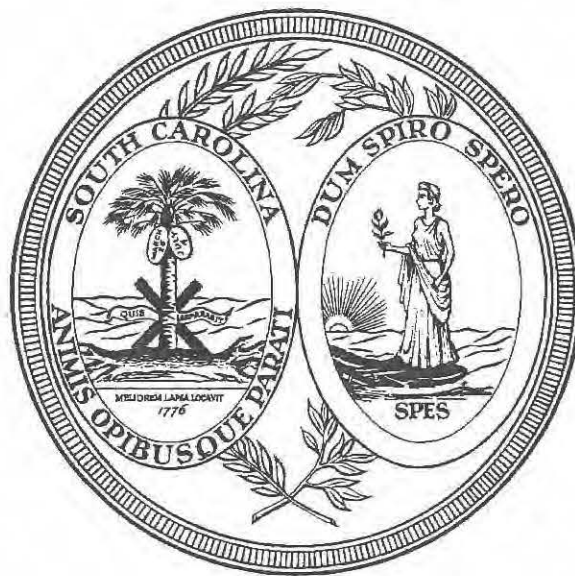


# **SOUTH CAROLINA RETIREMENT SYSTEM INVESTMENT COMMISSION**



## **STATEMENT OF INVESTMENT OBJECTIVES AND POLICIES**

As amended and adopted on November 17, 2011

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## **MISSION**

The South Carolina Retirement System Investment Commission will fulfill its fiduciary responsibility by prudently managing all assets held in trust for the sole benefit of the participants and beneficiaries of the South Carolina Retirement Systems. It will seek superior long-term investment results at a reasonable level of risk.

## **VISION**

The vision of the Commission is to be a world class investment organization that pursues strategies that contribute positively to the financial health of the South Carolina Retirement Systems.

## **PURPOSE**

The purpose of the Statement of Investment Objectives and Policies (“SIOP”) is to establish investment and performance objectives, policies and guidelines, roles, responsibilities, and delegation of authority for the management of assets of the South Carolina Retirement Systems (“Retirement System”), which includes:

South Carolina Retirement System,  
South Carolina Police Officers Retirement System,  
Retirement System for Members of the General Assembly of the State of South Carolina,  
Retirement System for Judges and Solicitors of the State of South Carolina, and  
National Guard Retirement System.

At least annually, the Retirement System Investment Commission (“Commission”) will review the SIOP to determine their continued applicability. If the liquidity needs, actuarial return assumptions, or the market risk/return expectations change, the SIOP will be reassessed in accordance with South Carolina law and Commission objectives.

The SIOP represents the overall guidelines that apply to the Retirement System’s Total Portfolio (“Portfolio”). All decisions that affect the management of the Portfolio must comply with the guidelines contained within this document and be consistent with the laws of the State of South Carolina.

# INVESTMENT POLICY

## Investment Return Guidelines

This policy defines the goals of the investment program. It is the Commission’s responsibility to implement the investment program with assistance from the CIO and the Commission’s investment staff (“Investment Staff”):

- The Policy Asset Allocation’s goal is to yield the most appropriate risk-adjusted return with consideration to achieving the Commission’s objectives.
- The desired rate of return for the Portfolio is a return greater than the return of the Portfolio’s Policy Asset Allocation.
- The desired rate of return for each asset class is any return greater than its benchmark return.
- The acceptable level of risk for an asset class is determined in the context of the Portfolio, rather than simply the intrinsic risk of the asset class.

## Policy and Strategy Asset Allocation Mix

Based on the Commission’s determination of the appropriate risk tolerance for the Portfolio and its long-term return expectations, it has authorized the following broadly defined Asset Allocation Policy Mix:

Policy Mix	Percent of Total Fund
Public Equity Investments*	0-70 %
Fixed-income Investments	5-100 %
Alternative Investments*	0-50 %
*Equity investments will not exceed 70% of the Portfolio’s total assets.	

## Allowable Investments

As it pertains to the above referenced asset classes within the Portfolio, exposure may be gained through investments in derivative instruments including, but not limited to futures, forward contracts, swaps, and options per the terms of each manager’s<sup>1</sup> specific governing documents and in accordance with the limitations outlined in the Annual Investment Plan (AIP). In addition to derivative instruments, leverage may be utilized in the implementation of these asset classes in accordance with each manager’s specific governing documents and in keeping with the investment limitations outlined in this policy. Also allowed are exchange traded funds (ETFs), warrants, rights, convertible bonds, and preferred stock. Currency hedges may also be used for non-dollar exposures within each respective asset class as outlined in each manager’s governing document. Absolute Return investment strategies may also be employed per the

<sup>1</sup> For purposes of the SIOP, references hereafter to “manager” will include an investment manager, investment advisor, general partner, managing member, or fund, as applicable.

terms set forth in the AIP; however, the majority of Absolute Return strategies would be expected to exist within the Alternative asset classes.

In addition to the instruments outlined in the paragraph above, for every asset class, a variety of investment structures may be utilized depending on the nature of a particular investment. Per the terms of the investment limitations outlined in this policy, these structures may include, but not be limited to, mutual funds, limited partnerships, limited liability companies, strategic partnership, trusts, commingled vehicles, fund-of-funds, and separately managed accounts<sup>2</sup> in which assets may be held by an external custodian who is selected and monitored by the external manager or general partner.

### **General Provisions Relating to the Alternative Investment Program**

South Carolina law, the Employee Retirement Income Security Act of 1974 (“ERISA”), and the Uniform Management of Public Employee Retirement Systems Act of 1997 (“UMPERSA”) each have similar or compatible, albeit not identical, definitions and responsibilities of fiduciaries with respect to managing and investing assets of retirement systems. For clarity and consistency it is prudent for the Commission to declare standards for interpretation of certain terms used in these sources.

For purposes of investments by, and implementation of, the Alternative Investment Program, the “Plan Assets” of the Retirement System include the System’s ownership interest in the following entities (e.g., a share or a unit), but do not include the underlying assets owned by the entity itself:

- (a) A registered investment company;
- (b) A registered security that is widely held and freely transferable;
- (c) an entity in which “benefit plan investors” hold less than 25% of the equity interest as defined and determined by ERISA §3(42);
- (d) An “operating company” engaged in the production or sale of a product or service other than the investment of capital;
- (e) A “real estate operating company” or REOC (which actively manages and develops real estate consistent with U.S. Department of Labor ERISA regulations);
- (f) A “venture capital operating company” or VCOC (which actively manages “venture capital investments” consistent with U.S. Department of Labor ERISA regulations);
- (g) A private investment partnership or offshore investment corporation the offering memorandum of which allows for the entity to take both long and short positions, use leverage and derivatives, and invest in many markets.

