

South Carolina Retirement System Investment Commission Meeting Minutes

Thursday, February 9, 2006

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

Commissioners Present:

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

Others present for all or a portion of the meeting: Nancy Shealy and Ashli Aslin from the South Carolina Retirement System Investment Commission; Anne Macon Flynn from the Budget and Control Board Office of General Counsel; Chris Byrd from the Budget and Control Board Office of Human Resources; Rick Patsy, Trav Robertson, Frank Rainwater, Paige Parsons, and Shakun Tahiliani from the State Treasurer's Office; Jay Love from Mercer Investment Consulting; Ernest Cruikshank from Jamison, Eaton & Wood, Inc.; Peggy Boykin, Tammy Davis, Faith Wright, Travis Turner, Sarah Corbett, and Joni Redwine from the South Carolina Retirement Systems; Henry Addy, Crawford Clarkson, and Wayne Pruitt from the State Retirees Association; Charley McDonald from the South Carolina Trooper's Association; and Arnold West from ING Investment Management.

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

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission (Commission) to order at 10:00 a.m.

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

Chairman Williams called for objections or amendments to the minutes from the Commission meeting on January 19, 2006. There being none, the minutes were adopted as presented.

Treasurer Grady Patterson moved to amend the minutes from the December 8, 2005, meeting by replacing the phrase "Mr. Patsy stated that Jamison was responsible for approximately 90 percent of the management of the fixed income portfolio while the STO was responsible for the remaining 10 percent," with "Mr. Patsy stated that Jamison was responsible for approximately 90 percent of the investment results of the fixed income portfolio." Mr. Blaine Ewing seconded the motion, which carried unanimously.

Chairman Williams reported that the Commission's Chief Investment Officer (CIO) Screening Committee (Committee) met to evaluate pending applications for the CIO position and to conduct telephone interviews.

Chairman Williams reported that he met with the House Ways and Means Legislative, Executive, and Local Government Subcommittee and provided an update on the Commission's activities. He stated that the Subcommittee seemed pleased with the Commission's progress.

Chairman Williams advised that Senate Bill 617 (S.617), a joint resolution to amend Article X, Section 16 of the Constitution of South Carolina to allow for additional equity asset classes, had been passed by the SC House of Representatives and the SC State Senate and was enrolled for ratification. The resulting referendum question to amend the constitution would be on the statewide ballot in the November 2006 general election, and Chairman Williams asked for the consensus of the Commission regarding the proposed amendment. Mr. Ewing made a motion that the Commission endorse S.617, and upon second by Mr. Gillespie, the motion carried unanimously. Chairman Williams asked that the Commission and staff begin developing a deliberate and refined public relations strategy.

Chairman Williams advised that Senators Hugh Leatherman, Thomas Alexander, and Greg Ryberg had sponsored a bill, Senate Bill 1094 (s.1094), which would amend provisions relating to acceptable investments of the Retirement Systems, amend provisions relating to fiduciaries' standards of conduct, and make technical amendments to the statutes relating to the National Guard Retirement System. Chairman Williams reported on the status of s.1094, outlined the provisions of the bill, and stated his intent to testify before the Senate Finance Committee's Retirement Subcommittee regarding the bill. Mr. James Powers made a motion that the Commission endorse the legislation, which was seconded by Mr. Ewing and carried unanimously.

II. INVESTMENT MATTERS

Chairman Williams recognized Mr. Rick Patsy from the State Treasurer's Office (STO) and Mr. Ernie Cruikshank from Jamison, Eaton & Wood, Inc. (Jamison) for a presentation on the fixed income investments of the South Carolina Retirement Systems (Retirement Systems).

Mr. Patsy provided a brief overview of the yield curve and the interest rate environment for the past 12-month period. He noted that short-term interest rates were higher than long-term interest rates, resulting in an inverted yield curve. Mr. Patsy noted that while an inverted yield curve historically indicated a recession, the STO was not concerned as the economy was expected to continue to grow at trend. Mr. Patsy noted that the Federal Reserve Board (Fed) was expected to cease measured interest rate increases within the next six months.

