

**RETIREMENT SYSTEM INVESTMENT COMMISSION
COMPENSATION COMMITTEE MEETING MINUTES**

March 12, 2012

**SC Retirement System Investment Commission
1201 Main Street, 15th Floor
Columbia, SC 29201**

Committee Members Present:

Mr. Allen Gillespie (via phone)
State Treasurer Curtis Loftis
Dr. Travis Pritchett (via phone)

Others present for all or a portion of the meeting on Monday, March 12, 2012: Commissioners Edward Giobbe and James Powers (observers); Sarah Corbett, Robert Feinstein, Hershel Harper, Adam Jordan, James Manning, Nancy Shealy and Brian Wheeler of the South Carolina Retirement System Investment Commission (“RSIC”); Tammy Nichols and Faith Wright of the South Carolina Retirement Systems (“SCRS”); Bill Leidinger and Shakun Tahiliani of the State Treasurer’s Office; Adam Barnett of McLagan.

- I. **Call to Order:** Chairman Allen Gillespie called the meeting of the RSIC Compensation Committee (“Committee”) to order. Dr. Travis Pritchett made a motion to approve the agenda, which was seconded by Mr. Curtis Loftis, and approved unanimously. Chairman Gillespie noted that Messrs. Giobbe and Powers would be observing this meeting, which, in compliance with the Commission’s governance policies, required them to remain silent and not participate in the Committee’s discussions.
- II. **Adopt Compensation Recommendations:** Chairman Gillespie asked RSIC’s Acting CEO, Mr. Adam Jordan, if he had distributed a list regarding McLagan’s recommendations entitled, “Key Questions for Compensation Committee”, to the Committee members. Mr. Jordan confirmed that he had. Chairman Gillespie opened the discussion regarding McLagan’s recommendations. Chairman Gillespie explained that the questions included on the list derived from a discussion he had held with Mr. Adam Barnett of McLagan.

Chairman Gillespie asked the other members of the Commission if they had any others issues they would like to see addressed. Dr. Pritchett responded that he wished to discuss an issue that was not included on the list, relating to whether the full Commission should approve certain levels of salary. Chairman Gillespie asked Dr. Pritchett if he had a preference on that issue. Dr. Pritchett answered that he favored that option, but would set the threshold at salaries above approximately \$150,000. Mr. Loftis agreed. Chairman Gillespie asked if there should be a salary level as the determining factor, or job title. Dr. Pritchett stated that he had no preference, but noted that McLagan suggested a salary threshold.

Mr. Harper stated that aggregated performance incentive compensation information had been approved by the Commission, but noted that compensation of individual staff members had historically not been discussed in a public forum.

Members of the Committee inquired whether employees working in risk management positions are eligible for performance incentive compensation. Mr. Jordan noted that based on the current organization chart, employees working in risk management positions would be eligible for performance incentive compensation. Mr. Loftis asked if there was a list of who is currently eligible and who is not. Ms. Sarah Corbett, the RSIC's Deputy Chief of Staff, said that, at present, all employees on the Investment Staff organization chart are eligible for performance incentive compensation, and all employees on the Administrative and Operations organization chart are not. The Investment staff chart includes risk management staff.

The history of the Commission's performance incentive compensation ("PIC") program was briefly reviewed.

Mr. Barnett joined the meeting via phone, and was asked by the Chairman to review the items on the list which had been distributed to members of the Committee. A summary of the Committee's discussion follows.

Number of position levels that should be included in the PIC plan

On a motion made by Dr. Pritchett and seconded by Mr. Loftis, the Committee unanimously agreed that the following four position levels should be included in the PIC plan: (i) CIO, (ii) Deputy CIO and Directors, (iii) Officers and (iv) Analysts.

Goals of the compensation plan

The Committee reviewed the goals and objectives of the Commission's compensation policy with Mr. Barnett. The interplay between base salaries, performance scale, multi-year weightings and maximum incentive opportunities were reviewed, both generally and with a focus on practices in the public fund universe.

Dr. Pritchett mentioned Mr. Powers' comment at an earlier Commission meeting that he would not be against structuring the Commission's compensation plan so as to target compensation equal to the 90th percentile of public plans. After discussion, on a motion made by Dr. Pritchett and seconded by Mr. Loftis, the Committee unanimously agreed to target total compensation equal to the 90th percentile of public plans.

Should the maximum incentive opportunity (expressed as a percentage of base salary) vary by position level?

McLagan sought the Committee's guidance as to whether the maximum incentive opportunity should vary by position level and, if so, what the maximum incentive opportunities should be for each position level. Mr. Gillespie asked Mr. Harper to review the current PIC maximums. Mr. Harper noted that historically, the maximum PIC opportunity for the CIO had been 50 percent, with the other three levels eligible to receive maximum PIC opportunities of 40 percent (Deputy CIO/Director level), 30 percent (Officer level), and 20 percent (Analyst level). Ms. Corbett and Mr. Jordan clarified that the Commission had voted in the summer of 2011 to

permit a 100 percent maximum incentive opportunity for eligible RSIC staff, but had never awarded incentive compensation based on this very recent change. Ms. Nancy Shealy, the Commission's General Counsel, added that while the Commission had approved maximum permissible incentive payments, the Commission's compensation policy had granted discretion to the CIO to decide on an individual basis what incentive payments would be paid. Mr. Loftis opined that the CIO should not wield that type of discretion, going forward.

There was consensus that the current maximum incentive opportunity for the CIO (100% of base salary) should be retained. Mr. Barnett suggested lower maximum incentive opportunities for the three other position levels, but noted that McLagan would perform an analysis and provide the Commission with recommendations as to the maximum incentive payouts for these positions.

Should the PIC plan include a qualitative component?

