

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

February 22, 2007

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

Commissioners Present:

Mr. Reynolds Williams, Chairman
Mr. James Powers, Vice Chairman
State Treasurer Thomas Ravenel
Mr. Blaine Ewing
Mr. Allen Gillespie
Dr. Travis Pritchett

Others present for all or a portion of the meeting: Ashli Aslin, Robert Borden, Donald Brock, Douglas Lybrand, Nancy Shealy, and Hilary Wiek from the South Carolina Retirement System Investment Commission; Katie Boling, Ed Evans, Brenda Gadson, Rick Patsy, and Shakun Tahiliani from the State Treasurer's Office; Richard Charlton and Donna Szeto from New England Pension Consultants; Ernie Cruikshank from Jamison, Eaton & Wood, Inc.; Peggy Boykin, Jocelyn Caldwell, Sarah Corbett, Tammy Davis, John Page, Ashley Nichols, Danielle Quattlebaum, Kelly Rainsford, Joni Redwine, Travis Turner, and Faith Wright from the South Carolina Retirement Systems; Stuart Bohart, Gil Caffray, Jack Coates, Brian Erickson, Jordan Gershuny, and Dan Waters from Morgan Stanley; Ari Barkan and David Beeman from Citigroup Alternative Investments; Chris Smajdor from AllianceBernstein L.P.; and Wayne Pruitt from the State Retirees' Association.

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. and welcomed the Commissioners and guests. Due to scheduling conflicts, State Treasurer Thomas Ravenel attended the meeting until 12:45 p.m.

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

Chairman Williams called for objections or amendments to the minutes from the Commission meeting held on January 18, 2007. Mr. Allen Gillespie reminded the Commission that notes related to the Commissioners' due diligence meetings with Aquiline Capital Partners, LLC. (Aquiline) were to be included in the minutes. After further discussion, the minutes were approved as presented, subject to the addition of such notes relating to Aquiline.

Chairman Williams reported that Constitutional Amendments 3(a) and 3(b) had been ratified by the Legislature.

Chairman Williams reported that he sent a letter to Senator Hugh Leatherman, Chairman of the Senate Finance Committee, regarding bills s.241 and s.242, which would prohibit pension fund assets from being invested in companies with ties to Sudan and in entities or countries that sponsor or support terrorist activities. Chairman Williams stated that the letter expressed the

Commission's view that particular decisions about investment styles and strategies should remain with the Commission. He also noted that the Commission policies included similar provisions relating to terrorism. Chairman Williams requested that a copy of the letter be included with the meeting's minutes.

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

Chairman Williams provided a summary of his testimony before the House Ways and Means Legislative, Executive, and Local Government Subcommittee concerning the Commission's budget for Fiscal Year (FY) 2008 and the Commission's activities, asset allocation, and strategic plans.

Chairman Williams referred to a letter from Treasurer Ravenel that had been distributed to the Commission prior to the meeting regarding coordination and transition of custody and fixed income investment management to the Commission and a proposed resolution. The item was carried over until later in the meeting.

II. CHIEF INVESTMENT OFFICER'S REPORT

Chairman Williams recognized Mr. Borden for the Chief Investment Officer's (CIO) report.

Mr. Borden stated that, as discussed previously, a Beta overlay manager could be engaged to transition the portfolio to the new target asset allocation in an efficient and cost effective manner. Mr. Borden reported that representatives from Citigroup Alternative Investments (Citigroup) and Morgan Stanley had been invited to provide an educational framework on the mechanics of a Beta overlay program.

Mr. Borden introduced Messrs. Ari Barkan and David Beeman from Citigroup. Messrs. Barkan and Beeman discussed the definitions of Beta and derivatives and how both would apply to the Beta overlay program and would be used to affect the allocation of the Retirement System's assets.

Mr. Borden and the Commission discussed methods by which to mitigate counterparty risk, i.e., the risk that the other party to an agreement would default.

Chairman Williams thanked Messrs. Barkan and Beeman for their presentation on behalf of the Commission.

