Harper provided background information regarding the Selene Residential Mortgage Opportunity Fund I L.P., and Selene Residential Mortgage Opportunity Fund II L.P. ("Fund II"), and stated that these were direct investments by the Commission, separate and distinct from the R-SC Financing Conduit, LLC ("Raneri") investment. Mr. Harper stated that Fund II fundraising had not been as successful as the general partner had hoped, and the Commission had a \$150 million commitment to this fund, which equated to approximately 32 percent of the total commitments by current investors in Fund II. Mr. Harper stated that he recommended that the Commission approve going beyond the 25 percent threshold for this particular type of investment. He advised the Commission that the initial approval of the investment was for up to \$150 million or 15 percent of Fund II; however, the 15 percent provision had not been included in the side letter. Mr. Harper reported that Fund II closed approximately one year after it was approved by the Commission, and the law firm of Arnall Golden Gregory, LLP, had been engaged to lead the closing process on Fund II and Ranieri. Mr. Harper added that this closing occurred at about the same time that the investment in Ranieri closed, and he opined that the involvement of additional people, rather than a single point of contact, may have led to the omission of the provision.

After further discussion, Mr. Powers made a motion to waive the restriction in the Commission's Statement of Investment Objectives and Policies limiting the initial commitment to a fund to 25 percent of the total commitments raised by an external fund manager for the Selene Residential Mortgage Opportunity Fund II, with the caveat that this commitment could be used as leverage in negotiating investments in the larger relationship with investments in Ranieri. Mr. Giobbe seconded the motion, which passed unanimously.

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



## **VI. RESERVOIR – CLARIFICATION OF COMMITMENT ALLOCATION**

Mr. Harper reported that in June 2009, the Commission approved the formation of a strategic partnership with Reservoir Capital Group, LLC (“Reservoir”). The Commission initially approved an allocation of \$300 million committed capital to Reservoir/Palmetto State Partners, L.P. (“Reservoir-SP”) which was to be allocated evenly to a private equity fund, a hedge fund seeding fund, and a co-investment focused fund. In September 2009, prior to the closing of the strategic partnership, the Commission committed \$100 million to the Reservoir Capital Partners (Cayman), L.P. (“RCP”), a private equity fund with a flexible investment mandate that allows for direct or indirect investments across the public and private markets. Reservoir-SP formally closed on June 1, 2011, and at that time the commitment to RCP was transferred into the Reservoir-SP. The Reservoir-SP Investment Committee then approved a \$100 million commitment to the Reservoir Strategic Partners Fund (“RSP”), a fund focused on hedge fund seeding. The third investment vehicle contemplated by the Commission’s June 2009 decision has not yet been created within the Partnership.

Mr. Harper explained that on November 17, 2011, the Commission approved an increase of the Reservoir-SP capacity to an amount not to exceed \$750 million. The recommendation memo and supporting partnership annual investment plan that was presented to the Commission described the purpose of the additional capacity as focusing on opportunities in the power, energy, and investment seeding areas. However, a verbal response provided to a question posed during the presentation indicated that the increase in capital would be allocated such that Reservoir-SP would have \$100 million committed to RCP, \$100 million committed to RSP, and up to \$550 million committed to a “co-investment” vehicle.

Mr. Harper stated that following the November 2011 Commission meeting, work commenced on negotiating amendments to the Reservoir-SP limited partnership agreement (“LPA”) to implement the Commission’s approval of the increased capacity. During review of the proposed amendments, the Commission’s General Counsel highlighted potential discrepancies between the language contained in the LPA, the language contained in the proposed amendments, and the scope of the Commission’s approval. The Staff researched the issue and held several calls with Reservoir’s staff to confirm the purpose of the additional capacity and how investments would be structured within Reservoir-SP. Mr. Harper added that discussions with Reservoir clarified that Reservoir-SP’s capacity of \$750 million was intended to be allocated to new investments as opportunities arose and as approved unanimously by Reservoir-SP’s Investment Committee. Reservoir-SP may allocate additional capital to (i) RCP, (ii) RSP, and/or (iii) other funds or co-investments within Reservoir’s opportunity set (currently power, energy, and hedge fund seeding strategies).

