South Carolina Retirement System Investment Commission
Meeting Minutes

February 21, 2019 9:30 a.m.
Capitol Center
1201 Main Street, 15th Floor
Columbia, South Carolina 29201
Meeting Location: Presentation Center

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

I. CALL TO ORDER AND CONSENT AGENDA

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

Mr. Giobbe made a motion to approve the draft minutes from the Commission's meeting held on November 8, 2018. Dr. Rebecca Gunnlaugsson seconded the motion. The minutes were unanimously approved.

II. CHAIR'S REPORT

Chair Wilder explained that the Commission decided that it was not the best time to hold the extensive strategic discussion. Although the discussion would begin at today's meeting during the asset allocation presentation, it will be continued at the next meeting in April. This concluded the Chair's Report.

III. HUMAN RESOURCES & COMPENSATION COMMITTEE REPORT

Dr. Gunnlaugsson began by stating that the Human Resources & Compensation Committee ("Committee") met on February 13, 2019. She reported that, during the meeting, she was elected as Chair of the Committee. The Committee then received an update about new hires and promotions amongst Staff. Staff also provided the Committee an update about the Request for Proposal ("RFP") for a Learning Management Software

System, which will assist with Staff's ongoing educational needs. She reported that the RFP should soon be complete.

Next, Dr. Gunnlaugsson explained that they also discussed the Committee Charter's requirement that RSIC conduct a compensation study every three years. Staff informed the Committee that, because RSIC's existing Compensation Policy ("Compensation Policy") has only been in place for three years, Staff is not planning on conducting a new compensation study at the current time. Instead, Staff plans to retain a vendor to provide compensation data to serve as a check on the Compensation Policy.

Dr. Gunnlaugsson also noted that the Committee received an update on RSIC's Succession Planning, which has progressed significantly and is expected to be finalized shortly. The Committee also received an update concerning CEM Benchmarking's analysis of RSIC's full-time employee headcount versus RSIC's peers. She explained that the Report showed that RSIC is generally in line with its peers. The last topic the Committee covered was a discussion of the CEO's compensation. There being no questions from the Commissioners, Dr. Gunnlaugsson concluded her report.

IV. CEO'S REPORT

Mr. Michael Hitchcock, Chief Executive Officer, began his report by providing an update on the House Ways and Means Committee's work on the budget. Mr. Hitchcock was pleased to report that they had accepted our request to lower our authorization by $500,000.00. He told the Commission that he will keep them informed as that moves through the process. He then responded to some questions regarding the $500,000.00 reduction in budgetary authorization.

Mr. Hitchcock then introduced Ms. Michelle Kennedy, the new Director of Enterprise Risk Management and Compliance. He explained that Ms. Kennedy has over 25 years' experience doing compliance work both in-house and as a consultant for registered investment advisors (RIA), and over the past ten years she has been President of Compass Compliance Services, which provides consulting to RIAs nationwide. Next Mr. Hitchcock introduced Ms. Mary-Myers Walker, the new Administrative Assistant to the Chief Investment Officer, Mr. Geoff Berg. Ms. Walker worked as a case administrator for the U.S. District Courts where she managed the progression of cases, reviewing documentation to ensure efficiency and accuracy of the Court's electronic case filing system.

Mr. Hitchcock reminded the Commissioners of the March 30, 2019 statutory deadline to file their individual Statement of Economic Interest.

V. CIO'S REPORT

The Chair recognized Mr. Berg who began his report by reviewing the performance of the Plan in 2018. In calendar 2018, cash was the highest performing asset class (on a benchmark basis) due to deterioration in the global economic picture. He explained that in late December 2018 RSIC added three percent to global equities, or $900 million of additional equity exposure. This overweight to equity was funded by underweights to emerging market debt, mixed credit, and government bonds (both Treasuries and TIPS). The early returns from this decision were very positive.

