

**South Carolina Retirement System Investment Commission
Audit and Enterprise Risk Management Committee Meeting
Minutes
November 12, 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 8:33 a.m. Mr. William J. Condon, Jr. made a motion, which was seconded by Ms. Peggy Boykin, to adopt the agenda as presented, and it was unanimously approved.

II. APPROVAL OF MINUTES (AUGUST 27, 2019)

Chair Hancock referred to the draft minutes from the Committee’s August 27, 2019 meeting. Ms. Boykin made a motion to adopt minutes from the August 27, 2019 Committee meeting as presented. Mr. Condon seconded the motion, and it was unanimously approved.

III. DISCUSSION OF PROPOSED 2020 MEETING DATES

Chair Hancock then referenced the Committee’s proposed 2020 meeting dates: February 18, 2020, May 19, 2020, August 25, 2020, and November 10, 2020. He asked if any of the Committee members had conflicts. Hearing none, Chair Hancock asked for a motion to approve the Committee’s 2020 meeting dates. Mr. Condon made a motion to approve the proposed meeting dates for the 2020 calendar year as presented. Ms. Boykin seconded the motion, and it was unanimously approved.

IV. ANNUAL REVIEW OF THE COMMITTEE’S CHARTER

Chair Hancock turned to the annual review of the Committee’s Charter (“Charter”). He asked Mr. Mitchell Goldsmith, Senior Legal Counsel, to lead the Committee in the review of the Charter. Mr. Goldsmith began by explaining that he was providing the Committee with a chart breaking down the requirements outlined in the Charter along with an indication of whether each requirement has been met by the Committee. He added that Mr. Andrew Chernick, Chief Operating Officer, and Ms. Michelle Kennedy, Director of Enterprise Risk Management (“ERM”) and Compliance (“Director of ERM and

Compliance”), had both reviewed the chart to ensure that they concurred. Mr. Goldsmith surmised that the Committee had substantially complied with all of the Charter’s requirements during the 2019 calendar year. However, he noted that some of the requirements in the “Staff Functions” section of the Charter are stale due to changes in how RSIC’s Internal Audit (“IA”) and ERM functions are staffed. Mr. Goldsmith stated that he had been in touch with RSIC’s engagement team (“Deloitte Team”) from Deloitte & Touche L.L.P. (“Deloitte”) regarding updating the Charter. He stated that RSIC Staff (“Staff”) plans on providing the Committee with proposed changes to the Charter in the near future.

Mr. Condon asked whether the updates would also apply to the Charter’s “Authority” section, which states that the Committee appoints, compensates, and oversees the work of RSIC’s IA and ERM staff. Mr. Michael Hitchcock, Chief Executive Officer (“CEO”), responded that the Charter has not been updated to reflect the changes made by the Pension Reform Act of 2017, which empowered the CEO to make all of RSIC’s staffing decisions. Mr. Condon suggested updating the Charter, and Mr. Hitchcock concurred. Following additional discussion, Chair Hancock stated that the responsibilities outlined in the Charter have been carried out for the 2019 calendar year.

V. INTERNAL AUDIT UPDATE

Chair Hancock then asked Mr. Goldsmith to provide the Committee with an update on RSIC’s IA function. Mr. Goldsmith began by discussing the engagements completed during the 2019-20 fiscal year. He stated that the Committee had received a report from CliftonLarsonAllen LLP (“CLA”) regarding the Agreed Upon Procedures (“AUP”) Review of RSIC’s Investment Valuation and Due Diligence Procedures (“AUP Review of Valuation and Due Diligence”) for fiscal year-end June 30, 2019. He explained that the review was expanded from previous years to cover certain areas of Staff compliance and investment compliance, including RSIC’s Securities Lending (“Lending Policy”) and Counterparty Risk Management Policies. Mr. Goldsmith then introduced Mr. Jason Ostroski, Principal from CLA, who had joined the meeting via telephone.

Mr. Ostroski began by stating that he worked with Mr. Chernick and Mr. Goldsmith in the testing of RSIC’s procedures for the AUP Review of Valuation and Due Diligence. He reported that CLA had no findings to report and asked if the Committee members had any questions. Ms. Boykin began her question by noting that CLA performs the annual audit of the South Carolina Retirement Systems’ Comprehensive Annual Financial Report (“CAFR Audit”). She asked if, based on CLA’s CAFR Audit and AUP Review of Valuation and Due Diligence, CLA had noted any gaps that need to be addressed in future AUP reviews. Mr. Ostroski responded that, in terms of what CLA is currently reviewing, RSIC’s policies and procedures are robust and that he could not think of anything to add. Mr. Goldsmith added that Staff would be expanding future AUP Reviews of Valuation and Due Diligence to include additional areas of Staff compliance.

