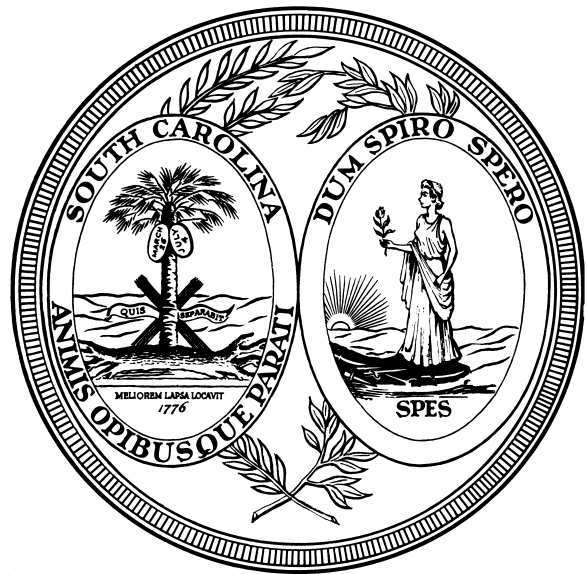


SOUTH CAROLINA RETIREMENT SYSTEM INVESTMENT COMMISSION



STATEMENT OF INVESTMENT POLICIES

As of September 18, 2008

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MISSION

The South Carolina Retirement System Investment Commission (Commission) shall 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 (Retirement System). We shall seek superior long-term investment results at an acceptable level of risk.

VISION

To accomplish this Mission, the Vision of the Commission shall be to:

- set investment Objectives and Policies;
- create an investment strategy;
- establish a disciplined investment process;
- implement the strategy and investment process in accordance to Policy;
- engage in attentive management and monitoring of performance;
- seek to attain high risk-adjusted alpha relative to appropriate benchmarks;
- strive for low and reasonable investment expense;
- assist the Budget and Control Board (Board) in projecting achievable long-term rates of return;
- assist with education on investment matters; and
- provide for open decision making and transparency of the decision making process;

Our results will be subject to constraints imposed by law, prudent investment management, and the performance of money and capital markets over 20- to 30-year periods.

PURPOSE

The purpose of the Statement of Investment Policies is to establish policies relating to the management of the assets of the Retirement System including:

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

This Policy Statement 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 and restrictions contained within this document, be consistent with the existing laws of the State of South Carolina, and reflect the philosophy and intent of the Commission.

INVESTING**

Guidelines

This policy defines the desired outcome of the investment program. It will be the Commission's responsibility to carry out the following duties with assistance of staff:

1. Develop a Nominal Return Objective (NRO) that will allow the Retirement System to exceed the actuarially assumed rate of return after all operating and investment management expenses.
2. Develop a Real Return¹ Objective (RRO) that will help the State of South Carolina keep contribution rates reasonably level over long periods of time, absent changes in actuarial assumptions.
3. Establish an asset allocation policy that is expected to meet the RRO while optimizing the fund's volatility. Secondary considerations include, but are not limited to, the expected rate of return for each asset class, the expected risk of each asset class, the correlation between rates of return among the asset classes, as well as the investment objectives and risk constraints of the fund.
4. Monitor costs associated with the efficient implementation of the asset allocation through the use of internal and external resources.

Policy and Strategy Asset Allocation Mix

Based on the Commission's determination of the appropriate risk tolerance for the Retirement System's portfolio and its long-term return expectations, it has authorized the following broad Asset Allocation Policy Mix:

Policy Mix	Percent of Total Fund
Public Equity Investments*	40-60 %
Fixed-income Investments	20-40 %
Alternative Equity* & Fixed Income Investments	15-25 %
*Under no circumstances will equity investments exceed 70 percent of the portfolio's total assets.	

Components of Investment Return

Investment Return is comprised of two components known as *beta* and *alpha*. **Beta** return is the return generated from exposure to the policy sub-asset classes identified in the above table. Beta return is thought of as the market return for the sub-asset class in question and is identified by the Policy Benchmark Index. **Alpha** return is generated as a result of manager skill or investment decisions that add or detract value relative to the Policy Benchmark Index. The following paragraphs define each component's respective role within the portfolio.

Beta Exposures

The policy mix outlined in the above table represents exposure to various markets the Commission has defined as sub-asset classes. It is also appropriate to think of these sub-asset classes as exposure to the *beta* component of the return equation. What follows are descriptions of components of each sub-asset class, their purpose in the overall portfolio, and more specifically, the types of investments that might normally be made within the sub-asset class.

