South Carolina Retirement System Investment Commission
Meeting Minutes

April 12, 2018 9:30 a.m.
Capitol Center
1201 Main Street, 15th Floor
Columbia, South Carolina 29201
Meeting Location: Presentation Center

Commissioners Present:
Dr. Rebecca Gunnlaugsson, Chair
Dr. Ronald Wilder, Vice Chair
Ms. Peggy Boykin, PEBA Executive Director
Mr. Allen Gillespie
Mr. Edward Giobbe
Mr. Reynolds Williams (via telephone)
Mr. William H. Hancock
Mr. William J. Condon

I. CALL TO ORDER AND CONSENT AGENDA

Chair Rebecca Gunnlaugsson called the meeting of the South Carolina Retirement System Investment Commission ("Commission") to order at 9:30 a.m. Mr. Allen Gillespie made a motion to approve the proposed agenda as presented. Dr. Ronald Wilder seconded the motion, which was approved unanimously.

The Chair referred to the draft minutes from the Commission's February 8, 2018 meeting and noted that the draft minutes had been revised after being posted for review by the Commissioners. The Chair then asked whether there was a motion to approve the revised minutes as presented. Mr. Bill Condon made a motion to approve the revised minutes as presented. Mr. Gillespie seconded the motion, which passed unanimously.

II. CHAIR'S REPORT

The Chair began by stating that Dr. Wilder's term as the Commission's Retiree Representative Member ("Retiree Representative") would be coming to a close at the end of the current fiscal year. She explained that, under current law, Dr. Wilder is eligible to serve an additional four-year term. She then asked Mr. Michael Hitchcock, Chief Executive Officer, to review the Commission's Governance Policies regarding the process for nominating the Retiree Representative. Mr. Hitchcock explained that the Governance Policies require that the Commission solicit input from South Carolina's retiree stakeholder groups: the State Retirees Association of South Carolina and the South Carolina State Employees Association ("Retiree Groups"). He stated that Staff had prepared a letter to the Retiree Groups to solicit nomination suggestions for the position of Retiree Representative. Mr. Hitchcock stated that the

Commission could nominate Dr. Wilder during the meeting, and Staff would inform the Commission if the Retiree Groups made additional nominations. The Chair asked Dr. Wilder if he was willing to serve another term, and he responded in the affirmative. The Chair then asked for a motion to nominate Dr. Wilder to serve another term. Mr. Reynolds Williams made a motion to nominate Dr. Ronald Wilder to serve as the Retiree Representative to the Commission from July 1, 2018 to June 30, 2022 or until a successor is appointed and qualified, pursuant to state law. Mr. Gillespie seconded the motion.

Next, the Chair turned to the topic of nominations for the positions of Chair and Vice Chair of the Commission. She explained that the current Chair and Vice Chairs' two-year terms will come to a close at the end of the current fiscal year, and the Commission will need to hold elections for both positions. The Chair then made a motion to nominate Dr. Ronald Wilder to serve as Chair of the Commission for the term commencing on July 1, 2018 and ending on June 30, 2020. Mr. Gillespie seconded the motion. Mr. Williams asked if it would be permissible under the Governance Policies to close the nomination process. Mr. Hitchcock responded that the Governance Policies require that the nominations be kept open until the Commission's next meeting in June of 2018. The Chair then asked for nominations for the position of Vice Chair. Dr. Wilder made a motion to nominate Dr. Rebecca Gunnlaugsson, the current Chair, to serve as Vice Chair of the Commission for the term commencing on July 1, 2018 and ending on June 30, 2020. Mr. Condon seconded the nomination. Ms. Gunnlaugsson expressed her appreciation for the nomination and stated that it would be an honor to serve as Vice Chair.

III. AUDIT & ENTERPRISE RISK MANAGEMENT COMMITTEE REPORT

Mr. Gillespie began by stating the Committee last met in March. The Committee reviewed the Committee Charter and have a recommendation for proposed updates. He stated that the updates are primarily technical in nature and reflect more of an outsourced model as it relates to some of the audit functions. Mr. Gillespie made a motion that the Commission adopt the recommendation of the Committee to amend the Audit and Enterprise Risk Management Committee Charter as presented and authorize staff to make the technical revisions to the charter and other RSIC policy documents to reflect this decision. Mr. Hitchcock explained that this motion did not require a second because it is an active motion from the committee. The motion passed unanimously.

