South Carolina Retirement System Investment Commission
Meeting Minutes

November 17-18, 2010

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

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

Others present for all or a portion of the meeting on Wednesday, November 17, 2010: Mike Addy, Dunkin Allison, Geoff Berg, Bob Borden, Jonathan Boyd, Harris Chewning, Dori Ditty, Brenda Gadson, Hershel Harper, Dave Klauka, Doug Lybrand, Jared O'Connor, Kathy Rast, Nancy Shealy, Nicole Waites, and Brian Wheeler from the South Carolina Retirement System Investment Commission; Rick Harmon, Frank Rainwater, and Shakun Tahiliani from the State Treasurer's Office; Ashli Aslin and Tim McCusker from New England Pension Consultants; Peggy Boykin, Greg Meetze, Tammy Nichols, John Page, and Faith Wright from the South Carolina Retirement Systems; Netti Bhalla, Samantha Davidson, Mark Evans, Pat Sullivan, and Katie Tipermas from Goldman Sachs Asset Management; Bruce Jackson and Matt Harris from Arnall Golden Gregory, LLP; Paul Podolsky from Bridgewater Associates; David Ader, Ben Carpenter, and Ken Hackel from CRT Capital Group, LLC; Chip Allen and Curtis Loftis from the State Treasurer-Elect's Office; Greg Beard and Barry Cohen from Apollo Capital Management; Bill Michaelcheck, Skip Shaw, and Mike Winchell from Mariner Investment Group; Greg Nordquist from Russell Implementation Services; John Garrett from Cavanaugh MacDonald Consulting, LLC; Bo Kerrison and David Kilborn from Ansonborough Capital; John Helmers from Swiftwater Capital; Torrey Rush from ED RUSH Development; and Michael Zimmerman from Tower Capital.

Others present for all or a portion of the meeting on Thursday, November 18, 2010: Mike Addy, Dunkin Allison, Geoff Berg, Bob Borden, Jonathan Boyd, Harris Chewning, Dori Ditty, Brenda Gadson, Hershel Harper, Dave Klauka, Doug Lybrand, Jared O'Connor, Kathy Rast, Nancy Shealy, Nicole Waites, and Brian Wheeler from the South Carolina Retirement System Investment Commission; Frank Rainwater and Shakun Tahiliani from the State Treasurer's Office; Ashli Aslin and Tim McCusker from New England Pension Consultants; Peggy Boykin, Greg Meetze, Tammy Nichols, John Page, and Faith Wright from the South Carolina Retirement Systems; Bruce Jackson and Matt Harris from Arnall Golden Gregory, LLP; Curtis Loftis, State Treasurer-Elect; Bill Michaelcheck, Skip Shaw, and Mike Winchell from Mariner Investment Group; and John Helmers from Swiftwater Capital.

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 10:00 a.m. and welcomed the Commission and guests to the Strategic Planning Retreat (Retreat) at the Wampee Training and Conference

Center. Reynolds Williams was not present at the meeting on November 17, 2010, due to a scheduling conflict.

Chairman Gillespie called for objections or amendments to the meeting's proposed agenda. There being no amendments and upon motion by State Treasurer Converse Chellis and second by James Powers, the proposed agenda was adopted as presented.

Chairman Gillespie reported on the Value Investing Conference, which he attended in New York. He stated that Kyle Bass, Managing Member and Principal of Hayman Advisors, LP, was a presenter, and he summarized the key points of Mr. Bass' presentation. Chairman Gillespie briefly highlighted topics addressed at the conference, including subprime sovereign debt, interest rates in Japan, banking systems in foreign countries, government debt default cycles, and currency issues.

Mr. Chellis introduced Curtis Loftis, the State Treasurer-Elect. The Commission welcomed Mr. Loftis to the Retreat.

II. PENSION FUNDING OVERVIEW

Chairman Gillespie recognized Bob Borden, Chief Executive Officer and Chief Investment Officer (CEO/CIO) to provide an overview of the agenda. Mr. Borden indicated that he wanted to begin with an overview of the actuarial status of the South Carolina Retirement Systems (Retirement System) and the relationship between assets and liabilities in order to get a sense of how the performance of the Retirement System's total portfolio (Portfolio) affected liabilities and resulting funding requirements for the State. He reported that a special Senate Finance subcommittee (Senate Subcommittee) had been formed to discuss issues relating to the Investment Commission, and he provided the Commissioners with a copy of his presentation to the Senate Subcommittee on November 3, 2010.

Mr. Borden said he wanted to review current asset exposures and provide a broad update of activities over the past year during the meeting, including the development of risk models to evaluate the inherent risk of the Portfolio's allocations. He said that macroeconomic overviews would be the focus of the first presentations, followed by emerging markets, fixed income markets, commodities markets, the quantitative easing program of the Federal government, and global currency issues.

Mr. Borden said he would review scenario-based analyses of asset allocations that were developed in cooperation with New England Pension Consultants (NEPC), which included factor-based risk analysis; overlay solutions to affect changes in allocation, rebalancing, hedging, exposure; asset class plans; and an overview of the due diligence processes used to implement the asset class plans. Mr. Borden used a three-legged stool chart as an example of the basic pension fund structure. He explained that the support of the stool was provided by contributions, investment returns, and benefit payments. Mr. Borden indicated that contributions included employee contributions, employer operating cost contributions, and employer unfunded accrued actuarial liability (UAAL) contributions. He reported that approximately $1.6 billion was the total annual contribution to the Portfolio currently. He stated that investment returns were variable and were estimated to be about 8 percent currently. Mr. Borden stated that approximately $2.4 billion was paid in annual benefit payments currently, which was more than the $1.6 billion in annual contributions. He said that most mature pension plans were in a net outflow phase as a result of overall defined benefit plan demographics. Mr. Borden said that the UAAL was basically a yearly measurement between the actuarial assets and actuarial liabilities.

