South Carolina Retirement System Investment Commission
Meeting Minutes

September 12, 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 (via telephone)
Mr. William H. Hancock
Mr. William J. Condon, Jr.

I. CALL TO ORDER AND CONSENT AGENDA

Chair Dr. Ronald Wilder 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. Mr. William J. Condon, Jr. seconded the motion, which was approved unanimously.

Mr. William Hancock made a motion to approve the minutes from the June 13, 2019 Commission meeting. Mr. Gillespie seconded the motion, which passed unanimously. Mr. Condon abstained from the vote due to his absence from the June meeting.

II. CHAIR'S REPORT

The Chair noted the hard work of the Chief Investment Officer, Chief Executive Officer, Staff, and Meketa over the past year in working to develop a more defined strategic direction for the Commission. After brief comments, he concluded his report.

III. AUDIT & ENTERPRISE RISK MANAGEMENT COMMITTEE REPORT

Mr. Hancock presented the report of the Audit & Enterprise Risk Management Committee as written and noted that it had been made available to the Commissioners for review prior to the meeting. After a brief discussion, he concluded his report.

IV. CEO'S REPORT

The Chair recognized Mr. Michael Hitchcock, CEO, for the CEO's Report. Mr. Hitchcock presented the proposed Fiscal Year 2021 South Carolina Retirement System Investment

Commission ("RSIC") Budget Request ("Budget") for Commission review and approval. He reminded the Commission that the Commission had requested reductions in its authorized amounts over the previous few years. The 2021 Budget request was for the same amount as the 2020 budget. Mr. Hitchcock explained that the prior year budget decreases were due to savings in operations expenses and decreases RSIC negotiated in other expenses, and not a reduction in personal services. The Commission then had a brief discussion regarding retention and recruitment of employees. There being no further discussion, Mr. Condon made a motion to authorize the CEO to submit a proposed FY 2021 detail budget substantially similar to the draft budget presented for inclusion in the Governor's annual budget. Mr. Gillespie seconded the motion, which passed unanimously.

V. CIO'S REPORT

The Chair introduced Mr. Geoff Berg, Chief Investment Officer, for his report. Mr. Berg began by giving an overview of the Plan's performance for the fiscal year ended June 30, 2019. He stated that there were several things that worked well, such as (i) the overweight to public equity, which was a positive contributor to returns from December to June; (ii) recent vintage private market investments; (iii) strong performance from the lower-risk private debt investments; and (iv) real estate. Mr. Berg recognized Senior Real Estate Officer, Mr. Eric Rovelli, for his continued good work. Mr. Berg noted several detractors from performance during the fiscal year, including some legacy private equity and private debt investments; being underweight to fixed income from December to June; equity options; and portable alpha. Mr. Berg noted that, although he believes strongly in portable alpha, it had not added value over the last year. Another area of concern noted by Mr. Berg was active management. Although the trust funds' active managers had generally strong performance in the second half of the year, he noted that this did not make up for their poor performance in the first half of the year.

A lengthy discussion ensued regarding the current interest rate and return environment and its implications for Plan performance and funding. Mr. Berg then turned the discussion over to Senior Reporting Officer, Mr. David King, to provide the investment performance update through June 30, 2019. Mr. King noted that during the fiscal year, the Plan had a return of 5.84 percent, versus the policy benchmark return of 6.50 percent. He noted that the Plan's three- and ten-year rolling returns were above the 7.25 percent target, at 8.48 percent and 8.33 percent, respectively.

Mr. King stated that during the fiscal year, the Plan had paid $1.1 billion to beneficiaries in net benefits. and had earned $1.7 billion in investment performance, which had increased Plan assets by $674 million. Mr. King stated that the Plan's market value at June 30, 2019 was approximately $32 billion, the Trust's highest fiscal year end market value since January 2008. He noted that the Plan had increased its assets by $6.4 billion since its inception in 2005, while paying out $13.5 billion in net benefits.

Mr. King then turned to a review of the Portfolio's exposure versus the policy benchmarks. He indicated that the global public equity portfolio ended the fiscal year at target, while the

Plan had a sizeable underweight to core fixed income, which was offset by an overweight in Treasuries. He stated that all asset classes were within the allowable ranges outlined in the Statement of Investment Objectives and Policies (the "SIOP").