Where the Commission invests in an entity that does not hold Retirement System’s assets, the Commission’s decision to invest in the entity will be subject, inter alia, to the South Carolina fiduciary rules set forth in S.C. Code Ann. §9-16-10 et seq., and the ethics laws set forth in S.C. Code Ann. §8-13-110 et seq., but the transactions engaged in by the entity generally will not be subject to the same rules.

On occasion the Commission will need to interpret statutes while implementing and administering the investment program. Whenever the South Carolina statutes are substantively similar to provisions of ERISA

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<sup>2</sup> For purposes of the SIOP, reference hereafter to “fund” will include a limited partnership, limited liability corporation, or commingled vehicle, as applicable.

or UMPERSA, and to the extent practicable and consistent with South Carolina law and other principles of general application relating to public pension plans, the Commission intends to use (1) pertinent provisions of ERISA; (2) interpretive rules and regulations of the U.S. Department of Labor relating to ERISA; and (3) the Reporter's official comments to UMPERSA for guidance.

**Terrorist Sponsors:** The Commission will not invest in any security or obligation issued by a company or a corporation that is a known sponsor of terrorist organizations or of a company domiciled in a country that is a recognized sponsor of terrorism or terrorist organizations as based on reports from the Office of Terrorism and Financial Intelligence of the Department of Treasury and the country Reports on Terrorism by the Office of the Coordinator for Counterterrorism of the U.S. Department of State.

### **Periodic Reports to Commission**

The Commission will monitor performance through periodic reports that will allow assessment of broad policy decisions, strategic allocation decisions, and implementation decisions. Performance, with the exception of private market investments, will be calculated using time-weighted rate of return methodology. Performance for private market investments will be calculated on a dollar-weighted basis.

- At least quarterly, the CIO will submit a report to the Commission addressing the Retirement System's success in accomplishing the investment objectives based on the benchmarks described by policy at the total fund level and each asset class level. This report may also include a brief of due diligence meetings held throughout the quarter for existing managers. Certain managers may be excluded when the disclosure of material information could obstruct the manager's performance or jeopardize the ability of the Commission or Investment Staff to implement a portion of the AIP or achieve investment objectives. The CIO will also provide the Commission with a brief commentary which summarizes thoughts on the market and key strategic decisions made in the quarter, along with justification for those decisions.
- At least every five years, a formal, external asset/liability study will be prepared for the Commission, and it may include an evaluation of the Commission's investment strategy as set forth in S.C. Code Ann. §9-16-320(G). Annually in the interim, the CIO will submit an opinion to the Commission that addresses the continued prudence of the current asset mix in achieving the RRO.
- Periodically, a cost effectiveness external consultant will be engaged to report to the Commission regarding the Retirement System's success in minimizing implementation cost without negatively impacting performance.

### **Manager Search Process**

The Commission may, at its discretion, retain investment managers to manage portions of the Retirement System's assets. The Commission will not consider any manager for selection without first setting a target allocation to a particular asset class and determining that a manager is needed to implement that allocation strategy. Investment managers will ordinarily be selected from financially sound organizations with proven records of managing funds with characteristics appropriate for the risk/return profile of the Portfolio. The recommendation will be summarized in a memo to the Commission for managers considered for hire. The selection process outlined below will ordinarily be used for a manager search.

### **Phase I – Initial Information Sourcing and Analysis**

In addition to the general minimum criteria outlined in the SIOB and AIP, the CIO, Investment Staff, and/or Consultant (collectively referred to as “Investment Team”) may choose to establish additional criteria that managers must comply with before consideration as a candidate. As the Investment Team receives sourcing documents from potential candidates it will conduct qualitative and quantitative analysis to determine which candidates are best suited for the mandate. The Investment Team may also choose to host meetings with potential candidates as part of the initial due diligence process.

### **Phase II – Onsite Due Diligence**

After Phase I, the Investment Team will have narrowed the list of potential candidates to a group of candidates to be considered for further due diligence. The Investment Team may then travel to the candidate’s offices for onsite due diligence. The purpose of these meetings is to gain a more thorough understanding of the candidates’ investment philosophy, quality of professionals, investment process, costs associated with an investment, risks associated with an investment, and the controls in place to mitigate potential risks.

### **Phase III – Manager Approval and On-Boarding Process**

After Phase II, the Investment Team will have narrowed the list of candidates to a group of finalists to be considered for inclusion in the Portfolio. The Investment Team will then present its recommendations to the RSIC Investment Committee, which is comprised of Investment Staff appointed by the CIO. If the Investment Committee approves the Investment Team’s recommendation, the Investment Team may then present the recommendation to the Commission for approval. If the Commission approves the Investment Team’s recommendation, the Investment Staff may begin the on-boarding process.

### **Investment Manager Criteria**

The screening criteria discussed above will be developed at the inception of each search with an expectation that each manager considered for placement will be evaluated on certain basic requirements:

- Managers must provide a verifiable and documented performance record for the strategy under consideration for a minimum of three years. In special situations (start-ups or new products of managers), the Commission may consider performance generated by a manager at a prior firm or the compelling logic behind a new strategy. Longer performance records are desirable. Consistency and the ability to add value over longer time periods will be important considerations.
- Managers with experience managing portfolios of similar size and complexity to the Retirement System’s placement will generally be preferred. Higher levels of assets under management will be required for certain placements, such as passively managed indexes. For placements with smaller cap managers or other distinctive asset classes or logic, the Commission may consider a broader range of values regarding assets under management. Managers may need to demonstrate that the assets under management have not increased beyond their ability to effectively manage the placement given the strategy under consideration.
- Candidate firms that are subsidiaries or branches of other organizations should devote their time and resources primarily to the management of tax-exempt assets. Candidate firms that display a relatively new strategy may vary from the size and durational minimums of the two preceding paragraphs.

