

**South Carolina Retirement System Investment Commission
Audit and Enterprise Risk Management Committee Meeting
Minutes
March 5, 2019**

**Capitol Center
1201 Main Street, Suite 1510
Columbia, South Carolina 29201**

Committee Members Present:
Mr. William H. Hancock, Chair
Ms. Peggy Boykin
Mr. William J. Condon, Jr. (Via Telephone)

I. CALL TO ORDER & ADOPTION OF PROPOSED AGENDA

Chair Mr. William H. Hancock called the meeting of the Audit and Enterprise Risk Management Committee (“Committee”) of the South Carolina Retirement System Investment Commission (“Commission”) to order at 8:30 a.m. Ms. Peggy Boykin made a motion, which was seconded by Mr. William J. Condon, Jr., to adopt the agenda as presented.

II. APPROVAL OF MINUTES (OCTOBER 24, 2018)

Chair Hancock referred to the draft minutes from the Committee’s October 24, 2018 meeting. Ms. Boykin made a motion to adopt minutes from the October 24, 2018 Committee meeting as presented. Mr. Condon seconded the motion, and it was unanimously approved.

III. COMPLIANCE UPDATE

Chair Hancock recognized Ms. Michelle Kennedy, Director of Enterprise Risk Management and Compliance, for the compliance update. Ms. Kennedy began by noting that compliance reviews regarding Securities Lending, Personal Trading, and Separately Managed Account Quarterly certifications for the quarters ending September 30, 2018 and December 31, 2018 were complete, and no material issues were noted. Ms. Kennedy then turned to a discussion of the Bank of New York Mellon’s (“Custodian”) coding of investment guidelines for RSIC’s global fixed income separately managed accounts (“SMA”). She explained that the Custodian had completed coding of the global fixed income SMA guidelines, and by the end of the week, RSIC Staff (“Staff”) would be sending the Custodian the investment guidelines coding for equity accounts.

IV. INTERNAL AUDIT UPDATE

Chair Hancock then recognized Mr. Andrew Chernick, Chief Operating Officer, for an update on internal audit matters. Mr. Chernick stated that, during his report, he would be providing both an update on internal audit matters as well as RSIC’s Executive Leadership Teams’ (“Leadership Team”) thoughts on a path forward for RSIC’s internal audit function. Next, Mr. Chernick reminded the Committee that ACA Performance Services, LLC recently completed the Global Investment Performance Standards (“GIPS”) verification review and that the

annual Agreed Upon Procedures (“AUP”) Review of RSIC’s investment valuation and initial and ongoing due diligence procedures is complete.

Mr. Chernick then turned to open engagements. He began by stating that the Cash Management Implementation Review (“Cash Management Review”), which was part of the 2018-19 Fiscal Year Audit Plan, has not been completed, and Staff is recommending the Cash Management Review be postponed and included in 2019-20 Fiscal Year Audit Plan. Mr. Chernick also notified the Committee that, per the South Carolina Office of the State Auditor (“State Auditor”), an outside audit firm will be coming onsite to RSIC’s offices to conduct an AUP Review of RSIC’s Procurement function in relation to Fiscal Year 2018.

Mr. Chernick then began a discussion about a path forward for RSIC’s internal audit function. He reminded the Committee about some of the staffing challenges RSIC has faced with respect to internal audit over the past few years. He then stated that the Leadership Team, with the help of Ms. Kennedy and Mr. Mitchell Goldsmith, Legal Counsel, have developed a plan for outsourcing the internal audit function. In terms of timeline, Mr. Chernick stated that the audit vendor will need to be in place to conduct RSIC’s 2019-20 Audit Plan. He then provided the Committee with a brief history of RSIC’s internal audit function, which began in 2012. RSIC’s first risk assessments were conducted in 2013. In 2016, Staff developed a spreadsheet showing all of the reviews performed at RSIC since its inception. He then highlighted some of the reviews conducted by third parties, which include reviews by the State Auditor’s Office, the fiduciary performance audits, the AUP Reviews of investment due diligence and valuations, as well as the GIPS review.

Next, Mr. Chernick explained to the Committee that Staff is recommending that the Committee outsource the internal audit function utilizing the list of preapproved audit vendors provided by the State Auditor’s Office, which includes Deloitte & Touche L.L.P., Elliott Davis, LLC, and Experis. He stated that Staff plans to engage an audit vendor to perform a risk assessment of RSIC, and based on the risk assessment, develop a three-year audit plan that the audit vendor will then perform. The focus of the three-year audit plan will be on higher risk areas and will also take into account the time elapsed since an area was last tested. In terms of timeline, Mr. Chernick stated that Staff has already spoken to the preapproved vendors and would begin drafting a scope for the engagement, which should be complete by May of 2019. Staff hopes to release the scope for the engagement to the preapproved vendors no later than early May of 2019. Proposals should be received before the beginning of June of 2019, and Staff intends to present the proposed vendor at the Committee’s June meeting. Thereafter, work on the risk assessment should begin by July of 2017 and culminate with a presentation of the risk assessment, the proposed auditable universe, and the three-year audit plan at the Committee’s August meeting. Upon approval by the Committee, the vendor would then begin executing on the three-year audit plan.

Following Mr. Chernick’s presentation, Mr. Condon inquired about the risk assessment. Mr. Chernick explained that the vendor would validate all auditable units within RSIC and then conduct a risk assessment in order to assign a risk rating to the auditable units. Mr. Michael Hitchcock, Chief Executive Officer (“CEO”), underscored that the value of outsourced internal audit vendor is to have an independent voice to the Committee that can relay risk concerns free of management bias. Chair Hancock expressed interest in receiving versions of the risk assessment and the three-year audit plan to provide advance feedback, and Mr. Chernick confirmed that Staff would do so.