Mr. King reviewed individual asset class performance. He reported that real assets had performed very well for the year, with infrastructure and REITS returning 12.7 percent and 11.2 percent respectively. He also noted strong performance from emerging market debt and core fixed income, with returns of 10.8 percent and 7.9 percent, respectively.

Mr. King explained that the 'other opportunistic' asset class was the highest outperforming asset class during the fiscal year, followed by equity options, REITS, and public infrastructure. He identified portable alpha hedge funds, private debt, and mixed credit as the most significant underperformers in terms of excess returns. There being no questions from the Commission, this concluded Mr. King's report.

Next, Mr. Berg presented a review of the Annual Investment Plan ("AIP") initiatives. He explained that the AIP included 34 different goal/initiatives, 28 of which were from the investment team. Of that subset, Mr. Berg noted that 16 were "single year" initiatives and 12 were multi-year, or "ongoing" initiatives. There were also other initiatives relating to Reporting, IT, and RSIC Legal. Mr. Berg reviewed the progress towards completing these initiatives. He reported that over 90 percent of the investment team's current year initiatives were completed, including: (a) an analysis of the use of equity options in international markets; (b) currency hedging; (c) the development of a way to track key differentials in private debt and credit; and (d) re-underwriting existing active equity strategies. After a brief review of other ongoing initiatives and a brief discussion by the Commission, he concluded the AIP update.

DELEGATED INVESTMENT REPORT

Mr. Berg noted that two delegated investments had closed since the last Commission meeting:

- a private equity investment with Great Hill Partners VII, which closed on June 26, 2019 in the amount of $52.5 million: and
- private credit investment with KKR BDC (Strategic Credit Opportunities Partners, LLC) in the amount of $125 million, which closed on June 25, 2019.

VI. MEKETA PRESENTATION

Mr. Hitchcock introduced Mr. Peter Woolley, co-CEO of Meketa Investment Group, Inc. ("Meketa"). Mr. Hitchcock stated that he was very pleased with the relationship with Meketa and the direction it is heading. He stated that he believes that RSIC is the going to be able to expand its use of the full capacities of Meketa. He then asked Mr. Woolley to provide an educational presentation on collapsing interest rates.

Mr. Woolley began his presentation by stating that in recent weeks the Treasury yield curve has provided grim signals regarding future economic prospects for the U.S. Specifically, the U.S. Ten-Year Treasury yield fell below two percent for the first time in almost three years, reaching close to historic lows. Additionally, the yield curve “inverted” from the perspective of the 10-year and two-year yields, adding to the earlier inversion seen at the 10-year versus three-month yields. He stated that U.S. yields cannot be evaluated in isolation, however, due to the highly interconnected developed world. He noted that U.S. Treasury yields currently offer the highest yields for government bonds across the developed world. He stated that an environment with Treasury yields at or near all-time lows and equity prices (in the U.S.) at or near all-time peaks is not conducive to future high expected returns. He further stated that current economic expectations of low growth across the world (especially the developed world) should also create headwinds for equity returns. While forecasts are pessimistic, market performance has been strong in 2019, with double-digit returns, or close to, in most major equity and credit markets and positive fixed income performance. A discussion between Commissioners ensued on this topic and its effect on the Plan.

VII. PORTFOLIO FRAMEWORK

The Chair recognized Mr. Berg for the portfolio framework discussion. He emphasized that approval of the portfolio framework was not being sought at this meeting, noting that the goal was to obtain the Commissioners’ consensus and incorporate that into a draft SIOP which would be presented at a later meeting. Mr. Berg then noted that broad agreement had been reached on the following topics at the prior meeting: (a) the benefit of a reporting framework tied to investment decisions; (b) the establishment of a reference portfolio with a 70/30 equity/bonds mix; (c) a reduction in complexity by establishing a five asset class Policy Benchmark; (d) classifying portable alpha as an implementation decision; and (e) a focus on long-term evaluation periods for investment decision-making.

Mr. Condon inquired about the reference portfolio discussion, due to his absence from the June meeting, and Mr. Berg explained that the Commission had engaged in an extensive discussion of this topic at the prior meeting. Mr. Berg gave a brief overview of the previous reference portfolio discussion, and noted that Staff was targeting a portfolio that would achieve the assumed rate of return over time, while not taking on too much additional risk, as additional risk would lead to a higher probability of a bad outcome. A bad outcome was defined as needing to raise contribution rates.

