South Carolina Retirement System Investment Commission
Meeting Minutes

July 19, 2007

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 Ken Wingate
Mr. Blaine Ewing
Mr. Allen Gillespie
Dr. Travis Pritchett

Others present for all or a portion of the meeting: Ashli Aslin, Robert Borden, Donald Brock, Douglas Lybrand, Nancy Shealy, Nicole Waites, Hilary Wiek, and Justin Young from the South Carolina Retirement System Investment Commission; Delores Dacosta, Rick Harmon, and Shakun Tahiliani from the State Treasurer's Office; Rhett Humphreys and Sean Gill from New England Pension Consultants; Sarah Corbett, Jennifer Dolder, Joyce McDonald, Kelly Rainsford, Joni Redwine, and Travis Turner from the South Carolina Retirement Systems; Lil Hayes from the House Ways and Means Committee; Ted Aronson from Aronson+Johnson+Ortiz, LP; Tom MacLennan from GNI Capital, Inc.; Gil Caffray, Jack Coates, Mark van der Zwan, and Eban Cucinotta from Morgan Stanley Investment Management; and Crawford Clarkson and Wayne Pruitt from the State Retirees' Association.

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

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 scheduling conflicts, Treasurer Ken Wingate was unable to attend the meeting until 10:20 a.m.

Chairman Williams called for objections or amendments to the meeting's proposed agenda and to the minutes from the Commission meeting on June 21, 2007. There being none, the proposed agenda and the minutes were adopted as presented.

Upon request of Chairman Williams and without objection, the Statement of Investment Objectives (SIO) and Statement of Investment Policies (SIP) were carried over until later in the meeting.

II. CHIEF INVESTMENT OFFICER'S REPORT

Chairman Williams recognized Mr. Robert Borden for the Chief Investment Officer's (CIO) report.

Mr. Borden stated that the Commission previously approved a 15 percent allocation to Portable Alpha, to be evenly bifurcated into a pool of hedge fund-of-funds (FOF) and a pool of direct funds. He further stated that the approved plan called for the retention of four FOFs and eight direct funds. Mr. Borden recommended that, due to the considerable time required to conduct due diligence on direct funds, the Commission consider a Portable Alpha transition implementation plan which would modify the structure from the 50/50 balance of FOFS and direct funds to a 71/29 ratio consisting of five FOFs and five direct funds.

Mr. Rhett Humphreys from New England Pension Consultants (NEPC) reported that during the month of June 2007, a three person due diligence team comprised of Mr. Allen Gillespie, Ms. Hilary Wiek from the Commission, and Mr. Humphreys conducted on-site due diligence meetings with EnTrust Capital Diversified Fund Ltd, (EnTrust) and GAM USA Inc. (GAM). He also reported that during the month of June 2007, a three person due diligence team comprised of Messrs. James Powers, Borden, and Humphreys conducted due diligence meetings with Grosvenor Institutional Partners, L.P. (Grosvenor). Messrs. Borden and Humphreys and other members of the due diligence team members provided detailed information about the three firms.

Mr. Borden referred to an article from the June 25, 2007 issue of “Pensions & Investments” relating to hedge fund fees and discussed the fees negotiated with Entrust, GAM, and Grosvenor.

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

Mr. Borden recognized Messrs. Gil Caffray, Jack Coates, Mark van der Zwan, and Eban Cucinotta from Morgan Stanley Investment Management (Morgan Stanley) for a presentation on the Portable Alpha services provided to the Commission by Morgan Stanley through its Completion Portfolio of External Hedge Fund Managers (Completion Portfolio) and the benefits of the proposed Portable Alpha transition implementation program. Dr. Coates and the Morgan Stanley team provided a brief review of portable alpha, an analysis of alpha engine components, the state of the South Carolina Retirement Systems’ (Retirement System) Portable Alpha program, and the services Morgan Stanley could offer the Commission. The Commission asked questions, to which the Morgan Stanley team responded.

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

Messrs. Borden and Humphreys recommended that the Commission increase the Morgan Stanley Completion Portfolio allocation from $500 million to $1 billion as part of the Portable Alpha transition implementation program.

Mr. Powers made a motion to authorize the Chairman or his designee to negotiate and execute agreements and any necessary documents with Morgan Stanley to increase the allocation in the Completion Portfolio to $1 billion, subject to review and approval for legal sufficiency by general counsel. Mr. Blaine Ewing seconded the motion, which after discussion passed. Mr. Gillespie recused himself from discussions relating to Morgan Stanley and abstained from the vote due to potential conflicts of interest, which he disclosed to the Commission.

