

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

June 16, 2016

9:30 a.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

Ms. Peggy Boykin

Mr. Allen Gillespie

Dr. Ronald Wilder

Mr. Reynolds Williams (Absent)

Mr. Curtis Loftis, State Treasurer (via Telephone)

Others present for all or a portion of the meeting on June 16, 2016: Ashli Aslin, Geoff Berg, Betsy Burn, Alexander Campbell, Andrew Chernick, Lily Cogdill, Kim Cornell, Dori Ditty, John Farmer, Robert Feinstein, Joshua Greene, Michael Hitchcock, Adam Jordan, Steve Marino, Tricia Miller, Bryan Moore, Weiyi Ning, Kathleen Shealy, and James Wingo from the South Carolina Retirement System Investment Commission; Clarissa Adams and Bert Cassell from the State Treasurer's Office; Suzanne Bernard and Tim McEnery from Aon Hewitt Investment Consulting; Sam Griswold and Wayne Pruitt from the State Retirees Association of South Carolina; John B. Collins, Bruce Crouch, Gaines Halford, Jared Nobles, Tom Posey and Stephen G. Younts from SC ETV; and M. Sean Cary and Barbara Ham 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 9:35 a.m. The Chairman referred to the proposed meeting agenda and asked for a motion to adopt the agenda. Commissioner Mr. Allen Gillespie made a motion to adopt the agenda as presented, Commissioner Dr. Ronald Wilder seconded the motion, which was unanimously approved, with Commissioner Mr. Reynolds Williams being absent.

Mr. Gillespie made a motion to approve the Minutes of the Commission Meeting held on February 25, 2016 as presented. Dr. Wilder seconded the motion, which was unanimously approved, with Mr. Williams being absent.

Dr. Wilder made a motion to approve the Minutes of the Commission Meeting held on April 21, 2016 with the caveat that there will be Addendum to the Minutes, which will reflect the Treasurer's special request that the Addendum include his comments over the years on Asset Allocation. Mr. Gillespie seconded the motion, which was unanimously approved, with Mr. Williams being absent.

II. CHAIRMAN'S REPORT

Mr. Michael Hitchcock, Chief Executive Officer, stated that the nomination period for a new Chair and Vice Chair had closed. Mr. Gillespie made a motion to elect Commissioner Dr. Rebecca Gunnlaugsson as Chair of the Commission for the term commencing July 1, 2016 and ending June 30, 2018, and Dr. Wilder seconded the motion. The motion passed unanimously with Mr. Williams being absent. Mr. Gillespie made a motion to elect Dr. Ronald Wilder as Vice-Chair of the Commission for the term commencing on July 1, 2016 and ending June 30, 2018, Dr. Gunnlaugsson seconded the motion, which passed unanimously with Dr. Wilder abstaining from the vote with Mr. Williams being absent.

III. AUDIT COMMITTEE REPORT

Mr. Gillespie, Chairman of the Audit Committee, presented the Audit Committee's Report. He stated that the Audit Committee met June 15, 2016 and that the Committee received compliance reports from Mr. Andrew Chernick, Managing Director of Operations and Operational Due Diligence. Mr. Gillespie stated that there were no material items to report. Mr. Gillespie stated that the Committee is in the process of completing Open Items and developing an Audit Plan for the next year.

IV. HUMAN RESOURCES AND COMPENSATION COMMITTEE REPORT

A. Amendment of the Human Resources and Compensation Committee

The Chairman recognized Dr. Gunnlaugsson, Chair of the Human Resources and Compensation Committee ("HRC"), who presented the Commission with the HRC Committee's Report. The first item presented were changes to the Bylaws, minor wording updates that reflect the hiring of a Human Resources Director, Mr. John Farmer. The Committee made a motion that the Commission (1) Approves the recommendation of the Human Resources and Compensation Committee that the Commission amend the Charter of the Human Resources and Compensation Committee ("Charter"); (2) Adopts the proposed revisions to the Charter as presented; and (3) Authorizes Staff to make technical revisions to the Charter and other RSIC policy documents to reflect the Commission decision, which passed unanimously, with Mr. Williams being absent.