- Investment Staff should be of sufficient depth and breadth to perform the ongoing duties of the firm and proficiently execute its investment philosophy. Each principal should have a demonstrated history of portfolio management with experience germane to the strategy.
- Managers must express a willingness to meet at least annually with the Investment Staff in South Carolina. Strong communication skills and responsiveness to specific client needs are desired qualities.
- Management firms that present unique insight and perspective within the discipline under consideration will be preferred. Firms will be evaluated on the logic of their security selection and portfolio construction techniques, risk control methods, research processes, and the consistency with which they apply their own standards.
- The firm should be professionally managed and have a long-range business plan. The plan should recognize a limitation to the size that the organization can achieve (assets under management and number/type of clients) and still provide the client with the service and attention required. Additionally, there should be a separate, established maximum for assets under management in many specialized strategies under consideration.
- Fees must be competitive relative to an appropriate peer group of managers for a particular strategy with similar performance expectations.

### **Strategic Partnerships**

The Commission may elect to establish Strategic Partnerships with certain asset managers who are believed to possess specific expertise, knowledge and capabilities for a limited or broad range of investment strategies. The Strategic Partnerships are utilized to implement investment ideas with the specific investment manager of the related Strategic Partnership. Each Strategic Partnership will maintain and adhere to an investment plan, which will be reviewed by the Commission periodically. The Commission may delegate certain day-to-day responsibilities to the CIO and/or Deputy CIO with respect to the Strategic Partnerships.

The investment approval and evaluation process within the Strategic Partnership is similar to that followed by direct investments by the Commission as described under the Manager Search process. Once an investment idea is sourced, the investment evaluation or due diligence process begins. The investment must pass each of the following due diligence steps before an investment can be made:

1. Evaluate the investment in regard to the Portfolio's overall asset allocation.
2. Meet certain return and risk characteristics, and size qualifications as deemed to be appropriate by the CIO or Deputy CIO in relation to the Strategic Partnership and Portfolio.
3. The investment is evaluated by an assigned team, including the RSIC Co-Investment Team, which is comprised of Investment Staff appointed by the CIO. The RSIC Co-Investment Team is then responsible for presenting its recommendation to the RSIC Investment Committee for approval.
4. Once approved by the RSIC Investment Committee, the investment must pass final review by the Strategic Partnership Investment Committee before becoming an eligible investment.
5. After being approved by the Strategic Partnership Investment Committee, the investment must be reviewed for legal sufficiency for the Portfolio.



## **Asset Allocation Monitoring and Rebalancing**

Among the decisions the Commission can make, asset allocation has the most significant impact on Portfolio returns; therefore, maintaining the target allocations within the Portfolio is crucial to long-term success, both in terms of returns and risk profile. It is important, however, to balance the cost of deviating from the target allocations against the real costs of actively rebalancing, i.e., taking funds away from one asset class and moving it to another asset class. Active rebalancing generates costs such as trading commissions, market impact, and potential market timing costs. These costs are to be taken into consideration when developing a plan to rebalance the Portfolio.

The general rebalancing policy depends on ranges around each target allocation, both for asset class targets and for the manager-level targets within each asset class. When an allocation reaches its minimum or maximum allocation, as specified in the AIP, it will be rebalanced to return the allocation to the established range.

There are three hierarchical levels to the asset allocation and rebalancing policy:

- Asset class
- Sub-asset class
- Manager

Each level will be reviewed at least quarterly to determine whether it is within its allocation range as delineated in the AIP. The review will begin at the top level (asset class) and proceed downward to the manager level. Each of the higher levels may impact the levels below it. The impact of the higher level activity will be modeled before conducting the lower level analysis.

In the event that any of the asset and sub-asset class allocation levels move outside of their target range, the Commission and the CIO will determine the rebalancing action most appropriate for the Portfolio. The Commission delegates to the CIO or his designee the authority to execute securities transactions to implement rebalancing, cash management, or other authorized investment strategies within target ranges. In some cases, no action will be the appropriate response.

## **Manager Terminations**

Termination of a manager may occur whenever the Commission determines that its objectives can more efficiently or effectively be met by the selection of another manager or under a different management mandate. The Commission retains the right to terminate a manager with or without cause and at any time. Circumstances which suggest an immediate review and a possible termination include, but are not limited to:

- Manager changes strategy or investment style;
- Critical elements of the investment process have broken down;
- Transaction costs are unreasonable;
- Management fees are higher than similarly styled managers for similarly sized portfolios;
- Manager is unable to meet the performance expectations within the risk tolerance specified;
- Material organizational or personnel changes;
- Manager is not complying with the applicable provisions of the Commission's SIOP;
- Manager is not complying with the applicable provisions of the Commission's AIP.

### **Execution of Security Trades**

The Commission expects the purchase and sale of its securities to be conducted in a manner designed to receive the best combination of price and execution. The Commission will evaluate policies that provide for the most efficient and effective trading process.

### **Investment Manager Guidelines**

Full discretion in implementing the investment strategy, within the parameters of all applicable guidelines described herein, is granted to the Commission's investment managers regarding the selection of securities and the timing of transactions within the portion of the Portfolio allocated to each manager. Unless otherwise approved and stated in the contract with the manager, the following guidelines apply to the asset classes below where assets are invested in separately managed accounts.

Compliance with all applicable guidelines must be monitored by the investment managers on a regular basis (monthly or more frequently when market conditions warrant) and based on then current market values. Securities that, at purchase, would move the portfolio out of compliance with these guidelines, based on the investment manager's most recent valuation, may not be purchased.

In the event that a portfolio moves out of compliance with the applicable guidelines, through market conditions or other changes outside the control of the manager, the manager must bring the portfolio composition back into compliance within 45 days or make a written request to the Commission for a compliance waiver.

### **Domestic Active Equity Manager Guidelines**

The guidelines listed below will apply to all actively managed domestic equity portfolios, unless otherwise specifically noted or waived by written consent:

- Domestic equity purchases are limited to common stocks, preferred stocks, mutual funds, Exchange Traded Funds ("ETFs"), American Depository Receipts ("ADRs") and convertibles that are publicly traded. Exceptions must be approved by the Commission in advance;
- Managers should disclose whenever a single holding accounts for more than 6% of the allowable equity portion of the portfolio managed for the Retirement System at market value;
- The Retirement System's domestic equity portfolios are expected to be fully invested. Managers are encouraged to utilize appropriate ETFs relative to the portfolio benchmark. In no case shall manager's cash exceed 5% after equitizing available cash in an appropriate ETF;
- No single holding in the Retirement System's Portfolio shall account for more than 5% of the outstanding common stock of any one corporation;
- The purchase of ADRs, stocks or convertibles in foreign companies which are publicly traded securities may be held by each domestic stock manager in proportions which each manager deems appropriate, up to 10% of the portfolio at market value (foreign companies are defined as incorporated outside of the U.S. and performing a predominant portion of their business outside of the U.S.). Securities purchased that are part of the manager's domestic benchmark are excluded from the 10% limit;
- Convertible bonds, convertible preferred stocks, warrants, rights, and ETFs may be purchased as equity substitutes as long as they meet the equity guidelines listed above; and,
- Short selling is permitted.

