South Carolina Retirement System Investment Commission
Meeting Minutes

November 19, 2015

Capitol Center
1201 Main Street, 15th Floor
Columbia, South Carolina 29201
Meeting Location: Presentation Center

Commissioners Present:
Mr. Edward Giobbe, Chairman
Dr. Rebecca Gunnlaugsson, Vice Chair
Ms. Peggy Boykin, PEBA Executive Director
Mr. Allen Gillespie
Dr. Ronald Wilder
Mr. Reynolds Williams
Mr. Curtis Loftis, State Treasurer

Others present for all or a portion of the meeting on October 22, 2015:
Mike Addy, Ashli Aslin, Geoff Berg, J.P. Boyd, Betsy Burn , Alexander Campbell, Andrew Chernick, Kim Cornell, Dori Ditty, Matt Dorchuck, John Farmer, Robert Feinstein, Mitchell Goldsmith, Joshua Greene, David Haas, Michael Hitchcock, Adam Jordan, James Manning, Steve Marino, Tricia Miller, Bryan Moore, Eric Nelson, Eric Rovelli, Brittany Storey, Nicole Waites, Brian Wheeler, James Wingo, Justin Young from the South Carolina Retirement System Investment Commission; Clarissa Adams and Bert Cassell from the State Treasurer's Office; Suzanne Bernard and Jenna Cullins from Aon Hewitt; Tammy Nichols and Faith Wright from PEBA; Wayne Bell, Wayne Pruitt, Sam Griswold from the State Retirees Association; Carlton Washington from the South Carolina State Employee Association; Gavin Jackson from the Charleston Post and Courier; Jay Collins, Karen Hermann, Jarad Nobles, and Steve Yountz from SC ETV; and Andrea Taylor from Creel Court Reporting.

I. CALL TO ORDER AND CONSENT AGENDA

Chairman Edward Giobbe called the meeting of the South Carolina Retirement System Investment Commission ("Commission" or "RSIC") to order at 9:14 a.m. Chairman Giobbe referred to the proposed meeting agenda and asked for a motion to adopt the agenda. Dr. Ronald Wilder made a motion to adopt the agenda as presented, and Mr. Reynolds Williams seconded the motion, which was unanimously approved.

II. CHAIRMAN'S REPORT

Chairman Giobbe said that the Commission would conduct the Executive Director's review during executive session. He also noted that old business from October would be considered during the meeting.

III. AUDIT COMMITTEE REPORT

Mr. Allen Gillespie provided the report on the activities of the Audit Committee which included receipt of a summary of the annual investment manager questionnaire and certification process, updates on policies including personal trading, insider trading, internal controls and fraud, and review of a draft of the enterprise risk management policy. Audit Committee also received an updated risk ownership grid, heard from ERM concerning enhanced SMA monthly compliance monitoring procedures, and received an update on the previous fiscal year's audit plan. The Committee also conducted reviews of its direct report.

IV. OUTSTANDING BUSINESS

The Chairman recognized Mr. Michael Hitchcock, Executive Director, and asked him to review outstanding items from the October 22, 2015 meeting. Mr. Hitchcock reviewed the proposal to change the title of the Executive Director to Chief Executive Officer. Mr. Williams moved that the Commission approve changing the title of the Executive Director to "Chief Executive Officer" and directed that the Staff update and revise the Commission's Governance Policies and other RSIC documents consistent with this action taken by the Commission. Dr. Wilder seconded, and the motion passed unanimously.

Mr. Hitchcock also reviewed the proposed changes to Governance Policies I and III that had been presented during the October 22, 2015 meeting, including the proposal that, upon a vacancy in the position of Chief Investment Officer, the Chief Executive Officer would propose a search plan to the Commission and, after conducting the search, present candidates for the approval of the Commission. Dr. Wilder moved that the Commission approve the amendments to Governance Policies I and III as presented and directed Staff to make any technical revisions or formatting edits to the Governance Policies and other RSIC policy documents consistent with the foregoing amendments. After discussion of the proposed changes, the language of the proposals were amended to strike the following language from each policy:

Proposed Policy I(E)(4): "Consult with the Executive Director prior to making employment decisions related to the Chief Investment Officer position and ensure that the Executive Director has opportunities to discuss employment concerns related to the Chief Investment Officer with the Commission upon his or her request."