B. Interview Teams For CIO Search

Mr. Hitchcock updated the Commission on the CIO Search and the RFP process to hire a search firm. He noted that contract to hire a search firm would be awarded soon. After the search firm is retained, the next step would be to establish interview teams for the CIO search. He further stated that by mid-August interviews will be scheduled for potential candidates. He would then narrow down the list to three candidates for the Commission as a whole to interview.

Next, he asked the Commission to identify three members to participate in the interview teams. The Chairman asked for three volunteers and Mr. Curtis Loftis, Ms. Peggy Boykin and Mr. Gillespie volunteered to serve on the interview teams. Dr. Wilder made a motion

for the Commission appoint Mr. Loftis, Ms. Boykins and Mr. Gillespie to interview teams for the CIO search. Mr. Gillespie seconded the motion, which was unanimously approved with Mr. Williams being absent.

V. CEO'S REPORT

Mr. Hitchcock gave the Commission an update on the RSIC's budget for fiscal year 2016 - 2017. He noted that the RSIC received approval of its full budget request for the fiscal year 2016 - 2017, which was the same as last fiscal year's minus a \$500,000 cut that the RSIC requested. Mr. Hitchcock and the Commissioners noted that it was unusual for any state agency to request a reduction in its own budget and a reduction in authorization. Mr. Hitchcock stated that staff would continue to analyze budgetary needs and make further reductions where possible in the future.

Mr. Hitchcock asked that Agenda Item V.B SIOP Recommendation and update be moved to the Acting CIO's Report.

VI. ACTING CIO'S REPORT

The Chairman recognized Mr. Geoff Berg, Acting Chief Investment Officer, to present his report. Mr. Berg began by noting some of the cultural changes which had begun to take root on the Investment team, including their increased level of engagement and greater willingness to challenge beliefs, and thanked his colleagues on the Investment team and Mr. Hitchcock for their support.

Mr. Berg reminded the Commissioners that the new asset allocation plan approved by the Commission in February, 2016 would go into effect on July 1, 2016. He noted that one of the changes that will take place will be the replacement of the current plan's three percent allocation to commodities with an allocation of up to two percent of the plan to a broader array of "other opportunistic" investments. Mr. Berg indicated that, for the time being, exposure to commodities would continue.

Mr. Berg stated that Staff would be undertaking a comprehensive review and re-writing of the Commission's Statement of Investment Objectives and Policies ("SIOP") and present a draft to the Commission at a future meeting. Mr. Hitchcock reiterated that the SIOP is a foundational document, and now that the RSIC is taking a new direction, it would be a good time to rewrite the entire SIOP so that it will provide a higher level of specificity and clarity. The Chairman noted his support, requesting that the document be clear and concise.

Mr. Berg introduced Mr. Tim McEnergy from Aon Hewitt Investment Consulting (AHIC), who presented a recommendation regarding the benchmarks and allowable ranges to be utilized as part of the Commission's new asset allocation plan. Mr. McEnergy began by reminding the commissioners that implementation of the new asset allocation plan will take approximately two to three years. Mr. McEnergy reviewed the new target allocations, and summarized AHIC's approach to defining appropriate ranges around target allocations. As to the private market asset classes (private equity, private debt and real estate), Mr. McEnergy stressed that Staff will not be trying to force investments just to stay

within the allowable ranges, and noted that if Staff and AHIC believe these investments will fall outside of the ranges, Staff and Consultant will communicate this to the Commission. Mr. McEnergy identified several other risk controls and constraints contained within this recommendation: (a) real estate, private equity and private debt would be reflected in the benchmark at their actual weight (rather than their target weight), allowing these allocations to float; (b) if illiquid assets exceed twenty-five percent (25%) of total assets, the Commission will be notified; (c) portable alpha strategies would be capped at twelve percent (12%) of total assets; and (d) hedge funds (including all hedge funds utilized within the portable alpha implementation) would be capped at twenty percent (20%) of total assets.

Mr. McEnergy discussed the proposed allowable ranges, noting that AHIC was recommending ranges that were sufficiently tight so that they reflected the Commission's long term policy asset allocation, yet flexible enough to provide Staff with latitude to deviate from the long term policy asset allocations in a tactical way should a need arise.

Mr. McEnergy provided a detailed review of the proposed benchmarks, which had been presented at the Commission's April 2016 meeting. He highlighted the asset classes where changes to the current benchmark were being proposed, as well as the recommended benchmarks for new asset classes.

