South Carolina Retirement System Investment Commission
Meeting Minutes

July 17, 2008

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

Commissioners Present:
Mr. James Powers, Chairman
Mr. Allen Gillespie, Vice Chairman
State Treasurer Converse Chellis
Mr. Blaine Ewing
Dr. Travis Pritchett
Reynolds Williams, Chairman Emeritus

Others present for all or a portion of the meeting: Dunkin Allison, Geoff Berg, Robert Borden, Donald Brock, Brenda Gadson, Hershel Harper, Douglas Lybrand, Heather Muller, Rick Patsy, Greg Putnam, Kathy Rast, Nancy Shealy, Nicole Waites, Brian Wheeler, and Hilary Wiek from the South Carolina Retirement System Investment Commission; Mike Addy, Delores Dacosta, Rick Harmon, Morgan O'Donnell, Shakun Tahiliani, and Matt Templeton from the State Treasurer's Office; Rena Grant from the SC House Ways and Means Committee; Rhett Humphreys from New England Pension Consultants; Peggy Boykin, Sarah Corbett, Tammy Davis, Robyn Leadbitter, Danielle Quattlebaum, Joni Redwine, and Travis Turner from the South Carolina Retirement Systems; Kelly Rainsford from the State Budget and Control Board's Employee Insurance Program; Wayne Pruitt from the State Retirees' Association; Chris Smajdor from AllianceBernstein L.P.

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

Chairman James Powers 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. State Treasurer Converse Chellis introduced Messrs. Morgan O'Donnell and Matt Templeton, who were interns from the State Treasurer's Office.

Chairman Powers called for objections or amendments to the meeting's proposed agenda and stated that information regarding Gottex would be removed from the agenda. The minutes from the meetings of March 20, April 17, May 15 and June 19, 2008, were carried over.

Chairman Powers and Vice-Chairman Allen Gillespie stated that corporate governance and policy and procedures were significant items that would continue to be discussed and refined within the next year. Mr. Gillespie stated that he felt the Commission should conduct internal research and then request assistance from an outside organization. He also suggested that since much of the portfolio had been diversified toward the target asset allocation, slowing new investments may be required to create the time needed to properly review internal policies.

II. INVESTMENT MATTERS

Chairman Powers recognized Mr. Robert Borden for the Chief Investment Officer's report. Mr. Borden referred to the draft of the Statement of Investment Objectives. Ms. Nancy Shealy, Administrative Director & General Counsel, said that the statute required an annual review to amend or reaffirm the Statement of Investment Objectives (SIO). She recommended reaffirming the current SIO with the understanding that the Commission would revisit the document to determine if any changes needed to be made to conform to other Commission documents.

Mr. Gillespie mentioned differences between the SIO, the Statement of Investment Policies, and the Annual Investment Plan for Fiscal Year 2008-2009 (AIP). Ms. Shealy noted that the AIP and the SIO should be similar currently. Dr. Travis Pritchett made a motion to reaffirm the SIO from August 16, 2007. Mr. Reynolds Williams seconded the motion, which passed unanimously.

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

Mr. Borden said that the draft amendments to the AIP had been submitted to the Commission and requested approval, noting that additional changes may arise once the Commission's internal policies and procedures were reviewed. Chairman Powers stated that future SIOs and the AIPs should combine aspects of both reports for better organization.

Mr. Blaine Ewing requested additional benchmark studies and reiterated his concerns discussed at previous meetings. Mr. Gillespie noted that contractual agreements with managers may differ from investment objectives and that changes within the AIP should be communicated to the managers so they would be aware of the revisions, or alternatively, contracts should include information stating that managers follow the AIP that was in effect when they signed the contract.

Mr. Borden said that the benchmarks in the final draft AIP were consistent with how the managers currently invested the portfolios. Mr. Gillespie stated concerns with language in the AIP and, after further discussion, Dr. Travis Pritchett made a motion to adopt the amendments to the AIP. Mr. Reynolds Williams seconded the motion, which passed unanimously.

