

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

September 10, 2013

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

Committee Members Present:

Mr. Allen Gillespie, Chairman
Mr. Edward Giobbe
Mr. David Avant

Others present for all of a portion of the meeting on Tuesday, September 10, 2013:

Geoff Berg, Andrew Chernick, Sarah Corbett, Robert Feinstein, Lorelei Graye, Hershel Harper, Monica Houston, Darry Oliver, Jon Rychener, Nancy Shealy and Katie Walker from the South Carolina Retirement System Investment Commission (“RSIC”); Clarissa Adams, Wesley Hill and David Padgett from the State Treasurer’s Office; Faith Wright from Public Employee Benefits Authority (“PEBA”); Wayne Bell, Sheila Gallagher, Sam Griswold, and Wayne Pruitt from The State Retirees Association of South Carolina.

- I. **Call to Order:** Chairman Allen Gillespie called the meeting of the RSIC Audit Committee (“Committee”) to order at 10:02 a.m. Chairman Gillespie asked for a motion to approve the proposed agenda. Mr. David Avant made a motion to approve the agenda, which was seconded by Mr. Edward Giobbe and passed unanimously.

- II. **Approval of Minutes (August 13, 2013):** The minutes from the August 13, 2013 Audit Committee meeting had not yet been reviewed by the entire Committee. After sufficient time was allotted for review, Chairman Gillespie requested a motion to approve the minutes. Mr. Avant made a motion to approve the minutes from August 13, 2013. The motion was seconded by Mr. Giobbe and passed unanimously.

- III. **Audit Committee Follow-up:** Ms. Monica Houston informed the Committee that the Audit Committee follow-up would be a standing agenda item in future meetings to ensure all committee meeting open issues are effectively resolved. Ms. Houston reviewed in detail the outstanding items from the previous Audit Committee meeting on August 13, 2013:
 - Review of Audit and Compliance staff
 - The staff review was completed during Executive Session at the August 13, 2013 Audit Committee meeting. The next step for this item’s completion is for Chairman

Gillespie to provide Ms. Houston and Mr. Andrew Chernick a copy of the review and discuss the results.

- Language clarification of “management letters” within the Audit Committee Charter
 - Chairman Gillespie recommended a revision be made to clarify the charter's language concerning management letters and be presented for approval at the next Audit Committee meeting in November 2013.
- Presentation of newly adopted compliance policies and procedures
 - Ms. Houston informed the Committee that she and Mr. Chernick would discuss this topic at the next Audit Committee meeting in November 2013.
- Audit Committee self-evaluation
 - Due to the ever-changing composition of the Audit Committee, this item has yet to be performed. Ms. Houston recommended that the self-evaluation be completed in June 2014, which would give current Committee members a full year of serving on the Audit Committee.
- Audit and Compliance to review the issue of portfolio rebalancing and give recommendations
 - Ms. Houston noted that the investment management team will give a presentation in today's meeting regarding this issue.

IV. Dodd-Frank Compliance – New Swap Rules: Mr. Chernick reminded the Committee that the Dodd-Frank Wall Street Reform and Consumer Protection Act signed in 2010 had brought several changes to the regulatory environment, with one of the main changes being the requirement to centrally clear certain Over-the-Counter (OTC) derivatives. Mr. Chernick explained that this central clearing initiative's final phase required institutional investors to centrally clear interest rate swaps and credit default swaps. Mr. Chernick noted that RSIC does not currently directly hold any interest rate swaps or credit default swaps, but wanted to inform the Committee of these requirements for future usage, as necessary. Mr. Chernick highlighted the positives and negatives of OTCs being centrally cleared. The main positive noted was that it would help reduce counterparty risk. Negatives noted were there would be additional fees and collateral postings requirements associated with centrally clearing. Mr. Chernick concluded by outlining the necessary steps if RSIC would participate in an interest rate swap or a credit default swap in the future.

V. Audit & Compliance Update: Mr. Chernick reviewed the Deloitte Risk Assessment Dashboard of the tasks completed within the past calendar year, referencing the handouts that had been given to the Committee. Mr. Chernick noted the task of “enhanced legal resources to expedite the contract process” had been completed since the previous Audit Committee meeting on August 13, 2013.

Mr. Chernick then detailed the tasks that were still in progress, including:

- Develop operational infrastructure;
- Fully develop a risk management function;
- Develop compliance function;
- Obtain additional FTEs to address key person risk and further enhance external manager oversight; and

- Document all policies and procedures.

For the tasks still in progress, Mr. Chernick noted the portions that had been completed, the next steps to be taken, and the estimated timeline for entire completion of the task.

VI. Rebalancing Presentation: Mr. Geoff Berg, Internal Asset Management Director, noted that the RSIC investment team receives the targets for each asset class and the ranges around those targets annually, which are approved by the Commission and listed in the Annual Investment Plan (AIP) and Statement of Investment Objectives and Policies (SIOP) publications. Mr. Berg stated that the Chief Investment Officer (CIO) had historically been given the authority by the Commission to manage the exposures of the plan within those given ranges. The CIO uses his authority to determine the timing and magnitude by which the asset classes differ from the target benchmarks over time. Mr. Berg explained in detail the mechanisms for changing exposures. Mr. Berg indicated that the goal of rebalancing the portfolio by definition is to return the portfolio into alignment with the target benchmarks.