He reported that as of July 1, 2009, the UAAL of the Retirement System was approximately $13.2 billion and that it was approximately 68.7 percent funded. Mr. Borden presented a timeline that showed since 1999, significant events had occurred which increased the UAAL. He indicated that lower investment performance, changes to benefit structures (including the TERI program), reduced retirement eligibility, and guaranteed cost of living adjustments (COLAs) had increased the UAAL. He stated that some legislators had discussed the efficacy of reducing the actuarial assumed rate of return. Mr. Borden said that in and of itself, reducing the actuarial assumed rate of return might sound like a prudent thing to do, but he noted the trade-offs of putting a COLA in place over 25 years and noted that the practice of granting COLAs each year might be considered by some a liability that was not on the books. He added that certain targets must be achieved before a COLA could be paid. Mr. Borden said that simply reducing the actuarial assumed rate of return might seem a conservative step, but it could have significant ramifications just as maximizing and exceeding the actuarial assumed rate of return could also have a profound impact on the UAAL. He reported that reducing investment management costs and carried interest must be considered as an avenue to increase the rate of return. He explained that the Federal government allowed pension plans to amortize their liabilities up to 30 years to comply with the Governmental Accounting Standards Board (GASB) standards. Mr. Borden estimated that the UAAL would grow over the next decade due to additional benefit payouts and decreased payroll contributions.

Mr. Borden discussed employer and employee contribution rates and trends nationwide and provided information about contribution rates in South Carolina. He explained several return scenarios of the UAAL over the past 10 years and stated that from 1999 to 2009 the UAAL had grown from $341 million to $13.2 billion based on actuarial asset values. Mr. Borden estimated the UAAL to be approximately $17.9 billon based on the market value as of September 30, 2010, and noted that had an 8 percent annualized return been earned over the past ten years, the UAAL would be approximately $7.5 billion currently. He said that to have fully offset the UAAL over the past 10 years, the assets would have had to have earned 10 percent annualized, notwithstanding the increase in the actuarial assumed rate of return from 7.25 percent to 8 percent.

Mr. Borden introduced Pat Sullivan, Relationship Manager, and Mark Evans, Managing Director for Global Portfolio Solutions and IMD Strategies, from Goldman Sachs Asset Management (Goldman) for a UAAL Analysis and Strategic Partnership Overview. Mr. Sullivan stated that the Goldman Sachs Palmetto State Fund Limited Partnerships with South Carolina were very unique and ahead of the Commission's peers. He reported that working in partnership with the Commission, Goldman had developed a risk framework and infrastructure to deploy. Mr. Evans opined that managing assets against liabilities was where the asset management side met the actuarial side of investing. He explained several scenarios in which the Portfolio would earn an 8 percent per year rate of return versus a 6 percent rate of return. Mr. Evans also described various outcomes of both scenarios, including changes in actuarial value, market value, and volatility. He provided the Commission with stochastic projections and information regarding funding ratios and funding status. The Commission and Mr. Borden asked questions throughout the presentation and discussed the impact of various factors on asset allocations and investment strategies for the Retirement System's Portfolio.

Mr. Borden stated that anything that could be done to reduce cost would be of great benefit in reducing the UAAL. He noted several possible solutions to reduce the UAAL. Mr. Borden explained that increasing contributions to the Portfolio through additional employee contributions and higher employer contributions would contribute to the health of the Retirement System. He also noted that decreasing benefit payments was another avenue to consider. Mr. Borden indicated that decreasing benefits for current participants might not be possible, although benefit reductions for new and prospective plan participants would be an option. He also highlighted the possible solution of increasing investment returns. He said that increased allocations to higher returning strategies would result in higher risk asset classes being considered. Mr. Borden added that superior execution of investment strategies within asset classes could also contribute to reducing the UAAL. He opined that the Commission needed to create flexible pools of capital, have a properly budgeted organization, have relief from the procurement code, and be able to match resources to the tenor of investments (short-term versus long-term). Mr. Borden indicated that one of the most important decisions facing the Commission was how to properly fund Commission operations. Mr. Borden asked Peggy Boykin, Director of the South Carolina Retirement Systems, if any of the presentations misrepresented the UAAL. Ms. Boykin indicated that the Goldman presentation did not highlight that the South Carolina Constitution required the South Carolina Budget and Control Board (Board) to reset the employer contribution rate to sufficiently fund the Retirement System. She said for instance, if the annual rate of return was 6 percent versus 8 percent, the Board would have to take action to increase employer contributions to sufficiently fund the Retirement System.

Mr. Borden reported that when compared to its peers, the Portfolio was significantly underweight to public equities. He said that reducing public equity was an intentional move that generated exceptional alpha since December 2008. Mr. Borden also noted that the Portfolio currently had a large cash component which had been a drag on earnings. He indicated that shifting into more private equity, emerging markets, and real estate would be of benefit to the Portfolio.

Mr. Borden referred to the 8 percent actuarial return assumption and indicated that there was a 50 percent chance that the Portfolio would exceed the assumption and a 50 percent chance the Portfolio would not meet the assumption. He said that over time there was a 99 percent chance that the returns would be between -22.6 percent and 38.6 percent. Mr. Powers stated that he attended a meeting with members of the South Carolina Legislature in which Mr. Borden referred to the chart regarding return assumption percentages. He said a legislator made a comment to the effect that if the Commission had a 50/50 chance of making 8 percent, then the Commission should go to Las Vegas and gamble all of the Portfolio on either red or black. Mr. Powers asked Mr. Borden to explain how that comment was erroneous. Mr. Borden said that the comment was comparing the 50/50 chance of achieving an 8 percent return to a coin toss or a spin of the roulette wheel. He said that for the chart to look like the legislator's comment, it would have to be a binary distribution with only two outcomes instead of a standard deviation curve; the chart would have only one positive outcome and one negative outcome, not the broad range of possible outcomes in a standard deviation curve. He said that the probability of making an 8 percent return was not an either/or situation.

