

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

June 16-17, 2014

**Wampee Conference Center
1274 Chicora Drive
Pinopolis, South Carolina 29461**

Commissioners Present:

Mr. Reynolds Williams, Chairman
Mr. Edward Giobbe, Vice Chairman
State Treasurer Curtis M. Loftis, Jr.
Dr. Rebecca Gunnlaugsson
Mr. Allen Gillespie
Dr. Ronald Wilder
Mr. Travis Turner

Others present for all or a portion of the meeting on June 16-17, 2014:

Ashli Aslin, Geoff Berg, Jonathan Boyd, Betsy Burn, Andrew Chernick, Sarah Corbett, Louis Darmstadter, Dori Ditty, Robert Feinstein, Hershel Harper, Monica Houston, Adam Jordan, Doug Lybrand, James Manning, Bryan Moore, David Phillips, Eric Rovelli, Brian Wheeler, James Wingo, and Justin Young from the South Carolina Retirement System Investment Commission; Clarissa Adams and Robin Johnson from the State Treasurer's Office; Brady O'Connell from Hewitt EnnisKnupp, Inc.; Wayne Pruitt and Donald Tudor from the State Retirees Association of South Carolina; Steve Townes from Ranger Aerospace; Bill McLendon from Perot Aerospace; M. Sean Cary from Creel Court Reporting; Bruce Crouch from Thoughtful Productions; and Blaine Ewing.

I. CALL TO ORDER

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission ("Commission") to order at 10:31 a.m. As there were no prior minutes to review, Chairman Williams asked for a motion to adopt the proposed agenda. Dr. Rebecca Gunnlaugsson made a motion to approve the agenda as presented, which was seconded by Dr. Ronald Wilder, and passed unanimously.

II. INVESTMENT BELIEFS

Mr. Hershel Harper, Chief Investment Officer, began discussion of RSIC's investment beliefs by recalling the Funston Fiduciary Audit Report's recommendations that broader strategic thinking and investment beliefs be incorporated into the Statement of Investment Objectives and Policies ("SIOP"). He reviewed the current mission, vision, and values of RSIC, as well as the SIOP to ensure all Commissioners had a common point of reference. Mr. David Phillips, Deputy Chief Investment Officer, then reviewed a draft of ten investment beliefs and elicited comments from the Commissioners.

Mr. Allen Gillespie raised concerns about the inclusion of bullet one—which appeared to be the organization's larger strategic mission statement—in the investment beliefs. Mr. Gillespie stated

that it should be incorporated in a different section. Dr. Wilder requested clarification from Mr. Gillespie about his statements, which Mr. Gillespie provided. Mr. Robert Feinstein, Chief Legal Officer, agreed with Mr. Gillespie stating that the inclusion of that statement could introduce ambiguity about the mission.

Mr. Gillespie made a motion, which was seconded by Dr. Gunnlaugsson, to remove bullet one from the revised draft of investment principles. The motion was passed unanimously.

Discussion continued at length regarding the investment beliefs that should govern the management of the Portfolio. Commissioners referred to the draft beliefs posted on the presentation board and proposed revisions to those investment beliefs based on whether the Commission should assume a longer-term, more strategic view to balance out market volatility or a shorter-term, more tactical approach to realize gains more quickly. Commissioners discussed asset allocation, diversification, and overall risk-adjustment of the Portfolio and decided to continue the discussion on the subsequent day as part of the strategic planning session.

Chairman Williams recessed the meeting for lunch at 12:09 p.m.

Chairman Williams reconvened the meeting at 1:05 p.m.

III. SOUTH CAROLINA PRIVATE EQUITY

Mr. Harper provided context for a presentation on South Carolina private equity, stating that it was meant to be informational only and not an investment recommendation. Mr. Harper noted that a Request for Proposal (“RFP”) to research investment opportunities focused on South Carolina had been issued by the Commission several years ago. Mr. Harper stated that the Commission had previously decided this strategy was not a prudent method of investing for the Portfolio as investment decisions should not simply be made based on the geography of the investment opportunity.