### **Passive Equity Manager Guidelines**

Passive strategies are expected to have characteristics substantially similar to the underlying benchmark. For example, a large cap passive equity portfolio must have substantially similar capitalization and sector exposure to the underlying benchmark.

### **International Equity Manager Guidelines**

The guidelines listed below will apply to all international equity portfolios, unless otherwise specifically noted:

- Short-term reserves may be held in U.S. dollar denominated, local currency securities, or investment vehicles available through the custodial bank;
- Managers may purchase or sell currency on a spot basis to accommodate securities settlements;
- Managers may enter into forward exchange contracts on currency provided that use of such contracts is designed to dampen portfolio volatility or to facilitate the settlement of securities transactions;
- International equity portfolios are expected to be fully invested. Managers are encouraged to utilize suitable ETFs relative to the portfolio benchmark. In no case shall manager's cash exceed 5% after equitizing available cash in appropriate ETFs;
- Equity securities should be issued by corporations chartered outside the U.S., although the manager has latitude to hold other securities provided that such investment is consistent with attainment of the portfolio's investment objectives and does not exceed 10% of the portfolio's market value. American Depository Receipts ("ADRs") do not apply toward this 10% limitation;
- The number of issues held and their geographic or industry distribution will be at the discretion of the investment manager, provided that equity holdings in any one company (including ADRs, common stock and convertible securities) do not exceed 6% of the market value of the portfolio. Additionally, bonds of the companies in question should be included in the exposure calculation if held in the manager's portfolio;
- Managers with developed country international equity mandates may invest up to 10% of their portfolio(s) in the non-developed markets; and
- Managers with an emerging markets equity mandate may invest up to 10% of their portfolio(s) in markets not deemed to be emerging markets, subject to the guidelines listed above.

### **Core Fixed Income Manager Guidelines**

The guidelines listed below will apply to all core fixed income portfolios, unless otherwise specifically noted. In all Fixed Income strategies, "Investment Grade" is defined as: a rating of BBB- or higher from S&P, BBB- or higher from Fitch, or Baa3 or higher from Moody's.

- Core fixed income investments may include U.S. Government and Federal Agency obligations, TIPS, corporate bonds, debentures, commercial paper, certificates of deposit, Yankee bonds, mortgage-backed securities, bank loans, fixed income, and other instruments deemed prudent by the investment manager;
- No more than 6% of the market value of the domestic fixed income assets may be invested in the debt securities of any one issuer, except that no limitations on issues and issuers will apply to obligations of U.S. Government and Federal Agencies;
- Issues below Investment Grade at the time of purchase may be purchased up to a maximum of 20% of the portfolio;

- Notwithstanding the above, each manager is allowed to hold a maximum of 5% of the portfolio in bank loans;
- Managers may invest up to 20% of their portfolio in non-U.S. fixed income securities regardless of currency and may hold foreign currency;
- The overall average quality of each core U.S. fixed income portfolio must be rated Investment Grade or higher by Moody's, Fitch or Standard & Poor's. Split-rated securities will be measured using the lower ratings. Non-rated issues, excluding bank loans, may be purchased up to a maximum of 10% of the Portfolio. These quality restrictions will not apply to a manager that is engaged by the Commission to manage dedicated high yield fixed income portfolios;
- The diversification of securities by maturity, quality, sector, coupon and geography is the responsibility of the manager. Active bond management is encouraged as deemed appropriate by the investment manager;
- The average duration (interest rate sensitivity) of an actively managed portfolio must not differ from the passive benchmark's duration by more than plus or minus 50% of the benchmark duration;
- Derivative contracts as delineated in the Allowable Investments section above may be utilized for duration management and managing yield curve exposures. Additionally, credit default swaps may be utilized to increase or decrease credit exposure; and
- Any mortgage-backed securities ("MBS") will be subject to the constraints listed below:
  - Agency fixed and floating rate pass-throughs, U.S. Treasury securities, and cash equivalents can be held without limitation;
  - Inverse floating rate, interest only ("I/O"), principal only ("P/O"), and accrual CMOs in aggregate will be limited to 15% of the mortgage securities portfolio, with no more than 5% of the portfolio invested in accrual CMOs. In the event that other types of mortgage-related securities with risk characteristics similar to those in this category are developed, the manager will inform the CIO of those securities and they will be included in this 15% limitation;
  - All other types of mortgage-related securities not explicitly cited herein will be limited to an aggregate 20% of the portfolio; and
  - The Commission recognizes that the calculation of the duration of a mortgage-backed security involves assumptions as to the expected future prepayment rate for the security at the time of calculation and that prepayment rates cannot be precisely determined in advance. However, the manager is expected to calculate expected duration prior to the initial purchase of a security and on a routine basis in monitoring the portfolio's compliance with these guidelines.

**Short Duration & Cash:** In response to the historically low interest rate environment in 2010, the Commission approved an allocation to a new sub-asset class designed to provide Investment Staff with the ability to pursue yield-enhancing investments to increase the returns to the Portfolio. In January 2010, the Commission authorized Investment Staff to internally manage a short-duration fixed income asset class in order to pick up incremental yield as well as to match specifically identified short-term liabilities. The short duration internal allocation may invest in Treasuries, Agencies, Commercial Paper, Repo's, and other similar money market type securities in accordance with South Carolina law.

Also, the Commission recognized that the actual target weight to this asset class should be driven by both the actual market opportunities at any one point in time as well as by the ongoing liquidity needs of the Portfolio, rather than by a static target. As a result, while the combined target weight for both Cash and

Short Duration is 10% of the Portfolio, the target mix of these will be determined by the actual investments. For example, if the Portfolio holds 4% Short Duration investments, then the target cash exposure will be 6% of the Portfolio. The "Cash" portion of this strategy will be used to meet daily liquidity needs, while the "Short Duration" portion will be used to pick up incremental yield as well as to match specifically identified short-term liabilities.