¹ The real return objective is the rate by which the total return exceeds the inflation rate as measured by the Consumer Price Index, U.S. City Average for All Urban Consumers (CPI-U).

Public Equity

Domestic Equity: This sub-asset class seeks to provide a combination of long-term capital appreciation and dividend income that is expected to substantially exceed the rate of inflation. It is expected that investments in this class will perform well during periods of rising economic growth and/or falling inflation. Investments in this sub-asset class may include a variety of US stock investments with varying characteristics related to market capitalization and investment style. These characteristics include large-cap, mid-cap, small-cap, and micro-cap stocks, and value and growth stocks. Investments could also be made in specific sectors of the overall market such as technology, energy, or real estate investment trusts (REITs). Short selling is permitted in this sub-asset class.

Hedged Equity: This sub-asset class provides diversification to the total portfolio and strives to reduce volatility within the total fund by targeting a very low *beta* relative to the US equity market. This low *beta*, in combination with *alpha* strategies, is expected to generate returns over a full market cycle in line with the returns of the Domestic Equity sub-asset class. However, because of the unique structure of this sub-asset class, it is expected to generate returns in a different fashion (i.e. absent a high correlation to US equity). It would be expected that during periods of stock market strength, this portfolio would lag the US equity sub-asset class. Conversely, during periods of stock market weakness, this portfolio would be expected to outperform the US equity sub-asset class. The *alpha* implementation strategies within this sub-asset class will include a variety of marketable alternative strategies including, but not limited to long/short equity, convertible arbitrage, event driven, relative value, global fixed income, currencies, managed futures, and commodities both on a domestic and international basis.

International Developed Equity: Like the Domestic Equity sub-asset class, International Developed Equity seeks to provide long-term capital appreciation and dividend income that, in aggregate, are expected to substantially exceed the rate of inflation. Investments in this category will be made through a diverse group of strategies varying in size, investment style, and exposure to opportunities in a large group of developed countries. It is expected that investments in this sub-asset class will perform well during periods of rising economic growth and/or falling inflation, however, because of the non-US nature of these investments, they will also include non-dollar currency exposure not found within the US equity portfolio. This currency exposure during periods of dollar weakness will improve the Portfolio's performance, and, conversely, during periods of dollar strength it is more likely that these investments will lag the US equity sub-asset class. Characteristics of this sub-asset class include large-cap, mid-cap, small-cap, and micro-cap stocks, and value and growth stocks. Investments may also be in specific sectors of the overall non-US market such as technology or energy. Managers could be hired with a global focus or for specific country exposures. This sub-asset class will be invested predominantly in equities that make up the Morgan Stanley Capital International (MSCI) Europe, Australia, and Far East (EAFE) Index, however, there may be minor investments in countries outside of EAFE. Short selling is expected in this sub-asset class from time to time to rebalance the overall fund.

Emerging Market Equity: This sub-asset class seeks to provide long-term capital appreciation in excess of inflation primarily through non-US equity investments in countries outside of those included in the MSCI-EAFE Index. Because of the higher growth rates in these countries, higher long-term returns are expected. Investments may range in size (large, mid, small, and micro-cap stocks) and style (growth and value) and may be both long and short.

Public Debt

Domestic Fixed Income: The core fixed income portfolio is designed to provide a source of current income and to reduce overall Portfolio volatility. In addition, it is expected that investments in this category would perform well in periods of falling inflation. Investments within this category may include US Treasuries, agencies, mortgage-backed securities, asset-backed securities, investment grade corporate debt, and international investment grade debt. Shorting is permitted in this portfolio from time to time as necessary to rebalance the overall fund.

Treasury Inflation Protected Securities (TIPS): This allocation is designed to provide a source of current income to the portfolio, while providing some protection for the inflation sensitivity of the System's liabilities. TIPS are fully guaranteed by the full faith and credit of the US government and are highly liquid. Additionally, the specific guidelines for the TIPS portfolio allow for the inclusion of a small portion of non-guaranteed securities that must also be structured to provide inflation protection but may be of agency quality or corporate obligations of high credit quality. Other instruments which are allowable holdings may include international inflation protected securities, nominal treasuries, swaps, forward contracts, and inflation futures, however, it is expected that these types of securities will not make up a high percentage of this category.

High Yield Bonds: This sub-asset class seeks to provide capital appreciation within the portfolio through investment in below investment grade debt instruments and debt considered to be "opportunistic" in nature. Generally, it is expected that securities in this allocation will be in "current pay" status with superior coupon cash flow because of the lower credit quality bias. Investments in this portfolio may include non-investment grade debt of both US and non-US issuers.