Mr. Harper then turned the discussion over to Mr. Gillespie who pointed out some reasons in favor of creating a South Carolina-based private equity program within the Portfolio. Mr. Gillespie provided additional background and explained why he believes a South Carolina private equity program should be established by the Commission. Next, Mr. Gillespie introduced Mr. Steve Townes from Ranger Aerospace, who presented information on the converging of the automotive, aerospace, advanced materials, and related technologies in the Southeastern United States. Mr. Townes explained the current and future impacts of this rapidly-growing sector in South Carolina, and the potential for growth and return on investment. Mr. Townes then introduced Mr. Bill McLendon from Perot Aerospace. Mr. McLendon reiterated Mr. Townes’ sentiment and provided information on an investment plan that he believed would generate substantial returns for the Portfolio’s beneficiaries and result in economic growth in South Carolina by capitalizing on the momentum of those and other industries that are critical to the state.

Discussion ensued regarding the most prudent manner for RSIC to take advantage of these types of opportunities. Mr. Gillespie raised the possibility of adopting other operational models that would allow for investing in South Carolina private equity. Mr. Harper and Ms. Sarah Corbett, Executive Director, stated that RSIC’s current strategic partnership model allows for some investing based on industry, geography, or other niche characteristics. Mr. Harper also described the investment models of other major public pension funds and how RSIC fits into that spectrum of models. Mr. Gillespie requested that as part of the regular asset class plans evaluations, RSIC staff (“Staff”) investigate creating an organizational structure that would allow for investing in

South Carolina private equity. Mr. Harper agreed to allocate resources to this research and report back to the Commission.

The Commission briefly recessed for a break at 2:34 p.m.

Chairman Williams reconvened the meeting at 2:51 p.m.

IV. ASSET CLASS PLANS

Mr. Harper began the discussion by describing the relationship between the asset class plans and the Annual Investment Plan, as adopted in April 2014. Mr. Harper then introduced Mr. Justin Young, Investment Analyst, who presented four frameworks through which asset allocation decisions can be made: portfolio construction, capital preservation, correlation and volatility, and the overall business cycle.

Next, Mr. Geoff Berg, Managing Director, delivered a presentation on the benefits of fixed income investments in the Portfolio. Mr. Berg explained that while not high-yielding, conservative fixed income investments help balance out other asset classes that perform poorly during times of equity stress. Mr. Curtis Loftis raised concerns about RSIC's access to its cash reserves and asked whether partnerships pose impediments to that access in the short duration. Messrs. Harper and Berg explained that RSIC's cash liquidity process is standard practice amongst public pension funds and does not present issues for the Portfolio.

Ms. Ashli Aslin, Investment Officer, presented information regarding the role of mixed credit and emerging market debt ("EMD") investments in the Portfolio. These investments are expected to outperform core fixed income investments based on Hewitt EnnisKnupp, Inc.'s ("HEK") research. Currently, mixed credit investments are managed externally through strategic partnerships, direct hedge fund investments, and passive implementation. RSIC is proposing to add one or two multi-sector credit managers to more actively focus on mixed credit investments. Ms. Aslin further explained that the Portfolio's current EMD investments are implemented through a combination of active and passive strategies. Staff is planning to implement a passive strategy, to be complemented by active and opportunistic strategies, which will require the addition of three to four EMD managers.

Mr. Adam Jordan, Director of Strategic Partnerships, continued the asset class discussion by presenting information on the role of private debt in the Portfolio. Similar in structure to private equity, private debt offers the potential for higher returns and reduced risks when compared with some other investment types. Mr. Jordan stated that historically private debt has outperformed the benchmark, and RSIC plans to increase weight in that portfolio to capitalize on that performance. Mr. Jordan noted that Staff and HEK have developed a pacing model to achieve the targeted private debt allocation over the next five years. Like management of the Portfolio's other asset classes, Mr. Jordan emphasized that maintaining balance in this maneuver is key.