Next Mr. Berg introduced Mr. David King, Senior Reporting Officer, to present the fiscal year to date numbers as of December 31, 2018. He stated that the year ended with very rough conditions, returning the Plan -4.47% for the fiscal year to date versus the Policy benchmark of -3.49%. During this time, he explained that $649 million was paid out in net benefits. Mr. King noted that the Plan started at $31.3 billion and ended with $29.3 billion with $649 million in net benefits payments and a $1.4 billion reduction to assets due to performance leaving the Plan.

Looking deeper into the net benefit payments, $2.0 billion was paid to beneficiaries versus $1.7 billion of deposits into the system. In addition, the continuing unwinding of the TERI program during this period resulting in $376 million of additional payments out of the Trust, although this was partially offset by a $105 million legislative inflow. The Chair asked if December 31, 2018 was the end of the TERI program. Mr. King responded by stating there is a small residual amount left to be paid out in TERI payments, but it is not very material. Mr. Berg noted that the amount is less than $5.0 million. A short discussion of the TERI program ensued.

Next, Mr. King discussed the Portfolio exposure, noting that the year ended with a slight overweight to public equities due to the trades Mr. Berg previously discussed. These were offset by an underweight to core fixed income, specifically treasuries.

Mr. King then shared the asset class performance details as of December 2018. Private equity and private real estate had the highest net performance for the fiscal year-to-date period. He noted that the Plan was underperforming the Policy benchmark by 98 basis points. He explained that other opportunistic was outperforming its benchmark by 8.05% followed by infrastructure, public credit and equity options. He also noted that – despite being the second-best performing asset class in the portfolio – private equity was underperforming its benchmark by 6.45%. He explained that this is due to the unique methodology associated with the benchmark.

Mr. King concluded by noting that the markets recovered sharply in January and as of February 15, 2019, the Plan NAV has recovered by more than a billion dollars and the estimated Plan performance at that time was once again in positive territory.

VI. EXECUTIVE SESSION

Mr. Allen Gillespie made a motion to recede into Executive Session to discuss investment matters pursuant to S.C. Code Sections 9-16-80 and 9-16-320; to discuss personnel matters related to the Commission's review of the CEO's compensation pursuant to S. C. Code Section 30-4-70(a)(1); and to receive advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2). Mr. Giobbe seconded the motion, which passed unanimously.

VII. POTENTIAL ACTION RESULTING FROM EXECUTIVE SESSION

Upon return to open session, Mr. Hitchcock noted that the Commission did not take reportable action while in executive session. He noted that any action that did occur while in Executive Session, pursuant to S.C Code Ann. §§ 9-16-80 and 9-16-320, would 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.

The Chair then noted that based on the outcome of the Commission's discussion in Executive Session, and its review of Mr. Hitchcock's performance review conducted in the November 2018 Executive Session, the Commission adopted the recommendation from the Human Resource and Compensation Committee to authorize the compensation increase for Mr. Hitchcock as discussed in Executive Session and directed the Human Resources department and other necessary parties to take all action necessary to implement this decision as approved by the Commission and directed that the salary increase be disclosed to the public in the official minutes of the February 21, 2019 minutes after the increase had been communicated to Mr. Hitchcock. Mr. Hitchcock's new salary, effective as of February 21, 2019, is $301,362.00.

VIII. DELEGATED INVESTMENT REPORT

The Chair then recognized Mr. Berg for the delegated investment report. Mr. Berg noted that Staff had closed three new investments since the last Commission meeting. Mr. Berg reminded the Commission that all of the due diligence and contract materials, as well as video presentations provided by Staff, had previously been provided to the Commissioners via a secure portal. The investments closed and the amounts committed to each are as follows: Brookfield Super Core Fund, LP ($200 million); Owl Rock Technology Fund ($100 million); and Blackstone Real Estate Fund IX ($100 million).