Internally managed Short Duration and Cash portfolio goals and guidelines:

- To outperform the 0-3 Yr Merrill Lynch Treasury Index
- 100% US dollar securities
  - Includes but is not limited to, Treasuries, Agencies, Commercial Paper, Repo's and other money market and fixed income securities eligible under South Carolina law
- Maximum final maturity : 3 years
- Maximum Issuer Weighting : 5%
- Minimum Average Credit Quality : Investment grade or better at the time of purchase

External managers may be used for short duration mandates with the following goals and guidelines:

- To outperform the 0-3 Yr Merrill Lynch Treasury Index
- To focus on short-term, low volatility high yield debt with an expected maturity of approximately 12-24 months
- 100% US dollar securities
- Includes calls, tenders, take-outs, bank loans, unregistered 144As
- No exposure to Credit Default Swaps
- Opportunistic investments in investment grade securities, converts, treasuries
- Maximum final maturity : 3 years
- Maximum Issuer Weighting : 5%
- Maximum Industry Weighting : 15%
- Maximum Sector Weighting : 25%
- Minimum Average Credit Quality : B+ (No CCCs)

### **High Yield Fixed Income Manager Guidelines**

The fixed income guidelines described above will apply to high yield fixed income managers, unless otherwise specifically noted:

- Managers may invest up to 40% of their portfolios in non-U.S. fixed income securities unless limited by their contract;
- Managers are allowed to hold a maximum of 10% of the portfolio in bank loans;
- The average credit quality for the portfolio should be no lower than B-, average quality should be calculated using the lower of split ratings; and
- Managers may not purchase issues with a quality rating lower than C, and should a holding be downgraded to a rating lower than C, the manager must notify the Consultant and Investment Staff within 48 hours.

### **Global Fixed Income Manager Guidelines**

The guidelines listed below will apply to all Global Fixed Income ("GFI") portfolios, unless otherwise specifically noted:

- Excluding government sponsored enterprises; no single non-government debt security shall constitute more than 6% of the global bond portfolio, as determined at the time of purchase. Securities issued by AAA-Rated Supranational Organizations (such as the World Bank) will be considered to be government equivalents;
- No industry, as defined by the Barclays Capital Global Aggregate Index, except securities issued or guaranteed by the government, its agencies or instrumentalities, or government sponsored entities of the United States, Canada, United Kingdom, Germany, France, Australia, New Zealand and Japan, or securities issued or guaranteed by AAA-rated supranational entities will comprise more than 25% of the market value of the portfolio, as determined at the time of purchase;
- Short-term reserves may be held in U.S. dollar denominated or local currency securities or investment vehicles available through the Portfolio's Custodian;
- Managers may invest in securities issued in any currency and may hold foreign currency. Managers may hedge all or a portion of their currency exposure through the use of foreign currency exchange contracts, including non-delivery forward foreign exchange contracts and cross hedges. Managers may invest in currency-linked non-leveraged structured notes;
- Common stock may be held if it is acquired as a result of financial restructuring, bankruptcy, or from an exchange or conversion of a permissible security held in the portfolio;
- The overall average quality of each GFI portfolio must be A- or higher, as rated by S&P, Moody's or Fitch. Non-rated issues or bank loans may be purchased, provided that in the judgment of the manager, they are of a quality sufficient to maintain the average overall portfolio quality of A- or higher. Issues below Investment Grade at the time of purchase may be purchased up to a maximum of 20% of the portfolio. Emerging market debt may not comprise more than 40% of the portfolio. Combined, these last two allocations should not exceed 50% of the portfolio;
- Managers may continue to hold securities that are downgraded in quality subsequent to their purchase if, in the opinion of the manager, it would be advantageous to do so;
- The average effective duration (interest rate sensitivity) of a GFI portfolio must not differ from the passive benchmark by more than three years; and,
- Notwithstanding the above, each manager is allowed to hold a maximum of 5% of the portfolio in bank loans.

### **Emerging Market Debt Manager Guidelines**

The guidelines listed below will apply to all Emerging Market Debt portfolios, unless otherwise specifically noted:

- No single debt security shall constitute more than 6% of the global bond portfolio, as determined at the time of purchase;
- Each manager may hold a maximum of 5% of the portfolio in bank loans;
- No industry, as defined by the J.P. Morgan Emerging Markets Bond Global Index ("JPM EMBI Global") Index, will comprise more than 25% of the market value of the portfolio, as determined at the time of purchase;
- Short-term reserves may be held in U.S. dollar denominated or local currency securities or investment vehicles available through the Portfolio's Custodian;
- Managers may invest in securities issued in any currency and may hold foreign currency. Managers may hedge all or a portion of their currency exposure through the use of foreign currency exchange contracts, including non-delivery forward foreign exchange contracts and cross hedges. Managers may invest in currency-linked non-leveraged structured notes;

- Decisions as to the number of issues held and their geographic distribution will be the responsibility of the manager;
- Common stock may only be held if it is acquired as a result of financial restructuring, bankruptcy, or from an exchange or conversion of a permissible security held in the portfolio; and,
- From time to time, the Commission, upon the recommendation of the Consultant and CIO, may combine the allocations to U.S. High Yield and Emerging Market Debt in an overall portfolio that includes Global Bonds. Such a manager would be expected to manage in the spirit of the guidelines set forth above.

### **Alternative Asset Manager Guidelines**

The guidelines listed below will apply to all Alternative portfolios, which include Global Asset Allocation, Absolute Return, Opportunistic Alpha, Private Equity, Opportunistic Credit, Real Assets and Real Estate:

- The Commission will only invest in alternative assets when there is sufficient transparency and policy compliance reporting. Thus, extensive due diligence will be taken in evaluating and fully understanding all aspects of an alternative investment opportunity;
- It is anticipated that the managers selected to provide the Portfolio's Absolute Return, Opportunistic Alpha, Private Equity, Opportunistic Credit, Real Estate and some Real Assets exposures will operate in the form of a partnership, commingled vehicle, or separately managed account. The policies of these managers will be dictated by the documents and/or contracts governing these relationships;
- The Commission's initial commitment to a fund will not exceed 25% of the committed capital of that fund, unless the Commission specifically suspends this restriction in order to take advantage of a new firm or product that has not yet built an asset base or in the case where the fund has been created specifically for RSIC.
- All partnership investments must have a mechanism with a timetable for exit. Other Alternative Investments should have reasonable and well-defined policies for withdrawal of funds from their strategies;
- Unless otherwise approved by the Commission, no more than 15% of the long-term targeted alternative asset investment allocation may be invested with a single manager, general partner, or single fund, with the exception of a Fund-of-funds and a Strategic Partnership;
- Preference will be given to those funds where the general partner equivalent is contributing at least 1% of the capital of the total fund; and
- A reference check on a general partner or equivalent must be performed prior to investing in a fund. This reference check can be completed and reported by the Consultant, or other service provider, subject to review and approval by the Investment Staff.