The Commission discussed the history and various issues with Reservoir, including NEPC’s position on the investment strategies. After further discussion, Mr. Powers made a motion to rescind the extension of the additional \$450 million commitment to Reservoir-SP so as to remain at the original \$300 million commitment. Mr. Giobbe seconded the motion. Further discussions ensued. Chairman Gillespie called the question of the motion to rescind the November 2011 motion for an additional \$450 million commitment to Reservoir-SP and to remain at the original \$300 million commitment. The motion passed with Messrs. Giobbe, Powers, Loftis, and Chairman Gillespie voting in favor of the motion, and Mr. Williams abstaining as he was not sure that he understood all of the issues discussed.

Dr. Pritchett made a motion, which was seconded by Mr. Powers and passed unanimously, to grant Staff flexibility in determining how to allocate investments made with the \$100 million that had been approved by the Commission but not yet invested within Reservoir-SP.

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

Chairman Gillespie recessed the meeting for a break at 10:51 a.m. Mr. Williams, who had been participating in the meeting via telephone, left the meeting.

Chairman Gillespie reconvened the meeting at 11:02 a.m.

## **VII. INVESTMENT CONSULTANT RFP PROCESS DEFINITION**

Mr. Adam Jordan, Acting Chief Executive Officer, stated that at the April 18, 2012 meeting, the Commission voted to extend the current investment consultant contract and corresponding investment consultant proposals until September 30, 2012. Mr. Jordan added that as directed by the Commission previously, Staff had reviewed the proposals and conducted a preliminary assessment of the prospective investment consultants. He said that the Staff had been previously directed to provide information to the full Commission for the body to make a selection. Mr. Jordan requested that a Commissioner be appointed as a lead on the investment consultant Request for Proposal ("RFP") (similar to the current process for investment manager recommendations) to help pare down the proposals and conduct onsite due diligence trips with respondents. Mr. Jordan said that the lead Commissioner would work closely with Staff to narrow the field to a list of finalists, conduct due diligence trips on those finalists, and then make recommendations to the full Commission, at which time the full Commission would receive presentations from the finalists and make a selection of the investment consultant. He reiterated that all Commissioners would have full access to the proposals during the selection process.

Mr. Powers made a motion, which was seconded by Mr. Giobbe and passed, to appoint Mr. Loftis and Dr. Pritchett to work with Staff on selecting a short list of candidates for the investment consultant search to be reviewed by the entire Commission. Chairman Gillespie and Messrs. Giobbe, Loftis and Powers voted in favor of the motion, and Mr. Williams was not present for the vote.

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

Mr. Williams re-joined the meeting via telephone conference call at 11:13 a.m.

## **VIII. DISCUSSION OF TIME-WEIGHTED RETURNS VS. DOLLAR-WEIGHTED RETURNS**

Mr. Harper introduced the next item on the agenda and explained that the Commission had requested that Staff and/or NEPC provide an educational presentation regarding time-weighted returns versus dollar-weighted returns. He said that particularly in evaluating the success of managers of private equity and private debt investments, the outcome could differ significantly depending on the calculations used.

Mr. Harper introduced Mr. Rhett Humphreys, Partner and Senior Consultant with NEPC. Mr. Humphreys reviewed the definitions of time-weighted and dollar-weighted returns and provided examples of when each should be used as performance measurements. He explained that time-weighted return is also known as compound return, which eliminated the impact of cash flows

during the time periods and allows managers to be measured on how well they performed independently and in comparison to benchmarks. Mr. Humphreys stated that internal rate of return is also known as dollar-weighted return, which is used with private equity managers because the manager controls the cash flow for the investments. The dollar-weighted return measures the growth of an average amount of dollars invested over the evaluation period. Mr. Humphreys provided examples and responded to questions by the Commission.

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

#### **IX. AVENUE-SC GLOBAL OPPORTUNITIES FUND, L.P. – PERFORMANCE REVIEW**

Mr. Harper introduced Mr. Dave Klauka, Director of Private Markets, to discuss the Avenue-SC Global Opportunities Fund, L.P. ("Avenue"). It was noted that at the Commission's April 2012 meeting, Mr. Powers had requested a review of this fund/manager.