Mr. Gillespie explained that the next topic covered during the Committee meeting was the fiduciary performance audit, which is required by State law to be completed every four years. He explained that the Office of State Auditor selected Funston Advisory Services LLC ("Funston") through a request for proposal ("RFP") process to perform the audit which will begin in May 2018. Mr. Hitchcock noted that Funston will conducting onsite interviews after the Commission meeting in June and that Funston will be contacting Commissioners individually.

Lastly, Mr. Gillespie provided an update on the GIPS certification vendor selection. He stated that the Committee issued a RFP for GIPS compliance verification and explained that the procurement process is ongoing.

IV. HUMAN RESOURCES & COMPENSATION COMMITTEE REPORT

The Chair recognized Dr. Wilder, Chair of the Human Resources and Compensation Committee ("HRC Committee"), who presented the Commission with the HRC Committee's Report. Dr. Wilder began by informing the Commission that the HRC Committee is recommending changes to the HRC Committee's Charter ("Charter") that would roll the HRC Committee's self-evaluation into the broader Commission evaluation process and provide for the HRC Committee to make recommendations regarding the CEO's salary. Dr. Wilder then turned to a discussion of the Commission's Compensation Policy. He explained that the HRC Committee is recommending changes to the Compensation Policy to reflect governance changes made by the Pension Reform Act of 2017 as well as cost of living adjustments to salary ranges received from the Commission's compensation consultant, Towers Watson & Co. ("Towers Watson"). Dr. Wilder added that the HRC Committee also received an overview of the new CEO and Staff Evaluation Processes. At that point, Dr. Wilder turned the discussion to the Commission's compensation consultant. He explained that RSIC's contract with Towers Watson would be expiring soon and that the Governance Policies require that a compensation study be conducted once every three years. He stated that, as a consequence, a compensation study would need to be completed in 2018, but the HRC Committee is recommending that the Commission delay the compensation study until 2019.

Upon concluding his remarks, Dr. Wilder asked that Mr. Hitchcock address the motions recommended by the HRC Committee. Mr. Hitchcock first reminded the Commissioners that, because the motion comes as a recommendation from the HRC Committee, no second to the motion is required. He then stated that the motion recommended by the HRC Committee is that the Commission: (1) Approves the recommendations of the Human Resources and Compensation Committee that the Commission amend the Charter of the Human Resources and Compensation Committee ("Charter"); (2) Adopts the proposed revisions to the Charter as presented; and (3) Authorizes Staff to make technical revisions to the Charter and other RSIC policy documents to reflect this Commission decision.

Mr. Gillespie then referred to the Compensation Policy and asked about the mechanics of determining employee merit increases. Ms. Peggy Boykin added that, under the Compensation Policy, if the South Carolina General Assembly approves state employee pay increases, Staff could receive a State-mandated increase in addition to an increase under the Compensation Policy. Mr. Hitchcock explained that employee merit increases are determined based on an order of merit list that is created by the Executive Leadership Team ("Leadership Team"). The Leadership Team reviews all employee performance scores to ensure standardization of Staff's performance scores, and those scores are then compared to the overall merit increase pool to determine individual performance increases. Mr. Hitchcock then overviewed the methodology for the pay bands in the Compensation Policy. At the end of the discussion, the Chair called the question, and the motion was unanimously approved.

Next, Mr. Hitchcock presented the second motion from the HRC Commission, which was that the Commission: (1) Approves the recommendation of the Human Resources and Compensation Committee that the Commission amend the Compensation Policy; (2) Adopts the proposed revisions to the Compensation Policy as presented; and (2) Authorizes Staff to make technical revisions to the Compensation Policy and other RSIC policy documents to reflect this Commission decision. A vote was taken, and the motion was unanimously approved.

V. CEO'S REPORT

The Chair recognized Mr. Hitchcock for the CEO's Report. Mr. Hitchcock introduced Mr. Kevin Reinhard, Reporting Analyst, who joined RSIC from the South Carolina Attorney General's Office. Mr. Reinhard previously worked with a financial advisory firm. He brings with him a unique combination of investment knowledge and forensic accounting skills. Mr. Reinhard is originally from Florence, South Carolina and currently resides in Lexington, South Carolina. Mr. Hitchcock then welcomed Mr. Reinhard.

