South Carolina Retirement System Investment Commission
Meeting Minutes

February 23, 2017
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. Curtis Loftis, State Treasurer (via teleconference and in person)
Mr. Reynolds Williams

Others present for all or a portion of the meeting on February 23, 2017: Christopher Alexander, Alex Baker, Geoff Berg, Betsy Burn, Andrew Chernick, Kim Cornell, Greg Cowell, Dori Ditty, John Farmer, Robert Feinstein, Scott Forrest, Michael Hitchcock, David King, Lynn Lesueur, Kevin Matherly, Steve Marino, Bryan Moore, Tricia Miller, Weiyi Ning, Jon Rychener, Kathleen Shealy, and James Wingo from the South Carolina Retirement System Investment Commission ("RSIC"); Clarissa Adams from the State Treasurer's Office; J.B. Collins, Jared Nobles, Tom Posey and Steve Younts from SC ETV; Suzanne Bernard, Tim McEnery and Phil Kivarkis from Aon Hewitt Investment Consulting; Wayne Bell, Sam Griswold and Wayne Pruitt from the State Retirees' Association of South Carolina; and Christine Cortright from Cola City Reporting.

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. Dr. Ronald Wilder made a motion to approve the proposed agenda as presented. Mr. Allen Gillespie seconded the motion, which was unanimously approved.

The Chair referred to the draft minutes from the November 17, 2016 Commission meeting and asked whether there was a motion to approve the minutes. Mr. Gillespie made a motion to approve the minutes of the November 17, 2016 Commission meeting as presented. Dr. Wilder seconded the motion, which passed unanimously.

II. CHAIR'S REPORT

The Chair reminded the Commissioners that the ethics forms should be provided to Mr. Andrew Chernick, Managing Director of Operations and Operational Due Diligence, and Statements of Economic Interest should be filed with the Ethics Commission by the end of March. She also announced that the Commission's 2017 meeting schedule had been posted to RSIC's website.

III. AUDIT AND ENTERPRISE RISK COMMITTEE REPORT

The Chair then recognized Mr. Gillespie for an Audit and Enterprise Risk Committee report. Mr. Gillespie stated that the Committee had met on February 9, 2017. He explained that at the meeting Mr. Chernick provided a compliance update and discussed other matters. Mr. Chernick had also reported that there were no material exceptions during the quarter ending September 30, 2016. Mr. Gillespie stated that all scheduled audits had been completed and the results had been posted to WatchDox. He noted in closing that the Committee continues to perform a personnel search related to filling RSIC's open Enterprise Risk Management position.

IV. HRC COMMITTEE REPORT

The Chair recognized Dr. Wilder for the Human Resources and Compensation ("HRC") Committee's report. Dr. Wilder announced that he had been elected Chair of the HRC Committee in December of 2016 and thanked the Chair for her work as the previous Chair of the HRC. He then explained that during the HRC Committee's December 2016 meeting RSIC Staff ("Staff") presented two new software programs Staff is utilizing in the Human Resources area. The first software system is the Intuition E-Learning System. This system provides hundreds of online courses on financial matters as well as general Human Resources topics. Dr. Wilder explained that all of the Commissioners should now have access. The second software system is Performance Pro, which is a cloud-based performance evaluation system. He noted that employee performance evaluation is a major part of RSIC's Compensation Policy, and the software system should make the process of evaluating employees much more streamlined.

Dr. Wilder then moved on to the next item of business. He explained that Staff had proposed revisions to the Commission's Governance Policies as to the way the Chief Executive Officer ("CEO") and Chief Investment Officer's ("CIO") evaluations are conducted in order to bring their review process in line with rest of the RSIC and to conform to changes the Commission had previously made to the Compensation Policy. The HRC Committee was briefed on these changes and had agreed with Mr. John Farmer's, Human Resources Director, assessment that the changes are necessary to hold the CEO and CIO to standard metrics of performance. Mr. Michael Hitchcock, CEO, explained that most of the changes are minor and others are conforming changes with RSIC's Governance Policies. He explained that the changes would require the CEO to recommend the initial salary and performance increases for the CIO. The remaining changes relate to setting timeframes for completing the CEO and CIO's evaluations.

