

South Carolina Retirement System Investment Commission Meeting Minutes

July 13, 2006

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

Commissioners Present:

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

Others present for all or a portion of the meeting: Ashli Aslin, Robert Borden, Tomas Jokl, Nancy Shealy, and Justin Young from the Retirement System Investment Commission; Frank Rainwater, Rick Patsy, and Shakun Tahiliani from the State Treasurer's Office; Jay Love from Mercer Investment Consulting; Peggy Boykin, Alice Copeland, Tammy Davis, Dianne Poston, Danielle Quattlebaum, Joni Redwine, Travis Turner, and Faith Wright from the South Carolina Retirement Systems; Anne Macon Flynn from the Budget and Control Board Office of General Counsel; David Lissek from Freeman Associates Investment Management, LLC; Kevin Kibler from the South Carolina Office of the Governor; Henry Addy, Crawford Clarkson, and Wayne Pruitt from the State Retirees Association; and Charley McDonald from the South Carolina Trooper's Association.

I. CALL TO ORDER AND CONSENT AGENDA

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission (Commission) to order at 10:00 a.m. and welcomed the Commissioners and guests. Due to a scheduling conflict, Treasurer Grady Patterson attended the meeting until 11:30 a.m.

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

Chairman Williams called for objections or amendments to the minutes from the Commission meeting on June 8, 2006. There being none, the minutes were adopted as presented.

II. REPORTS

Chairman Williams reported that in order to provide staff with sufficient time to prepare additional analysis relating to the portfolio performance, the Commission decided to

reschedule its regular meetings to the third Thursday of each month beginning with the August 2006 meeting. In light of the revised schedule and the retreat at Wampee Training and Conference Center in Pinopolis, SC, scheduled for November 30-December 1, 2006, the Commission decided not to schedule a meeting on December 21, 2006. The revised meeting schedule was received as information.

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

Chairman Williams recognized Ms. Nancy Shealy for the Administrative Director's report. Ms. Shealy referred to a report summarizing the Commission's FY2006 budget through June 30, 2006 (as reported through July 11, 2006). She stated that several items were still being processed through the accounting system and that a final report for FY2006 should be available at the Commission's August meeting. Ms. Shealy noted that a report summarizing the Commission's FY2007 budget was included in the Commissioners' meeting materials as information. At the request of Mr. Travis Pritchett, Ms. Shealy agreed to distribute a more detailed budget summary at the next meeting.

Ms. Shealy reported that the Fiduciary Liability Insurance policy premium for the State Budget and Control Board, Commission, State Retirement Systems Investment Panel (Panel), South Carolina Retirement Systems (Retirement System), and staff totaled \$376,300, which included an additional \$300 waiver of recourse for all those covered by the policy. In response to a concern voiced by Treasurer Patterson, Ms. Shealy stated that the Commission's premium for fiduciary liability insurance appeared to be comparable to premiums paid by other pension plans based upon available information.

The Commission received the Budget Allotment Summaries for FY2006 and FY2007 as information. (Information relating to this matter has been retained in the Commission's files and is identified as Exhibit B).

Ms. Shealy updated the Commission on the status of obtaining additional office facilities. She reported that an official request had not been made because specific space requirements were still being determined.

Ms. Shealy reported that the FY2006-2007 General Appropriations Act (H.4810) amended travel reimbursement rates for lodging and mileage. She stated that effective July 1, 2006, lodging reimbursements would be limited to the current maximum lodging rates, excluding taxes, established by the U.S. General Services Administration (GSA). The agency head was responsible for monitoring compliance and for approving all exceptions, taking into consideration location, purpose of travel, or other extenuating circumstances. Ms. Shealy noted that the current GSA standard rate for lodging was \$60 per night unless the location was specifically designated for a higher rate. Ms. Shealy explained that unless an exception was approved by the agency head in writing, reimbursements would be limited to the GSA rate, and reimbursement for taxes would also be limited to the rates associated with the GSA maximum daily rate. Chairman

Williams requested that each person ask for the government rate when making reservations to aid in his decisions regarding lodging rates exceeding the GSA rate.

Ms. Shealy reported that H.4810 also increased the rate for mileage reimbursement to 44.5 cents per mile beginning with travel on or after July 1, 2006. She noted that she would advise the Commission if the State lowered the rate in the future.

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

Chairman Williams recognized Mr. Robert Borden for the Chief Investment Officer's (CIO) report. Mr. Borden referred to the Investment Performance Summary as of May 31, 2006, and explained the volatility and performance of the portfolio over the quarter.

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

Mr. Borden reported that the transition of the J.L. Kaplan Associates (Kaplan) portfolio to the Passive Large Cap strategy had been completed. Mr. Borden noted that the cost of the transition was approximately 125 basis points (bps) higher than expected, which could be attributed to liquidity issues stemming from the large number of clients that terminated Kaplan during the same transition period. Mr. Borden stated that State Street Global Markets was able to transition a large portion of the portfolio with internal and external crosses.