Market Neutral: This sub-asset class provides diversification to the total portfolio and strives to reduce total fund volatility. The reasoning behind this sub-asset class being positioned within public debt is not due to the fact that all of its exposure will be debt instruments, but, more importantly, because it will be expected to have lower volatility (standard deviation) and similar returns over long periods of time to other public debt investments. This area will include investments in a group of skill-based managers using a variety of strategies. At any given point in time, the number of managers and types of investment and strategies being utilized may include the entire universe of available investment options. In addition, a variety of marketable alternative strategies may be utilized within this sub-asset class including, but not limited to, convertible arbitrage, event driven, and global, international, and emerging market fixed income/currencies.

Alternatives

Distressed Debt: This sub-asset class provides additional diversification to the total fund and is expected to provide equity-like returns. Investments include debt instruments of US and international companies which may be publicly traded or privately held that are financially distressed and are either in bankruptcy or likely candidates for bankruptcy. Typical holdings are senior and subordinated debt instruments and bank loans. Equity exposure is acceptable in this sub-asset class as debt positions are often converted to equity during the bankruptcy reorganization process.

Commodities: This sub-asset class is expected to provide meaningful diversification to the overall fund as it has exhibited a zero to slightly negative correlation to traditional assets (i.e. stocks and bonds). This sub-asset class is also expected to provide superior returns during periods of unexpected inflation. Investments in this category might include a variety of derivative instruments including futures, total return swaps, options, and forward contracts, as this is how most commodities exposure is obtained. It is also possible that this category might include limited partnerships and/or commodity trading advisors (CTAs) who seek exposure to various types of commodities and commodity-related investments, including oil, gas, and other energy investments.

Timber: This sub-asset class is expected to provide some protection against inflation, diversification, and current income to the total fund. Timber investments should lower the volatility of the overall fund. Investments in this category are expected to be very illiquid and long-term in nature. Timber is expected to earn real returns equal to traditional equity investments with volatility in between stocks and bonds over long periods of time. *Beta* exposures in this sub-asset class will include timberland and related assets in the US and on a global basis.

Private Equity: This sub-asset class is expected to provide high real returns over long periods of time while providing additional diversification to the fund. It is understood that the diversification benefit is primarily due to the lack of market pricing on these investments as opposed to the “true” diversification characteristic of these investments. Investments in this category are expected to be very illiquid and long-term in nature. Investments in this category include, but are not limited to, corporate buyout, venture capital, and opportunistic/special situations. These opportunities may be identified domestically or on a global basis.

Real Estate: This sub-asset class primarily serves as some protection against general price inflation and would also be expected to provide a relatively high real level of income. Real estate investments are expected to provide diversification to the overall fund. Investments in this category may be very illiquid and long-term in nature. Investments may include real estate investment trusts (REITS), opportunistic real estate funds, direct real estate holdings, and mezzanine debt investments.

*****The Commission will not invest in obligations issued by any country or corporation principally located in any country which the USA determines commits***

major human rights violations based on the Country Reports on Human Rights Practices by the Bureau of Democracy, Human Rights and Labor of the US Department of State.

****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 who is domiciled in a country that is a recognized sponsor of terrorism and 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 US Department of State.**

Allowable Investments in all Sub-Asset Classes (Beta Exposure)

As it pertains to the above referenced sub-asset classes within the Retirement System's portfolio, *beta* 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 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 sub-asset classes in accordance with each manager's specific governing documents and in keeping with the investment limitations outlined in this policy. Additional investments which are allowed include 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. Long/short investment strategies may also be employed per the terms defined in the AIP; however, from a *beta* perspective the predominance of long/short strategies would be expected to exist within the hedged equity and market neutral sub-asset classes.

In addition to the instruments outlined in the paragraph above, for every sub-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 mutual funds, partnerships, limited liability companies, trusts, fund-of-funds, and separately managed accounts in which assets may be held by an external custodian who is selected and monitored by the external manager or general partner.

Alpha Strategies

A variety of implementation strategies may be used in capturing *alpha* (skill-based manager returns) within the Portfolio. These strategies include both traditional active management strategies and marketable alternative market neutral strategies. Marketable alternative strategies may be used as long as the Commission's Chief Investment Officer (CIO) has a high degree of confidence that these strategies exhibit little to no market exposure. The use of investment instruments available to these managers is broad, covering a variety of investment types and strategies across numerous asset classes. In making implementation decisions related to the alpha component of the portfolio, the CIO may utilize any and all investment tools so long as they are defined in each manager's governing documents that are carried out in accordance with the AIP.