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

Mr. Borden introduced Messrs. Stuart Bohart, Gil Caffray, Jack Coates, Brian Erickson, Jordan Gershuny, and Dan Waters from Morgan Stanley. Dr. Coates discussed several options for managing a portfolio transition: 1) terminate some current asset class managers and replace them with high-quality managers in the target asset classes or with managers who could be brought to the target "synthetically", or 2) keep the current asset class managers with good performance expectations and use derivatives to reduce some current asset class exposures and add target asset classes "synthetically". Dr. Coates noted that the resulting exposure in either case would be exactly what it would have been had the portfolio been directly moved to the target asset allocation without using derivatives.

Dr. Coates discussed the derivatives operations process and described several nuances involved in synthetic exposure, including the importance of embedded beta estimation, significant factors to consider when determining which instruments to use, issues related to counterparty management, risk reduction through the staggering and early settlement of swaps, rebalancing issues, and administrative processes and controls.

Mr. Bohart elaborated on the process of monitoring and managing counterparty exposure.

Dr. Coates discussed Morgan Stanley's portable alpha approach and potential issues with constructing an alpha engine.

Chairman Williams thanked Messrs. Stuart Bohart, Gil Caffray, Jack Coates, Brian Erickson, Jordan Gershuny, and Dan Waters for their presentation on behalf of the Commission.

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

Mr. Ewing made a motion to authorize the CIO to issue a Request for Information (RFI) to select firms for proposals for Beta overlay services, subject to review for legal sufficiency by General Counsel. Treasurer Ravenel seconded the motion, which passed unanimously.

Mr. Borden recognized Ms. Hilary Wiek, the Commission's Senior Equity Officer, for a presentation on investment program style tilt. Ms. Wiek discussed the case for overweighting Large Cap Growth in the Retirement System's portfolio. She explained that the asset allocation approved by the Commission drastically reduced exposure to large cap US equities, and she suggested implementing a growth bias in the portfolio by targeting a reduction in allocation and/or terminating certain Value managers. Ms. Wiek stated that Commission staff would work with New England Pension Consultants (NEPC) to develop specific recommendations regarding Large Cap equity managers.

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

Chairman Williams referred to the item that had been carried over previously regarding the coordination and transition of custody and fixed income investment management from the State Treasurer's Office (STO) to the Commission. He explained that Treasurer Ravenel had previously sent a letter proposing to designate the Commission as his agent for managing the custodial banking relationship and recommending that management of the fixed income portfolio of the South Carolina Retirement Systems' (Retirement System) assets, which includes the liquidity pool that is used to fund investments and operations, be transferred to the Commission. After discussion and a review of the proposed resolution, Mr. Blaine Ewing made a motion that the Commission confirm and accept the Treasurer's proposal as outlined in his letter and adopt the proposed resolution. Treasurer Ravenel seconded the motion, which passed unanimously. Chairman Williams noted that the Commission's resolution would create a transition team which would be charged with the responsibility for directing, overseeing, and implementing the transfer as well as the implementation of the Commission's management of the fixed income portfolio, as required by applicable law. Chairman Williams stated that the transition team would be chaired by Mr. Robert Borden and would also include Mr. Douglas Lybrand from the Commission, Ms. Sarah Corbett and Ms. Tammy Davis from the Retirement System, and Messrs. Ed Evans and Rick Patsy and Ms. Shakun Tahiliani from the STO.

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

Mr. Borden requested authorization to continue due diligence reviews of three firms: The Aurora Funds, Inc. (Aurora), Bridgewater Associates, Inc. (Bridgewater), and D. E. Shaw & Co., L.P. (D.E. Shaw). Dr. Travis Pritchett made a motion to direct the CIO to continue due diligence reviews on Aurora Fund V, Bridgewater's Pure Alpha Fund, and DE Shaw's Multi Strategy Fund, and to make recommendations to the Commission upon completion of appropriate analyses. Mr. Ewing seconded the motion, which passed unanimously. It was noted that Mr. Gillespie had been involved in these due diligence reviews and would continue with the process.

Chairman Williams recognized Mr. Borden and Mr. Richard Charlton from NEPC for a summary of the Quarterly Investment Performance for Periods Ending December 31, 2006. Mr. Charlton reviewed key capital market observations, market returns, and broad market performance on both industry and sector bases. Mr. Charlton also reviewed the performance of the asset classes relative to the applicable indices.