In response to a question regarding duration, Mr. Hershel Harper, CIO, stated that the managers have discretion within the guidelines that were set with ranges and control management, and he wasn't aware of any specific duration constraints in place.

A discussion developed on how to audit the rebalancing portfolio process. Mr. Harper detailed several ways to adhere to the compliance guidelines, including:

- Both the investment and reporting teams have to approve and be aware of the exposures;
- The operational team and the State Treasurer's office must approve new trades;
- Quarterly reports are posted for staff and the Commission to review; and
- The annual compliance certification from Hewitt Ennis Knupp (HEK).

Mr. Chernick interjected that the Bank of New York Mellon compliance module that may be used to monitor Separately Managed Account (SMA) managers, also has the capability to monitor on a portfolio level. Mr. Chernick explained that this compliance module does not offer a granular view, but should be utilized as more of a first line defense.

Mr. Harper confirmed that with the implementation of the new asset allocation, the manager, Russell Investments, would not be relied upon as much as in the past.

A discussion ensued on whether rebalancing the portfolio should be included in the 2014 Audit Plan. Ms. Houston noted that the rebalancing portfolio process would have a low/moderate risk level. Chairman Gillespie suggested the item be reviewed at a later date due to the low risk level, and be discussed in an Investment Commission meeting.

VII. Annual Compliance Certification Report: Mr. Chernick explained that the compliance questionnaire gathered pertinent data from the underlying managers in a standardized format, which ties to the fiscal year end. The main topics covered within the questionnaire were;

- Regulatory oversight;
- Internal compliance procedures;
- Conflicts of interest;
- Legal terms; and
- Back office policies and procedures.

Mr. Chernick clarified that the questionnaire was an additional layer to manager oversight, and not considered a replacement for any current controls in place. Mr. Chernick informed the Committee there was also a certification portion to be completed, where managers attested to giving the information to their best available knowledge and they were in compliance with the investment guidelines. Mr. Chernick mentioned that all questionnaires distributed to our managers and the consultant, were received back in a timely manner. Mr. Chernick concluded his presentation by noting that the goal was to complete both the questionnaire and the certification process on an annual basis, though questions within the questionnaire could potentially change based on current and relevant topics.

VIII. FY2013 Investment Fees Report: Ms. Houston reminded the Committee that at the August 13, 2013 Audit Committee meeting, the Committee approved postponement of the FY2013 audit scheduled of the Investment Fees process and the election of the Internal Audit management to perform a consultative review instead, with the audit being completed in FY2014. Ms. Houston explained that typically a consultative review and any resultant report is usually between management and internal audit. However, she further explained that due to the origination nature of the engagement (was originally an internal audit) it was pertinent that the Committee receive the report as well. A 19-page, internal audit flash report that summarized the observations of the consultative review was presented to the Committee for review and discussion via inclusion in the meeting materials.

At the request of Chairman Gillespie for management to provide the Committee with any comments for consideration, Ms. Sarah Corbett, Operational Due Diligence Director noted that external audit opinions were always clean and the main purpose in making changes to the process was to improve transparency in the financial statement. Mr. Avant agreed with Ms. Corbett, in regards to PEBA's perspective.

The flash report was received by the Audit Committee for review and further discussion at the next Audit Committee meeting in November 2013.

IX. Executive Session to discuss investments or other financial matters pursuant to S.C. Code Ann. §§9-16-80 and 9-16-320, and receive advice from legal counsel pursuant to S.C. Code Ann. §30-4-70(a) (2): Chairman Gillespie requested a motion to recede into executive session to discuss investments and other financial matters, and receive advice from legal counsel. Mr. Giobbe made the motion which was seconded by Mr. Avant and passed unanimously. Chairman Gillespie announced the Committee would meet in executive session and the Committee receded into executive session at 11:15 a.m.

X. Adjournment: The Committee reconvened in open session at 1:12 p.m. Pursuant to the Committee's responsibility to "Oversee the process for monitoring compliance with RSIC policies and applicable laws, including but not limited to: ethics requirements and standards of conduct" as established within the RSIC Audit Committee Charter, Mr. Avant made the following motion which was seconded by Mr. Giobbe and passed unanimously.

To seek approval of the Attorney General to engage external associate counsel to advise the Audit Committee in the review and assessment of policies and processes established or recommended for establishment by management for organizational governance and compliance with applicable laws, including but not limited to: ethics requirements, standards of conduct, and personal trading policies and related reporting. Inclusive in the legal services to be provided would also be guidance on matters that have or may be brought before the Audit Committee pursuant to those policies and laws, as appropriate.

Given no further business the meeting adjourned at 1:13 pm with appropriate motion having been made by Mr. Avant, seconded by Mr. Giobbe, and passing unanimously.

[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, at 11:57 a.m. on September 6, 2013.]