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 System 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 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.

Performance Measurement

The Retirement System's success in achieving its return objectives will be evaluated over long time periods. The reason for the long-term focus of this measurement is to preclude the temptation to overreact to events in the marketplace that have no relevance in long-term asset/liability management. The resulting dilemma is the conflicting need to evaluate investment policy implementation decisions over shorter time frames while maintaining the longer-term focus necessary to manage and measure the fund's performance relative to its return objectives.

To address this dilemma, the Commission has established indices to define performance:

1. The Policy Benchmark Index is the weighted average of asset class targets set forth in this Policy multiplied by the appropriate benchmark indices for each class.
2. The Strategy Benchmark Index is the weighted average of the asset classes actually deployed through the AIP, multiplied by the appropriate benchmark indices for each class.

When appropriate to the asset class or strategy, a split benchmark, or a primary and a secondary benchmark, may be selected.

The Commission has established the following categories to analyze performance:

1. Commission Decisions
2. CIO Decisions
 - A. Strategy Decisions
 - B. Implementation Decisions

Commission Decisions

The value added through Commission decisions is measured by the difference between the Policy Benchmark Index return and the Required Rate of Return Objective (defined as the RRO + Inflation). This difference captures the value added by the Commission through their broad policy asset allocation decisions relative to the required rate of return objective necessary to meet the actuarial assumptions. A Policy Benchmark Index return greater than the Required Rate of Return Objective reflects value added through Commission decisions. A Policy Benchmark Index return less than the Required Rate of Return Objective reflects shortfalls in performance. These policy decisions are measured over long periods of time.

CIO Decisions

There are two key components to CIO decisions that are monitored by the Commission on an ongoing basis:

Strategy Decisions: Strategy decisions are sub-asset class asset allocation choices made by the CIO to deviate from the Policy Benchmark weights. The value added through these decisions to overweight and/or underweight these sub-asset classes is measured by the difference between the Strategy Benchmark Index return and the Policy Benchmark Index return. This difference captures the value added by the CIO through sub-asset class strategic decisions relative to the Commission's broad policy allocation decisions. A Strategy Benchmark Index return greater than the Policy Benchmark Index return reflects value added through

the within class allocation decisions. A Strategy Benchmark Index return less than the Policy Benchmark Index return reflects losses to the fund's performance based upon strategy decisions. Strategy decisions should be measured over all periods of time.

Implementation Decisions: Implementation Decisions are money manager selection choices led by the CIO. The value of these manager-related decisions is measured by the difference between the Actual Portfolio return and the Strategy Benchmark Index return. An Actual Portfolio return greater than the Strategy Benchmark Index return reflects value added through these decisions. An Actual Portfolio return less than the Strategy Benchmark Index return reflects losses to the fund's performance based upon implementation decisions. Implementation decisions should be measured over all periods of time.

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. All performance shall be calculated using time-weighted rate of return methodology.

- At least quarterly, the CIO will submit a report to the Commission addressing the Retirement System's success in accomplishing the investment ends based on the benchmarks described within this policy at the total fund level and each asset class or sub-asset class level. This report will also include a summary of due diligence meetings held throughout the quarter and will also provide the Commission with a brief commentary by the CIO 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 conducted; it shall include an evaluation of the Commission's investment strategy as required by S.C. Code Ann. §9-16-320(G). Annually in the interim, the CIO shall 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 shall 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 or advisors to manage all or a portion of the Retirement System's assets. The Commission will not consider selection of any manager without first setting a target allocation to a particular asset class, and then determining that a manager is needed to implement that allocation strategy. Once the Commission has determined that a manager search is warranted, it will establish minimum criteria for a manager to be considered eligible to participate in the search. Investment advisors shall ordinarily be selected from financially sound organizations with proven records of managing funds with characteristics appropriate for the risk/return profile of the Retirement System's portfolio. The selection process outlined below will ordinarily be used for a manager search. Whether particular circumstances call for a different process or not, the process actually used will be fully documented in the Commission's records.

Establishment of Selection Criteria – The general criteria for each manager search will be identified by the Commission. Prior to the inception of any particular search, the

specific criteria that applies for that search will be adopted by the CIO and one Commissioner will be assigned to the selection team. The specific guidelines required for a particular search will vary depending upon the preferred characteristics for that mandate and the amount of portfolio assets to be invested. While this criteria will serve as the basis for the selection process, additional comparative analysis will be conducted in order to narrow the list of candidates to a manageable number for rigorous research and due diligence.