Proposed Policy III(B)(9): "Prior to making any employment decision related to the Chief Investment Officer, the Commission will consult with the Executive Director."

Mr. Wilder's motion was restated as follows: the Commission approves the amendments to the Governance Policy I and II as presented and amended during discussion and incorporates the changes of the previous motion wherein the executive director title was changed to chief executive officer, and directs staff to make any technical revisions or formatting edits to the Governance Policies and other RSIC policy documents consistent with the foregoing amendments. Dr. Gunnlaugsson seconded, and the motion passed unanimously.

After presentation of the proposed CIO search plan, Dr. Gunnlaugsson moved to approve the Chief Investment Officer search proposal. Mr. Williams seconded and the motion passed unanimously.

Dr. Wilder moved to go into executive session to discuss the incentive compensation plan and any questions related to the implementation of the compensation plan that would impact individual employees pursuant to S.C. Code Section 30-4-70(a)(1). Dr. Gunnlaugsson seconded. The vote was unanimous.

Executive Session from 9:42 a.m. until 10:41 a.m.

Mr. Williams moved that the Commission approve the modified implementation of the Compensation Policy used to determine the proposed PIC awards for Fiscal Year 2014-15, as discussed in Executive Session*;* approves and deems Aon Hewitt's Fiscal Year 2014-15 Compliance Report and the supporting documentation acceptable; authorizes the aggregated PIC amount, and directs Staff to take all steps necessary to timely effectuate disbursement of the Performance Incentive Compensation payments. Dr. Wilder seconded and the motion passed 5-1 with Mr. Loftis opposed.

Mr. Williams moved that the Commission approve the amendments to the Compensation Policy as presented and directs Staff to make any technical revisions or formatting edits to the Compensation Policy and other RSIC policy documents consistent with the foregoing amendments. Dr. Gunnlaugsson seconded and the motion passed 5-1 with Mr. Loftis opposed.

V. EXECUTIVE DIRECTOR REPORT

Mr. Hitchcock reported on staff changes, his presentation to the State Fiscal Accountability Authority, and the recently held Foundations Forum hosted by RSIC.

VI. ACTING CIO REPORT

Mr. Geoff Berg introduced Mr. Joshua Greene, who presented a performance update for the quarter ending September 30, 2015. Mr. Greene noted that the plan's return for the quarter was -3.99 percent, net of fees, while the policy benchmark's return was -4.03 percent. Mr. Greene reviewed the performance of the various asset classes, and the portfolio allocation. Ms. Suzanne Bernard of Aon Hewitt Investment Consulting provided comments regarding recent market conditions and performance highlights.

Mr. Berg presented the Acting CIO's report. He began by providing an update regarding the "challenging beliefs" process. He summarized the eight topics which Staff had addressed to date, and explained how the exercise had yielded insights which both help and challenge Staff to improve how it manages the portfolio, whether by improving the efficiency of capital allocation, enhancing the expected return for the plan or spurring recommendations to change how we think about private markets. As to the first topic -- the plan's current five percent allocation to cash and short duration – Mr. Berg noted that the challenging beliefs exercise had yielded a recommendation to reduce the target allocation for net cash and short duration fixed income from five percent to two percent, and described certain enhancements to the liquidity framework which would be made in order to prudently accommodate this reduction. The Commissioners posed several questions, including the viability of holding zero cash and lessons learned during the 2008-09 global financial crisis. Mr. Loftis asked if the losses in the Russell overlay had been quantified. Mr. Berg noted that a more fulsome presentation on Russell and its part in the portfolio was warranted and would be forthcoming. Ms. Bernard noted that Aon Hewitt had run liquidity analyses regarding the portfolio, and stated that Aon Hewitt was comfortable with the proposed reduction to cash and short duration.

Mr. Berg summarized results of the second challenging convictions exercise -- should the plan's allocation to global public equity be increased – and stated that the exercise had resulted in recommendations to (a) increase the target allocation to global public equities by three percent at year end and (b) evaluate lower-volatility forms of equity investment. Mr. Gillespie stressed the importance of looking at even longer term data sets, especially those from historical panics and depressions. The Commissioners discussed various risks and benefits that could be associated with increasing the plan's equity exposure.

