

**South Carolina Retirement System Investment Commission
Audit and Enterprise Risk Management Committee Meeting
Minutes
August 27, 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.

I. CALL TO ORDER AND ADOPTION OF PROPOSED AGENDA

Chair Mr. William H. Hancock called the meeting of the Audit and Enterprise Management Committee (“Committee”) of the South Carolina Retirement System Investment Commission (“RSIC”) to order at 8:37 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 (JUNE 4, 2019)

Chair Hancock referred to the draft minutes from the Committee’s June 4, 2019 meeting. Mr. Condon made a motion to adopt the minutes from the June 4, 2019 Committee meeting as presented. Ms. Boykin seconded the motion, and it was unanimously approved.

III. INTERNAL AUDIT UPDATE

Chair Hancock then recognized Mr. Andrew Chernick, Chief Operating Officer, for an update on internal audit matters. Mr. Chernick began by notifying the Committee that the annual Agreed Upon Procedures (“AUP”) Review of RSIC’s Procurement-related areas (“Procurement AUP Review”) for Fiscal Year-End June 30, 2018 had been completed by the Hobbs Group and no findings were noted. He explained that the Procurement AUP Review covered RSIC’s cash receipts and disbursements; testing of payroll; review of journal entries and transfers; and review of compliance with the Appropriations Act. He then introduced Ms. Ally Rivers from the Hobbs Group who led the engagement. He also stated that Ms. Sue Moss, Director of State Audits from the South Carolina Office of the State Auditor (“State Auditor’s Office”), confirmed that RSIC has a three-year contract with the Hobbs Group and future Procurement AUP Reviews will be completed annually before May. In conclusion, Mr. Chernick congratulated Mr. Brian Wheeler, Administrative Manager, who oversees RSIC’s procurement function, for there being no findings resulting from the Procurement AUP Review for three consecutive years. Mr. Condon then inquired about the timeline of the Procurement AUP Review and whether it covered investment cash movements. Mr. Chernick responded that the delay in the most recent review was due to the process of hiring a firm to complete the Procurement

AUP Review and that the Procurement AUP Review only covers RSIC's operating budget.

Mr. Chernick then turned to a discussion concerning other engagements that are expected to be completed during Fiscal Year 2019-20. He began by explaining that RSIC Staff ("Staff") is planning to have ACA Compliance Group ("ACA") complete the Global Investment Performance Standards ("GIPS") Verification Review ("GIPS Review") for Fiscal Year-End June 30, 2019. As a reminder to the Committee, he noted that the GIPS Review was first performed for Fiscal Year-End June 30, 2018. Mr. Chernick explained that Staff anticipated that ACA would likely conduct fieldwork in September of 2019 and that the GIPS Report should be available at the Committee's next meeting.

Next, Mr. Chernick referenced the annual AUP Review of RSIC's Investment Valuation and Investment Due Diligence Procedures ("AUP Review of Valuation and Due Diligence"). He reminded the Committee that the AUP Review of Valuation and Due Diligence is conducted by CliftonLarsonAllen LLP ("CLA") in line with the audit of the South Carolina Retirement Systems' Comprehensive Annual Financial Report. Mr. Chernick explained that Staff is planning on expanding the AUP Review of Valuation and Due Diligence to cover employee compliance with RSIC's Code of Ethics as well as investment compliance in the areas of securities lending and counterparty risk. He added that Staff plans on expanding the AUP Review of Valuation and Due Diligence even further to other areas of Staff compliance in the coming year. Ms. Boykin stated that she appreciated the collaboration between RSIC and the South Carolina Public Employee Benefit Authority ("PEBA") to ensure the South Carolina Retirement Systems Group Trust as a whole is covered from a review standpoint. Mr. Chernick stated that CLA would be performing fieldwork in September of 2019 and that the AUP Review of Valuation and Due Diligence Report should be available at the Committee's next meeting.

Mr. Chernick then turned to a discussion of the Investment Cash Processing & Capital Call/Distribution Review. He reminded the Committee that the review was approved as part of the Fiscal Year 2019-20 Internal Audit Plan. Mr. Chernick stated that the review would be conducted by Deloitte & Touche L.L.P. ("Deloitte") with fieldwork beginning in November or December of 2019, and the resulting report should be available for the Committee's first meeting of 2020.

Following some discussion, Ms. Boykin made a motion to approve (i) the retention of ACA Compliance Group to perform the Global Investment Performance Standards ("GIPS") Review on behalf of RSIC; and (ii) the retention of CliftonLarsonAllen LLP to perform an Agreed Upon Procedures ("AUP") review on behalf of RSIC. Mr. Condon seconded the motion, and it was unanimously approved.

