

SECURITIES LENDING CHRONOLOGY**Spring 1982**

Treasurer Grady Patterson agrees to allow the State's then custodian, Morgan Guaranty Trust Company ("MGT"), to borrow South Carolina's securities for its own use and for its short-selling customers. MGT unconditionally obligated itself to discharge the obligations of each such loan.

1986

Securities Lending Agreement ("SLA") amended to allow MGT to invest Cash Collateral.

1990

Securities lending is subject to a 60/40 split of profits from lending activity, plus waiver of any custody fees. Authorized investments for cash collateral included US government bonds and federal agency notes.

1995 form SLA agreement with JP Morgan (successor-in-interest to MGT)

This contract had a NY *choice of law* clause and was silent on venue.

Investments in Asset-Backed Securities were allowed, with "Maximum Final Maturity" of no more than 3 years and "Weighted Average Lives" of no more than 1.5 years.

November 27, 1996 Securities Lending Agreement with BNYM (which had purchased JPM's custody operations)

Base document is BNYM form -- signed by Treasurer Richard Eckstrom. This contract contained clauses agreeing to application of South Carolina law and venue in South Carolina courts.

Schedule 1 describing authorized investments is essentially a re-write of guidelines set forth in 1995.

July 9, 1998

BNY's share of securities lending earnings was reduced to 70/30 division.

March 24, 2000

Securities Lending Agreement signed by Treasurer Grady Patterson.

BNYM's share of earnings split reduced again -- new division is 75/25; investment guidelines and the contract itself are unchanged from 1996 version, but with a more favorable earnings split.

July 2005

BNYM's share of securities lending earnings is again reduced -- new division is 85/15

October 2005

The Retirement System Investment Commission (“RSIC”) is created.

Late 2005

BNYM begins to purchase asset backed securities (“ABSs”) based on home equity loan in South Carolina securities lending accounts. This change was not discussed with South Carolina investment personnel.

In purchasing these ABSs, BNY relied upon “expected final maturities” which estimated repayment within three years.

July 2006

BNYM issues annual GASB compliance letter stating: “All cash collateral investments were in compliance with the States’ [sic] approved investment guidelines.”

Monthly paper statements (only information provided to South Carolina regarding securities lending cash collateral investments) reported ABS “Maturity Dates” of less than three years, based on the Bank’s reliance on “Expected Final Maturity.”

August 20, 2006

BNYM purchased \$129.75 million of Lehman Medium Term Note, CUSIP No. 52517PL33, all in the RSIC’s securities lending account.

November 2006

Thomas Ravenel elected State Treasurer; Ravenel takes office in January 2007.

March 23, 2007

BNYM purchased \$35 million of Lehman MTN, CUSIP No. 52517PW31 for the State Treasurer’s securities lending account.

June 2007

Investment Commission hired staff (formerly STO employees) to take over operational contact with BNYM for RSIC’s securities lending accounts.

State Treasurer Ravenel arrested on federal drug charges; suspended as Treasurer.

Kenneth B. Wingate is appointed to serve as interim State Treasurer.

August 2007

Converse Chellis elected State Treasurer by General Assembly

BNYM issues annual GASB compliance letter stating: “All cash collateral investments were in compliance with the States’ [sic] approved investment guidelines.”

Again, BNYM's monthly paper statements (only information provided to South Carolina regarding securities lending cash collateral investments) reported the ABS "Maturity Date[s]" of less than three years, based on the Bank's reliance on "Expected Final Maturity."

March 2008

Bears Sterns collapses and the Federal Reserve orchestrate acquisition by J.P. Morgan.

Emails sent from Russell to the RSIC proposing Lehman swap transaction.

May 2008

BNYM's proprietary "Workbench" computer platform allowing customer information access becomes available.

September 15, 2008 Lehman Brothers collapses

Account managers for both the State Treasurer and the RSIC send emails to BNYM inquiring about Lehman's exposure in securities lending.

The State Treasurer had no other Lehman exposure; The RSIC owned about \$35 million Lehman bonds purchased by third-party managers (fixed income and hedge funds), also credit default swap with Lehman as counter party which created about \$70 million liability for the RSIC.

BNYM unilaterally limits cash collateral reinvestment to low risk overnight repos.

November 2008

RSIC's CEO/CIO Bob Borden requests Portfolio review meeting with BNYM.

Primary focus of meeting was Lehman, but BNYM also assured the RSIC that the ABSs were "money good."

RSIC staff provides "directive" to BNYM limiting reinvestment guidelines for cash collateral to overnight repos.

The first version of the Lehman "Support Offer" – is sent independently by BNYM to both the RSIC and to the State Treasurer.

The offer was to refund BNYM's 15% securities lending agent's fee up to 15% of realized Lehman losses (with payments not to begin until final disposition of Lehman notes and to never exceed monthly amounts charged by BNYM as fees); offer required client to allow BNYM to continue to manage its cash collateral investment portfolio until support amount was paid. Limited to period of payments.

January 2009

The State Treasurer and the RSIC each instruct BNYM to retain securities lending earnings in reserve to offset investment losses.

BNYM makes Lehman “Support Offer” to refund BNYM’s 15% securities lending agent’s fee up to 15% of realized Lehman losses (with payments not to begin until final disposition of Lehman notes and to never exceed monthly amounts charged by BNY as fees); offer required client to allow BNYM to continue to manage its cash collateral investment portfolio until support amount was paid.

BNYM reports to South Carolina that it has retained outside analysis company (Fitch) to evaluate the ABSs collateralized by home equity mortgages.

