

**Fiduciary Performance Audit
of the South Carolina
Retirement System Investment Commission**

**Prepared for the South Carolina
Office of the State Auditor**

Final Report



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Executive Summary

Overview

Funston Advisory Services LLC (FAS) was selected by the South Carolina Office of the State Auditor (OSA) to conduct the 2018 South Carolina Retirement System Investment Commission (RSIC) fiduciary performance audit through a competitive bid process. FAS also completed the 2014 fiduciary performance audit of RSIC, which was conducted at the direction of the South Carolina State Inspector General. We began this fiduciary performance audit in May 2018, submitted a draft report for RSIC review and feedback in September, and submitted the final report in November 2018. The FAS team for 2018 was substantially the same which conducted the 2014 fiduciary performance audit.

The primary purpose of this audit is to evaluate the progress made in implementing the recommendations resulting from the 2014 fiduciary performance audit of RSIC. While the focus of this audit is on progress based on the 2014 report, OSA also requested that the review identify any areas of weakness in current operational policies and practices.

In addition, recommendations addressing weaknesses or regarding better practices and other observations should be articulated and prioritized according to significance and urgency and, where feasible, should include an analysis of potential costs or benefits associated with implementation.

Overall Assessment of Progress

When the 2014 review of RSIC was conducted, the organization was less than ten years old and was rapidly evolving and maturing. RSIC infrastructure had not kept pace with complex investment strategies (e.g., private equity, strategic partnerships, etc.) as initial back office and risk management procedures and support systems were often weak, manual or ad hoc. The Commissioners were involved in performing investment operations such as due diligence. Many of the legacy weaknesses had been identified and were beginning to be addressed by the Commission in 2014. During the prior two years, RSIC's processes had evolved and become more adequate and systematic.

In addition to the internal operational weaknesses, there were severe frictions between the Commission and the State Treasurer's Office amid accusations of malfeasance. This led to several investigations which further fractured and distracted the Commission from the overall mission of the agency. While there were differences of opinion among the Commissioners, lack of progress in improving the relationship between the Commission and the State Treasurer's Office was also related to governance and structural issues which confounded clear fiduciary decision-making authority and reflected a highly fragmented system and responsibilities.

In sum, RSIC was in a reactive, destabilized, crisis-response mode. Authorities and accountabilities were unclear. Staff were demoralized.

In this context, we are very impressed by the progress achieved by RSIC over the past four years. RSIC has emerged from a troubled and difficult situation to one of stability, with strong leadership, effective governance, and capable staff and operations. As recommended in the 2014 fiduciary performance audit,

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the Commission created and filled a new CEO position in 2014. The CEO has been instrumental in leading the organization forward with clear direction and purpose.

The 2014 fiduciary performance audit contained 126 recommendations for improvement. As evidence of the changes accomplished by RSIC, our assessment is that 110 of those recommendations are fully implemented and 9 are substantially implemented. Of the remaining 7 which have not been implemented, 5 are under the control of RSIC and 2 require action by the General Assembly. The recommendations contained in the 2018 report are primarily intended to build upon this progress for further improvement and continuing to move RSIC into leading practices.

Role and Functioning of the Commission

There has been significant progress by the Commissioners in removing themselves from the day-to-day investment execution processes and focusing more on oversight and the longer-term strategic challenges of RSIC. For example, since 2014, Commissioners are no longer involved in investment due diligence. During the second half of 2014, the Commission developed and approved a set of investment beliefs; since that time, the Commission has spent a significant portion of its efforts focused on re-thinking the strategic asset allocation, culminating in a new long-term asset allocation being approved in February 2018.

As recommended in the 2014 fiduciary performance audit, the two Commission committees, the Compensation Committee and the Audit Committee, were renamed the Human Resources and Compensation Committee (HRCC) and Audit and Enterprise Risk Management Committee (AERMC), respectively, and charters of each were expanded to reflect broader oversight authorities. The Commission now completes an annual self-assessment process to identify areas of improvement. The most recent self-assessment produced a list of key initiatives for the Commission to pursue in FY 2019.

The Commission is also to be commended for delegating most investment manager selection decisions to the CIO, effective as of October 2017. Together with a qualified, well-resourced staff, an effective investment policy statement, and appropriate governance policies and processes in place, we consider this to be a leading practice. This enables the Commission to focus on setting strategy and policy and overseeing performance. As this is a relatively new delegation, it remains to be seen how it will further impact the long-term strategic focus of the Commission, but it should be a positive step.

RSIC has improved its assurance and independent reassurance in several areas. First, the Commission retained the Public Employee Benefit Authority (PEBA) auditor, CliftonLarsonAllen, to conduct annual Agreed Upon Procedures (AUP). Typically, these have focused on due diligence procedures and investment valuations, but have also addressed other areas, as appropriate. These reports are submitted to the Audit and Enterprise Risk Management Committee. Second, the roles and responsibilities in the Internal Investment Committee charter have been strengthened, detailed and clarified. The charter was most recently updated and approved in May 2018. Third, CEM Benchmarking has been retained by RSIC to participate in CEM's annual peer investment performance and cost benchmarking. These reports are made available to the Commissioners and are also publicly available on the RSIC website.

Although the Commission had approved an enterprise risk management (ERM) program in 2014, and the AERMC charter includes responsibility for oversight of the ERM program, very little progress has been

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realized in this area. This is due, in part, to frequent turnover in the Director of ERM position and the complexity of the proposed ERM process.

Most recently, ERM, Internal Audit, and Compliance have been combined into a single position (Director of Enterprise Risk Management and Compliance). Internal audit activities are being outsourced and are also under the direction of that combined position. However, the most recent person in that position left during the course of this review. There is currently no functioning ERM program although significant attention is given to identifying and managing risk and there is very good tone at the top. Despite the absence of this position, all compliance responsibilities are being maintained and an audit plan is being followed.

Legislative Changes and Impact

Eight recommendations were made to the General Assembly in the 2014 RSIC fiduciary performance audit. The eight recommendations were:

1. Clarify fiduciary responsibilities, including giving RSIC the authority to contract with its own custodial bank;
2. Establish a 5-year cycle to review the expected rate of return, or delegate the function to PEBA or RSIC;
3. Enable the Commission to create the position of CEO as a single direct report to the Commission with the CIO reporting to the CEO;
4. Delegate selection of outside counsel to RSIC;
5. Delegate authority to the Commission for operational budgetary control and the setting of staff compensation and performance incentives;
6. Provide an exemption to the State procurement policy for investment management systems (this could also be accomplished through the Budget and Control Board (BCB));
7. Revise the qualification criteria for Commissioners; and,
8. Increase the number of voting Commissioners by one or three so as to establish an odd number of voting Commissioners.

The General Assembly is to be commended for its significant contribution through the 2017 Pension Reform legislation. With respect to RSIC, the reforms, which were signed into law in April 2017, addressed all but two of the legislative recommendations made in the 2014 fiduciary performance audit report. These improvements have been a major contributor to the ability of RSIC to continue to make strides in its governance and performance.

The fragmentation of fiduciary responsibilities has been significantly reduced, including removal of the State Fiscal Accountability Authority (SFAA) as a retirement system fiduciary. The General Assembly will now receive a recommendation every four years from PEBA, in consultation with RSIC and the system actuary, for the assumed annual rate of return. The reform legislation also codified the CEO position

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which had been implemented by RSIC in 2015. RSIC is now allowed to engage attorneys in consultation with the Attorney General. The Commissioner qualification criteria were modified to recognize relevant experience in lieu of specific credentials, and the size of the Commission was expanded with a seventh voting member.

The new statute also designated the PEBA Board as the custodian of the trust's assets and made RSIC responsible for the custodial banking arrangement. Since the new law took effect, RSIC signed a new custody agreement with Bank of New York Mellon (BNYM) in July 2017.

RSIC staff report that, since the new contract and direct relationship with BNYM has been in place, the ability to acquire the desired services and the responsiveness of the custodial bank has significantly improved. There is currently an effort underway to rationalize the custodial bank and investment administrator services. The concerns identified in 2014 appear to have been resolved and for this the General Assembly is again to be commended.

Based upon our current assessment of RSIC, these legislative changes have significantly contributed to the improvements RSIC has been able to implement since 2014. Of the two recommendations which were not adopted, we repeat our recommendations that the General Assembly delegate authority to the Commission for operational budgetary control, the setting of staff compensation and performance incentives, and to provide an exemption to the State procurement policy for investment management systems.

Organizational Development

RSIC has made significant progress in building its capabilities across the organization. An experienced Director of Human Resources was hired in 2014 who developed a new hiring and interviewing process, onboarding plan for new employees, core competency development, and training. Although he departed RSIC in 2017, the Human Resources (HR) program has been carried forward by an HR Manager who reports to the CEO and COO.

The HR function has been effective in supporting organizational development. However, the succession plan is out of date, which is a critical gap. Recruiting and retention for some positions (particularly those requiring technical investing skills and experience) can be challenging for RSIC in consideration of location and compensation levels, so it is important to recruit, develop and retain staff effectively and to have succession plans in place when key staff inevitably depart.

At the time of the 2014 review, RSIC had planned to begin a program to internally manage some public investments. This would have required significant new capabilities in trading systems and staffing as well as governance and oversight. Since that time, RSIC has revised its plans, has no immediate intention of managing assets internally and is focused on an externally-managed portfolio. As a result, many of the critical internal infrastructure needs identified in 2014 have been mitigated.

RSIC has made significant upgrades to its support capabilities through the hiring of an investment administrator in 2014. In addition, a risk analytics system was acquired. A document storage and management system had previously been implemented.

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RSIC formed an IT Steering Committee in 2016 which provides oversight and governance for IT-related needs of the organization. At the present time, RSIC is considering significant changes and upgrades to its risk and workflow capabilities. The Steering Group is a key driver of the process.

RSIC has also formed a cross-functional Business Internal Investment Committee which meets quarterly and is intended to ensure effective communication of business initiatives to and from the Investment Office.

RSIC has not developed an overall three- to five-year infrastructure plan as recommended in the 2014 review. However, in the key initiatives developed by the Commission through their most recent self-assessment process, a focus on more comprehensive organizational strategic planning for resourcing, personnel, infrastructure, risk management, systems and policies was identified as a goal. While this has become a lower priority due to the decision not to pursue internal asset management, it will still be a helpful step which could guide overall capability development for the future.

Opportunities for Further Improvement

While there has been significant progress, there will always be opportunities for improvement. This report includes 52 detailed new recommendations for improvement identified by the FAS team during the course of this review to help RSIC in the development and adoption of leading practices. At a summary level, the major recommendations for the General Assembly, the Commissioner appointers, the Commissioners, and RSIC staff are:

General Assembly

- Delegate authority to the Commission for budgets, staffing and compensation.
- Provide an exemption to the State procurement policy for direct investment support services.
- Consider fully delegating the responsibility for setting the assumed rate of return to PEBA and RSIC.

Commissioner Appointers

- When a Commissioner's term expires, close attention should be given to the timely appointment of successor Commissioners.

Investment Commission

- Develop a long-term (e.g., three to five years) strategic policy agenda to provide a framework for bringing key issues to the Commission and for planning Commissioner education in advance of addressing those issues.

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- Conduct the full asset liability and asset allocation study every three to five years, including a review of the Commission's investment beliefs, with an annual review to check adherence and underlying assumptions.
- Improve on-boarding and ongoing education of Commissioners through individualized training plans and creation of a one- to two-year onboarding program.
- The Commission should work more closely with its consultant to articulate overall expectations and to leverage the consultant's capabilities for Commissioner training.
- Develop a succession planning process for the CEO and the head of ERM/Internal Audit/ Compliance.
- Improve the Commission self-assessment process to increase Commissioner engagement.
- Update the securities litigation and ethics policies.
- With staff support, complete a three- to five-year business plan which includes assessment of internal vs. external resource requirements.

RSIC Staff

- Expedite development of an Enterprise Risk Management (ERM) program (see Appendix 2).
- Expand the broker/dealer selection and monitoring policy, including ethics reviews and compliance attestations.
- Update the template Investment Management Agreement (IMA) to incorporate the specific requirements of the Statement of Investment Objectives and Policies (SIOP).
- Update the succession plan and staff development plans for key leadership positions.
- Continue with selection of a new investment risk management system and integrate it with investment reporting processes and the quantitative solutions group.
- Continue to make refinements in due diligence and monitoring processes.
- As staff continues to develop and expand the co-investment program, develop a formal plan which considers what type of outside expertise and support is needed.
- Improve certain aspects of side letter term prioritization and related side letter processes.
- Refresh the outside counsel pool with a new RFP process (already underway).
- Pursue a service level agreement with the custodian.
- Develop a more formal IT plan which includes technology, vendor, data and disaster recovery strategies and considers overall resource requirements.

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Assessment and Findings

In conducting this fiduciary performance audit, the FAS team reviewed the recommendations from the 2014 fiduciary performance audit and the background and context for each recommendation. Through document reviews, interviews (both internal and external), and follow-up conversations, we developed our assessment of progress toward implementing each recommendation. Some were fully implemented, others partially implemented or still in progress, and a few were not implemented. We also identified opportunities for further improvement based upon leading practices at peer funds and the experience of our team members.

The remainder of this report is structured to reflect the recommendations made in the 2014 fiduciary performance audit. For each recommendation, we describe the background, our assessment of implementation progress, and opportunities for further improvement.

A. Major Overarching 2014 Recommendations

The 2014 RSIC fiduciary performance audit included five overarching recommendations which encompassed all the areas of scope included in the review. This section of the 2018 report reviews the background of each of those overarching recommendations, implementation progress, and opportunities for further improvement.

Overarching 1: Improve assurance and independent reassurance to build trust and confidence.

1. Background of 2014 recommendation: Providing reasonable assurance to the Commission is the responsibility of RSIC executives. Typically, such executive assurances include assertions that the organization's people, processes and systems are capable and performance and risks are managed within the agreed upon policy and exposure limits. Independent reassurance should also be obtained that management's report are reliable. Independent reassurance must come from those independent of management, such as external financial audits conducted under the auspices of the State Auditor who selects the external auditor for PEBA and thus for RSIC.

Independent reassurance can also come from consultants retained directly by the Commission, for example, the general investment management consultant. It also includes Internal Audit and Compliance, which typically reports directly to the Board's Audit Committee. The accounts payable and payroll procedures audit conducted by the Comptroller General as well as fiduciary performance audits under the auspices of the State Auditor General are yet other sources. As noted earlier, while offering reasonable assurance and reassurance, no audit can provide an absolute guarantee of compliance or the absence of misconduct. Nonetheless, reasonable assurance is still a high standard.

In 2014, the fiduciary performance audit recommended additional reassurance steps be taken. For example, the Commission could directly retain an external firm to assess valuations of underlying investments and/or internal controls. It was also recommended that RSIC institute a system of Enterprise Risk Management, and that the mandate and investment recommendation responsibilities of the Internal Investment Committee be clarified to enhance assurance. Finally,

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it was also recommended that the Commission retain the services of an independent expert to perform annual benchmarks of fund returns and management fees.

2. Assessment of implementation progress: RSIC has improved its assurance and independent reassurance in several areas. First, the Commission retained the PEBA auditor, CliftonLarsonAllen, to conduct annual Agreed Upon Procedures (AUP). Typically, these have focused on due diligence procedures and investment valuations, but have also addressed other areas, as appropriate. These reports are submitted to the Audit and Enterprise Risk Management Committee. We were told by a number of Commissioners, however, that they had not seen the AUP reports and did not have a good understanding of the effectiveness of and compliance with due diligence policies and processes.

Second, the roles and responsibilities in the Internal Investment Committee charter have been strengthened, detailed and clarified. The charter was most recently updated and approved in May 2018.

Third, CEM Benchmarking has been retained by RSIC to participate in CEM's annual peer investment performance and cost benchmarking. These reports are made available to the Commissioners and are also publicly available on the RSIC website. Several Commissioners expressed that they find the reports valuable.

Although the Commission had approved an enterprise risk management (ERM) program in 2014, and the Audit and Enterprise Risk Management Committee (AERMC) charter includes responsibility for oversight of the ERM program, very little progress has been realized in this area, in part due to staff turnover in the Director of ERM position. Most recently, ERM, Internal Audit, and Compliance have been combined into a single position (Director of Enterprise Risk Management and Compliance), with internal audit activities being outsourced and also under the direction of that position. However, the most recent person in that position left during the course of this review. There is currently no functioning ERM program.

3. Opportunities for further improvement:
 - As will be noted later in this report, there are a number of areas for further improvement for independent reassurance. Appendix 2 includes a more specific and detailed suggested approach for adapting ERM to the RSIC organization to achieve the most value.
 - While the Agreed Upon Procedures reports have been helpful, they could be expanded in scope and, in any case, should be communicated to and discussed more broadly with all Commissioners.

Overarching 2: Build capabilities across the organization (including HR, IT, Accounting, etc.).

1. Background of 2014 recommendation: In 2014 RSIC relied on certain key personnel for its successful operation, as it does today. There was a concern that the loss of key personnel would severely jeopardize its operations, and in the then-current environment, it would be difficult to recruit their replacements. The Commission also lacked HR capabilities and IT systems, the continued absence of which would contribute to operational risk. These included improvements

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in infrastructure planning, procurement and governance, and developing an investment accounting capability.

2. Assessment of implementation progress: RSIC has made significant progress in building its capabilities across the organization. An experienced Director of Human Resources was hired in 2014 who developed a new hiring and interviewing process, onboarding plan for new employees, core competency development, and training. Although he departed RSIC in 2017, the Human Resources (HR) program has been carried forward by an HR Manager who reports to the CEO. The HR function has been effective in supporting organizational development. However, there is currently no succession plan in place.

At the time of the 2014 review, RSIC had planned to begin a program to internally manage some public investments. This would have required significant new capabilities in trading systems and staffing as well as governance and oversight. Since that time, RSIC has revised its plans and has no immediate intention of managing assets internally and is focused on an externally-managed portfolio. As a result, many of the critical internal infrastructure needs identified in 2014 have been mitigated.

RSIC has made significant upgrades to its support capabilities through the hiring of an investment administrator in 2014. In addition, a risk analytics system was acquired. A document storage and management system had previously been implemented.

RSIC formed an IT Steering Committee in 2016 which provides oversight and governance for IT-related needs of the organization. At the present time, RSIC is considering significant changes and upgrades to its risk and workflow capabilities. The Steering Group is a key driver of the process.

RSIC has also formed a cross-functional Business Internal Investment Committee which meets quarterly and is intended to ensure effective communication of business initiatives to and from the Investment Office.

RSIC has not developed an overall three- to five-year infrastructure plan as recommended in the 2014 review. However, in the key initiatives developed by the Commission through their most recent self-assessment process, a focus on more comprehensive organizational strategic planning for resourcing, personnel, infrastructure, risk management, systems and policies was identified as a goal. While this has been a lower priority due to the decision not to pursue internal asset management, it will still be a helpful step which could guide the overall capability development for the future.

3. Opportunities for further improvement:
 - Develop a succession plan for key RSIC leadership positions
 - Develop a five-year capability development plan in conjunction with the next strategic plan for RSIC

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Overarching 3: Reset Commissioners' focus on strategy and oversight.

1. Background of 2014 recommendation: When RSIC was launched in 2005, there were six commissioners and an Administrative Director/ General Counsel with an Administrative Coordinator. The new CIO started in April 2006, and three additional full-time investment staff joined in January 2007. They were all charged with investing and managing \$25 billion. Due to limited resources, the Commissioners became very involved in "front office" investment operations such as due diligence. Initial back office and risk management procedures were often manual and ad hoc if they existed at all. By 2014, RSIC had reached a point in its capability development where the Commissioners needed to reset their focus to strategic issues such as asset allocation. They also needed to develop a statement of investment beliefs to guide the asset allocation and oversee the development of asset class plans. It was also recommended that the Commission expand the charters of its two standing committees to become Human Resources and Compensation and Audit and Enterprise Risk respectively, with expanded scope of their oversight. The 2014 report also recommended that RSIC improve the Commissioner's self-assessment and self-development processes.
2. Assessment of implementation progress: There has been significant progress by the Commissioners in removing themselves from the day-to-day investment execution processes and focusing more on oversight and the longer-term strategic challenges of RSIC. For example, since 2014 Commissioners are no longer involved in investment due diligence. During the second half of 2014, the Commission developed and approved a set of investment beliefs; since that time, the Commission has spent a significant portion of its efforts focused on re-thinking the strategic asset allocation, culminating in a new long-term asset allocation being approved in February 2018. As recommended in the 2014 fiduciary performance audit, the two Commission committees, the Compensation Committee and the Audit Committee, were renamed the Human Resources and Compensation Committee and Audit and Enterprise Risk Management Committee, respectively, and charters of each were expanded to reflect broader oversight authorities. The Commission now completes an annual self-assessment process to identify areas of improvement. However, most Commissioners stated that the results of the annual self-assessment program had been marginally helpful, at best. The most recent self-assessment did produce a list of key initiatives for the Commission to pursue in FY 2019. The Commission also has not developed a formal continuing education program linked to key policy decisions, which could be considered a leading practice.

The Commission is to be applauded for delegating most investment manager selection decisions to the CIO, which was effective as of October 2017. Together with a qualified, well-resourced staff, an effective investment policy statement, and appropriate governance policies and processes in place, we consider this to be a leading practice which allows the Commission to focus on setting strategy and policy and overseeing performance. As this is a relatively new delegation, it remains to be seen how it will further impact the long-term strategic focus of the Commission, but it should be a positive step.

3. Opportunities for further improvement:

The Commission could make further improvement in its shift to a more strategic orientation through the following:

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- The annual Commission self-assessment process should be improved to better focus on the strategic objectives of the Board and RSIC and to stimulate a more productive discussion of how the Commission can continue to become more strategic; to the extent permissible, the Commission may want to spend time in closed session without staff or consultants to discuss its own performance.
- The Commission should develop its long-term strategic policy agenda to ensure it identifies all known key decisions to be made over a three- to five-year time horizon and is prepared to make informed decisions in a timely manner. The list of key initiatives developed as part of the self-assessment is a good start, but it should be longer term, not just one year.
- The investment beliefs have not been updated since 2014, are relatively high-level, and could be revisited and revised to provide a more tangible direction to the asset allocation process.
- During its annual review of the asset allocation, as required by statute, the Commission could focus more on the underlying assumptions (e.g. correlations, returns and risk) and develop more insights about the portfolio and its allocations, rather than changing the allocations. Leading practice is to have a full review of the strategic asset allocation every three to five years, with minimal year-to-year changes in between. The continuing education program should be designed to prepare Commissioners for the next asset allocation cycle over a period of years.
- The RSIC staff should work with the Commission to identify ways to streamline the materials provided through improved executive summaries and hyperlinks to supporting materials. This topic was included in the FY 2019 key initiatives list developed by the Commission.

Overarching 4: Align fiduciary duties and responsibilities.

1. Background of 2014 recommendation: At the time of the 2014 fiduciary performance audit, the Retirement System had one of the most complex governance structures among state investment boards, with five separate entities that exercise fiduciary powers with overlapping authority for exercising fiduciary functions: the BCB (later the SFAA), the Legislature, PEBA, State Treasurer as Custodian, and RSIC. The authorities of the Commissioners did not match their responsibilities and duties, there were inherent conflicts in the roles played by the Treasurer as Custodian, and accountabilities were muddled.

To address these conclusions, the following eight recommendations were made to the General Assembly:

1. Clarify fiduciary responsibilities, if any, which remain with the BCB and, subsequently, with the new Department of Administration and the State Fiscal Accountability Authority.
2. In setting the expected rate of return, regularly review the process and underlying assumptions, or delegate the function to PEBA or RSIC, and establish a five-year cycle for the review.

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3. Enable the Commission to create the position of CEO/Executive Director as a single direct report to the Commission with the CIO reporting to the CEO.
 4. Delegate selection of outside counsel to RSIC.
 5. Delegate authority to the Commission for operational budgetary control and the setting of staff compensation and performance incentives.
 6. Provide an exemption to the State procurement policy for investment management systems (this could also be accomplished through the BCB).
 7. Expand the qualification criteria for Commissioners to recognize relevant experience and to allow for Commissioners with expertise in managing large, complex pension funds and investment operations.
 8. Increase the number of voting Commissioners by one or three so as to establish an odd number of voting Commissioners. This could include consideration of making the PEBA representative a voting member, recognizing this would require an exemption for a state employee.
2. Assessment of implementation progress: The General Assembly is to be commended for addressing nearly all of these recommendations through legislation which culminated in the Pension Reform Act of 2017, and the results have been very noticeable already.

The fragmentation of fiduciary responsibilities was significantly reduced, including removal of the SFAA as a retirement system fiduciary. The General Assembly will now receive a recommendation every four years from PEBA, in consultation with RSIC and the system actuary, for the assumed annual rate of return. The reform legislation codified the CEO position which had been implemented by RSIC in 2014. RSIC is now allowed to engage attorneys in consultation with the Attorney General. The Commissioner qualification criteria was modified to recognize relevant experience in lieu of specific credentials, and the size of the Commission was expanded with a seventh voting member.

Based upon our current assessment of RSIC, these legislative changes have significantly contributed to the improvements RSIC has been able to implement since 2014.

3. Opportunities for further improvement:

The two recommendations which were not addressed by the General Assembly would provide additional improvement opportunities for RSIC and are again recommended by FAS:

- Delegate authority to the Commission for operational budgetary control and the setting of staff compensation and performance incentives
- Provide an exemption to the State procurement policy for investment management systems

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Overarching 5: Improve the custodian relationships.

1. Background of 2014 recommendation: In 2014, the RSIC custodial relationship with the State Treasurer and Bank of New York Mellon (BNYM) was cumbersome, strained and inefficient, and that difficulty resulted in RSIC looking elsewhere for needed services and ultimately engaging an investment administrator for many services typically provided by the custodial bank. South Carolina was one of very few states where a public pension fund does not contract directly and manage the relationship with its custodial bank. Custody banks today provide many services which are essential to the smooth and effective functioning of a public fund, and the custodian is at least as much a technology and data management facility as a lockbox. The State Treasurer also interpreted his role as custodian to exercise a veto over the Commission's investment decisions, resulting in a lawsuit between the Commission and the State Treasurer's office.

In the 2014 fiduciary performance audit, several options were presented to resolve these difficulties with the Custodial bank's role, the State Treasurer's role as Custodian and custodial bank contracting, ranging from the status quo, improvements to the status quo, giving RSIC authority to contract with its own custodial bank with the State Treasurer remaining as custodian of record, making PEBA custodian of record with RSIC having custodial contracting authority, to transferring full custodial authority to RSIC (the most common model at other public pension funds in the U.S.).

2. Assessment of implementation progress: The General Assembly took legislative action in 2017 in the Pension Reform Act which essentially resolved this situation. The new statute designated the PEBA Board as the custodian of the trust's assets and made RSIC responsible for the custodial banking arrangement.

Since the new law took effect, RSIC signed a new custody agreement with BNYM in July 2017. RSIC staff report that since the new contract and direct relationship with BNYM has been in effect, its ability to acquire the desired services and the responsiveness of the custodial bank has improved dramatically. There is currently an effort underway to rationalize the custodial bank and investment administrator services. The issue as identified in 2014 has been completely resolved and the General Assembly is again to be commended.

3. Opportunities for further improvement: RSIC does not have a service level agreement (SLA) with BNYM that documents, in greater depth than the custody contract, mutually agreed upon performance goals and metrics as well as the respective responsibilities of the bank and RSIC in meeting service expectations. An SLA can help optimize the many parts of the custody relationship and reduce issues when there are personnel changes. Although not yet standard practice and not provided for in RSIC's current contract, an SLA is a leading practice to pursue now or as part of the next contract.

The opportunities for further improvement for the overarching recommendations are discussed in further detail in the following sections.

