

# **South Carolina Retirement System Investment Commission Meeting Minutes**

**August 17, 2006**

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

## **Commissioners Present:**

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

**Others present for all or a portion of the meeting:** Ashli Aslin, Robert Borden, Nancy Shealy, and Justin Young from the South Carolina Retirement System Investment Commission; Paige Parsons, Frank Rainwater, and Shakun Tahiliani from the State Treasurer's Office; David Frahm, Jay Love, and Jeff Schutes from Mercer Investment Consulting; Ernie Cruikshank from Jamison, Eaton & Wood, Inc.; Peggy Boykin, Alice Copeland, Sarah Corbett, Tammy Davis, Danielle Quattlebaum, Joni Redwine, Megan Reynolds, Travis Turner, Angie Warren, and Faith Wright from the South Carolina Retirement Systems; Anne Macon Flynn from the Budget and Control Board Office of General Counsel; Linda Rodarte from Sopher-Rodarte and Associates; Henry Addy, Crawford Clarkson, Sam Griswold, and Wayne Pruitt from the State Retirees Association; Charley McDonald from the South Carolina Trooper's Association, and Van Newman.

## **I. CALL TO ORDER AND CONSENT AGENDA**

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission (Commission) to order at 10:00 a.m. and welcomed the Commissioners and guests. Due to scheduling conflicts, Mr. Blaine Ewing was unable to attend the meeting, and Treasurer Grady Patterson attended the meeting until 11:30 a.m.

Chairman Williams called for objections or amendments to the meeting's proposed agenda and to the minutes from the Commission meeting on July 13, 2006. Treasurer Patterson made a motion to adopt the agenda and the minutes from July 13, 2006. The motion was seconded and passed unanimously.

## **II. CHAIRMAN'S REPORT**

Chairman Williams introduced Mr. Van Newman, the retired Chairman and CEO of CNSG (formerly Newman, Saylor, and Gregory) and reminded the Commissioners that Mr. Newman volunteered his services to help the Commission educate the public about the proposed Constitutional amendment that would allow for further diversification of the

South Carolina Retirement Systems' (Retirement System) portfolio. Mr. Newman introduced his associate, Ms. Linda Rodarte from Sopher-Rodarte and Associates, who collaborated with Mr. Newman on the project. Mr. Newman said he recommended focusing media messages and primary communication efforts during the three weeks prior to the general election on November 7, 2006, to increase voters' awareness as they went to the polls. He stated that these messages would be brief, succinct, and straightforward. Mr. Newman also distributed and outlined nine talking points directed to the state's opinion leaders. He suggested that each Commissioner use these points as they met with the editorial boards from the state's major newspapers and addressed the civic clubs and other organizations in their communities. Staff agreed to forward the talking points to Mr. Ewing.

Chairman Williams thanked Mr. Newman on the behalf of the Commission. *(Information relating to this matter has been retained in the Commission's permanent files and is identified as Exhibit A.)*

Chairman Williams reported that he was scheduled to speak before the Florence Rotary Club in October. He stated that he published an article regarding the proposed amendment in the South Carolina Association of Counties' *Carolina Counties* newsletter. In response to the public interest spurred by the article, Chairman Williams reported that he submitted it to three additional publications. Chairman Williams stated that he had been interviewed on National Public Radio's Business Report, which would be replayed until the election in November.

Chairman Williams stated that the Commission's strategic planning efforts had been delayed due to higher priority agenda items. He requested that each Commissioner review the preliminary strategic planning information previously outlined by the Commission in preparation for a strategic planning session, which would be held during the September meeting.

### **III. INVESTMENT MATTERS**

Chairman Williams recognized Mr. Robert Borden for the Chief Investment Officer's (CIO) report. Mr. Borden noted that the Commission had previously authorized him to begin the recruitment process for a Director of Research and/or a Research Analyst and an Equity Investment Officer. Upon further consideration, Mr. Borden requested that the Commission authorize him to fill all three positions if suitable candidates were identified. After discussion, Mr. James Powers made a motion to authorize Mr. Borden to fill the positions of Director of Research, Research Analyst, and Equity Officer/Analyst. Mr. Allen Gillespie seconded the motion, which passed unanimously.