March 2009

BNYM makes revised Lehman “Support Offer”

Offer is contingent upon the client continuing to make at least 75% of its lendable securities available to BNYM for management in the securities lending program through at least January 2012 and continuing through disposition of the Lehman notes. If this amount of assets were left within BNYM’s securities lending program through disposition, then BNYM would pay 15% of realized (or net) Lehman losses; if BNYM was not allowed to retain sufficient assets within the securities lending program, Lehman support was capped at the amount charged by BNYM as securities lending fees from January 2009 to the date of disposition.

April 6, 2009

The State Treasurer reiterates instruction to BNYM to retain securities lending earnings in reserve to offset investment losses.

June 2009

The RSIC engages Mariner to provide independent analysis of the ABSs.

July 28, 2009

Presentation made by BNYM to the State Treasurer and the RSIC.

BNYM contended that only 5 of the RSIC’s ABS holdings had real long-term problems.

BNYM’s advice was to continue to hold ABS and allow them to recover. The RSIC decided to remove the ABSs from BNYM’s control, since they did not trust BNYM’s management of this sort of asset.

The State Treasurer asks for report explaining BNYM’s claims that the ABS fit within the SLA maturity guidelines.

BNYM sends South Carolina another copy of its March 2009 Lehman support offer.

August 2009

BNYM discloses that it has overcharged the RSIC for securities lending – withholding 25% instead of 15% for agency fee.

RSIC's Bob Borden issues report analyzing model based on “free” custody services paid for by securities lending revenues, concluding that the RSIC has been overpaying for custody and other services provided by BNYM, which he valued at approximately \$1.2 million annually.

In response to the State Treasurer's inquiry, BNYM provides “term sheets” purportedly justifying its purchase of ABSs.

September 2009

Treasurer Chellis (with the approval of Attorney General McMaster) hires Willoughby & Hoefler, PA to review securities lending program and advise about strengthening the securities lending agreement.

October 2009

RSIC removes ABSs from BNYM's control and transfers them to Strategos Capital Management for workout services. BNYM requires the RSIC to deposit about \$75 million cash to cover difference between par (\$282 million) and market value (\$207 million) into the RSIC's accounts.

The Strategos transfer included all asset-backed securities, including non-MBS. Thus, one of the securities transferred to Strategos was Citibank Omni (CUSIP #17308BAC2) which is a permitted ABS, based on credit card receivables. The deposit into RSIC's account covered more than the ABS's allegedly not conforming to the investment guidelines.

November 2009

BNYM renews the Lehman support offer.

Spring 2010

Willoughby & Hoefler, PA presentation concerning potential BNY liability to RSIC; the board decided that it was the State Treasurer's contract and that therefore it was the State Treasurer's sole decision as to whether to proceed with litigation. If the State Treasurer decided to proceed, then the Investment Commission agreed that it would support the State Treasurer's decision with the time and effort of its staff in support of the litigation. RSIC did not want to be a party to the lawsuit.

June 2010

The RSIC required to pay about \$72 Million to settle the Lehman swap claims (loss on the RSIC's Lehman investment). Also lost on separate investment.

Willoughby & Hoefler, P.A. is retained by the State Treasurer with the approval of the Attorney General to represent the State in claims against the Bank of New York Mellon.

October 2010

Counsel and representatives of the State Treasurer's Office meet to discuss the State's claims in advance of litigation.

January 2011

Treasurer Loftis is sworn in as State Treasurer.

At the request of Willoughby & Hoefler, P.A., the firm of Montgomery Willard, LLC is added as co-counsel and the addition is approved by Attorney General Wilson and Treasurer Loftis. The contract used to employ counsel is the Attorney General's standard contingency fee agreement. The payment terms of the contract is not amended. There is no cost to the State.

January 26, 2011

After thorough review of this matter and based upon advice of counsel, Treasurer Loftis authorizes counsel to file the Summons & Complaint and proceed with the litigation against the Bank of New York Mellon.

February 2011 - May 2013

This dispute was referred to the Business Court where it was presided over by the Hon. Clifton Newman. The case was hotly contested and involved significant motions practice. BNYM filed two separate motions to dismiss, one in April 2011 and another in November 2011, both of which were denied by the Court. The Attorney General participated as counsel throughout the case and ultimately sought leave to join the case as a party plaintiff, which motion was granted by the Court. In addition, plaintiffs (the State Treasurer and the Attorney General) filed motions to compel and for summary judgment.

The case also involved extensive discovery proceedings. The State Treasurer produced over 400,000 documents on behalf both of his office and from the Investment Commission and the Retirement System, which were reviewed by South Carolina counsel prior to their production. BNYM produced in excess of three million pages of documents and well as tens of thousands of pages of documents from non-party witnesses, which were scrutinized by South Carolina's counsel. Dozens of depositions were taken in New York City, Pittsburgh, Pennsylvania, Princeton, New Jersey, San Francisco, California and in Columbia and Greenville, South Carolina.

A mediation was held in August 2012 but was unsuccessful. Thereafter, discovery continued in preparation for a trial then scheduled for July 2013. In late February 2013, near the close of discovery, BNYM produced an affidavit from Thomas Ravenel, in which the former Treasurer sworn that he was "well aware" of BNYM's investment in residential mortgage-backed ABS in the securities lending program and agreed with

BNYM's interpretation of maturity restrictions and that the Lehman collapse "was not foreseeable by anyone in the investment community."

In March 2013, the parties engaged in additional settlement discussions which ultimately led to a settlement of this litigation. The settlement agreement was signed by the parties, including the South Carolina Attorney General, and was approved by the Court.