Selection of Preliminary Candidates (Database Screening) – The Commission will use the Investment Consultant’s extensive database of investment product providers as the initial universe, with additions as they deem appropriate, from which candidates will be selected. Because the goal of the Commission is to be inclusive, the Investment Consultant establishes a dedicated request telephone line for managers who wish to add their firms’ disciplines to the database. Any firm that expresses an interest is invited to complete the questionnaire for the products it wishes to present for consideration. Each search will begin with the full universe, and candidates will be selected through the screening process based upon the selection criteria established for that particular search. Once the objective screening is complete, the search team may rely on additional quantitative comparative analysis and the subjective, qualitative input of the Investment Consultant to further narrow the field of candidates to a manageable number.

Preliminary Candidate Evaluation – Once the initial list of candidates is identified, each will be subjected to a detailed analysis. Each candidate meeting the criteria will be contacted to verify the manager’s willingness and ability to participate in the search and to confirm the continued appropriateness of the manager relative to the selection criteria.

Semi-Finalists Selection – Based upon all of the above research, the Investment Consultant and the CIO will narrow the list of qualified candidates to those organizations which are most appropriate for consideration, after the General Counsel has certified them as compliant with the Commission’s Policy.

Report Preparation – After the semi-finalists are identified, the Investment Consultant will prepare a report detailing these investment management firms. Data provided in these reports will include comparative return and risk histories, organizational information and fees, information on clients and professional staffing, profiles detailing the investment philosophy, strategies, process, and decision-making approach, the logic behind the firm’s tactical approach, and comments on each firm’s relative strengths and weaknesses.

Selection of Finalists – The CIO and the assigned Commissioner will review the report on the semi-finalists with the Consultant to select a reasonable number to interview. The team typically expects to interview no more than three qualified candidates for the placement, although the number of candidates selected for interviews is at the team’s discretion. After the team selects finalists for interviews, a copy of the Commission’s standard Manager Contract will be presented to each finalist. The Commission will require that any exception(s) be stated in writing and submitted as a part of the final interview.

Interviews/Selection – The Investment Consultant will coordinate the interviews and will inform the candidates of the basic information that should be included in the presentation. The assigned Commissioner, the CIO, and the Investment Consultant will compare and contrast the strengths and weaknesses of the finalists to determine the

investment manager(s) best suited for the mandate. The team will recommend a Manager, or more than one from which one or more will be chosen, when appropriate, to the Commission for approval action.

Implementation – Upon approval by the Commission and execution of a contract between the Commission and the Manager, the transition will be accomplished efficiently using appropriate, well-documented brokerage arrangements designed to provide a combination of best price and execution.

Investment Manager Criteria

The Screening Criteria discussed above will be developed at the inception of each search with an expectation that each manager or advisor considered for placement will be gauged by 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, the Commission may consider performance generated by a manager at a prior firm or the compelling logic behind a fresh 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.
- 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 and validate a compelling logic to 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 Commission 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 low relative to an appropriate peer group of managers for a particular strategy with similar performance expectations.

Asset Allocation Monitoring and Rebalancing

Among the decisions an investment committee 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 money 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 re-optimize and rebalance the Portfolio.

The asset allocation and rebalancing policy is a cascading policy that works both in conjunction with and independently of the larger equity/fixed income allocation/rebalancing policy. Any cash flow needs that arise out of the equity/fixed income allocation policy will be implemented through the policy outlined below to determine the source or destination of assets going into or out of the equity portfolio.

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

As there are three hierarchical levels to the asset allocation policy, the rebalancing policy must consider the interlocking nature of these three levels (Equity/Fixed Income, Equity or Fixed Income Sub-asset Class, Manager Allocations within the Sub-asset Class). Each level will be reviewed at least quarterly to determine whether it is within its asset allocation range as determined in the Annual Investment Plan (AIP). The review will be initiated at the top level (Equity/Fixed Income) 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 implemented before conducting the lower level analysis. This means that if the broad equity asset class is below its minimum range, then assets will be transferred from fixed income to equity. Those new assets will be distributed according to the cascading policy described below. After those assets are allocated to equity sub-asset classes and then managers, some of the equity sub-asset classes/managers that may have been originally outside of their ranges before the new assets were distributed may now be inside their ranges. In that case, no further rebalancing action would be necessary.