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B. Governance

G1: *The Legislature should better align Retirement System governance authority with assignment of obligations and clarify what fiduciary responsibilities, if any, still reside with the BCB and, subsequently, the Department of Administration and the State Fiscal Accountability Authority.*

1. Background: There were several entities with fiduciary responsibility for the retirement trust as well as oversight of RSIC. The Budget and Control Board (BCB) was a “cotrustee” with the South Carolina Public Employee Benefit Authority (PEBA) and had authority to approve RSIC’s purchasing policy. S.C. Code Ann. § 9-1-1310. The BCB also appointed four of seven commissioners. The BCB’s role was unclear with respect to oversight of RSIC. Arguably, the BCB had fiduciary obligations in exercising its powers to approve RSIC’s purchasing policy. This arrangement created confusion around governance, decision-making and accountability.
2. Assessment of implementation progress: The BCB was abolished pursuant to the Restructuring Act of 2014 (effective July 1, 2015), and the State Fiscal Accountability Authority (SFAA) and Department of Administration (DOA) were created. The SFAA and DOA assumed some of the responsibilities from the BCB. However, neither entity is identified as a “cotrustee”. Rather, the 2017 Pension Reform Act, made effective July 1, 2017, identifies PEBA and RSIC as “cotrustees.” In addition, all powers and duties of the BCB as investor in equity securities were transferred to RSIC. S.C. Code Ann. § 9-15-315(F).
3. Opportunities for further improvement: None identified.

G2: *The Legislature should resolve the Treasurer’s conflicting fiduciary duties (alternatives are discussed in I17).*

1. Background: The State Treasurer was responsible for multiple fiduciary roles, authorities and responsibilities which presented inherent conflicts. The Treasurer's three roles were:
 - a. Member of Budget and Control Board (BCB) (subsequently the State Fiscal Accountability Authority (SFAA));
 - b. Commissioner on RSIC; and,
 - c. Custodian of the funds.

This recommendation was intended to resolve the inherent conflicts by making changes in the statutory duties of the State Treasurer with respect to the RSIC.

2. Assessment of implementation progress: The identified conflicts have been resolved. The 2017 Pension Reform Act included several provisions which addressed the identified conflicts:
 - a. PEBA and RSIC were designated co-trustees of the trust’s assets and the SFAA was removed as a co-trustee;

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- b. Provided that all appointing authorities must appoint a member and may not choose to serve themselves; and,
 - c. Designated the PEBA Board as the custodian of the trust's assets and makes RSIC responsible for the custodial banking arrangement.
3. Opportunities for further improvement: None identified.

G3: *The Legislature should delegate selection of the custodial bank and management of the relationship to the RSIC (alternatives are further discussed in I17).*

1. Background: Selection of the custodial bank by the State Treasurer had created significant delays, costs, and duplication of effort. Lack of direct management of the custodial bank relationship by RSIC staff had also contributed to delays in building infrastructure and in obtaining performance data.
2. Assessment of implementation progress: The selection and management of the custodial bank relationship has been reassigned and is now working very well. The 2017 Pension Reform Act included provisions which designated PEBA and RSIC as co-trustees of the trust's assets and also designated the PEBA Board as the custodian of the trust's assets and RSIC responsible for the custodial banking arrangement.
3. Opportunities for further improvement: None identified.

G4: *The Legislature should revise legislation to allow the Commission to designate a single direct operating report with the title of either Chief Executive Officer (CEO) or Executive Director, and not require that the Chief Investment Officer (CIO) report directly to the Commission.*

1. Background: The RSIC had both the COO and CIO as direct reports to the Investment Commission, which FAS considers a lagging practice for investment board organizations due to the potential for confusion regarding authority and accountability for administrative decisions between the COO and CIO.
2. Assessment of implementation progress: This issue has been resolved through the creation and appointment of a Chief Executive Officer in fall of 2015 and is working very well. The CEO position was made a statutory requirement as of April 2017.
3. Opportunities for further improvement: None identified.

G5.1: *The Legislature should delegate authority for operating budget, staffing and all compensation approval to the Commission.*

1. Background: RSIC has total authority to invest trust assets, but it did not have the authority to build the infrastructure or hire the employees necessary to invest those assets. Funds for staff compensation, information systems, research services,

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consultants, legal services and overhead were appropriated from the trust by the General Assembly.

2. Assessment of implementation progress: In the 2017 Pension Reform Act, the CEO was given authority to hire employees and set their compensation pursuant to an organizational plan approved by the Commission: S.C. Code Ann. § 9-16-315(H) provides:

The chief executive officer shall employ the other professional, administrative, and clerical personnel he determines necessary to support the administration and operation of the commission and fix their compensation pursuant to an organizational plan approved by the commission.

However, RSIC is still subject to the budget process pursuant to S.C. Code Ann. § 11-11-30, which provides:

On or before the first day of November, annually, each of the several state ... agencies... receiving or asking for financial aid from the State shall report to the Governor ... an estimate in itemized form showing the amount needed for the year beginning with the first day of July or thereafter.

Although RSIC requested delegated budget authority as recommended in the 2014 fiduciary performance audit report, the General Assembly declined to create an exemption for RSIC, as it commonly uses the budget process to oversee agencies. The budget process still requires that RSIC submit a budget request and full time employee (FTE) request to the Governor. The Governor incorporates RSIC's responses into the annual budget proposal which is submitted to the General Assembly. Since the CEO's authority to hire employees and fix their compensation is limited by approvals received in the budget process, the risks identified in the 2014 fiduciary performance audit report regarding RSIC's dependence on the General Assembly for budget approval remain.

Like other agencies, RSIC has limited flexibility to move funds between budget categories and cannot carry forward unspent funds from one fiscal year to the next. Those limitations can be challenging for an organization like RSIC that has been going through a period of growth and reformation.

Recruitment and retention of talented investment staff remains a concern. RSIC has a strict external fiduciary duty standard which it must meet in fulfilling responsibilities to its beneficiaries. The ability to meet that standard is highly dependent on being able to attract and retain qualified personnel in a very competitive industry. If RSIC had full delegated authority to implement its own hiring and compensation decisions, then RSIC would have more flexibility to recruit top talent and take advantage of hiring opportunities.

In practice, RSIC does not appear to have difficulty receiving requested amounts in the budget. The General Assembly approved a large budget increase for fiscal years 2016 and 2017 and decreased requests for the fiscal years since then. RSIC appears to be adequately funded.

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However, we note that RSIC's dependency on the General Assembly to approve its budget could become a constraint in the future. There is potential for conflict between short-term political pressure to reduce expenses and RSIC's ongoing fiduciary obligation to have sufficient professional and other resources to prudently manage and monitor investment of its trust fund assets.

3. Opportunities for further improvement: RSIC should continue to engage over time with the General Assembly to seek delegated budget and personnel resourcing authority to RSIC that is commensurate with what is needed to meet RSIC's fiduciary obligations. This ongoing advocacy should emphasize accountability for delegated authority through continued maintenance of oversight monitoring and periodic independent expert fiduciary reviews to evaluate how that the authority is being exercised.

G5.2: RSIC should review its annual budget planning process to ensure that it is using existing allocations to full advantage and that requests for increased resources are based on a realistic assessment of staff and systems the organization can assimilate during the next budget period. The Commission should conduct a mid-year review of year-to-date and projected expenses compared to budgeted amounts.

1. Background: RSIC had not spent between 19% and 37% of its legislatively authorized budget for agency operations in each of the five years preceding FY 2014. Much of the unused amount was due to new staff positions not yet filled, incentive compensation not earned and major systems enhancements that were delayed. The COO and CIO were each to report budget plans to the Commission.
2. Assessment of implementation progress: The CEO has sole responsibility for recommending the annual operating budget to the Commission for submission to the State. Prior to approving the new request, the Commission receives an update on the amount expended during the prior fiscal year. The General Assembly approved a large budget increase for fiscal years 2016 and 2017 and a decreased request for fiscal years 2018 and 2019 to better align with the agency's needs. The resulting \$15.8 million budget exceeded FY 2018 expenses but RSIC anticipates it will meet its needs in FY 2019, with some margin for initiatives. The CEO receives a monthly update to ensure that expenditures are in line with the approved budget. RSIC concluded that a mid-year budget review with the Commission would not add value, given its current budget authority and practices.
3. Opportunities for further improvement: None identified.

G6: The Commission should have an annual external financial audit or an agreed upon procedures review of fund valuations, procedures and/or controls, consistent with other investment boards; either the Commission or a state agency (e.g., the State Auditor) could select the external firm.

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1. Background: The external auditor is retained by the State Auditor and the direct day-to-day contact with the auditor was through PEBA, not RSIC, which limited the depth of the external audit and the level of reassurance for the Commission. No external audit was directed by the Commission and there was no independent audit of RSIC alone.
2. Assessment of implementation progress: RSIC currently outsources an internal audit of initial and ongoing due diligence procedures that is performed by CliftonLarsonAllen (CLA). FAS independently confirmed through discussions with the CLA audit partner and RSIC and PEBA staff that CLA performs agreed-upon procedures (AUP) of the RSIC due diligence function. The procedures focus primarily on valuation. CLA presents the report to the RSIC Audit Committee which provides the opportunity to meet with the auditors to ask questions. In addition, accounting and internal audit staff at PEBA raised no new issues with the external auditors in the latest service period.
3. Opportunities for further improvement: None identified.

G7: *Decision-making within strategic partnerships should be assessed in the context of how all RSIC investment decisions are made and adjusted accordingly, if appropriate (see Recommendation I12.1).*

1. Background: At the time of the 2014 report, the RSIC investment program featured eight strategic partnerships, down from the original 14 which, by one estimate, could have held more than half of the assets of the fund if fully funded. The rationales for the existence of the strategic partnerships were fuzzy, and the value of the strategic partnerships was questionable. From a governance point of view, investment decision making within the fund often relied upon the CIO and only upon the CIO. The normal oversight mechanisms at the time did not apply, creating the potential for a single point of failure.
2. Assessment of implementation progress: RSIC has instituted a series of reforms and thereby mitigated the issue. Each partnership was reviewed with the previous general investment consultant. The number of partnerships has been reduced to seven, three of which are more active, and the investment staff can articulate the specific value added for each of those relationships. RSIC is also making considered judgements about whether or not a new investment with a strategic partner should be made within the partnership or outside the partnership structure. Each partnership is assigned to a specific investment officer for monitoring and that investment officer acts as the investment “sponsor” for new investments within the partnerships. Those proposed new investments within a partnership now go through the normal Internal Investment Committee (IIC) process.

The IIC also reviews the strategic partnership program generally twice a year.

In addition to the legally constituted strategic partnerships, the RSIC has created de facto partnerships through multiple mandates to at least one multi-product provider, resulting in both a deep knowledge of that provider and a “relationship” fee discount, without the de jure governance issues created by the previous generation of partnerships.

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3. Opportunities for further improvement: It would be useful to write a “lessons learned” memorandum analyzing what circumstances, abilities, resources, governance structures, and economics need to be present for a successful strategic partnership so as to memorialize the learnings for future generations of RSIC staff.

G8.1: The Legislature should revise the Commissioner’s qualification requirements to achieve a more diverse composition of members, including some Commissioners with a broader business experience beyond investments which is not as reliant on professional certifications when there is significant practical experience.

1. Background: RSIC criteria emphasized investment certification and qualifications or academic credentials but did not recognize equivalent experience, and also strongly preferred front-office expertise and experience over general management and back office operations experience. The criteria also limited the potential Commissioner pool of candidates; some commissioners no longer met the new criteria and had to be grandfathered.
2. Assessment of implementation progress: This recommendation was addressed by revised legislation in S.C. Code Ann. § 9-16-315 (2017) which provided additional commissioner qualifications to expand the pool of prospective commissioners:

(D) A person may not be appointed to the commission unless the person possesses at least one of the following qualifications:

(1) the Chartered Financial Analyst credential of the CFA Institute;

(2) at least twelve years as a Certified Financial Planner credentialed by the Certified Financial Planner Board of Standards;

(3) the Chartered Alternative Investment Analyst certification of the Chartered Alternative Investment Analyst Association;

(4) at least twenty years professional actuarial experience, including at least ten as an Enrolled Actuary licensed by a Joint Board of the Department of the Treasury and the Department of Labor, to perform a variety of actuarial tasks required of pension plans in the United States by the Employee Retirement Income Security Act of 1974;

(5) at least twenty years professional teaching experience in economics or finance, ten of which must have occurred at a doctorate-granting university, master-granting college or university, or a baccalaureate college as classified by the Carnegie Foundation;

(6) an earned Ph.D. in economics or finance from a doctorate-granting institution as classified by the Carnegie Foundation;

(7) the Certified Internal Auditor credential of The Institute of Internal Auditors;

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(8) at least twelve years of professional experience in the financial management of pensions or insurance plans; or

(9) at least twelve years of professional experience as a certified public accountant with financial management, pension, or insurance audit expertise.

(E) Except for the member appointed pursuant to subsection (A)(6) and (7), a person may not be appointed or continue to serve who is an elected or appointed officer of the State or any of its political subdivisions, including school districts.

3. Opportunities for further improvement: None identified.

G8.2: The Legislature should consider adding one or three additional voting members to the Commission to increase diversity, increase beneficiary representation and reduce the potential for tie votes (making the PEBA representative a voting Commissioner could be an option, but would require an exemption from the prohibition for a state employee).

1. Background: The Commission had six voting members which could contribute to tie votes (and had on one occasion). While tie votes can occur even when there is an odd number of Commission members (if members are absent or recused from voting on a matter) and tie votes merely result in failure to approve the pending motion, prevailing practice seeks to reduce tie votes, as they can contribute to deadlock and exacerbate conflicts.
2. Assessment of implementation progress: This recommendation was addressed by revised legislation in S.C. Code Ann. § 9-16-315 (2017) which increased the number of voting commissioners to seven by adding an additional gubernatorial appointee who must be an active member of one the defined benefit systems.

(A) There is established the "Retirement System Investment Commission" (RSIC) consisting of eight members, seven of which have voting privileges, as follows:

(1) two members appointed by the Governor, one of which is an active member of the South Carolina Retirement System, Police Officers Retirement System, the Judges and Solicitors Retirement System, or the National Guard Retirement System;

(2) one member appointed by the State Treasurer;

(3) one member appointed by the Comptroller General;

(4) one member appointed by the Chairman of the Senate Finance Committee;

(5) one member appointed by the Chairman of the House Ways and Means Committee;

(6) one member who is a retired member of the South Carolina Retirement System, Police Officers Retirement System, Judges and Solicitors Retirement System, or National Guard Retirement System. This representative member must be appointed by unanimous vote of the voting members of the commission; and

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(7) *the Executive Director of South Carolina Public Employee Benefit Authority, ex officio, without voting privileges.*

3. Opportunities for further improvement: None identified.

G9: *The Legislature should consider imposing term limits for Commissioners.*

1. Background: In 2014, there were no limits on the number of terms a Commissioner may serve. The State Treasurer serves as a commissioner for the length of the term of office. There are arguments both for and against term limits. The primary advantage of term limits is to provide fresh energy, ideas and expertise to the board. The most commonly cited disadvantage is loss of valuable experience and continuity, particularly as it may take up to a year for many board members to be fully up-to-speed.
2. Assessment of implementation progress: This recommendation was addressed by revised legislation in S.C. Code Ann. § 9-16-315 (2017) which changed the commissioner terms from 5 to 4 years and limits commissioners to two consecutive terms. Commissioners currently in their second or subsequent term may not be reappointed, but may complete their term.

Members shall serve for terms of four years and until their successors are appointed and qualify. Except for the Executive Director of the South Carolina Public Employee Benefit Authority, a person appointed may not serve until the appointing official certifies to the Secretary of State that the appointee meets or exceeds the qualifications set forth in subsections (D) and (E). A person appointed may not qualify unless he first certifies that he meets or exceeds the qualifications applicable for his appointment. Terms are deemed to expire after June thirtieth of the year in which the term is due to expire. Members are appointed for a term and may be removed before the term expires only by the Governor for the reasons provided in Section 1-3-240(C). A member may not be appointed to serve more than two consecutive full four-year terms. A member serving a second or greater term, beginning July 1, 2016, may not serve an additional consecutive four-year term upon the expiration of his term pursuant to the provisions of this subsection. A member who has served for ten or more years as of July 1, 2017, may complete the term for which he was appointed but may not be reappointed to the commission.

Some concerns have been expressed that term limits may be vulnerable to delays in appointments effectively extending the term of the incumbent. The language used in Title 9 is apparently consistent with legislative language commonly used in South Carolina.

3. Opportunities for further improvement: Close attention should be given to the timely appointment of successor Commissioners when terms expire.

G10.1: *The Commission should work with its general investment consultant and develop a set of investment beliefs to provide a basis for strategic management of the investment portfolio.*

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1. Background: At the time of the 2014 fiduciary performance audit, the Commission's primary focus was tactical, devoting much time to selecting (and itself performing due diligence on) managers. This recommendation was part of a series of recommendations designed to refocus the Commission on high-value strategic decisions.
2. Assessment of implementation progress: Completed. The investment beliefs are incorporated into the current SIOP, last affirmed on September 28, 2017.
3. Opportunities for further improvement: The investment beliefs should be revisited periodically (every 3-5 years, coterminous with the asset allocation study periodicity recommended in I2) or as required by new knowledge.

G10.2: In addition to an annual review of the asset allocation, throughout the year the Commission should review and discuss asset class strategies with the investment staff and provide oversight.

1. Background: At the time of the 2014 fiduciary performance audit, the Commission was focused tactically, devoting much time to selecting (and itself performing due diligence on) managers. This recommendation was part of a series of recommendations designed to refocus the Commission on high-value strategic decisions.
2. Assessment of implementation progress: The Commission approves an Annual Investment Plan which contains a high-level plan by asset class. In addition, the Commission receives presentations throughout the year from various asset class investment officers, including asset class deep dives in executive session.

Importantly, at the time of the 2014 report, investment decisions were finalized by the Commission itself. Since the delegation decision, that responsibility has been moved to the investment staff. We note that the asset classes do an annual "deep dive" presentation to the IIC on a rolling basis.

3. Opportunities for further improvement: The Commission approved a plan to improve the SIOP and AIP adoption process at its June 2018 meeting, which should improve the efficiency and logic of the process. Integrating an annual calendar of asset class presentations into that process should increase the robustness of the Commission's oversight and ability to provide strategic guidance.

G10.3: The Commission should shift its emphasis from a focus on advising on specific investments and participating in due diligence to providing oversight and strategic guidance to staff. This would include eliminating the assignment of asset classes to individual Commissioners and, as a general rule, preclude Commissioner's involvement in investment due diligence except as observers for either overseeing staff processes or for Commissioners' education and training purposes.

1. Background: At the time of the 2014 fiduciary performance audit, individual Commissioners were assigned oversight of asset classes, and Commissioners participated

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with staff and the general investment consultant in performing due diligence, a highly unusual situation which created multiple governance issues (e.g. the Commission ultimately had to oversee managers which it was at least partially responsible for selecting and a diligence process in which it had participated).

2. Assessment of implementation progress: Commissioners no longer participate in due diligence. The role of the Commission and the staff has been clarified, resolving the governance issues. Also, enabled by the 2017 Pension Reform Bill, the Commission has delegated investment discretion (to specific percentages of the fund) to the staff to hire and fire managers, while retaining jurisdiction over very large allocations, matters of first impression (such as the first mandate in a new asset class) and other key matters.
3. Opportunities for further improvement: None identified.

G12.1: The Commission should plan more frequent meetings, at least bi-monthly, and develop standing agenda items annually and for each meeting (e.g., asset allocation, investment beliefs, specific asset class reviews, infrastructure business plan review, etc.) (see also Recommendation I6.1).

1. Background: The Commission charter called for quarterly meetings, but approval of investments often requires meeting more frequently than quarterly. As a result, the Commission was meeting 7-8 times per year with numerous special meetings. In addition, meeting time was dominated by investment manager selection discussions and other tactical considerations rather than more long-term strategic issues and topics.
2. Assessment of implementation progress: The current RSIC Governance Policy Manual still states in Policy IV (F) Meeting Policies, "Regular meetings will be held at least once during each fiscal quarter and at other times as set by the Commission or Chair or requested by the Board of Directors of the South Carolina Public Employee Benefit Authority." However, as the Commission has delegated most investment manager and fund selection decisions to staff, the need for more frequent meetings is reduced. As a matter of practice, the Commission met eight times in both 2016 and 2017 and met three times during the first half of calendar year 2018.

Regarding development of standing agenda items on an annual basis, there appears to be a regular cadence for recurring items; however, there is not a long-term strategic agenda for the Commission which drives preparation for addressing major decisions and is linked to Commissioner education.

3. Opportunities for further improvement: RSIC should develop a long-term (e.g., 3-5 years) strategic policy agenda which includes decisions which are reserved for the Commission to make. The policy agenda should provide a framework for bringing key issues to the Commission and for planning Commissioner education in advance of addressing those issues.

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G12.2: The revised protocol for the agenda setting process should be formally adopted by the Commission and incorporated into the Governance Manual.

1. Background: A revised protocol for the agenda setting process had been presented by the Chairman at the September 2013 meeting to ensure opportunity for input by all Commissioners in development of the agenda. However, the minutes did not indicate that the amended protocol was adopted by the Commission. The 2014 fiduciary performance audit recommended that the amendment be formally adopted by the Commission and incorporated into the Governance Manual.
2. Assessment of implementation progress: The Commission adopted amendments to Governance Policy IV in June 2014 which incorporated the revised protocol process.
3. Opportunities for further improvement: None identified.

G12.3: Improve the effectiveness of Commission self-assessments by providing evaluations of individual Commissioners, utilizing peer-to-peer and upward evaluations (from RSIC staff), and providing individualized feedback and personalized improvement goals.

1. Background: The Commission utilized a self-assessment process which was prevailing practice. The Commission conducted self-assessments of the entire commission and the committees, but individual member, peer-to-peer, and upward (staff) evaluations were not used. The Commission chair coordinated the self-assessments using a questionnaire and open discussion. There was no individualized feedback or personalized improvement goals.

Although the Commission's self-development policies were prevailing practice, there were opportunities for improvement. Commissioner training was mandatory and the type of training was consistent with the peer group. While there was a training plan for new commissioners, there was no overall plan or budget for the Commission or individual members.

2. Assessment of implementation progress: There is an on-boarding process. New trustees have received a day long training program in addition to being able to attend third party training such as NCPERS although such participation is left to the discretion of the individual Commissioner.

Self-assessment surveys are completed and then analyzed by the CEO. Differences of opinion are identified. Some Commissioners expressed concerns about follow-through on results on self-assessments and the utility of the self-assessment process. The most recent process produced a list of key initiatives for the Commission for FY 2019.

It could be helpful for the Commission to revisit both the process and the self-assessment questionnaire to better engage the Commissioners. For example, consider having the process facilitated by an independent third party who interviews each Commissioner and is able to synthesize the results and help facilitate development of the long-term Commission strategic agenda and ongoing education needs.

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3. Opportunities for further improvement: The Commission self-assessment processes could be improved by improving Commissioner engagement and ensuring more systematic follow-up on opportunities for improvement. The Commission should also consider use of an experienced external facilitator.

G12.4: Develop an overall continuing education plan for Commissioners, including an on-going education budget for the Commission and plans for individual Commissioners.

1. Background: New commissioners attended mandatory fiduciary training. There was a training plan for new commissioners, but there was no overall plan or budget for the Commission or individual members.
2. Assessment of implementation progress: Since the 2014 fiduciary performance audit, RSIC has adopted the Governance Policy Manual, which requires as follows:

(a) In order to help fulfill their fiduciary duties, Commissioners should continually develop and maintain their knowledge of pension investment and administration matters by attending educational presentations and events.

(b) Commissioners should report all continuing education related to the Commission to the Chair or CEO.

(c) Commissioners are encouraged to participate in at least 16 hours of continuing education annually, including in-house seminars, pertinent national conferences, select investment and pension plan administration courses, and continuing educational courses offered through local colleges and universities.

New Commissioners participate in training sessions and receive a large on-boarding binder, which provides important information about their role on the Commission including an overview of governance policies, selected statutes and the investment process. The training and materials RSIC has developed for new Commissioners is consistent with peer funds but difficult to digest due to the volume.

Commissioners receive ongoing education from several sources. RSIC's asset managers often provide some education sessions. Also, Commissioners have participated in fiduciary training offered for peer funds (e.g., NCPERS). However, it does not appear that the Commission has developed a continuing education plan based on the needs of the commissioners. Additional education may be particularly important at this moment, as the Commission shifts from a tactical board that has been heavily involved in investment decisions to a strategic board that establishes policy and oversees staff. To address this need, RSIC may wish to consider forming a new committee or assigning responsibility to an existing committee for developing Commissioner education plans.

3. Opportunities for further improvement: RSIC could improve ongoing education of Commissioners in several areas:
 - a. For on-boarding of new Commissioners after selection or appointment:

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1. Training should begin as soon as practical and be individualized to the specific needs of new Commissioners by identifying skills gaps and developing a continuing education plan for that Commissioner to address those gaps;
 2. Rather than a one-time training event, on-boarding should be staged to provide an extended time period to complete the process. The additional time may avoid overwhelming Commissioners with too much information at once and also allow them more time to absorb the large amount of new information associated with Commissioner responsibilities;
 3. Better use can be made of executive summaries with hyper-links to more detailed materials for on-boarding.
- b. Commissioners' continuing education plans should:
1. Incorporate the results of the Commissioner self-assessment;
 2. Be better linked to anticipated policy decisions required (see Strategic Policy Agenda) and the specific related needs identified as part of the annual self-assessment.
- c. The education policy could be revised to identify a subset of education requirements relevant to the Commission. For example, instead of only requiring "at least 16 hours of continuing education annually," RSIC could specify that education cover fiduciary duty, communications/stakeholder relations, asset allocation, and other topics where skills development is determined to be appropriate (including those in the strategic policy agenda).

G13.1: The Audit Committee should review and approve the Internal Audit Charter.

1. Background: The 2014 fiduciary performance audit report recommended improvements to the RSIC independent reassurance function.
2. Assessment of implementation progress: The Audit Committee reviews and approves the Internal Audit Charter each year and has been doing so since 2014.
3. Opportunities for further improvement: None identified.

G13.2: Develop and implement an Enterprise Risk Program, as called for in the Governance Policy Manual and approved at the March 13, 2014 Commission meeting, and ensure the necessary tools are acquired to support effective risk management and oversight.

1. Background: The ERM, IA and Compliance functions provide an important source of internal independent reassurance to the senior executive, the AERMC, the Commission and their key stakeholders. Internal independent reassurance is provided by those who

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are independent of management in that they report directly to the Commission (not through the CEO) about the reliability of management's reports and assurances. There are also external sources of reassurance such as the external auditor and fiduciary performance audits (such as this report) commissioned by the Office of the State Auditor. The State Auditor also reviews RSIC directly, typically focused on the finance and administration areas. These reports are discussed by the Audit Committee and shared with all Commissioners via Watchdox.

Compliance conversations are frequent between executive leadership team. Until the Director's recent departure there were regular compliance conversations between legal and compliance. These are ongoing. Internal legal counsel is considered to be a great resource.

There is strong tone at the top. The CEO has made it clear that non-compliance is unacceptable and frequently checks in with Compliance. Compliance topics also get time as needed at Business IIC or Investment IIC to cover topics. The CIO also recognizes the importance of compliance. A compliance update was recently provided to the AERMC although this focused on processes rather than outcomes. More detailed discussions also happen as needed (e.g. when reviewing the results of annual manager compliance questionnaire).

2. Assessment of implementation progress: Risk discussions are an almost constant occurrence at the agency among key staff and, as needed, with Commissioners. However, there is no systematic way to understand and manage risks across the enterprise. RSIC was planning to implement an ERM program in 2014. Our recommendations, at that time, reinforced the proposed direction and emphasized its importance and rapid implementation, i.e., by July 2014. Unfortunately, ERM is one of the few functions within the control of RSIC where not much progress has been made.
3. Opportunities for further improvement: Expedite implementation of an ERM program. See Appendix 2 for more detailed explanation of contributing factors, tools, implementation considerations and recommendations.

G13.3: Add responsibility for Enterprise Risk Management to the Audit Committee charter; consider changing the name to the Audit and Enterprise Risk Committee.

1. Background: Although the Commission had approved an ERM program, at the time of the 2014 fiduciary performance audit there was no oversight of the ERM program by a committee of the Board. The 2014 report included a recommendation that the Audit Committee mandate and charter include oversight for ERM.
2. Assessment of implementation progress: The Audit Committee was renamed the Audit and Enterprise Risk Management Committee (AERMC) and its charter was updated to include oversight of the ERM program in April 2014. The current AERMC charter includes a comprehensive listing of risk-related oversight responsibilities for the AERMC. It does

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not appear that the AERMC is exercising its risk oversight responsibilities as originally envisioned given the lack of progress on the implementation of ERM.

3. Opportunities for further improvement: None identified. However, see G13.2 for recommendations for the ERM program.

G13.4 An independent third-party expert firm should regularly benchmark fund returns and costs (also see G18.4 and I11.2).