VI. INVESTMENT PERFORMANCE REPORT

The Chair recognized Mr. Geoffrey Berg, Chief Investment Officer ("CIO"), who stated that through the end of February, the Plan's fiscal year to date ("FYTD") return was slightly over 8 percent, which put the Plan slightly ahead of the median pension fund for the FYTD period. Mr. Berg noted that February and March had been challenging months, and indicated that the estimated FYTD return at the end of March was approximately 7.5 percent. Mr. Berg then introduced Mr. David King, Reporting Officer, to present the Investment Performance report.

Mr. King began his presentation by reviewing February FYTD performance. He stated that for the month of February, the Plan was down 2.17 percent versus a policy benchmark of 2.14 percent, which brought the Plan's FYTD performance to just above 8 percent versus a policy benchmark of 6.81 percent. Mr. King noted that the Plan was in compliance with all asset allocation ranges, with a slight overweight in GTAA and an underweight in non-portable alpha. Mr. King indicated that FYTD, the Plan had paid out $825 million in net benefits, with investment performance adding $2.4 billion to the Plan, bringing the Plan to a February month-end value of $31.7 billion.

After Mr. King reviewed the asset class contributions to performance and concluded his report, a lengthy discussion took place regarding investment performance, including the performance information from Bank of New York Mellon that is provided to the Commissioners.

VII. CONSULTANT REPORT

Mr. Berg introduced Mr. Frank Benham, Managing Principal and Director of Research for Meketa Investment Group ("Meketa") to provide a presentation on asset allocation and to provide follow up discussion on items from previous meetings. The first topic he discussed was target ranges for asset allocation. Mr. Benham explained that the first thing that should be done when adopting a new asset allocation policy, is the adoption of ranges around those targets. He explained that ranges allow you to stay in compliance with the investment policy as the market fluctuates. The more volatile asset classes will have more fluctuation, therefore those classes should have wider ranges. Mr. Benham stated that the second thing ranges do is provide the Staff the flexibility to be tactical.

Mr. Condon asked about the range for cash and short-term bonds and whether RSIC should have a cash target at zero. Mr. Benham explained that a good number of pension plans maintain a target of zero cash because they use their cash for frictional purposes. Mr. Benham explained that the plans must be able to pay benefits and make capital calls for private market asset classes, but because cash is the lowest returning asset class, plans try to minimize the cash allocation and the drag on returns.

Chair Gunnlaugsson asked whether there are any significant differences between Meketa's new proposed ranges and the previous ranges. Mr. Berg stated that the recommendation has a slightly wider band around global equity which is favorable because the narrower band had become a little burdensome. He explained that this is why he would like the Commission to make the adopted target ranges become effective immediately. He stated that RSIC is going to begin the process of transitioning to a slightly higher equity allocation in order to take advantage of the current environment.

Mr. Gillespie asked whether the ranges are closely tied to the volatility assumptions. He also stated that he believes the lower ranges need to come up a little and be tied with the volatility. A brief discussion ensued about the ranges and volatility. Dr. Wilder inquired about rebalancing the Portfolio on a monthly basis. Mr. Berg stated that Staff starts looking at rebalancing about one week before the end of the month, this way if there is a need to rebalance in the foreign market there still is time before the end of the month to implement changes. Mr. Berg explained that the range is of heightened importance for private equity, private debt and private real estate.

Mr. Benham explained that for some asset classes, specifically illiquid asset classes such as private equity and hedge funds, the benchmarks that are being used are benchmarks relevant to long term performance. Next Mr. Benham walked through the each of the proposed changes to the primary policy benchmarks beginning with global equity. Mr. Benham stated that Meketa recommends adopting a policy benchmark that is weighted according to target weights in US, Europe/Japan and emerging markets. The three benchmarks are MSCI USA, the MSCI World, and MSCI emerging markets. He stated that those benchmarks, when added together, are slightly different than the composition within the standard ACWI index. It is now weighted according to the Plan policy benchmark.

Mr. Benham reviewed the second proposed change, related to the equity option strategies. Currently RSIC is using a publicly available BuyWrite Index, which is an index that tracks the ability to write call options. The current implementation of the equity option strategies allows for two managers to do not just Buy-Writing but also Put-Writing. He recommended a mix of Put-Writing and Buy-Writing Index as more appropriate for RSIC.