In the event that any of the sub-asset class allocation levels move outside of their target range, it will be up to the Commission and the CIO to determine the rebalancing action most appropriate for the Portfolio. The CIO will have the discretion to rebalance the sub-asset class allocation levels within their target range. In some cases, no action will be the appropriate response.

Manager Terminations

Termination of a manager or advisor will 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 or advisor 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;
- Investment 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;
- The portfolio is exhibiting style characteristics which are not consistent with the defined mandate;
- Material organizational or personnel changes;
- The manager is not complying with the Commission's Statement of Investment Objectives;
- The manager is not complying with the Commission's Annual Investment Plan.

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.

ADMINISTRATION

Commission's Role

1. The Commission will cultivate a sense of group responsibility. The Commission, not the staff, will be responsible for excellence in governing. The Commission will be the initiator of policy, not merely a reactor to staff initiatives. The Commission may use the expertise of individual members to enhance the ability of the Commission as a body, rather than to substitute the individual's judgments for the Commission's values.
2. The Commission will direct, control, and inspire the organization through the careful establishment of broad written policies reflecting the Commission's values and perspectives. The Commission's major policy focus will be on the intended long-term impacts outside the organization, not on the administrative or programmatic means of attaining those effects.
3. The Commission will enforce upon itself whatever discipline is needed to govern with excellence. Discipline will apply to matters such as attendance, preparation for meetings, policymaking principles, respect of roles, and ensuring the continuance of governance capability.
4. Continual Commission development will include orientation of new Commission members in the Commission's governance process and periodic Commission discussion of process improvement.
5. The Commission will allow no officer, individual, or committee of the Commission to hinder or be an excuse for not fulfilling its commitments.
6. The Commission will produce written governing policies that at the broadest levels address each category of organizational decision.
 - A. **Ends:** Impacts, outcomes, and their relative worth (what's good for recipients & at what cost).
 - B. **Executive Limitations:** Constraints on executive authority that establish the prudence and ethics boundaries within which all executive activity and decisions must take place.
 - C. **Governance Process:** Specification of how the Commission conceives, carries out, and monitors its own task.
 - D. **Commission – Administrative Director – CIO Linkage:** How power is delegated and its proper use monitored; the Administrative Director and CIO role, authority, and accountability.
7. To accomplish its responsibilities with a governance style consistent with Commission policies, the Commission will follow an agenda which: (a) completes a re-exploration of Objectives annually and (b) continually improves Commission performance through Commission education which enriches input and deliberation.
8. Any individual Commission member who wants to raise an issue to be placed on the agenda should notify the Chairman of the Commission who, in turn, will put the item on the agenda of the next Commission meeting.
9. Commission members may not attempt to exercise individual authority over the organization except as explicitly set forth in Commission Policies.
 - A. Members' interaction with the Administrative Director, CIO, or staff must recognize the lack of authority vested in individuals, except when explicitly Commission-authorized.
 - B. Members' interaction with the public, press, or other entities must recognize the same limitation and the inability of any Commission member to speak for the

Commission, except to repeat explicit Commission decisions.

- C. Members will not make individual decisions regarding the Administrative Director, CIO, or staff performance.
- 10. Members will respect the confidentiality appropriate to issues of a sensitive nature.
- 11. Members will be properly prepared for Commission deliberation.

Commission Officers; Terms; Nominating Committee

- 1. Chairman; Vice-Chairman. The Officers of the Commission shall be a Chairman and a Vice-Chairman, each of whom shall serve a two-year term ending June 30 of even numbered years and shall be ineligible for re-election to the term immediately following. The Vice-Chairman shall act as Chairman during the Chairman's absence or other inability to serve and shall become Chairman at the conclusion of his term.
- 2. Nominations. The Chairman and the Vice-Chairman shall serve as the nominating committee for the successor Vice-Chairman. Their nominee shall be reported to the Commission no later than the meeting prior to the election to be held. Nominations from the floor may be entertained following the report of nomination until the election.

Chairman's Role

The Chairman assures the integrity of the Commission's processes and represents the Commission to outside parties and may execute all documents on behalf of the Commission.