Prior to beginning his presentation, Mr. Klauka introduced and welcomed the newest staff member to the private markets team, Mr. Eric Rovelli, Senior Real Estate Officer. Mr. Klauka stated that for the past 11 years, Mr. Rovelli served as the primary real estate point of contact for the Arizona State Retirement System.

Mr. Klauka referred to materials that had been provided to the Commission and discussed the structure of the Avenue partnership, which is essentially a master fund established for the Retirement System that invests in distressed debt funds managed by Avenue Capital in the United States and Europe. He discussed performance of Avenue as of December 31, 2011, noting that the Avenue Europe I fund had performed exceptionally well with a gross internal rate of return ("IRR") of 23 percent, and a net IRR of 17.5 percent. Mr. Klauka added that Avenue had invested \$167 million of this fund, and they had returned \$164 million to its investors, so essentially all of the investors had received their contributions back and there was still another \$80 million of unrealized value in the fund. Mr. Klauka stated that the Avenue Special Situations Fund VI was still in the investment period and had made no distributions back to the investors. Avenue had invested about \$1.5 billion of the Special Situations Fund VI. This fund had negative returns for the fourth quarter of 2011, which decreased the value of the investments that they were currently holding to approximately \$1.4 billion. Mr. Klauka added that currently, the fund had a negative IRR because of market volatility, but many of those losses were unrealized and had been recovered during the first quarter of 2012. Mr. Klauka answered questions about the Avenue investments and concluded his presentation.

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

#### **X. SOUTH CAROLINA PRIVATE EQUITY**

Mr. Harper provided background information regarding the past efforts of the Commission to establish an in-state private equity program, and then he introduced Ms. Kelly Williams, Managing Director and Group Head of the Customized Fund Investment Group ("CFIG") of Credit Suisse Asset Management, LLC ("Credit Suisse") to present an approach for a geographically focused private equity program. Mr. Harper advised the Commission that the Staff had not conducted a manager search process and was not recommending any approvals at this time. Mr. Harper noted that Credit Suisse manages a number of in-state programs for other states, including North Carolina and Florida.



Ms. Williams introduced her colleagues, Mr. Mel Carter, Principal, and Mr. Lee Brashear, Vice President, and provided a summary of CFG's proposal for a South Carolina private equity fund. Ms. Williams stated that the proposed strategy would include equity co-investments of 60 percent to 80 percent, growth capital fund investments of up to 20 percent, and mezzanine investments through the creation of a Small Business Investment Company ("SBIC") of up to 20 percent. The fund would seek to achieve competitive risk-adjusted returns while supporting the economic well-being of South Carolina.

Ms. Williams provided an overview of CFG and stated that they were one of the largest fund investors in the world, managing approximately \$28 billion of capital for institutional investors. CFG focuses on helping investors tailor portfolios to their individual needs, and they have an experienced team of 120 professionals globally. Ms. Williams advised that CFG manages approximately \$1.5 billion of regionally targeted programs, including North Carolina, Florida, Indiana, Oregon, New York, and Michigan.

Mr. Brashear provided an overview of the Florida Opportunity Fund, which is a \$29.5 million regional private equity program that makes targeted investments in seed and early stage venture capital funds.

Dr. Pritchett opined that the Commission should focus on returns, not just seeking economic development within the state. Ms. Williams agreed and stated that the fund would be customized for South Carolina, and CFG would collaborate with the Commission on how the branding would be communicated to attract the right types of proposals.