1. Background: The 2014 fiduciary performance audit included an independent review by CEM Benchmarking of the cost-effectiveness of RSIC's investment program. It concluded that RSIC's reporting of costs is more complete than its peers. It found that although RSIC's total costs were higher than its peers, they were normal for funds with a similar asset mix. The report also examined the effect of RSIC's asset allocation and implementation styles on investment returns compared to its peers.
2. Assessment of implementation progress: Since 2014, RSIC has annually contracted with CEM for a benchmarking report. The most recent documents a reduction in RSIC's costs from 2012 to 2016, how it was accomplished, and the effect of changes in RSIC's asset allocation on its investment returns. It also identifies aspects of RSIC's asset allocation and implementation strategies that vary significantly from peers, how that is changing over time, and how that affects relative costs and returns. The report is available on RSIC's website. RSIC is currently reviewing an initial draft of CEM's report for 2017. CEM also conducted a peer benchmarking review of RSIC's staff level (see O3.2).
3. Opportunities for further improvement: None identified.

G14: The Commission should adopt a mid-year review process for its direct reports to provide guidance and interim feedback.

1. Background: Executive evaluations occurred annually, with executives completing a self-evaluation which was then reviewed by the Commissioners. There was no formal feedback process in between the annual reviews.
2. Assessment of implementation progress: The Commission now has a single direct report with the CEO position. The CEO meets regularly with the Commission Chair and other Commissioners and generally receives feedback throughout the year.
3. Opportunities for further improvement: None identified.

G15.1: As part of a shift in emphasis by the Commission to enterprise oversight, the Compensation Committee charter should be expanded to include oversight of human resources and infrastructure and to provide guidance to staff on human resources and capability development.

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1. Background: The Compensation Committee charter did not include oversight of the adequacy of human resources recruitment, selection and management.
2. Assessment of implementation progress: The Human Resources and Compensation Committee (HRCC) charter was updated to include “provide oversight relating to human resources” in its purpose and “providing guidance and oversight to the human resources function” and “receiving recommendations from the Director of Human Resources for human resources functional needs and changes as well as for RSIC staff development” in the primary responsibilities.
3. Opportunities for further improvement: None identified.

G15.2: The Compensation Committee should change its name to Human Resources and Compensation to reflect the new focus.

1. Background: As RSIC was facing human resource challenges such as morale and reputation, recruitment and retention, key person risk, and succession planning, the 2014 fiduciary performance audit report recommended that the Commission provide leadership in developing organizational capabilities, particularly in the back office and risk management areas. To reinforce this emphasis, it was recommended to change the name of the committee.
2. Assessment of implementation progress: The Compensation Committee was renamed the Human Resources and Compensation Committee in May 2014.
3. Opportunities for further improvement: None identified.

G16.1 The role of the Internal Investment Committee (IIC) should be clarified.

1. Background: At the time of the 2014 fiduciary performance audit, the IIC was relatively new, attendance was limited, there was minimal cross-asset class pollination and even less interaction between non-investment functions such as legal and operations.
2. Assessment of implementation progress: There has been a major evolution in the IIC. It is now central to the RSIC’s investment program. Voting members are appointed by the CEO, with the input of the CIO. New investments must be approved by the IIC, and it is the forum at which all the diligence (investment and operational) is discussed. It has been successful in surfacing issues, cross-pollinating analyses across asset classes and raising both investment and specific manager diligence questions. There is a forward calendar and scheduled performance and risk reviews. The voting members of the IIC meet as a peer review committee to guide and track potential new investments. The first peer review examines the potential investment for “fit”; in other words, if the investment were to satisfy due diligence requirements, would it achieve the desired impact on the overall portfolio. The second peer review (and a subsequent follow up) examines the qualifications of the particular manager/general partnership by reviewing the investment and operational due diligence and consultant report (if any). Effectively that means that the IIC members examine new investments three times (twice constituted as peer

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reviews and, finally, as the formal IIC). The IIC charter was amended most recently on May 16, 2018.

3. Opportunities for further improvement: The IIC could be improved through:
 - a. The IIC is technically advisory to the CIO. In reality, it would be highly unusual for the CIO to proceed with an investment decision opposed by the IIC. Given that, the charter should be revised to note that any such CIO override of a formal vote by the IIC should be reported to the CEO and Commission, so that they can be aware of the situation. While the CEO attends IIC meetings, and would very likely be aware of such a situation, formalizing the process so as to provide documentation in such a rare instance would be a helpful governance procedure, particularly since the CEO can veto such a decision.
 - b. An important function of the IIC is to review and modify policies and procedures. At present, there is no obligation that the broker-dealers used by the short-term fixed income desk affirm annually that they comply with the RSIC's ethics and gifts policy. (The RSIC staff makes such an affirmation, and the requirement for such an affirmation is included routinely in investment management agreements with external asset managers.). The IIC should work with Compliance and Legal to create an annual affirmation for any broker-dealer executing trades for the RSIC directly.
 - c. Our understanding is that there is a broker-dealer selection policy which requires a broker-dealer to have \$25 million in net capital, as well as certain regulatory checks. Brokers are recommended by the head of the short-term desk and approved by the CIO. The IIC reviews trade volumes by broker-dealer semi-annually and there is an informal annual review process. There is no formal process to detect potential issues at broker-dealers, though the head of short-term fixed income monitors news services. The IIC should formalize the annual review process and add an environmental scan (news feeds, FINRA and SEC checks, etc.).

G16.2: If the named member of the IIC is not available (due either to being out of the office, on vacation, or the position being vacant), the next ranking staffer with similar responsibilities should attend IIC meetings to ensure appropriate participation.

1. Background: See the background to G16.1, above.
2. Assessment of implementation progress: Voting members of the IIC are appointed by the CEO. While they may occasionally miss a meeting, the combination of a wide variety of attendees, plus the forward calendar, and circulation of minutes, mitigates the potential issue of needed expertise being absent.
3. Opportunities for further improvement: None identified.

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G16.3: The CIO should routinely invite other investment, operations and legal staff to attend IIC meetings as visitors so as to facilitate dissemination of information across functional silos.

1. Background: See the background to G16.1, above.
2. Assessment of implementation progress: The COO and Legal both attend the IIC. In addition to the improved communication resulting from the broadening of the IIC attendees, there are now additional structures such as the quarterly business committee meeting the weekly leadership meeting to institutionalize cross-functional information sharing. Cross functional communication now seems to be welcomed, as evidenced by the Chief Legal Officer's attendance at some peer review and private equity pipeline meetings.
3. Opportunities for further improvement: The IIC (including the peer review process) may also present an opportunity to improve communications to the RSIC's private asset class consultant. We do not suggest inviting the consultant to the meetings on a routine basis for two reasons: 1) There is a balance between using the IIC to broaden and improve communications and the free flow of informed discussion around sensitive investment issues which become unwieldy with a large number of participants, and 2) there is the threat of group think if the independent consultant regularly participates in IIC meetings. However, a verbal or electronic report following the initial peer review meeting, including which partnerships are being considered for investment, could be circulated timely to the consultant, thereby furthering the consultant's understanding of the investment staff's thinking and priorities. That would serve to both alert the consultant as to potential upcoming due diligence needs, as well as provide the consultant with an early opportunity to volunteer relevant information to the RSIC staff.

G16.4: The CIO should consider whether to mandate annual plans by asset class and/or functional area. If so, the plans should be presented to the IIC to facilitate dissemination and cross-silo knowledge sharing.

1. Background: Annual asset class plans serve several functions: They force asset class heads to think strategically rather than merely reactively, provide a process and document which crystalizes constructive criticism from other members of the investment team, aide a CIO in understanding potential future investment program changes and resource requirements, facilitate oversight, etc.
2. Assessment of implementation progress: The RSIC has an effective annual asset class planning process which results in several work products, including part of the Annual Investment Plan, "challenging beliefs" asset class baselines, and deep dive presentations to both the IIC and the Commission.
3. Opportunities for further improvement: None identified.

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G18.1: RSIC's communications policy should be reviewed and revised, as appropriate, to address who is responsible for proactively speaking out on behalf of the RSIC and any policies which might be necessary to develop key messages.

1. Background: In 2014, RSIC's communications policies and practices were stressed by a significant public dispute with the State Treasurer, who was a member of the Commission. At the time, either the COO or CIO could serve as RSIC's spokesman.
2. Assessment of implementation progress: The CEO has primary responsibility for communications and is to annually report to the Commission on key initiatives. Under the CEO's oversight, communications with state government are managed by the Director of External Policy and for other stakeholders by the recently created position of Director of External Communications. The Commissioners report that there are no longer the conflicts within its ranks which previously contributed to significant communications issues.
3. Opportunities for further improvement: None identified.

G18.2: RSIC should develop a communications plan which identifies each stakeholder group, considers what information is important for each stakeholder to know, and identifies responsibility for maintaining stakeholder communications.

1. Background: RSIC lacked a goal-driven communications plan and review process. Emphasis was on communications with the Legislature, less so with other stakeholders.
2. Assessment of implementation progress: The FY 2019 communications plan identifies goals, audiences, methods and proactive initiatives to expand stakeholder understanding of RSIC's role and objectives.
3. Opportunities for further improvement: Identify metrics, such as activity on RSIC's website and surveys of stakeholders, to help measure the progress of the communications plan.

G18.3: In the communications plan, RSIC should consider an initiative to draw greater national attention to the need for all public pension funds to disclose costs in a consistent way and for investment managers to provide the level of reporting necessary to accomplish that objective.

1. Background: RSIC's cost reporting was the most complete in the industry due to its considerable efforts to verify and disclose all expenses for private equity partnerships. More standardized and complete cost reporting across the industry would lead to more informed investment choices and better benchmarking.
2. Assessment of implementation progress: RSIC collaborated with CEM to produce a white paper in 2015 that drew the industry's attention to the need for total cost disclosure for private equity. RSIC participated in the ILPA Fee Reporting Template Development Committee and formally endorsed the template. RSIC continues to talk with other

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investment organizations and shares its internally developed template with them. Not enough information is yet being gathered and reported by enough peers to benchmark much of the private equity costs RSIC reports. The move toward greater cost transparency by public pension funds varies state to state but seems to be slowly building according to CEM.

3. Opportunities for further improvement: None identified.

G18.4: RSIC should conduct a periodic benchmarking of its returns and costs by an independent expert to provide added assurance to stakeholders about the facts of its performance compared to peers (see Recommendation G13.4).

1. Background: RSIC had adopted an increasingly complex investment program which was challenging to explain to stakeholders. The Commission needed to effectively explain the investment program and engender public trust in its strategy and the related costs that were difficult for the layperson to understand. This recommendation was intended to provide an external, independent perspective on the returns and costs of the RSIC investment program.
2. Assessment of implementation progress: RSIC has continued to participate in the investment cost peer benchmarking of CEM Benchmarking, which provides an assessment of returns, net value added, costs, and cost effectiveness. The CEM reports for calendar years 2015 and 2016 are available on the RSIC website. RSIC is currently reviewing an initial draft of CEM's report for 2017.
3. Opportunities for further improvement: None identified.

G19: RSIC should confer with PEBA to determine whether legislative action is needed to ensure that a funding mechanism is in place for the State's indemnity and defense obligations that are not covered by insurance.

1. Background: PEBA purchases commercial fiduciary liability insurance for the Commission and other Retirement System fiduciaries, which is a somewhat unique arrangement compared to peer funds. The Commissioners may also be indemnified directly by the State. S.C. Code Ann. § 9-15-370 provides:

The State shall defend the members of [RSIC] ...against a claim or suit that arises out of or by virtue of their performance of official duties on behalf of the Commission and must indemnify these members for a loss or judgement incurred by them as a result of the claim or suit, without regard to whether the claim or suit is brought against them in their individual or official capacities.

2. Assessment of implementation progress: Members from the RSIC Legal Division met with their counterparts at PEBA to discuss fiduciary liability insurance coverage and the State's capacity to fund future indemnification claims. After conferring with PEBA, RSIC

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determined to rely on existing insurance coverage and payment mechanisms outlined in the South Carolina Code.

3. Opportunities for further improvement: None identified.

C. Policy review and development

P1.1: *The Commission should, as a general rule, preclude Commissioners' involvement in investment due diligence except as an observer for occasional educational purposes (see also G10.3 and I5.1).*

1. Background: In the Governance Policy Manual, Policy IV Commission Operations, (D) Education (1) Overview and Continuing Education (a), the policy explicitly stated that a Commissioner “*may perform due diligence regarding issues such as investment manager selection and custodial bank selection.*” However, the Commissioners' role in due diligence was not explicitly described or limited, e.g., their relationship to advisors and staff or reporting to Commissioners while engaged in due diligence. As referenced in Recommendation G10.3, FAS believed the Commission should, as a general rule, preclude Commissioners' involvement in investment due diligence except as an observer for occasional educational purposes.
2. Assessment of implementation progress: Reference to Commissioner involvement in due diligence has been deleted from the Governance Policy Manual. Commissioners and staff report that Commissioners are no longer involved in due diligence.

Some concerns were expressed by Commissioners about the need to verify that there is robust due diligence in place. The Compliance Department does a completeness check for every new investment and the investment cannot go to the Commission prior to confirmation. CLA also annually performs agreed-upon procedures which have reviewed the RSIC due diligence processes; however, several Commissioners were not aware of or familiar with the CLA reports even though they are available on the online Board portal.

3. Opportunities for further improvement: None identified.

P1.2: *When the Commission's investment beliefs have been articulated, they should be included in the Statement of Investment Objectives and Policies (see G10.1).*

See G10.1

P1.3: *The Governance Policy Manual should be revised to describe the potential role of a Commissioner in due diligence activities as an observer for educational and quality assurance purposes only, and that as a general rule Commissioners are not involved in due diligence activities (see also G10.3 and I5.1).*

See P1.1

P2.1: *A counterparty acceptance and monitoring policy should be developed and implemented. (See also I4.2 – The RSIC should adopt a formal counterparty risk policy.)*

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1. Background: RSIC viewed counterparty risk primarily in the context of its derivatives overlay program managed by Frank Russell Securities, Inc. (Russell). While RSIC monitored exposure reports from Russell, it determined that initial and on-going due diligence of overlay counterparties was the main responsibility of Russell who served RSIC in a fiduciary capacity.
2. Assessment of implementation progress: An overlay counterparty risk policy was approved in March 2015. The policy is “limited to OTC derivative transactions executed by an OM [overlay manager] on behalf of RSIC. Non-overlay counterparty risks are covered by separate governing documents.”

The policy establishes internal monitoring standards, material violation of which results in escalation to the attention of the IIC. In such cases, RSIC may then decide to override the recommendations of the overlay manager, as approved by the CIO.

RSIC addressed the area it deemed had the most exposure, i.e. overlay, counterparty risk and also assessed the risk in other areas of RSIC investment activities, such as custody. Our prior report did not narrow the recommendation to RSIC’s overlay program and RSIC considered what its exposures were prior to developing the overlay policy.

RSIC believes all non-overlay counterparty risks are covered by separate governing documents. Going forward, RSIC should continue to evaluate counterparty risk potential if it enters into foreign exchange, bond swap, other collateralized assets, and electronic securities exchange transactions, for example, where counterparties may pose significant counterparty risks to RSIC.

3. Opportunities for further improvement: RSIC should update the policy to address custodial relationship and continue to evaluate exposures when its counterparty relationships change.

P2.2: The broker selection policy should be strengthened and require periodic reaffirmation by the fixed income team. (see G 16.1 and I4.3).

1. Background: The broker selection policy relied on a fixed income team decision without specific requirements.
2. Assessment of implementation progress: A broker-dealer policy was approved by the CIO in December 2015. The policy includes roles and responsibilities, broker-dealer selection criteria, monitoring requirements, and a semi-annual reporting process to the IIC.
3. Opportunities for further improvement: See G16.1 and I4.3

P2.3: RSIC should finalize the proxy voting process rules that are in development, require that investment managers vote in the best interests of plan participants, monitor how managers are voting proxies and include a field to track voting in Tamale.

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1. Background: Proxy voting was delegated to RSIC's separate account managers. RSIC was in the process of developing an amendment to the SIOF clarifying that separate account managers are authorized to vote proxies in keeping with their fiduciary obligations and describing the separate account managers' proxy voting reporting obligations.
2. Assessment of implementation progress: RSIC has decided not to develop its own proxy voting policy, and it continues to delegate proxy voting decisions to its separate account managers. We recommend that RSIC make language changes to the SIOF and its template Investment Management Agreement (IMA) to ensure that RSIC is delegating proxy voting authority in a manner that is consistent with its statutory fiduciary duties and proxy voting practice standards established under Federal regulatory interpretations for the investment industry.

The SIOF says that RSIC's investment managers are "authorized to vote all proxies, or to direct the Physical Custodian to vote proxies in keeping with the manager's duties under federal and state law to act *in the best interests of its clients...*" This language implements the investment manager's fiduciary duty of loyalty to plan participants, and is largely restated in the template IMA, which provides that "Manager is authorized and directed to vote all proxies, or to direct the Physical Custodian (as defined below) to vote proxies, *according to its best judgment.*" However, the language of the template IMA should more clearly restate the language of the SIOF and the investment manager's fiduciary obligations under S.C. Code Ann. § 9-16-30 (*i.e.*, proxy votes should be cast in the interest of the retirement systems and participants rather than with the "best judgment" of the investment manager, which appears to be a subjective and lower standard of care than the objective statutory standard).

The SIOF also requires that the investment manager provide an annual report to (1) identify any changes that have occurred in the manager's proxy voting practices and (2) note any instances where proxies are not voted in accordance with the best interests of the Retirement System's plan participants. This language has been substantially reproduced in the template IMA, except that with the second requirement, the IMA requires that the manager must "note any instances where *proxies were not voted in accordance with the recommendation of the Manager's third-party proxy service provider.*" Since RSIC does not have a direct contractual or reporting relationship with the manager's proxy advisor and there could be a difference between the best interests of the Retirement System's plan participants and the policy or recommendations of an investment manager's third party proxy service provider (*e.g.*, long-term investor considerations or situations where the proxy advisor's recommendation is influenced by other inconsistent client interests), we recommend that RSIC update the language of the template IMA to follow the language of the SIOF.

The SIOF and IMA require RSIC's managers to "provide a written annual summary to [RSIC] summarizing proxy votes cast during the previous year." However, it does not appear that RSIC reviews (a) the manager's proxy voting policies or (b) the manager's processes for overseeing its own proxy voting practices, including oversight of proxy advisors, prior to engagement. We recommend that RSIC update its due diligence

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policies to include an initial review of the new manager's proxy voting policy and procedures for overseeing its own proxy voting practices.

The Securities and Exchange Commission (SEC) requires that investment advisers voting a client's proxies adopt policies and procedures reasonably designed to ensure that the investment adviser votes proxies in the best interests of the client. For example, in SEC Staff Legal Bulletin No. 20 (June 30, 2014), the SEC notes that an investment adviser could adopt a policy that would require the advisor to sample proxy votes so as to confirm compliance with the investment advisor's proxy voting policies, identify shareholder proposals that may require additional analysis, and review the proxy voting policy annually to confirm it is designed to ensure that proxies are voted in the client's best interests. RSIC should confirm that its managers have adopted such policies and procedures. After reviewing a prospective new manager's proxy voting policy and voting oversight processes, if RSIC staff identifies any process inadequacies or inconsistencies between the manager's proxy voting policy and the best interests of plan participants, then RSIC may consider directing the new manager to make improvements or vote RSIC's proxies differently at the outset of the relationship.

In addition to more thorough due diligence, we recommend that RSIC take additional measures to ensure that it is fulfilling its ongoing responsibility to monitor its proxy votes, which are considered plan assets. In recent years, the Department of Labor (DOL), which issues guidance to ERISA plans, has issued guidance on proxy voting and fiduciary obligations to monitor proxy voting. For example, DOL Interpretive Bulletin 2016-1 requires that ERISA named fiduciaries (which are similar to RSIC) "monitor the activities of the investment manager with respect to the management of plan assets, including decisions made and actions taken by the investment manager with regard to proxy voting decisions." [Emphasis added.] While RSIC is not directly subject to DOL interpretations of ERISA, the Commissioners' statutory fiduciary duties are patterned after fiduciary duties under ERISA. For example, S.C. Code Ann. § 9-16-30 (B) (3) requires that the performance and compliance of managers with delegated authority be periodically reviewed.

RSIC may improve the monitoring of its proxy votes by requesting and reviewing additional reporting from its managers. If RSIC's investment adviser relies on a proxy advisor, then the investment adviser should have additional policies and procedures in place to oversee the proxy advisor. SEC regulatory interpretations require the investment adviser to confirm that the proxy advisor has knowledgeable staff that is adequately overseen, that the information provided to the investment adviser is accurate, and that the proxy advisor is managing any conflicts of interest. To verify that RSIC's managers are, in fact, overseeing their proxy advisors, we recommend that RSIC requests from its managers the results of the managers' evaluations of proxy advisors, particularly regarding the proxy advisor's management of conflicts of interest.

We also recommend that RSIC require its investment managers to promptly notify RSIC if the manager has changed proxy advisors or voting policy. We recommend that this notice be provided as soon as practicable, rather than in response to the annual compliance questionnaire, so that responses can be reviewed prior to the annual general

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meetings that take place during the spring proxy season. The notice should include a copy of the voting policy that will be used for RSIC's proxy issues so that RSIC can again confirm that the policy is in best interests of plan participants. A report on the manager's evaluation of a new proxy advisor's capabilities and processes for managing conflicts of interests should also be provided to RSIC.

Finally, we recommend that RSIC formalize its internal practices for monitoring its managers' proxy votes, either in the SIOF or in a free-standing policy. We understand that RSIC reviews the proxy votes it receives from its managers in response to the annual compliance questionnaire. RSIC spot checks the manager's proxy votes to confirm that the manager is voting proxies and that the proxies are voted in the best interests of plan participants. This process should be documented and should require RSIC staff to identify key votes on issues that are material to the interests of plan participants for evaluation (e.g., votes on mergers and acquisitions, shareholder rights, contested director elections, executive compensation plans).

3. Opportunities for further Improvement: RSIC should update the template IMA to incorporate specific requirements of the statutes and SIOF. In addition, RSIC should update its policies to:
 - i. Require that prospective new managers submit their proxy voting policies to RSIC for initial review so that RSIC can confirm that the proxy voting policies are consistent with the interests of the retirement systems and their participants and with proxy advisor oversight requirements at the beginning of the relationship;
 - ii. Require existing managers to provide copies of the manager's policies and procedures for monitoring its proxy voting on behalf of RSIC and evaluating the capabilities of its proxy advisors so that RSIC can verify that each manager is able to meet its obligation to vote proxies in the interests of the retirement systems and their participants;
 - iii. Require managers to submit their evaluations of proxy advisors, including how proxy advisors manage conflicts of interest;
 - iv. Require managers to notify RSIC if the manager has changed proxy advisors and to provide a copy of any new proxy voting policy covering RSIC's proxy issues so that RSIC can confirm the policy is in the interests of the retirement systems and their participants; and
 - v. Formalize RSIC's process for monitoring its proxy voting, including documentation of RSIC's annual review of proxy votes submitted in response to the annual compliance questionnaire. This review should focus on identifying key votes that are material to the plan.

We also note that under fiduciary law, proxy votes are considered plan assets that must be exercised in accordance with the interests of fund beneficiaries. Many peer funds have their own proxy voting guidelines, either as stand-alone policies or within their investment policy statements. Proxy issues often change from year to year, and voting

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policies (whether internal or external) should be reviewed annually to ensure that new and evolving issues are appropriately covered. At some point in the future, RSIC might consider developing its own proxy voting guidelines to consistently guide its investment managers (especially in regard to application of the S.C. Code Ann. § 9-16-40 (4) duty of impartiality in regard to balancing strategies focused on short-term returns and on the generation of sustainable long-term future shareholder value) as they vote proxies on RSIC's behalf. Proxy voting policies may also be of value to RSIC's investment staff as they monitor proxy voting activities of investment managers.

P2.4: Policies which describe responsibilities for securities litigation activities should be refined to clarify approval roles of RSIC Legal, the Commission and Attorney General.

1. Background: In the 2014 fiduciary performance audit, FAS recommended that the Securities Litigation Policy be clarified to identify whether the Commission, the Legal Division or the Attorney General has final approval in pursuing a claim. In addition, the policy was unclear regarding the role (if any) of the Attorney General in approving litigation and outside litigation counsel.
2. Assessment of implementation progress: The Securities Litigation Policy, which is Part VI of the SIOP, describes the process RSIC will follow for identifying and considering a securities claim, including the process for identifying potential claims, hiring claim evaluation counsel, serving as lead plaintiff, and selection of outside counsel. However, the Securities Litigation Policy has not yet been updated to clarify the roles of the Commission, the Legal Division, executive leadership, and the Attorney General (if any). RSIC has recently released an RFP for securities litigation counsel, and the Legal Division plans to update the Securities Litigation Policy to incorporate important considerations learned in that process as well as this recommendation.
3. Opportunities for further Improvement: RSIC should update the Securities Litigation Policy to clarify the approval roles of the Commission, the Legal Division, executive leadership, and the Attorney General (if any).

P2.5: The staff conflict of interest policies should be modified to include more guidance on what is covered by the statutory standards of conduct.

1. Background: The 2014 fiduciary performance audit noted that Commissioners and RSIC employees are both subject to the statutory standards of conduct in S.C. Code Ann. § 9-16-360, which generally prohibit self-dealing, disclosing confidential information, and otherwise acting in any manner that is adverse to the interests of the plan. The Governance Policy Manual describes and applies these standards of conduct for the Commissioners, but RSIC had not adopted a similar policy describing and applying these standards of conduct for employees.

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2. Assessment of implementation progress: RSIC revised the Ethics Policy applicable to employees in July 2016. The Ethics Policy describes the sources of ethics laws and addresses common ethics issues that arise for employees, such as the travel policy. However, while the Ethics Policy references the standards of conduct described in S.C. Code Ann. § 9-16-360, it does not provide the same level of specificity on them as is provided for Commissioners in the Governance Policy Manual. For example, the Ethics Policy does not indicate that an employee may not represent anyone before RSIC while that person is employed with RSIC and a year afterwards. In addition, the Ethics Policy does not mention that there is a three year “cooling off period” during which RSIC is prevented from doing business with a former employee. These Standards of Conduct are described in Policy I(1)(3) of the Governance Policy Manual, and we recommend that a similar description of the statutory standards of conduct be incorporated into the Ethics Policy so that that they provide the same level of guidance to employees as for Commissioners.
3. Opportunities for further Improvement: RSIC should amend the Ethics Policy to provide the same level of specificity regarding standards of conduct applicable to employees as is provided in Policy I(1)(3) of the Governance Policy Manual applicable to Commissioners.

P2.6: RSIC should consider developing and implementing a policy which requires Commissioners and senior investment staff to disclose personal financial or legal distress.

1. Background: Other public pension funds have required fiduciaries to disclose personal distress (e.g. health, financial, or legal issues), as personal distress is closely associated with risk.
2. Assessment of implementation progress: RSIC has considered the issue and declined to adopt a policy to require disclosure of personal distress. Instead, RSIC may expand the scope of background checks.
3. Opportunities for further Improvement: None identified.

P2.7: The Sudan divestment policy should be completed and approved by the Commission.

See L4.3

P2.8: RSIC should consider developing a flowchart which describes the investment review and approval process, including responsibilities and timelines.

1. Background: At the time of the 2014 report, there was a wide variance in due diligence processes from asset class to asset class. The flowchart was a means to clarify the due diligence steps and responsibilities for the overall RSIC investment shop and the ultimate decision makers at the time, the Commission.

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2. Assessment of implementation progress: A flowchart has been created. Perhaps more importantly, the due diligence processes are now much more transparent and specific, defined in large part by the requirements of the peer review and IIC process.
3. Opportunities for further improvement: None identified.

P2.9: *RSIC should develop a referral tracking and reporting mechanism, like the sourcing and conflict disclosure process used for investments, to cover service provider referrals.*

See L4.2

P3.1: *Continue to allow standing instructions for the custodial bank to receive incoming funds and allow sweeping of cash to maximize income.*

1. Background: Prior to February 2014, multiple signatures were required for the custodial bank to receive payments. Since then, standing instructions have been used to accept funds and sweep the accounts daily. Other investment board peer funds also use standing instructions. While delays from the prior process were rare, RSIC reported that its staff had to make many last-minute efforts to prevent delays that could cost RSIC interest earnings.
2. Assessment of implementation progress: With responsibility for the custody relationship moving from the State Treasurer's Office to RSIC in 2017, RSIC has the authority to manage signature requirements under the bank contract. Standing instructions is still the practice.
3. Opportunities for further Improvement: None identified.