Mr. Barnett asked the members of the Committee if they desired to include a qualitative component in the PIC plan. Mr. Barnett suggested that staff members be required to receive a "meets expectations" score in his or her Employee Performance Management System ("EPMS") review in order to be eligible for a PIC payout. The Committee embraced this suggestion. Mr. Loftis made a motion that in order to be eligible to receive a PIC payment, an eligible employee must receive a "meets expectations" grade on his or her EPMS. Dr. Pritchett seconded the motion and it was approved unanimously. No other qualitative component was recommended.

Should the Commission have discretion to pay out PIC in negative absolute return years?

Mr. Barnett noted that currently, if the Retirement System trust fund has negative returns of any amount, PIC will be automatically deferred. McLagan suggested that the Commission have the discretion to pay out PIC if they choose, based on the facts and circumstances of the portfolio's performance at that time. Mr. Barnett left the meeting. There was extensive discussion by the Committee as to the pros and cons of McLagan's suggestion, and certain alternatives, including creating thresholds below which PIC would be deferred or forfeited. The Committee ultimately arrived at a consensus, whereby (i) PIC payouts would be deferred if absolute returns were between 0 and negative 10 percent, and (ii) if absolute returns were below negative 10 percent, PIC would be forfeited.

Mr. Loftis made a motion that (i) if absolute returns are between 0 and negative 10 percent, PIC will be deferred and (ii) if absolute returns are below negative 10 percent, PIC will be forfeited. Dr. Pritchett seconded the motion and it was approved unanimously.

Should there be a high water mark?

Mr. Gillespie brought up the question of whether a high water mark should be included in the Commission's compensation policy. The inclusion of a high water mark would mean that PIC would be deferred and not paid until losses are recovered, after accounting for flows.

Mr. Loftis made a motion to create a high water mark in the Compensation Policy, which was seconded by Dr. Pritchett and approved unanimously.

What should be the formula for new hires who have had no impact on the longer term numbers?

Mr. Gillespie asked what the formula should be for new investment staff who have had no impact on the longer term numbers. In the ensuing discussion, Dr. Pritchett suggested that non-senior staff who had been with the Commission less than a year should not be qualified for PIC, or with the same formula. He suggested that senior staff who had been with the Commission for at least six months should be eligible. No decision was made.

The Committee then discussed how the 1/3/5 year formula should be applied to new hires. Given the complexity of the issues, McLagan was asked to opine on whether to phase in the 20/30/50% formula for the 1/3/5 year returns.

Approval of salaries above \$150,000/year

Mr. Gillespie asked for the Committee to make a decision regarding a threshold salary at which the Commission will have to approve.

Mr. Loftis made a motion for the Commission to approve any salary above \$150,000 a year, with notification of hires for salaries below that amount. It was seconded by Dr. Pritchett, and approved unanimously.

Performance scale

Mr. Jordan noted the Committee had not made a decision regarding the performance scale, which McLagan had recommended moving to 0-50 basis points. After the Committee expressed support for McLagan's suggestion, Mr. Loftis made a motion to incorporate McLagan's recommended 0-50 basis point performance scale into the Commission's compensation policy, which was seconded by Dr. Pritchett and approved unanimously.

Risk management staff's inclusion in PIC

Mr. Gillespie returned to the topic of whether risk management staff members were eligible for PIC. Mr. Jordan confirmed that they are eligible. Dr. Pritchett asked for an explanation as to why or why not they should be included. Mr. Gillespie and Mr. Harper provided the requested explanation, noting that while the risk management professionals may not be involved in day to day investment decisions, they are assisting the investment staff to make informed decisions, and should be incentivized to give proper guidance, and perform rigorous due diligence. It was the Committee's consensus that RSIC's risk management staff should continue to be eligible to participate in the PIC program.

Should the compensation policy include the strategy and policy benchmark, or the policy benchmark only?

Mr. Jordan noted that the Committee's guidance was needed as to whether the compensation policy should continue to include both strategy and policy benchmarks. Mr. Gillespie opined that the Committee should embrace McLagan's suggestion to eliminate the dual benchmarks. Mr. Loftis made a motion to accept McLagan's recommendation to use the policy benchmark only in the revised compensation policy. The motion was seconded by Dr. Pritchett and approved unanimously.

If the PIC is deferred in negative years, should interest be included in future payouts?

Mr. Jordan noted that the final question on the list that had been distributed concerned whether an interest payment should be included in deferred PIC. In the ensuing discussion, questions were raised as to (i) rate at which interest would accrue and (ii) whether, if the payment is earned but deferred, there is a tax liability to that person. After discussion, Mr. Jordan suggested leaving interest off of the recommendations to be forwarded to the Commission, until further guidance could be obtained from McLagan. The Committee agreed to defer the decision until further guidance could be obtained from McLagan.

Ms. Shealy mentioned that the Committee did not vote on pro-rating for new hires. She observed that, based on the Committee's prior discussions, it appeared that there had been consensus among the members of the Committee that the following procedures should be used to pro-rate incentive compensation for new hires:

- (i) non-senior level staff would not be eligible to receive PIC during their first year of employment with the RSIC; and
- (ii) senior staff would have to be employed for six months to be eligible for PIC, with any PIC award to be pro-rated by weeks.

Dr. Pritchett made a motion that the procedures summarized directly above by Ms. Shealy be used to pro-rate incentive compensation for new hires. The motion was seconded by Mr. Loftis and approved unanimously.

Mr. Jordan suggested bringing any outstanding questions regarding the compensation policy to the full Commission at its next meeting (date to be determined).

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

III. Adjournment

Mr. Loftis made a motion to adjourn, which was seconded by Dr. Pritchett and approved unanimously.

[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 15th Floor Conference Room at 1201 Main Street, Columbia, SC, on March 8, 2012.]