Ms. Williams described the private equity programs developed for New York, Indiana, and Michigan. Mr. Brashear followed this discussion with an overview of the North Carolina Innovation Fund and then described CFG's projections for opportunities in South Carolina. Mr. Brashear stated that South Carolina had a great tax regime for incentives as well as low corporate tax rates and a very pro-business environment. He pointed out that South Carolina also offers a great infrastructure for supporting all types of businesses with the Charleston Port, and South Carolina is a major manufacturing state. He said South Carolina's major business sectors include aerospace, automotive, biotechnology and pharmaceuticals, distribution, food processing, forestry and wood products, and plastics and chemicals. Mr. Brashear advised the Commission that South Carolina ranks 33rd in the nation for dollars invested into the state. Over the last ten years, the majority of private equity investments in South Carolina had been in industrial and energy, retailing and distribution, software, and electronics. Mr. Brashear added that the private equity capital invested in South Carolina over the last ten years was allocated to buyout at 70.4 percent, venture capital at 27.9 percent, and mezzanine at 1.7 percent.

Mr. Carter provided funding details of a proposed South Carolina Opportunity Fund and stated that there were three different opportunities for growth, including equity co-investments, growth capital fund investments, and mezzanine investments through the creation of a regionally-targeted SBIC. He stated that the South Carolina Opportunity Fund would provide the further diversification of the Retirement System's private equity portfolio and would help bridge the funding gap for South Carolina-based growth companies. Mr. Carter discussed the key aspects of building a regionally-targeted fund, including community outreach, sourcing of opportunities, and customization to meet the Commission's specifications.

Following further discussion, Mr. Harper thanked Ms. Williams and her team for their presentation and educating the Commission on CFG's private equity proposal. Mr. Harper

reiterated that this proposal was not a Staff recommendation, but rather educational information about in-state private equity programs.

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

## **XI. CUSTODIAN RFP UPDATE**

Mr. Jordan provided the Custodian RFP update and stated that the State Treasurer's Office ("STO"), the South Carolina Retirement Systems ("SCRS"), and the Commission entered into a contract with Callan Associates ("Callan") to assist with the Custodian RFP and search process in August of 2011. The cost of the contract with Callan was shared three ways, and Callan had helped to evaluate the proposals received from custodian candidates. Mr. Jordan advised that after a thorough evaluation process, including onsite visits, the evaluation panel (which included representatives from the Commission, the SCRS, and the STO) would reconvene on May 22<sup>nd</sup> to make decisions on securities lending, custody, and ancillary services, and thereafter make their recommendations to the State Treasurer. Mr. Jordan advised the key decisions that needed to be made by the Commission included: (1) whether the Commission would engage in securities lending, and if so, with whom; (2) if the Commission engaged in securities lending, then what would be the investment guidelines for that portfolio; (3) where would the revenues be booked; (4) would the Commission contract for ancillary services, and if so, which services; (5) how the costs would be paid; and (6) how the contract would be structured.

Mr. Jordan turned the floor over to Mr. Harper to discuss securities lending. Mr. Harper provided an historical recap about the experience of the securities lending program and explained the mechanics of securities lending in general. Mr. Harper stated that currently the estimated revenue generated from the securities lending pool would total approximately \$1.3 million dollars. This amount, split 85 percent to the Retirement System trust and 15 percent to Bank of New York Mellon, is extremely low compared to historic levels. Mr. Harper opined that securities lending had a poor risk/return trade-off because of the amount of securities that had to be on loan to generate income.

Responding to a question from Mr. Giobbe, Mr. Harper opined that he would not recommend pursuing securities lending, but pointed out that a key factor was deciding who should be the contracting party for securities lending -- whether the contract should stay with the State Treasurer or whether the Commission would take responsibility for contracting for securities lending. Mr. Harper explained that currently, the securities lending program was wrapped on a bundled basis with the custodian, the Bank of New York Mellon. In 1996, all of the Retirement System's assets were still managed by the STO. It was not until 1999-2000 that assets started being managed outside of the STO. Mr. Harper advised the Commission that the contract for custody and securities lending had never been unbundled.

Mr. Bill Leidinger, Chief of Staff of the STO, opined that at this stage of the procurement, the Commission might not have sufficient information to make a decision on the securities lending program. Mr. Harper disagreed, and stated that what needed to be decided was who should be contracting for securities lending and ancillary services on behalf of the Commission. Mr. Harper opined that because securities lending was an investment decision, it should be the decision of the Commission, as should the ancillary services that support the Commission.

