

State Retirement System Investment Commission Meeting Minutes

Tuesday, September 20, 2005

**Governor's Conference Room
Wade Hampton Building, First Floor
Columbia, South Carolina**

Commissioners Present:

Mr. Reynolds Williams, Chairman
Mr. James Powers, Vice Chairman
Treasurer Grady Patterson
Mr. Blaine Ewing
Mr. Allen Gillespie

Transition staff present for the meeting: Frank Fusco, Steve Osborne, and Mike Sponhour from the South Carolina Budget and Control Board, Office of the Executive Director; Ed Evans and Anne Macon Flynn from the Budget and Control Board's Office of General Counsel; Nancy Cassells from the Office of State Budget; Rick Patsy, Frank Rainwater, Trav Robertson, Paige Parsons, and Shakun Tahiliani from the State Treasurer's Office; Nancy Shealy and Ashli Aslin from the State Retirement Systems Investment Panel; Faith Wright, Tammy Davis, Travis Turner and Sarah Corbett from the South Carolina Retirement Systems; Lil Hayes from the House Ways and Means Committee; Keith Wood and Ernest Cruikshank from Jamison, Eaton & Wood, Inc. **Others present for all or a portion of the meeting:** Wayne Pruitt from the State Retirees Association and Charley McDonald from the South Carolina Trooper's Association; Sam Wilkins from the Budget and Control Board Office of Human Resources; Jeff Stensland from The State Newspaper; and Gary Forte, a South Carolina resident.

I. CALL TO ORDER AND ADMINISTRATIVE MATTERS

Chairman Reynolds Williams called the meeting of the State Retirement System Investment Commission (Commission) to order at 10:05 a.m. and noted that the meeting had been posted properly pursuant to the South Carolina Freedom of Information Act.

Approval of the minutes from the meeting on September 8, 2005, was carried over.

Mr. Frank Fusco stated that the Commission had been set up as a separate agency in the state's accounting system.

Member Report of James Powers

Chairman Williams recognized Mr. James Powers for his report on issues relating to filling the Chief Investment Officer (CIO) position. Mr. Powers discussed concerns such as: job description; salary ranges; required qualifications; and advertising/posting considerations. Mr. Powers provided the Commission with job descriptions and salary

comparisons for similar positions with other public pension plans. Mr. Powers agreed to provide a report proposing the organizational structure of the CIO's position, considerations under the State Retirement System Preservation and Investment Reform Act (Act 153), and composition of the job description. He stated that the report would be distributed to the Commissioners prior to the next meeting. Chairman Williams stated that these items would be included on the agenda for the next meeting.

Mr. Fusco noted that the Board's Office of Human Resources has extensive expertise in the classification of job descriptions and could assist in evaluating pay structure relative to the duties for the job. He also noted that the State has a recruiting office that would, for a fee, recruit and screen candidates.

Member Report of Grady Patterson

Chairman Williams recognized Treasurer Grady Patterson for his report on the search process for the retiree member. Treasurer Patterson made a motion on behalf of the State Treasurer's Office (STO) to volunteer, free of charge, the services of Mr. Rick Patsy to assist the Commissioners with their investment responsibilities on a temporary basis. Mr. Powers seconded the motion, and, after discussion, the motion was tabled until the Commission received Allen Gillespie's report on staffing and organizational issues.

Treasurer Patterson reported that he compiled a list of retiree associations that may have a nominee with the qualifications required of the retiree Commissioner. On behalf of Treasurer Patterson, Mr. Patsy proposed a process and timeline for selecting the retiree member, with the retiree member to be chosen by December 2005. Treasurer Patterson made a motion that the Commission accept the process and timeline for selecting a retiree member. Mr. Ewing seconded the motion, which passed unanimously.

Member Report of Allen Gillespie

Chairman Williams recognized Mr. Gillespie for his report on staffing issues, resource requirements, and organizational considerations. Mr. Gillespie presented an organizational chart outlining such considerations. He discussed the needs of the Commission related to these issues.

Mr. Gillespie stressed the importance of investment accounting and reporting and stated that it would require the collaborative effort of Commission staff, the actuary, the STO, and Mercer Investment Consulting (Mercer). Mr. Powers expressed the need to have accurate numbers readily available at all times for both the portfolio's assets and the liabilities and suggested that the accounting functions be independently audited. Mr. Patsy informed the Commission that the Bank of New York (BoNY) acts as the custodian for the South Carolina Retirement Systems' (Retirement Systems) assets and that they have the ability to provide impartial performance measurements. Chairman Williams requested a copy of the STO's contract with BoNY outlining BoNY's reporting responsibilities, which Mr. Patsy agreed to provide.