Mr. Chernick then turned the discussion back to the Cash Management Review. He stated that Staff recommends adding the Cash Management Review to the Fiscal Year 2019-20 Audit Plan. Mr. Condon inquired about the timing of the Cash Management Review, and Mr. Chernick explained that the review would be prioritized on the three-year audit plan. Mr. Chernick and Mr. Hitchcock both explained that, while cash management is a high-risk area that should be reviewed soon, a few months' delay should not be a cause for concern.

Ms. Boykin then made a motion to amend the Fiscal Year 2018-19 Internal Audit Plan, as discussed during the meeting, to postpone the Cash Management Implementation Review to Fiscal Year 2019-2020. Mr. Condon seconded the motion, which passed unanimously.

V. OVERVIEW OF RSIC INVESTMENT DUE DILIGENCE PROCEDURES

The Chair then recognized Mr. Bryan Moore, Managing Director of Public Markets, to provide a presentation on RSIC's investment due diligence procedures. Mr. Moore explained that he would be providing two presentations: one on initial investment due diligence and one on ongoing investment due diligence. Mr. Moore stated that the goal of initial due diligence is to have a repeatable process that prevents haphazard decision-making. Mr. Moore explained that the first step is to identify an investment need within the Portfolio ("Portfolio"). Next, Staff conducts a peer review process with the first of two peer reviews focusing on determining portfolio fit, active versus passive management, and what sort of investment manager would be most efficient. He added that the peer review convenes the members of RSIC's Internal Investment Committee ("IIC").

Chair Hancock asked at what stage the decision to implement a strategy actively or passively is made. Mr. Moore responded that the decision can be made during the peer review process but is typically ongoing throughout the process. Then, Mr. Condon asked if Staff makes decisions to select certain investment managers during the peer review process. Mr. Moore responded that lists of investment managers are narrowed during the peer review but not necessarily selected at that point. He added that, in some cases, the decision to invest actively or passively depends on investment manager availability in the space.

Mr. Moore continued by explaining how, after peer review one, RSIC's Quantitative Solutions Group ("QSG"), which is headed by Mr. James Wingo, Director, evaluates alpha creation with respect to an investment. Along with the QSG review, RSIC's Investment Team sends out RSIC's Due Diligence Questionnaire, which contains roughly 120 questions covering various risk-related areas. RSIC's Legal department is also engaged to identify legal considerations. Once these departments have had a chance to review, a peer review two meeting is held to discuss the findings. Next, a due diligence report is created, which highlights the pros and cons of an investment as well as other key investment terms. Before an investment can proceed to a vote during an IIC meeting, the Director of Enterprise Risk Management and Compliance confirms to the Chief Investment Officer ("CIO") that all required documents have been retained. Mr. Moore stated that, ultimately, the investment is voted on during an IIC meeting and is passed on to the CIO for final approval.

Following the CIO's approval, the investment's legal documents, the investment due diligence materials, and the legal certifications are posted to RSIC's online portal for a three-day review period so that the Commissioners may review. Mr. Hitchcock noted that the three-day review period is the same for investments approved by the Commission or pursuant to RSIC's Investment Authority Delegation Policy. At the end of the third day, the legal documents are signed by the CEO, and the investment closes. Mr. Moore then stated

that Staff's execution of RSIC's Investment Due Diligence Policy for a sample of investments is tested annually as part of the AUP Review conducted by CliftonLarsonAllen LLP. Mr. Moore then took questions from the Committee. As an aside, Mr. Moore added that, at the Committee's next meeting, Mr. Scott Forrest, Director of Investment Operations, will present to the Committee on RSIC's investment operational due diligence process.

A five-minute break was taken.

VI. ENTERPRISE RISK MANAGEMENT UPDATE

The Chair then recognized Mr. Hitchcock and Ms. Kennedy for a discussion concerning RSIC's Enterprise Risk Management ("ERM") function. Mr. Hitchcock began by noting that Funston's Fiduciary Performance Audit Report ("Funston Report") was delivered to the South Carolina General Assembly, and Staff has received no comments or questions. Mr. Hitchcock stated that, utilizing the recommendations of the Funston Report, Staff plans on working towards developing a world class ERM function. He added that, while Ms. Kennedy would be overseeing and facilitating ERM, all members of the Leadership Team will be responsible for RSIC's ERM function. With that, Mr. Hitchcock asked Ms. Kennedy to discuss her plans for the ERM function.

Ms. Kennedy began by noting that she has been in her role for two months, and she is beginning the ERM buildout process. She explained that she plans to leverage the Funston Report as well as Funston's ERM Roadmap, which contains four key steps to building out an effective ERM function. She stated that the first step is to define the business model, and Funston has done so for RSIC in the Funston Report. The second step is to define the key risks, and again, the Funston Report did so, defining five risks: strategic, investment, operational, business continuity, and reputational risk. She noted that Staff will still need to define the sub-types of those risks. The third step is to define the key performance indicators ("KPIs") and the key risk indicators ("KRIs"). Finally, the last step is monitoring the KPIs and the KRIs within their preset tolerance levels. Ms. Kennedy surmised that Funston's ERM Roadmap provides the tools for a robust ERM function, and she anticipates making substantial progress over the next year.

VII. ADJOURNMENT

There being no further business, Ms. Boykin made a motion to adjourn. Mr. Condon seconded the motion, which passed unanimously. The meeting adjourned at 10:01 a.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 on February 28, 2019 at 4:12 p.m. at the entrance, in the lobbies, and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, S.C.]