Mr. Borden and the Commission briefly discussed a target asset allocation chart and a chart explaining active portfolio weights across various asset classes. Mr. Borden said that there was a critical need to obtain the resources the Commission needed to fulfill its fiduciary responsibilities. He also indicated that without necessary resources, the Commission would be forced to regress back to a significantly reduced asset class portfolio.

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

III. ASSET ALLOCATION AND RISK OVERVIEW

Mr. Borden said that within the last year, the Commission had spent considerable time reviewing risk management and that they had issued a Request for Proposals (RFP) for a third party risk assessment. On a separate note, Mr. Borden reported that Goldman had a wealth of risk management tools that they had made available to the Commission within the past year.

Mr. Evans began discussions regarding asset allocation and risk management overview. He reported that in conjunction with Doug Lybrand, the Commission's Compliance and Risk Management Officer, Goldman had studied the Commission's various risk components. Mr. Evans said that risk management tools were not used to suggest appropriate investments, but instead were used to promote discussions and make actionable decisions to manage the Portfolio. He introduced Samantha Davidson, Vice President and Managing Director, from Goldman to continue risk management discussions. Ms. Davidson explained the thought processes, the framework, and the creation of the Commission's risk dashboard. She noted that the risk dashboard contained historical, current, and potential future performance information to better guide the discussions and decision-making processes with regard to risk mitigation. Ms. Davidson stated that additional risk dashboard metrics would be added to future risk dashboards. Mr. Lybrand briefly highlighted salient points of the risk dashboard as presented. Mr. Borden noted that a tremendous amount of time and data-scrubbing was performed within the past year to create the risk dashboard. The Commission and Mr. Borden asked questions throughout the presentation and discussed the impact of various factors on asset allocations and investment strategies for the Retirement System's Portfolio.

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

IV. DISCUSSION ON GLOBAL MARKETS AND KEY THEMES

During lunch, Mr. Borden introduced Netti Bhalla, Managing Director, from Goldman for a presentation on Emerging Markets. She reported that over the last 17 years, emerging markets had significant outperformance. Ms. Bhalla explained arguments and counterpoints for continuing to overweight allocations to emerging markets. She opined that valuations were the better because starting valuation levels had tended to be a more important driver of forward returns than growth differentials. Ms. Bhalla also opined that current valuations did not justify the risk premiums in overweighting emerging market equities. She highlighted sovereign bonds and local currencies versus US currency debt, and she stated that it was unknown as to whether emerging markets would deliver on their promise to deliver growth. Ms. Bhalla noted that local currency emerging market debt was preferred, and in closing, she recommended that the Commission allocate no more than current market cap weights to emerging market equities; gain exposure to popular emerging market themes through more attractively valued developed equities with exposure to emerging market domestic growth; add an allocation to emerging market private equity; and select hedge funds which could take advantage of themes such as increased demand for commodities by emerging market countries. The Commission and Mr. Borden asked questions throughout the presentation and discussed the impact of various factors on asset allocations and investment strategies for the Retirement System's Portfolio.

Mr. Borden introduced David Ader, Head of Government Bond Strategy, and Kenneth Hackel, Head of Securitized Products, from CRT Capital Group, LLC, for a presentation on Fixed Income and Credit Markets. Mr. Ader discussed interest rates; forecasting yield curve through review of market structure; quantitative easing; high unemployment; and inflation. He also described current and possible economic trends and how they related to the Federal Reserve;

treasuries and trading volume; and broker-dealer scenarios. Mr. Hackel reported on bond investing, duration positioning, credit cycles, mortgage rates, and the sharp rise in the upgrade/downgrade ratio. The Commission and Mr. Borden asked questions throughout the presentation and discussed the impact of various factors on asset allocations and investment strategies for the Retirement System's Portfolio.

Mr. Borden introduced Greg Beard and Barry Cohen from Apollo Capital Management for a presentation on commodities. Mr. Beard said that commodities were an attractive asset class which represented a significant portion of global equity markets. He also provided the Commission with an in-depth explanation of various opportunities with regard to energy, metal, and agricultural commodities. The Commission and Mr. Borden asked questions throughout the presentation and discussed the impact of various factors on asset allocations and investment strategies for the Retirement System's Portfolio.

Mr. Borden introduced Paul Podolsky, Portfolio Strategist from Bridgewater Associates, Inc. (Bridgewater), to begin discussions about the current global economic outlook. Mr. Podolsky discussed general economic factors and explained Bridgewater's analysis of economic data in implementing investment strategies. He also focused on debt cycle changes; reviewed historical performance across differing economic environments; and explained possible future scenarios, including currency issues. In closing, Mr. Podolsky provided an in-depth review and commentary regarding the current market environment. The Commission and Mr. Borden asked questions throughout the presentation and discussed the impact of various factors on asset allocations and investment strategies for the Retirement System's Portfolio.

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

V. ASSET ALLOCATION AND RISK BUDGETING

Mr. Borden introduced Tim McCusker, Senior Consultant and Director of Traditional Research, from NEPC for the 2011 Asset Allocation Analysis. Mr. McCusker provided an overview of Commission actions taken in 2010 with regards to asset allocation strategies. He also discussed risk allocation; assumptions and strategies over all asset classes; and risk budgeting versus asset volatility. He detailed the challenge of meeting an 8 percent return based on current market environments, especially since forward-looking expected returns had declined. In closing, Mr. McCusker explained how NEPC used scenario analysis to determine and test the viability of alternative asset mixes through various economic scenarios. The Commission and Mr. Borden asked questions throughout the presentation and discussed the impact of various factors on asset allocations and investment strategies for the Retirement System's Portfolio.