IX. CONSULTANT REPORT

Geoff Berg introduced Mr. Aaron Lally, Executive Vice President of Meketa Investment Group, to provide a recommendation for a benchmark clarification for the policy benchmark. Mr. Lally explained that the recommendation was not to make any changes to individual asset class benchmarks, but rather, how those individual asset class benchmarks are rolled up into the policy benchmark calculation. He explained that since the portable alpha assets serve as collateral for the overlay, a simple summation of each piece and its weight multiplied by the respective benchmark does not provide the appropriate calculation because it causes a double inclusion of the cash or T-bill component. The recommendation is to adjust the calculation for the policy benchmark to net out the double inclusion of the T-bill rate. Mr. Lally stated that this calculation note would be included as a footnote in the Statement of Investment Objectives and Policies. In response to a question from the Chair, Mr. Lally confirmed that the change would not affect the benchmark to look at when comparing portable alpha to its benchmark. Mr. Berg also confirmed that the benchmark for the asset class would stay the same: cash plus 250 basis points. Mr. Gillespie made a motion that the Commission adopt the recommendation of Meketa to update the policy benchmark as set forth on red number page 53 of the open session agenda materials as presented, with the change to the policy benchmark to be effective retroactively to July 1, 2018; directed that the updated policy benchmark be incorporated into, and made a part of, the Statement of Investment Objectives and Policies; and authorized Staff to finalize the benchmark by making any technical revisions or formatting edits consistent with the action taken by the Commission. Dr. Gunnlaugsson seconded the motion, which was approved unanimously.

X. ASSET ALLOCATION REVIEW AND DISCUSSION

Mr. Benham began with a discussion about a recent survey Meketa conducted about the asset allocation practices of other pension plans. In total, 39 plans responded to the survey of which most were larger state plans. The survey asked how often such plans reviewed their asset allocations, and of the results, the vast majority responded every four to five years. The survey also touched on how much time the plans spend talking about asset allocation when they revisit their current strategies, and the responses varied from two to six meetings. The next questions the survey focused on was where the plans obtained their capital market assumptions and what time horizon they used. Virtually all of the plans used their consultants' capital market assumptions with some having input from the plans' internal staff. As for the time horizon, half used 10 years, and the other half used 20 or 30 years.

Mr. Benham explained that the survey went on to ask questions about the number of asset classes for which policy targets are set. He explained that the number ranged from five to seventeen asset classes with the majority in the six to ten range. Mr. Benham surmised that the results of the survey indicate a small number of asset classes appears to be best practice. He then turned to the survey's question about what drives changes to asset allocation and explained that the results show that changes to capital markets assumptions universally drive such changes. Mr. Benham then summarized the best practices coming out of the survey. He stated that most plans spend more than one meeting discussing asset allocation, which includes a discussion of capital markets assumptions. There is a split between plans using 10- and 20- to 30-year time horizons for asset allocation. In addition, the vast majority of plans are setting targets for ten or fewer asset classes, and nearly half of the plans set interim targets.

Mr. Benham then summarized some recommendations for the Commission's consideration. He stated that the first is to set explicit objectives for the Plan that are quantifiable. Next, he stated that, although the Plan's asset allocation must be reviewed annually, RSIC should set a longer period of time for making changes. He added that the Commission should plan on blocking off a longer meeting for a discussion on the topic of asset allocation. Fourth, Mr. Benham stated that the Commission needs to continue giving due consideration to setting targets and ranges for asset classes as well as setting interim targets for asset classes that take longer than six months to change. Finally, he explained that the Commission should document the reasons for changes to the Plan's asset allocation when they are made to document the reasoning. Then, Mr. Berg fielded questions from the Commissioners.

Mr. Benham then turned to a discussion of the Plan's asset allocation. He began by referencing the 2018 and 2019 return assumptions for the Plan and noted that the expected return for the current year is nearly 60 basis points higher than in the previous year. However, Mr. Benham cautioned that achieving the assumed rate of return every year is not an appropriate measure of the Plan's success. Instead, achieving funded status for the Plan over the next 20+ years is likely the best gauge of success. He added that, although the return assumptions are up, the Plan's funded status has decreased. Mr. Benham went on to underscore the need for caution as most investors believe the coming ten years will bring increased market volatility.