Mr. Borden referred to the sample quarterly report, which was included in the Commission's meeting materials. Mr. Borden provided an overview of the document and the changes that had been made based on the discussions at the Commission's previous meeting. Mr. Borden explained that based on the discussions, a policy benchmark had been constructed using the historical asset allocation of the Retirement System's portfolio. The policy benchmark had been applied retrospectively and included

on the report to provide a realistic view of performance given the legal constraints on the portfolio's diversification. Chairman Williams noted that the report must also include any waivers to the statutory code of conduct that the Commission granted for investment managers during the quarter, which included the contract renewal with AllianceBernstein LP. The Commission approved both the format and content of the quarterly reports, and Mr. Borden agreed to make the discussed changes and distribute the reports as soon as possible. *(Information relating to these matters has been retained in the Commission's files and is identified as Exhibit B.)*

Based on issues raised by Mr. Powers, Mr. Borden suggested that the Commission consider whether active management in the Large Cap sector was optimal given management fees, performance relative to respective indexes, and market trends. After a thorough discussion, Mr. Borden agreed to provide a summary report on active management versus indexing at the September meeting.

Mr. Borden provided an update on the investment consultant search. He noted that the preliminary finalists were CRA Rogers Casey, Mercer Investment Consulting, Inc. (Mercer), and New England Pension Consultants. Mr. Borden reported that due diligence visits with the semi-finalists were scheduled to begin the week of August 28, 2006, and that the target completion date was September 21, 2006, at which time the finalists would make presentations before the Commission.

Mr. Borden provided an update on the global fixed income manager search. He noted that the semi-finalists were Franklin Templeton Investments, Western Asset Management Company, Loomis Sayles & Company, L.P., Mondrian Investment Partners, Crédit Agricole Asset Management, and Goldman Sachs Asset Management. Mr. Borden reported that due diligence visits were scheduled to begin the week of August 21, 2006, and that the target completion date was October 19 or November 16, 2006.

Mr. Borden stated that while conducting the due diligence visits, he and Mr. Gillespie would also meet with several hedge fund managers whose services may be used in the future should a more complex asset allocation be adopted.

Mr. Borden stated that for the year ended June 30, 2006, the total portfolio performance was 5.1 percent, compared to a median return of 11.9 percent for large public funds. He explained that the relatively inferior performance was due to the legal/structural limitations placed on the portfolio. Mr. Borden briefly discussed the performance of the equity and fixed income portfolios and noted that the fixed income portfolio's performance was in the top quartile compared to similar portfolios.

Chairman Williams recognized Mr. Ernie Cruikshank from Jamison, Eaton & Wood, Inc., for a presentation on the fixed income investments of the Retirement System. Mr. Cruikshank provided a brief overview of the yield curve and the interest rate environment for the past 12-month period. He noted that the economy experienced a period of dramatically rising interest rates, and he explained the implications that an

environment such as this had on financial markets and the resulting impact on the strategy for managing the fixed income portfolio.

Mr. Cruikshank 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. Mr. Cruikshank and the Commission reviewed the fixed income portfolio's characteristics, including the average maturity, coupon, duration, and ratings. Mr. Cruikshank 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 State Treasurer's Office (STO) expected to make in the coming months. He also provided the Commission with a summary of the STO's economic forecast.

Chairman Williams and the Commission thanked Mr. Cruikshank for his presentation. *(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit C.)*

Chairman Williams recognized Messrs. Jay Love and Jeff Schutes of Mercer to review the equity portfolio Quarterly Investment Performance for Periods Ending June 30, 2006. Mr. Love reviewed economic factors and broad market performance. He 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 second quarter of 2006.

The Commission and Mercer discussed the Retirement System's equity portfolio performance. Mr. Love reported that the equity portfolio totaled approximately \$13.65 billion, which was consistent with the targets and ranges set forth in the Annual Investment Plan (AIP). He said that for the three- and five-year periods ended June 30, 2006, the equity portfolio returned 12.7 percent and 3.3 percent, outperforming the S&P 500 by 150 basis points (bps) and 80 bps, respectively. He noted that for the quarter, the equity portfolio underperformed the Total Equity Index (a weighted average of the benchmarks of all the Retirement Systems equity investment managers) by 40 bps, which was largely attributable to the active Large Cap portfolio. 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 equity portfolio's allocation by sector and noted that the overall equity portfolio was aligned with the broad market in terms of sector allocations.