- 1. The Chairman strives to see that the Commission behaves consistently with its own rules and those legitimately imposed upon it from outside the organization.
 - A. Meeting discussion content will be only those issues, which according to Commission policy, clearly belong to the Commission to decide, not the Administrative Director or the CIO.
 - B. Deliberation will be fair, open, and thorough, but also timely, orderly, and kept to the point.
- 2. The authority of the Chairman includes making decisions which, by reasonable interpretation, fall within topics covered by Commission Policies and Investment Objectives with the exception of: (a) employment or termination of an Administrative Director or CIO, and (b) where the Commission specifically delegates portions of its authority to others.
- 3. The Chairman is empowered to chair Commission meetings with all the commonly accepted power of that position (e.g., ruling, recognizing).
 - A. The Chairman may represent the Commission to outside parties, explain Commission positions, and state Chair decisions and interpretations within the area delegated to him.
 - B. The Chairman may delegate authority but remains accountable for its use.

General Counsel

A direct, unlimited access to the Commission by General Counsel is integral to governance and management.

- 1. If the General Counsel has reason to believe that any action or proposed action of the Commission, a Commission member, the CIO, or other staff is either illegal or in violation of a Governance Policy, the General Counsel shall provide the Commission with an opinion with regard to the specific matter. General Counsel shall implement all procedures necessary to maintain compliance with fiduciary standards and conduct.
- 2. General Counsel may direct legal matters pertaining to potential or actual litigation to outside legal counsel and develop strategies in conjunction with the outside legal counsel

to resolve all such matters. The General Counsel and outside legal counsel shall keep the Commission apprised of all potential and actual litigation.

3. General Counsel shall monitor the performance of and review all billing statements from the outside legal counsel.

Administrative Director

A direct, unlimited access to the Commission by the Administrative Director is integral to governance and management.

1. The Administrative Director shall be responsible for all Commission activities, staff, budgeting, logistics, and decisions not otherwise reserved to the Commission or delegated to the Chairman, a Committee of the Commission, a named Commissioner, or the CIO.
2. The Administrative Director shall be responsible for seeing that staff does not endanger the organization's public image or credibility, or conduct itself in ways that would hinder the accomplishment of its mission.

Compensation and Benefits

The Administrative Director is authorized to administer a pay plan structure for staff subject to the following limitations:

1. Beginning Fiscal Year 2008 and thereafter, in accordance with the General Appropriations Act regarding employee compensation for unclassified employees, the Administrative Director may adjust the base pay of all staff no greater than 80 percent of the Consumer Price Index (CPI-W) for Wage Earners and Clerical Workers (CPI-W) subject to the maximum percentage set forth by the Appropriations Act or in guidelines established by the Budget and Control Board. The CPI-W will be determined as of the end of the preceding calendar year and shall be the increase in the ratio of the CPI-W as of that date to the index as of the previous calendar year.
2. The Administrative Director shall administer the performance management/incentive compensation program for staff each February under the pay proposal approved by the Commission. An eligible Administrative employee may receive an increase of up to 1 percent of base pay for accomplishment of performance objectives and of up to 2 percent of base pay for accomplishment of individual performance objectives.
3. The Administrative Director shall administer the incentive compensation program for Investment staff under a pay proposal as determined by the CIO and approved by the Commission.

Chief Investment Officer

A direct, unlimited access to the Commission by the CIO is integral to governance and management.

1. The CIO's access to the Commission for submission of investment reports, information, or communications required by or implicit in these policies, and any other information or opinions specifically requested by the Commission with regard to the investment program is unlimited, timely, and frequent.
2. The CIO shall monitor the performance of and review all billing statements from all outside providers of service to the investments (external money managers, securities lending managers, specialty consultants, and the master custodian) to ensure accuracy.
3. The CIO shall periodically report investment results net of all costs/fees.

Global Executive Constraint

The Executive Staff shall not cause or allow any practice, activity, decisions, or organizational circumstance which is unlawful, imprudent, or in violation of commonly accepted business and professional ethics. The Administrative Director is the gatekeeper for oversight of this policy.

Quarterly and Annual External Reporting

At least quarterly, the Commission will provide to the Governor, the State Budget and Control Board, the Speaker of the House of Representatives, the President *Pro Tempore* of the Senate, and other appropriate officials and entities an investment report of the total portfolio of the Retirement System as required by S.C. Code Ann. §9-16-90(A). An annual report shall be provided to interested parties as required by S.C. Code Ann. §9-16-90(B).

Voting of Proxies

Voting of proxy ballots shall be for the exclusive benefit of the participants, retirees, and beneficiaries of the Retirement System. The investment manager shall vote the proxies in accordance with this policy on all shareholder issues. The Commission reserves the authority to direct the voting of proxy ballots on specific issues at its discretion.