Mr. Gillespie stated that the Commission currently had three full-time positions, one of which was the CIO position that had not been filled. He suggested that staffing decisions should eventually fall under CIO's purview with the Commission's oversight.

Mr. Powers stated that he visited the Retirement Systems and toured space that would be available for the Commission's offices. Mr. Gillespie stated that he spoke both with staff at the STO and Mrs. Peggy Boykin at the Retirement Systems regarding physical space for the Commission. He said that both facilities had space available, although he had no strong opinion as to which location would be appropriate. Chairman Williams stated that he was scheduled to visit the Retirement Systems later in the week, and after viewing the available space, he would make the decision about the physical location for Commission staff as an operational matter. He stated that the Commission could ratify that decision at the next Commission meeting.

Chairman Williams stated that the proposed CIO duties should be put on the next meeting's agenda, and the organizational chart addressed after preliminary organizational decisions are then made.

The Commission further discussed Treasurer Patterson's pending motion to volunteer the services of Mr. Patsy to the Commission. Treasurer Patterson stressed that there would be no cost to the Commission for Mr. Patsy's services. Chairman Williams reiterated that Mr. Patsy would assist the Commission in a purely advisory capacity on a temporary basis. After further discussion, the motion passed unanimously. Chairman Williams asked Mr. Patsy to provide a written report of the fixed income portfolio outlining investment strategies, past returns, and transaction costs.

Member Report of Reynolds Williams

Chairman Williams reported on fiduciary insurance matters. He stated that the Fiduciary Insurance Policy was expected to be in place on or before October 1, 2005. He stated that this policy currently pertains to the Board and the Panel, and it provides for \$15 million in coverage with a \$10 million umbrella for the entire Commission. Chairman Williams asked whether the Commissioners thought that level of coverage was adequate. The Commission agreed that the policy seemed inadequate, but it would suffice in the very short term, while the availability and cost of increased coverage were determined.

Mr. Williams stated that there were resources available within state government that the Commission could use on a temporary basis. He stated that it was previously thought that the Commission would have access to the Board's human resources and budgeting resources, but that was not the case, and the Commission must look into developing their own capabilities. He stated that the Retirement Systems could be a source of these services, but that he was uncertain as to whether this was practical or feasible.

II. INVESTMENT MATTERS

To begin Mr. Ewing's presentation on Investment Matters, Mr. Patsy was recognized to discuss the fixed income portfolio. Mr. Patsy introduced the STO's staff and discussed

the investment objectives, organization, asset allocation and performance of the fixed income portfolio. Mr. Patsy gave an overview of the assets and investment functions for which STO was responsible. Mr. Patsy stated that the STO had had a long-standing relationship with BoNY, the custodian. In response to a question posed by the Commission, Mr. Patsy explained that the Commission's annual allocation to the STO paid for the Bloomberg system, phone service, and infrastructure costs for the fixed income portfolio, and paid for the QED accounting system for the Retirement Systems' assets. Mr. Patsy also explained the relationship with BoNY for securities lending, noting that the STO recently negotiated a contract that provides for 85 percent of the securities lending income to be credited to the Retirement Systems and 15 percent to be retained by BoNY. He explained further that BoNY deducts its banking costs from the 15 percent it retains. Mr. Patsy stressed that the STO had an effective integration of investments, operations, accounting, and administration with a professional and experienced staff, excellent long-term performance, and an extremely low cost structure.

Mr. Gillespie asked Mr. Patsy to provide maturity breakdowns of the fixed income portfolio, and he agreed to do so.

Mr. Patsy recognized Mr. Keith Wood from Jamison, Eaton & Wood, Inc. (Jamison). Mr. Wood explained that Jamison had worked with the STO in an advisory capacity for 26 consecutive years. He stated that Jamison aided the STO with strategy formulation, portfolio building, and in the execution thereof for the fixed income portfolio. Mr. Wood discussed the history of the company as well as the history of Jamison's relationship with the STO. Mr. Wood explained that Jamison's investment philosophy was centered on producing competitive, risk-adjusted returns on a consistent basis, while keeping in mind the Retirement Systems' objectives and risk levels.

Mr. Wood discussed Jamison's investment goals and process. Mr. Gillespie asked if the responsibility of setting investment goals for the fixed income portfolio would move to the Commission on October 1, 2005, and Mr. Fusco responded in the affirmative.

Chairman Williams asked what strategy Jamison proposed to manage inflation risk. Mr. Wood replied that inflation was a relatively low-risk problem that could be managed by shortening the duration. He explained that higher inflation lead to higher interest rates, presenting the opportunity to invest the reserve position at a higher rate of interest. Mr. Patsy explained that was the strategy currently in place, with average duration of approximately four years. Mr. Patsy stated that the portfolio currently held many short- and long-duration assets, and minimal mid-duration assets.