Messrs. Borden and Humphreys recommended that the Commission invest $400 million in the Entrust Capital Diversified Fund at an annual fee rate of 75 basis points (bps) fee plus a fixed operational fee of 5 bps, $750 million in the GAM US Institutional Diversity Fund at an annual fee rate of 75 bps plus a fixed 5 bps operational fee, and $750 in Grosvenor Institutional Partners, L.P., at an annual asset-based fee rate 1.4 percent on the first $10 million, 1.2 percent on the next $15 million, 1 percent on the next $25 million, 0.8 percent on the next $50 million, and 0.6 percent on amounts in excess of $100 million plus operating expenses, which historically ranged from 4-6 bps, as part of the Portable Alpha transition implementation program.

Mr. Powers made a motion to adopt the recommendations of Messrs. Humphreys and Borden and authorize the Chairman or his designee to negotiate and execute agreements and any necessary documents with Entrust to invest $400 million in the Entrust Capital Diversified Fund , GAM to invest $750 million in the GAM US Institutional Diversity Fund, and Grosvenor to invest $750 million in Grosvenor Institutional Partners, L.P., at the fee rates presented, subject to review and approval for legal sufficiency by general counsel. Mr. Ewing seconded the motion, which after discussion passed unanimously.

Mr. Borden and Ms. Wiek recognized Mr. Ted Aronson from Aronson+Johnson+Ortiz, LP (AJO) for a review of the AJO Large Cap Value portfolio and an educational presentation on 130/30 strategies. Mr. Aronson discussed the key characteristics of the AJO firm, process and investment strategy. He also discussed the Retirement System's AJO Large Cap Value portfolio, its performance-based fee schedule, and performance history.

Mr. Aronson provided an educational presentation on 130/30 strategies and how such strategies could potentially offer more investment opportunity, flexibility, and return per unit of risk. He also discussed how 130/30 strategies could also contain more risk, more cost, and require more administration.

Ms. Wiek noted that she and Mr. Borden conducted due diligence on AJO and confirmed their continued support of AJO's investment process and intellectual capital, despite recent underperformance in the Large Cap Value product. She noted that, as part of the asset allocation shift approved in December 2006, each portfolio manager had been thoroughly reviewed to determine the appropriateness of their investment strategies in the portfolio. She explained that part of the purpose of these reviews was to determine whether the Retirement System's was utilizing managers' skills in an optimal manner. Mr. Borden and Ms. Wiek recommended that the Commission shift the AJO mandate to a 130/30 strategy in order to make the best use of the firm's investment skills.

Mr. Borden explained that entering into a long/short strategy in a separate account might entail the hiring of a Prime Broker, who would be responsible for the sourcing of the borrowed securities identified by the investment manager. He stated that this would require additional due diligence, as it would essentially require hiring another custodial agent for the Retirement System's portfolio. He noted that he was uncertain as to whether or not the Bank of New York could provide such services. Mr. Aronson stated that the Commission could either invest through a separately managed account or could form a partnership whereby the partnership could provide brokerage services.

Mr. Ewing made a motion that the Commission authorize the Chairman to determine the most appropriate structure for the recommended AJO investment (separately managed account or partnership) and to negotiate and execute agreements and any necessary documents with AJO to shift the AJO mandate from a Large Cap Absolute Value product to the Large Cap Value 130/30 strategy, subject to review and approval for legal sufficiency by general counsel and subject to the operational and legal requirements being resolved. Mr. Gillespie seconded the motion, which, after discussion, passed unanimously.

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

The Commission discussed the selection process within hedge FOFs and the due diligence and education required in order to have a broad understanding of those processes.

Mr. Borden explained that an analysis had been provided to the Commission, the purpose of which was to determine the appropriate product to fund with Loomis Sayles Trust Company, LLC (Loomis) and Mondrian Investment Partners Limited (Mondrian) and to reassess the allocations to the global bond asset sub-class in relation to the total portfolio. Messrs. Borden and Humphreys discussed the analysis and recommended that the Commission reconsider the initial allocations and products approved previously for Loomis and Mondrian and the allocations to Credit Agricole and Western Asset Management Company (WAMCO). They recommended that the Commission invest $780 million in the Loomis' Multisector Full Discretion Trust and $780 million the Mondrian Global Debt Opportunities Fund, L.P., and increase the allocations to Credit Agricole and WAMCO to $780 million each in an attempt to avoid a large overweight allocation to global bonds and to gain greater access to High Yield and Emerging Market Debt.

Treasurer Wingate made a motion to approve the that the initial allocations to Loomis and Mondrian be invested in the Loomis Multisector Full Discretion Trust and the Mondrian Global Debt Opportunities Fund, L.P., that the allocation to each be increased from $750 million to $780 million, and that the allocations to Credit Agricole and WAMCO be increased to $780 million each. Mr. Gillespie seconded the motion, which passed unanimously.