Mr. Berg reviewed the results of a third challenging convictions review which examined whether the plan's existing ten percent allocation to core fixed income should be changed, and noted that one of the topics addressed was using levered core fixed bonds as a way to outperform equities. Mr. Williams asked what amount of leverage was used to determine that levered bonds outperform equities nearly two-thirds of the time. Mr. Berg responded that the approach reviewed by Staff entailed using core bonds that were two times levered. In response to a comment by Mr. Gillespie regarding the importance of testing the levered bonds return assumptions by using data more similar to current conditions, Mr. Berg concurred and concluded that such analysis leaves little impetus for pursuing either leveraged structures or longer duration bonds at this time.

Mr. Berg reviewed the fourth challenge: should the plan continue to invest in hedge funds. After summarizing the arguments for and against hedge funds, Mr. Berg noted that Staff will work to differentiate hedge fund alpha from hedge fund "beta" and seek ways to improve portfolio efficiency by employing hedge funds as a part of a portable alpha framework, with a more detailed recommendation to be presented to the Commission at a subsequent meeting. The Chairman opined that hedge funds have a role in the portfolio and that the key to their success lay in manager selection. Ms. Bernard concurred as to the importance of manager selection.

Mr. Berg reviewed the fifth challenge: should the Commission hedge its foreign currency ("FX") exposure. After reviewing the arguments for and against hedging FX risk, Mr. Berg noted that Staff had not reached any definitive answers. He also noted that Staff would continue to assess the merits of "currency for alpha" approaches. A number of topics were addressed in the ensuing discussion, including the historically very unusual recent decline of a number of currencies against the US Dollar. Ms. Bernard added that foreign currency hedging was done by certain of the Commission's managers. Mr. Berg concluded by reiterating that Staff's review would continue.

Mr. Berg reviewed the sixth challenge: whether private equity offered a compelling return when compared to public equity. After summarizing the arguments pro and con, Mr. Berg recommended that the private equity allocation be implemented with a floating target, in lieu of the current fixed target. It was noted that this approach should provide the flexibility to allocate to high conviction opportunities, rather than selecting and sizing investments pursuant to an annual pacing plan. The Chairman expressed the opinion that this asset class, too, remains heavily dependent for success upon manager selection. Ms. Bernard stated that Aon Hewitt has a favorable view of private equity, but reminded the Commissioners of certain of the asset class' risk factors. Discussion ensued regarding a number of topics, including reporting, valuation, and the appropriate risk premium to apply to private equity.

Mr. Berg reviewed the seventh challenge: whether private debt offered a compelling opportunity when compared to liquid credit alternatives. Mr. Berg summarized the arguments for and against private debt. Among the arguments for private debt, it was noted that public market liquidity has diminished significantly due to regulatory changes implemented in the last several years in the U.S. and other countries. Mr. Berg recommended that, as with private equity, this allocation be implemented with a floating, rather than fixed, target weight. Mr. Berg also noted that Staff would monitor regulatory changes which might erode the illiquidity premium presently enjoyed by private debt. The Commissioners had an extensive discussion of this topic. The Chairman noted that a significant amount of private debt is floating rate and that can be an advantage in the current environment.

Mr. Berg reviewed the eighth challenge: whether the Commission should consider investing in public forms of real estate (REITs). After Mr. Berg summarized the arguments for and against, Mr. Eric Rovelli discussed REITs as a component of the existing real estate program. Mr. Berg concluded the challenging convictions discussion by reaffirming that REITs will be pursued within the real estate asset class in conjunction with private real estate.

The Chairman announced that the meeting would recess for a brief lunch break.

