

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

January 4, 2016

1:00 P.M.

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. Allen Gillespie (via telephone)

Dr. Ronald Wilder

Mr. Reynolds Williams (via telephone)

Mr. Curtis Loftis, State Treasurer

Absent: Ms. Peggy Boykin, PEBA Executive Director

Others present for all or a portion of the meeting on January 4, 2016:

Geoff Berg, Betsy Burn, Andrew Chernick, Kim Cornell, Dori Ditty, John Farmer, Robert Feinstein, Scott Forrest, Mitchell Goldsmith, Joshua Greene, David Haas, Michael Hitchcock, Adam Jordan, David King, James Manning, Tricia Miller, Bryan Moore, Eric Rovelli, and Jon Rychener from the South Carolina Retirement System Investment Commission; Edward Frazier from the State Treasurer's Office; Suzanne Bernard and Tim McEnery from Aon Hewitt Investment Consulting (via telephone); Tammy Nichols and Faith Wright from the South Carolina Public Employee Benefit Authority; Sam Griswold and Wayne Pruitt from the State Retirees Association of South Carolina; Gavin Jackson from The Post and Courier; Jay Collins, Bruce Crouch, and Christopher Weber from SC ETV; 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 1:02 p.m. The Chairman referred to the proposed meeting agenda and asked for a motion to adopt the agenda. Mr. Curtis Loftis made a motion to adopt the agenda as presented, and Dr. Ronald Wilder seconded the motion, which was unanimously approved.

II. CHAIRMAN'S REPORT

The Chairman stated that he had nothing to report at the current time.

III. CEO'S REPORT

Mr. Michael Hitchcock, Chief Executive Officer, began his remarks by reviewing the Commission's meeting schedule for 2016. Mr. Hitchcock also informed the Commissioners that draft minutes from the Commission's September and October minutes were not posted in order to keep the agenda short, however those minutes and the minutes from the Commission's November meeting would be posted to WatchDox soon after the meeting. He asked that the Commissioners review the draft minutes so that they could be presented for approval at the Commission's next meeting.

Next, Mr. Hitchcock informed the Commission that the South Carolina Public Employee Benefit Authority (“PEBA”) had requested that the Commission adopt an asset allocation plan for the trust funds’ Portfolio (“Portfolio” or “Plan”) before PEBA’s actuaries conduct their latest experience study, and that this would require a special Commission meeting in early February. Mr. Hitchcock explained that he, along with Acting Chief Investment Officer Geoff Berg (“Acting CIO”) and RSIC Staff (“Staff”), are working to create a proposed asset allocation plan for review by the Commissioners at a special Commission meeting in early February. He stated that Staff would be contacting Commissioners individually ahead of the special meeting to discuss the proposed asset allocation plan. The Chairman encouraged Commissioners to ask questions and offer suggestions in advance of the special meeting.

IV. ACTING CIO’S REPORT

The Chairman recognized Mr. Berg to present his report. Mr. Berg introduced a consent to assignment related to Russell Investments. Mr. Berg reminded the Commission that in 2014, the London Stock Exchange Group acquired Russell Investments from Northwestern Mutual. Mr. Berg explained that the London Stock Exchange Group retained Russell Investment’s index business but was selling its remaining lines of business to two private equity firms. He noted that the anticipated closing date for the sale was mid-2016. Mr. Berg explained that RSIC currently has two contracts with Russell Investments for services that will be included in the proposed sale. The first contract concerns transition services that Staff uses to manage the Portfolio, while the second contract provides Staff with access to certain research. Mr. Berg stated that Russell is required to seek the Commission’s consent to assign these contracts to the new owners.

Mr. Loftis made a motion to adopt the recommendation of the Acting CIO to (i) approve the Consent to Assignment of the Russell Implementation Services Agreement with Russell Implementation Services Inc., (ii) approve the Consent to Assignment of the Manager Research Agreement with Russell Investment Management Company, and (iii) authorize the Chairman or his designee to execute any necessary documents to implement the decision as approved by the Commission. Dr. Wilder seconded the motion, which was unanimously approved.

Mr. Berg then introduced Mr. Joshua Greene, Senior Analyst, to provide the Commission with a Portfolio performance update. Mr. Greene reviewed performance for the fiscal year to date as of October 31, 2015. He noted that a number of asset classes rebounded during the month of October, but noted that plan performance for the three month period and FYTD was negative. Plan performance for the fiscal year was -1.04 percent, lagging the benchmark by 26 basis points.

Mr. Loftis asked Mr. Greene if real estate and private equity returns appeared to be lower than anticipated due to the time lag associated with performance reporting for those asset classes and how Staff accounts for the lack of complete performance numbers. Mr. Greene responded that it was more appropriate to evaluate asset classes with performance reporting lag times by evaluating them over a longer period of time so there is less skew in the performance numbers. Mr. Greene provided a FYTD attribution summary of Plan performance.