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

Mr. Borden recognized Mr. Sean Gill from NEPC for a review of the first draft of the proposed structure of the Real Assets investment plan. Messrs. Gill and Humphreys stated that the Commission previously approved a 5 percent allocation to Real Assets. They reported that NEPC recommended that this allocation consist of a mix of open-end and closed-end products, which would be committed over time to achieve vintage year diversification similar to that found in Private Equity. Mr. Gill provided an overview and forecast of the Real Assets market. He also provided an overview of the Timber and Infrastructure markets and how they could be used to diversify the Real Asset allocation of the Retirement System's portfolio.

Mr. Travis Pritchett made a motion to accept the Real Assets Strategic Investment Plan and implementation strategy. Mr. Powers seconded the motion, which passed unanimously.

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

Mr. Borden discussed the investment performance of the Retirement System's portfolio as of June 30, 2007. Mr. Borden briefly discussed the performance of the equity, fixed income, and total portfolio and the contributing factors to that performance.

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

Mr. Borden provided an update on the progress of the Beta Overlay portfolio, an overview of which was included in the Commissioners' meeting materials.

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

Mr. Borden referred to the proposed amendment to the Annual Investment Plan (AIP), which was included in the Commissioners' meeting materials. He noted that the Commission had approved an exception when it voted to invest in Putnam Investments' (Putnam) Total Return Fund, which was consistent with the proposed amendment to the AIP. Mr. Borden explained that when the AIP was drafted, it included a provision stating that the Commission's initial commitment to a partnership/fund would not exceed 25 percent of the committed capital of that partnership/fund and stated that the proposed language repealed that 25 percent limit. Mr. Powers made a motion to adopt the amendment to the AIP, which was seconded by Mr. Ewing seconded the motion and passed unanimously.

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

Mr. Borden reported the Chairman or his designee had been granted the authority previously to negotiate and execute a contract with Jamison, Eaton & Wood, Inc. (Jamison) for investment advisory services for the Fixed Income portfolio. Mr. Borden stated that he and a team consisting of Messrs. Gillespie, Rick Patsy, and Powers worked with representatives from Jamison to develop a scope of services and a fee schedule for the services. Mr. Powers made a motion to ratify those negotiations, which included a scope of services and an annual fee of $491,000, subject to review and approval for legal sufficiency by general counsel. Mr. Gillespie seconded the motion, which passed unanimously.

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

Mr. Borden reported that the fee for the Loomis Multisector Full Discretion Trust was 10 bps higher than the product previously approved by the Commission, and the Mondrian Global Debt Opportunities Fund, L.P., was 9 bps higher than the product previously approved by the Commission. A motion was made by Mr. Powers, seconded by Mr. Gillespie, and unanimously passed to accept these fee structures.

Mr. Borden stated that he had conducted due diligence meetings with Carousel Capital (Carousel), a private equity firm located in Charlotte, NC, and that he had requested Mr. Gill meet with Carousel representatives. Mr. Gill gave an overview of the firm, fund, and its investment history. Mr. Borden agreed to continue meetings with Carousel representatives and update the Commission as appropriate.

Upon the request of Chairman Williams and without objection, the item related to amendments to the Statement of Investment Policies (SIP) was carried over.

Chairman Williams referred to the draft Statement of Investment Objectives (SIO) and amendment document, which were included in the Commissioner's meeting materials. The Commission and staff thoroughly reviewed and discussed various aspects of the document and offered comments, suggestions, and modifications. Mr. Gillespie 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.

III. ADMINISTRATIVE MATTERS

Chairman Williams recognized Ms. Nancy Shealy for the Administrative Director/General Counsel's report.

Chairman Williams commended Ms. Shealy for her valiant efforts, which made it possible to implement the Commission's investment decisions. He stated that these efforts included both legal expertise and physical stamina, since Ms. Shealy did not have support staff dedicated to help her with all of those duties. Treasurer Wingate stated that the Commission should act to ensure that she had sufficient resources to maintain administrative and legal duties for the Commission. Treasurer Wingate offered his assistance and the assistance of his staff to remedy this situation.

Ms. Shealy stated that while the Commission did not employ a dedicated staff for all administrative functions currently, she had received assistance with her varied duties. She thanked those who had provided or offered her assistance, including staff from the South Carolina Budget and Control Board, particularly Caroline Agardi, Keri DePiro, Belinda Ogorek, and Tim Baskins from Human Resources and other staff from Internal Operations in the Budget and Procurement offices; Retirement System staff in various divisions; and the State Treasurer's Office staff. She also noted that Kathy Rast from the Retirement System staff had provided extraordinary assistance with procurement, accounting, and budgetary matters and that Donald Brock from the Commission staff had volunteered and been of tremendous assistance in processing documents for investment closings.

Ms. Shealy stated that when office space became available, she intended to post the Administrative Manager position approved by the Commission previously, which should consolidate and streamline some of the administrative functions. Ms. Shealy updated the Commission on other personnel issues.

Chairman Williams thanked Ms. Shealy for her report.

IV. ADJOURNMENT

Chairman Williams thanked everyone for attending, and the meeting adjourned at 2:45 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 17, 2007.]