

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

September 17, 2015

**Capitol Center
1201 Main Street, 15th Floor
Columbia, South Carolina 29201
Meeting Location: Presentation Center**

Commissioners Present:
Mr. Edward Giobbe, Chairman
Dr. Rebecca Gunnlaugsson, Vice Chair
Mr. Curtis Loftis, State Treasurer
Ms. Peggy Boykin, PEBA Executive Director
Mr. Allen Gillespie
Dr. Ronald Wilder
Mr. Reynolds Williams

Others present for all or a portion of the meeting on September 17, 2015:

Geoff Berg, Betsy Burn, Andrew Chernick, Dori Ditty, Matt Dorchuck, Robert Feinstein, Mitchell Goldsmith, Joshua Greene, David Haas, Hershel Harper, Michael Hitchcock, Adam Jordan, David King, Tricia Miller, Bryan Moore, Eric Nelson, Weiyi Ning, Eric Rovelli, Brian Wheeler, James Wingo, and Justin Young from the South Carolina Retirement System Investment Commission; Tammy Nichols, Travis Turner, and Faith Wright from the Public Employee Benefit Authority; Clarissa Adams, Bert Cassell, and Edward Frazier from the State Treasurer's Office; Suzanne Bernard and Tim McEnery from Aon Hewitt Investment Consulting; Wayne Bell, Sam Griswold, and Wayne Pruitt from the State Retirees Association of South Carolina; Bruce Crouch, Jared Nobles, and Tom Posey from SC ETV; David Sirota from the International Business Times; and Andrea Taylor from Creel Court Reporting.

I. CALL TO ORDER AND CONSENT AGENDA

Chairman Edward Giobbe called the meeting of the South Carolina Retirement System Investment Commission ("Commission" or "RSIC") to order at 9:07 a.m. Chairman Giobbe referred to the proposed meeting agenda and asked for a motion to adopt the agenda. Mr. Allen Gillespie made a motion to adopt the agenda as presented, and Dr. Ronald Wilder seconded the motion, which was unanimously approved.

Chairman Giobbe referred to the draft minutes from the June 9, 2015 and June 18-19, 2015 Commission meetings and asked for a motion to adopt the minutes. Dr. Wilder made a motion to adopt the minutes of the June 9, 2015 and June 18-19, 2015 Commission meetings as presented, which was seconded by Mr. Reynolds Williams. The motion was approved 5-0, with Mr. Gillespie abstaining.

II. CHAIRMAN'S REPORT

Chairman Giobbe opened by recognizing Mr. Hershel Harper, CIO. Mr. Harper announced that he would be leaving the Commission to explore other career opportunities and thanked the Commission for the trust and confidence bestowed on him over the years. Chairman Giobbe thanked Mr. Harper for his years of service to the Commission and the State of South Carolina. Next, Chairman Giobbe referred the Commissioners to a memorandum listing the Commission's proposed 2016 meeting dates and asked for a motion to approve the meeting dates. Mr. Gillespie made a motion, which was seconded by Mr. Williams and passed unanimously, to approve the Commission's proposed 2016 meeting dates. Chairman Giobbe concluded his remarks by informing the Commissioners that Mr. Eric Nelson, Director of Enterprise Risk Management and Compliance, would be distributing the Statement of Material Interest Certification ("Certification"). The Chairman asked that the Commissioners complete the Certification and return it to Mr. Nelson by September 30, 2015.

III. AUDIT COMMITTEE REPORT

The Chairman recognized Mr. Gillespie to present the Audit Committee's report. Mr. Gillespie began his remarks by explaining to the Commission that Ms. Monica Houston, Chief Audit Officer, has been out of the office due to health issues. Mr. Gillespie noted that the prior fiscal year's audit plan was running behind plan, and that the goal was to complete work on the prior year's plan by month's end. Mr. Gillespie then turned to the current fiscal year's audit plan. He informed the Commission that the Audit Committee had preliminarily approved an audit plan for FY 15-16, but would be meeting again to address the resourcing and budgeting components of the FY 15-16 audit plan.