P3.2: *Review the positions required to sign to release cash transfers with the custodial bank and revise the requirements to allow two appropriate RSIC signatories, one from investments and the other from operations.*

1. Background: South Carolina required four signatures to release funds, two from RSIC and two from the State Treasurer's Office. Leading practice was two signatures, one from an investment officer and one from an operations executive such as a Chief Financial Officer or Director of Operations.
2. Assessment of implementation progress: Signatures from the State Treasurer's Office are no longer required. Capital calls are the vast majority of RSIC's money movements and require one signature. The signature required depends on a preset level of authorization. BNYM indicates that a one signature requirement for such calls is common practice. Payment of management fees and custody expenses requires two signatures. A new electronic payment system to manage cash transfers was implemented with BNYM as of July 30, 2018.

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3. Opportunities for further Improvement: None identified.

P3.3: Instruct the custodial bank to accept signatory changes based upon a letter from the Commission Chair or the RSIC COO and CIO (or CEO if a CEO position is created).

1. Background. The STO needed to approve changes in RSIC's signatories. At all peers surveyed, signature changes were authorized based upon a letter to the custodial bank from the fund CEO, with the exception of one fund which provided a board resolution. At none of the peer funds did the State Treasurer have a role in this process.
2. Assessment of implementation progress: A June 2017 letter from the CEO to BNYM provides the detailed list of authorized persons. BNYM confirmed with RSIC that any changes to the authorized signer list received from anyone other than the CEO would be rejected.
3. Opportunities for further improvement: None identified.

P3.4: STO should revise its policies to allow electronic payment authorization for release of funds to cover capital calls using the existing technology offered by BNY Mellon.

1. Background. The STO required written and faxed signatures. This created problems when key RSIC staff were away from the office (e.g., due diligence trips). One RSIC operations staff was primarily assigned to coordinating capital call funding. Although not all peer funds utilize electronic signatures to release funds, it is leading practice and becoming more commonplace.
2. Assessment of implementation progress: As a result of a change in state law by the 2017 Pension Reform Act, RSIC now has statutory authority to manage signature requirements under the bank contract. Electronic payment authorization took effect July 30 of this year. RSIC indicates that it will continue to evaluate the authorization process to maintain the proper balance between controls and efficiency.
3. Opportunities for further improvement: None identified.

P4.1: The Compensation Committee should conduct an annual review of RSIC's implementation of the Compensation Policy.

1. Background: The South Carolina statutes authorize the Commission to establish compensation for all employees. The Commission's Compensation Policy defined the purpose, goals and method for establishing salaries for all staff and Performance Incentive Compensation (PIC) for investment staff. The Compensation Policy had been amended in May 2012 and the Commission adopted a goal to "target total compensation at the 90th percentile of a select group of comparably sized U.S. public pension funds. RSIC's goal reflected the view that RSIC compensation needs to be near the top of its public fund

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peers in order to attract the experience and skills needed to manage a portfolio with a large allocation to alternative investments. The Commission had not taken the next step to define how this goal should be reached and over what time period.

2. Assessment of implementation progress: The current Human Resources and Compensation Committee (HRCC) charter includes as primary responsibilities reviewing and making recommendations related to the RSIC's Compensation Policy and conducting or procuring a new peer compensation study at least every three years.

RSIC eliminated the Performance Incentive Compensation (PIC) program and restructured the overall compensation system. The HRCC annually reviews staff performance and receives an update from the RSIC compensation consultant. The HRCC is actively engaged on reviewing and updating the RSIC compensation program.

3. Opportunities for further improvement: None identified.

P4.2: The Commission should engage an independent expert to conduct a new peer compensation study at least every three years to assess the current level of RSIC staff compensation and make revisions to the target ranges, as appropriate.

1. Background: Independent benchmarking prior to 2014 indicated that RSIC was well short of the compensation goals it established in 2012.
2. Assessment of implementation progress: Independent benchmarking was done in 2016 and 2017 along with consultant advice about changes in the compensation plan. The next benchmarking review is planned for 2019.
3. Opportunities for further improvement: None identified.

P5: To facilitate timely acquisition and implementation of information systems, RSIC should develop a proposed modified procurement process for approval by the BCB or the Legislature which would allow acceptable transparency and objectivity, improve the ability to evaluate, select and implement new systems, as needed, and include documentation to allow oversight on a post-purchase audit basis (rather than imposing pre-purchase restrictions).

1. Background: Although RSIC was exempt from the standard State procurement process for brokerage, investment management and advisory services, it was not exempt for investment support systems. RSIC cited multiple examples of systems procurements that have taken a year or more to complete. See recommendations IT1 and IT4 from the 2014 Final Report. State procurement processes limited RSIC's ability to do the same kind of expert due diligence on complex investment system purchases as they do to hire investment managers. This limitation could impede RSIC's ability to timely respond to service needs from market developments and to consistently meet its fiduciary duty of care. Benchmarking indicated that half of RSIC's investment board peers have an

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exemption from state procurement requirements for direct investment support services such as IT systems, which is a leading practice.

2. Assessment of implementation progress: The General Assembly chose to retain the requirement for RSIC to follow state procurement processes for direct investment support services.
3. Opportunities for further improvement: RSIC should engage with the General Assembly to revise the statutes to exempt RSIC from state procurement requirements for direct investment support services, including IT systems, similar to brokerage and investment management and advisory services.

D. Organization structure

O1.1: RSIC should consider creating the position of chief executive officer who would be accountable to the Commissioners for managing the entire organization.

1. Background: The Investment Commission had multiple direct reports (COO and CIO) and responsibilities were fragmented and siloed. The CEO position was intended to create a single direct report to the Investment Commission and clear leadership responsibilities for the RSIC organization.
2. Assessment of implementation progress: The CEO position is now a statutory requirement as of April 2017. The Investment Commission created the CEO position in fall of 2015. This is functioning well.
3. Opportunities for further improvement: None identified.

O1.2: Given the delay in the migration to internal management, the CIO (hopefully in conjunction with the new senior HR professional) ought to examine the way the investment team is organized today to determine if staffing as aligned with AUM, complexity and risk.

1. Background: The CIO and investment philosophy of the fund had changed relatively recently before the 2014 report, and there was a need to align resources to better implement the investment program.
2. Assessment of implementation progress: While the RSIC faces challenges in hiring and maintaining staff, the RSIC investment program appears adequately staffed (as of the time of this review). One possible exception to that analysis may be private markets, which was categorized as a “pain point” by one senior RSIC official, and which may become more so with the planned increase in co-investments.

It is worth noting a number of positive staffing initiatives which have occurred in the last four years. The creation of the internship and junior analyst program have been valuable in providing entry points, training and career pathways for the RSIC investment program. The succession plan has worked, smoothing a number of internal promotions following staff departures. There is now a fulsome on-boarding program. Finally, at the agency level, there is a senior HR professional, a material change from the 2014 time period (see O3.1).

FAS notes that RSIC prefers hiring from within for mid- and senior-level positions, particularly investment staff positions. That is understandable, and even admirable, as it maintains culture and purpose. However, there is also something lost in not hiring from other organizations – the opportunity to cross-pollinate with different procedures or analyses. Senior RSIC staff is aware of the situation and affirms that RSIC would hire appropriate mid and senior investment staff from outside to provide “leavening” to the largely home-grown composition of the investment office.

3. Opportunities for further improvement: The investment organization could be improved

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through:

- a. There have been a number of personnel changes made since the last full succession plan review. As a result, the succession plan is out of date and should be revised.
- b. The CIO should determine if additional resource(s) are needed in private markets.

O2: *The RSIC should develop an enterprise-wide capabilities and resources assessment and determine:*

- 1) *What are the overall support needs and priorities?***
- 2) *Where are the major resource gaps?***
- 3) *Should the gaps be filled through internal and/or external resources?***

1. Background: The prior report pointed out areas where RSIC relied more heavily for key services than peers on the use of third party providers, including other state entity providers. These services included investment accounting and audit functions of the retirement fund, as well as various administrative and information technology services. The arrangements are governed by an MOU with PEBA and, in some cases, by service contracts.
2. Assessment of implementation progress: While RSIC does not have a written assessment per se, staff reports that it routinely discusses resources and capabilities and more formally considers this recommendation through its strategic planning and budgeting processes and has continued to make strides in the resolution of this recommendation. For example, it exercises more direct control over the investment accounting process since it is now the contact point for the investment accounting software contract rather than the State Treasurer.

Also, it has developed its own internal audit function rather than place reliance on the PEBA internal audit team. Additionally, RSIC outsources some internal audit work to third party professional service firms that have audit and investment expertise. By implication, RSIC has assessed its own internal audit capabilities and found that it had a need which it meets by outsourcing, which is an acceptable practice among public funds.

3. Opportunities for further improvement: Please see the Information Technology (IT) and Enterprise Risk Management (ERM) sections of this report and the discussion about how RSIC addresses capabilities, needs, resources and procurement and opportunities for further improvement.

O3.1: *A senior human resources professional position should be created and filled to lead development of an overall HR strategy to support the organization's business plan.*

1. Background: Lack of a dedicated internal human resources function contributed to a deficit of HR policies and procedures and lack of a strong focus on organizational development. Primary HR functions were handled by senior executives which detracted

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from their core duties and made consistent focus on HR difficult.

2. Assessment of implementation progress: The HR Manager position was created to “manage comprehensive human resources functions, programs, initiatives, and solutions”, reporting to the COO and CEO. All final decisions regarding HR policy, hiring, terminations and compensation rest with the CEO who meets regularly with the Manager. Progress on HR goals is reviewed with the HRCC and Commission. Since 2015, the HR Director (now Manager) position and CEO have given significant attention to hiring, training, evaluation, compensation and other core HR components. HR has also worked with legal staff on a complete revision of the employee handbook. RSIC does not yet have a longer-term business development plan (see O3.6).
3. Opportunities for further improvement: see O3.6

O3.2: Policies and processes should be developed which ensure that the HR implications of proposed new initiatives are recognized and addressed before launch.

1. Background: In 2014, the total number of RSIC staff was below that recommended in a 2012 Deloitte & Touche review. RSIC has a larger allocation than its peers to alternative investments that are more labor intensive to manage, and it has been more reliant than its peers on outside parties for support services.
2. Assessment of implementation progress: The HR Manager and CEO meet regularly, and HR is covered as needed in Executive Leadership Team meetings. RSIC’s authorized staff level has increased from 42 to 51 FTE since 2014, which RSIC indicates is sufficient to manage the current investment program. It is approximately the number of staff recommended in the Deloitte & Touche report and is similar to that projected in a 2016 CEM benchmarking review. RSIC’s reliance on outside parties for accounting, financial reporting and information technology services remains greater than its peers and would need to be revisited if it chooses in the future to significantly expand internal asset management.
3. Opportunities for further improvement: None identified.

O3.3: RSIC should implement more thorough compensation planning and evaluations to enable recruitment and retention of highly skilled and experienced staff (see Recommendation P4.1).

1. Background: In 2012, the Commission set a goal to be at the 90th percentile of total compensation paid by its peers. At the time of the 2014 FAS review RSIC was well short of this goal and the Commission had not yet made decisions as to how it would be reached. RSIC lacked a CEO or a senior human resource professional to provide focused leadership for the compensation plan.
2. Assessment of implementation progress. The compensation policy provides that it be reviewed by the Commission at least every three years; it was last amended in April 2018.

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It established objectives, modified targets and replaced performance incentive compensation only for investment staff with base salary increases that can be earned by all staff. Although the overall compensation target was reduced, current salaries will still need to rise to reach the new target. The hiring and retention of quality staff remains challenging. The performance awards pool available to investment staff now is smaller than under the previous incentive program. However, the current program addressed issues the Legislature had with the previous program and provides RSIC more authority in making awards. The CEO is to annually report to the Commission on the effects of the compensation policy and to provide regular updates to the HRCC.

3. Opportunities for further improvement: The Commission will need to closely monitor the effects of recent changes in the incentive payment plan on the recruitment and retention of investment staff.

O3.4: More formalized staff training and development plans and programs should be developed.

1. Background: Policies were supportive of education, but staff had received inconsistent messages regarding education; at least some staff were told that they should not go to industry conferences for cost or workload reasons.
2. Assessment of implementation progress: Through employee goal statements, staff are encouraged to pursue training. RSIC reimburses expenses for conferences, degree programs, study materials and CFA and CAIA certifications. Since 2013, the annual total paid has increased almost fifty percent. Base salary increases are also awarded for completion of certifications. RSIC now makes on-line courses available to staff and Commissioners, and it has introduced a development program for junior analysts. Recently completed revisions to the employee handbook are intended to provide greater clarity and consistency regarding the types of training that are reimbursed.
3. Opportunities for further improvement: None identified.

O3.5: RSIC should utilize succession planning, including cross-training and other actions, to develop staff for broader responsibilities.

1. Background: Organizations like RSIC need succession planning throughout their operations to maintain workforce and leadership continuity. There had been several changes in senior management within a short period of time prior to 2014, including the elimination of the CEO position and three different chief operating officers in less than two years. To fill gaps, several managers had an unusually broad range of responsibilities.
2. Assessment of implementation progress: The HR Manager has responsibility to support individual development plans and succession plans training requirements. Since 2014, RSIC has filled the newly created CEO position through outside recruitment and the Chief Investment Officer, Chief Operating Officer and Chief Legal Officer positions through internal succession. Their succession plans need to be refreshed. RSIC provides financial

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incentives for training and professional certifications, and access to on-line courses to help staff prepare for more responsibility (see O3.4). The Commissioners do not have a specified role in succession beyond the hiring of the CEO.

3. Opportunities for further improvement: Staff development could be improved through:
 - a. Update succession plans for senior management positions.
 - b. Annually review succession planning across the organization with the HRCC.

O3.6: The Human Resources function should provide leadership for development of a multi-year (3-5-year time horizon) infrastructure business plan which considers the needs and priorities of the organization.

1. Background: RSIC was considering a number of multi-year changes (such as expansion of internal investment management and further development of risk management) which would require careful planning for staffing, technology and budgetary requirements. In order to effectively develop RSIC's capabilities, it was necessary to have a longer-term plan which incorporates human resources, systems, training, and third-party resources.
2. Assessment of implementation progress: RSIC has a three-year strategic plan that broadly outlines its investment beliefs, vision and objectives, but does not yet have a broad-based plan for developing the organization's capabilities to meet longer term objectives. Management indicates that its attention over the last several years has had to focus on more immediate matters. However, one of the Commission's key initiatives for FY 2019 is to "Focus on more comprehensive organizational strategic planning for resourcing, personnel, infrastructure, risk management, systems, and policy."
3. Opportunities for further improvement: Complete a three- to five-year business plan.

O3.7: RSIC should develop an internal governance process to plan and manage capability and infrastructure development (see IT3.2).

1. Background: RSIC did not have a CEO position or process to focus authority and leadership for development of the organization capabilities.
2. Assessment of implementation progress: The IT Committee vets systems topics from staff from across the organization. The Business IIC focuses on back and middle office matters. Any major decisions that will significantly affect the agency coming from either committee are to be presented to the Executive Leadership Team. That team is comprised of the CEO, CIO, COO, and CLO, and its purpose is to discuss high level topics and determine the direction of the agency.
3. Opportunities for further improvement: None identified.

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O4: *RSIC should adopt a standard process for documenting, approving and updating operational procedures and should continue its effort to provide on-line access to them as they are completed.*

1. Background: At the last review RSIC was working on workflow procedures to ensure consistent and accurate execution. At that point, they had created an on-line index and access to workflow procedures it had documented but more workflows needed to be completed. RSIC was focused on documenting the on-boarding of new investment managers, procedures for collecting return information from strategic partnerships, preparation of various investment reports and a business continuity plan. RSIC's first priority then was to create standard procedures where they did not exist with less focus on documenting procedures that were in place and working effectively.
2. Assessment of implementation progress: RSIC has documented operational processes and continues to keep them updated through a periodic review process. The documentation process, established in early 2015, requires involvement of staff and supervisor, the use of a standard template, review and approval at the Director level, and publication to the RSIC intranet. The documentation procedure also requires a review at three years, or sooner if material changes have occurred.
3. Opportunities for further improvement: None identified.

E. Investment administration

11: If the Legislature continues to set the expected rate of return, it should regularly review the process and its assumptions on a periodic basis. Ideally, that cycle should be set to take advantage of the information available from the every five year PEBA experience study and RSIC's asset liability study.

1. Background: The General Assembly set the assumed rate of return at 7.5% in 2012. The General Assembly considered the input of its actuary and investment consultant. The assumed rate of return has a significant impact on RSIC, as the assumed rate of return will impact asset allocation and amount of acceptable investment risk. However, there was no requirement for the General Assembly to consider input from RSIC or PEBA when setting the assumed rate of return, even though RSIC conducts an asset liability study every five years and PEBA engages its own actuary to review assumptions and conduct a full experience study (designed to predict the cost of benefits) every five years. The 2014 fiduciary performance audit recommended that the General Assembly consider these reports prior to setting the assumed rate of return.
2. Assessment of implementation progress: The 2017 Pension Reform legislation changed the process by which the assumed rate of return is determined, though the General Assembly retains control to set the assumed rate of return. First, the Pension Reform Act requires that the assumed rate of return be reconsidered on an every four years' basis. The current assumed rate of 7.25% will expire July 1, 2021. Second, the Pension Reform Act shifts the responsibility for proposing the assumed rate of return from the General Assembly to PEBA. The assumed rate of return that PEBA proposes must be developed based on the recommendations of PEBA's actuary "and in consultation with the Commission." S.C. Code Ann. § 9-16-335(B). Accordingly, RSIC will have more input into determination of the assumed rate of return. PEBA's proposed assumed rate of return will become effective unless the General Assembly rejects or revises PEBA's proposed assumed rate of return during the six months before the July 1 effective date. Finally, the Pension Reform Act made RSIC a third party beneficiary of the contract with PEBA's actuary, so RSIC may independently enforce the terms of the agreement. S.C. Code Ann. § 9-1-240.

Even though PEBA, in consultation with RSIC, has more direct influence on setting the assumed rate of return, the ultimate authority remains with the General Assembly. It is not a prevailing practice amongst peers for the state legislature to set the assumed rate of return for a public pension plan. Typically, the retirement system board of trustees determines the assumed rate of return.

In this case, the General Assembly retains ultimate authority to set the assumed rate of return. This arrangement creates risk that the RSIC may be pressured to take on more investment risk in order to achieve an unrealistic assumed rate of return designed to artificially reduce required current contributions. For example, it might result in adoption of a higher risk asset allocation than what an otherwise unconstrained prudent investor

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would use. Of course, the Commission is required to perform in accordance with its duty of care, regardless of the assumed rate of return. S.C. Code Ann. § 9-16-40(3).

3. Recommendation: In order to minimize the likelihood that the Commission may accept unreasonable investment risk in order to achieve the assumed rate of return, the General Assembly should consider fully delegating the responsibility for setting the assumed rate of return to PEBA and RSIC, consistent with peer practices.

12: The Commission should spend more time discussing its underlying investment beliefs and ensure that the asset allocation strategy remains consistent with those beliefs (see Recommendation G10.1).

1. Background: Asset allocation, rather than manager selection, explains most of the return of a fund. However, At the time of the 2014 fiduciary performance audit, the Commission's primary focus was tactical, devoting much time to selecting (and itself performing due diligence on) managers. This recommendation was part of a series of recommendations designed to refocus the Commission on high-value strategic decisions.
2. Assessment of implementation progress: The Commission annually reviews asset allocation, with the aid of its investment consultant. The Commission's deliberations include looking at potential risk/return profiles of various potential asset allocation mixes, liquidity needs, cash flows and other considerations typical of a full-blown asset allocation study. The contract with the new investment consultant specifically calls for the consultant to assist with an annual asset allocation review; however, it does not appear there has been a robust discussion of the investment beliefs since their initial adoption.
3. Opportunities for further improvement: A full asset liability and asset allocation study should be conducted every three to five years, to include a review of plan's investment beliefs. While an annual review is needed to check adherence, and is a useful safeguard in the event of a major market change (such as the global financial crisis of 2008) or a material change to a specific fund's assets or liabilities (such as one caused by legislative changes or collective bargaining benefit changes), it is generally regarded as better to adhere to the longer-term strategic plan rather than materially change the asset allocation annually. Therefore, the Commission ought to consider what should be the appropriate periodicity of asset allocation study, the level of review to be performed annually, and the periodicity of review of its investment beliefs.

13.1: As part of an overall infrastructure development plan, the RSIC should continue to prioritize a new risk management system and capability as a top priority.

1. Background: The RSIC was in the process of procuring a risk management system at the time of the 2014 fiduciary performance audit.
2. Assessment of implementation progress: A BarraOne risk management system was installed in 2014. However, BarraOne is based on position-level data and is used primarily

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in constructing portfolios. For a fund which is largely externally managed, BarraOne may be a mismatch, though many externally-managed funds do use it. RSIC is considering migrating to other systems which could provide asset class and total plan analytics, rather than on an analytical system which would provide position-based analysis. It is also considering whether it can leverage the new custodial relationship to provide risk management analysis. In such a case, it would likely have to build a number of “home-grown” applications atop the custodial data and available analyses.

RSIC’s experience is not unusual. Very few public plans find an “off the shelf” risk system that fulfils all the needs of the plan, and even fewer do so with intuitive user interfaces. Nonetheless, the search for an appropriate risk management solution remains an ongoing priority.

3. Opportunities for further improvement: RSIC should finalize a decision as to how to create the necessary risk analytical system.

13.2: RSIC should create a Risk Management/Investment working group to design the functionality of risk reporting.

1. Background: At the time of the 2014 fiduciary performance audit, the previous risk management head had resigned, risk management was a sporadic participant in the IIC, and there was less than optimal coordination amongst risk management and the asset class investment officers.
2. Assessment of implementation progress: There is a risk steering committee, whose purview includes the investment staff’s input into the selection of a risk system and consideration of the desired functionality. Also, quantitative solutions presents monthly to the IIC.

In general, coordination has improved greatly. The Quantitative Solutions Group (QSG, which includes risk management) provides a quarterly risk presentation at the IIC. RSIC has an ambitious project to determine performance attribution in the private asset classes. That is leading edge research. Also, we note that a separate group, Investment Reporting and Performance, generates investment reports and some public market risk analyses.

3. Opportunities for further improvement: Investment risk management could be improved through:
 - a. Once a risk system is selected, quantitative solutions and reporting should create a user group to inform the types and periodicity of standard reports, which will likely vary by asset class. We also suggest that the plan include a plan for user training.
 - b. Risk management and investment reporting should determine if there are ways to cooperate to extend risk measurement/analysis and performance attribution to other asset classes. For instance, can the data from reporting allow the quantitative solutions group to provide useful analyses to public market asset class heads for

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ongoing monitoring of public securities portfolios? The specific example is indicative only, designed to suggest how pairing the analyses provided by quantitative solutions, fueled by a new risk management system, and aided by reporting, could be leveraged across various asset classes.

13.3: Investment Risk Management should be a participating member at all IIC meetings.

1. Background: See I3.2
2. Assessment of implementation progress: The quantitative solutions group attends IIC meetings and presents monthly to the IIC. The head of the group is a voting member of the IIC.
3. Opportunities for further improvement: None identified.

13.4: Risk Management should produce an annual plan which is reviewed and approved at the IIC; this should improve risk discipline, provide a benchmark for performance evaluation, create an opportunity for other investment officers to understand Risk Management capabilities, and improve communication.

1. Background: At the time of the 2014 fiduciary performance audit, the role, capabilities, resources and focus of risk management was in flux, primarily due to the change from a focus on the type of systems and processes which would have been needed for internal management. Few elements of a plan existed.
2. Assessment of implementation progress: There has clearly been a maturation in conceptualization of risk management, so as to focus on whole plan risk, as well as on a few specific risks/opportunities such as liquidity risk and the drivers of private market performance. Risk management is largely contained in QSG, though investment reporting provides some risk analytics for public markets. There is now an annual risk plan, approved by the CIO.
3. Opportunities for further improvement: None identified.

13.5: The RSIC should explore whether the secondary market in LP interests could help it rationalize its private equity portfolio, while keeping in mind the variable inefficiencies of that secondary market.

1. Background: At the time of the 2014 fiduciary performance audit, RSIC was trying to simplify its overall investment program, and the private equity portfolio in particular.
2. Assessment of implementation progress: In progress. As of the time FAS held its on-site interviews (June 2018), this was a priority for the private markets investment staff. The investment officers pledged to perform a deep information dive into the secondary

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market, identify the key firms, and decide whether or not to proceed, and, if so, how and to what extent.

3. Opportunities for further improvement: RSIC should continue with its plans to activate a secondary LP interest program, or to decide explicitly not to proceed. It should also take advantage of Albourne's expertise and knowledge base (the private market consultant) in this area as part of its exploration.

14.1: The overall RSIC infrastructure development plan should fully consider and incorporate the staffing, systems and policy requirements to significantly increase internal asset management and manage risk prior to significantly expanding the current limited amount and types of assets managed internally.

1. Background: RSIC was planning to bring management of several public market asset classes in-house, which would have required new governance policies, trading systems, staff capabilities, and other new capabilities. There was not a plan in place which identified and planned to develop these requirements.
2. Assessment of implementation progress: Based upon extensive review of strategic priorities, in 2016 the management team decided not to increase internal asset management. Should the strategy change and plans for internal asset management be restarted, an infrastructure development plan should be a priority.
3. Opportunities for further improvement: None identified.

14.2: The RSIC should adopt a formal counterparty risk policy (see Recommendation P2.1 – A counterparty acceptance and monitoring policy should be developed and implemented.).

1. Background: The 2014 fiduciary performance audit recommended infrastructure enhancements designed to support more internal investment management. For example, we observed that RSIC did not have a formal counterparty exposure policy that would inform the overlay manager, or be used as a guideline against which to judge the counterparty risk reports produced by the overlay manager.
2. Assessment of implementation progress: RSIC created a comprehensive counterparty risk management policy and procedure in early 2015.
3. Opportunities for further improvement: None identified.

14.3 RSIC should review its broker/dealer selection policy with an eye towards increasing its robustness by creating objective measures for acceptability and setting a time period for reaffirmation of the acceptable broker/dealers (see also G16.1 and P2.2).

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1. Background: The broker selection policy relied primarily on the judgment of the fixed income team without specific requirements and did not require any periodic review or affirmation.
2. Assessment of implementation progress: Internal trading is still limited to liquidity and short duration fixed income accounts. In 2015, RSIC adopted a policy that requires an approved list of brokers for internally managed accounts, with sign-off by the CIO. The policy includes standards for brokers to be placed on the approved list and for selecting an approved broker to execute a particular transaction. The IIC is responsible for reviewing the methodology and receives a semi-annual report listing approved broker dealers and trading volume. In 2017, RSIC had an outside firm conduct an independent review of the trading process and supporting operations. It observed that the RSIC team is small so there is “key man” risk that can be lessened by systems improvements and stronger documentation of procedures. There is an annual broker review process that is undocumented.
3. Opportunities for further improvement: The broker/dealer policy could be improved through:
 - a. Require broker/dealers to perform background checks of employees directly responsible for RSIC relationships. Prior to approval of any broker/dealer eligible to do business certify that the broker is familiar with RSIC restrictions on RSIC accepting gifts and hospitality and that the broker provides training to its employees on those restrictions. Also certify that the firm will monitor compliance and promptly notify RSIC if it becomes aware of violations.
 - b. Formalize the annual broker review procedures into RSIC policy (see G16.1 and P2.2).
 - c. Continue to implement the recommendations from the 2017 independent review of the fixed income trading process and supporting operations.

15.1: The policy of Commissioner involvement in due diligence should be changed to limit participation to no more than occasional involvement as an observer for educational or reassurance purposes only; Commissioners could be invited to all manager meetings held in Columbia (see Recommendations G10.3 and P1.3).

See G10.3

15.2: Ideally operations should perform on-site reviews of all potential new managers. If staffing makes that impractical, the RSIC should adopt a formal operational due diligence calendar so as to a) minimize the number of managers hired without such an on-site visit, and b) prioritize an on-site operational visit as soon as possible following selection.