Mr. Gillespie suggested that there was a need for a broader or more flexible range for the short duration/cash component, as well as other elements, of the conservative fixed income allocation, based on current developments in credit markets. In the ensuing discussion, several topics were addressed, including (a) whether there should be an increase in any of the proposed ranges, and (b) mechanisms or processes to be followed by Staff and the Commission in response to extreme market conditions, including the development of a contingency plan for the portfolio.

Further discussion continued regarding possibly increasing the upper end of the range for the short duration fixed income/cash component of conservative fixed income beyond the four percent (4%) that had been recommended. Mr. Berg expressed his support for such a change. Ms. Suzanne Bernard of AHIC asked if the Commission wanted to allow Staff, if necessary, to work outside the allowable range for the short duration/cash allocation, and inquired as to how the Commission would like to be notified of such a situation. Ms. Boykin stated her preference for having a range that was appropriate, and would be able to give Staff flexibility to react immediately if necessary and at the same time keep the Commission informed in an extreme situation to preserve capital. Mr. Loftis opined that there already were procedures in place for Staff to rebalance and communicate regarding market emergencies, and noted his concerns regarding the potential impact of these kinds of developments on funded status. Dr. Gunnlaugsson inquired about the current provisions in place, and asked who on the Commission would need to be immediately informed if Staff had to deviate from established ranges. There was consensus that the Chair, the Vice Chair, CEO and CIO would initially confer as to the appropriate course of action, and the remainder of the Commission would thereafter be informed, if actions were to be taken that were outside of established parameters. Ms. Betsy Burn, Acting Chief Legal Officer, clarified that the current SIOP states that if any allocation is outside of the

established ranges, rebalancing is required. However, if the Staff determines that the best course of action is to stay outside the approved ranges for some reason, then Staff is required to seek Commission approval.

In light of the discussion, Ms. Bernard suggested that the Commission accept a slightly higher range for the short duration/cash allocation, and consider reviewing this topic's treatment in the SIOP. Ms. Bernard recommended an upper limit of seven percent (7%) for the short duration/cash allocation. Mr. Berg expressed support for this change.

Mr. Gillespie made a motion that the Commission: adopt the recommendation of the Acting CIO and Aon Hewitt Investment Consulting to approve the benchmarks and ranges set forth on red number pages 78, 84 and 85 of the open session materials (copies attached), with the caveat that the range for the short duration/cash allocation on page 78 would be zero to seven percent, effective July 1, 2016; and direct that the approved benchmarks and ranges be incorporated into, and made a part of, the SIOP; and authorize Staff to finalize the benchmark and asset allocation ranges by making any technical revisions or formatting edits consistent with the action taken by the Commission. Dr. Gunnlaugsson seconded the motion, which passed unanimously, with Mr. Williams being absent.

After a brief recess, the Chairman asked Mr. Berg to continue with his report. Mr. Berg stated that one of the projects that Staff has been working on for little over a year involves developing a quantitative approach to the analysis of active versus passive portfolio implementation. Mr. Berg then introduced Mr. Bryan Moore, Director of Public Markets, to share with the Commission some details about the quantitative approach to the active versus passive analysis. Mr. Moore discussed the four main goals of the project: (a) focus time and attention to asset classes where active management is rewarded; (b) identify performance metrics that are statistically significant in these asset classes; (c) use data to inform decisions and start discussions; and (d) use analysis to optimize a screening tool for identifying active managers in a given universe.

Mr. Moore explained how the Investment team intended to apply its findings in the public markets. This research will be incorporated into an initial screening methodology to identify a short list of prospective managers for further analysis.

Mr. Berg then introduced Mr. Joshua Green, Reporting Senior Analyst, to provide a performance update through March 31, 2016. Mr. Green stated that it had been a challenging quarter. He noted that the Plan's fiscal year to date return was negative 2.45 percent, and that the Plan underperformed the policy benchmark, which returned negative 1.26 percent. Mr. Green identified drivers of underperformance during the quarter, including domestic small cap underperforming large cap equity, and lower quality credits underperforming higher quality credits. He reviewed the performance of each asset class, noting that GTAA, Global Public Equities, and Mixed Credit all underperformed their benchmarks during the quarter, while Commodities and Emerging Market Debt outperformed.

Mr. McEnery provided some further comments regarding the portfolio. He noted that GMO had recently announced a number of organizational changes, stated that AHIC had

changed its rating from “buy” to “in review,” and indicated that AHIC would be meeting with the manager in early July.