Chairman Gillespie recognized Dr. Rebecca Gunnlaugsson, Systems and Economic Specialist. Dr. Gunnlaugsson described ancillary services as all the system services which were used to

manage the investments in the trust fund. The categories that the systems fall under include: performance and attribution; analytics and risk management; support for private investments, transparency, and administration of hedge funds; and data management. Dr. Gunnlaugsson provided a background of why ancillary services within the scope of the custody RFP were being discussed and other options by which these services could be retained, including going to a third-party administrator or building out each one of the components independently. She advised that both of these latter options would have a large cost and require multiple RFP processes, which would be time consuming.

Mr. Jordan advised the Commission that Staff's recommendation was that the Commission affirm that it is the only entity which could determine whether the trust fund would participate in a securities lending program, determine what services were required by the Commission to properly invest and manage the Retirement System's Portfolio, and to enter into those contracts in the near term. Mr. Jordan added that in the future, Staff would come back to the Commission with recommendations on the securities lending program, the services that Staff recommended be obtained through the custody bank or elsewhere, and any budget impacts that those recommendations might have.

Mr. Loftis voiced his concern about the timeliness of the information being posted to the extranet and said he would have liked to have reviewed this information prior to attending the meeting. Mr. Loftis opined that this was another example of lack of transparency and accountability. He stated that he could not discuss what he wanted to talk about because of the onerous confidentiality agreements that the Commission had in place. Dr. Pritchett stated that he had not seen the information until today himself, and he did not know when it was posted to the extranet. Mr. Jordan explained that he would have liked to have had a presentation on the extranet earlier; Staff had worked diligently to have the information ready to post, and external legal counsel for the lawsuit against the Bank of New York Mellon had to confirm that they were comfortable with certain language in the document. Chairman Gillespie commented that the Commission has been consistent for the last two or three years in its request to have the information posted to the extranet at a minimum of one week in advance. Chairman Gillespie stated that if this continued to be an issue, the item would have to be pulled and posted to the next Commission meeting agenda.

In response to a question from Mr. Loftis, Mr. Jordan introduced the external legal counsel, Mr. Mitchell Willoughby from Willoughby and Hoefer, and Mr. Mike Montgomery from Montgomery and Willard.

Mr. Jordan pointed out these issues were first outlined in a letter dated December 1, 2011, from the Chairman to Mr. Loftis in which Chairman Gillespie discussed these issues of contracting and engaging in securities lending. The latest communication from Mr. Loftis indicated that there may not be another opportunity to bring this information back to the Commission to make a decision; therefore, Staff felt it was necessary to bring these issues to the Commission's attention as it is the entity that invests and manages the assets of the Retirement System. Mr. Loftis reiterated that he did not know that this topic was going to be included on the agenda, and he referred to earlier discussions about management of the OPEB trust funds and questioned the communication between Staff and Commissioners regarding securities lending and ancillary services for the Commission.

Mr. Harper advised that he and Dr. Gunnlaugsson had met with Mr. Loftis a few weeks ago in the Commission's offices, and one of the issues discussed was who would contract for these

services. Mr. Harper said that Mr. Loftis responded that he had not been involved with some of the details, but he asked Mr. Leidinger to follow up. Mr. Leidinger stated that the State Treasurer would not enter into a contract for securities lending and ancillary services without first bringing it to the Commission. Several hours after that conversation, Mr. Leidinger sent an email that said there may not be an additional opportunity for the Commission to address this issue. As a result, Mr. Harper stated that he sent an email to all Commissioners to make them aware of the change. Mr. Harper reiterated that for purposes of this agenda item, the primary concern was with the securities lending program and ancillary services for the Commission.

Further discussion ensued. Mr. Loftis raised concerns about proper notice of agenda items and confidentiality issues. He said that he was unable to discuss certain items due to confidentiality issues, stating that he had talked to probably hundreds of people about the confidentiality issues and he could not find anyone with contracting like the Commission's provisions. Mr. Powers stated that everyone was entitled to their opinion and perhaps it was time to start putting all of the facts on the table in front of a mediator or getting lawyers involved, because the issues were not getting resolved. Mr. Giobbe agreed that another objective opinion would be helpful, and these issues should not impede the Commission's mission, which is to invest and manage the assets of the Retirement System.