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

Mr. Borden referred to materials relating to performance of the portfolio, which had been provided to the Commission as information. He said that the Standard & Poor's Index (S&P) for the fiscal year to date was down 13.1 percent, the Russell 2000 index was down 16.2 percent, the current U.S. equity component was down 14.9 percent, the International component was down 10.6 percent, the Lehman Aggregate was up 7.1 percent and the portfolio of the South Carolina Retirement Systems (Retirement System) was up 5.6 percent.

Mr. Borden reported that the Lehman Global Aggregate was up 12.9 percent and stated that the move to global bonds and the dollar's poor performance created this increase. Additionally, he said that the hedge fund program had a fiscal year return of 11.2 percent. Mr. Borden noted that long-only investments, in general, were down, and reiterated the success of reducing those allocations. Mr. Borden estimated the total fund's performance for the fiscal year to date at negative 2.6 percent. He also mentioned that other state pension plans were experiencing worse performance and mentioned that diversification of the fund within the past year had prevented further loss.

Chairman Powers requested information that would show what the fund's performance would have been if it had not been diversified. Mr. Borden said he would provide the Commission with comparison data. Mr. Ewing suggested a comparison with long-term data and mentioned that it was possible look at performance differences too often.

Mr. Ewing questioned the absence of benchmark data for treasury bills and absolute return strategies. Mr. Borden responded that they were in the amended AIP, and it would be at least thirty days before current figures could be compiled.

Mr. Borden said that the study by Independent Fiduciary Services was still in progress and noted that conferences with the State Treasurer's Office, the Retirement System and the Commission were conducted within the past week. Mr. Greg Putnam said that interviews with individual Commission staff members were completed, but the auditors had not provided any feedback information.

Mr. Borden referred to a report about the large cap equity portfolios and introduced Ms. Hilary Wiek for her presentation. Ms. Wiek introduced a new member of the Commission's staff, Mr. Geoff Berg, who was the new Public and Private Equity Officer.

Ms. Wiek said that $500 million had been transferred from the equity managers in March 2008 and noted that despite the S&P being up in April and May, June's weak S&P performance mitigated any potential increase from April and May had that allocation remained in equities. She said that 20 percent of the portfolio was currently targeted to portable alpha over a mix of futures. Ms. Wiek recommended moving to synthetics by reducing long-only managers in the large cap portfolio. Ms. Wiek said that the current managers were hired after a long streak of overperformance, but they were currently underperforming. She discussed her lack of confidence in the managers' ability to overcome that underperformance.

Ms. Wiek discussed performance of the Barclays Global Investors (BGI) Alpha Tilts strategy and noted that 2007 was its worst performance in 20 years, but noted that it was ahead of the S&P for the first two quarters of 2008. She also proposed moving away from the BGI Alpha Tilts long-term product and allocating funds to two short-term investment strategies offered by BGI.

Ms. Wiek mentioned that Legg Mason Capital Management (Legg Mason) outperformed their benchmark in 2007 by 4.02 percent, but currently trailed the Russell 1000 Growth Index by 10.7 percent for 2008. Additionally, she noted that $50 million had been transferred from Legg Mason just before three months of underperformance.

Ms. Wiek advised that WCM Investment Management's (WCM) strategies, which were outperforming Legg Mason in 2008, often suffered from 24-36 months of negative returns and questioned investors' ability to endure loss. She said that although WCM outperformed in June 2008, its allocation had been reduced by $100 million just before two prior months of underperformance.

Mr. Borden added that absolute return strategies offer superior risk adjusted return and with consistently positive returns over two decades whereas strategies such as WCM's required the ability to withstand extended loss to provide similar alpha.

Ms. Wiek said that Aronson, Johnson, and Ortiz (AJO) was currently ahead of the Russell 1000 Value Index by 2.21 percent for 2008 and noted that because it was below its benchmark over longer periods, no management fees had been paid for management of that portfolio. Ms. Wiek said that Pzena Investment Management's performance had suffered due to problems at Countrywide, Fannie Mae and Freddie Mac, but was confident that, based on historical data, they would be able to recover in 6-9 months.