Mr. Patsy reviewed the general performance of the total portfolio, fixed income portfolio, and equity portfolio for the previous month, quarter, one-year, three-year, and five-year periods. He discussed the performance of the fixed income portfolio relative to its benchmark, the Lehman Aggregate, as well as the performance attribution analysis using the Wilshire Axiom during the same periods.

Mr. Patsy and the Commission reviewed the fixed income portfolio's characteristics, including the average maturity, coupon, duration, and ratings. Mr. Patsy also discussed asset allocations within the fixed income portion of the portfolio, the changes that occurred over the previous 12-month period, and the changes the STO expected to make in the coming months. He also provided the Commission with a summary of the STO's economic forecast. In response to a question posed by Treasurer Patterson, Mr. Patsy and the Commission discussed Ben Bernanke's appointment as Chairman of the Federal Reserve.

Mr. Ewing asked Messrs. Patsy and Cruikshank whether additional fixed income asset classes, such as high yield bond, would improve returns. Mr. Cruikshank said they did not feel constrained by current fixed income asset classes. Mr. Patsy noted that adding additional fixed income asset classes would not necessarily improve performance because effectively managed duration and yield curve exposure were the most significant sources of returns.

Chairman Williams thanked Messrs. Patsy and Cruikshank for their presentation.

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

Chairman Williams recognized Mr. Jay Love of Mercer Investment Consulting (Mercer) to review the equity portfolio Quarterly Investment Performance for Periods Ending December 31, 2005. Mr. Love reviewed economic factors and broad market performance. He explained that the economy, in general, grew at its slowest pace in three years during the fourth quarter of 2005. Mr. Love provided an overview of market performance on an industry and sector basis, discussed market returns, and provided an overview of the largest positive and negative contributors to the S&P 500 for the fourth quarter of 2005.

The Commission and Mercer discussed the South Carolina Retirement Systems' (Retirement Systems) equity portfolio performance. Mr. Love reported that the equity portfolio totaled approximately \$13.26 billion, which was consistent with the targets in the Annual Investment Plan (AIP). Mr. Love explained that the equity portfolio outperformed the Total Equity Index (a weighted average of the benchmarks of all the investment managers for the Retirement Systems' equity portfolio) by 70 basis points (bps). For the three- and five-year periods ended December 31, 2005, the portfolio returned 16.1 percent and 2.1 percent, outperforming the S&P 500 by 170 bps and 160 bps, respectively. The Commission and Mr. Love reviewed the performance of the asset classes relative to the applicable indices. They also reviewed the performance of the

individual managers and compared them to the applicable indices and rankings within their respective peer groups. Mr. Love discussed the total portfolio's allocation by sector and noted that the overall equity portfolio was aligned with the broad market in terms of sector allocations.

Mr. Love noted that the Retirement Systems portfolio reached the 50 percent allocation to equity and that all managers were largely in line with the target allocations. Mr. Love explained that a transition account held a residual balance of approximately \$500,000, which would be transitioned into the S&P Index Fund at the next reasonable opportunity.

Mr. Love updated the Commission on several changes regarding individual investment managers, which included changes in client service representatives from Fidelity and Barclays Global Investors (BGI) and changes in the Large Cap Growth portfolio management team with Alliance Capital Management (Alliance). Mr. Love stated that these changes should not negatively impact the portfolio.

Mr. Love referred to the January 2006 performance update and noted that the equity portfolio gained approximately 3.8 percent while the S&P 500 gained approximately 2.7 percent.

At Chairman Williams' request, Mr. Love agreed to provide the Commission with a report to aid in the Commissioners' discussions with legislators and other interested parties concerning the benefits of international equity exposure.

The Commission received the report for the Quarterly Investment Performance for Periods Ended December 31, 2005, and the Executive Summary as information. No amendments to the Interim Annual Investment Plan were proposed.