Mr. Borden reported that the assets formerly managed by Nicholas-Applegate Capital Management (NACM) were transitioned to ClariVest Asset Management, LLC (ClariVest). Mr. Borden noted that ClariVest's June performance was quite favorable.

Mr. Borden referred to the sample quarterly report, which was included in the Commission's meeting materials. Mr. Borden provided an overview of the document and asked the Commission to offer suggestions, comments, and modifications to the content of the document. Mr. Blaine Ewing expressed concern with including Public Fund Median Return data on the quarterly report given the asset allocation differences between the median public fund and the Retirement System's portfolio, which were due to legal constraints beyond the Commission's control. After discussion, it was determined that the Policy Index Benchmark and the Public Fund Median Return data would be included in the document. Mr. Borden stated that amendments consistent with the discussion would be integrated into the document and a new draft would be presented at the August 2006 meeting.

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

III. INVESTMENT MATTERS

Chairman Williams recognized Ms. Shealy to discuss the AllianceBernstein L.P. (Alliance) contract amendments. Ms. Shealy stated that on May 8, 2006, the Commission authorized the Chairman or his designee to negotiate and execute another contract with Alliance for the Large Cap Growth strategy upon approval for legal sufficiency by General Counsel. Ms. Shealy noted that the existing contract with Alliance would have expired on June 22, 2006.

Ms. Shealy reported that during negotiations, Alliance provided a copy of its Code of Business Conduct and Ethics (Code), which applies to all of its employees and subsidiaries, and requested an exemption to S.C. Code Ann. §9-16-360(B), as amended (Statutory Code of Conduct). She stated that Alliance represented that it would not agree to be bound to the Statutory Code of Conduct; its prior contract pre-dated §9-16- 360(B). Ms. Shealy advised that the statute authorized the Commission to waive application of the Statutory Code of Conduct for employees or affiliates of a corporate fiduciary by written contract, which would be disclosed in the Commission's quarterly report. She explained that after a thorough review of the information provided, it was determined that the Code was substantively consistent with the Statutory Code of Conduct. She stated that amendments to Paragraph 2(I) were accepted by both parties confirming that Alliance and its employees and affiliates or subsidiaries would be subject to its Code and Alliance would be required to disclose any actions taken for violation of its Code against its employees or affiliates or subsidiaries who would have access to information relating to the Retirement System's accounts. The amendments also required Alliance to provide the Commission with reports relating to compliance upon the Commission's request.

Ms. Shealy stated that amendments were also accepted to allow an exception to the "most favored nations" clause in Paragraph 10(D) for Alliance's non-US based clients and technical amendments to conform. She said that the amendments were consistent with the Alliance's current contract for the Large Cap Value strategy and appeared to be reasonable given that different services were provided to those clients.

Mr. Ewing made a motion to ratify the contract with Alliance, as amended and executed on June 22, 2006, for continued management of assets in the Large Cap Growth strategy. Mr. James Powers 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).

Chairman Williams recognized Ms. Shealy to discuss assignment of the Fidelity Management Trust Company (Fidelity) contract. Ms. Shealy explained that upon recommendation of the Panel, the Board executed an agreement with Fidelity on May 18, 2000, to manage assets of the Retirement System in the Smaller Cap Core strategy and that, upon expiration, another contract was executed May 18, 2005. Fidelity notified the Panel and the equity investment consultant, Mercer Investment Consulting (Mercer), in early 2005 that its holding company, FMR Corporation, intended to

separate its retail business from its institutional business and would form another wholly owned subsidiary to manage assets for institutional clients. Subsequently, FMR Corporation formed Pyramis Global Advisors Holdings Company, which also has two wholly owned subsidiaries that provide investment management services: Pyramis Global Advisors Trust Company (Pyramis), which manages non-mutual fund products; and, Pyramis Global Advisors, LLC, which manages sub-advised products and Canadian mutual funds. Ms. Shealy stated that Fidelity requested consent to assign its current contract to Pyramis to transfer management of the Retirement System's assets. She noted that Commission staff and Mercer had been advised by Fidelity and Pyramis that the portfolio manager and team for the Retirement System's account would remain the same after the transfer. Ms. Shealy noted further that Fidelity managed approximately \$385 million (or approximately 1.48 percent) of the Retirement System's portfolio, and since inception, the portfolio, relationship, and business aspects of Fidelity had been monitored by the Panel (until October 1, 2005), staff, and Mercer. Staff and Mercer reviewed information about the ownership transfer and the potential impact on the management of the Retirement System's account. Upon Mercer's recommendation and after General Counsel's review of information from and discussions with Fidelity/Pyramis, Ms. Shealy recommended that the Commission authorize the Chairman or his designee to execute consent to the assignment of the current investment management contract with Fidelity to Pyramis.

After discussion, Mr. Ewing made a motion, which was seconded and unanimously passed, to authorize the Chairman or his designee to execute consent to the assignment of the investment management contract with Fidelity to Pyramis for continued management of Retirement System's assets in the Smaller Cap Core investment strategy.

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

Before reviewing the Statement of Investment Objectives (SIO), the Statement of Investment Policies (SIP), and the Annual Investment Plan (AIP), Chairman Williams and the Commission addressed several stylistic issues relating to consistency of terms throughout Commission documents.