Mr. Bryan Moore, Senior Investment Officer, delivered a presentation on RSIC's low beta hedge fund portfolio, which seeks to determine hedge fund managers' skills while incurring lower levels of volatility. Mr. Moore explained that this portfolio is divided into traditional hedge fund strategies and hedge fund seed strategies. Over the next three to five years, RSIC will optimize its portfolio's traditional strategies as they become more liquid. RSIC will also distribute liquidation proceeds to high-performing seed funds or traditional hedge funds. Staff will approach this decision in a disciplined manner that will complement the diversification of the Portfolio.

Mr. Berg next presented information on the Portfolio's global asset allocation. Mr. Berg explained that this asset class has historically been comprised of two main strategies: global tactical asset allocation ("GTAA") and risk parity. Currently, this asset class is equally disbursed amongst GTAA, risk parity, and passive strategies. Mr. Berg stated that RSIC will begin selectively pursuing opportunistic investments and reduce the asset class' passive exposures. The purpose of this shift is to pursue better managers and bring more balance to the asset class.

Mr. Eric Rovelli, Senior Investment Officer, presented information on the real asset portfolio. Mr. Rovelli stated that real assets can offer income and capital appreciation with some partial protection against inflation. Over the next five years, Staff will work to balance the portfolio so that it is comprised equally of both core and non-core assets. Mr. Rovelli further stated that this structure supports diversification and risk management.

Mr. Young reviewed RSIC's commodity portfolio explaining that its returns stem from roll yields of futures and spot price increases. While a very volatile asset class, which RSIC needs to mitigate in other areas, commodities do offer potential diversification benefits, especially in later parts of the business cycle. Messrs. Harper and Young summarized the strategies that RSIC has and will employ going forward to hedge inflation and derive returns, including allocating to broader benchmarks as opposed to focusing on a few specific commodities.

Mr. Moore continued the asset class discussion with a presentation on RSIC's global public equity assets, which comprise 31 percent of the Portfolio. Updating the Commission on the status of this asset class, Mr. Moore reported that Staff had successfully transitioned \$2 billion of synthetic exposure to physical exposure, is currently searching for two to three more managers, and is rebalancing this asset class to maintain appropriate diversification. In addition, Mr. Moore stated that RSIC will be implementing an enhanced indexing strategy, which will reduce fees.

V. PRIVATE EQUITY

Mr. Louis Darmstadter opened his presentation on the private equity portfolio by providing information on its recent performance, which amounted to a 13.6 percent rate of return through the end of Fiscal Year 2013. With 25 active managers, private equity was the only asset class that exceeded the actuarial rate of return of 7.5 percent. Demonstrating quarter-over-quarter improvement over the year, RSIC's private equity program would be considered successful by most commonly used measures, reported Mr. Darmstadter. It is an asset class that is best evaluated over the long term, and Staff expect it to generate above average returns.

VI. EXECUTIVE SESSION

Chairman Williams made a motion, which was unanimously passed, to recede to Executive Session to discuss investment matters and legal matters, pursuant to S.C. Code Ann. §§9-16-80 and 9-16-320. After a brief break, the Commission receded into executive session at 4:50 p.m.

The Commission reconvened in open session at 5:28 p.m. The Chairman reported that the Commission did not take any reportable action while in executive session, but they discussed investment matters and received a legal briefing.

The meeting recessed at 5:29 p.m., to reconvene at 8:30 a.m. on Tuesday, June 17, 2014.

VII. CALL TO ORDER

Chairman Reynolds Williams called the meeting of the South Carolina Retirement System Investment Commission ("Commission") to order at 8:40 a.m.

VIII. STRATEGIC PLAN

Ms. Sarah Corbett began discussion of the strategic plan by providing context on the plan's most recent versions, which were adopted in 2009 to 2012. The Commission has not had a strategic plan since then, hence the need to collaborate and develop consensus on the overarching goals of the organization. After presenting the proposed strategic goals, Ms. Corbett asked Commissioners to refer to a summary of input provided by RSIC staff during a meeting held in early June and the Funston fiduciary audit report recommendations. In order to drive discussion, she also reviewed the results of a survey given previously to Commissioners in which they ranked RSIC issues based on priority.