The Commission received the Quarterly Investment Performance for Periods Ending June 30, 2006, and the Executive Summary as information. No amendments to the AIP were proposed. *(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit D.)*

Mr. Borden reported that he had met with representatives from WCM Investment Management (WCM). He stated that the firm had a sound ownership structure and investment philosophy, and he felt comfortable with the highly concentrated nature of

the portfolio. He stated that Mr. Gillespie also conducted a favorable due diligence meeting with representatives of Pzena Investment Management (Pzena) in New York, New York.

Chairman Williams recognized Mr. Borden and Ms. Nancy Shealy for a discussion on the contract renewal with State Street Global Advisors (State Street) for the Russell 2000 Index Fund. Ms. Shealy stated that the current contract would expire on September 25, 2006, and that the Russell 2000 product included a securities lending component. She noted that several provisions of the contract might differ from the standard contract prototype because the funds are invested in a commingled investment product. Mr. Borden recommended that the Commission renew the contract with State Street for the Russell 2000 Index Fund. Mr. Powers made a motion to authorize the Chairman of the Commission or his designee to negotiate and execute a contract with State Street for the Russell 2000 Index Fund with the availability of securities lending upon approval for legal sufficiency by General Counsel. The motion was seconded by Mr. Gillespie and passed unanimously.

Chairman Williams recognized Ms. Paige Parsons from the STO for a report on the portfolio integration and pooling project. Ms. Parsons reported that the project was completed on July 1, 2006, was on schedule, and was within budget. Ms. Parsons commended everyone who helped to make the project a success. Ms. Parson noted that the team would reconvene at a later time to begin a similar project for the equity portfolios. Chairman Williams thanked everyone who was involved in the project and commended them for a job well done.

Chairman Williams asked about the status of transitioning assets of the National Guard Retirement System (NGRS) into the equity portfolios. In response, Ms. Parsons stated that the assets of the NGRS were invested solely in fixed income securities. Upon the direction of the Commission, Mr. Borden agreed to research and implement a plan to transition the NGRS assets in the most prudent, efficient, and cost effective manner to provide the NGRS with exposure to the equity markets comparable to the other Retirement System defined benefit plans.

Mr. Borden recognized Messrs. David Frahm, Jay Love, and Jeff Schutes from Mercer for an update on the Asset Liability Modeling Study (ALM). Mr. Schutes stated that Mercer completed Phase I of the ALM, which provided a complete understanding of the Retirement System's liability structure. He explained that they had evaluated the effects of equity allocation, international diversification, and fixed income duration on a macro basis. Messrs. Frahm and Schutes discussed the assumptions on which the analysis had been based, the analytical process, and results of the ALM.

In response to concerns that Mercer's report projected a 40-year Unfunded Liability Amortization Period, Mr. Frahm explained that the portfolio's 2006 returns were less than the 7.25 percent actuarial expected rate of return. Also, additional benefits had been granted while the additional employer contributions to cover those increased benefits would not be fully implemented until 2008. He explained that the 40-year

Amortization Period was temporary; when the increased employer contributions were completely phased-in during 2008, the Unfunded Liability Amortization Period would return to 30 years.

Messrs. Frahm and Schutes concluded that an equity allocation in the range of 50 to 70 percent of total assets would be necessary to fund the Retirement System's current obligations. Mr. Frahm explained that international equity would provide equity diversification and downside risk protection to the portfolio and recommended an international equity allocation of 20 to 40 percent of the total equity allocation. In addition, Mr. Frahm stated that longer duration bonds would not benefit the Retirement System's funded status. Messrs. Love and Schutes explained that the results of the ALM would be used to structure the sub-asset class allocation.

Mr. Borden reiterated that the ALM Phase I report was in draft form until such time as appropriate parties reviewed and verified the contents of the report.