IV. EXECUTIVE DIRECTOR'S REPORT

The Chairman recognized Mr. Michael Hitchcock, Executive Director, to present his report. Mr. Hitchcock began his remarks by thanking Mr. Harper for his service to RSIC. Mr. Hitchcock then updated the Commission on the status of the compensation study being conducted by the Commission's compensation consultant, Towers Watson. He explained that the Human Resources and Compensation Committee has reviewed the work completed by Towers Watson and provided RSIC Staff ("Staff") with guidance on moving forward. He stated that he anticipated a presentation of the final proposal to the Commission at its next meeting. Next, Mr. Hitchcock informed the Commission that Staff had received a draft report of the findings of the Legislative Audit Council ("LAC"). He stated that a copy would be made available to the Commissioners following the meeting and that comments concerning the report would be due to the LAC within the following ten days.

V. CIO'S REPORT

The Chairman recognized Mr. Harper to present the CIO's report. Mr. Harper reminded the Commissioners about the memorandum he had sent to them concerning the recent volatility in global markets and the need to maintain a long-term perspective on investing the trust funds' portfolio ("Portfolio"). He then introduced Ms. Suzanne Bernard of Aon Hewitt Investment Consulting ("Aon Hewitt") to provide a performance update. Ms. Bernard summarized the Portfolio's performance through June 30, 2015 and commented on general market conditions. She explained that the performance of global stock markets was relatively flat with the worst performance coming from emerging markets. Ms. Bernard noted that fixed income markets were flat, hedge fund performance was low, and

U.S. commodities markets had performed very poorly. She stated that the real estate portfolio had performed exceptionally well and that private equity returns continue to be strong. Ms. Bernard added that private equity returns may appear lower than expected due to the exceptionally strong performance of the U.S. equities markets.

The Chairman asked Ms. Bernard if the recent strong performance of the U.S. equities market is sustainable. Ms. Bernard responded that Aon Hewitt believes that U.S. equities' current performance is unsustainable over the long-term, but she stated that Aon Hewitt does not anticipate a substantial downturn in the near future. Mr. Curtis Loftis expressed concern over the anticipated returns and illiquidity of the private equity asset class. Ms. Bernard explained that private equity return projections may seem low because private equity managers more readily write down the value of their assets as opposed to writing them up. She added that the private equity asset class is important because public equities markets are unlikely to continue producing returns in excess of private equity.

Ms. Bernard then updated the Commission on the Portfolio's compliance with the asset allocation ranges set forth in the Statement of Investment Objectives and Policies. She explained that all asset classes were in compliance with the applicable guidelines. Ms. Bernard stated that, even though performance lagged for the 2014-15 fiscal year, the Plan ("Plan") remains over its benchmark on a three- and five-year basis. She then discussed the Plan's performance relative to its peers. Ms. Bernard explained that the Portfolio's return efficiency per unit of risk was quite good, but in terms of overall return, the Portfolio has underperformed its peers. Mr. Loftis questioned whether the Commission is too concerned with volatility in allocating assets. Ms. Bernard responded that minimizing volatility is an important component of insuring the actuarial assumptions for the Plan remain consistent over time. The Commissioners then had a discussion about the role of risk in developing a long-term strategy for the Portfolio.

Mr. Geoff Berg, Managing Director, presented Staff's performance update. Mr. Berg began his remarks with a discussion of how weightings to asset classes and decisions about manager selection had driven overall Plan performance. Mr. Berg noted that decisions about asset class weightings have had mixed results. He explained how the Plan's underweighting to real estate had negatively impacted performance because real estate had performed very well. By contrast, he noted that Staff's decision to be underweight to two underperforming asset classes, commodities and emerging market debt, had reduced losses. Mr. Berg then explained that Staff's ability to select managers had driven much of the Plan's excess returns. He stated that the investment managers selected for the hedge fund, global public equity, global tactical asset allocation, and real estate asset classes had performed well. Mr. Berg noted that, even though the private equity asset class had performed well, the return numbers may be deceptively low because that asset class' benchmark has a three month lag time, which has the effect of raising the benchmark.