Mr. Borden introduced Mike Winchell, Portfolio Manager, from Mariner Investment Group (Mariner) for a factor-based risk estimation update. Mr. Winchell indicated that Mariner had created an exchange-traded fund proxy portfolio for scenario analysis, which under simulation, came close to mirroring the performance of the Portfolio. He reported that possible future scenarios were also modeled to better understand how domestic economic conditions could affect return. The Commission and Mr. Borden asked questions throughout the presentation and discussed the impact of various factors on asset allocations and investment strategies for the Retirement System's Portfolio.

Mr. Borden suggested that the Commission create a risk overlay program, which could be rebalanced or hedged as necessary by Commission staff. He said it was great to have the tools to monitor risk, but that the Commission needed additional tools to implement the risk metrics.

Mr. Borden introduced Geoff Berg, the Commission's Director of Research and Analytics, for a review of overlay and exposure management. Mr. Berg explained the positive effects of overlay, emphasizing that Commission staff was able to achieve a target allocation without rebalancing among physical portfolios. He also reported significant alpha generated as a result of implementing commodity exposure through overlay. Mr. Berg discussed using overlay for efficiently expressing views and managing risk, for hedging and portfolio protection strategies (including implementing tail risk management strategies) and for increasing return enhancement strategies. He also suggested that the Commission reaffirm that the current guidelines in the Annual Investment Plan (AIP), the Statement of Investment Policies (SIP), and the Statement of Investment Objectives (SIO) remained appropriate for the Beta Overlay program. Mr. Borden reported that additional guidelines and parameters would be presented at a future Commission meeting. Mr. Borden briefly discussed the cash allocation within the last 2 years. He reported that some cash was placed into a laddered treasury portfolio, which put cash to higher and better use.

Mr. Borden introduced Greg Nordquist, Senior Portfolio Manager, from Russell Investments to discuss currency exposures. Mr. Nordquist stated that part of the cash allocation was diversified into other currencies. He suggested keeping cash in a separate silo that would limit currency exposure. Mr. Borden reported that historically, the Portfolio had actively traded currencies in order to more efficiently close on foreign investments that required investment through local currencies. Mr. Nordquist suggested various short-term strategies in order to protect cash from additional market risk. The Commission and Mr. Borden asked questions throughout the presentation and discussed the impact of various factors on asset allocations and investment strategies for the Retirement System's Portfolio.

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

VI. ASSET CLASS PLANS

Mr. Borden introduced Harris Chewning, Alternative Investment Officer, for a presentation on the South Carolina Co-Investment Program. Mr. Chewning provided a brief background of the program and highlighted similar programs in other states. He also indicated that the proposal for an outsourced "gatekeeper" was not the most favorable operational model. Mr. Chewning reiterated that the purpose of the program was to earn revenue for the Portfolio, not to be a solely economic enterprise to help economic development in South Carolina. He reported that South Carolina lagged both North Carolina and Georgia in terms of private market equity investment per capita. Mr. Chewning listed the current private market funds raised or located in South Carolina. He reported that South Carolina's productive workforce, the Port of Charleston, low costs, low taxes, and aggressive economic development in the state's counties gave South Carolina a competitive advantage. Mr. Chellis cautioned that removal of the "gatekeeper" operational model could increase political influence on the program. Mr. Borden suggested that any potential investment have a co-investor with no political ties to South Carolina.

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

Chairman Gillespie suggested that the remainder of the items on Wednesday's agenda be carried over until the following morning, and the Commission concurred. Chairman Gillespie thanked the guests in attendance and recessed the meeting at 6:00 p.m. on Wednesday, November 17, 2010, to resume at 9:00 a.m. on Thursday, November 18, 2010.

VII. REGULAR COMMISSION BUSINESS MEETING

Chairman Gillespie reconvened the meeting at 9:00 a.m. on Thursday, November 18, 2010, and noted that Reynolds Williams would participate via telephone conference call.

Chairman Gillespie stated that the remaining items from Wednesday's agenda relating to the asset class plans review and the implementation enhancements had been carried over, several items needed to be reordered on the agenda, and Mr. Powers wanted to provide an update on Aquiline Financial Services Fund, LP (Aquiline). Chairman Gillespie noted that there would be several items for the Commission to discuss in executive session at the end of the meeting as well. Chairman Gillespie also suggested that the meeting be codified as the "special meeting" following the Commission meeting on September 23, 2010. He explained that the Commission had passed a motion in September to call a "special meeting" to discuss the Strategic Plan, particularly "Goal VII: Perform Feasibility Study and Prepare Recommendations for Long-Term Organizational Structure" (Goal VII). Since this was the first meeting after that motion passed, he thought the update for Goal VII should be incorporated into this agenda. Mr. Borden said that an update on the Strategic Plan was on the agenda, and this meeting would serve as that "special meeting" contemplated by the Commission's actions at the September meeting. Chairman Gillespie suggested moving the item relating to Goal VII to the beginning of the agenda and moving several other items to adjust for the items that were carried over from Wednesday's meeting. Mr. Powers made a motion, which was seconded by Mr. Chellis and passed unanimously, to approve the agenda as amended and to codify the meeting as the "special meeting" pursuant to the Commission's action on September 23, 2010.

Mr. Borden began discussions about Goal VII. Chairman Gillespie indicated that individual Commissioners and Mr. Borden had met with the Board, constituent groups and a number of individuals to discuss Goal VII. Mr. Chellis made a motion, which was seconded by Mr. Ewing, to re-consider the vote on September 23, 2010, that authorized Commission staff to begin implementing Goal VII with regard to the private markets program proposal after a "special meeting" of the Commission following the meeting with the Board on September 29, 2010. The motion to reconsider passed with Messrs. Chellis, Ewing, and Gillespie voting in favor of the motion, Mr. Powers voting against the motion, and Mr. Williams abstaining from voting on the motion.

Mr. Chellis made a motion which was seconded by Mr. Ewing, to table the motion from the meeting on September 23, 2010, relating to Goal VII. Chairman Gillespie opened the floor for discussion. Mr. Powers made a parliamentary inquiry as to the ramifications of tabling the motion. Chairman Gillespie replied that under Roberts Rules of Order, the options were to lay the motion on the table, amend it, or postpone action indefinitely. He said that to table the motion or postpone action indefinitely would require a new motion at a later date.