After further discussion, Chairman Gillespie stated that he would like to see the Commission make a commitment to hire the STO as a fixed income manager, have the Commission decide the portfolios and parameters, and let the State Treasurer decide if he wants to hire a sub-advisor to manage this portion of the securities lending program.

Following further discussion, Mr. Powers made a motion to contract with the State Treasurer's Office, pursuant to the Commission's statutory authority, to perform securities lending duties and to acquire ancillary services in accordance with any specifications determined appropriate by the Commission. Dr. Pritchett seconded the motion. Further discussion ensued to clarify the differences between securities lending and ancillary services, and the motion passed unanimously.

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

## **XII. UPDATE REGARDING INFORMATION ACCESS AND CONFIDENTIALITY DISCUSSIONS WITH STO**

Mr. Feinstein provided an update regarding information access and confidentiality discussions with the STO. He stated that at the April 2012 Commission meeting, Staff was directed to continue discussions with the STO to determine their requirements regarding sharing information necessary to properly discharge the State Treasurer's duties with regard to the Retirement System and to report back to the Chairman. Mr. Feinstein advised that Staff attempted to implement the directive, and there had been an exchange of letters between Staff and the STO. A meeting took place on May 14, 2012, involving representatives of the Commission, STO, and SCRS, but these various communications had not yielded any resolution with regard to information access and the core custody functions that needed to be performed. Mr. Feinstein stated that the STO continued to take the position that it would not approve the initial funding of any new investments approved by the Commission after April 17, 2012, unless the State Treasurer or his office was provided all information that the STO deemed necessary. Mr. Feinstein advised that Staff was not able to obtain clarification from the STO as to the exact information that the STO required in order to approve the initial funding of new investments. Mr.

Feinstein stated that this was a basic core custody function, and the STO had been asked on numerous occasions to provide new forms or revisions to existing forms that set forth information needed to open an account and proceed with the funding of a new investment.

Mr. Feinstein reminded the Commission that there were four investments approved at the April 2012 Commission meeting which were presently slated to go to closing at the end of May and would thereafter be presented to the STO for funding. The four investments included: (1) Kildonan Castle Partners; (2) Highbridge Quantitative Commodities Fund; (3) Blackstone Real Estate Partners VII, L.P. ("Blackstone"); and (4) Sankaty Credit Opportunities Fund V, L.P. ("Sankaty"). Mr. Feinstein advised that after the Commission goes to closing on Blackstone and Sankaty, the Retirement System would be contractually obligated to fund the entire commitment amount that was approved by the Commission at the April meeting. He noted further that in the case of Blackstone, the manager would be presenting the initial capital call at or just after closing. If the initial capital call was not honored, it would constitute a default on the initial capital call, which would cause immediate and serious consequences, both in terms of monetary penalties and reputational harm to a number of entities, not limited to the RSIC. Mr. Feinstein advised the Commission that Staff and counsel were obligated to move forward with the process of finalizing and preparing to close on the investments that the Commission had approved, unless directed otherwise by the Commission.

Responding to a question by Mr. Giobbe, Mr. Feinstein clarified that the investment contracts had not been signed, but noted that if the Chairman did not execute the contracts, effectively he would be vetoing what the Commission had approved.

Mr. Loftis opined that the Commission was asking him to send money out of the State's control without any information on where it goes, and as a fiduciary and custodian, he had a right to look over the contracts. Mr. Loftis also opined that the Commission was deciding for him what his fiduciary responsibilities are, and he was only receiving the information that the Commission wanted him to have.

Responding to a question from Mr. Loftis, Ms. Shealy clarified that Staff was bound to confidentiality by statute. She pointed out that the statutes specifically apply to Commissioners and Commission staff, whereas employees of other agencies were not referenced in those statutes.

