

**South Carolina Retirement System Investment Commission
Audit Committee Meeting Minutes**

February 12, 2013

**SC Retirement System Investment Commission
1201 Main Street, 15th Floor
Columbia, SC 29201
Meeting Location: Presentation Center**

Committee Members Present:

Mr. Allen Gillespie, Chairman
Mr. Reynolds Williams, Vice Chairman

Others present for all or a portion of the meeting on Tuesday, February 12, 2013:

Andrew Chernick, Sarah Corbett, Hershel Harper, Monica Houston, Adam Jordan, James Manning, Nancy Shealy and Brian Wheeler from the South Carolina Retirement System Investment Commission (“RSIC”); Jim Holly from the Comptroller General’s Office; The Honorable Curtis Loftis and David Padgett from the State Treasurer’s Office; Wayne Bell and Wayne Pruitt from the State Retirees Association of South Carolina; Tammy Nichols, John Page and Faith Wright from the South Carolina Public Employee Benefit Authority (“PEBA”).

- I. Call to Order:** Mr. Allen Gillespie called the meeting of the RSIC Audit Committee (“Committee”) to order at 10:30 a.m. Mr. Gillespie asked for a motion to approve the proposed meeting agenda. Mr. Reynolds Williams made a motion, which was seconded by Mr. Gillespie, and passed unanimously.
- II. Approval of Minutes:** Mr. Gillespie requested the date of the last meeting and asked for a motion to approve the minutes from the Committee meeting held on November 2, 2012. Mr. Reynolds Williams made a motion to approve the Committee minutes from November 2, 2012, which was seconded by Mr. Gillespie and approved unanimously. Mr. Gillespie noted the minutes should be shared with the PEBA Board.
- III. Audit and Compliance Update:** Mr. Andrew Chernick, Director of Internal Audit & Compliance, informed the Committee on the recent adjustments made to the valuation policies and procedures conducted by RSIC and PEBA. Additionally, Mr. Chernick stated the Retirement System financial statements and the PEBA Comprehensive Annual Financial Report (CAFR) were issued with unqualified opinions.

Ms. Monica Houston, Internal Audit & Compliance Officer, presented proposed adjustments needed to the FY 2013 Audit Plan, resulting from a lack of resources and responsiveness to organizational needs in the area of management requests. The Committee discussed the possibility of reprioritizing projects within the allotted hours and calendar quarters. A discussion also ensued on how to properly procure additional temporary resources. Mr. Williams made a motion for a procurement request for up to \$50,000 with the purposes of acquiring additional temporary audit resources. Mr. Gillespie seconded the motion, which passed unanimously.

IV. Review of Risk Assessment Dashboard: Mr. Chernick noted that the Budget and Control Board would receive an updated copy of the Deloitte Risk Assessment Dashboard on a quarterly basis. Ms. Sarah Corbett, Director Due Diligence confirmed that such was being done at the request of General Eckstrom and that Dr. Barrett was responsible for communicating such. Mr. Chernick reviewed the updates to the dashboard including:

- Implementation of formal ongoing due diligence guidelines; a standardized format for ongoing due diligence has been rolled out across all investment asset classes and checklists are to be completed every six months;
- Director of Operations hired;
- IT team released Tamale, a new Central Management System (CMS), that will serve as the data repository for the organization and should be helpful from a compliance/ internal audit perspective, system is currently in beta testing stage;
- Private i and Private Informant, which will give the investment team greater transparency and reporting capabilities, were in the final contract phase;
- Request For Proposal (RFP) scope for the risk management system is being finalized with plans to release it within the next month;
- The compliance framework was formalized for presentation to the Audit Committee;
- Internal discussion have been held related to the potential use of Bank of New York Mellon's compliance monitoring software, which would allow the monitoring of Separately Managed Accounts (SMA) to ensure they stay within investment guidelines.