Mr. Charlton reported that during the fourth quarter of 2006 the total portfolio increased 4.3 percent, compared to a median large fund return of 5.9 percent for large public funds. Mr. Charlton stated that decisions to overweight equities added approximately 20 basis points (bps) of return, while active managers subtracted 10 bps of return during the quarter. He also stated that relative to peers, a zero allocation to asset classes such as international equities, international bonds, and alternative investments hindered performance.

Mr. Charlton reviewed the products of several individual investment managers and suggested that the Commission consider alternative products for several current managers. At the Commission's request, Mr. Borden agreed to provide a report outlining specific recommendations at the next meeting.

The Commission received the Quarterly Investment Performance for Periods Ended December 31, 2006, as information.

Mr. Borden referred to the Commission's draft quarterly report dated December 31, 2006, which was included in the meeting materials. Mr. Borden provided an overview of the document and the changes that had been made from previous reports. He also discussed format changes he intended to make on future quarterly reports. The Commission approved both the format and content of the quarterly report.

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

Chairman Williams stated that, unless there were objections, staff was authorized to make technical and conforming changes to the Annual Investment Plan (AIP), Statement of Investment Objectives (SIO), and the Statement of Investment Policies (SIP) based on the asset allocation targets that were adopted at the Commission's retreat. There being no objections, staff agreed to make such technical and conforming changes.

III. ADMINISTRATIVE MATTERS

Chairman Williams recognized Ms. Nancy Shealy for the Administrative Director's report. Ms. Shealy reported on the Request for Proposal (RFP) for legal services to the Commission to review, negotiate, and draft contracts and other necessary documents relating private equity

and limited partnerships. Ms. Shealy reiterated that state law required approval from the South Carolina Attorney General (Attorney General) when a government entity sought outside legal counsel. Chairman Williams stated that, after the meeting, he would request the Attorney General to approve outside counsel to meet the February 28, 2007, closing date for the Aquiline Capital Partners, LLC (Aquiline) investment opportunity.

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

Ms. Shealy provided the Commission with a budget status report for Fiscal Year (FY) 2007, which the Commission received as information.

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

Ms. Shealy referred to the FY 2007 expense reimbursement projections from the STO and the STO's invoice for the second quarter of FY 2007. Ms. Shealy explained that historically, the STO had been reimbursed for 85 percent of the total cost for consulting services and online services and 100 percent of Mr. Patsy and Ms. Tahiliani's travel reimbursements. After discussion, Mr. Gillespie made a motion to approve reimbursement for the STO's second quarter FY 2007 expenses as submitted, subject to normal reimbursement procedures. Mr. James Powers seconded the motion, which carried unanimously.

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

Ms. Shealy stated that one of the administrative positions included in the budget for FY 2007 was for an Administrative Manager who, under the supervision of the Administrative Director and General Counsel, would perform and coordinate complex administrative functions relating to the daily management of office facilities, budgetary, and procurement matters. Ms. Shealy discussed the salary range and qualification requirements for such position.

Mr. Powers made a motion to authorize the Administrative Director/General Counsel to recruit and hire an Administrative Manager within the salary range previously approved by the Legislature and authorize the Chairman to approve a higher salary upon sufficient justification. Mr. Ewing seconded the motion, which, after discussion, passed unanimously.

IV. OTHER BUSINESS

Mr. Powers updated the Commission on the status of the Commission's new office facilities. He explained that the Budget and Control Board would allow the Commission to construct the office space needed for future staffing requirements at one time instead of the three-phased approach previously required.

Based on a discussion concerning fiduciary responsibility guidelines previously reviewed by the Commission, Ms. Shealy was asked to develop a process or checklist by which the Commission could review and monitor adherence to fiduciary standards.

Dr. Pritchett reported on the Opal Investment Education Symposium, which he attended February 14-16, 2007, in New Orleans, Louisiana. Dr. Pritchett provided an overview of the conference and stated that the conference was very relevant to issues the Commission faced.

V. ADJOURNMENT

Chairman Williams thanked everyone for attending, and the meeting adjourned at 1:50 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 20, 2007.]