

**South Carolina Retirement System Investment Commission  
Audit and Enterprise Risk Management Committee Meeting  
Minutes  
June 4, 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)

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**I. CALL TO ORDER AND 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 (“RSIC”) to order at 8:39 a.m. Ms. Peggy Boykin made a motion, which was seconded by Mr. William J. Condon, Jr., to adopt the agenda as presented, and it was unanimously approved.

**II. APPROVAL OF MINUTES (MARCH 5, 2019)**

Chair Hancock referred to the draft minutes from the Committee’s March 5, 2019 meeting. Ms. Boykin made a motion to adopt minutes from the March 5, 2019 Committee meeting as presented. Mr. Condon seconded the motion, and it was unanimously approved.

**III. COMPLIANCE AND ENTERPRISE RISK MANAGEMENT UPDATE**

Chair Hancock then recognized Ms. Michelle Kennedy, Director of Enterprise Risk Management and Compliance, for the compliance update. Ms. Kennedy began by stating that the quarterly compliance reviews regarding Separately Managed Accounts (“SMAs”) and Securities Lending are complete for the period ending March 31, 2019, and no material issues were noted. Ms. Boykin inquired about whether all of RSIC’s securities lending is still conducted by its custodial bank, the Bank of New York Mellon (“BNYM”), and Mr. Geoffrey Berg, Chief Investment Officer (“CIO”), responded in the affirmative. Ms. Kennedy continued by stating that the quarterly compliance review regarding Personal Trading for the period ending March 31, 2019 was also complete, and no material issues were noted.

Ms. Kennedy then turned to a discussion of BNYM’s coding of RSIC’s investment guidelines for the SMA accounts. She reminded the Committee that RSIC Staff (“Staff”) has been working with BNYM to code the investment guidelines for the short duration, global fixed income, and equity accounts. Ms. Kennedy explained that Staff has begun receiving weekly exceptions reports from BNYM, which allow Staff to monitor for any investment guideline breaches within RSIC’s SMAs.

Next, Ms. Kennedy provided an update on the buildout of RSIC’s Enterprise Risk Management (“ERM”) function. She began by referring the Commissioners to the vendor presentation in the Executive Session materials, which she stated outlines Staff’s vision for

RSIC's utilization of an ERM consultant. Ms. Kennedy stated that, at a high level, there are three phases through which an ERM consultant would assist RSIC: (1) a strategic phase; (2) a review and challenge phase; and (3) a transition phase. With respect to the strategic phase, the ERM consultant will assist Staff by providing an ERM gap analysis, determining Staff's progress to date, and developing a strategic plan. The ERM consultant will then conduct the review and challenge phase in which the ERM consultant will assist Staff in reviewing and challenging RSIC's current ERM framework. During this phase, the ERM consultant will assist with the identification of appropriate risk owners amongst Staff as well as identifying the key risk and performance indicators. The ERM consultant, during the final phase, will help RSIC transition to the new ERM approach.

#### **IV. INTERNAL AUDIT UPDATE**

Chair Hancock then recognized Mr. Andrew Chernick, Chief Operating Officer, for an update on internal audit matters. Mr. Chernick began by reminding the Commissioners about the three engagements completed in Fiscal Year 2018-19: (1) the Global Investment Performance Standards ("GIPS") Verification Review; (2) the annual Agreed Upon Procedures ("AUP") Review of RSIC's Investment Valuation and Investment Due Diligence Procedures ("AUP Review of Valuation and Due Diligence"); and (3) the Fiduciary Performance Audit. He also reminded the Commissioners that the Cash Management Implementation Review was pushed to the 2019-20 Fiscal Year Audit Plan.

Looking forward, Mr. Chernick stated that Staff is preparing for an AUP Review for the Fiscal Year ending June 30, 2018 of RSIC's covered cash receipts and disbursements; targeted testing of payroll; review of journal entries and transfers; and review of compliance with the Appropriations Act during the fiscal year. He explained that the South Carolina Office of the State Auditor ("State Auditor's Office") has selected a vendor and fieldwork will commence soon. Mr. Chernick then stated that Staff would provide a draft of the Fiscal Year ended June 30, 2019 AUP Review of Valuation and Due Diligence at the Committee's next meeting and also noted that the GIPS verification review for the Fiscal Year ended June 30, 2019 should begin in September of 2019.