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1. Background: At the time of the 2014 fiduciary performance audit, RSIC had an operational due diligence capability, but it was being used intermittently, and there was turnover in the operational due diligence staff.
2. Assessment of implementation progress: Between the private market consultant and internal staff, RSIC has almost always performed on-site operational due diligence (ODD) on potential new managers or new general partners in recent years. RSIC's ODD consistently receives high marks from internal staff, consultants and external managers and general partners. RSIC utilizes both a written ODD questionnaire and an on-site visits by a skilled ODD staff. In addition, in 2017 RSIC hired Albourne, which provides additional ODD within the private market asset classes.

In the instances where on-site ODD was not performed, RSIC provided a rational explanation for the decision based on the extensive knowledge that RSIC had of the manager from recent due diligence efforts for other products. Also, in those cases, ODD was performed through a combination of phone and e-mail communication.

3. Opportunities for further improvement: None identified.

15.3: Operational due diligence recommendations to the IIC should require a sign off from the head of RSIC operations.

1. Background: See I5.2
2. Assessment of implementation progress: The Director of Investment Operations, who leads ODD, reports to the Chief Operating Officer (COO), who is a voting member of the IIC.
3. Opportunities for further improvement: None identified.

15.4: RSIC should clarify the level of authority operations has on manager hiring and retention. Two potential options would be to give a veto to operations or, alternately, to mandate that should the CIO decide to recommend an investment despite operational concerns, an operations memorandum should go to the Commission along with the CIO's recommendations explaining why the investment should be made notwithstanding operation's concerns.

1. Background: See I3.2 and I5.3
2. Assessment of implementation progress: As noted in I5.3, ODD reports to the COO. While the COO does not have a veto over investments, as one of five voting members of the IIC he has adequate input and authority. The level of authority is specified and clear.
3. Opportunities for further improvement: None identified.

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16.1: *RSIC should re-assess its due diligence practices towards identifying opportunities to streamline and reduce the cycle time of activities without impacting the thoroughness or effectiveness of the overall process. Among the possible improvements not covered by other recommendations would be weekly management report of due diligence progress at the IIC.*

1. Background: At the time of the 2014 fiduciary performance audit, the due diligence process was unwieldy, causing the RSIC to miss out on some investment opportunities altogether, and in other cases on better economics available to investors able to invest in first closings.
2. Assessment of implementation progress: The due diligence process has been greatly streamlined, even while becoming more robust. RSIC adopted a number of changes to improve its efficiency (in addition to other changes in process, such as the peer review meetings, noted elsewhere in this section)
 - a. Diligence is now clearly the responsibility of staff (as opposed to the Commission or the consultant). See L5.2
 - b. RSIC hired a private markets consultant (Albourne) to serve private equity, private debt, real estate and infrastructure asset classes. Albourne's resources complement RSIC's own due diligence efforts.
 - c. RSIC has established additional internal meetings to coordinate and prioritize workflow. These meetings include a biweekly leadership team meetings (which includes those that report directly to the CEO and CIO) and a bimonthly meeting to discuss the investment pipeline.
 - d. RSIC has hired a paralegal who prepares the initial draft of the investment pipeline, which generally improves the efficiency of legal review. See L1.2

By and large, the process seems to result in a process within industry norms for time. RSIC has committed to a policy of making larger, earlier commitments to fewer private market funds, both to be able to know those partnerships more thoroughly and to take advantage of the economic benefits which come with being an early, sizeable investor. That said, there are occasions when the process is slower than desired, putting the ability to meet a closing deadline at risk. (FAS notes this is a common issue throughout the public plan universe in the United States.)

3. Opportunities for further improvement: RSIC could realize further improvements in its due diligence processes through:
 - a. In one recent situation, the decision to involve the quantitative solutions group occurred relatively late in the process. While the group's review did not cause the RSIC to miss a close, it involved extraordinary cooperation by the general partner, which held open the closing date for RSIC. FAS suggests that the quantitative solutions group attend the pipeline meeting, along with ODD and legal, and that one output of that meeting be a schedule of any other resources within RSIC which will

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be needed for the due diligence (other asset class specialists, quantitative strategies, legal, consultant, ODD, etc.).

- b. The peer review process is designed to catch issues early, and, particularly, to stop the resources from being wasted on new investments as soon as a “no go” point is reached. The first peer review looks at the incremental benefit of the investment irrespective of the manager, while the second peer review (2A) examines the manager due diligence. Another peer review meeting (2B) examines any follow ups from the managerial due diligence, and then, finally, the IIC votes. (In certain cases, usually related to size or matters of first impression, the investment is brought to the Commission.) The CIO ought to consider what circumstances would warrant a combined 2B peer review/final IIC meeting.
- c. RSIC uses outside counsel to review private placement memoranda, limited partnership agreements and related subscription documents. RSIC relies heavily on one attorney for most private equity reviews. That has an advantage in that the attorney is familiar with RSIC’s requirements and business priorities, but it has created a bottleneck on occasion. Legal should consider marginally expanding the roster of outside counsel firms so as to relieve any time pressure stemming from outside counsel constraints. Our understanding is that Legal has commenced this process since the time of the FAS site visit. See L5.1

16.2: *RSIC legal staff should work with outside counsel to standardize contracting practices where possible. This should reduce delays in the contracting process (see L2.1).*

1. Background: As noted above, RSIC’s due diligence process was slower than peer funds. One source of delay was the contracting process. FAS recommended that RSIC develop standardized contracts.
2. Assessment of implementation process: RSIC developed a template Investment Management Agreement and template side letter request, which it provides to investment managers early in the contracting process to minimize delays. See L2.1
3. Opportunities for further improvement: None identified.

16.3: *The Commission should seek alternate means of assuring and reassuring itself as to the quality of the legal review, thereby enabling it to eliminate the 30-day review period before funding.*

1. Background: As noted above, RSIC’s due diligence process was slower than peer funds. One source of delay was the 30-day review period that the Commission required.
2. Assessment of implementation process: The 30 day review period has been shortened to three days. See L3.1
3. Opportunities for further improvement: None identified.

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17.1: *RSIC should consider establishing a formal policy for frequency of site visits to external managers as part of the monitoring process. Leading practice is to make the periodicity annual, but given staff constraints and the existing semi-annual contact requirement, a biannual periodicity could be considered.*

1. Background: While due diligence, monitoring and reporting at the time of the 2014 fiduciary performance audit was considered well above average, there was no formal policy for on-site visits as part of the monitoring regime.
2. Assessment of implementation progress: This recommendation has not been implemented. However, FAS notes that RSIC does typically visit most managers and general partners annually, including through service on Limited Partnership Advisory Committees (LPACs) for private market investments. Moreover, RSIC continues to have a robust monitoring program, typically featuring monthly reporting from managers for public markets and quarterly reporting from managers for private markets. Indeed, in one case, there is a weekly call from a particular set of managers. Written reporting is extensive and appropriate. Managers often visit the RSIC investment offices in Columbia. While FAS continues to support our 2014 recommendation – we believe that on-site visits allow skilled investment officers to note warning signs and cultural changes at managers before they become manifest in the portfolio – we note that the decision to not visit each manager or general partner annually can be a rational decision as to how to triage resources, particularly in an otherwise robust monitoring program.
3. Opportunities for further improvement: FAS continues to suggest that all managers and general partners be visited on-site annually. However, if an asset class head chooses to not do so because he/she believes the particular manager is adequately monitored without an annual site visit, he/she should document the rationale for not performing an annual on-site monitoring visit. That documentation should have a statement from the investment officer in charge stating what he/she believes should be the periodicity of on-site visits for that manager. That written document should be reported timely to the CIO, who should either affirm or countermand the decision. FAS notes that the investment staff disagrees with this recommendation, stating that: a) it has a robust monitoring program; b) the value of on-site monitoring is variable; and c) where the asset class head believes an on-site monitoring is needed, it is done. FAS agrees with all those assertions. Nevertheless, FAS continues to believe that periodic on-site monitoring is desirable, and the decision to not do such an on-site visit, while justifiable, should be treated as an exception, which means it should be justified in writing and escalated for affirmation or override. Also, FAS notes that this recommendation implies leeway for an asset class head to suggest a less frequent than annual on-site visit. Variants of such decisions about periodicities abound (for example risk-based periodicity based on such issues as liquidity, custody, public/private, etc.).

17.2: *RSIC should consider how it wants to gain assurance that managerial trading is efficient. It could suggest that its external managers trading in public securities provide independent trade*

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execution measurements or engage a trade execution management vendor itself to “spot check” external managers.

1. Background: The Statement of Investment Objectives and Policies mentioned trading efficiency but the RSIC did not engage any independent external trade execution measurement system or vendors.
2. Assessment of implementation progress: The IMA template requires managers to seek best execution at the most favorable prices reasonably obtainable. Abel Noser reviewed calendar year 2013 trade execution and later reviewed six months of 2017 trading for dedicated, externally managed RSIC accounts custodied at BNYM. Continuing to do periodic follow-up reviews may provide reassurance about trends and new issues that may arise for such accounts. RSIC concluded that it may be more valuable to conduct such reviews before an external manager is hired. RSIC now excludes soft dollar trading authority in its negotiations with new managers and seeks to negotiate it out of existing agreements.
3. Opportunities for further improvement: None identified.

19.1: RSIC staff should update the 2012 plan for expanded internal management and include a full business plan which considers all requirements (see Recommendation 14.1).

See 14.1

19.2: RSIC should continue to pursue reductions in fees where it pays greater costs than its peers, taking into account potential net return and risk.

1. Background: Fees were a contentious issue at the RSIC at the time of the 2014 fiduciary performance audit. RSIC’s reported costs had grown from \$29.8 million in 2006 to \$427.5 million in 2013, though much of that growth had occurred because of changes in asset allocation from low-fee to high-fee categories, and due to increased reporting of performance fees from alternative managers (which many other funds were not reporting as fees at time). Even at the time of the earlier report, RSIC had begun a program to reduce external asset management costs.
2. Assessment of implementation progress: RSIC has used several strategies to reduce fees, from aggressively asking and renegotiating with existing managers, to making fewer (and larger) allocations so as to reap economies of scale, to obtaining first close fee discounts in partnership investments, to obtaining relationship discounts from asset managers with whom it has multiple relationships. For example, RSIC just negotiated an increased relationship discount (from \$80,000 to \$130,000) with one multi-asset firm because the fund hired the manager for a third product line. The overall result, as the CEM benchmarking study notes, is that fees have decreased from 2012 to 2016. In total, CEM also found that RSIC pays somewhat less in basis points than its peers for similar externally managed portfolios. However, CEM identified strategies for which RSIC pays more where

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there may be opportunities to pursue further fee reductions. Since 2012, RSIC has more than doubled the share of assets managed with low cost passive strategies. However, it still relies more heavily than its peers on active external management. With appropriate resources and strategies, an eventual expansion of RSIC's internal asset management could reduce total costs.

Looking to the future, RSIC has now hired a co-investment manager to enable it to take greater advantage of co-investment opportunities, with a target of eventually moving one-third of its private equity program into co-investments, which should further decrease private asset class fees (by an estimated \$30 million) in the future. Similarly, the RSIC is reallocating from hedge strategies to alternative beta managers, primarily to achieve fee savings while maintaining desired risk exposures.

3. Opportunities for further improvement: RSIC should consider expanding the co-investment program to include real estate and private credit.

19.3: RSIC should consider whether the use of a pool of asset-class specialist consultants to perform due diligence on co-investment opportunities would be beneficial and consistent with current asset allocation plans.

1. Background: Co-investment opportunities often require quick investment decisions and also need ongoing monitoring and management (normally provided the general partner in partnership structures). Very often, those time frames preclude some institutional investors from investing, as they cannot fulfill their due diligence requirements in adequate time, and, for others, the operational issues create operational risk. This recommendation was designed to remove barriers to RSIC's goal of creating a robust co-investment program.
2. Assessment of implementation progress: RSIC has a goal of having at least one-third of its private equity portfolio in co-investments over time. RSIC has taken logical steps to achieve that, including the development of a co-investment philosophy for private equity opportunities and hiring a co-investment manager. Between the co-investment manager, the private asset class consultant, and RSIC staff, RSIC should have better ability to take advantage of more co-investment opportunities, at least within private equity.
3. Opportunities for further improvement: As RSIC considers expanding the co-investment program to other private asset classes such as real estate or private credit, it should consider what type of outside expertise and support it needs to access, and whether that expertise and support is resident in the current consultant and co-investment manager or whether it needs additional resources for those asset classes.

110.1: RSIC fee reporting for alternative investments should be restructured to improve transparency and comparability with peer funds; management fees should be broken down into invoiced and non-invoiced management fees, performance fees and carried interest, and pass-through fees.

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1. Background: For alternative investment asset classes, RSIC was reporting management fees, performance and incentive fees, carried interest, and limited partnership pass-through costs (such as set up organizational costs, legal costs, taxes, audit, accounting). No other U.S. public pension funds at that time disclosed all of these fees, and some did not report any, simply netting out all costs and reporting net returns. Among the investment board peer group, the most categories of fees reported by any of the funds amounted to less than half of the fees reported by RSIC. Because RSIC was the only fund with this level of fee disclosure, it opened up RSIC to charges of being significantly higher cost
2. Assessment of implementation progress: Beginning with the FY 2014 CAFR, PEBA and RSIC began to provide more fee detail, breaking out performance fees and other fees separately for each investment so that more comparable comparisons could be made with peer funds.

A new South Carolina statutory requirement in S.C. Code Ann. § 9-16-90 went into effect in July 2017 which specifies that RSIC must disclose asset class management fees, performance fees or carried interest, and other expenses charged to the managed investment vehicle. The RSIC Annual Investment Report includes this breakout for each asset class in dollars as well as expressed as a percentage of net asset value.

3. Opportunities for further improvement: None identified.

110.2: Investments in strategic partnerships should be allocated to the appropriate asset classes for performance and fee reporting in the PEBA CAFR.

1. Background: At the time of the 2014 report, “Strategic Partnerships” were reported as an asset class in the PEBA CAFR, which was inconsistent and decreased transparency. This occurred despite the completion of a mapping exercise which allowed the investments to be reported accurately, by asset class, for internal purposes.
2. Assessment of implementation progress: Investments in strategic partnerships have been allocated to the appropriate asset classes since FY 2014 CAFR.
3. Opportunities for further improvement: None identified.

111.1: Given the controversy the decision to disclose all external manager fees has engendered, the Commission should more clearly articulate its policy decision.

1. Background: RSIC’s decision to identify and report all manager fees provides transparency and information useful to its investment process. According to CEM, other funds may appear to be managing at less cost although they are actually less comprehensive in what they report than RSIC, particularly for private equity partnership expenses. This contributes to some misleading criticism of RSIC’s costs compared to those of other public pension funds.

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2. Assessment of implementation progress: On its website and in publications RSIC explains its rationale and approach to fee transparency and cites independent sources that corroborate that its reporting is more complete than its peers.
3. Opportunities for further improvement: None identified.

I11.2: The RSIC should contract with CEM, or a similar service from another provider, on an annual basis to develop a source of “apples-to-apples” benchmarks of investment management costs for each asset class and for the entire fund, as well as to provide an additional source for returns performance benchmarking (see G13.4).

See G13.4

I12.1: The RSIC should formalize its policies with respect to oversight of the strategic partnerships and controls over underlying investments within RSIC, e.g., use of the IIC to vet investments, two RSIC staff participating in meetings, etc. (see Recommendation G7).

See G7

I12.2: RSIC should develop a guideline, rather than current situational decision making, for when and how much long-only, traditional assets should be in strategic partnerships.

1. Background: While the majority of assets in the strategic partnerships were private assets or alternative strategies, there were some long-only, public securities in the strategic partnerships at the time of the 2014 fiduciary performance audit.
2. Assessment of implementation progress: The rationalization of the strategic partnership program (see G7) has largely ended this practice, though it continues in one instance. RSIC pays only a normal, non-partnership fee in that case. Otherwise, when RSIC desires to hire a partner to run a long-only portfolio, it does so explicitly and, most recently, outside the existing partnership.
3. Opportunities for further improvement: RSIC should examine the costs and benefits of keeping or removing the remaining long-only account within its strategic partnership. If appropriate, a plan for removing it should be undertaken.

I12.3: RSIC should develop a guideline regarding the appropriate level of cash to remain within strategic partnerships and for the return of any cash in excess of partnership needs.

1. Background: For various internal and operational reasons involving the difficulty in wiring money from the custodial bank at the time of the 2014 fiduciary performance audit, cash was often kept in the partnerships, and there were no formal policies limiting the practice.

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2. Assessment of implementation progress: The rationalization of the strategic partnership program, and the improvement in the relationship with the custodial bank, has mitigated both the opportunity and motivation to keep cash in the strategic partnerships. The CIO maintains a “minimum cash possible” policy.
3. Opportunities for further improvement: None identified.

112.4: The Commission should take increased advantage of the information, insights and experience resident in the RSIC’s strategic partners. In-person education programs in Columbia would be one possibility, either in conjunction with regularly scheduled Commission meetings or, as in the past, at special educational or strategic planning retreats in-state.

1. Background: One rationale for the strategic partnership program was to enable information sharing from leading investment organizations to the RSIC. That sharing had been sporadic, and not recent.
2. Assessment of implementation progress: The Commission appears to recognize both the need for professional education and the ability of its general partners and investment managers to provide it. We note that the Commission recently hosted a presentation by the three new Global Tactical Asset Allocation (GTAA) managers.
3. Opportunities for further improvement: The Commission should task its consultant to coordinate with the Chair to schedule appropriate professional education, aligned to the forward calendar, so that the education is related to upcoming strategic decisions to be made by the Commission.

113: Rebalancing policies should be revised to require a quarterly rebalancing review to be scheduled on the annual meeting calendar of the IIC or Wednesday markets meeting to ensure compliance with SIOP; in the event the CIO and staff review balancing in the interim due to market movements or otherwise, that should be reflected in the IIC minutes to demonstrate compliance.

1. Background: At the time of the 2014 fiduciary performance audit, rebalancing was performed appropriately, but there was little documentation or specified process.
2. Assessment of implementation progress: Rebalancing is done monthly, with input from the heads of the public and private market portfolios. Rebalancing is often achieved through use of the overlay portfolio. The IIC receives a report on rebalancing on an exception monitoring basis.
3. Opportunities for further improvement: None identified.

114.1: RSIC should explore alternate transition management programs, such as manager-to-manager transitions (cherry picking) with the remaining securities sold, or principal bids. RSIC should educate itself about when each technique is most appropriate.

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1. Background: A single vendor performed all public market transitions at the time of the 2014 fiduciary performance audit. There were no independent transition cost analyses done, though that vendor gave its analysis following each transition.
2. Assessment of implementation progress: While that vendor continues to be the only designated transition manager, RSIC staff has appropriately taken advantage of other of its asset managers to reduce transition costs in some creative ways, including manager to manager transitions, internal crossing, ETF creations, etc. The net result of these actions has been a more robust and materially less costly transition program.
3. Opportunities for further improvement: In addition to the appropriate actions taken to date, we suggest exploring the possibility of retaining more than one transition manager.

114.2: RSIC should determine if it wants to independently measure transition management costs, at least on a spot check basis.

1. Background: See 114.1
2. Assessment of implementation progress: A known trade execution measurement firm performed an analysis which included transition measurement.
3. Opportunities for further improvement: None identified.

116: RSIC should complete development of an annual assessment process for the Commission to evaluate the performance of its general investment consultant and the Commission should adopt and implement the process.

1. Background: RSIC hired Hewitt EnnisKnupp (HEK) as its investment consultant which provided a range of consulting services. At the time of the 2014 fiduciary performance audit, RSIC staff was developing an annual assessment process for the Commission to evaluate the performance of its consultant. Since the 2014 fiduciary performance audit, RSIC has shifted its consulting services model from retaining one general consultant (formerly HEK/Aon) to a more limited scope consultant (Meketa) and a private markets consultant (Albourne).
2. Assessment of implementation progress: The Commission has adopted a general policy for RSIC staff to evaluate service providers in its Governance Policy Manual, though it does not identify a process for the Commission to evaluate its own general consultant. The Commission has an informal process for evaluating the general investment consultant. The Commission will consider whether the consultant is complying with its obligations under its contract and RSIC's policies and procedures. Some Commissioners noted that there is a need for a formal, annual evaluation process, as the Commission has terminated the contracts of two investment consultants since the 2014 fiduciary performance audit. An annual evaluation process could be a useful tool for the Commission to communicate any concerns. In addition, the evaluation process would

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demonstrate that the Commission has a reasonable process for evaluating its consultants and monitoring its general consultant, consistent with its duty of care.

3. Opportunities for further improvement: We recommend that the Commission adopt and implement a formal process for evaluating the Commission's investment consultant.

I17: The Legislature should consider four potential options to significantly improve the ability of the RSIC to obtain services from and work with its custodial bank (see Recommendations G2 and G3).

See G2 and G3

I18.1: The Commission should determine the future of securities lending based on an assessment of the potential investment benefits and risks of different approaches to participating in the lending market.

1. Background. RSIC was one of many public pension funds which adopted more conservative lending approaches after losses in the 2008 credit market collapse. In 2013, the investment consultant presented several options for the program to the Commission, but choices were complicated by the fact that the BNYM lending agreement was with the STO not RSIC.
2. Assessment of implementation progress: RSIC became fully responsible for lending management and oversight as of July 1, 2017. The program remains significantly smaller than it was prior to the 2008 market collapse (\$2.1 billion on loan in FY 2009 compared to \$164.7 million in FY 2017). After several years of revenue decline, RSIC broadened its reinvestment guidelines and revenues rose to an estimated \$1.8 million in FY 2018. While well below revenues when lending was at its peak, it is sufficient to pay BNYM's \$1.2 million custody fee and \$0.6 million of RSIC's \$47.0 million loss from 2008. BNYM indicates that RSIC's cash reinvestment guidelines are still more conservative than many of its other clients. Because RSIC does not plan on any significant changes to the program in the near future, there are no immediate plans to do a review with the Commission, given the program's small size and relatively low materiality of earnings.
3. Opportunities for further improvement: Share the results of the IIC securities lending review with the Commission when there are significant changes in the economic terms, performance or risk.

I18.2: RSIC will need to develop new policies and practices if it chooses to continue securities lending through BNYM or another third party; a new policy should include a statement of lending objectives, risk tolerance and guidelines approved by the Commission.

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1. Background: In 2014, the Commission authorized RSIC to lend through another third-party agent but it had not yet adopted a policy regarding the goals and administration of the program.
2. Assessment of implementation progress: The AIP states that the program operates with very conservative investment guidelines and that RSIC is evaluating the risks and benefits of increasing lending and expanding reinvestment guidelines. The securities lending policy was approved in 2015 and last updated in January 2018 with some expansion of reinvestment guidelines. The policy states that the objective is to provide incremental return with incremental risk. It addresses eligible assets, collateral management, risk management, responsibilities and reporting. To limit risk, the program has two types of indemnification.
3. Opportunities for further improvement: Seek separate bids for securities lending and custody services the next time these services are rebid.

I18.3: The RSIC securities lending agent should be required to provide quarterly reporting to management and the Commission regarding program activity, including amounts on loan, borrower concentration, return and risk.

1. Background: BNYM was providing a limited quarterly report to RSIC.
2. Assessment of implementation progress: BNYM is providing a more robust quarterly report that includes performance, borrower concentration and utilization rates. RSIC and BNYM are in discussions about further enhancements.
3. Opportunities for further improvement: None identified.

I18.4: RSIC should obtain an annual benchmarking of its activities against lending activity across the industry.

1. Background: RSIC was not receiving independent industry benchmarking data.
2. Assessment of implementation progress. The lending policy requires that staff annually assess the performance of the program by comparing it to an appropriate benchmark or industry composite. The last such review occurred at the IIC in October 2017. Such reviews use data from BNYM, including an independent benchmarking, to compare utilization of the asset classes and rebates to others in the large BNYM universe.

If the lending program grows more rapidly, or if RSIC adds another lending agent, RSIC may want to directly secure industry benchmarking data.

3. Opportunities for further improvement: None identified.

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118.5: If RSIC decides to significantly grow securities lending, it should implement enhanced and more automated compliance functions, including compliance reporting from the lender(s) and periodic review by RSIC's compliance officer.

1. Background: At the time of the 2014 fiduciary performance audit, RSIC was evaluating the future direction of securities lending and the Commission had just given staff approval to contract with a third-party agent. It would be important that RSIC's compliance monitoring be equipped for changes in lending agents or significant growth in the program.
2. Assessment of implementation progress: RSIC has not significantly expanded the lending program and BNYM remains the sole lender. BNYM performs an automated pre-trade compliance check for most guidelines and monitors guideline compliance. RSIC has daily access through BNYM's portal to lending activity, and RSIC's compliance staff produce a quarterly report that tracks guideline compliance. If lending were to expand considerably, RSIC indicates that it would consider producing this report more frequently.
3. Opportunities for further improvement: None identified.

119: RSIC should ensure that its policy pertaining to Commissioner requests for information from the RSIC staff is followed. This would include timely fulfillment of routine requests, a transparent process for determining the priority of requests which require approval at Commission meetings, and all responses being made available to all Commissioners through the portal.

1. Background: At the time of the 2014 fiduciary performance audit, RSIC had a prevailing practice policy for handling requests for information by Commissioner which included directing questions to the Chief Investment Officer ("CIO"), COO, or the appropriate designated staff member. The policy also had a provision for requests for information that required significant expenditure of RSIC staff time or use of external resources should, in addition, be formally requested and approved at a Commission or committee meeting. Finally, the policy required that the CIO and COO ensure that information that has been requested by the Commission or a Commission member is made available to the Commission members as appropriate, and in a timely and complete manner. There were complaints, primarily from the State Treasurer, that this policy was not being consistently followed and that information was being withheld.
2. Assessment of implementation progress: With the change in reporting structure following the appointment of the new CEO, the CEO was made the primary point of contact for information requests for Commissioners. In addition, all information to be made available to Commissioners is provided to all through the Watchdox portal. During interviews with Commissioners, none expressed concern with the responsiveness of RSIC staff to Commissioner requests.
3. Opportunities for further improvement: None identified.

F. Legal compliance

L1.1: *RSIC's procedure for use of legal counsel should be revised to assign inside or outside counsel to each investment transaction during the final due diligence process prior to approval of the Commissioners, as needed.*

1. Background: Prior to the 2014 fiduciary performance audit, the Commission reviewed and approved of all investment transactions. This limitation prevented internal legal staff and outside counsel from becoming involved in the diligence process until after the transaction was approved by Commissioners. In addition, the RSIC Legal Division had to obtain deal-by-deal approval of outside counsel from the Attorney General.
2. Assessment of Implementation Progress: The 2017 Pension Reform Act authorized the Commission to delegate investment authority to the CIO, subject to the oversight of the CEO. The IIC was established to assist the CIO perform his duties. The IIC meets weekly and approves investments. The IIC meets much more frequently than the Commission, which means that investments can be approved more quickly. Once the IIC approves the investment, the RSIC Legal Division begins its review or will retain outside counsel to review.

The 2017 Pension Reform Act allows the Legal Division to hire outside investment counsel without obtaining approval from the Attorney General. This authority has improved the efficiency of legal review. See Recommendation L5.2. Comments from external investment counterparties indicate that responsiveness in the review process has improved significantly. The improved efficiency of the review process will also allow RSIC to take advantage of fee discounts and better terms offered to first closers.

3. Opportunities for further improvement: None identified. See L5.1 below regarding our recommendation for improving the timeliness of outside counsel reviews.

L1.2: *RSIC should add a paralegal to the legal staff to provide administrative support and assist in document control (see Recommendation I6.1).*

1. Background: The 2014 fiduciary performance audit noted that RSIC could improve the tracking and timeliness of the document negotiation process by hiring a paralegal.
2. Assessment of implementation progress: RSIC hired a paralegal approximately three years ago. The paralegal performs the roles of both paralegal and legal assistant. The paralegal performs a broad range of duties including taking minutes at Commission meetings, docketing, drafting an investment compendium (which identifies major deal terms and creates a record of negotiated deal terms), preparing reports to the Attorney General's Office regarding the use of outside counsel, and otherwise supporting the three other attorneys in RSIC's Legal Division.
3. Opportunities for further improvement: None identified.

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L2.1: RSIC should establish a standard side letter and contract clauses to improve bargaining leverage and increase contract consistency, and internal counsel should work with investment staff and outside lawyers on prioritization of the “asks” (see Recommendation 16.2).