Chairman Williams thanked Messrs. Love, Frahm, and Schutes for their work on the ALM. *(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit E.)*

Mr. Borden requested that the Commission consider engaging Cost Effectiveness Measurement Benchmarking, Inc. (CEM), the largest and most well-known cost benchmarking provider, in a cost benchmarking study. Mr. Borden noted that CEM had the ability to provide the Commission with customized peer group data using both the current and projected asset allocation, which could be used to compare the Commission's investment and administrative costs to those of similar organizations. Mr. Borden explained that CEM measured costs based on two important criteria: asset allocation and implementation. He said that as the Commission considers changing the portfolio's asset allocation, the information would be a valuable tool for developing a reasonable expectation of the cost involved in such an endeavor. Mr. Borden stated that the cost of a CEM cost benchmarking study would be \$18,500. Mr. Gillespie made a motion to authorize the Chairman or his designee to execute a contract to engage CEM to conduct a cost benchmarking study upon approval for legal sufficiency and compliance with South Carolina procurement laws. Mr. Powers seconded the motion, which passed unanimously. *(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit F.)*

#### **IV. ADMINISTRATIVE MATTERS**

Chairman Williams recognized Ms. Shealy for the Administrative Director's report. Ms. Shealy referred to a report summarizing the Commission's Fiscal Year (FY) 2006 budget through June 30, 2006 (as reported through August 8, 2006). She stated that a final budget for FY 2006 would be distributed when all accounts were reconciled. She also noted that due to the timing and delivery of services, some expenses that were anticipated during FY 2006 would be paid in FY 2007, which could lead to a budget

shortage in FY 2007. *(Information relating to this matter has been retained in the Commission's files and is identified as Exhibit G.)*

Ms. Shealy reported that she had completed the closing packages for the South Carolina Comptroller General's (CG) Office for FY 2006 and was preparing several other reports required by state law, including an employee travel report. In addition, Ms. Shealy reported that she submitted an activities-based budget for FY 2007 to the State Budget Office and explained that the governor would use the report to compile his state budget.

Ms. Shealy reported that she submitted the position descriptions for the eight additional fulltime employees (FTEs) for inclusion on the state's human resource information system. She reported further that she had submitted the information for the general tort liability and non-owned automobile liability insurance with the State Insurance Reserve Fund. She noted that the premium totaled approximately \$5,200 to maintain the Commission's current coverage.

Ms. Shealy noted that technical corrections were made to the Statement of Investment Policies (SIP), the Statement of Investment Objectives (SIO), and the AIP and that they were now in their final adopted form. She offered to forward copies of the documents to the Commissioners.

Ms. Shealy reported that the request for office facilities through the State Budget and Control Board's Office of General Services was complete. At the request of the Chairman, Mr. Powers agreed to serve as the Commission's representative in meeting with leasing agents and designing appropriate office facilities.

Chairman Williams recognized Mr. Gillespie for an update on the Investment Retreat. Mr. Gillespie stated that the retreat would focus on several relevant and timely topics and would follow the same general format and schedule as the Commission's retreat in March 2006, with time scheduled for strategic planning and asset allocation analysis.

Chairman Williams recognized Mr. Borden for an update on the development of the Commission's website. Mr. Borden reported that the Retirement System's information technology staff established an unlisted website address for the Commission and that the website's content had been reviewed and vetted by both the Chairman and Vice Chairman. Mr. Borden stated that he would send the link to the Commissioners and would welcome their comments, suggestions, and modifications to any of the content.

Mr. Borden reported that he spoke at the South Carolina Association of Counties annual convention in Hilton Head Island, South Carolina. He stated that his presentation covered the establishment of the Commission, the status of the retirement plans, and the benefits of international diversification.

Chairman Williams noted that the specific questions and explanations that would be on the statewide referendum in November 2006 were included in the Commissioner's meeting materials as information.

Chairman Williams called for suggested topics for the September meeting, which included strategic planning, rebalancing of the NGRS portfolio, FY 2007 budget, personnel policies, interviews of the finalists in the investment general consultant search, and a report on active management versus indexing for the Large Cap strategy.

## **V. ADJOURNMENT**

Chairman Williams thanked everyone for attending and adjourned the meeting at 1:20 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 2<sup>nd</sup> Floor Conference Room at 202 Arbor Lake Drive, Columbia, SC, on August 15, 2006.]