Mr. Ewing provided an overview of the equity portfolio and discussed organizational and operational aspects of the State Retirement Systems Investment Panel (Panel). He stated that the Panel was formed in 1998 for the purpose of managing the equity portion of the Retirement Systems' portfolio. He explained that initially the equity portfolio was allocated 40 percent of the total portfolio's assets, which was implemented in ten percent increments over a four-year period. He stated that after a thorough search,

Mercer was hired as the Panel's consultant, and they had been acting in that capacity since that time. Mr. Ewing discussed Mercer's advisory responsibilities.

Mr. Ewing discussed the equity portfolio and the changes that occurred during the Panel's seven-year tenure. Mr. Ewing also discussed the limitations on the portfolio's allowable asset classes. He stated that he hoped there would be a referendum to expand the allowable asset classes in the November 2006 election. Mr. Ewing explained that substantial changes had recently been made to the equity portfolio, particularly in the large cap growth strategy. Mr. Ewing discussed the individual investment managers, the general strategic asset allocation, and changes that had been made over the last six years.

Mr. Ewing stated that given new legislative changes, the Panel thought it was appropriate to increase the equity allocation from a 40 to 50 percent allocation of the total portfolio's assets, to be implemented in 2.5 percent quarterly increments this fiscal year. He explained that the increased allocation would be placed pro rata among the equity asset subclasses and among managers, but that until new investment managers were hired, the Small Cap allocations would be invested in passive management.

In response to a question by Mr. Powers, Ms. Shealy stated that Mercer's contract was for one-year periods that would automatically extend on an annual basis for a total of five years, but there were termination provisions in the contract and Mercer, as well as the investment managers, served at the pleasure of the Commission.

Mr. Ewing stated that on October 1, 2005, the Commission would become responsible for having an interim investment plan and recommended that the Commission adopt the current Annual Investment Plan (AIP) and Statement of Investment Objectives and Policies (SIP), which had been distributed to the Commission previously, with several adjustments. He recommended that the provision for local brokerage preference be deleted, consistent with the changes in Act 153 and that guidelines for the fixed income portfolio be included. After discussing the proposed changes, Mr. Ewing made a motion to adopt the provisions of the SIP and the AIP, as previously adopted by the Board, effective October 1, 2005, deleting the provisions relating to the local brokerage preference and adding fixed income guidelines; authorize staff to add appropriate notes to the documents to explain the transition of the documents from the Board, Panel, and STO to the Commission, and to make any technical changes to conform to the authority of the Commission; and direct staff to provide the Commission with information relating to any of the provisions of the documents that would not directly correlate between the Board/Panel and the Commission for the Commission's consideration at the next meeting. Mr. Gillespie seconded the motion.

Chairman Williams proposed amending Mr. Ewing's motion to provide additional modifications to the Emergency Procedures, which were included in the SIP. After thorough discussion, the motion was amended to modify the Emergency Procedures to read: "The Retirement System Investment Commission recognizes the possibility that events may occur affecting investments which would necessitate immediate action to

safeguard the Retirement Systems' assets. Once the Chairman of the Commission, with advice of the General Counsel to the Commission, determines that emergency action should be taken, the Chairman shall notify members of the Commission that such action is necessary. After such notification, the Chairman shall direct the State Treasurer to take the necessary steps to protect the assets pending further action by the Commission." Chairman Williams called for the question, and the interim AIP and SIP were adopted unanimously by the Commission, as modified. Chairman Williams asked staff to incorporate the proposed changes and distribute the documents to the Commission for ratification at the next meeting.

Chairman Williams suggested that the Commission adopt an internal standard for calling meetings. Mr. Fusco explained that Act 153 of 2005 stated that the Commission would meet at times as set by the Commission, the Chairman, or as requested by the Board. Mr. Ewing made a motion that the Commission adopt a policy to meet upon the request of any one member. Mr. Gillespie seconded the motion and after discussion, the motion passed unanimously.

III. EXECUTIVE SESSION

Chairman Williams asked for a motion to convene in executive session. Mr. Ewing made a motion that the Commission convene in executive session to receive legal briefings and to discuss personnel matters. Mr. Powers seconded the motion, which carried unanimously. Chairman Williams announced that the Commission would meet in executive session for the purpose of receiving legal briefings and to discuss personnel matters.