After further discussion, Mr. Powers stated that in his opinion, the motion was well-worded and passed unanimously, so he would not vote to table or amend the motion. He said at most he would opt to postpone action indefinitely, which would be the minority view. He reiterated that he thought it was a good idea, it was well-worded, it was voted on and passed unanimously, and he would agree to delaying implementation to a later date.

Mr. Williams stated that the motion was well thought out, it was well vetted, it was carefully considered, and it would have saved the taxpayers roughly $1 billion. He said he recognized the reality that the political process had intervened and that in his experience with government, a delayed action equaled no action, particularly under these circumstances. He said he thought the unique market opportunity had probably passed by now, and he was willing to face the reality that the political interests had substituted their judgment for judgment of the Commission. However, he said he did not accede to the wisdom of the political interests' overruling the Commission's judgment, particularly when the Commission's judgment was not flawed. He said that the motion had been thoroughly explained and was transparent to those who understood and paid attention throughout the process. He said he was not in favor of taking any action that would have the effect of rescinding or permanently tabling the motion. He thought the better part of valor would be to delay the implementation of the motion with the recognition that it was probably effectively terminated by the actions of political engineering.

There being no further discussion, Chairman Gillespie called for a vote on the motion to table the motion relating to Goal VII from the Commission meeting on September 23, 2010. The motion to table passed with Messrs. Chellis, Ewing, and Gillespie voting in favor of the motion, and Messrs. Powers and Williams voting against the motion.

Mr. Powers began discussions about private equity by noting that the Commission's first private equity investment was in Aquiline in 2007. He opined that the Commission might earn 3 to 4 times the initial investment. Mr. Powers explained possible future investments with Aquiline, especially with regard to the banking industry.

Mr. Borden introduced Hershel Harper, Deputy Chief Investment Officer, for an update on the hedge fund transition plan. Mr. Harper reviewed the key steps and approvals needed for the transition from the current fund of funds structure to direct hedge funds, which included hiring external counsel for advice on specialized legal issues; maintaining relationships with Grosvenor Capital Management and EnTrust Partners LLC as key business partners through strategic partnerships; converting the current investments with Grosvenor and EnTrust to separate accounts; transferring the remaining/key direct hedge fund strategies to the new legal structures; and systematically redeeming from other fund of funds accounts. He explained the proposed hedge fund platform structure and identified accomplishments, challenges, and next steps for the migration. Mr. Harper provided the Commission with information regarding the current state of the hedge fund program and indicated that migration to the direct hedge fund structure would reduce management fees and increase cash flows. Mr. Borden opined that in order to execute the migration plan from 360 strategies to 60, the Commission would need to either structure a master account or create 3 to 4 distinct strategic partnerships. The Commission discussed the transition plan as proposed.

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

Mr. Borden introduced Dave Klauka, Senior Alternatives Officer, for an update on private equity and opportunistic credit plans. Mr. Klauka provided a brief overview of the current private equity market environment. He reported that within Fiscal Year 2010, the Commission had 5 new direct commitments totaling $231.5 million and 7 new commitments within strategic partnerships totaling $199.7 million. Mr. Klauka also indicated that these commitments were focused in the United States and were diversified among buyout, growth capital, mezzanine, venture, and secondary strategies. He opined that moving forward, focusing on additional opportunistic credit strategies would be beneficial to the Portfolio. With regard to the opportunistic credit commitments, Mr. Klauka reported that within the past fiscal year, there were 3 new direct investments totaling $507 million and 4 new commitments within strategic partnerships totaling

$268 million. He said that these strategies focused on distressed mortgages and middle market direct lending with a geographical focus on the United States and Europe.

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

Mr. Klauka also provided the Commission with an update on the real estate program. He explained current market trends and noted that as commercial real estate debt matured, there would be additional opportunities for investments. Mr. Klauka added that the Portfolio currently had $209 million invested of the $1.35 billion target allocation to real estate. He also presented the proposed allocation strategy and made several strategy recommendations for the next fiscal year. Mr. Borden noted that timing from commitment to investment with regard to real estate was usually longer than in other asset classes.

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

Mr. Borden introduced Jared O'Connor, Investment Officer, for a review of the Commission's Due Diligence Guidelines for New Investments. Mr. Borden noted that a cross-functional due diligence work team was created to develop and review internal processes. Mr. O'Connor reported that the due diligence work team was in the process of constructing a standardized due diligence manual. He indicated that all potential managers would be required to complete an Initial Inquiry Form. He indicated that this form would allow staff and the Commission to quickly screen potential investments for key criteria, for compliance with the AIP, SIP, and SIO, and would standardize the Commission's records retention and reporting automation. Mr. O'Connor said the 3 phases of the due diligence process were initial information sourcing and analysis, onsite due diligence, and investment approval and on-boarding, and he explained the processes and criteria within each phase. Mr. O'Connor also indicated that time-sensitive investments might have a different due diligence process if the window of opportunity for the investment was shorter.

Dr. Pritchett questioned whether Commissioner involvement in the due diligence process was outlined in the due diligence manual. Chairman Gillespie opined that Commissioners should feel free to be involved in the due diligence process, but suggested that Commissioners refrain from interjecting themselves into the daily operations of the agency as long as activities were reported to the Commission clearly. Mr. Powers disagreed and said that given the nature of hundred million dollar investments, he felt more comfortable with a Commissioner being involved in the initial due diligence process. Mr. Powers added, however, that he was in favor of individual Commissioners not being involved in on-going due diligence after a manager is hired if staff activities were reported. Mr. Borden stated that irrespective of the final determination of the due diligence processes, codifying those processes would be necessary. He referred to the draft of the due diligence guidelines and reiterated that internal processes would continue to strengthen. Mr. Chellis cautioned against the Commission micro-managing the Commission staff. Chairman Gillespie noted that once the Portfolio was more fully developed, the process of hiring and firing managers should slow down. He opined that more time needed to be spent on rebalancing decisions. Mr. Borden said that focusing on asset allocation would contribute more to the success of the Portfolio ultimately than intense focus on manager related decisions. Mr. Ewing suggested establishing a threshold to require Commissioner involvement in the due diligence process. Mr. Williams cautioned against limiting Commissioner involvement in the due diligence process given the Commission's fiduciary responsibility.