The Chairman asked Mr. Berg if the stage of a private equity fund's lifecycle could contribute to significant return variations. Mr. Berg responded that private equity funds typically follow a "J-Curve". He stated that the "J-Curve" explains how early in a private equity fund's lifecycle managers tend to report negative returns because investors are paying fees on committed capital while capital is not being invested. However, returns generally improve as time goes on and investments are made. Mr. Berg stated that as

the Plan's private equity asset class matures, the impact of the "J-Curve" will be diminished because the Portfolio will be harvesting returns from some investments, while experiencing fee drag from others. Mr. Loftis emphasized the importance of understanding the impact of the "J-Curve" on the private equity asset class. Mr. Berg concurred with Mr. Loftis and added that the "J-Curve" should cease to have an effect on the private equity portfolio once the target allocation is reached. The Commissioners then had a discussion about anticipated private equity returns and the asset class' fit in the Portfolio.

The Commission briefly recessed for a break at 10:21 a.m. Chairman Giobbe reconvened the meeting at 10:38 a.m.

VI. ASSET ALLOCATION DISCUSSION

The Chairman recognized Mr. Hitchcock for introductory remarks regarding the topic of asset allocation. Mr. Hitchcock explained to the Commissioners how he had worked with Staff to begin challenging RSIC's investment convictions. He stated that Staff planned to bring no investment recommendations to the Commission's November meeting so that Staff could focus on this project. Mr. Hitchcock explained that the ultimate goal of challenging RSIC's investment convictions is to improve the Plan's overall performance. He then turned the presentation over to Mr. Berg.

Mr. Berg reaffirmed Mr. Hitchcock's comments regarding the process Staff had undertaken to challenge their convictions on asset allocation. Mr. Berg explained that Staff would begin challenging the existing asset allocation first by constructing what he referred to as a "100-year portfolio." Such a portfolio would draw upon long-term historical performance data in order to understand the behavior of assets over a number of business cycles, rather than simply extrapolating recent history. He stated that this focus on understanding the long-term performance of assets provides the proper context for setting a 100-year portfolio. Mr. Berg also added that this approach is prudent because a long-term perspective is consistent with the Plan's structure (years of service plus retirement time period). Mr. Berg then pointed out that Staff will explore frameworks for how the asset allocation should deviate over time from this 100-year portfolio. He further explained the 100-year portfolio concept and how it will inform the Staff's work.

The Chairman asked Mr. Berg why Staff would utilize a 100-year portfolio when the Plan's actuarial assumptions are based on a 30-year period. Mr. Berg responded that 30 years is not a sufficient time horizon to understand different asset classes. Ms. Peggy Boykin concurred and stated that, while the amortization period might be 30 years, the benefit stream will need to last for a much longer period of time. Mr. Loftis expressed concerns about whether the approach outlined by Mr. Berg would provide the Plan with sufficient returns to make benefit payments. Mr. Berg responded that the 100-year portfolio contemplates meeting benefit obligations while also positioning the Plan to succeed.

Mr. Loftis expressed concern about the level of the Plan's assumed rate of return and that attempting to meet that benchmark could lead to the Plan assuming more risk. He also stated that he was concerned about whether contribution rates would need to increase. Ms. Boykin responded that until the actuarial valuations were received, no determination could be made about the impact on contributions. The Chairman asked Ms. Bernard if

other public pension plans were lowering their assumed rates of return, and Ms. Bernard said that some plans had done so. Mr. Loftis then expressed concern that the General Assembly may not fully understand the scope of the unfunded commitment. In response, Mr. Hitchcock assured the Commissioners that he and Ms. Boykin were working collaboratively to keep the General Assembly and other stakeholders informed, provide them with the necessary information, and urging all to take a holistic approach in addressing the retirement system.

Mr. Berg asked if the Commissioners were comfortable with Staff and Aon Hewitt beginning work on a proposed 100-year portfolio. The Chairman asked if the 100-year portfolio would contain a diversified portfolio or be more asset-specific, which could result in some asset classes being eliminated. Mr. Berg reiterated that all asset classes would be reviewed, and all beliefs challenged in developing the 100-year portfolio. The Chairman said that he would expect Staff and AHIC to have recommendations prepared for the Commission's November meeting. The Chairman also encouraged the Commissioners to provide comments and suggestions to Mr. Berg.

The Commission briefly recessed at 11:27 a.m. Chairman Giobbe reconvened the meeting at 11:42 a.m.