Mr. Borden introduced the Chairman of New England Pension Consultants (NEPC), Mr. Dick Charlton, to provide insight regarding the use of large cap long-only management in portfolios.

Mr. Charlton said that over long-term periods, the odds were stacked against active managers. He suggested transitioning from active management to either an index or a portable alpha approach and noted that, without transition, current managers' ability to add value was close to non-existent. Mr. Rhett Humphries of NEPC advised that moving to the portable alpha construct would be appropriate.

Chairman Powers said that in the interest of protecting the portfolio, further discussions should occur in executive session, and Mr. Ewing concurred.

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

Mr. Borden introduced Mr. Rick Patsy to discuss the recommendations of the high yield manager search team, which was comprised of Messrs. Ewing and Patsy and representatives from NEPC. Mr. Patsy expressed concerns with inconsistent performance and firm stability in this strategy, but noted that Post Advisory Group and Penn Capital Management were stable and produced quality performance. He said that on a calendar year basis, the Post High Yield Plus product had never underperformed the Lehman High Yield Index since inception and added that on a state fiscal year basis, it had only underperformed the benchmark twice. Mr. Patsy indicated similar consistent performance from Penn Capital Management, and he said that the search team recommended that the Commission retain both firms.

Chairman Powers asked if the fee structure was competitive. Mr. Patsy responded that the fees were competitive and said that Post Advisory Group had $13 billion under management and Penn Capital Management $7 billion under management, including $1.5 billion in high yield. Mr. Ewing added that Penn Capital Management's equity product worked in cooperation with their high yield product. Mr. Gillespie asked if the high yield allocation would be reduced in the future. Mr. Patsy responded that currently the Retirement System had a small allocation to high yield and even if the proposed managers were hired, the allocation would still be underweight. Mr. Humphreys added that allocations could be modified in the future. Mr. Ewing questioned the proposed total allocation for high yield, and Mr. Borden responded that the high yield target exposure of the total portfolio was approximately 3.5 percent currently. Upon questions by Mr. Gillespie, the commission discussed credit exposure and risk reporting.

Mr. Borden suggested easing into the allocation over the next year. Mr. Ewing concurred with Mr. Borden's recommended approach. After further discussion, Mr. Gillespie made a motion to invest an amount not to exceed $400 million in the Post High Yield Plus fund and an amount not to exceed $200 million in Penn's Opportunistic High Yield Fixed Income fund, to authorize the Chairman or his designee to negotiate fees, and to authorize the Chairman to negotiate and execute any necessary documents to implement the investment upon approval for legal sufficiency by General Counsel. Mr. Ewing 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 referred to materials that had been provided to the Commission relating to a proposal for a strategic partnership with D.E. Shaw as recommended by the search team, which was comprised of Messrs. Gillespie and Borden and representatives of NEPC. Mr. Borden discussed positive aspects of increasing the allocation to the D.E. Shaw Group, reiterating that D.E. Shaw had an innovated organizational structure that lent itself to being a high quality fund. He said that the search team recommended allocating a total of $750 million to the strategic partnership, which was an additional $300 million to the current $450 million invested with the

D.E. Shaw Group in other strategies. He noted that the Retirement System's current investments with D.E. Shaw would be rolled into the strategic partnership.

Mr. Ewing asked about the benefits of D.E. Shaw's 130/30 fund. Mr. Borden responded that it was the global fund component and noted that its alpha generation was unique and created similar characteristics to an absolute return strategy. Mr. Gillespie said that D.E. Shaw had a competitive advantage in certain areas, and Mr. Borden added that the Retirement System would also benefit from the creation of several possible co-investment opportunities. Mr. Gillespie concurred with Mr. Borden's observations regarding D.E. Shaw's uniqueness and innovative structure. Dr. Pritchett questioned the amount of allocation to private equity that the strategic partnership would hold. Mr. Borden responded that he planned to recommend a recast of the real estate and private equity plans, and he believed that involvement with strategic partnerships would increase the fund's success in alternate investments.

