



THE HONORABLE CURTIS M. LOFTIS, JR.
State Treasurer

March 4, 2013

Ms. Suzanne M. Bernard, CFA, CAIA
Principal, Hewitt EnnisKnupp, Inc.
10 South Riverside Plaza, Suite 1600
Chicago, IL 60606

Dear Ms. Bernard,

Thank you for Hewitt's recent analysis of management and other investment fees incurred by investments selected by the South Carolina Retirement System Investment Commission. As your recommendation stated, this first pass at examining our complicated fee structure illustrates that more work is needed so that the Commission can understand and manage our *more* than \$297 million in fees. Everyone agrees that state lawⁱ directs that ALL fees should be included in our annual reporting. I am also sure that everyone agrees that all fees should be included in our analysis so fees can be properly evaluated in relation to the performance we receive in return for those fees.

It appears that not all "Fund of Hedge Fund" fees were included in your fee report or in our annual reporting for FY 2012. As you know, we have approximately \$3.3 billion (\$3,369,934,303)ⁱⁱ in "Fund of Hedge Funds." At present, we report only the "top layer" of fees, but we do not report the "bottom layer" of fees charged by the underlying fund managers. To estimate the bottom layer of unreported fees on the "Hedge Fund of Funds," we can use the 3.17% rate that Hewitt noted on page 7 of its report. That rate reflects what we paid in FY 2013 for the direct hedge fund fees. At the rate of 3.17%, the bottom layer of unreported fees would be approximately \$106,826,917 (\$3,369,934,303 times 3.17%).

These \$106,826,917 bottom-layer fees are not presently disclosed as investment expenses in our annual report even though they were fees incurred by the plan. I believe this oversight can be remedied this fiscal year by including the bottom-layer fees in the disclosure in our annual report, in a footnote to the financial statements of the retirement system, and in future reports concerning fees by Hewitt and other consultants.

In addition to the \$106 million of unreported fees regarding "Fund of Hedge Funds," the Hewitt report also did not include another \$8 million of incurred fees. For various reasons,

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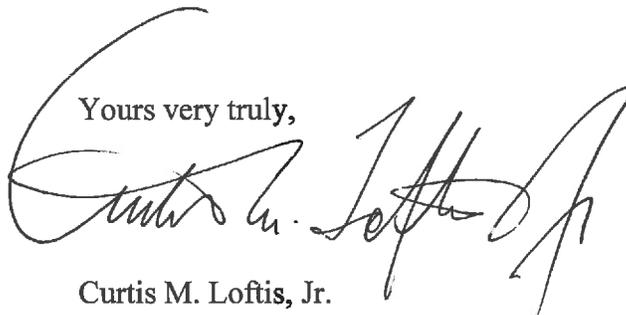
Hewitt removed approximately \$8 million of incurred fees from the fee computations; however, removing these fees understates our fees, which would seem to distort the results of a fee study. I suggest that Hewitt find a way to include these fees in their next analysis.

Finally, to completely assess our fees, it seems that Hewitt would include an estimate of the costs incurred by us to internally manage certain investments in-house. Therefore, an allocation of the agency's cost for in-house management of funds should be included in your next analysis and, of course, in our annual reporting that is required by law.

When these additional paid fees of approximately \$114 million (\$114,826,917) are included into your next report, they will affect not only our peer comparisons but also our ability to appraise the value added by these fees.

I appreciate your efforts on behalf of the Investment Commission. Even though Hewitt's study of fees did not include all fees incurred, Hewitt's conclusion was that our fees were reasonable for "our allocation." I think, in time, it will be shown that our allocation is dependent on costly investment structures that add little value but demand significant fees. I hope that Hewitt's advice regarding the upcoming Annual Investment Plan and our proposed allocation will be to alter our allocation, and therefore our fee structure, to one that is reasonable and that results in a substantial first step to a portfolio that will bring increased returns, lower fees, and an acceptable level of risk.

Yours very truly,



Curtis M. Loftis, Jr.
State Treasurer

CMLjr/afw

CC: Retirement System Investment Commissioners

ⁱ SC State Law 9-16-80: (annual reporting)

a schedule of the sum of total investment expense and total general administrative expense for the fiscal year expressed as a percentage of the fair value of assets of the system on the last day of the fiscal year, and an equivalent percentage for the preceding five fiscal years.

ⁱⁱ From Annual Report FY 2012: Fund of Funds \$3,174,131,803 + Pantheon Europe and USA \$195,802,500 = \$3,369,934,303.