Mr. Goldsmith then turned to an update on the Global Investment Performance Standards (“GIPS”) Verification and Performance Examination (“GIPS Review”) for fiscal year-end

June 30, 2019. The GIPS Review was performed by ACA Performance Services, LLC (“ACA”) for the Portfolio (“Portfolio”) with fieldwork conducted in September of 2019. Mr. Jon Rychener, Director of Investment Reporting and Performance, then introduced Mr. Douglas Finlay who is a Senior Principal Consultant with ACA. He reminded the Committee that ACA is the firm that first helped RSIC become GIPS compliant. Mr. Rychener then turned over the presentation to Mr. Finlay.

Mr. Finlay began by stating that he would be providing an overview of ACA’s findings and a preview of changes to the GIPS standards that will be taking effect. In order to certify an organization as GIPS complaint, ACA conducts a firm-wide review of an organization and then performs an examination of the total fund. During the firm-wide review, ACA is confirming that the organization has correctly constructed composites as well as adopted policies and procedures that will ensure GIPS compliance. Mr. Condon asked about the timing of the GIPS Review. Mr. Finlay responded that July 1, 2017 through June 30, 2019 comprises the cumulative period that ACA has reviewed RSIC for GIPS compliance. He explained that the GIPS Review is conducted annually, but as part of the GIPS Review, ACA also reviews monthly performance. He noted that, while a GIPS Review is not real-time, the annual review should provide assurance of compliance throughout a given year.

Mr. Finlay continued by explaining the mechanics of a GIPS Review. He stated that some of ACA’s testing samples a portfolio’s new investments as well as investment liquidations to determine if those samples were appropriately recorded. Mr. Finlay explained that performance is driven by valuations, and ACA tests values by reviewing the underlying investment manager and custodian statements. He added that ACA utilizes fair value to value holdings and may use lag values where appropriate. Mr. Finlay then turned to the GIPS calculation methodology explaining that ACA utilizes time-weighted returns. ACA also conducts drilldowns to asset class returns, which are also calculated on a time-weighted basis.

Mr. Finlay then turned to the performance examination report that ACA issued to RSIC for fiscal year-end June 30, 2019. He explained that the GIPS Compliant Presentation contains a performance table with a couple of return streams, including the total fund net return, net of external costs only return, and the net money-weighted return. The total fund net return is the required GIPS return, which means the return is net of all fees and expenses at the investment manager level and is further reduced by RSIC’s internal investment costs. The net of external costs only return is the official total plan return but is not net of RSIC’s internal investment costs. The net money-weighted return, which the GIPS standards recommend be reported, shows that rate of return that will set present values of cash flows equal to the value of an initial investment. He noted that RSIC currently reports net money-weighted returns for the Portfolio. Mr. Finlay made a clarification that the GIPS return does not include funds that are not available for investment, such as cash set aside to pay benefits. He noted that ACA made an adjustment to RSIC’s performance examination report for fiscal year 2019 because the performance examination report for fiscal year 2018 included cash for benefit payments in the total fund net return. However, the change was immaterial to overall performance.

Mr. Finlay then turned to a discussion of the changes to the GIPS standards, which will go into effect on January 1, 2020. He overviewed the changes and noted that the overall goal of the changes is to make GIPS compliance more accessible to a wider range of investment managers. Mr. Condon inquired about the number of RSIC's investment managers that are currently GIPS compliant. Ms. Kennedy responded that 35 percent of RSIC's investment managers are GIPS compliant. Mr. Chernick added that RSIC's private equity and real estate investment managers are typically not GIPS compliant. Mr. Finlay noted that the 2020 version of GIPS is designed to encourage such investment managers to become GIPS compliant. Mr. Chernick added that RSIC does not require GIPS compliance of its investment managers, but Staff inquires annually about an investment manager's status.

Following the completion of Mr. Finlay's presentation, Mr. Goldsmith turned to a discussion of the recently completed AUP Review of RSIC's Procurement-related areas ("Procurement AUP Review") for fiscal year-end June 30, 2018. He reminded the Committee that the review was performed by the Hobbs Group and covered RSIC's cash receipts and disbursements; testing of payroll; review of journal entries and transfers; and review of compliance with the Appropriations Act. Mr. Goldsmith reminded the Committee that the Procurement AUP Review will be an ongoing, annual review. Chair Hancock asked about the timing of the review for fiscal year-end June 30, 2019. Mr. Chernick responded that Staff plans on fieldwork taking place in January or February of 2020.