Mr. Reynolds Williams made a motion that the Commission approve amendments to Governance Policies III and V, as presented, 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. Mr. Edward Giobbe seconded the motion, and Mr. Gillespie then asked for further discussion before the final vote. Mr. Hitchcock then answered questions from Mr. Giobbe and Mr. Curtis Loftis. Mr. Hitchcock stressed that the changes to the Governance Policies are essentially a delegation of the day-to-day decisions to the CEO. The Chair called the question, and the motion passed with five Commissioners in favor of the motion and Mr. Loftis opposed.

V. CEO'S REPORT

Mr. Hitchcock began by introducing Mr. Alex Baker, Junior Analyst, as a new addition to Staff. Mr. Baker graduated from Georgetown University and previously worked for an energy company located in Charleston, South Carolina. Mr. Hitchcock then began a discussion of the activity concerning RSIC in the General Assembly. He noted that the Commissioners had received copies of the introduced legislation that had gone through the House Ways and Means Commission and the Senate Finance Committee. Mr. Hitchcock stated that he believed that the legislation would be on the floor of both houses of the General Assembly in the coming weeks and that he would continue to update the Commissioners on the legislation as it develops. Mr. Hitchcock noted that RSIC's budget request for the 2017-18 Fiscal Year had been submitted to the General Assembly and that RSIC has asked for a $1.5 million budget decrease. Mr. Giobbe inquired about the reduction. Mr. Hitchcock responded that there would be a corresponding decrease to RSIC's personal services budget.

VI. CIO'S REPORT

Following the conclusion of Mr. Hitchcock's report, the Chair recognized Mr. Geoff Berg, CIO, to provide his report. Mr. Berg began by explaining that Mr. David King, Reporting Officer, would be providing the RSIC Internal Performance Review. Mr. Berg stated that as of the end of the calendar year 2016, the Plan's ("Plan") performance was up 4.87 percent and performing well against both the policy benchmarks and peer group of funds.

Mr. Berg explained the extraordinary level of low volatility in the markets. To illustrate this point, Mr. Berg noted that during the previous 92 days, U.S. equities had not declined by one percent on any single day. Mr. Berg also stated that there had been a tremendous flow of capital into private markets but reaffirmed that RSIC will continue to approach private markets investments in a disciplined way.

Mr. Giobbe asked about some private equity managers liquidating assets. Mr. Berg stated that he did not have sufficient data on the matter to comment and asked Ms. Suzanne Bernard of Aon Hewitt Investment Consulting ("Aon Hewitt") for her opinion. Ms. Bernard described the growing pressure on private equity managers to invest their "dry powder" and added that she does not see these pressures going away anytime soon.

Mr. Berg then introduced Mr. King to provide a Fourth Quarter Investment Performance Summary Mr. King noted that the performance during the quarter represented a continuation of the trend from the prior quarter. He noted that the fiscal year-to-date Plan return of 4.87% exceeded the policy benchmark return of 4.14%, resulting in 73 basis points of excess return. He further noted that the Plan's assets increased by $792 million during this time. He stated that interest rate sensitive assets had underperformed other asset classes. Mr. King concluded his presentation by providing an overview of the contribution of each asset class to the Plan's excess return. Dr. Wilder inquired about the meaning of "ported cash" in Mr. King's presentation. Mr. King responded that Staff uses short duration cash as collateral for the beta overlay program, which is known as "ported cash" for reporting purposes. Mr. Gillespie asked Staff to consider the timeliness of the information RSIC displays on its website. He stated that it would be helpful if information was more freely available. Dr. Wilder suggested that a glossary of investment terms also be made available on the website. Next, Ms. Bernard announced that the new Commissioner digests are available and provide performance information through the most recent period.

Ms. Peggy Boykin arrived at the meeting at 10:16 a.m.