#### **V. EXECUTIVE SESSION**

Ms. Boykin made a motion to recede into Executive Session to discuss negotiations incident to proposed contractual arrangements for an internal audit and consulting services vendor and to receive legal advice pursuant to S.C. Code Ann. Section 30-4-70(a)(2). Mr. Condon seconded the motion, and it was unanimously approved.

#### **VI. POTENTIAL ACTIONS RESULTING FROM EXECUTIVE SESSION**

Upon returning from Executive Session, Ms. Boykin made a motion to authorize the retention of Deloitte & Touche L.L.P. as the internal audit and consulting services vendor as discussed in Executive Session and pursuant to the Internal Audit and Consulting Services Request for Information issued on April 19, 2019; and authorize the CEO or his designee to negotiate and execute any necessary documents to effectuate the retention upon approval for legal sufficiency by RSIC Legal. Mr. Condon seconded the motion, and it was unanimously approved.

## VII. OVERVIEW OF VALUATION AND OPERATIONAL DUE DILIGENCE PROCEDURES

Chair Hancock then recognized Mr. Chernick to provide a presentation on the South Carolina Retirement System's Investment Valuation Policy ("Valuation Policy"). Mr. Chernick began his presentation by recognizing Mr. Donald Brock from the South Carolina Public Employee Benefit Authority ("PEBA") where he serves as Accountant and Fiscal Analyst. Mr. Brock stated that, in his role, he jointly works with RSIC to help ensure compliance with the requirements of the Valuation Policy. Mr. Chernick then explained how the Valuation Policy was developed in March of 2013 as a collaborative effort between RSIC and PEBA. Since that time, updates have been made to the Valuation Policy, and it has been formalized in the Amended and Restated Memorandum of Understanding between RSIC and PEBA. The Valuation Policy created the Joint Valuation Committee ("Valuation Committee"), which is composed of RSIC's senior Reporting and Investment Operations Staff as well as PEBA's Finance and Investment Accounting Staff ("Accounting Team"). The Valuation Committee meets no less than quarterly with some of its primary responsibilities being reviewing the Valuation Policy, making preparations for the Retirement Systems Trust Fund's fiscal year-end external audit, discussing any investment valuation concerns, and reviewing BNYM's pricing guidelines as well as its SOC-1 Report.

Mr. Chernick then turned to an overview of the Valuation Policy stating that the purpose of the Valuation Policy is to provide a framework for objective and consistent reporting of the fair market value of the Portfolio ("Portfolio"). He reminded the Commissioners that BNYM is the official valuation provider for all custodied investments and consolidates investment manager provided valuations for non-custodied investments, which consist primarily of private markets fund investments. Mr. Chernick then explained some examples of independent oversight mechanisms relating to the methods by which the Portfolio's investments are valued. The Retirement Systems Trust Funds financial statements are audited annually by external auditors hired by the State Auditor's Office, currently CliftonLarsonAllen LLP ("CLA"). In addition, CLA annually performs the annual AUP Review of Valuation and Due Diligence.

Turning to the subject of accounting guidance, Mr. Chernick stated that all investments in the Portfolio are reported at fair value in accordance with the Governmental Accounting Standards Board Statement No. 72 ("GASB 72"). For non-custodied fund investments, the Plan ("Plan") uses Net Asset Value ("NAV") to value investments in accordance with GASB 72. RSIC and PEBA have detailed procedures in place to ensure that, for investments that are valued by NAV, the NAV is measured in a manner consistent with the Financial Accounting Standards Report ("FASB") Requirements for Fair Value Measurement. RSIC includes these valuation procedures as part of RSIC's initial and ongoing due diligence processes, which are documented in the Valuation Policy.