The Chairman recommenced the meeting and recognized Mr. Berg, who presented two new potential strategies for enhancing returns. The first strategy discussed was portable alpha. Mr. Berg provided background about the concept, noting that portable alpha is a term for an implementation strategy that involves separation of beta from alpha. Beta is typically gained passively, using derivative instruments, rather than owning securities. The alpha is frequently sought from low beta or market neutral hedge fund strategies. Mr. Berg also discussed implementation issues, stressing the importance of beta diversification so as to reduce the potential need for capital during periods of market distress. Ms. Bernard added that the key to success with these strategies is to be modest with regard to one's excess return expectations. The Chairman noted that over relatively long periods of time, approximately 85 percent of mutual funds underperform the S&P and asked why it would not make more sense just to invest in S&P index funds. Mr. Berg said that the goal here is to shift the use of hedge funds, giving them a very specific role within the portfolio. Ms. Bernard said that the odds of performance are lowered in a long-only environment but that in a long-short environment more consistent alpha is added. Mr. Gillespie said that one must be comfortable with the leverage required to pursue the strategy. The Chairman agreed that this possibility should be explored further.

Mr. Steve Marino reviewed a second potential strategy for enhancing returns: the use of option strategies. Mr. Marino explained that the purpose of option strategies would be to provide similar or better cumulative returns compared to traditional long-only equity exposure over long periods. Mr. Marino summarized other potential advantages offered by options strategies: (i) changing the distribution of outcomes; (ii) lowering volatility and lessening the severity of drawdowns, and (iii) monetizing volatility by providing insurance to a risk adverse market. The mechanics of option strategies was also discussed. The Chairman expressed the concern that covered call strategies can often give away significant upside. Mr. Berg noted that while an environment of high expected returns would not be optimal for this strategy, the current environment of low expected returns made this strategy more attractive.

Mr. Marino continued his review of the strategy. Mr. Gillespie asked if the strategy would work best on the most volatile classes such as emerging markets, and Mr. Marino responded that it would. Dr. Wilder asked if options markets are large enough that RSIC could participate in big chunks without having a price effect on the market. Mr. Marino responded affirmatively. Mr. Berg noted that this strategy would not have worked for the last five years, given the sustained, marked run up in the U.S. equity market. Mr. Marino concluded by summarizing the business case for use of this strategy, noting that a meaningful increase in equity exposure was prudent in order to attain the 7.5 percent target, and that this strategy offered a way of adding equity exposure with lower volatility and less severe drawdowns. Mr. Williams expressed support for implementing this strategy. Mr. Gillespie agreed with the potential benefits. It was noted that Staff will proceed with evaluation of different implementation strategies.

Mr. Berg discussed the long-term performance of asset classes in the context of a 100-year portfolio. He then presented five portfolios for discussion, consisting of the current RSIC portfolio, a median peer fund portfolio, and three alternatives (Portfolios A, B and C). Mr. Berg reviewed each of the portfolios and their long-term risk and return expectations as calculated by Aon Hewitt. Mr. Berg asked if the Commissioners found value in this exercise and if anyone had different concepts they would like modeled and considered. The Chairman discussed Portfolio C and Mr. Berg characterized it as the one most closely tracking the peer portfolio. The Chairman said that this was not a reason to favor it, but that it was useful as a consideration or guidepost. Ms. Bernard provided a high-level comparison of the current portfolio to several of the alternatives. The Chairman asked which one would give the best shot at improving absolute returns, while offering the possibility of improvement in peer rankings. Ms. Bernard said that while it is impossible to predict the markets' future performance, Portfolio A likely is the best option. Dr. Gunnlaugsson asked about the pace of implementation, and Mr. Berg said that some elements could be implemented rapidly, but much of the implementation effort would require a longer term phase-in.

After additional discussion, Mr. Berg asked the Commissioners whether staff should continue to refine the work presented regarding asset allocation, or whether the Commissioners felt that there are other things they would like to see reflected in a potential asset allocation. Questions were posed about the possibility of implementing an asset-liability matching strategy, as has been done by a number of corporate plans. Ms. Bernard provided an overview of the significantly different legal/regulatory framework applicable to corporate plans, noting that corporate plans' liabilities are based on market rates, with the result that their liabilities shift rapidly in response to market moves. Dr. Wilder said that considering these alternative portfolios is a big step forward for the Commission in his two years of service. The Chairman echoed Dr. Wilder's sentiments, and stated that this discussion needed to move forward.