Lunch Recess was taken at 12:09 p.m. until 12:39 p.m.

VII. EXECUTIVE SESSION

Mr. Gillespie 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 legal advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2). Dr. Gunnlaugsson seconded the motion, which passed unanimously with Mr. Williams being absent. The Commission recessed from executive session at 2:31 pm.

[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 10:50 a.m. on June 14, 2016.]

New Policy: Long-term Asset Class Targets and Allowable Ranges

New Policy (Approved 2/4/2016)	Long-Term Policy Targets	Long-Term Policy Recommended Ranges
Equity	47%	42 – 52%
▪ Global Equity	33%	22 – 36%
▪ Equity Options Strategies	5%	0 – 6%
▪ Private Equity	9%*	6 – 12%*
Conservative Fixed Income	12%	10 – 16%
▪ Short Duration	2%	0 – 4%
▪ Core Bonds	10%	5 – 15%
Diversified Credit	18%	15 – 21%
▪ Mixed Credit	6%	4 – 8%
▪ Emerging Markets Debt	5%	3 – 7%
▪ Private Debt	7%*	4 – 10%*
Opportunistic	12%	9 – 15%
▪ Global Asset Allocation	6%	3 – 12%
▪ Hedge Funds (Non-Portable Alpha)	4%	0 – 8%
▪ Other Opportunistic Strategies	2%	0 – 5%
Real Assets	11%	8 – 14%
▪ Real Estate (Public REITS)	1%	0 – 3%
▪ Real Estate (Private)	7%*	4 – 10%*
▪ World Infrastructure	3%	0 – 5%

* Each of these illiquid asset classes has a floating target, which is adjusted based on actual allocation at the prior quarter end. We anticipate that the actual asset allocation will fall into the Recommended Ranges in the coming year, but Staff will not force investments they deem unattractive to remain within the range. Should we believe the illiquid investments will fall outside of the ranges, Staff and Consultant will communicate this to the Commission.

Total Fund and Individual Asset Class Benchmark Recommendations (effective 7/1/2016)

Asset Class Category	Current Benchmark	Proposed Asset Class Benchmarks (Primary)
Global Equity	MSCI All Country World Index	MSCI All Country World Investable Market Index
Global Equity (Portable Alpha)	--	MSCI All Country World Investable Market Index
Equity Options Strategies	--	CBOE S&P 500 BuyWrite Index (BXM)
Private Equity	<u>Fixed Policy-Weighted Blended Benchmark</u> <ul style="list-style-type: none"> ▪ 80% Russell 3000 Index + 3% (3-month lag) ▪ 20% MSCI EAFE Index + 3% (3-month lag) 	No Change
Cash and Short Duration	Merrill Lynch 3 Month T-Bills	No Change
U.S. Aggregate	Barclays Aggregate Bond Index	No Change
U.S. Aggregate (Portable Alpha)	--	Barclays Aggregate Bond Index
Mixed Credit	<u>Fixed Policy-Weighted Blended Benchmark</u> <ul style="list-style-type: none"> ▪ 33% S&P LSTA Leveraged Loan Index ▪ 33% Barclays High Yield Index ▪ 33% Barclays MBS Index 	<u>Fixed Policy-Weighted Blended Benchmark</u> <ul style="list-style-type: none"> ▪ 50% S&P LSTA Leveraged Loan Index ▪ 50% Barclays High Yield Index

Total Fund and Individual Asset Class Benchmark Recommendations (cont'd)(effective 7/1/2016)