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

Mr. Borden referred to the presentation regarding procurement overview and challenges. He explained that the ability of the Commission to acquire specific professional services and investment management systems was severely hampered by the current State Procurement Code. Mr. Borden said that other state agencies had special exemptions from the Procurement Code that allowed them to operate more efficiently and effectively. He reported that Commission staff had been in contact with members of the Senate Subcommittee to request exemptions from the Procurement Code.

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

Chairman Gillespie advised that a new chairman needed to be appointed for the Audit Committee since Mr. Chellis would be leaving the Commission in January and asked for nominations. After discussion, Mr. Ewing nominated Dr. Pritchett and made a motion to close the nominations. Mr. Powers seconded the motion, and Dr. Pritchett was appointed to the Audit Committee by acclamation. Mr. Williams requested that another member of the Commission replace him on the Audit Committee. Chairman Gillespie suggested that either committee members be rotated on a regular basis or the Commission's Vice Chairman serve on the Audit Committee given that it was a standing committee. Mr. Powers concurred that the Vice Chairman should serve on the Audit Committee, and he made a motion to remove Mr. Williams and to appoint Mr. Ewing to serve on the Audit Committee. Mr. Williams seconded the motion, which passed unanimously.

Mr. Borden referred to materials relating to a review and update on plan expenses. Mr. Borden introduced Mr. Lybrand. Mr. Lybrand provided the Commission with historical data regarding expense forecasts for Portfolio diversification. He reported that data was compiled to estimate the cost per asset class. Mr. Lybrand stated that plan expenses were accurately predicted. Mr. Harper explained that managers were asked for more granular information relating to management, performance, and other fees. Mr. Chellis stated that performance fees appeared high, but when compared to the value added to the Portfolio, the fees appeared appropriate. Mr. Ewing stated that fees should be managed better, but the trade-off between fee limitations and decreased rate of return was difficult to calculate. Mr. Borden opined that more strategic partnerships would allow the Commission to reduce fees and that the Commission should continue to explore ways to reduce fees while ensuring the same quality level of management.

Mr. Williams said that he understood that the Commission was waiting for information from the Senate Subcommittee regarding an increase in the budget. He expressed concerns with the Commission fulfilling its fiduciary and legal responsibilities and being able to function adequately under the current operating budget if the proposed budget increase was not approved. He said that in his opinion, the Commission had constitutional and statutory authority to fund this activity from the earnings of the Retirement System. Mr. Williams made a motion, which was seconded by Mr. Powers, for the Commission to obtain a legal opinion from outside counsel on the extent and scope of the Commission's authority to use the earnings of the Retirement System Portfolio to operate the Commission, independent of legislative approval.

Chairman Gillespie opened the floor for discussion and asked whether the Commission should seek an opinion from the Attorney General. Mr. Powers suggested hiring outside counsel to issue an opinion and submit the opinion to the Attorney General for review and comment, and

Mr. Williams concurred. After further discussion, Ms. Boykin advised that Ed Evans, General Counsel to the Board, had been asked to render a legal opinion regarding the Commission's authority. She said that he had provided the opinion to her and she would ask him to release it to the Commission. In the interim, she said that his opinion was that while the statute clearly said that both the operations of the Retirement System and the Commission were to be funded out of the earnings of the trust fund, it did not negate the necessity for going through the appropriations process to get authority from the Legislature to draw down the funds. Ms. Shealy noted that when the Commission was created, she researched to see if the Commission would be required to follow the standard state agency budget processes. She said that the general answer was that there was a statute regarding "other funds" (non-state funds), which would include funds for the Commission's operating budget. Under that statute, she explained that the Legislature would have to authorize the expenditure of operating expenses, i.e., "other funds". Chairman Gillespie suggested obtaining a copy of Mr. Evans opinion before moving forward.

Mr. Borden stated that he had discussed these issues with the Senate Subcommittee. In summary, he said that if the budget was not approved, the Commission in a worst case scenario could meet its fiduciary responsibility with the current operating budget by concentrating the Portfolio to the level where it could be managed with the available resources, although the result would be that the plan sponsor would have to figure out a way to fund the Retirement System. Mr. Ewing asked how other states operated, and Mr. Borden replied that all states were different, but that the Louisiana State Employees Retirement System did not have to request approval from the state's legislature. He said that the Louisiana Legislature was only interested in the total plan performance, net of all cost. Mr. Borden noted that in South Carolina, it appeared to be easier to spend $315 million in management fees than it was to spend $10 million on agency infrastructure. In response to questions, Mr. Borden provided a summary of the discussions, requests, and projected timeline for action by the Senate Subcommittee. Mr. Powers stated that with all due respect to the Board, the law is an interpretive process, and the way that the Board's attorney interprets the law may be different from an interpretation by external counsel. He said that he sees no harm in obtaining an outside opinion. Mr. Williams, agreeing with Mr. Powers, indicated that the operating statute explicitly grants to the Commission the power to interpret the law, as long as the Commission interprets the law in a way that is consistent with the Commission's fiduciary responsibilities. He indicated that even with multiple opinions, it was ultimately the Commission's responsibility to interpret the law reasonably in a way that was consistent with fiduciary responsibilities. Mr. Ewing suggested asking the Legislature to clarify the Commission's authority, and Messrs. Williams and Powers reiterated that the Commission had the authority. Mr. Borden opined that if the budget increase was not approved and the Commission opined that it had the ability to proceed anyway, the Legislature would create a new statute that would prevent the Commission from proceeding. Mr. Chellis opined that the political reality was that if the Legislature did not believe the Commission needed additional funding, then the Commission would not receive additional funding. Mr. Ewing suggested that the Commission partner with the Legislature rather than be in an adversarial posture. Chairman Gillespie suggested that the Commission obtain opinions prior to taking further action.