Mr. Feinstein asked Mr. Loftis if the STO would be willing to revise the existing set of custodial forms to show what additional or different information he would require to provide approval for initial funding. Mr. Loftis replied that he was prepared to let a court settle everything. Mr. Loftis opined that the custodian's interest may not always be aligned with the Commission, and stated that he did not work for the Commission, was not the custodian for the Commission, and he was not supposed to be in alignment with the Commission.

At this point, Mr. Loftis asked if the Commission could go into executive session. Mr. Feinstein stated that the Commission could recede to executive session for the purpose of receiving legal advice.

### **XIII. EXECUTIVE SESSION**

Mr. Powers made a motion to recede to executive session. Mr. Loftis seconded the motion, which passed unanimously, and Chairman Gillespie announced that the Commission would meet



in executive session to discuss matters relating to personnel recruiting, receipt of legal advice and discussion of proposed contractual matters, receipt of a legal briefing relating to pending litigation and discussion of investment matters pursuant to S.C. Code Ann. §§ 9-16-80 and 9-16-320.

Chairman Gillespie thanked the guests in attendance, and the Commission recessed into executive session at 2:36 p.m. The Commission reconvened in open session at 6:11 p.m., and Chairman Gillespie stated that while in executive session, the commission took no reportable action, but they discussed legal issues relating to confidential information, reviewed and discussed information relating to strategic partnership investments, and received a legal briefing on pending litigation involving the Bank of New York Mellon.

The meeting recessed at 6:12 p.m., to reconvene at 8:30 a.m. on Friday, May 18, 2012.

#### **XIV. CALL TO ORDER, REGULAR COMMISSION BUSINESS MEETING**

Chairman Gillespie reconvened the meeting at 8:30 a.m. on Friday, May 18, 2012. It was noted that Mr. Williams was unable to attend due to a scheduling conflict.

#### **XV. LIGHTHOUSE PLATFORM & PARTNERSHIP REVIEW**

Mr. Harper introduced Sean McGould, CEO/CIO, Kelly Perkins, Co-CIO, and David Pollok, Legal Counsel, from Lighthouse Partners. Mr. Harper stated that the Lighthouse Palmetto Strategic Partnership (“Lighthouse-SP”) was a very important strategic partnership for the Commission, and it was one of the largest at \$3.5 billion in total capacity. Mr. Harper provided a brief background of the hedge fund transition which began in 2009 and described the rationale behind the transition from Fund of Funds Hedge Funds to Direct Hedge Funds, as well as the key benefits and challenges of transitioning to Direct Hedge Funds.

Mr. Harper recognized Mr. David Phillips, Senior Alternatives Officer, who provided an overview of the benefits and advantages of managed accounts. Mr. Phillips then recognized Mr. McGould who provided a brief background of Lighthouse Partners (“Lighthouse”) and summarized what the firm was doing with regards to managed accounts. Mr. McGould stated that Lighthouse was formally established and began accepting assets from external investors in 1999. Gradually, ownership transferred from SunTrust Banks, Inc. to the management of Lighthouse.

Mr. McGould outlined key control and protection benefits of managed accounts. He said that asset ownership helped to mitigate the risk of fraud. Asset segregation reduced influences of external investors, and there was an increased ability to revoke an investment manager’s trading authority. There were no holdbacks or suspensions at the underlying manager level, and investment managers traded the portfolio subject to agreed-upon guidelines. He noted further the benefits of independent valuation, administration and audit; and diversification of counterparty risk.

Mr. McGould discussed the transparency of managed accounts and stated that managed accounts provided daily position-level exposure and enhanced risk analysis; more data to support investment decisions; and the ability to detect and address style drift, correlation and concentration.

Mr. McGould reviewed the cumulative estimated daily performance of the Lighthouse-SP versus traditional benchmarks.

Responding to a question regarding custodial issues, Mr. Pollok discussed the custodial aspects of Lighthouse and stated that Lighthouse worked with approximately 10 primary custodians currently.

Following additional questions and discussion, Mr. Harper thanked Lighthouse for their presentation.