Mr. Berg stated that the three remaining points for discussion were: benchmarking for private market asset classes; performance reporting; and policy documentation through the SIOP and AIP. He then turned to the following points to guide the discussion:

- Why simplify the Policy Benchmark?

The current policy benchmark ensured a complex portfolio, as it contained 21 underlying benchmarks. The proposed path, utilizing a five-asset class Policy Benchmark, would establish a simpler "home base". It was also noted that a large bond allocation would improve liquidity and therefore the ability to exploit market opportunities.

- What question do we want a benchmark to help us answer?
  Mr. Berg used private equity as an example to illustrate this larger topic. He posed the question, "Did our private equity do for us what we hoped it would do?" He noted that the current private equity benchmark (public equity plus 300 basis points) only indicates how the portfolio performed versus public equity. It does not provide the Commission with any information on the quality of implementation of the private equity portfolio. If, however, the Commission shifted to a private equity universe benchmark, Mr. Berg explained that the Commission would be in a position to analyze whether private equity improved the Policy Benchmark return and gain insight into how RSIC performed against a "generic" private equity portfolio.

Mr. Berg then walked the Commissioners through an example to demonstrate the potential benefits of using a private equity universe benchmark rather than a public equity plus 300 basis points benchmark. He noted that using a private equity universe benchmark would enable the Commission to answer two important questions:

(i)Asset Allocation - Did the decision to include private equity in the Policy Benchmark improve its performance?

(ii)Manager Selection – How did the Portfolio perform relative to this generic universe of private equity?

After a lengthy discussion of private equity benchmarking, both long and short term, the Commission came to a consensus that over a longer term, comparing the choice to include private equity in the Policy Benchmark versus public equity was valuable, and over short-term horizons, it would be more valuable to answer how RSIC's private equity implementation compared against other private equity portfolios.

Next, Mr. Berg turned the discussion over to Mr. Frank Benham from Meketa to discuss Meketa's recommended benchmarks for the simplified portfolio framework. Mr. Benham explained that RSIC Staff and Meketa had been working to provide an improved framework for evaluating the success of the investment program. He noted that over the last two Commission meetings, the structure discussed had been based on the following four benchmarks/portfolios:

•The *Reference Portfolio*, a two-asset portfolio set by the Commission, which would serve as an overall risk guide. Mr. Benham noted that at the June meeting, Meketa recommended that the Commission adopt the 70 percent global equity and 30 percent U.S. Treasury benchmark as the Reference Portfolio.

•*Policy Benchmark* - Mr. Benham explained that the Commission would continue to set policy targets and ranges, and the Policy Benchmark would be determined by these targets. He expressed Meketa's opinion that comparing the Policy Benchmark to the Reference Portfolio would be a useful tool to evaluate the value from diversification.

•An *Implementation Benchmark* would be determined by the actual weights of different asset classes in the Portfolio. Mr. Benham explained that comparing the Implementation Benchmark to the Policy Benchmark would be a useful tool to evaluate the success of Staff's tactical decisions, as well as style or 'misfit' differences, and recommended that the Policy Benchmark and the Implementation Benchmark use the same indices, but with different weights.

•The *Actual Portfolio* – Mr. Benham noted that comparing the actual portfolio returns to the Implementation Benchmark would be a useful tool to evaluate the success of active management.

Mr. Benham then turned to a discussion of the five asset classes which it had been the Commission's consensus to incorporate in the Policy Benchmark. Mr. Benham reviewed the Commission's current benchmarks and presented Meketa's recommended Policy Benchmark constituents for the Commission's consideration.

- Bonds - Current benchmark: multiple benchmarks. Meketa recommendation: Bloomberg Barclays Aggregate.
- Private Debt - Current benchmark: S&P LSTA Leveraged Loan Index plus 150 basis points on a three-month lag. Meketa recommendation: no change.
- Global Equity - Current benchmark: multiple benchmarks. Meketa recommendation: MSCI ACWI IMI (All Country World Index – Investable Market Index).
- Private Equity - Current benchmark: 80 percent Russell 3000 Index and 20 percent MSCI EAFE Index plus 300 basis points on a three-month lag. Meketa recommendation: Burgiss Private Equity composite.
- Real Assets - Current benchmark: two benchmarks. Meketa recommendation: NCREIF ODCE Net.