V. Presentation on Operational Risk – Hedge Funds: In response to articles previously provided to the Audit Committee on hedge funds and related risks by Ms. Houston and inquiry of such by Mr. Gillespie, Mr. Chernick began delivering a presentation on operation risk within hedge funds. Mr. Chernick stated that as an organization, the goal is to constantly monitor the SEC updates and ensure that RSIC's program captures current risks, future risks and potential risks. Mr. Chernick gave a detailed background on what operational risk is within a hedge fund, what RSIC does currently (in regards to

mitigating operational risks) and what they potentially plan to roll out. The specific risks of complexity, illiquidity, transparency, performance pressures, variations in back office practices, single entity control, independent governance, and favored investor were discussed. The recent initiatives to further standardize and institutionalize the process around operational due diligence was also discussed. In response to a discussion started by Mr. Gillespie relative to the specific mechanics and delineation of responsibility for certain due diligence procedures, Mr. Hershel Harper, Chief Investment Officer, provided clarity by stating that Ms. Corbett had been promoted to Director of Operational Due Diligence. Mr. Harper described her responsibilities as overseeing the outsource solution for operational due diligence which included working with the consultants and any other vendors that conduct operational due diligence (on RSIC's behalf). Mr. Chernick completed his presentation with a brief discussion on the future development of comprehensive due diligence guidelines (which will dovetail current practices with the newly acquired services from HEK) noting that a formal analysis of such would be presented at the next Audit Committee meeting on April 30, 2013.

VI. Presentation on Fiduciary Audits: Mr. Chernick informed the Committee of new South Carolina legislation that requires the office of the State Inspector General to employ a private firm to perform a fiduciary audit of the RSIC and PEBA on an annual basis. Mr. Chernick stated the new requirement was scheduled to go into effect in FY 2012, but it was delayed until this year; assuming the Inspector General gets funding from legislation for such cost, which is paid out of the general fund the audit is to be submitted no later than January 15, 2014. At the inquiry of Mr. Gillespie a discussion was had relative to the type, level, and budgeting of resources to support the fiduciary audit. Mr. Chernick provided background information on fiduciary audits previously performed. Thereafter he defined fiduciary audits, discussed what to expect if one were to happen and provided insight on the potential scope. It was noted that performing fiduciary audits are expensive and extremely time consuming, but adds value in that they provide an independent assessment and help to identify best practice ideas. The presentation concluded with a discussion on the next steps which included obtaining budgeted dollars from the General Fund; the issuance of an RFP, and a timeline on performance of the work.

VII. Presentation of Compliance Framework: Ms. Houston explained that there are a multitude of people from RSIC under the compliance umbrella that include the legal team, investment team, as well as audit and compliance. Ms. Houston outlined in detail the high-level compliance framework that consists of:

- 1) Governance: How the organizational and investment committees are structured
- 2) Compliance Program: What the organization does on a day to day basis

- a. Policy Creation and Revision
 - b. Policy Training and Education
 - c. Policy Adherence
 - d. Policy Monitoring and Advisement
- 3) Reporting: What reporting is needed as it relates to compliance, continuous monitoring and the final reporting

The presentation concluded with an overview of the framework that was previously discussed at a more granular level between Mr. Gillespie, Mr. Chernick and Ms. Houston.

VIII. Executive Session to discuss investments or other financial matters pursuant to S.C. Code Ann. Sections 9-16-80 and 9-16-320: Mr. Gillespie requested a motion to adjourn the public portion of the meeting to go to Executive Session to discuss investments and other financial matters, specifically Ranieri Partners and the strategic partnership document tracking sheet. Mr. Williams made the motion which was seconded by Mr. Gillespie and passed unanimously. Upon returning from Executive Session it was noted that no action was taken.

IX. Adjournment: There being no further business, on motion duly made and seconded, the meeting was adjourned at 12:52 pm.

[Staff Note: In compliance with S.C. Code Ann. §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 Conference Room at 1201 Main Street, Columbia, SC, on February 7, 2013.]