Chairman Williams referred to the draft Statement of Investment Objectives (SIO) and noted that it had been vetted and incorporated amendments consistent with the discussions of the previous meeting. Chairman Williams called for additional comments, suggestions, and modifications to the SIO. Ms. Shealy offered a modification that conformed the language defining Acceptable Investments for the Equity and Alternative Portfolios. After discussion, Mr. Gillespie made a motion to accept the modification to the draft SIO. Mr. Ewing seconded the motion, which passed unanimously. Mr. Powers made a motion to adopt the draft SIO, as amended, and authorize staff to make any technical changes and typographical corrections to the document to conform style and syntax. The motion was seconded by Mr. Ewing and passed unanimously.

Chairman Williams referred to the draft Statement of Investment Policies (SIP) and noted that it had been vetted and incorporated amendments consistent with the discussions of the previous meeting. Chairman Williams called for additional comments, suggestions, and modifications to the SIP. After discussion, Mr. Gillespie made a motion to strike the entire Statement of Investment Objectives and Policies as last amended on December 8, 2005, adopt the SIP as presented, and authorize staff to make any technical changes and typographical corrections to the document to conform style and syntax. The motion was seconded by Mr. Ewing and passed unanimously.

Mr. Borden referred to the draft Statement Annual Investment Plan (AIP) and noted that it had been vetted and incorporated amendments consistent with the discussions of the previous meeting. Mr. Borden summarized the document and outlined amendments that may become necessary as changes are made to the portfolio. Chairman Williams called for additional comments, suggestions, and modifications to the AIP. Ms. Shealy offered a modification to the Ethics Report section of the draft document. After discussion, Mr. Ewing made a motion to accept the modification to the draft AIP. Mr. Powers seconded the motion, which passed unanimously. There being no further amendments or modifications to the draft AIP, Mr. Gillespie made a motion, which was seconded by Mr. Powers and passed unanimously, to amend the Annual Investment Plan for Fiscal Year 2006-2007 as adopted on April 13, 2006, by striking all in the existing document and inserting the provisions of the draft AIP, as amended, and to authorize staff to make any technical changes and typographical corrections to the document to conform style and syntax.

(Information relating to the SIO, SIP and AIP has been retained in the Commission's files and is identified as Exhibits H, I, and J, respectively.)

IV. ADMINISTRATIVE MATTERS

Chairman Williams recognized Mr. Ewing for a report on the Alliance Bernstein 2006 Global Symposium (Symposium). Mr. Ewing reported that he attended the Symposium on May 23, 2006, in New York, New York. He said he found that the presentations were very relevant to issues facing the Commission and highlighted some of the topics. He agreed to share the presentation documents from the conference with the Commissioners and staff.

Chairman Williams recognized Mr. Pritchett for a report on the Fiduciary College. Mr. Pritchett reported that he attended the Fiduciary College at Stanford University on June 21-23, 2006, in Stanford, California. He said he found that the presentations were very relevant to issues facing the Commission, particularly presentations on fiduciary principles and "best practices" for fulfilling responsibilities prudently and effectively.

Chairman Williams reported that he and Ms. Shealy attended the National Association of Public Pension Attorneys (NAPPA) 2006 conference on June 27-30, 2006, in New York, New York. Chairman Williams and Ms. Shealy said that many of the presentations were very relevant to issues facing the Commission, particularly presentations on board governance, fiduciary responsibility, real estate investing, and foreign investing. Ms.

Shealy found a presentation entitled "What To Do If the Government Comes Knocking" of particular interest and offered to share conference materials with the Commission.

V. OTHER BUSINESS

Chairman Williams recognized Mr. Jay Love from Mercer for an update on the Asset Liability Modeling Study (ALM). Mr. Love reported that Milliman Consultants and Actuaries (Milliman), the actuary for the Retirement System and the Board, provided Mercer with the initial liability data necessary for the ALM, and Mercer had checked the data and verified it for consistency with the current year valuation. Mr. Love also reported that Milliman indicated that they would provide Mercer with a final revised dataset when it became available. Mr. Love explained that Mercer would begin the modeling process upon receipt of the final data. He said that Mercer expected to provide initial results of the ALM at the Commission meeting in August.

After discussions with Mr. Love, the Commission determined that Mr. Ewing and Mr. Borden would confer with Mercer on issues such as asset classes, liability, and return assumptions for the ALM.

Mr. Powers suggested that at the end of each meeting, Commissioners and staff make recommendations for topics to be included on the next meeting's agenda. Chairman Williams called for suggested topics for the August meeting, which included: a report on the progress of acquiring new office facilities, a discussion on indexing, topics of interest for the retreat at Wampee, the State Street Global Advisors Russell 2000 contract renewal, a report on the portfolio pooling project, a report on quarterly performance and compliance with the AIP, and the global fixed income search.

VI. ADJOURNMENT

Chairman Williams thanked everyone for attending and adjourned the meeting at 12:20 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, on July 11, 2006.]