Mr. Benham concluded his presentation and introduced Mr. Aaron Lally from Meketa to present a deeper discussion of private markets benchmarking. Mr. Lally reviewed what other plans' benchmarking of private equity, private debt, private real estate, private infrastructure and hedge funds, and evaluated which data providers had the most complete and comprehensive dataset for peer universe benchmarks. He explained that Meketa had compared RSIC's benchmarks to those used by peer plans, and highlighted the pros and cons of the two common approaches to benchmarking (public market index plus a spread and fund universe benchmarks). Mr. Lally noted that both approaches presented certain tradeoffs and concluded by reiterating that there was no industry standard for private market benchmarking. This concluded Mr. Lally's presentation.

Break was taken from 12:42 p.m. to 1:13 p.m.

The Chair recognized Mr. Berg for an update on the status of performance reporting. He stated that the goals were to streamline the performance reporting package and provide a new decision-based performance report for the quarter ending September 2019. He stated that full risk reporting capabilities were not yet established, but the risk system implementation was underway.

Mr. Berg noted that there would be substantial changes to the AIP and SIOP as Staff worked to embed the principles of the portfolio simplification framework into these documents, and outlined the anticipated timeline for distributing the AIP and SIOP.
The Chair and Mr. Hitchcock inquired whether the Commissioners were comfortable with Meketa's benchmark proposals and the performance reporting framework. An extensive discussion ensued regarding the proposed benchmarks. Certain concerns were expressed regarding the benchmarking of private equity, and Mr. Condon requested that the rationale for Staff's recommendations relating to the portfolio simplification framework be included in the draft documents. At the conclusion of the discussion, the Commissioners expressed general support for utilizing the five benchmarks proposed for the Policy Benchmark. Mr. Hitchcock noted that Staff would work to incorporate the Commissioners' feedback into the draft SIOP and AIP document for the Commission's review. This concluded the discussion.

VIII. STRATEGIC CALENDAR DISCUSSION

The Chair introduced Mr. Hitchcock to discuss the Strategic Calendar proposal. Mr. Hitchcock noted that he and Staff had developed a proposed Strategic Calendar which would establish strategic discussion items for each regular meeting on an annual basis. The schedule was developed to maximize the availability of the quarterly performance data. He added that a yearly calendar would provide clarity for both annual topics and non-annual topics, stating it would give everyone the ability to have visibility into the agenda for future meetings and ensure that strategic items were being covered. Most importantly, he stressed it would aid in instilling a longer-term focus on investment performance and on asset allocation decisions.

Mr. Hitchcock then provided the Commissioners with a sample of the Strategic Calendar and outlined what topics would be covered in each meeting, including an asset class deep dive at each meeting, strategic investment topic presentations by third party experts, and ongoing AIP progress reports, in addition to other specific topics at each meeting. Dr. Gunnlaugsson moved that the Commission adopt the Strategic Calendar as proposed and presented at Pages 158 to 162 in the red numbered document and authorized Staff to finalize the Calendar by making any technical revisions or formatting edits consistent with the action taken by the Commission. , Mr. Hancock seconded the motion, which was passed unanimously.

IX. EXECUTIVE SESSION

Dr. Gunnlaugsson 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; to discuss personnel matters pursuant to S.C. Code Section 30-4-70(a)(1); and receive legal advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2). Mr. Gillespie seconded the motion, which passed unanimously.

X. POTENTIAL ACTION RESULTING FROM EXECUTIVE SESSION

Upon completion of executive session, Mr. Condon moved to adopt the recommendation of the CIO as set forth in the Memo and presentation on TA Realty as discussed in executive session; (ii) authorize an additional commitment of up to $300 million to TA Realty-SC LP; (iii) authorize the CEO or his designee to negotiate and execute any necessary documents to implement the investment as approved by the Commission (1) upon documented approval for legal sufficiency by RSIC Legal and (2) upon expiration of the three business day review period as approved by the Commission on May 1, 2014 (or as the review period may be amended or superseded by the Commission); and (iv) authorize the CEO and/or the CIO or their designee(s) to thereafter authorize the custodian of funds to transfer such funds as are necessary to meet the Retirement System Trust Fund's obligations with respect to the Investment. Dr. Gunnlaugsson seconded the motion, which passed unanimously.

XI. ADJOURNMENT

There being no further business, Mr. Gillespie moved to adjourn the meeting. Mr. Giobbe seconded the motion, which passed unanimously, and the meeting adjourned at 4:15 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., 5:03 p.m. p.m. on September 9, 2019]