Mr. Chernick then turned to a discussion of RSIC's investment manager due diligence processes as related to valuation oversight. With respect to initial due diligence of an investment manager, Mr. Chernick stated that RSIC collects the investment manager's valuation policy, which is reviewed by Mr. Scott Forrest, Director of Investment Operations, and in the case of a private markets fund, RSIC's private markets investment consultant, Albourne America LLC ("Albourne"). In addition, Mr. Forrest has developed extensive due diligence questionnaires for both investment managers and their administrators, when administrators are utilized. He also added that, whenever possible, historical valuation exit reviews on private markets funds are performed by Staff. Turning to a discussion of ongoing due diligence, Mr. Chernick explained that Staff reviews investment funds' annual audited

financial statements. RSIC's also sends its Annual Investment Manager Compliance Questionnaire ("Compliance Questionnaire") to its investment managers. The Compliance Questionnaire covers a wide array of topics, including changes to investment managers' respective valuation policies and service providers, compliance with FASB Accounting Standards Codification 820, which covers Requirements for Fair Value Measurement, as well as collecting investment manager's SOC-1s, if available. The responses to the Compliance Questionnaires are reviewed by Staff across numerous RSIC departments and valuation question responses along with any SOC-1s are shared with PEBA. Staff also utilizes BNYM's monthly performance reporting to monitor and evaluate performance of RSIC's investment managers. Finally, Staff also conducts ongoing due diligence calls with investment managers that cover a wide array of topics, including issues impacting investment manager's valuation and valuation oversight capabilities.

Mr. Chernick then asked Mr. Brock to discuss the valuation oversight performed by PEBA. Mr. Brock began by stating that PEBA has a team of four accounting professionals that conduct monthly and annual reconciliations of every investment account. He explained that in-bank assets can be reconciled quickly but out-of-bank assets take longer. He stated that, if PEBA's Accounting Team flags any issues, those issues are escalated to the Valuation Committee. Chair Hancock inquired about how Staff deals with investment managers that are tardy in providing reporting information. Ms. Betsy Burn, Chief Legal Officer, responded that RSIC's Legal Team attempts to negotiate reporting requirements within the legal documentation for each investment manager. Mr. Brock then discussed some of the other responsibilities of PEBA's Accounting Team, which include ensuring capital calls are paid, distributions are received, and annually preparing the CAFR.

Following Mr. Brock's presentation, Mr. Forrest began a presentation about RSIC's Operational Due Diligence ("ODD") procedures. Mr. Forrest explained that the purpose of ODD is to identify operational risks associated with investment managers and determine if they are appropriately mitigated. He underscored that the goal of ODD is to independently evaluate investment managers. Mr. Forrest explained that, in his role, he uses three Due Diligence Questionnaires ("DDQ"). The first two DDQs are addressed to investment managers, and the third is addressed to fund administrators that are utilized by some investment managers. Mr. Forrest overviewed the entire ODD process explaining that the ODD Team typically has two weeks to perform an ODD review, which culminates with an ODD Report on an investment manager. He then highlighted examples of positive and negative ODD findings. Turning to the ongoing ODD that RSIC performs, Mr. Forrest explained that RSIC monitors investment managers' Form ADVs, which are filed with the U.S. Securities and Exchange Commission, reviews the responses to the Compliance Questionnaire, reviews consultants' ODD updates for existing firms and collaborates with RSIC's Legal Team on regulatory issues related to existing or prospective investment managers.

Upon concluding his remarks, Mr. Forrest turned the discussion over to Mr. Steve Taylor of Albourne. Mr. Taylor reaffirmed Mr. Forrest's explanation noting that Albourne and RSIC's ODD Team operate independently but share information, including discussing best practices. Mr. Taylor then gave an overview of Albourne's operational due diligence capabilities. Next, he explained Albourne's methodology for rating the quality of investment managers and their report structure. He then concluded his comments.

## **VIII. ADJOURNMENT**

There being no further business, Ms. Boykin made a motion to adjourn. Mr. Condon seconded the motion, which was unanimously approved. The meeting adjourned at 10:18 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 May 31, 2019 at 3:01 p.m. at the entrance, in the lobbies, and near the 15<sup>th</sup> Floor Presentation Center at 1201 Main Street, Columbia, S.C.]