The third and fourth recommendations Mr. Benham stated are changes to the global asset allocation and other opportunistic strategies. He explained that the rest of the assets that are not invested in the global assets mandates could theoretically be invested in the rest of the portfolio, and more specifically in the liquid portions of the Portfolio. Thus, Mr. Benham stated the recommendation is to use the total system's benchmark, minus the illiquid parts, to represent the true opportunity for where the global assets could otherwise be invested.

The next topic Mr. Benham discussed was real estate, and he recommended a technical change by changing the benchmark to one that is net of fees. Net fees are going to be a lower hurdle therefore Meketa recommend reviewing the expected "spread" over the benchmark. The non-core mix is 60 percent core and 40 percent non-core. Meketa expects the non-core to earn about 200-300 basis points over the core. A lengthy discussion ensued regarding the real estate market.

Dr. Wilder inquired about the global equity benchmark and targets for the Developed Market Equity (non-U.S.) and the Emerging Market Equity components of the global public equity benchmark. A discussion took place regarding the benchmarking process. During the discussion, Chair Gunnlaugsson suggested that it would be helpful to retain and use the current benchmark for global public equity as a secondary benchmark to the new benchmark. She stated that the secondary benchmark would provide a picture of value added from the benchmark changes to global public equity. Mr. Berg agreed that providing this secondary benchmark might offer valuable insight.

Dr. Wilder made a motion that the Commission adopts the recommendation of Meketa and the CIO, as amended, to approve the benchmarks and ranges set forth on red numbered pages 71-72 of the open session agenda materials as presented with the ranges to be effective as of April 12, 2018, to insert the current benchmark for global public equity as the secondary benchmark for global public equity, and the benchmarks to be effective July 1, 2018; directs that the approved benchmarks and ranges be incorporated and made part of the SIOP; and authorizes Staff to finalize the benchmark and asset allocation ranges by making any technical revisions or formatting edits consistent with the action taken by the Commission. Ms. Betsy Burn, Chief Legal Officer, clarified that the motion should reference red numbered pages 70-72. Mr. Edward Giobbe seconded the motion, which was unanimously approved.

A break was taken from 10:48 a.m. to 10:58 p.m.

Upon returning from break, Mr. Peter Woolley, Managing Principal and Co-Chief Executive Officer for Meketa, began his presentation by reviewing what was discussed at the February 8, 2018 meeting regarding sequence of return analysis and how RSIC can achieve a 7.25 percent average return over 20 years. Mr. Woolley pointed out that sequence of returns do not matter at all to the end result if cash flow is neutral, however because there is negative cash flows for the Plan, sequence of returns matters a great deal. He stated that additional analysis being presented demonstrates the impact of the fund becoming fully funded and the continuation of the funding status. A discussion ensued regarding projected levels of funded status based on different scenarios of expected returns, strong early versus strong late, and impact on funding percentage. Chair Gunnlaugsson noted that she would like the Commission to be provided with updates on the funded status and would like Staff to work with Meketa on developing insight regarding what other plans might be doing in terms of how are they reporting. Mr. Berg and Mr. Woolley both agreed to work on the reporting per Chair Gunnlaugsson's request.

Mr. Woolley's final topic of discussion was of the estimated impact of the Tax Cuts and Jobs Act ("TCJA") on the Retirement Systems. He stated that he believes that changes in the tax policy do not warrant a significant change to long-term strategic asset allocation. But there are three categories he wanted to go over, the first being positive impact. Global growth being the biggest positive impact. He stated economists are predicting a positive impact on the GDP over the next few years, possibly a half percent per year.

He explained the next category would be impacts of the TCJA that are neutral. The impact on domestic equities and international equities are neutral because it is already priced into the market today. The last category would be the negative impacts, specifically the effect on the U.S. dollar, fixed income, and debt level. After a discussion including the positive impacts on TIPS, Mr. Wooley concluded his presentation.

VIII. CIO'S REPORT

Mr. Berg began his report by discussing the increased volatility in the markets, particularly in the U.S. equity market. Mr. Berg reviewed the key challenges for markets: the Federal Reserve is motivated to raise interest rates, given continued strong U.S. economic growth; higher interest rates reduce the appeal of risk assets; most risky assets are perceived as expensive; the flattening of the yield curve, and a return to historically higher, more "normal" equity volatility may reduce the attractiveness of risk assets.