After further discussion, Chairman Gillespie called for a vote on Mr. Williams' motion, and the motion failed. Messrs. Powers and Williams voted in favor of the motion, and Messrs. Chellis, Ewing, and Gillespie voted against the motion.

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

Mr. Borden presented information relating to the BD100 approval and an update on the proposed budget increase. He reiterated comments made at previous Commission meetings indicating that since the Commission's inception, portfolio risk exposures represented the greatest threat to the Portfolio, forcing the Commission to prioritize portfolio diversification over infrastructure development. Mr. Borden reported that significant progress had been made towards the goal of portfolio diversification, which was over 85 percent completed, and since prioritization was now shifting towards infrastructure development, significant budgetary increases were necessary. He stated that if the Commission wanted to have a desired return, the Portfolio must have a certain level of complexity to achieve that return. Mr. Borden said that to be compliant with fiduciary standards, the Commission must have the appropriate operating budget and resources. He explained that over the last 3 years, the Commission had constrained the growth of the agency, even though the agency remained in a continual start-up phase. He said that the Portfolio was developed significantly over this period and that the Commission would need to slow its momentum if additional funding could not be secured. Mr. Borden explained the need for additional personnel and compared proposed staffing levels with public peers and hedge fund of funds universe data. He reiterated that consolidating the Portfolio would allow the Commission to remain compliant with fiduciary standards given its current resources. He added that reducing the diversity of the Portfolio would undo many years of progress and would not reduce the associated risk. He also explained that given the complexity of the Portfolio, it would be almost impossible to quickly reverse-engineer the structure to its original state in 2005. Mr. Powers opined that the proposed budget request would cost the Portfolio $500 million if additional operating funds were not approved. Mr. Borden explained that roughly $3 million of the proposed increase was simply including off-budget costs such as custody services in the operating budget. Mr. Borden and the Commission discussed custody costs and the costs for earning returns. Mr. Ewing provided an historical summary about the rationale for creation of the Commission, which included producing a higher rate of return. He opined that the Commission's operating model was the best in the nation, but also noted that when it was created, it was impossible to foresee all issues that might arise as the agency developed. He further suggested that the Commission needed to explain to the Legislature that this model could work even better and earn additional revenue if certain changes were made. After further discussion, Dr. Pritchett made a motion, which was seconded by Mr. Williams and passed unanimously, to approve the Fiscal Year 2011 budget increase request of $1.4 million and to amend the budget request for Fiscal Year 2012 to $17.4 million.

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

Chairman Gillespie suggested that in the interest of time, voting items on the agenda be addressed next by the Commission. Mr. Powers made a motion, which was seconded by Mr. Williams and passed unanimously, to modify the order of items on the remainder of the agenda.

Mr. Borden referred to information pertaining to the proposed changes to the target asset allocations and explained the recommended changes. After discussion, Mr. Williams made a motion, which was seconded by Mr. Chellis and passed unanimously, to adopt the target asset allocations as recommended, which were delineated in green in the meeting materials.

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

Mr. Borden introduced Dunkin Allison, Strategic Partnership Investment Officer, to discuss recommendations regarding the Mariner/Palmetto State Partners, L.P. (Mariner). Mr. Allison reviewed information that had been provided to the Commission and explained that Mariner had agreed to sell a portion of the equity of its holding company to a third party financial services firm. He advised that under the U.S. Investment Adviser's Act, Mariner could not assign its contract with a client to another adviser without the client's consent or the contract would terminate. He explained that the term "assignment" was broad, so to the extent that there would be an assignment, Mariner sought the Commission's consent. He discussed the impact that the sale would have on management of the account and recommended that the Commission consent to the assignment. After further discussion, Mr. Powers made a motion, which was seconded by Mr. Chellis and passed unanimously, to consent to the assignment of the contracts relating to Mariner and the underlying investments and to authorize the Chairman to execute any necessary documents upon approval for legal sufficiency by General Counsel to provide the consent.

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

Mr. Borden referred to the next item on the agenda, which related to the emerging market equity managers that had been approved by the Commission previously. He explained that originally some investments were going to be made in commingled account structures and some were going to be made in separately managed account structures. He said that the Retirement System's legal staff was in the process of creating a new group trust document and depending on the timing of the documents, it might be more expeditious for the assets to be invested through commingled vehicles versus separate account vehicles. He recommended that the Commission authorize its staff to determine which of the vehicles should be used to meet the custody and group trust progression of events and the investment objectives. Chairman Gillespie noted that one of the issues that was discovered when the Commission was discussing NewCo was that the law required the Board to hold the assets in a group trust. He said that all of the steps had not been taken to form the group trust for investment purposes, so this was a matter of timing of how long it would take to complete the necessary items for the group trust and to establish accounts in the emerging market countries. Mr. Powers made a motion, which was seconded by Mr. Ewing and passed unanimously, to authorize the investments previously approved by the Commission in the emerging market equity asset class to be made in either commingled or separately managed account structures as determined by staff in consultation with the Chairman and to authorize the Chairman or his designee to negotiate and execute all necessary documents to implement the investments upon approval for legal sufficiency by General Counsel.

Mr. Chellis reported on his due diligence meeting with Greystar Equity Partners (Greystar) and concluded that Greystar met all of Commission's requirements with regard to the real estate investments. The Commission accepted his report as information and reaffirmed its approvals to invest in Greystar Equity Partners VII, LP, as set forth at its meeting on September 23, 2010.