Issues of particular import raised during the discussion of strategic goals were:

- A. Execute major investment portfolio initiatives designed to meet the actuarial rate of return and exceed the policy benchmark while maintaining a prudent level of risk;
- B. Build trust and confidence in the organization at the Commission level and with broader stakeholder groups by improving assurance and reassurance and clearly communicating investment beliefs, strategies, and performance;
- C. Enhance the Commissioners' focus on strategy and oversight;
- D. Advocate and educate the General Assembly regarding the alignment of fiduciary duties and responsibilities, and improve custodian relationships;
- E. Develop, implement, and maintain robust technology systems and processes to provide timely, relevant, and accurate data upon which to make prudent investment decisions to appropriately monitor investment actions; and
- F. Develop, implement, and maintain human resource practices that support the investment strategy and objectives of RSIC and encourage, empower, and direct staff to achieve Commission goals.

Upon conclusion of the discussion, the Commission agreed to accept the proposed strategic goals. Ms. Corbett and Mr. Hershel Harper stated that RSIC staff would develop the underlying tasks required to achieve the goals and present them at the next Commission meeting.

IX. COMMISSION EVALUATION

Chairman Reynolds Williams presented a summary of the results of the Commission Evaluation from Fiscal Year 2013 in which Commissioners rated the Commission's performance using various criteria based on a scale of 1 (the highest score) to 4 (the lowest score). The overall average grade for the Commission was 2.89, the median was 2.93.

The area with the highest score of 3.66 related to the following criteria:

- A. Ensuring staff provides new Commissioner information with prompt and thorough orientation;
- B. The Commission members understand their fiduciary responsibilities related to membership on the Commission; and
- C. The issues and matters presented for Commission review and decision-making are appropriate work for the Commission.

The area with the lowest score of 2.14 related to the following criteria:

- A. The Commission meets with sufficient frequency and duration to conduct the affairs of the agency appropriately;

- B. The Commission has achieved the goals and objectives it set out to accomplish during the past year; and
- C. The Commission engages in long-term strategic thinking and planning.

Chairman Williams provided the Commissioners with a compilation of comments received as a part of the Commission Evaluation.

X. AUDIT COMMITTEE REPORT

Mr. Allen Gillespie gave a brief update on the Audit Committee's activities since the prior Commission meeting. Mr. Gillespie reported that the current audit was in process, the annual investment report field work was completed, and the information technology risk assessment was completed and a report was being drafted by Deloitte and Touche. Development of the 2014-2015 risk assessment and audit completion plan was postponed until after the strategic planning meeting to ensure these plans were consistent with overarching goals.

XI. ENTERPRISE RISK MANAGEMENT UPDATE

Mr. Andrew Chernick gave a presentation on RSIC's new enterprise risk management ("ERM") program, which was created on April 1, 2014 by the Audit Committee, in response to the Funston fiduciary audit report recommendations. Mr. Chernick defined ERM as efforts to identify, manage, and mitigate risk in the achievement of RSIC's goals. In addition to the operational risks Mr. Chernick identified in his presentation, he solicited input from Commissioners regarding types of risk about which they were most concerned. Commissioners raised concerns on risk pertaining to politics, personnel issues, IT management, budget, and legal issues. Mr. Chernick noted the importance of communicating these risks to all staff and the Commission, maintaining proper documentation of efforts to address the risks, and inclusion of ERM activities in the strategic plan. Mr. Chernick also requested that the Commission be actively involved in the enterprise risk monitoring process so that ERM is nimble and able to meet the needs of Commissioners.