Ms. Bernard then turned the discussion over to Mr. Timothy McEnery of Aon Hewitt to provide the Fourth Quarter 2016 Investment Performance Update. Mr. McEnery began his presentation by stating that 2016 ended on a good note despite a negative start. He stated that there are three major events that led to the recent market recovery. The first involved an easing of concern regarding growth prospects for both China and the US. The second factor was the recovery from the selloff that followed UK's vote to leave the European Union. Lastly, the unexpected US Presidential election results led to heightened market volatility before the US election, which subsequently abated. Mr. McEnery then provided a manager update explaining that GMO LLC has hired a new CEO. In conclusion, Mr. McEnery reiterated that strong performances in private equities in the fourth quarter, and he stated that Aon Hewitt is projecting strong performances from equities as well as high yield bonds.

Mr. Berg introduced Mr. Robert Feinstein, Managing Director of Public and Private Markets, to provide the Commission with a draft of the Annual Investment Plan ("AIP") for the 2017-18 Fiscal Year. Mr. Feinstein began his presentation by stating that Staff was not seeking action, but Staff was requesting the Commissioners' feedback by mid-March in order to have a revised draft of the AIP ready for the Commission's approval at its April meeting. Mr. Feinstein highlighted three key aspects of the draft AIP. The first aspect Mr. Feinstein highlighted was the strategic initiatives completed in the prior fiscal year, including asset allocation changes and the establishment of portable alpha and equity options strategies. The second aspect was the ongoing asset class initiatives. Currently, Staff is revising the Plan's active/passive framework, risk management function, and fee and expense reduction efforts. Staff is also continuing to discuss ongoing asset class initiatives, which include private markets, co-investment opportunities, and value creation. Mr. Feinstein concluded by discussing new Staff initiatives. Staff is evaluating the implementation of equity option strategies, including international, portable alpha, lower cost alternative beta strategies, global asset allocation, and the roles of private debt and real estate in the Portfolio ("Portfolio").

Mr. Berg turned the discussion to the Portfolio's asset allocation. He stated that Staff would be recommending a four percent reduction to the hedge fund allocation to take place over the next two fiscal years. Mr. Berg explained that this change would result in a slight increase to global equity exposure as well as to GAA strategies. Mr. Berg summarized that he would like for the Portfolio to be positioned in such a way that Staff can adapt to and exploit changing market conditions. Mr. Berg then discussed equity exposure and the attractiveness of expanding the use of equity options to include non-U.S. equity.

Mr. Berg turned the discussion over to Ms. Bernard who gave a brief overview of the asset liability study and asset allocation review materials provided to the Commission.

Ms. Bernard reviewed Aon Hewitt's ten-year capital markets expectations that RSIC had utilized over the last six years, highlighting the very persistent trend in lower return forecasts. She noted that Aon Hewitt's capital market expected returns for the first quarter of 2017 showed modest improvement due to inflation, expectations for global growth, and interest rates climbing, which she suggested will likely have a positive impact on the performance of several asset classes. Mr. Williams asked if there was a historical capital market forecast from 1981 to 1991. Ms. Bernard responded that such a forecast does exist but the slide was not included in the materials. She stated that she would make this information available to the Commission.

Ms. Bernard and Mr. Gillespie discussed risk and the difference between distribution phases verses accumulation phases. Ms. Bernard summarized what was agreed upon at last year's meeting regarding new asset allocations and the recommended changes for the fiscal year 2018-2019:an increase in global equity, the reduction in hedge fund allocation, and an increase in global asset allocation.

A brief recess was taken from 10:53 a.m. to 11:04 a.m.

After the recess, Ms. Bernard introduced Mr. Phil Kivarkis of Aon Hewitt, who led a discussion of the asset – liability study which Aon Hewitt had prepared. Mr. Kivarkis described the portfolio as well-constructed and well-diversified. Mr. Kivarkis explained that the SCRS had a liability growth rate of 9.3 percent per year, and stated that the growth rate required of the plan's assets to keep pace with the liability growth rate was 17.8 percent per year. Mr. Kivarkis explained that defined benefit plans rely upon contributions and investment performance to meet this asset growth requirement

Mr. Curtis Loftis entered the meeting at 11:33 a.m.