### **Guidelines for Use of Pooled/Commingled Funds<sup>3</sup>**

Commingled investment vehicles provide, under some circumstances, lower costs and better diversification than can be obtained with a separately managed account pursuing the same investment objectives. However, commingled investment funds cannot customize investment policies and guidelines to the specific needs of individual clients. The Commission will accept the policies of such funds in order to achieve the lower costs and diversification benefits of commingled vehicles. Therefore, commingled investment vehicles are exempt from the required guidelines if:

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<sup>3</sup> For purposes of this section, reference to commingled "fund" or "vehicle" will include a limited partnership, limited liability corporation, or any commingled structure, as applicable.

- The investment practices of the commingled vehicle are consistent with the spirit of this policy and are not significantly different in letter, and
- The benefits of using a commingled vehicle rather than a separate account are material.

In some cases, the Commission may structure a portfolio as a separate account that allows for the advantages of commingled vehicles, but the Retirement System will be the only investor. With the introduction of international assets, in particular, commingled vehicles save the Commission from having to provide additional accounting for currency and foreign custody issues as the manager will have responsibility for these functions.

In instances where an investment mandate is structured through a commingled vehicle, the investment policies of that vehicle will be the legal governing policies of the investment of assets allocated to that vehicle.

### **Manager Reporting Guidelines**

Managers must provide a quarterly summary of the following, which will be used to evaluate investment performance:

- Guideline compliance;
- Brief review of investment process;
- Discussion of any changes to the investment process;
- Investment strategy used over the past year and underlying rationale;
- Evaluation of strategy's successes/disappointments;
- An assessment of the current liquidity of the portfolio and the market(s) in which the portfolio is invested.
- Provide total partnership, asset class and individual fund returns as a monthly time series, for the last quarter, year-to-date, last year, three-years, five-years, and since inception versus designated benchmarks;
- Discuss performance relative to benchmarks including attribution; and
- Provide Portfolio characteristics relative to benchmark (In the case of a manager basing returns on an IRR and not a benchmark, there will not be any characteristic comparisons).

Additionally, the Commission may rely on reports generated by the Consultant or other third party services to evaluate investment managers on performance and compliance with guidelines.



## SECURITIES LITIGATION POLICY

(A) Purpose of Policy; Objectives - The purpose of this document is to set forth the Commission's policies with respect to securities litigation. The principle objective of the Commission with regard to securities litigation is to prudently and effectively manage securities claims as assets of the Retirement System. Prudent and effective management of securities claims consists of the following functions:

- (1) Timely initial identification of potential claims.
- (2) The ability to conduct an in-depth assessment of certain claims, where warranted.
- (3) Making determinations regarding the most appropriate method of managing claims. Most, if not all, of these claims will be prosecuted by the class action bar whether or not the Commission takes an active role. Consequently, the Commission will focus on identifying those cases where active involvement could add value, either in the specific case or on a long term and portfolio-wide basis. Decisions as to what claims should be actively managed and how to manage them requires a balancing of the costs and benefits involved.
- (4) Insuring that all claims are timely filed and recoveries are collected.

Each of these functions is discussed in greater detail below.

(B) Initial Identification of Potential Claims – The identification of potential claims is a time-sensitive process, due to federal law's requirement that any party interested in seeking appointment as lead plaintiff in a federal securities class action must file a notice of its intention to seek appointment within 60 days of the filing of the initial complaint. Potential claims may be identified internally by the Commission's staff, investment consultants and analysts, or externally (by a third party "claims monitoring" service or by the class action bar). Experience has shown that the class action bar typically identifies and files actions on almost all claims first. Therefore, the most expedient way to identify claims is usually to monitor class action filings, determine whether the Retirement System is a member of the class and make other preliminary assessments regarding the potential claim.

The following summarizes the process presently used by the Commission to identify claims in which it has an interest:

- (1) The Commission's legal counsel reviews cases listed on various websites when notices of filings are received. Cases may also be identified by other information services or called to the Commission's attention by outside counsel.
- (2) The "class periods" (that is, the start and end dates proposed in cases, which may (i) have an effect on the Retirement System's potential losses and (ii) be modified during the course of the litigation) in new cases are compared to Retirement System's trading history to identify those in which Retirement System is a class member.

- (3) The Commission's legal counsel obtains a Retirement System trading history and a price chart for cases in which Retirement System may have a claim. Where available, other information describing the case may also be obtained.
- (4) The current size of Retirement System's holding in the company is determined.
- (5) Upon request by the Commission's legal counsel, a rough damage estimate will be prepared by staff or otherwise, based on the price drop after the end of the class period and the number of shares purchased and sold during the class period.
- (6) If the potential claim has a measurable, material impact on our investment return, the Commission's legal counsel obtains a copy of the complaint and seeks to gather other publicly available information.
- (7) Advice from the CEO/CIO, the portfolio manager(s), the Commission's investment consultant, and other analysts is obtained when the Retirement System has a substantial claim.

(C) Evaluating Claims - Unless adequate internal resources are available, claims identified for further evaluation are generally sent to experienced securities/litigation counsel engaged specifically to evaluate claims and advise the Commission on options for prudently managing the claims in question. A list of qualified securities/litigation counsel will be maintained by the Commission, in consultation with the Attorney General, for evaluating and/or prosecuting claims. The same general process and standards are used to evaluate each claim, as well as to determine and implement an appropriate claim management strategy, regardless of how the case is identified or referred to the Commission. That process generally includes the following steps and considerations:

- (1) Claim evaluation counsel performs due diligence on claims.
- (2) In instances where the Retirement System has a large current position in a company, claims are evaluated as to whether they are nuisance suits. If such a claim is likely to cause unnecessary serious harm to the company or the industry (and the value of Retirement System's holding), consideration may be given to whether the Commission could add value to the Retirement System's holding by supporting the company in seeking dismissal of the frivolous or immaterial lawsuit.
- (3) Claim evaluation counsel examines reasonable options for protecting the Retirement System's interests in a way that is likely to produce the greatest risk/reward benefits. Options may include (i) passive participation in class action, (ii) filing to become lead plaintiff, (iii) attempting to get a larger claimant to become lead plaintiff, (iv) monitoring the case from the sidelines, (v) writing a letter to the court and/or lead outside counsel to bring up issues being ignored, (vi) filing a motion to support or oppose a particular lead plaintiff or lead outside counsel candidate, (vii) filing a notice of appearance and more actively monitoring the case, (viii) attempting to negotiate an agreement with prospective lead outside counsel that will require them to keep the Commission informed of case developments, providing the Commission with access to discovery upon request and allow the Commission to participate in settlement

negotiations or be consulted on a settlement, (ix) waiting until settlement and reviewing the settlement carefully with the option to object to a poor settlement or excessive fees<sup>4</sup>, and (x) opting out of the class to file a separate action (e.g., where the Retirement System has a substantial Section 18 claim for direct reliance on misrepresentations in a document filed with the SEC that is unlikely to be pursued by the class).

- (4) Where other institutional investors appear to have similar large claims, consideration may be given to contacting them about a joint effort.
- (5) Pursuit of a shareholder derivative action might be considered where the company is not pursuing claims it has against third parties if the shareholders would benefit from realizing on those claims.
- (6) Non-litigation alternatives to addressing the underlying cause of the company's problem are also considered (e.g., contacting appropriate law enforcement agencies about potential prosecution of wrongdoers, filing a shareholder resolution or negotiating for remedial corporate governance changes, such as addition of independent directors).
- (7) Resource and other potential impacts may be considered in recommending a course of action. Factors which will be considered include impact of the proposed litigation on the Commission's staffing and resources, as well as other issues (e.g., strength of potential witnesses, likelihood that an investment will be sold, contents of Commission's files, support of the portfolio manager for legal action, and potential compromise of Commission's trading strategy if material, non-public information were to be acquired through involvement in discovery).
- (8) The Retirement System's portfolio impact of active claims management on long-term value may be taken into consideration in addition to the factors involved in a single case (e.g., the deterrence of future fraud from pursuit of claims against corporate bad actors or culpable auditors that are unlikely to be pursued without active case management by a knowledgeable lead plaintiff, introduction of competition between law firms to lower the size of legal fee awards taken out of recoveries, raising the standard for acceptable recoveries in class actions, objecting to unreasonable fees, and fostering changes in corporate culture that are likely to benefit shareholders).
- (9) Potential conflicts with other members of the class should also be taken into consideration in determining how to best manage the Retirement System's interests in a particular lawsuit (e.g., where the Retirement System has an overriding interest in getting the case dismissed because of its large continuing position and negative view of the suit's merits, the Commission may not want to seek appointment as lead plaintiff).
- (10) Claim evaluation counsel generally provides a written analysis and a recommendation to the Commission's Legal Division on what the most cost-effective options appear to be for managing the claim.

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<sup>4</sup> The Commission will develop guidelines addressing arrangements which constitute "excessive fees."

- (11) Recommendations may be discussed with portfolio managers, outside counsel and other Commission and Retirement System staff as appropriate prior to a final decision on management of the claim by the Commission's Legal Division.

**(D) Serving as Lead Plaintiff** - Where the claim evaluation process results in a decision to seek appointment as lead plaintiff, specific principles for adding value through the Commission's participation in the litigation may be identified (e.g., reduction of class legal fees and costs, pursuit of recoveries from culpable officers, directors, auditors, or other third parties, maximization of the recovery, and correction of underlying corporate governance problems). The Commission believes the most important decisions a lead plaintiff makes are usually those on selection/compensation of lead outside counsel and evaluation of potential settlement offers. In that regard, the Commission will always seek to structure lead outside counsel's compensation in a way that aligns interests of the class and its lawyers. The Commission believes that deterrence goals can be achieved in settlements through pursuit of claims against individuals and third parties that are bad actors. The following outlines the Commission's approach to serving as lead plaintiff.

- (1) When the Retirement System acts as sole lead plaintiff, the Commission will select lead outside counsel based on proposals submitted by and interviews of one or more potential lead outside counsel firms. [Note: A sample form of request for proposals may be found in Appendix A hereto]. A selection/review panel will evaluate candidates for lead outside counsel. Panel members will include the Chairman of the Commission, a member of the Commission's Legal Division, and a designee of the South Carolina Attorney General. That panel will also receive the advice of the Commission's general investment consultant and other analysts. A majority of the panel will constitute a quorum. The panel will make a recommendation regarding proposed lead outside counsel for a particular case to the Commission for a final decision.
- (2) The lead outside counsel selection should be done so as to establish for the court and other class members that lead outside counsel was selected on merit.
- (3) If the Commission does not prefer to serve as the sole lead plaintiff, other institutions may be invited to participate as joint lead plaintiffs. When a group is formed to function as lead plaintiff, similar procedures should be agreed upon for selection of lead outside counsel and supervision of the litigation. In the absence of other arrangements, the Commission generally prefers to have each participant designate a representative to serve on a lead plaintiff committee. The committee could be authorized to function much the same way that creditors' and equity holders' committees in bankruptcies do, with the committee electing its own officers, being updated regularly by lead outside counsel and convening as needed to review events or make decisions. Lead outside counsel could effectively serve as staff to the lead plaintiffs' committee.
- (4) Only qualified lead outside counsel candidates should be invited to submit proposals.