1. Background: RSIC had not developed a template side letter describing RSIC’s required investment terms, such as public records, specialized fee reporting and limitations on indemnification. As a result, each of RSIC’s outside law firms developed their own language, which created significant variation in the contracts.
2. Assessment of implementation progress: RSIC has recently developed a template side letter. The template side letter effectively communicates RSIC’s state law limitations, such as the South Carolina Freedom of Information Act and prohibitions on placement agent fees and lobbyist contact with RSIC. Overall the template side letter is consistent with peer funds and will likely improve contract consistency.

RSIC has not expressly prioritized side letter terms. RSIC may wish to develop an internal document or simply annotate the existing side letter request to identify priority terms and the reason why the side letter term is a priority. For example, the template side letter request states that RSIC will not waive trial by jury, which is a common request among public pension funds. It may be helpful to identify the source of that requirement (*e.g.*, public policy of the State of South Carolina or Attorney General’s Opinion), as external managers are increasingly pressing public pension funds for this information. As another example, the template side letter requests fee reporting consistent with the Institutional Limited Partnership Association (ILPA) template. It may be helpful to note that fee reporting is important so that RSIC can comply with its own fee reporting requirements and identify the minimum level of reporting that is required for RSIC to comply. This information will guide outside counsel, reduce time and legal fees associated with negotiating side letters, and improve compliance.

3. Opportunities for further improvement: RSIC may consider developing an internal document or annotated side letter template describing which side letter terms are priorities and the legal basis for prioritizing those terms.

L.2.2: RSIC should identify investment terms that are deal-breakers and provide those terms to investment counterparties early in the investment due diligence process.

1. Background: In the 2014 fiduciary performance audit, FAS recommended that RSIC identify required terms for transaction counterparties early in the investment process in order to facilitate negotiation of more consistent and favorable contract terms.
2. Assessment of implementation progress: RSIC recently developed its template side letter, which is provided to fund counsel early in the investment process. The template side letter does not specifically identify “deal-breakers,” but the template side letter does include references to the South Carolina laws upon which the side letter request is based. We also note that South Carolina’s state law requirements for investment transactions (*e.g.*, public records, sovereign immunity, fee reporting) are similar to peer funds’ state law

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requirements, and experienced attorneys that represent RSIC's investment managers would understand that the template side letter request is likely required by state law or RSIC's established policies. Further, the side letter terms that are required by state law have not caused an investment transaction to terminate and only cause minor delays with new managers. This is consistent with peer practices in our experience.

3. Opportunities for further improvement: None identified.

L3.1: RSIC should consider eliminating the 30-day review period and instead rely on an appropriately documented Legal Sufficiency Certificate to confirm that all legal compliance and due diligence is complete. Alternatively, RSIC could shorten the Commission review period and add a provision to the Governance Policy Manual clarifying the purpose for this review period and confirming that it does not delegate Commission authority to individual Commissioners or revoke authority otherwise delegated to the CIO or COO.

1. Background: The 2014 fiduciary performance audit noted that RSIC had been slower in closing on investments than other investors. One reason for the delay was that Commissioners were required to have 30 days to review final contract language before the investment could be funded.
2. Assessment of implementation progress: RSIC has eliminated the requirement that Commissioners have 30 days to review the final contract. The Commission voted to reduce the requirement to three days in May 2014. After the adoption of the 2017 Pension Reform Act, which permitted delegation of investment authority to RSIC staff, the Commission incorporated the three day review period into the Investment Authority Delegation Policy. The Investment Authority Delegation Policy requires that RSIC provide all applicable documentation and reports to the Commission three days before the closing of the investment. The Commission must still review the investment transaction, but the review may occur post-closing.

Following the adoption of the 2017 Pension Reform Act, the Commissioners are not involved in due diligence and have a more limited role overseeing RSIC staff make delegated investment decisions. This is a significant change in the Commission's role, and the Commission may require additional assurance that investment transactions are being executed in accordance with the policies and procedures adopted by the Commission. In the 2014 fiduciary performance audit FAS recommended that a member of the investment staff sign the Legal Sufficiency Certificate, which RSIC has implemented (see Recommendation L3.3). RSIC may also consider updating the Legal Sufficiency Certificate to include a statement addressing whether outside counsel has verified that final transaction documentation complies with all material requirements, including state law and investment policy requirements identified in the template side letter (see Recommendation L2.1). Alternatively, outside counsel could sign a closing letter to the Chief Legal Officer providing this verification. In our experience, this is a common practice among peer funds and would provide independent assurance for the Commission that appropriate legal diligence has been completed.

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3. Opportunities for further improvement: RSIC should consider supplementing the Legal Sufficiency Certificate to include a statement addressing whether outside counsel has verified that final transaction documentation complies with all material requirements, including state law and investment policy requirements, or otherwise asking outside counsel to provide a closing letter to the same effect.

L3.2: RSIC could require more frequent Commission meetings to consider investments. (See also Recommendation G12.1). Alternatively, the Commission could consider delegating greater authority for approval of alternative investments to the CIO or Internal Investment Committee.

1. Background: See Recommendation G12.1. As noted above, the 2014 fiduciary performance audit noted that RSIC has been slower in closing on investments than other investors. One reason for the delay was that Commissioners were required to approve each investment transaction.
2. Assessment of implementation progress: As noted above, the 2017 Pension Reform Act allowed the Commission to delegate investment authority to the CIO, subject to the oversight of the CEO. The Commission granted this authority to the CIO in the Investment Authority Delegation Policy, which also placed limits on the amount and types of investments the CIO could make without obtaining Commission approval. Most investments may be approved by the CIO and the IIC though some investments are reserved for the Commission (e.g., investments in a new asset class or investments implementing a new strategy). The IIC meets weekly, which means that most investments can be approved more quickly. Investment counterparties have commented that RSIC is able to approve investments on a shorter timeframe than in the past, which has allowed RSIC to take advantage of strategic opportunities and fee discounts.
3. Opportunities for further improvement: None identified.

L3.3: The Legal Sufficiency Certificate should include confirmation that documentation for each investment is consistent with material terms approved by the Commission and with authority delegated to staff by the Commissioners in the Statement of Investment Objectives and Policies.

1. Background: The Legal Sufficiency Certificate was provided to the Commission at the end of the contract negotiation process, prior to the 30-day review period. It was intended to provide confirmation that legal compliance and due diligence items were completed and the investment documentation was consistent with the terms presented to the Commission. The 2014 fiduciary performance audit recommended that RSIC expand the Legal Sufficiency Certificate to confirm that the final negotiated documents are consistent with the delegated authority under the SIOP and the Commission's approval.
2. Assessment of implementation progress: Since the 2017 Pension Reform Act permitted the Commission to delegate investment authority to RSIC staff, RSIC has developed a separate process for approval of a delegated investment. If an investment transaction has been

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delegated to RSIC staff, then a member of RSIC investment staff and a member of RSIC legal staff prepare an “Investment Certification Letter—Delegated Investment.” The Investment Certification Letter identifies the material investment terms that were approved by the CIO and any variances in the final transaction documents. The Investment Certification Letter also confirms that the final transaction documents are legally sufficient. The signed Investment Certification letter is posted into Watchdox along with the final transaction documents for the Commissioners to review for three days. After the three day period has ended, the CEO signs a Closing Certification which confirms that the investment conforms to the amount and extent of delegation permitted by the South Carolina Code and the Investment Authority Delegation Policy. The CEO’s Closing Certification implements the requirements of S.C. Code Ann. § 9-16-330(B)(2).

3. Opportunities for further improvement: None identified.

L4.1: The Audit Committee should approach the State Ethics Commission to establish a process for regular confirmation that RSIC Statements of Economic Interests have been audited.

1. Background: The prior report recommended potential conflict of interest disclosure enhancements. Specifically, it was recommended that external reassurance could be sought that staff and Commissioners have not obtained a benefit for themselves or related parties from sourcing investments or otherwise acting on RSIC matters. It was also stated that sourcing information is relevant to implementation of co-fiduciary monitoring obligations, so timely disclosure to all Commissioners is important.
2. Assessment of implementation progress: RSIC has not received a confirmation that the State Ethics Commission audits the Statements of Economic Interests (SEI). However, the RSIC Compliance function performs a review for compliance with the filing requirements. The review focuses on:
 - ensuring that the forms are submitted timely;
 - notifying individuals as the filing deadline approaches;
 - ensuring that the details from each individual form are reviewed for potential conflicts or gifts; and,
 - flagging any potential conflict of interest.

The Director of ERM updated the AERMC on his review of the 2018 SEI at its June 2018 meeting. ERM plans to report annually on its SEI compliance review.

3. Opportunities for further improvement: None identified.

L4.2: Consideration should be given to extending coverage of the Sourcing and Conflict Disclosure Form to Commission approval of consultants and professional service providers exempted from State procurement processes.

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1. Background: The 2014 fiduciary performance audit noted that RSIC's Sourcing and Conflict Disclosure Form, which was required to be completed by Commissioners and staff in connection with new investment approvals, was consistent with leading peer practices. However, it did not cover consultants and professional service providers hired by the Commission, which present the same conflict of interest risks as investment managers.
2. Assessment of implementation progress. RSIC adopted a separate Sourcing and Conflict Disclosure Form for Exempt Service Providers (*i.e.*, those service providers hired directly by the Commission). The Sourcing and Conflict Disclosure Form for Exempt Service Providers is substantially similar to the form applicable to investment managers.
3. Opportunities for further improvement: None identified.

L4.3: The Sudan divestment policy should be completed and approved by the Commission (See also P2.7).

1. Background: S.C. Code Ann. § 9-16-55 prevents RSIC from making investments in certain companies that do business in Sudan. The 2014 fiduciary performance audit noted that RSIC had begun to develop a Sudan Divestment Policy, but it was not yet finalized.
2. Assessment of implementation progress: The Sudan Divestment Policy was approved by the Commission in 2016 and has been fully incorporated into the SIOP.
3. Opportunities for further improvement: None identified.

L4.4: The Enterprise Risk Management (ERM) program planning should be completed and the new function launched as soon as practical.

See G13.2

L5.1: Outside counsel should be refreshed, since it has been more than six years since the last RFP market test.

1. Background: The 2014 fiduciary performance audit noted that RSIC has not refreshed its pool of outside counsel in more than six years, and most peer funds refresh their pool of outside counsel at least every five years. The Report noted that the standards for selection and compensation of law firms should ensure that RSIC may retain counsel with appropriate experience that will match the qualifications of counsel used by peer funds and contract counterparties.
2. Assessment of implementation progress. The Pension Reform Act authorized RSIC to hire outside counsel without having to obtain deal-by-deal approval from the Attorney General. S.C. Code Ann. § 9-16-315(l) says that RSIC "in consultation with the Attorney General, may engage on a fee basis attorneys necessary to exercise its exclusive authority to invest and manage the retirement system's assets." RSIC has more flexibility to hire outside counsel

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on investment matters, subject to its obligation to report the fees and rates of outside counsel to the Attorney General.

Although RSIC has the flexibility to hire outside investment counsel, it has not refreshed the pool of law firms that it relies on for investment counsel services. RSIC relies on two law firms for its investment counsel services, and only one attorney for most private equity and real estate transactions. While the Legal Division staff is satisfied with the efficiency and quality of legal services provided, RSIC's reliance on one attorney was cited as a source of bottlenecks.

We also note that the Commission has a duty to only incur costs that are "appropriate and reasonable." S.C. Code Ann. § 9-16-40(5). It is important for RSIC to test the market and ensure that it is paying reasonable rates. RSIC should periodically solicit bids from outside law firms to confirm that its rates are reasonable. RSIC has initiated the RFP process since the FAS site visit.

3. Opportunities for further improvement: RSIC should complete an RFP selection process for outside counsel, since it has been more than ten years since the last RFP market test. Our understanding is that RSIC Legal Division has commenced this process since the time of the FAS site visit.

L5.2: The process for approval of outside counsel by the Attorney General could be streamlined through development of a pre-approved pool of qualified investment counsel, with agreed engagement contract form and budget standards, and requirements for regular reporting to the Attorney General and Commissioners.

1. Background: The 2014 fiduciary performance audit noted that RSIC requires the approval of the Attorney General to hire outside counsel, which falls short of leading practices. The Attorney General's approval process can cause delays in completing legal due diligence.
2. Assessment of implementation progress. In general, state agencies in South Carolina are required to receive approval from the Attorney General before hiring legal counsel. S.C. Code Ann. § 1-7-170(A). However, the 2017 Pension Reform Act created an exemption for RSIC to hire investment counsel or other attorneys required to manage the retirement system's assets. S.C. Code Ann. § 9-16-315(I). Pursuant to the 2017 Pension Reform Act, the Commission is required to develop policies and procedures for the retention of outside counsel and notify the Attorney General of the terms of the representation upon engagement. The Commission must also provide quarterly reports to the Attorney General describing the attorneys hired, hourly rates, and estimated maximum fees.

RSIC has satisfied these requirements. RSIC has adopted a Procedure for Retention of Associate Counsel for Investment Related Matters, which identifies a number of factors for selection of outside counsel by RSIC's Legal Division. The factors include consideration of the outside counsel's knowledge of the type of investment, fees, and experience working with public funds. Outside counsel must also confirm that there are no conflicts of interest. In addition to the Procedure, RSIC developed a template notification form to provide the

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Attorney General with the required information, and RSIC reports to the Attorney General on a quarterly basis, as required by the statute.

3. Opportunities for further improvement: None identified.

L5.3: Consideration should be given to engagement of qualified, independent fiduciary counsel.

1. Background: RSIC was experiencing a number of legal issues that could have been addressed by outside counsel. However, RSIC had been unable to engage fiduciary counsel because it could not obtain approval from the Attorney General to pay competitive rates.
2. Assessment of implementation progress. As noted above, RSIC is no longer required to obtain the approval of the Attorney General before engaging counsel on investment matters. However, we understand there is uncertainty as to whether this extends to fiduciary counsel unless related to specific investments. In addition, RSIC has decided not to hire fiduciary counsel at this time, since there appears to be no immediate need for fiduciary counsel.

The Commission is transitioning from a tactical board that is heavily involved in investment decisions to a strategic board that establishes policy and oversees staff. As the Commission makes this change, it is more likely to encounter questions about its role and responsibilities. Fiduciary counsel would be able to address these questions and allow the Legal Division to focus on investments. We believe it is generally preferable to have fiduciary counsel already in place before issues develop. Then, if a fiduciary duty question arises, RSIC would be able to quickly address the issue without having to first go through the RFP process. Furthermore, because all of RSIC's duties relate to the exercise of investment management responsibilities, the Attorney General might reasonably interpret current RSIC authority to engage investment legal counsel to include fiduciary counsel.

3. Opportunities for further improvement: RSIC should continue to consider engaging qualified, independent fiduciary counsel and consult with the Attorney General, when determined appropriate, regarding the extent to which the authority to engage fiduciary counsel is delegated.

G. Information technology

IT1.1: Guided by an overall business and IT plan, RSIC should complete the acquisition of systems to:

- **Track commitments and provide return calculations for private market investments**
- **Provide security-based risk management that includes position level transparency and risk and performance analytics**
- **Monitor compliance of investments with investment policies and contracts**
- **Automate trade order management**
- **Warehouse data for the whole investment portfolio in order to seamlessly feed other systems for analysis**

1. Background: The 2014 fiduciary performance audit recommended significant improvements in five system areas that comprise the core of the needed IT infrastructure which was based on increased investment in private markets and strategic partnerships and the expectation that these will increase over time, the need for better investment risk analytics, and better operational risk management systems, including the investment accounting application.

Hurdles in the path to technology improvements that were noted at the time included the disconnect between RSIC and the vendors (BNYM & QED) due to the relationship being between the vendors and the STO rather than RSIC, and also the state's policy constraints on procurement and management of information technology.

At the time, RSIC had just signed (March 2014) a contract with an investment administrator (Conifer, now SS&C Technologies). A risk analytics system (BarraOne) was implemented. A document storage and management system (Tamale) had also been implemented. Management reports that these systems are functioning as expected and works with the vendors to continuously review, modify and enhance them.

2. Assessment of implementation progress: The applications provided by Conifer/SS&C Technologies meet the large majority of the needs identified in our prior report. This has greatly helped RSIC to better manage and monitor the portfolio of private market investments.

The contractual relationships with BNYM and QED are now directly between RSIC and the vendors. This is a significant improvement and benefit for the system because both are critical systems for RSIC and PEBA and integral to financial and performance reporting. The change in these relationships has resulted in very positive developments that include the ability of RSIC to communicate directly to the vendors to get custody service improvements and upgrade the investment accounting system.

Based on the specific system areas identified in the prior report, this table sets out the current status:

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Critical System	Need/Purpose	Status
Private Equity	To track terms, fees, performance, commitments	A private markets system (Conifer/SS&C Technologies) was implemented in 2014. RSIC is reviewing pros and cons of obtaining services from BNYM ¹ and continuously assesses its functionality.
Hedge Funds	To track terms, fees, performance, commitments	Same as above.
Risk Management	To provide position level transparency, risk and performance analytics across the total portfolio	A risk management system (BarraOne) was implemented in 2014. RSIC continuously assesses its functionality.
Compliance Monitoring	To provide daily compliance monitoring of internal investments and external managers	Pre-trade compliance monitoring for internally managed fixed income securities is available through the trade order management system (TOMS) (Conifer). (Note: QED and BB also has a trade order management function.) Post-trade compliance is available through a combination of BNYM Workbench/Conifer/BarraOne. Post-trade compliance monitoring is in place through BNYM for the internally managed short duration fixed income account. Monitoring of externally managed accounts through BNYM is just beginning.
Trade Order Management (TOM)	To provide real-time trade execution for internally managed portfolios; To create trade blotters to update investment accounting; To maintain audit and control records	Fixed income trades are not entered through a TOMS. The TOMS provides for user coded pre-trade compliance rules and alerts.
Data Warehouse	To provide essential information about the whole investment portfolio to feed other systems	A Data Warehouse (Conifer/SS&C Technologies) was implemented and currently feeds other systems for reporting and analysis.
Investment Accounting	To maintain transactional level control over investments, and to provide the basis for financial reporting	QED was upgraded (See recommendation IT1.2) and the contract is now under RSIC oversight.

¹ Systems Roadmap. RSIC April 2018.

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3. Opportunities for further improvement: Enhancements with significant potential for the organization include:
 - a. RSIC uses PowerBI in numerous areas, including risk and performance and is testing its usage on management fees analysis and reporting. For Business Intelligence and Data Mining applications a strong Excel programmer is needed with training in the BI application. A third-party support firm may also be needed until the person is adequately trained. We encourage RSIC to devote appropriate resources to use these applications to their fullest extent.
 - b. Now that the MS Dynamics platform has been purchased, RSIC will need additional resources to implement it. RSIC is in the process of developing an RFP to hire a consultant for the build out of MS Dynamics. The IT business plan should describe short- and long-term goals for PowerBI and MS Dynamics, e.g., for CRM, ERP, BI, etc.

IT1.2: The QED internal accounting system provided by vendor contract with the State Treasurer's Office should be upgraded or replaced.

1. Background: We noted in the prior review that the QED version was not current.
2. Assessment of implementation progress: RSIC now manages the contract with QED since July 2017 having taken over responsibility from the STO. The move also included an upgrade of QED functionality to a current version of QED that provides web-based access, the ability for automated trade order management and cloud-based data that strengthens back-up and recovery modes. The updated version of QED provides for the financial accounting and reporting needs of PEBA. The change in the management of the contract from STO to RSIC has provided a better channel for communication between QED and RSIC.
3. Opportunities for further improvement: None identified.

IT2: Guided by a business plan for the whole organization, RSIC should seek the number and types of additional IT staff needed to adequately support its expanding systems infrastructure (see O3.6).

1. Background: The 2014 fiduciary performance audit identified the lack of sufficient IT staff as a substantial risk to RSIC even without expansion of internal investment management.
2. Assessment of implementation progress: Since then RSIC has significantly broadened the types and functionalities of its systems. These now include additional BNYM applications, the BarraOne risk system, the Conifer systems, and an expanded role performing some things that PEBA was doing. The IT department has added one full-time employee to the support team. The current complement in IT is a Director, an IT infrastructure support employee, a full-time IT Help Desk employee and two interns. As we identified earlier in

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this report, IT has not created a strategic plan to address the RSIC's IT needs for the future or to make the related business case(s).

The 2014 fiduciary performance audit pointed out that a longer-term staffing plan is needed. This would run parallel with the overall strategic IT plan. We note that a Systems Roadmap has been created to compare pros and cons, primarily between Conifer and BNYM, but this is not an overall IT Plan. While one staff has been added to accommodate the needs created by the domain split, there appears to be no basis, e.g., a strategic IT plan or business case, for determining future staff needs. Without the IT business plan and accompanying business case(s) for resource expansion the IT department is not leading the organization in the technology area (please see the next recommendation.)

3. Opportunities for further improvement: RSIC may benefit from an application development team to leverage the full potential of the Data Warehouse (e.g., business intelligence, data mining, real-time dashboards, real-time reports), but without an IT plan and the respective business cases it is not likely that it will be able to justify them to the CEO or to the state legislature. However, these positions could add significant value to support the investment team.

IT3.1: Guided by a business plan for the whole organization, RSIC should develop a strategic IT plan with clearly defined objectives, a full assessment of the current state of its systems and a timetable for completing needed improvements (see O3.6).

1. Background: The overall business plan was recommended to address several potential changes which were under consideration (e.g., expansion of internal investment management, further development of risk management) which of necessity would require careful planning for staffing, technology and budgetary requirements. In order to effectively develop RSIC's capabilities, it was considered necessary to have a longer-term business plan which incorporated human resources, systems, training, and third-party resources. This plan would have provided multi-year direction for the IT function and for its strategic plan.
2. Assessment: An overall organizational business plan was not completed. An IT plan was not completed. However, for many years, RSIC management has completed a three-year *strategic* plan that could have informed an overall IT plan, albeit in less detail than might be hoped for had the recommended business plan been completed. Independent of whether RSIC plans significant changes in its internal/ external investment management strategy, the organization would benefit from a written IT plan.
3. Opportunities for further improvement: RSIC should develop more formal IT plans, including:
 - a. RSIC should complete an overall IT strategic plan with clearly defined objectives, a full assessment of the current state of its systems and a timetable for completing needed improvements. The written IT strategic plan should address the key areas of:

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- Technology Management and Information Security
 - IT Vendor Contracts & Oversight
 - Data Governance & Management
 - Business Continuity and Disaster Recovery
- b. The COO and IT Director should meet to lay out a list of responsibilities and timeline for completion of the IT plan.
- c. This should consider the impact of the timing and completion of the overall business plan (see O3.6) but if the completion of that plan will be delayed further, then the matter should be escalated to the CEO for resolution. Nonetheless, the IT Director should strive to complete an overall IT plan and assessment with the components recommended and under available verbal and written direction, i.e., the RSIC Strategic Plan, plans for risk systems evolution, etc.

IT3.2: RSIC should establish a project governance process with representation from across the organization to determine IT priorities and monitor progress of initiatives, and to assure resources are appropriately targeted and that issues are addressed promptly. See also Recommendation O3.7

1. Background: At the last review, RSIC lacked an IT project governance process, guided by an overall business plan which would consider the needs and priorities of the organization. We recommended that the overall business plan should address which investment and support functions are best performed internally and which are better outsourced.
2. Assessment: The IT Steering Committee vets systems topics from staff from across the organization. Major decisions that are expected to significantly affect technology are presented to the ELT. It is good for the organization's communication and morale to have input from across the organization and react favorably.
3. Opportunities for further improvement: None identified.

IT4.1: RSIC should be authorized to procure investment systems under a modified procurement process that includes appropriate accountability.

1. Background: Procurement of needed systems has been a perennial problem for RSIC. RSIC has to work around imposed dollar limitations, approved vendor lists, and other constraints. The problem has persisted for decades. RSIC is a multi-billion global institutional investor yet it is viewed as state agency when it comes to technology procurement. The same issues raised in the 2014 fiduciary performance audit continue in this one. For example, a recent and lengthy procurement of the MS Dynamics CRM/ERP platform was initially denied because it had gone off state contract. RSIC was able to 'piggy-back' on another state agency contract in order to purchase it after much

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negotiation. MS Dynamics is a line of customer relationship management and enterprise resource planning tools from Microsoft Corporation.

2. Assessment of implementation progress: RSIC has made little progress in getting relief from the General Assembly despite best efforts. The General Assembly should recognize that RSIC is a major global institutional investor which needs the ability to procure systems as it deems necessary to support its investment operations.
3. Opportunities for further improvement: RSIC should engage with the General Assembly to seek authorization to procure investment systems under a modified procurement process that includes appropriate accountability (See also P5)

IT4.2: RSIC should continue to pursue the eventual move of IT support from PEBA to RSIC.

1. Background: The 2014 fiduciary performance audit recommended that RSIC pursue further direct control over IT support under the premise that RSIC and PEBA, which provided a significant amount of the support, have significant differences in their needs for the service to be provided rapidly in the event of an interruption.
2. Assessment of implementation progress: Under the guidance of a written project plan², RSIC created a separate domain and active directory, as well as transferred several office suite applications to cloud-based applications. PEBA continues to provide some IT management and support services. RSIC is continuing to evaluate bringing additional IT responsibilities in-house.
3. Opportunities for further improvement: None identified.

² Project Plan for RSIC Domain Separation. PEBA April 2017

H. Additional Observations and Recommendations

Delegation of Investment Manager Selection

One of the most significant changes RSIC implemented for its investment program was the recent delegation of investment decision-making to the CIO and staff. This policy was implemented late in 2017 and certain aspects are still evolving. In our experience, it is a leading practice for public pension boards to delegate external investment manager selection, as well as authority to manage selected internal investment portfolios, to an appropriately skilled and resourced investment staff.

This policy both allows the Board, which has limited time available for oversight of the retirement system, to spend sufficient time on the oversight of the overall investment strategy and other important matters. It also moves investment management decision-making responsibility into the hands of full-time investment professionals who have both the skills and time to adequately assess investment opportunities.

In order for a public pension board of trustees to continue to provide effective oversight of its investment program under this type of delegated investment authority, leading practice is to have strong capabilities in a number of areas which provide the appropriate assurance and independent reassurance that are necessary for the Board to exercise its fiduciary responsibilities. Leading practices include:

- A clearly-articulated investment policy statement (IPS) which identifies the board's investment beliefs and risk tolerance, investment allocation decisions, and related policies to be implemented;
- Transparency to the board of decision rationale for investments made by investment staff;
- An internal investment decision-making committee or group which provides a peer review of each investment opportunity and includes other key staff such as general counsel, compliance, and operational due diligence;
- Organizational checks and balances which provide effective controls and minimize the potential for single point of failure decision making;
- Effective investment risk management policies, procedures and reporting;
- An effective internal audit capability and process which monitors investment processes and controls;
- An effective investment compliance function which ensures investments remain within policy guidelines;
- A general investment consultant which is hired by the board, provides counsel to both the board and investment staff, and opines on investment staff decisions; and,
- Other external sources of independent reassurance to the board, for example, an investment consultant independent of staff, peer investment performance benchmarking, or fiduciary reviews.

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Assessment of the RSIC Policies and Practices for Delegated Investment Manager Selection

In general, RSIC already has most of the leading practice elements described above in place. The Statement of Investment Objectives and Policies (SIOP) includes a statement of investment beliefs, the investment allocation decisions, and the necessary policies for implementation. The Commission receives a report on delegated investments at each meeting.

The RSIC Internal Investment Committee (IIC), which has been in place for a number of years, has become more structured and disciplined, functions well as a peer review process, and is now a voting body. It includes a Tactical Asset Allocation Subcommittee and a Co-Investment Subcommittee to evaluate opportunities in each of those areas. The COO is a voting member of the IIC.

The functioning of the IIC as a peer review process provides a strong check and balance process, which is reinforced by the CEO having oversight for all investments and the authority to veto an investment.

Although RSIC has an investment risk management system and has a strong focus on risk, this is an area where improved tools could assist staff in preparing more effective risk analyses. Staff is currently evaluating new tools and may be making a decision in the near future. Several Commissioners commented that they would like to see a stronger focus on risk in their deliberations.

As mentioned elsewhere in this report, there has been significant turnover in the areas of independent reassurance – Internal Audit, Enterprise Risk Management, and Compliance – which have been combined into a single position supported by external resources. This is an area which needs significant improvement to support the good governance practices of the Commission. This should include an effective, functioning enterprise risk management program, a more robust and integrated internal audit program, and a compliance function which can reassure compliance in all key areas.