IV. RISK ASSESSMENT AND THREE-YEAR AUDIT PLAN PRESENTATION

Chair Hancock then recognized Mr. Ben Quigley, Mr. Matt Haberman, and Mr. Marcus Canady from Deloitte to present a risk assessment of RSIC as well as a proposed three-year audit plan for the organization. Mr. Quigley began by providing an overview of RSIC's engagement team at Deloitte ("Deloitte Team"). He explained

that the Deloitte Team breaks down into two groups: the Enterprise Risk Management (“ERM”) Group (“ERM Group”) and the Internal Audit Group (“IA Group”). Mr. Quigley stated that the ERM Group is composed of Mr. Adam Regelbrugge, Mr. Craig Stanton, and Mr. Canady. The IA Group is composed of Mr. Quigley, Mr. Haberman, and Mr. Todd Scarpino. In addition, the Deloitte Team is supported by Deloitte’s worldwide network of subject matter specialists.

Mr. Quigley then turned to a discussion of Deloitte’s risk assessment methodology. He explained that, working over the previous eight weeks, the Deloitte Team had been developing alongside Staff a risk assessment of RSIC that would inform a three-year audit plan. He stated that the Deloitte Team utilized a four phase approach: (1) understanding the organization; (2) developing a risk model; (3) assessing and prioritizing risk; and (4) developing an internal audit plan. In terms of understanding the organization, the Deloitte Team reviewed documentation provided by Staff, gained an understanding of the existing control environment, conducted Staff risk surveys, and conducted Staff interviews. Based on that information, the Deloitte Team created a risk model for RSIC.

Chair Hancock asked if the Deloitte Team encountered any surprises in the course of conducting the risk assessment. Mr. Quigley replied that there were no surprises, but the Deloitte Team encountered risk themes, including potential risks around cash processing, derivative overlay implementation, and securities lending. He added that the themes Deloitte encountered were taken into account in developing the Deloitte Team’s proposed Three-Year Audit Plan (“Three-Year Plan”). Mr. Quigley then explained how Staff had provided a predefined auditable universe for RSIC but noted that Deloitte challenged the predefined auditable universe and clarified areas in order to tailor the risk assessment to RSIC.

Mr. Quigley then returned to a discussion of the Deloitte Team’s four phased approach. The Deloitte Team assessed and prioritized risks, and based on the prioritization, developed the Three-Year Plan. Mr. Quigley then displayed a heat map showing the nine risk domains that the Deloitte Team mapped for RSIC. He explained that risk categories are comprised of multiple risks. Mr. Quigley also stated that the Deloitte Team took into account coverage of risk areas that are reviewed by third parties. Mr. Quigley noted that there are two areas with high residual risk: Staffing (“Staffing Risk”) and Systems/Infrastructure (“Systems Risk”). According to Mr. Quigley, the Staffing Risk relates to RSIC losing current members of Staff and being unable to locate suitable replacements. He opined that the Staffing Risk results from the geographic location of RSIC’s office and the skillsets required to meet RSIC’s staffing needs. Mr. Quigley noted that a review of this risk would not improve the risk rating. He then turned to the second risk noting that Systems Risk is inherent in all organizations due to the pervasive nature of cyber-attacks.

Mr. Condon then inquired about whether the Deloitte Team uncovered any areas that lack controls or other matters that presented immediate concerns. Mr. Quigley replied that there were no areas that the Deloitte Team thought lacked controls. However, Mr. Quigley noted that he was unable to speak to the effectiveness of the controls because the Deloitte Team had only assessed the design of RSIC’s controls. Mr. Quigley further explained that the proposed Three-Year Plan would

shine light on the effectiveness of RSIC's controls. Mr. Condon then expressed concern about not addressing the Staffing Risk. Mr. Michael Hitchcock, Chief Executive Officer, stated that Staff would be addressing the Staffing Risk by continuing to regularly examine RSIC's compensation practices to ensure that RSIC remains competitive in the marketplace as well as continuing to develop RSIC's Analyst Trainee Program to build new talent for the organization. Chair Hancock noted that succession planning would also help reduce Staffing Risk. Mr. Condon then expressed concern about documenting a plan for addressing the Staffing Risk, and Ms. Boykin suggested that it would be more appropriate to list the Staffing Risk as an ERM-related item due to its ongoing nature.

Following additional discussion, Mr. Quigley turned to the topic of the proposed Three-Year Plan. He explained that, utilizing the work that had been done to date, the Deloitte Team will perform eleven engagements over three years. He also stated that, depending on the type of risk and the controls in place, the Deloitte team will utilize one of three methods for each engagement: (1) discretionary reviews; (2) embedded assurance; and (3) consultative reviews. Mr. Quigley explained that discretionary reviews focus on back-testing controls. Embedded assurance would allow the Deloitte Team to provide "ride-along" assistance during the implementation of a process or procedure. Consultative reviews focus on advising and providing feedback on the effectiveness of how the organization is dealing with certain matters. Mr. Quigley clarified that, before each engagement, the Deloitte Team will provide a scope of review identifying the type of method that will be utilized.

Chair Hancock inquired about the prioritization of the engagements. Mr. Hitchcock stated that a review of RSIC's cash management processes and procedures was a top priority for Staff. Ms. Boykin noted that reviews concerning business continuity may need to have flexible timing considering any such reviews would involve PEBA as well. Based on the Committee's feedback, Mr. Quigley stated that the Deloitte Team's next steps would be to develop foundational internal audit tools for RSIC, develop a schedule for the engagements, and assist with updating the Committee's policies. The Committee then had a discussion about the risks associated with different types of public and private market investments.