Mr. Ewing questioned how strategic partnerships would be judged and evaluated to see if their advice was accurate and beneficial to the Retirement System. He also asked how result targets would be created and monitored. Mr. Borden responded that over the total portfolio, combining benchmarks of various asset classes would be difficult, and added that he was working in cooperation with strategic partners to solve these difficulties. He said that to the extent that a specific investment was well defined, there were appropriate benchmarks. In regard to undefined benchmarks, Mr. Borden said that absolute benchmarks would need to be established for managers.

After further discussion, Mr. Williams made a motion to invest an amount not to exceed $750 million in a strategic partnership with D.E. Shaw and to authorize the Chairman to negotiate and execute any necessary documents to implement the investment upon approval for legal sufficiency by General Counsel. Mr. Ewing 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 referred to information from the search team, which was comprised of Messrs. Williams, Gillespie, and Mr. Borden and representatives from NEPC, relating to a recommendation to enter into a strategic partnership with Apollo Management (Apollo). Mr. Borden discussed Apollo's ability to create opportunities from distressed debt and private equity in the buyout sector. He said that they proposed allocating assets to a capital markets fund and to a buyout/distressed private equity fund. Mr. Borden said that Apollo's ability to work on a local level in locations with distressed debt contributed to its performance return success. After further discussion, Mr. Borden advised that Apollo would also be contributing significant capital to the strategic partnership fund.

After further discussion, Mr. Williams made a motion to invest an amount not to exceed $750 million as recommended to a strategic partnership with Apollo Management and to authorize the Chairman to negotiate and execute any necessary documents to implement the investment upon approval for legal sufficiency by General Counsel. Mr. Ewing seconded the motion, which passed unanimously.

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

Mr. Ewing reiterated concerns regarding risk and evaluation of strategic partnerships. Mr. Gillespie noted that establishing policies and procedures would be beneficial in addressing Mr.

Ewing's concerns. Mr. Borden added that knowledge transfer and the creation of a standardized punch list to conduct scenario analysis would also address those concerns.

III. ADMINISTRATIVE MATTERS

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

Ms. Shealy advised that the Commission would transfer to a new administrative accounting system, the South Carolina Enterprise Information System (SCEIS), on November 3, 2008. She explained the basics of the system and noted that per state law, all agencies would be required to migrate to the new system eventually. She added that all administrative financial records (except payroll) would be created and processed in-house before being sent to the Comptroller General, which would eliminate the Commission's dependence on the State Budget and Control Board's Office of Internal Operations for these functions, which had provided the Commission administrative financial support since the Commission's inception in October 2005. She said the total cost to obtain mandatory SCEIS access was $30,000 and that funds remaining from the Fiscal Year 2008 budget had been earmarked and transferred to the current budget in accordance with state law.

Ms. Shealy referred to hardcopies of the State Auditor's Report for Fiscal Year Ending June 30, 2007, which related to the Commission's agency operations and had been provided to the Commission as information. She noted that no exceptions were found during the audit.

Ms. Shealy provided the Commission with a budget status report for Fiscal Year 2008. She said due to pending legal fees and unfilled positions, approximately $515,000.00 of authorization remained. Additionally, Ms. Shealy provided the Commission a budget for Fiscal Year 2009 and said that the preliminary budget for Fiscal Year 2010 would be due in August 2008.

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

Ms. Shealy reported that Sankaty Advisors, LLC, Selene Investment Partners, LLC, and D.E. Shaw Direct Capital Fund were closed since the last meeting and noted that several strategic partnerships were under legal review. She also mentioned working in cooperation with the Bank of New York Mellon regarding securities and class action monitoring. Ms. Shealy reported that the Commission had filed a claim against Adelphia, which was under investigation by the United States Securities and Exchange Commission and United States Department of Justice.