Mr. Borden reported that Bridgewater's success with its Pure Alpha Fund II (PA Fund) strategy had led the manager to conclude that it must return profits to its investors to maintain a conservative capacity target of $50 billion. He reported that the fund's estimated return for this year was over 30 percent through October 31, 2010, which resulted in excess capacity and liquidity issues if the fund continued to grow. He said that the firm had developed a new fund, the Bridgewater Pure Alpha Major Markets Fund II (PAMM Fund), and after conducting due diligence meetings and discussions, he recommended reallocating earnings from the PA Fund to the PAMM Fund. He noted that the PAMM Fund was managed by the same investment team using the same investment approach as the PA Fund, but it traded in only the larger, more liquid markets and strategies where capacity was of less concern. He said that Commission staff also recommended increasing the combined total allocation to the PA Fund and the PAMM Fund from $250 million to $500 million for rebalancing purposes and to maintain appropriate hedge fund exposures during the Commission's hedge fund program transition. He noted that the investment guidelines for the PAMM Fund would need to be amended also. After discussion, Mr. Powers made a motion, which was seconded by Mr. Ewing and passed unanimously, to authorize the profits that are distributed from the Bridgewater Pure Alpha Fund II, Ltd., to be invested in the Bridgewater Pure Alpha Major Markets Fund II, Ltd., to increase the combined total investment in the PA Fund and the PAMM Fund from an amount not to exceed $250 to an amount not to exceed $500 million, to authorize any necessary amendments to investment guidelines for the investment, and to authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the investments upon approval for legal sufficiency by General Counsel.

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

Mr. Harper referred to information regarding the FrontPoint Partners insider trading allegations. He explained that due to the illegal activity of a FrontPoint Portfolio Analyst, FrontPoint had announced its intention to fully liquidate its healthcare funds and to return capital to investors by December 31, 2010. Mr. Harper reported that the Commission staff had submitted a redemption request for all FrontPoint Strategies, but would conduct due diligence before finalizing either full, partial, or no redemption from the FrontPoint Multi Strategy Fund. Mr. Borden explained that no Commission action was necessary and indicated that the Commission staff submitted the redemption request to protect the Portfolio's interest.

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

Mr. Borden asked Mr. Lybrand to provide an update on the status of the RFP for a third party to provide an investment risk assessment. Mr. Lybrand reported that two of the respondents had visited the Commission's offices to provide oral presentations. Mr. Ewing expressed concern that the RFP respondents had not met with the full Commission, and Chairman Gillespie and Mr. Powers suggested that Mr. Ewing review the scope of the proposal before the next meeting, and if Mr. Ewing had any concerns, the Commission would address them at that time.

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

Mr. Borden reported that Dori Ditty, Policy and Legal Counsel, had combined all of the approved governance policies into a manual, which was distributed to the Commission. Mr. Powers reminded the Commission that the governance policies were "living documents" that could be amended by the Commission at any time. Ms. Shealy noted that the Commission may take action during meetings that would amend the policies, and Chairman Gillespie suggested that staff be authorized to make any necessary amendments. Mr. Powers made a motion, which was seconded by Mr. Ewing and passed unanimously, to authorize Commission staff to make any necessary amendments to the governance policies to conform to any actions taken by the Commission during meetings under the oversight of the Chairman of the Commission.

Mr. Borden introduced Mr. Berg for the Fiscal Year 2010 Portfolio performance review. Mr. Berg stated that higher performance had not been a result of asset allocation, but instead was due to manager selection and creative implementation. He said that during the fiscal year ending June 30, 2010, performance was 4.07 percent ahead of the policy benchmark. Mr. Berg stated that performance was hindered by significant exposure to small to mid cap equities and little exposure to real estate recovery. He also noted the negative impact from small size bias in equities. Mr. Berg briefly reviewed the impact of manager selection within the asset classes. He reported that there were plans to correct disappointing manager performance in equities, and he noted that several equity managers had been terminated during Fiscal Year 2010. Mr. Borden reported that the Portfolio outperformed the Florida State Retirement System, the California Public Employees Retirement System, the California State Teachers Retirement System, the Harvard Retirement Plan, and the Yale Staff Retirement Plan. He said that the Portfolio performance was exceptional in Fiscal Year 2010 even with the significant cash allocation. Mr. Berg reported that Portfolio performance since June 30, 2010, was up approximately 9.62 percent. After discussion, the Commission received the report as information.

Mr. Berg introduced Mr. McCusker for the third quarter investment performance review. Mr. McCusker, noting that the Portfolio's asset allocations were close to their targets, highlighted performance across the asset classes. After discussion, the Commission received the report as information.

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

Chairman Gillespie said that the next item on the agenda was the executive session. Mr. Chellis made a motion, which was seconded by Mr. Ewing and passed unanimously, to meet in executive session to discuss personnel matters involving the evaluation of the CEO/CIO in accordance with the Commission's governance policies and to receive an update and legal advice covered by the attorney client privilege relating to fixed income securities and legal advice relating to potential claims. Chairman Gillespie announced that the Commission would meet in executive session for those purposes as stated in the motion, and he asked Mr. Borden and Ms. Shealy to remain in the meeting.

The Commission reconvened in open session and Chairman Gillespie reported that the Commission did not take any action while in executive session. Upon motion by Mr. Powers, which was seconded by Mr. Ewing and passed unanimously, the Commission authorized the Chairman to execute any necessary documents consistent with the discussions during executive session relating to legal matters upon approval for legal sufficiency by General Counsel.

There being no further business, Chairman Gillespie thanked everyone for attending, and the meeting adjourned at 12:45 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 entrances of the office of the South Carolina Retirement System Investment Commission at 1201 Main Street, Suite 1510, Columbia, South Carolina, and at the Wampee Training and Conference Center at 1274 Wampee Plantation Road, Pinopolis, South Carolina prior to 9:00 a.m. on November 16, 2010.]