An extensive discussion of topics relating to the asset-liability study ensued involving the Commissioners, Aon Hewitt, Mr. Hitchcock and Mr. Berg. Among the topics addressed were the history of the SCRS's funded status, the impact of various asset allocation targets on required contributions and funded status under a range of different macro-economic scenarios, and the challenges presented by State law's current actuarially assumed rate of return of 7.5 percent. Mr. Loftis stated a number of concerns regarding the Plan's funded status, and noted the burdens that this situation imposed upon taxpayers. The discussion concluded with an invitation to the Commissioners to offer further comments and feedback.

Mr. Berg introduced Mr. Kevin Matherly, Associate Analysist, to present two investment recommendations for Algert Global, LLC ("Algert") and Numeric Investors LLC ("Numeric"). Mr. Matherly started by stating that these investment recommendations are very similar. Both will be held in bank at the Bank of New York Mellon, both investment managers received a pass rating from RSIC's Operational Due Diligence team and a qualified rating from AON Hewitt. He stated that one difference between the investments is their fee structures. Algert's management fee is 60 basis points up to $200 million and 85 basis points thereafter. Numeric's management fee is 73 basis points on the first $75 million and 63 basis points thereafter. Mr. Giobbe inquired about the difference in fees, and Mr. Matherly explained that managers typically have a higher fee than other forms of equity due to a number of factors. Mr. Matherly further explained that the primary goal of this recommendation is to reduce the plan's underweight to international small cap equity. The secondary goal for this recommendation is to generate a consistent excess return in a cost effective manner. He then explained individual considerations for each manager.

Mr. Giobbe asked how international small caps have performed relative to international large caps over the same period in terms of absolute performance. Mr. Matherly explained that the international small cap market has performed in line with international large caps, however he noted the strong excess returns available in the smaller mandates over the past 15 years. Mr. Giobbe then asked Mr. Matherly if Staff has any concerns about international small caps managers getting access to capital given. Responding, Mr. Matherly said that Staff did not have such a concern.

Mr. Williams made a motion to dispense the reading of the motions which were included in the Commissioner's materials. Mr. Gillespie seconded the motion, and it was unanimously approved. The Chair asked for a motion to approve both managers. Mr. Gillespie made a motion to approve both investments as outlined in the written motions, and Mr. Williams seconded the motion, which passed unanimously. The motions for each investment are as follows:

a. Algert Global LLC - i. Adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Summary Terms Chart on Page 1 of the Due Diligence Report dated January 24, 2017; ii. Authorize an investment of up to 2% of Total Plan Assets into the Algert Global International Small Cap Strategy through the use of a separately managed account agreement (the "Investment"); iii Authorize the Chair or her 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 Chair 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 funds' obligations with respect to the Investment.

b. Numeric Investors LLC- i. Adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Summary Terms Chart on Page 1 of the Due Diligence Report dated January 24, 2017; ii. Authorize an investment of up to 2% of Total Plan Assets into the Man Numeric International Small Cap Strategy through the use of a separately managed account agreement (the "Investment"); iii. Authorize the Chair or her 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 Chair 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 funds' obligations with respect to the Investment.

VII. EXECUTIVE SESSION

Mr. Loftis 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 discuss personnel matters 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. Gillespie seconded the motion, which passed unanimously. The Commission receded into closed session at 12.33 p.m.

VIII. POTENTIAL ACTION RESULTING FROM EXECUTIVE SESSION

The Commission reconvened in open session at 4:07 p.m. Mr. Hitchcock reported that the Commission did not take any reportable action while in Executive Session. Any action that did occur while in Executive Session pursuant to S.C. Code Ann. Sections 9-16-80 and 9-16-320 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.

IX. ADJOURNMENT

There being no further business, upon a motion made by Dr. Wilder and seconded by Mr. Williams, the Commission voted unanimously to adjourn. The meeting adjourned at 4:07 p.m.

[Staff Note: In compliance with S.C. Code Ann. Section 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, S.C., at 4:42 p.m. on February 21, 2017.]