85

Asset Class Category	Current Benchmark	Proposed Asset Class Benchmarks (Primary)
Emerging Markets Debt	<u>Fixed Policy-Weighted Blended Benchmark</u> <ul style="list-style-type: none"> ▪ 50% JP Morgan EMBI Global Diversified (USD) ▪ 50% JP Morgan GBI-EM Global Diversified (Local) 	No Change
Private Debt	S&P LSTA Leveraged Loan Index + 1.5% (3-month lag)	No Change
GAA	<u>Fixed Policy-Weighted Blended Benchmark</u> <ul style="list-style-type: none"> ▪ 50% MSCI World Index ▪ 50% Citigroup World Government Bond Index 	<u>Fixed Policy-Weighted Blended Benchmark</u> <ul style="list-style-type: none"> ▪ 50% MSCI World Index ▪ 50% Barclays Aggregate Bond Index
Hedge Funds (Non-Portable Alpha)	HFRI Fund Weighted Composite Index	<u>Fixed Policy-Weighted Blended Benchmark</u> <ul style="list-style-type: none"> ▪ 50% MSCI World Index ▪ 50% Barclays Aggregate Bond Index
Other Opportunistic Strategies	--	<u>Fixed Policy-Weighted Blended Benchmark</u> <ul style="list-style-type: none"> ▪ 50% MSCI World Index ▪ 50% Barclays Aggregate Bond Index
Real Estate (Public REITS)	--	FTSE NAREIT Equity REITs Index
Real Estate (Private)	NCREIF ODCE Index + 0.75%	No Change
World Infrastructure	--	Dow Jones Brookfield Global Infrastructure Index
Total Fund	Blend of asset class benchmarks at policy weights	

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9:00 a.m.

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Columbia, South Carolina 29201

Meeting Location: Presentation Center

Commissioners Present:

Mr. Edward Giobbe, Chairman

Dr. Rebecca Gunnlaugsson, Vice Chair

Ms. Peggy Boykin

Mr. Allen Gillespie

Dr. Ronald Wilder

Mr. Reynolds Williams (Absent)

Mr. Curtis Loftis, State Treasurer (via telephone)

Others present for all or a portion of the meeting on June 17, 2016: Geoff Berg, Betsy Burn, Alexander Campbell, Andrew Chernick, John Farmer, Robert Feinstein, Michael Hitchcock, Adam Jordan, Steve Marino, Tricia Miller, Kathleen Shealy, and James Wingo from the South Carolina Retirement System Investment Commission; Clarissa Adams and Bert Cassell from the State Treasurer's Office; Suzanne Bernard and Tim McEnery from Aon Hewitt Investment Consulting; John B. Collins, Bruce Crouch, Gaines Halford, Jared Nobles, Tom Posey and Stephen G. Younts from SC ETV; and M. Sean Cary and Barbara Ham from Creel Court Reporting.

I. EXECUTIVE SESSION

The Executive Session from July 16, 2016 reconvened at 9:00 a.m., concluding at 10:54 a.m. Mr. Michael Hitchcock, Chief Executive Officer, stated that the Commission did not take any reportable action while in Executive Session. Any action that did occur while in Executive Session pursuant to SC Code Ann. 9-16-80 and 9-16-320 will be publicized when doing so will not jeopardize the Commission's ability to achieve its investment objective or implement a portion of the Annual Investment Plan.

II. 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.

III. BRIDGEWATER ASSOCIATES PRESENTATION

The Chairman recognized Mr. Berg, who introduced Mr. Alan Bowser of Bridgewater Associates ("Bridgewater"). Mr. Bowser briefly reviewed the performance of the accounts that Bridgewater manages for the Commission, and then introduced Mr. Paul Podolsky. Mr. Podolsky's presentation focused on the forces which have created the most challenging investment environment in decades. He noted that, largely because of the low return on cash, expected returns for many investments are low, creating challenges

for investors and constraining the ability of central banks. Mr. Podolsky also offered observations about steps that investors could take in order to maximize their returns in this type of environment. In the ensuing discussion, a number of topics were addressed, including: (a) Bridgewater's views of Europe and emerging markets, (b) strategic asset allocation, (c) the limitations facing the Federal Reserve, and (d) Bridgewater's views regarding the U.S. dollar. The Commissioners thanked Messrs. Bowser and Podolsky for their presentation.

Recess was taken from 11:57 a.m. to 12:09 p.m.

IV. EXECUTIVE SESSION

Mr. Gillespie 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 legal advice from legal counsel pursuant to S.C. Code Section 30-4-70(a)(2). Dr. Gunnlaugsson seconded the motion, which passed unanimously, with Mr. Williams being absent. The Commission reconvened in open session. Mr. Hitchcock stated that no action was taken in Executive Session.

V. ADJOURNMENT

There being no further business, Mr. Gillespie moved to adjourn, Dr. Gunnlaugsson seconded the motion, which passed unanimously, with Mr. Williams being absent and the meeting adjourned 12:53 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 10:50 a.m. on June 14, 2016.]