Mr. Berg went over the Portfolio's risk versus the 70 percent equity/30 percent fixed income risk benchmark which had recently been implemented by RSIC's Risk Team. He noted that while certain factors suggest elevated risk for investors, growth remains strong globally. Mr. Berg concluded by stating that the Investment Team does not expect a return to the lowvolatility environment of recent years, and noting that rising volatility may create attractive opportunities.

The next order of business was the discussion and adoption of the Annual Investment Plan ("AIP") for Fiscal Year 2018. Mr. Berg noted that on March 17th, a draft of the AIP had been distributed and thanked all of the Commissioners for their helpful feedback. Mr. Berg stated that 34 different initiatives are being included in the AIP. He noted that many of the Investment Team's initiatives are ongoing in nature, and indicated that six of the initiatives reflect goals of both the Operations team as well as the Legal team. Mr. Condon asked if the initiatives are required to be part of the AIP, and suggested that the Commission should discuss how it monitors the progress of implementing the initiatives included in the AIP. Mr. Hitchcock responded by recommending that the Commission discuss this topic during the Commission's June meeting.

Mr. Gillespie asked about the rebalancing language in the AIP. After some discussion, Mr. Berg recommended that the Staff make a technical amendment to the draft AIP to address inter-asset class rebalancing. After additional discussion regarding the AIP, Dr. Ron Wilder moved that the Commission adopt the recommendation of the CIO and Staff to approve the proposed Annual Investment Plan for Fiscal Year 2018, as set forth in the red-numbered document beginning on page 93, with an effective date of July 1, 2018, and authorize Staff to finalize the AIP by making any technical revisions or formatting edits consistent with the action taken by the Commission. Mr. Gillespie seconded the motion, which passed unanimously.

IX. DELEGATED INVESTMENT REPORT

Mr. Berg noted that the next Agenda item was the report on an investment made pursuant to the delegation policy (the "Policy"). He reminded the Commission that the Policy authorizes the Chief Investment Officer to approve investments within certain limitations. The Policy also requires that Staff provide an update to the Commission about delegated investments once they are closed at the next Commission meeting. Mr. Berg introduced Mr. Derek Connor, Senior Investment Officer, to provide a summary regarding Digital Colony Partners, a private equity investment in digital infrastructure.

Mr. Connor stated that an investment of $125 million with Digital Colony Partners closed on March 22, 2018. He explained that Digital Colony is a joint venture between two different firms, Digital Bridge, an experienced owner and manager of digital infrastructure, and Colony NorthStar, a large real estate manager with approximately $46 billion in assets under management. Mr. Connor noted that Digital Bridge will be primarily responsible for the investment management function, while Colony NorthStar will provide back-office functions, including compliance, and assistance with fundraising.

Mr. Connor explained that Digital Colony Partners will invest in macro cell towers, small cells, data centers and fiber. He described how this investment fits into the private equity portfolio although it is focused on infrastructure-type investments, and indicated that co-investment opportunities may arise. After answering questions from the Commissioners regarding the investment, Mr. Connor concluded his report.

X. EXECUTIVE SESSION

Mr. William Hancock made a motion that the Commission recede into Executive Session to discuss investment matters pursuant to S.C. Code Sections 9-16-80 and 9-16-320; to receive advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2) related to litigation filed by American Timberlands Fund II, LP and to receive advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2). Mr. Williams seconded the motion, which passed unanimously.

XI. POTENTIAL ACTION RESULTING FROM EXECUTIVE SESSION

Upon return to open session at 2:19 p.m., Mr. Hitchcock noted that the Commission did take action while in executive session. Any such action that did occur while in executive session will be publicized when doing so would not jeopardize the Commission's ability to achieve its investment objectives or implement a portion of the annual investment plan.

XII. ADJOURNMENT

There being no further business, upon a motion made by Mr. Gillespie and seconded by Mr. Giobbe, the Commission voted unanimously to adjourn. The meeting adjourned at 2:20 p.m.

[Staff Note: In compliance with S.C. Code Section 30-4-0, public notice of and the agenda for this meeting was 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, S.C., at 3:58 p.m. on April 10, 2018]