Following additional discussion, Ms. Boykin made a motion to approve the Fiscal Years 2019-2020, 2020-2021, 2021-2022 Internal Audit Plan as presented by Deloitte & Touche, subject to annual reviews by the Committee. Mr. Condon seconded the motion, which was unanimously approved.

V. EXECUTIVE SESSION

Chair Hancock noted that no Executive Session was required for the meeting and moved on to the next topic on the Committee's Agenda.

VI. ENTERPRISE RISK MANAGEMENT UPDATE

Chair Hancock then recognized Ms. Michelle Kennedy, Director of Enterprise Risk Management and Compliance ("Director of ERM and Compliance"), for the ERM update. Ms. Kennedy began by informing the Committee that RSIC's ERM function is beginning to gain momentum. She stated that the Deloitte Team's completion of

the Risk Assessment has enabled her to begin performing an internal functional analysis and begin identifying potential gaps. In terms of next steps, Ms. Kennedy will be working with the Deloitte Team to finalize a list of strategic priorities. She then informed the Committee about her strategic vision for RSIC's ERM function, which includes: (1) developing a risk framework with risk owners; (2) creating a risk taxonomy; (3) developing a dashboard for ERM reporting; (4) gaining an understanding of key risk appetites; and (5) potentially conducting workshops for risk owners. Mr. Condon inquired about the recipients and frequency of the dashboard. Ms. Kennedy notified Mr. Condon that the dashboard would be provided to the Committee on at least a quarterly basis.

VII. COMPLIANCE UPDATE AND OVERVIEW OF RSIC'S COMPLIANCE FUNCTION

Ms. Kennedy began by notifying the Committee that her presentation would include normal reporting of routine compliance matters as well as an educational presentation on RSIC's compliance functions. She first addressed RSIC's Securities Lending Policy ("Lending Policy"). Ms. Kennedy stated that, in the event an exception to the Lending Policy is noted, the Director of ERM and Compliance notifies appropriate members of Staff in addition to the Chief Investment Officer ("CIO"). She explained that RSIC's Compliance Staff ("Compliance Staff") monitors for compliance with the Lending Policy by cross-referencing the Lending Policy guidelines with the quarterly reports provided by the Bank of New York Mellon. Ms. Kennedy explained that for the quarter ending June 30, 2019 the review is complete and no material issues were noted.

Next, Ms. Kennedy turned to a discussion of the Separately Managed Account ("SMA") Certification ("SMA Certification") process. RSIC's Ongoing Due Diligence Policy requires investment managers' compliance with SMA Investment Guidelines ("Investment Guidelines") be monitored quarterly. Investment Guideline compliance may be verified via investment manager certifications or independent guideline reviews. RSIC collects investment manager certifications and reports on submissions during RSIC's Internal Investment Committee ("IIC") meetings for the first, third, and fourth quarters of each calendar year. RSIC's Annual Investment Manager Compliance Questionnaire ("Compliance Questionnaire") satisfies the requirement for the second quarter of each calendar year. Ms. Kennedy noted that any breaches of Investment Guidelines must be cured within 45 days. She also stated that there would be no report for the current quarter during the meeting because the Compliance Questionnaires are under review.

Ms. Kennedy then turned to a discussion on RSIC's Personal Trading Policy ("Trading Policy"). She explained that the Trading Policy requires that all RSIC employees provide their covered account statements to the Compliance Staff within 30 days of the end of each quarter. Compliance Staff reviews the covered account statements to identify any potential violations of the Trading Policy. Ms. Kennedy stated that the quarterly compliance review for the quarter ending June 30, 2019 is complete, and no material issues were noted.

Thereafter, Ms. Kennedy began a discussion of the Ongoing Due Diligence Policy's requirement to collect the Compliance Questionnaire from RSIC's investment managers. She explained that the Compliance Questionnaire is prepared by

Compliance Staff and is designed to detect material issues that could impact opinions amongst RSIC's Investment Staff ("Investment Staff") about an investment manager. The Compliance Questionnaire covers a wide variety of topics, including investment managers' compliance with legal agreements, their compliance oversight programs, changes in their service providers, as well as their regulatory oversight programs. Individual members of the Investment Staff review the Compliance Questionnaire responses from the investment managers and such reviews are documented as complete by the Compliance Staff. In terms of timing, Ms. Kennedy noted that Compliance Questionnaires are sent to all investment managers beginning July 1 of each year, and receipt of the completed Compliance Questionnaires is a roughly 30- to 45-day process. The Committee and Staff then received an overview regarding the Compliance Questionnaire process at the end of each calendar year. She stated that 92 Compliance Questionnaires had been sent out, and all responses had been received and are being reviewed.

Ms. Kennedy concluded her presentation with a final slide listing additional compliance matters that RSIC monitors.

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 9:21 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 August 23, 2019 at 2:45 p.m. at the entrance, in the lobbies, and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, S.C.]