South Carolina Retirement System Investment Commission
Meeting Minutes

April 11, 2019 9:30 a.m.
Capitol Center
1201 Main Street, 15th Floor
Columbia, South Carolina 29201
Meeting Location: Presentation Center

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

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. Allen Gillespie made a motion to approve the proposed agenda as presented, which was approved unanimously.

The next order of business was the review and approval of the minutes from the February 21, 2019 Commission meeting. Mr. Gillespie requested that additional detail be added to the asset allocation discussion section from the meeting minutes. After a brief discussion, Mr. Gillespie moved that the February 21, 2019 meeting minutes be carried over until the next meeting. Mr. William Hancock seconded the motion, which was passed unanimously.

II. CHAIR'S REPORT

The Chair reported that he and Vice Chair Dr. Rebecca Gunnlaugsson met with the senior Retirement System Investment Commission ("RSIC") Staff several times since the February 21, 2019 Commission meeting to discuss the agenda in preparation for an in-depth strategic discussion. The Chair noted that he hoped for active participation from the Commissioners during the asset allocation framework and strategic discussions during the meeting.

III. AUDIT & ENTERPRISE RISK MANAGEMENT COMMITTEE REPORT

Mr. Hancock, Chair of the Audit & Enterprise Risk Management Committee, began by stating that the Committee met on March 5, 2019. He reported that, during the meeting, a compliance update was provided, and no material exceptions were noted. He noted that there was an Internal Audit update provided to the Committee along with an overview of the history of the Retirement System Investment Commission's ("RSIC") Internal Audit function. The Committee also received an update on previously completed engagements, including the GIPS Verification, the Agreed Upon Procedures, and the Fiduciary Audit.

Next, Mr. Hancock noted that, during the period when RSIC had no in-house internal auditor, Staff went through an exercise to ensure all major business functions had been or were to be reviewed. External service providers and other state agencies were successfully utilized during this period, including the Division of State Human Resources and State Auditor's Office ("State Auditor").

Mr. Hancock then explained that the Committee received a recommendation from Staff concerning outsourcing RSIC's internal audit function to one of the State Auditor's pre-approved vendors, which includes Elliott Davis, Deloitte, and Experis. He stated that Staff has begun work on a Request for Information ("RFI") in order to select an outsourced internal audit vendor. The successful vendor will first conduct a risk assessment and then present a three-year audit plan for approval by the Committee, which the successful vendor will then execute. The RFI should be awarded by June of 2019 with the three-year audit plan ready for the Committee's review in August of 2019.

Mr. Hancock also reported that the Committee received a presentation on RSIC's Investment Due Diligence Procedures as part of an ongoing educational series about RSIC's processes and procedures. The Committee then received the Enterprise Risk Management ("ERM") update. Mr. Hancock noted that, during this update, Staff presented a plan to implement the ERM framework set forth in the Funston Fiduciary Performance Audit Report. With no questions from the other Commissioners, Mr. Hancock's concluded his report.

IV. CEO'S REPORT

Mr. Michael Hitchcock, Chief Executive Officer, began his report by recognizing Mr. David King, Senior Reporting Officer, for his achievement of being on Columbia's Top 20 under 40. He stated that Mr. King helped found Cola Town Bike Collective, which provides alternative transportation options, bicycle paths, repair stations, and has provided over 400 people with bicycles. Mr. Hitchcock commended Mr. King for his dedicated community service. This concluded his report.

V. CIO'S REPORT

The Chair recognized Mr. Geoff Berg, Chief Investment Officer, who began his report by reviewing the Plan's performance for the 2018-19 fiscal year for the period ending February 28, 2019 ("FYTD"), as well as the quarter ending December 31, 2018. Mr. Berg first noted that, while results for the quarter ended March 31, 2019 were not yet final, it appeared that the quarter would prove to be one of the best in the history of the organization. He noted the positive impact from adding equity exposure at the end of 2018 as well as an improvement in the managers' performance. Mr. Berg then provided the Commission with an overview of how the Portfolio was presently positioned. He stated that the Portfolio was modestly overweight in equities by approximately 2.5 to 3 percent. Within equities, the largest overweight was to domestic equity, U.S. large cap, with a smaller overweight to emerging markets, and an underweight to developed non-U.S. equities. Mr. Berg noted that the Portfolio is underweight fixed income, both to support the overweight to equity and in response to the low yields. . He explained that for the first time since the financial crisis there was not a penalty for holding cash versus core fixed income assets. Mr. Berg went on to explain that within the cash and short durations portfolios, the Portfolio had moved up in quality, in an effort to avoid being liquidity-constrained at the end of the cycle.