VII. INVESTMENT RECOMMENDATIONS

The Chairman recognized Mr. James Wingo, Investment Officer, who provided a presentation regarding Wellington CTF Emerging Local Debt Portfolio ("Wellington") and recommended a \$400 million commitment. He discussed the search objectives and process, the Wellington team, the firm's investment strategy and process, the strategy's fit in the Portfolio, the investment rationale and considerations, and the fees for the strategy. The Chairman asked if Staff had confidence that the exchange rate risk could be managed given the currency volatility in some emerging markets. Mr. Wingo replied that Staff has confidence in Wellington's exchange rate risk strategy. Mr. Loftis asked why Aon Hewitt provided a qualified recommendation for Wellington. Ms. Bernard responded Aon Hewitt qualified the recommendation because Wellington had recently experienced portfolio manager turnover, but Aon Hewitt remained confident in the manager and strategy. Dr. Wilder asked if Staff was concerned that Wellington had not invested in the strategy, and Mr. Wingo responded that Wellington's partners own equity in the firm, which incentivizes them to perform.

Dr. Rebecca Gunnlaugsson made a motion that the Commission (i) adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Summary Terms Chart on Page 1 of the Due Diligence Report dated September 17, 2015 regarding Wellington Trust Company, NA's CTF Emerging Local Debt Portfolio; (ii) authorize an investment of up to 4% of Total Plan Assets into the CTF Emerging Local Debt Portfolio with an anticipated initial investment of \$400 million; (iii) authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the Investment as approved by the Commission (1) upon documented approval for legal sufficiency by RSIC Legal, and (2) upon expiration of the three business day review period as approved by the Commission on May 1, 2014 (or as the review period may be amended or superseded by the Commission); and (iv) Authorize the Chairman and/or the CIO or their designee(s) to thereafter authorize the custodian of funds to transfer such funds as are necessary to meet the obligations of the South Carolina

Retirement Systems Trust Funds with respect to the Investment. Mr. Gillespie seconded the motion, which was unanimously approved.

Mr. Eric Rovelli, Senior Investment Officer, then provided a presentation regarding Crow Holdings Realty Partners VII, LP (“Crow”). He discussed the search objectives and process, the Crow team, the firm’s investment strategy and process, the strategy’s fit in the Portfolio, the investment rationale and considerations, and the fees for the strategy. Mr. Rovelli recommended a \$100 million commitment. Mr. Loftis noted that he had concerns about the performance of Crow’s previous funds since some still have assets on their books. He also added that, in his opinion, utilizing internal rates of return to evaluate private equity returns could be misleading. Mr. Harper noted that the distributions received from a private equity fund and multiples on capital invested are also important metrics. Mr. Loftis also voiced concerns about potential preferential treatment of the Crow family’s investment in the fund. Mr. Rovelli assured Mr. Loftis that the Crow family would be treated like other investors.

Dr. Wilder moved that the Commission (i) adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Summary Terms Chart on Page 1 of the Due Diligence Report dated September 17, 2015 regarding Crow Holdings Realty Partners Fund VII, LP; (ii) authorize a commitment not to exceed \$100 million into Crow Holdings Realty Partners Fund VII, LP (representing capital commitment applied to investments, management fees to be billed outside of the committed capital); (iii) authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the Investment as approved by the Commission (1) upon documented approval for legal sufficiency by RSIC Legal, and (2) upon expiration of the three business day review period as approved by the Commission on May 1, 2014 (or as the review period may be amended or superseded by the Commission); and (iv) authorize the Chairman and/or the CIO or their designee(s) to thereafter authorize the custodian of funds to transfer such funds as are necessary to meet the obligations of the South Carolina Retirement Systems Trust Funds with respect to the Investment. Mr. Williams seconded the motion.

The Commissioners continued their discussion of the Crow investment, as well as other topics, including private equity fees and the extent of their transparency. Mr. Hitchcock suggested that the Commissioners continue their discussion of the details of the Crow investment in Executive Session.

VIII. EXECUTIVE SESSION

Mr. Gillespie made a motion, which was seconded by Mr. Williams and passed unanimously, to go into Executive Session to discuss investment matters pursuant to S.C. Code §§ 9-16-80 and 9-16-320.

After the vote to recede into Executive Session, Mr. Gillespie asked the Chairman for clarification about whether all of the Executive Session agenda items would be addressed during the session. Mr. Williams suggested that he table his motion to approve the Crow investment, so that the Commission could take up all of the Executive Session agenda items in one session. The original motion to go into Executive Session was withdrawn. Mr. Williams then moved to table the motion to approve the Crow investment until after Executive Session, which was seconded by Mr. Gillespie and passed unanimously.