- (5) Consideration may be given to expanding competition between competent counsel within the class action bar, in order to encourage long-term reduction of fees.
- (6) While other innovative fee proposals may be solicited, the Commission will generally favor an arrangement that starts at a very low level (e.g., 5-10 percent) for a minimal recovery (this mitigates against counsel pursuing a frivolous case) and increases in brackets up to a maximum level for the highest recovery dollars. (The Commission does not ordinarily favor a descending fee schedule out of concern that it might operate to impose an artificial cap on lead outside counsel's incentives at the point where the fee percentage starts to decline. The last dollars are usually the hardest to obtain and lead outside counsel should be duly motivated to get them.) To prevent a windfall for lead outside counsel, the Commission also believes the fee schedule should contain a component that lowers the fee for early recoveries and gradually increases as the case proceeds. The fee schedule could be viewed as a grid, with the size of the recovery on one axis and the stage of litigation on the other. If costs and expenses are anticipated to be a major factor, consideration could be given to determining fees after costs are deducted from the recovery so that lead outside counsel is encouraged to keep costs under control.
- (7) The Commission will not advance fees or expenses for the class.
- (8) Lead outside counsel is generally expected to indemnify the Retirement System and Commission for any sanctions.
- (9) Lead outside counsel must provide information on its malpractice insurance coverage.
- (10) A written proposal is usually requested from lead outside counsel candidates. The proposal should include an evaluation of the case, the suggested fee arrangement, and a litigation plan. Unless the Commission is otherwise familiar with the outside counsel, the proposal should also explain the firm's experience in similar cases and the expertise of the lawyers that would work on the case.
- (11) The Commission believes it should retain the right to consent to an increase in a fee agreement at a later stage in the litigation if circumstances change such that the fee schedule is a disadvantage to the class.
- (12) Separate fee levels for claims against different defendants may be considered, if it is likely that efforts to obtain recoveries would vary from one to another.
- (13) Written proposals are generally reviewed by the selection/review panel (or the lead plaintiff committee) and the top candidates may be asked to provide an oral presentation (either in person or by conference call).
- (14) If time does not permit selection of lead outside counsel to be completed prior to the deadline for lead plaintiff applications, the Commission's Legal Division may file the lead plaintiff motion.
- (15) A case management agreement covering reporting, approval and other procedures should be established with lead outside counsel to ensure that Commission/Retirement System will be able to perform effectively its responsibilities as lead plaintiff.
- (16) Use of local or co-counsel by lead outside counsel will require approval from the Commission, where it will not unreasonably increase class fees or costs.

(E) Filing of Claims -Upon the settlement or other resolution of class action or other securities litigation, the Commission's custodial bank shall timely file all documents and take other steps necessary to insure that (a) the interests of the Commission and Retirement System are protected and (b) all monies due the Retirement System from such litigation are collected. The Commission's Legal Division will receive information from the custodial bank regarding the filing of claims and receipt of settlement proceeds and other recoveries, and periodically report to the Commission.

## II. ADMINISTRATION OF POLICY

(A) Processing Claims – The Commission's Legal Division is responsible for managing and coordinating the processing of all securities claims of the Commission/Retirement System either directly to court or through lead outside counsel.

(B) Reporting - The Legal Division will submit quarterly reports to the Commission regarding the status of (i) securities claims in which the Commission may be eligible to obtain a recovery and (ii) recoveries collected.

(C) Conclusion - As the Commission gains more experience with securities class action litigation, this process is expected to evolve. Changes in law and developments in court interpretations of the Private Securities Litigation Reform Act of 1996 and other laws may also impact procedures used by the Commission. Questions about the Commission's securities class action procedures may be addressed to the Commission's legal counsel.

## III. POLICY REVIEW & HISTORY

(A) The Commission will review this policy at least every three years to ensure that it remains relevant and appropriate, or when there is an amendment to state law relevant to any section of this policy, or when there is a Commission approved change in the responsibilities, duties, or operations of the Commission generally.

(B) This policy was adopted \_\_\_\_\_, 2011.

## IV. APPENDICES

(A) Sample Request for Proposals

## Appendix A – Sample Request for Proposals

The Commission may solicit proposals for lead outside counsel, though it will be more customary for the applicants to solicit the Commission. When the Commission does solicit proposals, the Sample Request below will often suffice.

Legal Division  
South Carolina Retirement System Investment Commission  
1201 Main Street, Suite 1510  
Columbia, South Carolina 29201

### Sample Request for Proposals

Date: \_\_\_\_\_

To: Candidate Law Firms

Re: \_\_\_\_\_ Class Action

\_\_\_\_\_ is soliciting proposals from selected qualified law firms to represent it in seeking appointment as lead plaintiff and in representing the class as lead counsel (subject to approval by the court) in the above securities class action litigation. \_\_\_\_\_ invites your firm to submit a proposal.

A list of the known pending class action lawsuits against the company is attached. We have also attached our trading history in the stock during the proposed class periods. Additional information can be provided upon request. I assume you will have to review the filed complaints and additional information about the company in order to evaluate the case and provide us with your legal analysis and proposal.

Proposals must be no more than ten pages in length and should be submitted to the attention of \_\_\_\_\_ by \_\_\_\_\_. Please provide at least six copies of all materials. The following items should be addressed, either in the written proposal or subsequent presentation:

- Whether you believe this case is one in which we should seek appointment as lead plaintiff;
- Your firm's experience in handling similar litigation;
- Identification of staffing arrangements you would make in order to accommodate workload;
- The results of any investigations you have performed for the case;
- Analyses of the causes of action which could be pursued by the class or us;
- Separate consideration of claims against the various defendants and potential defendants, including the company's accountants, underwriters, directors and officers;
- A damage analysis for claims of both us and the class, including likely recovery projections;
- Anticipated defenses to each claim and motions that might be brought by the parties;
- A general litigation plan outline for the case, including discovery plans and a target trial date;

- Consideration of the potential need for subclasses;
- What the appropriate class period should be;
- Evaluation of how the case might be handled to enhance deterrence of future fraud;
- Identification of firm personnel who would work on the case, including the roles each person would play and their normal hourly rates;
- Plans for use of co-counsel or other law firms and our relationship with any other plaintiffs;
- Arrangements for retaining and compensating experts and third parties on behalf of the class;
- Suggested reporting arrangements for supervision of lead outside counsel by us;
- Identification of your firm's malpractice coverage;
- Confirmation that your firm would cover litigation costs, any bonds required by the court and potential Rule 11 liability; and
- Proposed fee arrangements.

We invite alternative and thoughtful fee proposals for consideration. We seek an arrangement that aligns the interests of lead outside counsel with those of class members. We invite suggestions for a progressive fee structure which rewards lead outside counsel for success in pursuing damage recovery and other litigation goals, encourages prompt resolution of the matter, discourages unnecessary discovery and motion practice, and eliminates outcomes where counsel could obtain a cheap settlement that provides unreasonable fees. While fees will be a consideration in the selection process, our decision on lead outside counsel will also include evaluation of other factors, including those listed above.

Please note that we will not be responsible for fees or costs prior to recovery. As you know, representation of the class as lead outside counsel is subject to court approval.

If you submit a proposal, you may be contacted regarding a presentation to us by the primary firm personnel who would be responsible for the case. The presentation may be done in person or by teleconference.