With the hiring of Meketa Investment Group by the Commission, it appears that this important element of independent reassurance is also functioning. The Commission should ensure that it has an ongoing dialogue with Meketa which includes a discussion of their expectations and feedback on Meketa's performance.

Finally, RSIC has at least two other sources on independent reassurance. First, CEM Benchmarking provides an annual benchmarking of investment performance and costs. Second, every four years the Office of the State Auditor will be commissioning this fiduciary performance audit.

Potential opportunities for improvement:

Using the leading practices framework for delegated investment manager selection as described above, we make the following recommendations for effectively implementing the policy:

1. Refine the investment beliefs statement and develop a companion statement which describes the Commission's risk tolerance.
2. Continue to pursue acquisition of a new investment risk management system and capability to improve fund risk reporting to the Commission.

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3. Improve the overall internal independent reassurance capabilities by focusing on development of Internal Audit, Enterprise Risk Management and Compliance; as these all report to the AERMC, the Commission should be involved in providing guidance and authorizing appropriate resources.
4. The Commission should ensure it has effective ongoing dialogue with Meketa and clearly articulates its expectations.

These recommendations are already identified earlier in the report.

Appendix 1 – Enterprise Risk Management (ERM), Internal Audit and Compliance

Background and Observations

The current situation should be seen in the context of RSIC's progress since our last review. As noted throughout this report, the South Carolina General Assembly and RSIC have made significant progress in implementing almost every one of our prior recommendations including, for example: legislative; governance; continuity of leadership; investment management functions and HR.

The ERM, IA and Compliance functions provide an important source of internal independent reassurance to the senior executive, the AERMC, the Commission and their key stakeholders. Internal independent reassurance is provided by those who are independent of management in that they report directly to the Commission (not through the CEO) about the reliability of management's reports and assurances. There are also external sources of reassurance such as the external auditor and fiduciary performance audits (such as this report) commissioned by the Office of the State Auditor.

Compliance conversations are frequent between executive leadership team. Until the Director's recent departure there were regular compliance conversations between legal and compliance. These are ongoing. Internal legal counsel is considered to be a great resource.

There is strong tone at the top. The CEO has made it clear that non-compliance is unacceptable and frequently checks in with Compliance. Compliance topics also get time as needed at Business IIC or Investment IIC to cover topics. The CIO also recognizes the importance of compliance. A compliance update was recently provided to the AERMC although this focused on processes rather than outcomes. More detailed discussions also happen as needed (e.g. when reviewing the results of annual manager compliance questionnaire).

Risk discussions are an almost constant occurrence at the agency between key staff and, as needed, Commissioners. However, there is no systematic way to understand and manage risks across the enterprise. RSIC was planning to implement an ERM program in 2014. Our recommendations, at that time, reinforced the proposed direction and emphasized its importance and rapid implementation, i.e., by July 2014. Unfortunately, ERM is one of the few functions within the control of RSIC where not much progress has been made.

This lack of progress may be attributed to several possible factors:

1. Frequent changes in leadership of the function;
2. Competing priorities in a single person's responsibilities;
3. The complexity of COSO as an ERM framework and its potential irrelevance to operating management;
4. Lack of buy-in from risk owners as to the value of ERM;
5. A perception that the Director of ERM is responsible for ERM rather than supporting and enabling it.

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1. Frequent changes in the leadership of the function.

There have been three directors in four years with intervening gaps. A new director was hired in February 2015 and began the rollout of the function. The Audit and Enterprise Risk Management Committee (AERMC) received information as early as May 2015 and October 2015 concerning ERM risk reporting. The second director left in February 2016 and the position was left unfilled until the third and most recent director was hired in October 2017. The third director had planned to present a timeline and roadmap to the AERMC in October 2018. However, in late June, he announced he would be leaving effective July 13, 2018. Although RSIC is currently recruiting, the position remains vacant at the time of this report.

2. Competing priorities of the director due to the competing job responsibilities of Internal Audit and Compliance as well as special project assignments such as the coordination of this fiduciary performance audit.

Even though the IA function is outsourced (see IA section of this report), when combined with Compliance responsibilities and special projects, ERM seems to always take the lowest priority. This needs to change.

3. Potential confusion over the most appropriate risk taxonomy for RSIC to use and its choice of the COSO ERM framework.

We reviewed a draft risk taxonomy provided by the then ERM Director dated July 28, 2015. To our knowledge, this framework has not been reviewed or embraced by RSIC. It identified 13 major risk types with 45 sub-risks. It provides definitions, identifies potential owners, an overlay of IA's coverage and a framework for ranking inherent and residual risk. It does not, however, directly relate to RSIC's investment function business model. The risk taxonomy is both comprehensive and complex. It is typical of many risk taxonomies conventionally used for ERM.

Each of the prior RSIC ERM Directors has adopted the Committee of Sponsoring Organizations of the Treadway Commission (COSO) ERM framework. This too is a prevalent practice and the most recent COSO iteration was in 2017.

However, COSO itself, while it has many useful elements, can often be a source of confusion and delay due to its complexity and emphasis on process rather than outcomes. Its complexity can contribute to perceptions of irrelevance and cumbersomeness by those directly responsible for managing performance and risk. In addition, assessments are often of individual risks rather than how they might interact and estimates of inherent and residual risk are often subjective. There is also a tendency to factor in likelihood in estimating residual risk.

The combination of these factors: complexity; process emphasis; isolated risk focus; and, subjective assessments of impact and likelihood; can often result in the systematic under and over-estimation of exposures and the mis-allocation of resources. COSO has recently recognized these limitations in its most recent work with the World Business Council for Sustainable Development.³ FAS is a member of the Advisory Committee to these bodies. Although making specific reference to Environment, Social and Governance (ESG) Risks, the draft states "Although impact and likelihood are common criteria for risk

³ Enterprise Risk Management. Applying enterprise risk management to environmental, social and governance-related risks. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) and the World Council for Sustainable Business Development. 2018. Preliminary Draft

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prioritization, relying on these attributes alone can result in an inaccurate assessment or prioritization of (ESG-related) risks...Risk assessments also tend to be affected by organizational biases that exist when assessing and prioritizing risks." We strongly agree.

They also cite a study by PWC⁴ that states (note we have deleted specific reference to ESG-related risks because we believe it has broader applicability):

- "Risks can be more unpredictable and manifest over a longer and often uncertain timeframe.
- Assessment of risk is often based on historical data. For risks, particularly those that are new or emerging, it can be difficult to find historical precedence to estimate the risk impact.
- Some risks are macro, multi-faceted, interconnected and can affect the business on many dimensions.
- Risks may be outside a company's control. Responding to a risk may rely on the actions of other parties or may require coordinated efforts."⁵

4. Lack of buy-in from risk owners as to the value of the ERM process

- Irrelevance / lack of results / time taken
- Complexity / Subjectivity
- Accountability

Perceptions of irrelevance are compounded by the lack of a direct linkage in COSO between the risk taxonomy and the value creation and value protection processes in any organization's business model. A business model describes how an organization will create, deliver and capture value for its stakeholders and in RSIC's case, its participants and beneficiaries (both current and future). Questions about utility are compounded by the lack of progress.

Those accustomed to more quantitative risks assessments, i.e., investments, are rightly skeptical. This is not to suggest that quantitative risk assessments are without fault or not prone to extreme variation. If executive owners are held directly accountable for performance and risk, they are much more likely to embrace the value of a more systematic approach.

5. A perception that the Director of ERM is responsible for ERM rather than supporting and enabling it.

Internal RSIC functions such as ERM, Compliance and IA report directly to the Commission and not through operating management. Calling the function ERM is potentially misleading. Their role is to provide independent reassurance of the reliability of management's reports and assurances and to support and enable improved risk management. Performance and risk management is the responsibility of operating management.

⁴ Resilience: A journal of strategy and risk. PWC

⁵ Borsa, L., Frank, P., Doran, H. (2014). How can resilience prepare companies for environmental and social change? Retrieved from PwC: <https://www.pwc.com/gx/en/governance-risk-compliance-consulting-services/resilience/publications/pdfs/resilience-social.pdf>

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ERM Implementation Roadmap

Because of RSIC’s lack of progress, we have developed a set of recommendations which prescribe an approach to the rapid and effective deployment of ERM throughout the organization. The remainder of this section of our report provides specific recommendations (**highlighted in bold**) as a roadmap to expedite implementation of a process to support RSIC’s essential responsibility to create and protect value for its participants and beneficiaries. It is organized in the following manner:

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Step 1: Define RSIC’s Investment Function Business Model

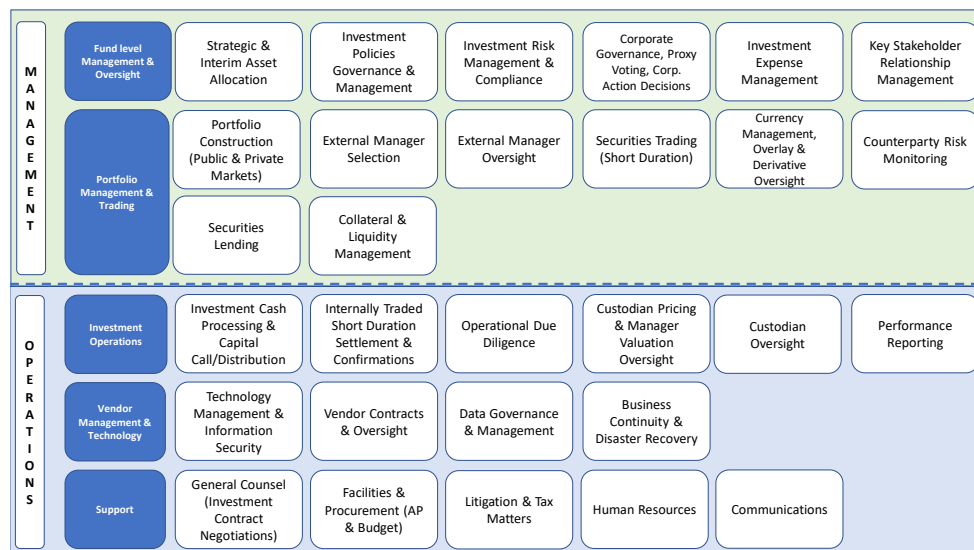
In an investment organization such as RSIC, value creation and value protection are accomplished through its Investment Management and Investment Operations functions. Intelligent risks must be taken to create value and intelligent measures put in place to protect value. Some risks hold the potential for reward while others, such as operational risk do not.

Investment Management functions need Investment Operations to support and sustain the investment process. Investment operations functions include finance, HR, technology, legal, risk and compliance. It is a symbiotic and mutually dependent relationship. Performance is clearly the responsibility of executive management and all staff and so is risk management. When risk is decoupled from performance, it becomes irrelevant. For risk management to be relevant, it must be directly linked to performance.

Tying operational risks to specific investment and operations functions would address both relevance and potential problems of evaluating individual risks in isolation. The use of key performance indicators (KPIs) and key risk indicators (KRIs) would increase transparency of performance and accountability. RSIC’s business model could become the basis for a performance and risk dashboard directly tied to the business. This would clearly and immediately demonstrate its relevance.

FAS has worked with RSIC senior management to develop a customized investment function business model to describe its Investment Management and Investment Operations (see Figure 1 below). The investment function business model describes (at a high level) RSIC’s investment management and investment operations functions. A clearly defined business model should provide the basis for RSIC’s performance and risk analysis. It would create top-down and bottom-up assessments and alignment, i.e., enterprise-wide and enterprise-deep.

Figure 1. Example Investment Function Business Model⁶



⁶ Adapted from “One of a Kind! A Practical Guide for 21st Century Public Pension Trustees”. 2017. Funston Advisory Services LLC. See Chapter 25 “Understanding Investment Operations” by Lance Ihinger and Shankar Subramanian. Cutter Associates.

Step 2: Verify / Assign Executive Owners

The CEO has overall responsibility and is the ‘de facto’ chief risk officer. The CEO should verify and/or assign executive owners for each investment management and operations function and cross-function. This would include responsibility for all related processes and sub-processes in RSIC’s business model.

Executive ownership should be consistent with RSIC’s organizational structure and delegated authorities. In some cases, there will be cross-functional responsibilities with PEBA and other state agencies. Operating management has the primary responsibility for performance and risk and for providing reasonable assurances to the AERMC and the Commission that risk exposures are tolerable and within policy limits.

- **The CEO should assign primary executive ownership for each function’s performance and risk.**

Figure 2. Primary Executive Ownership

Type of Performance and Risk	Primary Executive Ownership
1. Investment	The Chief Investment Officer
2. Operations	The Chief Operating Officer
3. Stakeholder	The Chief Executive Officer (who is, de facto, the Chief Risk Officer)

Executive owners are primarily responsible for ensuring their people, processes and systems are capable of the expected performance. This includes managing factors that may contribute to unwanted / unacceptable performance.

- **Executive owners should assign and delegate specific responsibilities to other executives and staff and hold them accountable for performance and risk (functional and cross-functional).**
- **Criteria should be developed for the escalation of exceptional performance (good and poor) to the CEO, the AERMC and Commission.**
 - The emphasis in such reports should be on exceptions in expected performance, clarity and insights vs. complexity.
 - The clarity, insightfulness, timeliness and reliability of management’s assertions about performance and risk should be part of executive evaluations.
 - Metrics should be developed to form a basis for this component of evaluation.
- **Executive owners should be responsible for reporting exposures and vulnerabilities to RSIC’s AERMC and, as needed, to the Commission as a whole.**
- **The AERMC should require regular reports on exceptional performance (risk exposures) and, as needed, mitigation plans (not just program development activities). Independent reassurance about the reliability of management’s reports and assurances is essential.**

Step 3: Assess Performance and Risk

- **The AERMC should require executive owners to provide reasonable assurances that performance and risk are within expected limits and, if not, to provide corrective actions and a time frame for reporting back.**

Operating management has the primary responsibility for performance and risk and for providing reasonable assurances to the AERMC and the Commission that risk exposures are tolerable and within policy limits. These assurances will necessarily be qualitative initially. As described below, this should rapidly shift to a quantitative assessment as metrics are put in place.

- **RSIC's KPIs and KRIs should be mapped to each process within the business model by asset class and investment operations and aggregated by ERM to the enterprise-level.** See later discussion of KPIs and KRIs.

The ERM Director had recently solicited feedback from managers about their risk concerns. Investment risk assessments are typically quantitative and measure variance from expected performance. Traditionally, operational risk assessments and COSO-based risk assessments often rely on qualitative assessments of impact and probability. As noted earlier, such qualitative assessments are subject to inevitable biases that may systemically over or underestimate risk exposure.

- **Like investment risk, RSIC's approach to operational risk should be more quantitative in measuring variation in expected performance. (Investment risk is addressed under investment operations.)**

Obviously, quantitative assessment is not a panacea. There will still be issues of unexpected variability in investments and understanding of total portfolio and correlation risk. A quantitative assessment doesn't eliminate risk but it does help to reduce bias.

Assessments of the acceptability of risk exposures are inevitably subjective but should be informed by quantitative metrics to the extent practical.

We define risk as the potential for loss, harm or missed opportunity.⁷ RSIC has made some progress in the development of a draft risk taxonomy but this has not been well communicated to the rest of the organization. At present, the draft risk taxonomy is disconnected from RSIC's business model and its actual performance.

- **RSIC should adopt a performance and risk taxonomy that describes its primary risk types in direct relation to its investment function business model.**

In our opinion, RSIC has five primary types of performance and risk:

1. Strategic – risk that the investment business model may become outdated and the income generated by investment is insufficient over the long-term.
2. Investment – the risk of losses relative to the expected return of an investment.

⁷ "Surviving and Thriving in Uncertainty: Creating the Risk Intelligent Enterprise" Funston and Wagner, 2010, Wiley & Sons.

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3. Operational – the risk of unwanted variability in performance caused by people, processes, systems or external factors including cyber risk.
4. Business Continuity – the inability to prevent, detect or correct business outages within established recovery limits
5. Reputation – risk that may result in loss of key stakeholders’ confidence (including beneficiaries) and, for example, may have adverse impacts on reputation, legislation and public perceptions, the ability to recruit and retain personnel and the ability to function effectively as an organization.

Match the tool with the risk

All risk assessment tools have different strengths and weaknesses. None are perfect. Conventionally, impact and likelihood have been used to assess risks regardless of the type of risk. Global reinsurer Swiss Re: states: “Predictions about the likelihood of multi-causal losses actually depend on either sound understanding of cause-and-effect relationships or on a detailed loss-history and the risks of the future have neither of the two.”⁸ Subjective probabilistic analyses are inevitably biased and may result in the over- or under-estimation of opportunity or exposure.

Risk assessment tools and methods need to be matched to the type of risk. Some risks (i.e., those with established cause-effect relationships and supported by large bodies of data) are more amenable to a conventional analysis. Others are not. As noted earlier, although impact and likelihood are common criteria for risk prioritization, relying on these attributes alone can result in an inaccurate assessment or prioritization of risks. The table below attempts to provide some examples of matching assessment tools to the type of risk.⁹

⁸ Porro, Bruno and Schaad, Werner, “The Risk Landscape of the Future,” Swiss Re, 2004.

⁹ “Matching risk assessment tools to specific risks”. Funston Advisory Services LLC, 2018. Submission to the COSO and WBCSD Committee on COSO ERM and ESG.

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Risk and Tool Examples			
Performance (Effect / Risk)	Risk	Causes	Assessment Tools for Signal Detection and Pattern Recognition
Strategic	Failure to anticipate or adapt policy direction and business model in a rapidly changing environment	<ul style="list-style-type: none"> • Governance risk • Products / Services risk • Business model risk • Competitive risk • Environmental risk • Social / stakeholder risk • Geo / Political risk • Legislative / regulatory risk 	<ul style="list-style-type: none"> • Adaptability and critical assumptions challenges • Environmental scanning • Competitive analyses • Geo-political assessments • Stakeholder assessments
Investment	Unacceptable differences between actual and expected investment performance	<ul style="list-style-type: none"> • Market risk • Credit risk • Counterparty risk • Interest rate risk • Equity risk • Inflation risk • Liquidity risk • Currency risk • Systemic risk • Model risk 	<ul style="list-style-type: none"> • Probabilistic / stochastic analyses (estimates of future impact and likelihood) e.g., Monte Carlo simulations, stress tests, scenario analyses, VaR • Volatility / Velocity
Operational	Unacceptable differences between actual and expected operational performance, e.g., product / service quality, ethics, stability, training, morale, due diligence, fraud, cyber	Inadequate or failed internal factors: <ul style="list-style-type: none"> • People / Organization risk • Policy / Process risk • Systems / Cyber Protection risk • Information / Intelligence risk 	<ul style="list-style-type: none"> • Statistical process control using upper and lower limits • Severity, frequency and duration • Root Cause Analysis (RCA) • Failure Modes and Effects Analysis (FMEA)
		External Factors: <ul style="list-style-type: none"> • Legal risk 	<ul style="list-style-type: none"> • Environmental scanning • Threats and Vulnerabilities
Business continuity	Inability to prevent, detect or correct business outages within established recovery limits	Independent of cause: <ul style="list-style-type: none"> • Natural disaster <ul style="list-style-type: none"> ○ Ice storm ○ Hurricane ○ Flood ○ Tornado ○ Earthquake ○ Mudslides ○ Fires • Power outage • Supplier failure • Terrorism • Criminal acts 	<ul style="list-style-type: none"> • Probabilistic analyses • Threats / Vulnerabilities / Resilience • Maximum allowable outages • Critical dependency analyses e.g., Supplier-Input-Process-Output-Customer (S-I-P-O-C)
Reputational	Unacceptable differences between how an organization wants and needs to be perceived and how it is actually perceived	A consequence of failure to manage other risks	<ul style="list-style-type: none"> • Multi-media monitoring • Stakeholder engagement / surveys

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The remainder of our observations focus primarily on operational performance and risk. Investment risk is addressed separately under Investment Management.

- **Sub-types of risk should be defined for each primary risk type and mapped to each of the investment business functions.**

Operational risk sub-types can include unwanted/unacceptable variability in performance, for example:

- Compliance with laws, regulations, policies and contracts
- Vendor provider performance and compliance
- Cash management
- Trade settlement
- Transaction processing
- Asset reconciliation
- Financial reporting
- Valuation
- Performance measurement
- Data integrity
- Security – network/system, physical, information
- HR Recruitment, retention, training / development / succession planning
- Business continuity: facilities, communications, data / system / process recovery
- Legal: contract development, advice, litigation

Lack of effective operational controls can result in unwanted performance variability, fraud or misconduct.

- **The performance and risk framework should provide a standard set of terms and definitions, be updated annually and include vendor performance and compliance.**
- **The performance and risk framework should be directly tied to RSIC's investment function business model.**

Similar to investment risk, limits for acceptable vs. unacceptable variability should be established by the respective risk owners with concurrence from the CEO and the Director of ERM (if the position is continued). These operational limits should be shared with the AERMC and where appropriate the entire Commission.

Abnormal performance is performance that is approaching or exceeds expected variability in performance. Subjective assessments of inherent and residual risk should be avoided due to inevitable biases that may result in over- or under-estimation of exposure.

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- **RSIC could use its investment function business model as a dashboard to show performance and risk. The macro processes could be coded, for example:**
 - **Green**
 - **Yellow**
 - **Red**

- **Metrics and thresholds should be established for each of the above, i.e., green, yellow, red. This is described further below.**

- **Executive owners should be assigned clear responsibility and accountability for risk identification and assessment, management and reporting.**

Step 4: Define / Refine Key Performance and Key Risk Indicators

- RSIC should identify key performance indicators (KPIs) for each core process and acceptable ranges of variation between expected and actual performance as key risk indicators (KRIs). This would practically establish risk tolerances.

Figure 3. KPIs / KRIs and Risk Tolerance

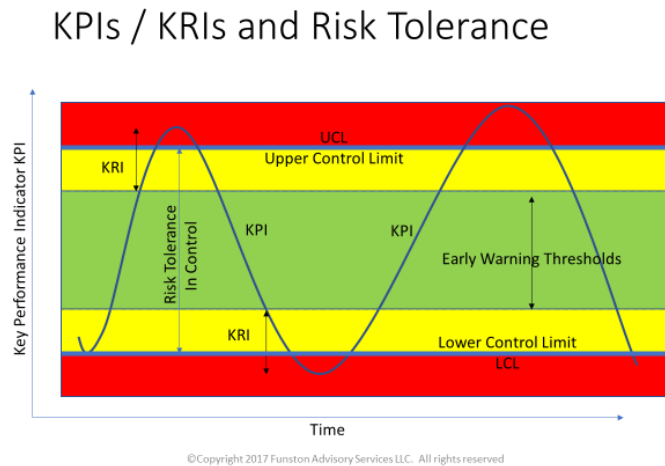
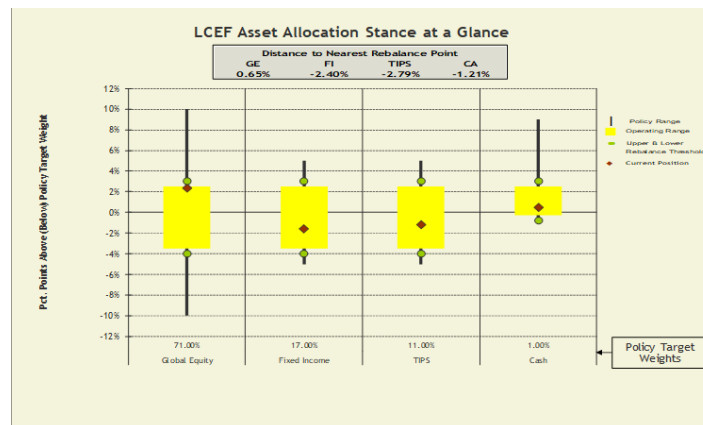


Figure 3 above depicts a KPI and the range of variability in performance (risk tolerance) that would be considered acceptable, i.e., in the green zone. Before the KPI goes beyond the range of acceptability (the upper or lower control limits), it should trigger an alert or early warning KRI (i.e., yellow zone) although the Upper and Lower Control limits may not always apply. There will also be external KRIs that should be tracked.

The example in Figure 4 below illustrates how Florida State Board of Administration, tracks one type of investment risk using KPIs and KRIs. A rebalancing report to the Senior Leadership Group describes the policy range, the operating range, upper and lower rebalance thresholds and current position. It does not ask for opinions about the inherent or residual likelihood of being out of balance.

Figure 4. Example Rebalancing Report



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- **RSIC should identify strategic goals and capabilities required for the future and reflect those in its business model. Resources could then be more strategically aligned with performance improvement and risk mitigation priorities.**

- **RSIC should establish a set of enterprise risk and control policies that are comprehensive, regularly reviewed and easily accessible based on its KPIs and KRIs.**

Figure 5. Example KPIs and KRIs

Example Investment Function	Example Performance / Risk Indicators
Collateral Management	<ul style="list-style-type: none"> • Timely periodic trustee review of collateral policies and practices • Timely reports of collateral policy compliance & remedial measures taken • No unresolved exceptions • Evidence of escalation of collateral issues • Annual or other periodic review of collateral practices • Annual or other periodic staff training in collateral management issues • Annual/periodic Custodian review with CIO • Assigned staff member, properly trained, in position • Collateral credit quality reviewed more intensely by CIO or deputy during capital markets stress periods • Internal and independent audits completed as scheduled
Corporate Action Processing	<ul style="list-style-type: none"> • Policy documented and current • Procedures documented and reviewed by staff semi-annually • Staff trained and in position • Staff reporting to CIO is timely and complete • Exceptions reported to proper oversight authorities and corrective measures documented & reported per policy
Data Governance and Management	<ul style="list-style-type: none"> • Updated investment data governance plan reviewed by staff at least semi-annually • Board oversight report presented timely and issues identified • Timely periodic Independent review of data management processes and reports • Annual/periodic staff training in investment data management • Data management addressed in internal audit plan
Stakeholder Relations & Communications	<ul style="list-style-type: none"> • Timely engagement and regular reporting to: stakeholders, media, etc. -CAFR, other special investment reports • Annual (communications) satisfaction survey of key stakeholders • Periodic plan participant survey or focus group • Timely scheduled meetings with plan sponsor(s), labor, beneficiaries, etc. • Periodic peer professional reviews of investment communications • (Gold Star) Recent professional awards for investment communication

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- **KPIs should be used to drive performance and risk management**
- **The RSIC investment function business model graphic (Refer to recommendation in Step 1) can be used as a dashboard to show normal, cautionary and abnormal performance, e.g., green, yellow or red.**

While it is to be expected that metrics may not initially be readily available for each aspect of performance, these can and should be developed and continually refined over time. Subjective assessments may be necessary until quantitative metrics can be used reliably. However, quantitative assessments will help to better inform judgments about exposures. The refresh cycle on metrics should be identified and understood taking into account the volatility of the performance metric.

Step 5: Manage Performance and Risk

As stated earlier, it is the responsibility of operating management to manage both performance and risk to expected performance. Investment Management is currently examining the utility of tools such as BarraOne. This is dealt with separately in the Investment section of this report.

- Investment Operations should consider the use of tools such as Root Cause Analysis (RCA) after a risk event and Failure Modes and Effects Analysis (FMEA) in advance of an event.