Next Mr. Berg introduced Mr. King to present the investment performance update through February. Mr. King stated that the new year had started off with a sharp recovery from the sell-off experienced last December, and noted that the Plan's FYTD return was 1.99 percent versus the Policy benchmark's return of 2.02 percent. Mr. William Condon, Jr. asked if the Plan historically had not taken enough risk. Mr. King explained that in the short term, there was more tracking error to the benchmark. As an example, Mr. King pointed out that in December, the private equity asset class had been the biggest detractor from the Plan's excess return, but over the course of two months, the benchmark had increased by 700 basis points. Mr. King noted that while the benchmark had moved very dramatically, the asset class' underlying valuations had not experienced much change, a whipsaw effect caused by benchmark volatility. A discussion ensued regarding the Plan's historical asset allocation, the impact of the financial crisis, and changes that had been implemented by the Commission and Staff during the last three years.

Mr. King noted that the Plan had commenced the current FY at $31.3 billion, paid out $805 million in net benefits FYTD, and had a value of $31.8 billion as of February 28, 2019. Mr. King indicated that $2.7 billion had been paid to beneficiaries FYTD, versus $2.1 billion of deposits into the system. The continuing unwinding of the TERI program during this period had resulted in $376 million of additional payments out of the Trust, although this was partially offset by a $100 million legislative inflow. Dr. Gunnlaugsson asked at what point would the Plan not pay out more than it takes in. Ms. Peggy Boykin noted that if one did not take into consideration investment returns, the Plan would continue to pay out more in benefits than what is collected in contributions. Ms. Boykin noted that the current employer contribution rate (14.56 percent) was due to increase to 15.56 percent on July 1, 2019 and ultimately go up to 18 percent pursuant to the Pension Reform Act. A brief discussion was held regarding contributions, the remaining TERI payments, and cash flow. The Chair stated that discussing these issues was important based on the cycle of the meetings, noted that the asset liability discussion is upcoming, and, echoing a request made by Dr. Gunnlaugsson, asked that the System's actuary attend the asset liability discussion to answer any questions the Commissioners might have.

Mr. King then shared the FYTD asset class performance details, noting that the Plan was overweight public equity and underweight core fixed income with a strong overweight in cash. Mr. William Hancock asked Mr. Berg to explain the overweight to cash. Mr. Berg explained that this overweight related to the inversion of the treasury yield curve, noting that the Plan currently received more to hold a three-month treasury, which is classified as cash, than in short duration fixed income, and that Staff made a decision to hold the treasury exposure in cash to maximize the flexibility to react to changes in the markets. Mr. Hancock noted that the Plan is getting as good or better returns with a lot less risk than in previous years.

Mr. King noted that the portfolio's highest performing asset class FYTD was Other Opportunistic which outperformed the benchmark by 689 basis points, followed by private infrastructure, equity options and public real estate. It was noted that Portable Alpha Hedge Funds and Mixed Credit had underperforming their benchmarks FYTD, followed by Emerging Markets Debt and Private Debt. Ms. Boykin inquired about the underperformance of Public Equity and whether it was domestic or international. Mr. Berg replied that both components underperformed, and noted how challenging the environment had been for active managers.

Mr. Condon inquired about the asset class categories and sub-asset classes the Plan shown on certain of the performance reports, as compared to the asset allocation which the Commission had approved. Mr. Berg stated that it would be difficult for Mr. King to break down performance returns by asset class and subclasses due to certain mandates that invest across multiple sub-asset classes, as well as the restructuring of the mandates the previous year. Mr. King added that RSIC's reporting team tracks exposures across sub-asset classes for public equity, and includes this information in the flash report circulated to the Commissioners. There was additional discussion regarding reporting.

Lastly Mr. King concluded his report by discussing the attribution to the Plan's excess return. There was a large allocation effect due to the equity exposure added at the end of last year. Fixed core income and equity options were the highest contributors to the Plan's excess return, with global public equity and cash being the largest detractors.

Mr. Berg discussed the fiscal year 2019 AIP progress report. He started by explaining that the initiatives had been broken out into areas where completion is expected during the current year. Mr. Berg highlighted certain key developments. He noted that negotiations had been completed for the co-investment platform with GCM Grosvenor, and thanked the members of Staff who had played a role in completing this important initiative.