Emergency Procedures

The Commission recognizes the possibility that events affecting investments may occur which would necessitate immediate action to safeguard the Retirement System's assets. Once the Chairman of the Commission, with the advice of the General Counsel to the Commission, determines that emergency action should be taken, the Chairman shall notify members of the Commission that such action is necessary. After such notification, the Chairman shall direct the State Treasurer, the CIO, or others to take the necessary steps to protect the assets pending further action by the Commission.

Securities Class Action Procedures

Introduction

The Commission sometimes has a fiduciary duty to pursue legal action to recover on a claim, but 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 focuses 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 on what claims should be actively managed and how to manage them requires a balancing of the costs and benefits involved.

Identifying Claims

Claims may be identified internally by the Commission's staff, investment consultants and analysts, 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 and determine whether the Retirement System is a member of the class. The following summarizes the process used by the Commission to identify claims in which it has an interest:

- General 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 our attention by outside counsel.
- Class periods in new cases are compared to Retirement System's trading history to identify those in which Retirement System is a class member.
- General Counsel obtains a Retirement System trading history and a price chart for cases

in which Retirement System may have a claim. Where available on the Internet or elsewhere, press releases/news articles describing the case may also be obtained.

- The current size of Retirement System's holding in the company is determined.
- Upon request by General Counsel, a rough damage estimate is prepared by the Commission's Investment Consultant 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.
- If the potential claim has a measurable, material impact on our investment return, the General Counsel obtains a copy of the complaint and obtains publicly available information.
- Advice from the CIO, the portfolio manager(s), the Commission's investment consultant, and other analysts is obtained when the Retirement System has a substantial claim.

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 claims recoveries. A list of qualified securities/litigation counsel will be maintained by the Commission 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 management strategy, regardless of how the case is identified or referred to the Commission. That process generally includes the following steps and considerations:

- Claim evaluation counsel performs due diligence on claims.
- 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.
- 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 taking no action, filing to become lead plaintiff, attempting to get a larger claimant to become lead plaintiff, monitoring the case from the sidelines, writing a letter to the court and/or lead outside counsel to bring up issues being ignored, filing a motion to support or oppose a particular lead plaintiff or lead outside counsel candidate, filing a notice of appearance and more actively monitoring the case, 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, waiting until settlement and reviewing the settlement carefully with the option to object to a poor settlement or excessive fees, and 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).

- Where other institutional investors appear to have similar large claims, consideration may be given to contacting them about a joint effort.
- 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.
- 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).
- Commission's staffing, resources, and 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) may be considered in recommending a course of action.
- 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).
- 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).
- Outside counsel generally provides a written analysis and a recommendation to General Counsel on what the most cost-effective options appear to be for managing the claim.
- 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 General Counsel.

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.

- 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 lead outside counsel suitors. A selection/review panel will evaluate candidates for lead outside counsel. Panel members include the Chairman of the Commission, General Counsel, and a designee of the South Carolina Attorney General. That panel will also receive the advice of the Commission's Investment Consultant and other analysts. A majority of the panel will constitute a quorum. The panel will make a recommendation for lead outside counsel for a particular case to the Commission for a final decision.
- 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.
- 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.
- Only qualified lead outside counsel candidates should be invited to submit proposals.
- Consideration may be given to expanding competition between competent counsel within the class action bar, in order to encourage long-term reduction of fees.
- 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.
- Commission will not front fees for the class.
- Lead outside counsel is generally expected to indemnify Retirement System for any sanctions.
- Lead outside counsel must provide information on its malpractice insurance coverage.
- 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.

- 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.
- 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.
- 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).
- If time does not permit selection of lead outside counsel to be completed prior to the deadline for lead plaintiff applications, the Commission's General Counsel may file the lead plaintiff motion.
- Reporting and approval 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.
- Use of local or co-counsel by lead outside counsel requires approval from the Commission, where it will not unreasonably increase class fees or costs.

Processing Claims

General Counsel is responsible for managing and coordinating the processing of all securities class action claims of the Commission/Retirement System either directly to court or through lead counsel.

Conclusion

As the Commission gains more experience with securities class action litigation, this process is expected to evolve. Court interpretations of the Reform Act provisions may also impact procedures used by the Commission. Questions about the Commission's securities class action procedures may be addressed to General Counsel.

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.

General Counsel
Retirement System Investment Commission
Post Office Box 11960
Columbia, South Carolina 29211-1960

Sample Request for Proposals

Date:

To: Candidate Law Firms

From:

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. I 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 me 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;
- 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.