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

## **XVI. BRIDGEWATER – RISK OVERVIEW**

Mr. Harper introduced Mr. Alan Bowser and Mr. Jeff Gardner from Bridgewater Associates ("Bridgewater"). Mr. Gardner provide information related to Bridgewater's market analysis, their views on the investment-related risk of running a pension fund, and how they would address some of those risks. Mr. Gardner explained the definition of deleveraging and stated that a deleveraging occurs when debt and debt service payments become too high relative to the cash flows needed to service them. Deleveraging could be well managed or badly managed, and the differences in outcomes depended largely on the amount and pace of austerity, defaults, transfers, and money printing.

Mr. Gardner discussed passive versus active market risk. He stated that the traditional portfolio was productive in the past, but the majority of the returns came from cash. However, with cash rates near zero, the traditional approach would not meet the target returns. Mr. Gardner added that risk was multi-dimensional, and protecting against risk involved many different layers and different kinds of risk controls. He stressed that risk controls were not a separate function; they had to be built into the overall investment discipline. He opined that the best way to mitigate risk and raise returns was by diversification.

Mr. Gardner stated that alpha could be extremely valuable to a portfolio by providing a high potential for return and allowing for diversification; however, there was no guarantee of a positive return because alpha was driven by manager skill.

Following additional questions and discussion, Mr. Harper thanked Bridgewater for their presentation.

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

## **XVII. ACTUARIAL UPDATE**

Mr. Joe Newton from Gabriel, Roeder & Smith, provided an actuarial update. Mr. Newton stated that there were three factors that affect pension plans: contributions, benefits, and investments. He discussed the results of an experience study of the Retirement System conducted in 2011, and highlighted significant changes that had been made as a result of the study, including decreasing the investment rate of return from 8 percent to 7.50 percent.

Mr. Newton also reviewed the 2011 valuation results for the South Carolina Retirement System, including the actuarial accrued liability, the unfunded actuarial accrued liability ("UAAL"), the current funding ratio, current contribution rate, and the 30 year employer contribution rate. Additionally, he explained how lowering the current investment return from 7.5 percent to 7.0 percent would impact UAAL, the funding ratio, and 30-year employer contribution rate.

Mr. Newton discussed the historical UAAL growth for the South Carolina Retirement System, funding ratios, and the estimated yields based on market value of assets from 2002 to 2011. Mr. Newton concluded his discussion by stating that future ad hoc benefit enhancements and overall payroll growth were the largest non-investment related risk.

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

## **XVIII. RETIREMENT SYSTEMS UPDATE**

Mr. Jordan introduced Mr. Bill Blume, Director, and Mr. David Avant, Managing Legal Counsel, from the South Carolina Retirement Systems.

Mr. Avant provided an overview and update on the Retirement System. He discussed the importance of investments to the overall income of the trusts and reviewed the five defined benefit plans that make up the South Carolina Retirement Systems, including the South Carolina Retirement System; the Police Officers Retirement System; the Retirement System for Members of the General Assembly; the Retirement System for Judges and Solicitors; and the National Guard Retirement System. Mr. Avant reported on the total active and inactive members of all systems, the total number of annuitants, total covered payroll, and total number of employers within all of the plans. Mr. Avant also reviewed the average benefit for all annuitants, the benefits formula, eligibility, and the actuarial accrued liability of the South Carolina Retirement System and the Police Officers Retirement System.

Mr. Avant concluded his discussion by providing a summary of pending legislation related to the Retirement Systems that was being considered by the legislature.

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

Chairman Gillespie stated that he received a request from Legal Counsel for a motion related to the confidentiality issues and sharing of information with the STO. Mr. Powers made a motion to obtain external fiduciary counsel to review issues relating to confidentiality and disclosure matters. Mr. Giobbe seconded the motion, which passed unanimously.

## **XIX. ADJOURNMENT**

There being no further business, Chairman Gillespie thanked everyone for attending. Mr. Giobbe made a motion to adjourn, which was seconded by Mr. Powers and passed unanimously, and the meeting adjourned at 12:31 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 and in the lobby at 1201 Main Street, Columbia, SC, and at the Wampee Training and Conference Center at 1274 Wampee Plantation Road, Pinopolis, South Carolina prior to 9:00 a.m. on May 14, 2012.]