XII. HUMAN RESOURCES AND COMPENSATION COMMITTEE REPORT

Mr. Giobbe discussed the Compensation Policy issues that were addressed in the May 19, 2014 meeting to include Funston's recommendation to review RSIC's Compensation Policy and to conduct a new peer compensation study at least every three years. Mr. Giobbe noted that the Human Resources and Compensation Committee ("HRC Committee") will ensure that actual individual Performance Incentive Compensation payments ("PIC") are subject to an individual assessment in accordance with the Compensation Policy for FYE 2014 before PIC is paid to eligible staff. Mr. Giobbe added that the HRC Committee will focus on this topic in upcoming meetings as part of its commitment to the House Ways and Means Committee. Mr. Giobbe presented the recommendation from the Human Resources and Compensation Committee to approve the issuance of a Request for Proposals ("RFP") in accordance with the scope of work as outlined and posted on Watchdox. The motion was approved unanimously.

XIII. INVESTMENT REPORT

Mr. Harper requested that RSIC staff have time to combine all recommendations and suggestions from the investment belief session held the day prior and circulate a third draft to Commissioners for comment and review. Mr. Harper provided an update on the process and legal issues surrounding the transition of the global equity portfolio to its new manager. Reporting on the 2013-2014 Annual Investment Plan, Mr. Harper stated that progress continued to be made on all objectives including those related to hedge fund, global equity, and global fixed income portfolios. Staff is also in the process of filling four FTE positions in the private equity, credit and research areas. Mr. Harper also noted that research was being done on potential outsourcing solutions

due to the high number of managers covered by investment staff. Mr. Harper concluded the report by announcing that estimated plan performance through May 2014 was up 14.5% and the policy return was up 13.5%.

XIV. PERFORMANCE UPDATE

Mr. Phillips reported on the performance of the Plan through March 2014, which resulted in returns of 11.2% versus policy of 10.74%. Net benefit payments were just over \$750 million. With estimates for May and June basis points factored in, Mr. Phillips posited that fiscal year performance expectations to date would be 14.99%. Mr. Phillips announced that Plan value exceeded \$29 billion for the first time since the Fund's creation. Commissioners inquired about the established risk limit and how that exposure could affect fund performance. Messrs. Harper and Phillips explained that the risk limit is self-imposed, and can be revisited, but is established to reduce exposure of the Fund.

XV. INTEGRITY CONSENT

Mr. Harper gave a brief update of the Integrity Asset Management ("Integrity") which was previously purchased by Munder Capital Management and its parent company, Munder Capital Holdings, LLC and has recently entered into a purchase agreement with Victory Asset Management ("Victory"). While Integrity will continue to manage the assets, ownership will lie with Victory. This transfer of ownership will require an assignment of the investment management agreement under the Investment Advisors Act. Mr. Harper noted that Staff continues to believe that the team managing the assets with Integrity is a strong team and the change in ownership structure does not negatively impact Staff's view of the manager. Mr. Gillespie proposed a motion to adopt the recommendation of the CIO and RSIC Staff to consent to the assignment of the investment management agreement with Integrity Asset Management to Victory Capital Management, to permit the Integrity management team to continue managing the U.S. Small Cap Value portfolio, and to authorize the Chairman or his designee to execute any necessary documents to implement the decision as approved by the Commission. Dr. Wilder seconded the motion, which was unanimously approved.

XVI. HEK SERVICE PROVIDER REVIEW

Ms. Ashli Aslin provided historical context on the contractual relationship with Hewitt EnnisKnupp, Inc. ("HEK"), RSIC's general investment consultant for the past eighteen months. Ms. Aslin noted that HEK's performance as a service provider will be monitored on an ongoing basis, with reports to the Commission provided at least annually. HEK is required to provide investment manager composite and plan specific reports, including an annual report to the Commission. Ms. Aslin reported that HEK is meeting its contractual obligations and providing the research and analysis as required.

XVII. ADJOURNMENT

There being no further business and upon unanimous consent, Chairman Williams announced that the Commission meeting was adjourned at 11:37 am.

[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 9:28 a.m. on June 13, 2014.]