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

Chairman Williams recognized Mr. Allen Gillespie for a report on his due diligence meeting with Alliance. Mr. Gillespie stated that he met with key professionals at Alliance in New York, NY on January 30, 2006, to discuss the Large Cap Growth and Large Cap Value portfolios. He said that they also provided information about other investment strategies offered by the firm. He discussed Alliance as an organization and addressed several concerns he had about Alliance, including their total assets under management and their tracking error, which he felt limited active bets in the portfolio. Mr. Gillespie stated that Alliance published various reports and would make those resources available to clients, which could prove to be a valuable research resource to the CIO.

Chairman Williams recognized Ms. Paige Parsons from the STO for an update on integrating or "pooling" the fixed income portfolios of the five retirement systems for investment purposes. Ms. Parsons stated that a team, appointed by Ms. Peggy Boykin, director of the Retirement Systems, and Treasurer Patterson, met several times to

discuss the issues, and they determined that pooling the fixed income investments was both desirable and feasible. Ms. Parsons addressed the steps necessary to convert the investments into a pooled environment. Ms. Parsons stated that QED Information System (QED), which is the accounting system used by the STO and Retirement Systems, determined that the preliminary cost for the project was \$55,440 and noted that the cost did not include internal staff time and resources. Ms. Parson's suggested July 1, 2006, as the target date for pooling the fixed income investments.

Ms. Parsons noted that the project plan with the Bank of New York and QED focused on pooling the fixed income assets. She said they did not address the equity commingled funds because integration of the fixed income portfolio was a first priority and the area in which the most efficiency could be accomplished.

Mr. Ewing made a motion to receive Ms. Parson's report as presented, to approve the target date and the cost of the project that may be attributable to the Commission, and to direct the team to continue with the plan. Treasurer Patterson seconded the motion, which passed unanimously.

Ms. Nancy Shealy noted that the issue remained regarding pooling the commingled equity portfolios, i.e., the index funds and the Large Cap Core portfolio managed by BGI. Chairman Williams asked that the STO and Retirement Systems begin working on a similar report with respect to pooling those portfolios. Shakun Tahiliani with the STO advised that she had discussed the issue with the custodian of the equity index funds, and they indicated that there would be no problems with pooling the Retirement Systems' portfolios. She had not received information from BGI, but she said she did not believe there would be any major implications with pooling those portfolios into one account for investment purposes. Chairman Williams said that, based on the information presented regarding pooling the fixed income investments and the equity commingled portfolios, the Commission's expectation is for all of the investments to be pooled by the target date of July 1, 2006, and to bring any problems to the Commission's attention in the interim.

III. ADMINISTRATIVE MATTERS

Chairman Williams stated that Ms. Shealy intended to have a draft of the Commission's personnel policies completed before the March meeting. Ms. Shealy outlined some of the items that would be included in the personnel or human resources policies, noting that they would be of general applicability to Commission employees.

Chairman Williams recognized Mr. Ewing for an update on the agenda for the Commission's retreat at Wampee. Mr. Ewing reviewed the ideas for topics and guest speakers that he had discussed with Commissioners, Mr. Schutes, and various investment managers.

Chairman Williams referred to the draft job description for the CIO position which was previously circulated. Mr. Powers made a motion to adopt the CIO job description as presented. Mr. Gillespie seconded the motion, which carried unanimously.

IV. EXECUTIVE SESSION

Mr. Gillespie made a motion, which was seconded and carried unanimously, that the Commission enter into executive session to discuss candidates for the CIO position, to receive legal advice about conducting interviews, and then to interview candidates for the CIO position. Chairman Williams announced that the Commission would meet in executive session for those purposes and that the Commission would move to Room 102 at the Retirement Systems to conduct the interviews.

V. ADJOURNMENT

There was no further business after conducting the interviews, and upon a motion, which was seconded and carried, the meeting adjourned at 3:00 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 February 7, 2006.]