Mr. Berg explained that Staff continues to work on whether to employ active or passive managers in the public markets, noting that Mr. Bryan Moore, Director of Public Markets, had developed a score card system that Staff had begun to use. Mr. Berg promised the Commissioners that there would be more details on this program to come at a future date. He then discussed private debt and mixed credit, where Staff continued to research differences between the two exposures to help determine whether we want to express a preference for one. Mr. Berg concluded his report by summarizing the significant developments relating to multi-year initiatives.

VI. DELEGATED INVESTMENT REPORT

The Chair recognized Mr. Berg for the delegated investment report. Mr. Berg noted that only one delegated investment had closed since the last Commission meeting, a private equity investment with Providence Strategic Growth IV, which closed on April 2, 2019 in the amount of $75 million. There was an ensuing discussion regarding co-investments and private equity amongst the Commissioners and Mr. Berg.

VII. EXECUTIVE SESSION

Mr. Hancock moved that the Commission recede into Executive Session to discuss investment matters pursuant to S.C. Code Sections 9-16-80 and 9-16-320; and to receive advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2), Dr. Wilder seconded the motion, which passed unanimously.

VIII. POTENTIAL ACTION RESULTING FROM EXECUTIVE SESSION

The Chair reported that the Commission took no action in Executive Session.

IX. PORTFOLIO FRAMEWORK PROPOSAL

The Chair introduced Mr. Hitchcock to present the Portfolio Framework proposal. Mr. Hitchcock stressed that this topic was the one of the most important and meaningful strategic discussions that the Commission had ever taken up. He noted that since the first Funston audit, the Commission had evolved from a board participating in due diligence of individual investments to one functioning like a corporate board, overseeing the portfolio from a much higher level.

Mr. Hitchcock stated that the portfolio framework proposal would facilitate the assignment of responsibility and accountability for decisions made with regard to the portfolio by both the Commission and by Staff. He stated that the ability to measure those decisions will give the Commissioners greater insight when it comes to evaluating Staff's implementation of the Portfolio (including the quality of managers hired to manage investments on behalf of the Plan).

Mr. Berg was asked to review the seven main components of the portfolio framework (noted below in italics). Mr. Berg commenced by echoing Mr. Hitchcock's introductory comments, noting that the proposed framework was intended to assist with: (a) measurement of portfolio risk by providing accountability for decisions made and evaluating those decisions; (b) alignment of key performance objectives; and (c) improved reporting.

Mr. Berg stated that he was proposing that the Commission utilize a reference portfolio and two benchmarks. The ***Reference Portfolio*** would be a simple, two-asset (stock and bond) portfolio designed to have the same level of volatility as the ***Policy Benchmark***. Mr. Berg explained that the Policy Benchmark would represent the Commission's decision to diversify beyond the two assets of the Reference Portfolio, while maintaining the same level of volatility. The Policy Benchmark would be based upon the unique needs of the System, and would incorporate input from both the CIO and the Consultant. One of the benefits of having the Reference Portfolio and Policy Benchmark would be to isolate the ***value derived from the decision to diversity the portfolio beyond the two-asset portfolio****.*

The second benchmark proposed by Mr. Berg was the ***Implementation Benchmark***. He stated this benchmark was designed to include any decision that Staff makes to structure the portfolio differently than the Policy Benchmark, either (a) a decision to overweight or underweight an asset class, or (b) a decision to construct an asset class differently than the benchmark. One major benefit of having the Implementation Benchmark is that, by comparing it with the Policy Benchmark and the ***Actual Portfolio****,* one can accurately differentiate the ***quality of portfolio structure*** (the impact of how RSIC Staff structured the portfolio) from the ***quality of implementation*** (that is, the impact of who was hired to manage the portfolio).

Mr. Berg stated that one role of the Commission is to create the right policy ecosystem for the day-to-day decisions to be made by the Staff and to maintain appropriate oversight of those decisions. He stated that in the future, Staff would replace the current portfolio reports produced by RSIC's reporting and analytics team and develop in its place a reporting package for the Commissioners integrating the foregoing components of the portfolio framework proposals. Extensive discussion ensued, during which the Commission addressed a number of topics, including the following:

- Mr. Gillespie indicated that the proposed framework offered a good example of higher-level decisions versus lower-level decisions and then offered his thoughts regarding how the proposal should be applied to review of the portable alpha program. Mr. Berg reiterated that his objective was to simplify the portfolio.