Ms. Shealy provided the Commission with a brief report on the seminars she attended at the annual National Association of Public Pension Attorneys Conference in Boston, Massachusetts, in June 2008. She said that she found the conference most informative and pertinent to some of the topics being addressed by the Commission.

IV. OTHER BUSINESS

The Commission was presented with a resolution for their consideration recognizing Mr. Williams for his service as the first chairman of the Commission and designating Mr. Williams as Chairman Emeritus of the South Carolina Retirement System Investment Commission. The resolution read as follows:

R E S O L U T I O N
OF THE

SOUTH CAROLINA RETIRMENT SYSTEM INVESTMENT COMMISSION

WHEREAS, Reynolds Williams achieved academic success at the University of Virginia and the University of South Carolina School of Law; and

WHEREAS, he honorably served our country in the Vietnam War, earning the Bronze Star and Combat Infantry Badge; and

WHEREAS, he has enjoyed professional success in legal, legislative, business, civic, educational, religious, and cultural endeavors as a leader and a participant; and

WHEREAS, he was appointed to the Retirement System Investment Commission on July 28, 2005, by Senator Hugh K. Leatherman, Sr.; and

WHEREAS, he was unanimously elected as the first chairman of the Commission on September 8, 2005; and

WHEREAS, he has devoted considerable time and effort in organizing and leading the Commission into the position as being one of the best public pension investment boards; and

WHEREAS, he successfully led the efforts to amend the South Carolina Constitution to allow more flexibility and diversity in pension investments;

WHEREAS, he oversaw the transition and diversification of the investment portfolio into a variety of asset classes including, international, private equity, and global fixed income, as well as alternative investment strategies; and

WHEREAS, his immeasurable contributions to the Retirement System Investment Commission have set the standard for leadership and professionalism and have earned him the unqualified respect of his peers both in the public and private sectors;

NOW, THEREFORE, BE IT RESOLVED that the South Carolina Retirement System Investment Commission, acting for itself and on behalf of the people of South Carolina, recognizes, commends, and extends its deep appreciation to its first chairman, Reynolds Williams, for his distinguished public service, and bestows upon him the recognition of "*CHAIRMAN EMERITUS*" and, by this means, offers its best wishes for every success in his future endeavors.

FURTHER, the Commission directs that a copy of this Resolution be presented to Mr. Williams and that a copy be retained among the Commission's official records.

Unanimously adopted this seventeenth day of July, 2008, at the meeting of the South Carolina Retirement System Investment Commission.

Upon motion and second of the entire Commission, the Commission adopted the resolution. Mr. Williams abstained from voting. Chairman Powers also presented a plaque on behalf of the Commission, Mr. Borden, and Ms. Shealy to Mr. Williams for his distinguished service to the South Carolina Retirement System Investment Commission.

(A copy of the resolutions has been included as part of the Commission's official records and is identified as Exhibit H).

V. EXECUTIVE SESSION

Mr. Chellis made a motion that the Commission recede to executive session to receive legal advice and to discuss investment matters pursuant to S.C. Code Ann. §§9-16-80 and 9-16-320. Mr. Gillespie seconded the motion, which passed unanimously. Chairman Powers announced that the Commission would meet in executive session for those purposes.

The Commission reconvened in open session and Chairman Powers reported that the Commission did not take any reportable action while in executive session. Chairman Powers noted that any action that did occur while in executive session pursuant to S.C. Code Ann. §§9-16-80 and 9-16-320 would be publicized when doing so would not jeopardize the Commission's ability to achieve its investment objectives or implement a portion of the annual investment plan.

VI. ADJOURNMENT

There being no further business, Mr. Gillespie made a motion, which was seconded by Mr. Ewing and passed unanimously, that the Commission adjourn. Chairman Powers thanked everyone for attending, and the meeting adjourned at 1:05 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 15, 2008.]