Mr. Gillespie then made a revised motion, which was seconded by Dr. Gunnlaugsson and passed unanimously, to go into Executive Session to discuss investment matters pursuant to S.C. Code §§ 9-16-80 and 9-16-320, to discuss personnel matters pursuant to S.C. Code § 30-4-70(a)(1), and receive advice from legal counsel pursuant to S.C. Code § 30-4-70(a)(2). The Commission recessed into Executive Session at 1:22 p.m. and reconvened in open session at 4:00 p.m.

IX. ACTIONS AS A RESULT OF EXECUTIVE SESSION

The Chairman recognized Mr. Hitchcock who stated that, as a result of discussions that took place during Executive Session, three motions were to be presented for action. Mr. Hitchcock explained that the first motion related to the appointment of an Acting Chief Investment Officer (“Acting CIO”). Mr. Gillespie moved that the Commission ratify the Executive Director’s recommendation of Mr. Geoff Berg as RSIC’s Acting CIO effective October 1, 2015. Dr. Gunnlaugsson seconded the motion, which passed unanimously.

Mr. Hitchcock noted that the second motion pertained to conducting a national search for a permanent CIO. Dr. Gunnlaugsson moved that, in regards to conducting a national search for a permanent CIO, the Commission delegate to the Executive Director and Staff all responsibility and authority necessary to provide for the procurement of a national search firm and selecting the search firm in order to conduct the national search. Mr. Gillespie seconded the motion, which passed unanimously.

Mr. Hitchcock explained that the third item pertained to personnel and investment decisions made in Executive Session. Mr. Gillespie made a motion that the Commission approve all other personnel and investment matters that were discussed in Executive Session and direct the Executive Director and other necessary parties to take all actions necessary to implement these decisions as approved by the Commission. Dr. Wilder seconded the motion, which passed unanimously.

Mr. Hitchcock stated that two investment items required action by the Commission. Mr. Gillespie made a motion that the Commission (i) adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Summary Terms Chart on Page 1 of the Due Diligence Report dated September 17, 2015 regarding Crow Holdings Realty Partners Fund VII, LP; (ii) authorize a commitment not to exceed \$100 million into Crow Holdings Realty Partners Fund VII, LP (representing capital commitment applied to investments, management fees to be billed outside of the committed capital); (iii) authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the Investment as approved by the Commission (1) upon documented approval for legal sufficiency by RSIC Legal, and (2) upon expiration of the three business day review period as approved by the Commission on May 1, 2014 (or as the review period may be amended or superseded by the Commission); and (iv) authorize the Chairman and/or the CIO or their designee(s) to thereafter authorize the custodian of funds to transfer such funds as are necessary to meet the obligations of the South Carolina Retirement Systems Trust Funds with respect to the Investment. Dr. Wilder seconded the motion, which was approved 5-1, with Mr. Loftis opposed.

Next, Mr. Gillespie made a motion that the Commission (i) adopt the recommendation of the CIO and the Internal Investment Committee as set forth in the Summary Terms Chart

on Page 1 of the Due Diligence Report dated September 17, 2015 regarding Torchlight Debt Opportunity Fund V, LP; (ii) authorize a commitment not to exceed \$100 million into Torchlight Debt Opportunity Fund V, LP; (iii) authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the Investment as approved by the Commission (1) upon documented approval for legal sufficiency by RSIC Legal, and (2) upon expiration of the three business day review period as approved by the Commission on May 1, 2014 (or as the review period may be amended or superseded by the Commission); and (iv) authorize the Chairman and/or the CIO or their designee(s) to thereafter authorize the custodian of funds to transfer such funds as are necessary to meet the obligations of the South Carolina Retirement Systems Trust Funds with respect to the Investment. Dr. Wilder seconded and the motion, which passed 5-1, with Mr. Loftis opposed.

X. ADJOURNMENT

There being no further business, Mr. Gillespie made a motion to adjourn. Mr. Williams seconded the motion, which passed unanimously, and the meeting adjourned at 4:04 p.m.

[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 the entrance, in the lobbies, and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, SC, at 5:03 p.m. on Wednesday, September 16, 2015.]