- Mr. Giobbe inquired how the existing benchmarks were set and expressed dissatisfaction with certain of the current benchmarks. Mr. Berg explained that if the Implementation Benchmark was in place, the Commissioners would be able more clearly to assess the managers' performance going forward. Mr. Berg further explained that strategy benchmarks will be identified for each manager.

- Ms. Boykin stated that she liked the idea of separating what the Commission's responsibilities are from those of Staff and getting a clear direction on how to measure same. She stressed the importance of looking at peers, so as to understand how and why the Commission looks different from its peers. Mr. Hitchcock responded by noting that peer comparisons can be a useful tool, but should not be the primary yardstick for evaluating the portfolio's performance. After additional discussion, Mr. Berg concluded his presentation.

X. STRATEGIC PLANNING ROADMAP DISCUSSION

Mr. Hitchcock introduced the strategic planning roadmap. He noted that it may take the Commission months to complete all of the items on the roadmap, but indicated that Staff would begin to provide the Commission with reporting supporting the revised portfolio framework by September 2019. Mr. Hitchcock summarized the roadmap's key milestones:

- June 2019 meeting - further discussion and potential approval of the Reference Portfolio.
- September 2019 meeting – further discussion and potential adoption of the policy benchmark (that is, the benchmark representing the Commission's decision to diversify beyond the two asset Reference Portfolio, while maintaining the same level of volatility).
- November 2019 meeting – review and adoption of the Statement of Investment Objectives and Policies ("SIOP") and the Annual Investment Plan ("AIP") incorporating the revised portfolio framework discussed in the April, June and September meetings.

Mr. Hancock expressed support for continuing discussion of the revised portfolio framework, but asked whether the timetable for discussion could be accelerated. The Chair sought to gauge the Commissioners' feedback regarding the roadmap as outlined by Mr. Hitchcock. In the ensuing discussion, Mr. Hancock inquired how the Commission's investment consultant felt about the plan. Mr. Frank Benham, Managing Director of Meketa Investment Group ("Meketa"), opined that the framework was very positive and noted that Meketa had held numerous conversations with Staff regarding the subject. He stated that the framework offered a good way to align Staff incentives and for the Commission to be able to measure and monitor Staff's success.

Mr. Condon expressed support for continuing discussion of the revised framework, noted that he was not clear whether the revised framework was just a reporting methodology, and inquired whether the discussion would entail going back and reassessing prior decisions. After additional discussion, Mr. Berg responded that the revised framework was both an oversight tool for the Commissioners and the CIO, as well as a framework for thinking about asset allocation.

Mr. Williams suggested that by the September meeting, decisions about asset allocation should have been discussed and made. There was discussion regarding the utility of convening a special meeting between the June and September meetings. Mr. Hitchcock suggested that Staff engage in further discussions with Meketa regarding the framework so that they could provide a more detailed plan to the Commissioners. This concluded the discussion of the strategic planning roadmap.

XI. ANNUAL INVESTMENT PLAN CONTINUATION

Chair Wilder turned to the next agenda item, the continuation of the Annual Investment Plan. Mr. Hitchcock reminded the Commissioners that state law requires that the Commission review and adopt or ratify an AIP each year by no later than May 1. Because of the ongoing AIP initiatives already discussed, and the strategic discussions regarding the potential adoption of a new asset allocation framework, Mr. Hitchcock and the Chair recommended that the Commission ratify the existing Annual Investment Plan for the fiscal year 2019-2020. Mr. Hitchcock noted that once the new portfolio framework is completed the Commission could then incorporate it by reference into the AIP and Statement of Investment Objectives and Policies ("SIOP") as needed. Mr. Hancock moved that the Commission adopt the recommendation of the CIO and CEO to affirm and ratify the Annual Investment Plan last approved on April 12, 2018, for fiscal year 2019-2020, unless and until further subsequent action is taken by the Commission; and incorporate this work by reference into the Plan and authorize Staff to make any technical revisions or formatting edits consistent with the action taken by the Commission. Mr. Williams seconded the motion, which passed unanimously.

XII. ADJOURNMENT

Dr. Gunnlaugsson moved to adjourn, Mr. Williams seconded the motion, which passed unanimously. The meeting adjourned at 1:30 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]