Mr. Berg discussed Staff's strategy for Portfolio rebalancing. He explained that Staff was currently rebalancing the more liquid components of the Portfolio monthly, but noted that exceptions to this practice would be made if Staff had strong convictions about market conditions. Mr. Berg added that, despite the elevated market volatility, Staff did not currently have such convictions and a tight rebalancing discipline would be appropriate. The Chairman asked what Staff currently uses as the threshold for rebalancing. Mr. Berg responded that Staff currently sets the threshold at 0.5 percent because rebalancing an asset class incurs cost, and rebalancing at a lower threshold might not be prudent. The Chairman then asked whether Staff ever rebalances an asset class intra-month. Mr. Berg responded that Staff has done so in the past, but in those instances, the purpose of rebalancing was to take advantage of market opportunities.

Dr. Wilder asked Mr. Berg about the status of the new asset allocation targets (adding three percent to public equity and reducing the target allocation to net cash from five to two percent) which the Commission had approved at its November 19, 2015 Commission meeting. Mr. Berg explained that these transitions began on December 31, 2015 and had been completed shortly thereafter. The Chairman asked whether increases in short-term interest rates would have a meaningful impact on the Portfolio. Mr. Berg responded that Staff did not believe that interest rate increases would be the cause of further impact on equities because the increase was overdue, and the impact of the increase appeared to be already priced into the market. Mr. Berg added that recent market volatility had been driven more by disappointing growth in China and escalating geopolitical tensions in the Middle East than interest rate increases.

Mr. Berg then addressed the asset allocation plan Staff had been preparing in conjunction with Aon Hewitt Investment Consulting ("Aon Hewitt"). Mr. Berg thanked Ms. Suzanne Bernard and Mr. Tim McEnery of Aon Hewitt for their help in creating a proposed asset allocation plan and noted that Staff is working with Aon Hewitt on improvements to the proposed "Portfolio A" asset allocation discussed at the Commission's November 2015 meeting, including a multi-year glide path for implementation.

Mr. Berg informed the Commission that Staff would shortly commence the second wave of challenging investment beliefs and summarized the four topics which will be reviewed: securities lending; commodities; co-investments, and the global asset allocation ("GAA") program.

After Mr. Berg concluded his remarks, the Chairman encouraged all Commissioners to ask questions and offer suggestions as the Commission attempts to meet the challenges of a changing marketplace.

INVESTMENT RECOMMENDATION

The Chairman introduced Mr. Adam Jordan, Director of Private Debt, who provided a presentation regarding KKR Special Situations Fund II L.P. ("KKR"), which is a distressed credit workout strategy. Mr. Jordan discussed the search objectives and process, the KKR team, the strategy's fit in the Portfolio, the investment rationale and considerations, and the fees for the strategy. Mr. Jordan further explained that during Staff's recent challenging of investment beliefs, Staff had come to the conclusion that private debt

investments are only justifiable where there is no public market alternative. He explained that with respect to the proposed investment there is no equivalent in the public markets because of the inherent complexity premium KKR will generate from engaging in workouts of troubled credits. Mr. Allen Gillespie asked Mr. Jordan whether KKR anticipates a large amount of the fund being invested internationally. Mr. Jordan responded that in their last fund KKR invested nearly 30 percent in Asia, and KKR anticipates this fund will have similar exposure. The Chairman asked about the use of currency hedging, and Mr. Jordan responded that KKR uses a three-month rolling forward hedge, which should not be complex or costly for investors.

Dr. Wilder moved that the Commission (1) Adopt the recommendation of the Acting CIO and Internal Investment Committee as set forth in the Summary Terms Chart on Page 1 of the Due Diligence Report dated December 1, 2015; (2) Authorize a capital commitment not to exceed \$150 million (representing capital commitment applied to investments, management fees to be billed outside of the committed capital); (3) Authorize the Chairman or his designee to negotiate and execute any necessary documents to implement the Investment as approved by the Commission (i) upon documented approval for legal sufficiency by RSIC Legal, and (ii) upon expiration of the three business day review period as approved by the Commission on May 1, 2014 (or as review period may be amended or superseded by the Commission); and (4) 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 Retirement System trust funds' obligations with respect to the Investment. Dr. Rebecca Gunnlaugsson seconded the motion, which was approved 5-1, with Mr. Loftis opposed.

V. EXECUTIVE SESSION

Mr. Loftis moved to go into Executive Session and discuss investment matters pursuant to S.C. Code Sections 9-16-80 and 9-16-320 and to receive advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2). Dr. Wilder seconded the motion, which passed unanimously. The Commission reconvened in open session. Mr. Hitchcock reported that no reportable action had been taken during Executive Session. Any action that occurred in Executive Session, pursuant to S.C. Code Sections 9-16-80 and 9-16-320, would be publicized when doing so would not jeopardize the Commission's ability to achieve its investment objectives.

Mr. Hitchcock then announced that RSIC Legal had advised him of one correction to the motion to approve the Commission's investment with KKR. He explained that the Summary Terms Chart on Page 1 of the Due Diligence Report was not dated December 1, 2015, as stated in the motion, but should reflect a date of January 4, 2016. Dr. Gunnlaugsson made a motion to approve the change, and Dr. Wilder seconded the motion, which passed unanimously.

VI. ADJOURNMENT

There being no further business, Mr. Loftis moved to adjourn. Mr. Gillespie seconded the motion, which passed unanimously, and the meeting adjourned at 2:55 p.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 at the entrance, in the lobbies, and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, SC, at 12:39 p.m. on Monday, December 30, 2015.]