IV. OTHER BUSINESS AND FUTURE MEETINGS

The Commission reconvened in open session. Messrs. Ewing and Powers asked to revisit the policy for calling Commission meetings. After further discussion, Mr. Ewing made a motion to amend the policy concerning calling a Commission meeting at the request of any one Commissioner so as to provide that a meeting could be called upon the request of any two Commissioners. The motion received a second and carried unanimously.

Mr. Gillespie stated that the Board had offered to authorize the two employees, Nancy Shealy and Ashli Aslin, who currently serve as staff to the Panel, to assist the Commission during the remainder of the transition period. Mr. Gillespie made a motion to accept the Board's offer and to authorize Ms. Shealy and Ms. Aslin to provide services to the Commission until October 1, 2005, upon which time they would become full-time employees of the Commission. Mr. Ewing seconded the motion, which passed unanimously.

Mr. Powers made a motion that the Commission designate, appoint, and hire Ms. Shealy to be the acting General Counsel and Administrative Director of the Commission during the remainder of the transition period and continuing after October 1, 2005. Mr. Ewing seconded the motion, which passed unanimously.

Chairman Williams reported that during executive session, in addition to discussing personnel matters, the Commission received a legal briefing on pending litigation and procedures to develop additional legal advice as needed, and no action was taken in executive session.

The Commission received a video presentation on fiduciary responsibility by Professor John Freeman from the University of South Carolina. Professor Freeman reviewed the statutory definition of fiduciary set forth in Act 153. He explained that the Commissioners must act impartially and solely in the interest of the Retirement Systems, participants, and beneficiaries for the exclusive purpose of providing benefits to participants and beneficiaries, and must use skill and caution under the circumstances which a prudent person acting as a fiduciary would use. Professor Freeman discussed the Commission's responsibilities to incur only reasonable and appropriate costs and suggested that the Commission require "Most Favored Nation" (MFN) treatment from investment professionals. He explained that any Commissioner or other fiduciary who breaches a duty imposed by the Act may be personally liable to the Retirement Systems for any losses resulting from the breach.

Professor Freeman discussed the standards of conduct or "Eleven Rules" for fiduciaries set forth in Act 153. He said that Commissioners should:

1) take no action to purchase or acquire services or property for the Commission where a fiduciary member has a financial interest in the services or property, meaning that a fiduciary should avoid self-dealing,

2) take no action to invest Retirement Systems funds in any investment where a fiduciary or any member of a fiduciary's family is an underwriter of, or receives any fees from the investment,

3) have no interest in the profits or receive any benefit from a contract entered into by the fiduciary,

4) not use his or her position to secure, solicit, or receive things of value,

5) not represent, while serving as fiduciary or for one year thereafter, anyone before any agency with respect to any matters in which the fiduciary personally participated while serving as or employed by the fiduciary,

6) not take any official action that would result in a benefit to the fiduciary member, family, or business association,

7) not abuse or use any confidential information,

8) not use any assets of the Retirement Systems for the fiduciary member's own personal interest,

9) not act on behalf of a party whose interests are adverse to the Retirement Systems or the fiduciary,

10) not have any direct or indirect interest in gains or profits of any Retirement Systems' investment such as, for example, receiving a commission or fee from the Retirement Systems' investment, and

11) not make any investment through or purchases from, or otherwise do any business with a former fiduciary member or employee or with a business that is owned or controlled by a former fiduciary member or employee for a period of three years after the fiduciary member or employee leaves the fiduciary.

He summarized the standards of conduct by reiterating that a fiduciary should focus exclusively on the best interests of the plan, beneficiaries and participants, divorcing himself from any pecuniary gain that the fiduciary or a member of a fiduciaries' family or business might receive by virtue of the person being a fiduciary for the Retirement Systems.

The Commission sent thanks and appreciation to Professor Freeman for an informative briefing. Chairman Williams stated that he plans for there to be continuing education on the topic of fiduciary responsibility.

Chairman Williams proposed that the next meeting of the Commission be on October 13, 2005, at 10:00 a.m. in the Retirement Systems' second floor conference room. Chairman Williams also suggested that Commission meetings be held on the first Thursday of each month beginning in November, and the Commissioners concurred.

V. ADJOURNMENT

Chairman Williams thanked everyone for attending the meeting. Treasurer Patterson made a motion to adjourn, Mr. Ewing seconded the motion, and the meeting adjourned at 2:15 p.m.

[Staff Note: Per S.C. Code Ann. §30-4-80, public notice of and the agenda for this meeting were distributed to the press, posted in the Wade Hampton Office Building, and posted at the entrance, in the lobbies, and near the 2nd Floor Conference Room at 202 Arbor Lake Drive, Columbia, SC, on September 16, 2005.]