The Chairman asked about the possible effect in the future in the event of a lowered assumed rate of return and how many peers had lowered their rates. Ms. Bernard noted that some public pension plans had recently lowered their actuarially assumed rates of return, and others were contemplating it.

After the lengthy discussion, Dr. Gunnlaugsson asked Mr. Berg about any immediate action items as a result of this discussion. Mr. Berg noted that the Commission was being asked to consider taking three proposed actions at this time: (i) reducing the target weight for cash and short duration from five percent to two percent; (ii) making a corresponding three percent increase to global public equities, and (iii) eliminating the static target weights to private equity and private debt, and allowing these allocations to be implemented with a floating target. Dr. Wilder moved that the Commission adopt the recommendations of the Acting CIO and staff to amend the Statement of Investment Objectives and Policies ("SIOP"), Section III(C) Investment Policies/Asset Allocation as presented in the attached chart, which will go into effect the second half of the fiscal year, and authorize RSIC staff to make any technical revisions or formatting edits consistent with the action taken by the Commission. Mr. Williams seconded the motion, which was approved by a vote of 5-0, with Mr. Loftis absent.

VII. **EXECUTIVE SESSION**

Dr. Wilder moved that to go into Executive Session to discuss investment matters pursuant to S.C. Code Sections 9-16-80 and 9-16-320; personnel matters pursuant to S.C. Code Section 30-4-70(a)(1), and receive advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2). Dr. Gunnlaugsson seconded and it passed 5-0 with Mr. Loftis absent. The Commission reconvened in open session. Mr. Giobbe reported that no action had been taken in executive session.

VIII. ADJOURNMENT

There being no further business, Dr. Gunnlaugsson moved to adjourn. Mr. Gillespie seconded and the motion passed 5-0 with Mr. Loftis absent. The meeting adjourned at 2:47 p.m.

[Staff Note: In compliance with S.C. Code Ann. § 30-4-80, public notice of and the agenda for this meeting were delivered to the press and to parties who requested notice and were posted at the entrance, in the lobbies, and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, SC, at 5:04 p.m. on Monday, November 16, 2015.]

	Policy Allocation	Minimum	Maximum
Global Equity:	**43%**	**30%**	**48%**
Global Public Equities	34%[1,2]	25%	40%
Private Equity	9%[2]	6%	12%
Real Assets:	**8%**	**4%**	**15%**
Commodities	3%*	0%	5%
Real Estate	5%	3%	10%
Infrastructure	0%	0%	5%
Other Real Assets	0%	0%	5%
Opportunistic:	**20%**	**15%**	**25%**
GTAA/Risk Parity	10%*	5%	20%
Hedge Funds (low beta)	10%*	5%	20%
Diversified Credit:	**17%**	**10%**	**25%**
Mixed Credit (HY, Loans, Structured)	5%[1,2]	2%	10%
Emerging Markets Debt	5%*	2%	10%
Private Debt	7%[1,2]	3%	10%
Other Credit	0%	0%	5%
Conservative Fixed Income:	**15%**	**10%**	**25%**
Core Fixed Income	10%	5%	20%
Global Fixed Income	0%	0%	10%
Cash & Short-Duration (net of overlays)	2%	0%	10%

[1]Hedge funds within these asset classes will be included in the 20% maximum for hedge funds at the Portfolio level.

[2]The target weights to Private Equity and Private Debt will be equal to their actual weights, reported by the custodial bank, as of the prior month end. In the case of Private Equity, the use of the actual weight will affect the target allocation to Public Equity, such that the combined target weight of both asset classes shall equal 43% of the Plan. For Private Debt, the use of the actual weight will affect the target allocation to Mixed Credit, such that the combined target weight of both asset classes shall equal 12% of the Plan.

Pursuant to S.C. Code Ann. §9-16-340(B), this policy must also include the minimum and maximum allocations to equity investments on an ongoing basis, not to exceed 70 percent. The statute does not stipulate whether the limitation of 70 percent is based on cost or market value, and the Commission manages this limitation on a market value basis. Therefore, in the event that the allocation to equity investments exceeds 70 percent of the total market value of the Portfolio, the CIO is required to rebalance the Portfolio.

D. LONG-TERM EXPECTED RETURN AND RISK ASSUMPTIONS