Mr. Goldsmith then referenced the Investment Cash Processing & Capital Call/Distribution Review ("Investment Cash Review") that was proposed by the Deloitte Team and approved as part of RSIC's Fiscal Year 2019-20 Audit Plan. By way of background, Mr. Goldsmith noted that in 2018 RSIC implemented the Bank of New York Mellon's ("BNYM") Capital Call Management System, which is provided via BNYM's NEXEN Platform. Deloitte will be performing this consultative review to ensure that proper policies and procedures have been put in place. The Deloitte Team will focus on the period from September 30, 2018 through September 30, 2019 and expects to bring in subject matter specialists to assist with the review. Mr. Goldsmith stated that fieldwork should commence in early December of 2019, and Staff anticipates having a report for the Committee to review prior to the Committee's first meeting in 2020.

Mr. Goldsmith then turned to a discussion of the two other items on RSIC's Fiscal Year 2019-20 Audit Plan: (i) the Derivative Overlay Implementation Review ("Overlay Review"); and (ii) the Information Technology General Controls Review ("IT Controls Review"). With respect to the Overlay Review, Mr. Goldsmith stated that the review will be performed by the Deloitte Team with anticipated fieldwork between February and May of 2020. Moving on to the IT Controls Review, Staff is working with Deloitte to develop a scope for the review, which will likely consist of back testing controls and ensuring appropriate controls are in place. He stated that the IT Controls Review will likely overlap with the Overlay Review. Mr. Condon inquired about the amount of back testing that will occur during the Investment Cash Review. Mr. Goldsmith responded that consultative reviews are designed to look at the policies and procedures RSIC has in place, whether they are effective and efficient, and then test to determine if Staff is following those policies and

procedures. Mr. Ben Quigley, who is a Senior Manager with the Deloitte Team, then provided an overview of the types of reviews that Deloitte performs.

VI. COMPLIANCE AND ENTERPRISE RISK MANAGEMENT UPDATES

Ms. Kennedy began her presentation by providing an update of her ongoing efforts to build out an ERM Dashboard (“ERM Dashboard”) for the organization. She displayed a draft form of the ERM Dashboard to the Committee. She further detailed how the ERM Dashboard will have a drilldown so that the Committee will be able to see the risk categories/functions, the risk owners, the associated tasks, the risk level, the risk level rating, how the risk is trending, and any comments. Ms. Kennedy stated that Staff intends to provide the ERM Dashboard to the Committee no less than quarterly. She added that the buildout is ongoing, and she will continue to work with RSIC’s risk owners on this project. Ms. Kennedy stated that, once certain groundwork has been laid, she would be working with the Deloitte Team to ascertain key performance indicators (“KPIs”) and key risk indicators (“KRIs”) to feed the risk ratings on the ERM Dashboard.

Ms. Kennedy then turned to the compliance update and reported that the compliance reviews regarding Securities Lending, Personal Trading, and Separately Managed Accounts for the quarter ending December 31, 2019 are complete, and no material issues were noted.

Thereafter, Ms. Kennedy began a discussion concerning RSIC’s Annual Investment Manager Compliance Questionnaire (“Compliance Questionnaire”) process. Ms. Kennedy emphasized that the Compliance Questionnaire process is a collaborative effort amongst RSIC’s various departments. She explained that the topics covered by the Compliance Questionnaire include: regulatory oversight, compliance procedures, legal issues, conflicts, back office structures, SMA monitoring, and various other topics. The Compliance Questionnaire process typically begins in July of each year, and most responses are received in mid-August. Ms. Kennedy reported that RSIC currently has 92 investment managers, and all investment managers have responded to the Compliance Questionnaire. In addition, both of RSIC’s investment consultants, Meketa Investment Group, Inc. and Albourne America, LLC, responded.

Ms. Kennedy then highlighted some information from the Compliance Questionnaire responses. She noted that 91 percent of RSIC’s investment managers utilize “big four” audit firms, and the remaining investment managers not utilizing big four audit firms utilize top twenty firms. Then, Ms. Kennedy turned to valuation policies and procedures of RSIC’s investment managers, she stated that 95 percent are in compliance with Accounting Standards Codification 820 (“ASC 820”). She clarified that the five percent of investment managers not in compliance with ASC 820 are foreign investment managers that follow the International Private Equity and Venture Capital Valuation (“IPEV”) Guidelines, which are viewed as best practice for private equity valuation. Ms. Kennedy then explained that the majority of RSIC’s investment managers are regulated by the U.S. Securities and Exchange Commission, but some are regulated by other oversight bodies due to their structure and/or domicile. Ms. Kennedy concluded her presentation by explaining that approximately 35 percent of RSIC’s investment managers are currently GIPS compliant.

VII. 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 9:32 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 November 7, 2019 at 3:18 p.m. at the entrance, in the lobbies, and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, S.C.]