Next, Mr. Benham noted that Meketa has continued working with Staff on asset allocation and reconsidering the right number of asset classes. Mr. Benham explained that in Meketa's opinion, one of the best methods of simplifying the asset allocation is to reduce the number of asset classes within the Portfolio. Currently, the Portfolio has four buckets of asset classes: fixed income securities, equity and equity-like assets, real assets, and a catchall for other categories. Mr. Benham stated that there are many different ways to simplify the asset classes in the Portfolio, and he would be presenting two simplification options: Mix A and Mix B.

With respect to Mix A, Mr. Benham noted that this portfolio combines high quality bonds into core bonds with a single target. Mix A also combines U.S., developed, and emerging market public equities into a public equities bucket. Both public and private real estate and infrastructure are combined into a real estate and infrastructure asset class. Global Tactical Asset Allocation ("GTAA") and the other opportunistic classes are rolled into a single line. Mr. Benham surmised that Mix A would reduce the number of asset classes in the Portfolio to eleven. In turning to a discussion of Mix B, Mr. Benham noted that this proposed portfolio is even simpler than Mix A. Mix B combines all public market fixed income, including high yield, bank loans, and emerging markets debt, into a single asset class. All global public equity is combined into a single asset class. Mix B does not alter the private equity asset class but combines real estate and infrastructure into a single asset class. In addition, the GTAA asset class is reallocated into public stocks and bonds.

Mr. Benham noted that the forecasted returns for both Mix A and Mix B are comparable to those for the current portfolio, but he cautioned that just because a proposed portfolio is modelled one way does not mean that returns will match the model. The performance of an asset class is often dependent upon how the asset class is implemented. Mr. Benham further explained that simplifying the Portfolio would require a further discussion around the allowable ranges for the asset classes in order to encourage alignment with the Commission's risk and return objectives. He then overviewed the proposed asset class target ranges for Mix A and Mix B and noted other important considerations that accompany a more simplified asset allocation.

Mr. Benham, Mr. Berg, and Mr. Gillespie then discussed how a simplified portfolio target might have altered Mr. Berg's response to recent market conditions. After some discussion, Mr. Benham noted that simplifying asset allocation can complicate reporting and benchmarking. Then, Mr. Gillespie expressed concern over rolling up bonds into a single asset class citing the inherent differences between U.S. Treasuries and high yield bonds. Mr. Berg responded that, within a simplified portfolio, a bond portfolio should still be a diversification tool. However, limiting the number of asset classes should help ensure that investment decisions are not as event-driven or reflexive as they may have been in the past. Mr. Benham and Mr. Berg then answered additional questions from the Commissioners.

Following a lengthy discussion with the Commissioners, Mr. Berg asked whether the concept of a simplified portfolio resonated with the Commissioners so that further work could be performed by Staff and Meketa. Mr. Gillespie noted with approval the simplified portfolio approach but concluded that additional discussion would be necessary.

A break was taken from 2:33 p.m. to 2:39 p.m.

Upon returning to the meeting, the Chair asked Mr. Berg to remind the Commissioners where the discussion left off before the break. Mr. Berg responded that the Commission had been discussing conceptual models for simplifying the Portfolio and asked the Commissioners' thoughts on Staff doing more work on ways to simplify the Portfolio. Dr. Gunnlaugsson expressed approval for the approach noting that she would like to discuss risk requirements to ensure the Portfolio does not become so simple that risk is too concentrated. The Chair also voiced his approval for the approach Mr. Berg outlined but stated that he would like to see a list of positives and negatives before the Commission approves any Portfolio simplification initiatives.

Mr. Hitchcock underscored that the simplification of the Portfolio could also help establish clear accountability for certain decisions. Mr. Berg opined that he would prefer, from an investment management standpoint, to establish a clear purpose for different asset classes, a home base in terms of asset allocation, and very clear principles that establish the framework for evaluating investment decisions that diverge from that home base. The Chair then asked for further comments about the simplification of the Portfolio. Hearing none, the Chair noted that the Commission would discuss the matter further at the Commission's next meeting.

XI. ADJOURNMENT

Mr. Gillespie moved to adjourn, Mr. Giobbe seconded the motion, which passed unanimously. The meeting adjourned at 3:08 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 12:32 p.m. on February 18, 2019]