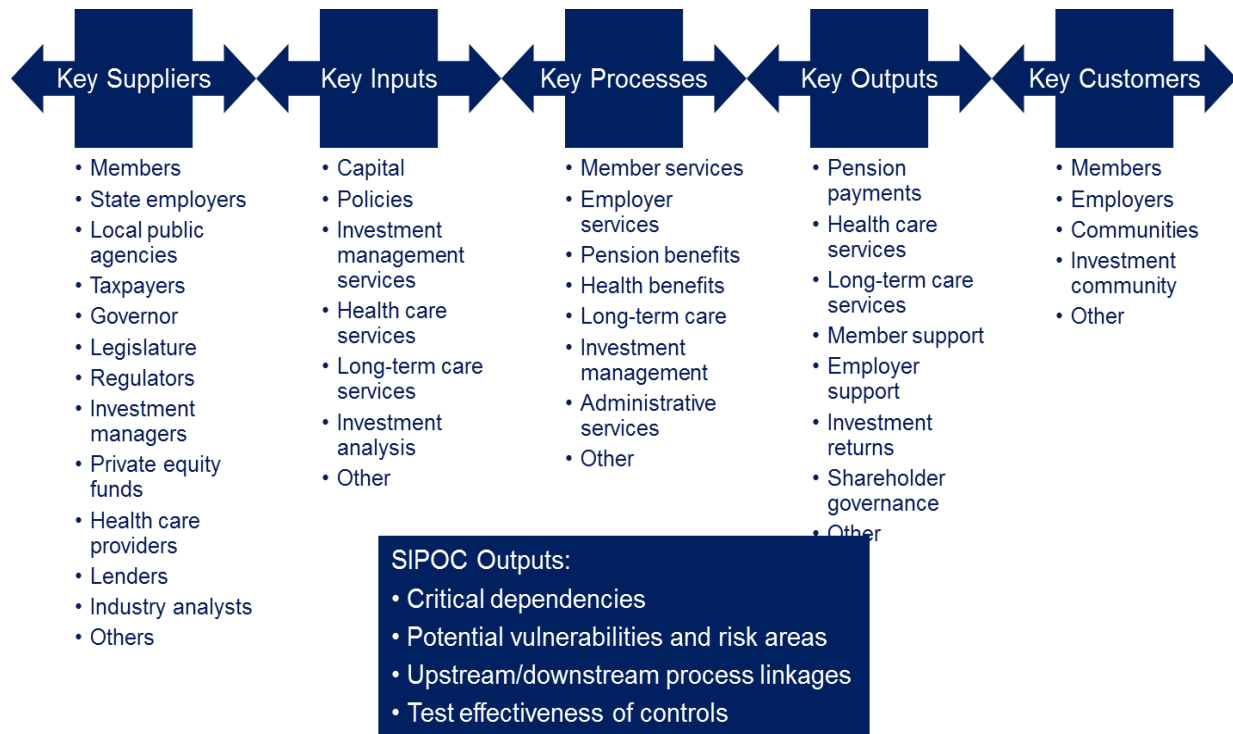
Figure 6. Example RCA/FMEA chart



- RSIC should consider use of quality improvement tools such as Supplier-Input-Process-Output-Customer (SIPOC) as well as inclusion of specific downstream impacts in job descriptions and related training.

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Figure 7. Example SIPOC chart ¹⁰



¹⁰ ©Copyright 2013. All rights reserved. Funston Advisory Services LLC

Step 6: Monitor and Report Performance and Risk

- Key performance and risk metrics should be managed by exception, i.e., if it goes beyond established risk tolerances.
 1. Green – should be managed by consent (if everyone agrees it is green and subject to later independent verification of controls and reassurance of operating effectiveness by IA and others.
 2. The risk owner should be responsible for leading the discussion of red/yellow key performance and risks indicators to address the following questions.
 - i. Is the exposure / variation acceptable? How quickly can the situation deteriorate?
 - ii. If not acceptable, what is the target and corrective action required?
 - iii. By whom? Cross-functional support?
 - iv. By when?
- Performance and risks which exceed tolerances (positive/negative) should be escalated to the Executive, the AERMC and the Commission, as required.
- Escalation criteria and an escalation process should be clearly defined.
- The Performance and Risk Owner should explain the reasons for the exception and the action being taken.

Step 7: Define / Refine Risk Appetite and Tolerances

Risk appetite is a statement of the amount and type of risk an organization is willing to accept to meet its objectives.

- **RSIC should establish statements of risk appetite for each of the primary types and sub-types of risk.**

Risk appetite statements should address RSIC's:

- willingness to accept uncertainty
 - the choices available
 - the trade-offs it is willing to accept
- **The AERMC should review and the Commission should approve overall risk appetite statements and risk tolerance based on the type of risk.**

Figure 8. Example Risk Appetite Statement¹¹

Rating	Risk Taking Philosophy	Tolerance for Uncertainty	Choice	Trade-off
		<i>How willing are you to accept uncertain outcomes?</i>	<i>When faced with multiple options, how willing are you to select an option that puts this objective at risk?</i>	<i>How willing are you to trade-off this objective against the achievement of another objective?</i>
Averse	Close to zero tolerance	Unwilling	Will always accept the lowest risk option	Never
Cautious	Accept uncertainty when it can be carefully measured and monitored?	Limited	Will accept if limited, with favorable risk-reward scenario	Prefer to avoid
Flexible	Open to intelligent risk taking	Fully willing	Will choose option with highest benefit and accept possibility of failure	Willing

¹¹ CalPERS Enterprise Risk Management Division

Roles and Responsibilities

Incident Management

- Senior management should consider the formation of an incident management team to oversee and coordinate RSIC’s preparedness, response and management of an emergency incident.

This would include:

- Incident Management Planning (includes breach of Cyber Security)
- Business Continuity Planning
- Emergency Management Planning
- Disaster Recovery Planning

Figure 9. Example Incident Management Responsibilities¹²

Incident Management Planning	Coordinates and Leads Response Crisis Communications Activates BC and DR Plans Ensure Business Continuity
Business Continuity Planning	Business processes Alternate Sites Business Impact Analysis Define RTOs and RPOs
Emergency Management Planning	Life safety planning Crisis leaders / crisis managers Emergency response Ensure life safety
Disaster Recovery Planning	Technology recovery Infrastructure and Systems Alternate Data Center Site Failover testing

¹² Florida SBA Incident Management Framework

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Role of the AERMC

From charter:

The Purpose of the Committee.

The Commission has established an Audit and Enterprise Risk Management Committee to oversee the audit, enterprise risk management, and compliance functions, as well as the internal control environment and any engagements with external audit firms.

Its Primary Responsibilities include:

(A) Overseeing the audit, enterprise risk management, compliance and control activities of the RSIC, including without limitation the development and execution by management of strategies to mitigate risks.

(B) Overseeing the risk assessment process conducted by the Enterprise Risk Management and Audit functions.

(C) Approving, periodically, the audit plans of the Audit function.

(D) Assessing and providing oversight to Management relating to the identification and evaluation, of major strategic, operational, regulatory, information and external risks inherent in the business of the RSIC (the "Risks") and the control processes with respect to such risks.

(E) Reviewing, periodically, the findings of audits and approving any necessary follow up items or recommendations to be conducted by auditors.

(F) Monitoring the implementation of any approved follow up items or recommendations.

(G) Overseeing the process for monitoring compliance with the RSIC policies and applicable laws, including but not limited to: ethics requirements and standards of conduct

VI. Authority

(D) Appoint (or dismiss), compensate, and oversee the work of the Audit and Enterprise Risk Management Staff in accordance with the RSIC's personnel policies and applicable state law, and oversee the work of the Audit, Enterprise Risk Management, and Compliance functions.

VII. Detailed Listing of Responsibilities:

The Committee will carry out the following responsibilities:

(A) Internal Control Function. Oversee the policy and framework for an effective system of internal controls and provide the mechanisms for periodic assessment of the system of internal controls.

(B) Staff Functions

(1) Assure and maintain the independence of the audit process. The Audit and Enterprise Risk Management Staff ("A & ERM Staff") will report to the Audit and Enterprise Risk Management Committee. For administrative purposes, such as approving leave requests, the A & ERM Staff will report to the Chief Executive Officer ("CEO") (dotted line). The CEO will also provide oversight related to internal staff matters

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and otherwise to the extent that such oversight will not interfere with the independence of the A & ERM Staff.

(2) The Committee will evaluate the performance of the A & ERM Staff at least annually. The Committee may confer with the CEO and other members of Management as deemed appropriate by the Committee. Discussions regarding the performance of the A & ERM Staff may be held in executive session in accordance with state law.

(D) Enterprise Risk Management and Compliance Functions

(1) Assure competency and objectivity in the enterprise risk management process.

(2) Review and evaluate Management's identification of all major Risks to the business and their relative weight;

(3) Assess the adequacy of Management's Risk assessment, its plan for Risk control or mitigation, and disclosure;

(4) Review and evaluate Management's development and execution of certain risk mitigation strategies and opportunities proposed by Management and selected by the Committee for further review; and

(5) Review, assess and discuss with the RSIC Legal, the Chief Executive Officer and the A & ERM Staff: (i) any significant enterprise risks or exposures, (ii) the steps management has taken to minimize such enterprise risks or exposures; and (iii) the RSIC's underlying policies with respect to risk assessment and enterprise risk management.

(6) Provide the policy and framework for compliance with applicable law and provide the mechanisms for periodic assessment of compliance, including compliance by named and other service providers, consultants, and investment managers.

(7) Review the findings of any examinations by regulatory agencies and any auditor observations.

(8) Review the process for communicating applicable ethics requirements and standards of conduct to the Commission and the RSIC staff, and for monitoring compliance therewith.

(9) Obtain regular updates from Management, the A & ERM Staff, and/or legal counsel regarding compliance matters.

Observations

The current charter of the AERMC was last revised on April 12, 2018. The charter is appropriate and well-crafted. Unfortunately, given the lack of progress in implementing ERM, the AERMC does not appear to be fulfilling the ERM aspects of its charter.

- **The charter of the AERMC should be re-evaluated if there is no demonstrable progress on ERM in the near future.**

Role of the ERM function

ERM's role is to support and enable function owners develop an effective and harmonized approach to performance and risk management but not to manage risks. Its role in independent reassurance is to opine on whether there are capable, people, processes and systems in place to manage performance and risk within established limits. If not, its role is to escalate concerns to the AERMC and, as needed, the entire Commission.

Where are the risks? A key role is to help establish common risk identification, assessment, and management methods and aggregate risk exposures. The goal is to enable effective oversight and timely course correction. An important role of ERM is also to act in an independent capacity to opine on the reliability of management's assessments of exposure and the effectiveness of its risk responses.

Its role is also to support the development of capable people, processes and systems and to help embed risk management as a fundamental part of everyone's job – enterprise-wide and enterprise-deep. Like quality, risk management should be built in not bolted on.

- **RSIC should clarify that the ERM function is a risk management support and enabling function not a risk management function.**
- **ERM should develop and deploy an annual training program for all staff to emphasize the important role everyone plays in performance and risk management. It's everyone's job.**
- **In conjunction with HR, ERM should develop and deploy a culture and control environment survey to heighten awareness and to identify areas for improvement.**
- **ERM should support the deployment of tools such as RCA, FMEA and SIPOC to improve risk identification and management.**

Tracking Progress

Typically, a great deal of time is spent by management and a board in tracking progress on implementation of the ERM process rather than focusing on performance and risk especially when implementing a COSO style model. This further contributes to perceptions of irrelevance and undermines risk management efforts.

Instead, the focus of the RSIC executive team and Commissioners should be directly on performance and risk beginning with the identification of those responsible for performance and risk and their assessments of the current exposures facing RSIC. The ERM process is simply a means to enable that focus. It is not an end in and of itself. The process will mature over time and laser-like focus on performance and risk will produce a better process.

- **The executive team should regularly review performance and risk with the AERMC and the Commission and seek feedback on how insights and risk intelligence for decision-making can be improved.**

Independent Reassurance: The role of Internal Audit (IA) and Compliance

Operating Management has the primary responsibility for providing reasonable but not absolute assurances to the Commission that core processes are performing as expected and within policy tolerances unless otherwise noted.

Parties independent of management, e.g., internal audit and third parties such as external audit and specialist auditors and consultants, should provide independent reassurance that management's reports are reliable. AERMC and the Commission can be seen to have prudently delegated authority to the CEO if they have such independent reassurance. In this way, management's reporting to the Commission can focus on exceptions (either good or bad) and the Commission and its Committees are freed up to focus on the strategic policy agenda.

Independent reassurance should focus on those business processes that pose the highest inherent risk to the organization and where there is the greatest reliance on controls to mitigate those risks. In this way, both management and the Commission can be independently reasonably reassured that the controls they are counting on to protect the organization are working as expected.

As noted earlier, there are currently three internal independent sources of reassurance: ERM, IA and Compliance.

If ERM moves to a function/process centric model, alignment with IA resources and processes will be made much easier. Because the Director of ERM is also the Head of Internal Audit and Compliance, there should also be easy alignment of Internal Audit resources, especially given its model of outsourcing and the ability to retain specialist resources.

The focus of IA should be on areas with the highest inherent risk, i.e., risk before mitigation. Where is value created? Where can value be destroyed? Are the controls that management relies upon effective and efficient? Can management's assurances about performance and risk exposure be reasonably relied upon by the AERMC and the Commission? Are there exceptions that need to be escalated?

Compliance is typically responsible for monitoring but not managing RSIC's compliance in three areas: statutory, policy and contractual. The role of Compliance is also to escalate exceptions to the executive, AERMC and, as needed, the entire Commission.

Given that IA and Compliance both report directly to the AEMC and the Commission, concerns about performance and risk can be readily escalated.

- **The Director of the ERM, IA and Compliance functions should be re-titled as Chief Reassurance Officer to recognize the independent and important nature of the function.**

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Appendix 2 – Implementation Priorities

FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
B. Governance					
G5.1: RSIC should continue to engage over time with the General Assembly to seek delegated budget and personnel resourcing authority to RSIC that is commensurate with what is needed to meet RSIC’s fiduciary obligations. This ongoing advocacy should emphasize accountability for delegated authority through continued maintenance of oversight monitoring and periodic independent expert fiduciary reviews to evaluate how that the authority is being exercised.	Critical	Difficult	No	Yes	General Assembly
G7: It would be useful to write a “lessons learned” memorandum analyzing what circumstances, abilities, resources, governance structures, and economics need to be present for a successful strategic partnership so as to memorialize the learnings for future generations of RSIC staff.	Necessary	Easy	No	No	
G9: Close attention should be given to the timely appointment of successor Commissioners when terms expire.	Critical	Difficult	No	Yes	Appointing authorities
G10.1: The investment beliefs should be revisited periodically (every 3-5 years, coterminous with the asset allocation study periodicity recommended in 12) or as required by new knowledge.	Important	Medium	Yes	No	
G10.2: The Commission approved a plan to improve the SIOP and AIP adoption process at its June 2018 meeting, which should improve the efficiency and logic of the process. Integrating an annual calendar of asset class presentations into that process should increase the robustness of the Commission’s oversight and ability to provide strategic guidance.	Important	Easy	Yes	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
G12.1: RSIC should develop a long-term (e.g., 3-5 years) strategic policy agenda which includes decisions which are reserved for the Commission to make. The policy agenda should provide a framework for bringing key issues to the Commission and for planning Commissioner education in advance of addressing those issues.	Important	Medium	Yes	No	
G12.3: The Commission self-assessment processes could be improved by improving Commissioner engagement and ensuring more systematic follow-up on opportunities for improvement. The Commission should also consider use of an experienced external facilitator.	Important	Easy	Yes	No	
G12.4: RSIC could improve ongoing education of Commissioners in several areas:					
a. For on-boarding of new Commissioners:					
1. Training should begin as soon as practical and be individualized to the specific needs of new Commissioners by identifying skills gaps and developing a continuing education plan for that Commissioner to address those gaps;	Important	Medium	Yes	No	
2. Rather than a one-time training event, on-boarding should have a one- to two-year time horizon to extend and be staged to provide an extended time period to complete the process. The additional time may avoid overwhelming Commissioners with too much information at once and also allow them more time to absorb the large amount of new information associated with Commissioner responsibilities;	Important	Medium	Yes	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
3. Better use can be made of executive summaries with hyper-links to more detailed materials for on-boarding.	Necessary	Easy	No	No	
b. Commissioners' continuing education plans should:					
1. Incorporate the results of the Commissioner self-assessment;	Necessary	Easy	Yes	No	
2. Be better linked to anticipated policy decisions required (see Strategic Policy Agenda) and the specific related needs identified as part of the annual self-assessment.	Important	Medium	Yes	No	
c. The education policy could be revised to identify a subset of education requirements relevant to the Commission. For example, instead of only requiring "at least 16 hours of continuing education annually," RSIC could require a certain number of hours of specify that education cover related to fiduciary duty, communications/stakeholder relations, asset allocation, and other topics where skills development is determined to be appropriate (including those in the strategic policy agenda).	Important	Medium	Yes	No	
G13.2: Expedite implementation of an ERM program. See Appendix 2 for more detailed explanation of contributing factors, tools, implementation considerations and recommendations.	Critical	Difficult	No	No	
G16.1: The IIC could be improved through:					
a. The IIC is technically advisory to the CIO. In reality, it would be highly unusual for the CIO to proceed with an investment decision opposed by the IIC. Given that, the charter should be revised to note that any such CIO override of a formal vote by the IIC should be reported to the CEO and Commission, so that they can be aware of the situation. While the CEO attends IIC	Necessary	Easy	No	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
meetings, and would very likely be aware of such a situation, formalizing the process so as to provide documentation in such a rare instance would be a helpful governance procedure, particularly since the CEO can veto such a decision.					
b. An important function of the IIC is to review and modify policies and procedures. At present, there is no obligation that the broker-dealers used by the short-term fixed income desk affirm annually that they are in compliance with the RSIC's ethics and gifts policy. (The RSIC staff makes such an affirmation, and the requirement for such an affirmation is included routinely in investment management agreements with external asset managers.). The IIC should work with Compliance and Legal to create an annual affirmation for any broker-dealer executing trades for the RSIC directly.	Necessary	Medium	No	No	
c. Our understanding is that there is a broker-dealer selection policy which requires a broker-dealer to have \$25 million in net capital, as well as certain regulatory checks. Brokers are recommended by the head of the short-term desk and approved by the CIO. The IIC reviews trade volumes by broker-dealer semi-annually and there is an informal annual review process. There is no formal process to detect potential issues at broker-dealers, though the head of short-term fixed income monitors news services. The IIC should formalize the annual review process and add an environmental scan (news feeds, FINRA and SEC checks, etc.).	Necessary	Medium	No	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
G16.3: The IIC (including the peer review process) may also present an opportunity to improve communications to the RSIC’s private asset class consultant. We do not suggest inviting the consultant to the meetings on a routine basis for two reasons: 1) There is a balance between using the IIC to broaden and improve communications and the free flow of informed discussion around sensitive investment issues which become unwieldy with a large number of participants, and 2) there is the threat of group think if the independent consultant regularly participates in IIC meetings. However, a verbal or electronic report following the initial peer review meeting, including which partnerships are being considered for investment, could be circulated timely to the consultant, thereby furthering the consultant’s understanding of the investment staff’s thinking and priorities. That would serve to both alert the consultant as to potential upcoming due diligence needs, as well as provide the consultant with an early opportunity to volunteer relative information to the RSIC staff.	Necessary	Easy	No	Yes	Asset class consultant
G18.2: Identify metrics, such as activity on RSIC’s website and surveys of stakeholders, to help measure the progress of the communications plan.	Necessary	Medium	No	Yes	Stakeholders
<i>C. Policy review and development</i>					
P2.1: RSIC should update the policy to address custodial relationship and continue to evaluate exposures when its counterparty relationships change	Important	Easy	No	No	
P2.3: RSIC should update the template IMA to incorporate specific requirements of the statutes and SIOP. In addition, RSIC should update its policies to:					

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
a. Require that prospective new managers submit their proxy voting policies to RSIC for initial review so that RSIC can confirm that the proxy voting policies are consistent with the interests of the retirement systems and their participants and with proxy advisor oversight requirements at the beginning of the relationship;	Important	Easy	No	No	
b. Require existing managers to provide copies of the manager’s policies and procedures for monitoring its proxy voting on behalf of RSIC and evaluating the capabilities or its proxy advisors so that RSIC can verify that each manager is able to meet its obligation to vote proxies in the interests of the retirement systems and their participants;	Necessary	Medium	No	No	
c. Require managers to submit their evaluations of proxy advisors, including how proxy advisors manage conflicts of interest;	Necessary	Medium	No	No	
d. Require managers to notify RSIC if the manager has changed proxy advisors and to provide a copy of any new proxy voting policy covering RSIC’s proxy issues so that RSIC can confirm the policy is in the interests of the retirement systems and their participants; and	Necessary	Medium	No	No	
e. Formalize RSIC’s process for monitoring its proxy voting, including documentation of RSIC’s annual review of proxy votes submitted in response to the annual compliance questionnaire. This review should focus on identifying key votes that are material to the plan and evaluating inconsistencies in votes between managers.	Necessary	Hard	No	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
<p>We also note that under fiduciary law, proxy votes are considered plan assets that must be exercised in accordance with the interests of fund beneficiaries. Many peer funds have their own proxy voting guidelines, either as stand-alone policies or within their investment policy statements. Proxy issues often change from year to year, and voting policies (whether internal or external) should be reviewed annually to ensure that new and evolving issues are appropriately covered. At some point in the future, RSIC might consider developing its own proxy voting guidelines to consistently guide its investment managers (especially in regard to application of the S.C. Code Ann. §. 9-16-40 (4) duty of impartiality in regard to balancing strategies focused on short-term returns and on the generation of sustainable long-term future shareholder value) as they vote proxies on RSIC’s behalf. Proxy voting policies may also be of value to RSIC’s investment staff as they monitor proxy voting activities of investment managers.</p>					
<p>P2.4: RSIC should update the Securities Litigation Policy to clarify the approval roles of the Commission, the Legal Division, executive leadership, and the Attorney General (if any).</p>	Necessary	Easy	No	No	
<p>P2.5: RSIC should amend the Ethics Policy to incorporate the specific standards of conduct applicable to employees, similar to in Policy I(1)(3) of the Governance Policy Manual applicable to Commissioners.</p>	Necessary	Easy	No	No	
<p>P5: RSIC should engage with the General Assembly to revise the statutes to exempt RSIC from state procurement requirements for direct investment support services, including IT systems, similar to brokerage and investment management and advisory services.</p>	Important	Difficult	No	Yes	General Assembly

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
<i>Organization Structure</i>					
O1.2: The investment organization could be improved through:					
a. There have been a number of personnel changes made since the last full succession plan review. As a result, the succession plan is out of date and should be revised.	Important	Easy	Yes – for CEO	No	
b. The CIO should determine if additional resource(s) are needed in private markets.	Critical	Easy	No	No	
O3.3: The Commission will need to closely monitor the effects of recent changes in the incentive payment plan on the recruitment of investment staff.	Important	Medium	Yes	No	
O3.5: Staff development could be improved through:					
a. Update succession plans for senior management positions.	Important	Easy	Yes – for CEO	No	
b. Annually review succession planning across the organization with the HRCC.	Important	Easy	Yes	No	
O3.6: Complete a three- to five-year business plan.	Important	Medium	Yes	No	
<i>D. Investment administration</i>					
I1: In order to minimize the likelihood that the Commission may accept unreasonable investment risk in order to achieve the assumed rate of return, the General Assembly should consider fully delegating the responsibility for setting the assumed rate of return to PEBA and RSIC, consistent with peer practices.	Important	Difficult	No	Yes	General Assembly
I2: A full asset liability and asset allocation study should be conducted every three to five years, to include a review of plan’s investment beliefs. While an annual review is needed to check adherence, and is a useful safeguard in the event of a major	Critical	Medium	Yes	Yes	General Investment Consultant

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
market change (such as the global financial crisis of 2008) or a material change to a specific fund’s assets or liabilities (such as one caused by legislative changes or collective bargaining benefit changes), it is generally regarded as better to adhere to the longer-term strategic plan rather than materially change the asset allocation annually. Therefore, the Commission ought to consider what should be the appropriate periodicity of asset allocation study, the level of review to be performed annually, and the periodicity of review of its investment beliefs.					
I3.1: RSIC should finalize a decision as to how to create the necessary risk analytical system.	Important	Medium	No	No	
I3.2: Investment risk management could be improved through:					
a. Once a risk system is selected, quantitative solutions and reporting should create a user group to inform the types and periodicity of standard reports, which will likely vary by asset class. We also suggest that the plan include a plan for user training.	Critical	Easy	No	No	
b. Risk management and investment reporting should determine if there are ways to cooperate to extend risk measurement/analysis and performance attribution to other asset classes. For instance, can the data from reporting allow the quantitative solutions group to provide useful analyses to public market asset class heads for ongoing monitoring of public securities portfolios? The specific example is indicative only, designed to suggest how pairing the analyses provided by quantitative solutions, fueled by a new risk management system, and aided by reporting, could be leveraged across various asset classes.	Important	Medium	No	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
I3.5: RSIC should continue with its plans to activate a secondary LP interest program, or to decide explicitly not to proceed. It should also take advantage of Albourne’s expertise and knowledge base in this area as part of its exploration.	Important	Medium	Yes	No	
I4.3: The broker/dealer policy could be improved through:					
a. Require broker/dealers to perform background checks of employees directly responsible for RSIC relationships. Prior to approval of any broker/dealer eligible to do business certify that the broker is familiar with RSIC restrictions on RSIC accepting gifts and hospitality and that the broker provides training to its employees on those restrictions. Also certify that the firm will monitor compliance and promptly notify RSIC if it becomes aware of violations.	Necessary	Medium	No	No	
b. Formalize the annual broker review procedures into RSIC policy (see G16.1 and P2.2).	Necessary	Easy	No	No	
c. Continue to implement the recommendations from the 2017 independent review of the fixed income trading process and supporting operations.	Important	Medium	No	No	
I6.1: : RSIC could realize further improvements in its due diligence processes through:					
a. In one recent situation, the decision to involve the quantitative solutions group occurred relatively late in the process. While the group’s review was accomplished and did not cause the RSIC to miss a close, it involved extraordinary cooperation by the general partner, which held open the closing date for RSIC. FAS suggests that the quantitative solutions group attend the pipeline meeting, along with ODD and legal, and that one output of that meeting be a schedule	Necessary	Easy	No	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
of any other resources within RSIC which will be needed for the due diligence (other asset class specialists, quantitative strategies, legal, consultant, ODD, etc.).					
b. The peer review process is designed to catch issues early, and, particularly, to stop the resources from being wasted on new investments as soon as a “no go” point is reached. The first peer review looks at the incremental benefit of the investment irrespective of the manager, while the second peer review (2A) examines the manager due diligence. Another peer review meeting (2B) examines any follow ups from the managerial due diligence, and then, finally, the IIC votes. (In certain cases, usually related to size or matters of first impression, the investment is brought to the Commission.) The CIO ought to consider under what circumstances would warrant a combined 2B peer review/IIC meeting.	Necessary	Easy	No	No	
c. RSIC uses outside counsel to review private placement memoranda, limited partnership agreements and related subscription documents. RSIC relies heavily on one attorney for most private equity reviews. That has an advantage in that the attorney is familiar with RSIC’s requirements and business priorities, but it has created a bottleneck on occasion. Legal should consider marginally expanding the roster of outside counsel firms so as to relieve any time pressure stemming from outside counsel constraints. Our understanding is that Legal has commenced this process since the time of the FAS site visit. See L5.1	Important	Medium	No	Yes	Attorney General
17.2: Periodically conduct “spot checks” of soft dollar trades and other external manager trades.	Necessary	Difficult	No	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
I9.2: RSIC should consider expanding the co-investment program to include real estate and private credit.	Important	Difficult	Yes	No	
I9.3: As RSIC considers expanding the co-investment program to other private asset classes such as real estate or private credit, it should consider what type of outside expertise and support it needs to access, and whether that expertise and support is resident in the current consultant and co-investment manager or whether it needs additional resources for those asset classes.	Important	Difficult	Yes	No	
I12.2: RSIC should examine the costs and benefits of keeping or removing the develop a plan to remove the remaining long-only account from within its strategic partnership. If appropriate, a plan for removing it should be undertaken.	Necessary	Easy	No	No	
I12.4: The Commission should task its consultant to coordinate with the Chair to schedule appropriate professional education, aligned to the forward calendar, so that the education is related to upcoming strategic decisions to be made by the Commission.	Important	Easy	Yes	Yes	General Investment Consultant
I14.1: In addition to the appropriate actions taken to date, we suggest exploring the possibility of retaining more than one transition manager.	Important	Medium	Yes	No	
I16: We recommend that the Commission adopt and implement a formal process for evaluating the Commission's investment consultant.	Necessary	Easy	Yes	No	
I18.1: Share the results of the IIC securities lending review with the Commission when there are significant changes in the economic terms, performance or risk.	Necessary	Easy	No	No	
I18.2: Seek separate bids for securities lending and custody services the next time these services are rebid.	Necessary	Medium	Yes	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
<i>E. Legal compliance</i>					
L2.1: RSIC may consider developing an internal document or annotated side letter template describing which side letter terms are priorities and the legal basis for prioritizing those terms.	Important	Medium	No	No	
L3.1 RSIC should consider supplementing the Legal Sufficiency Certificate to include a statement addressing whether outside counsel has verified that final transaction documentation complies with all material requirements, including state law and investment policy requirements, or otherwise asking outside counsel to provide a closing letter to the same effect.	Important	Easy	No	Yes	Outside Counsel
L5.1: RSIC should complete an RFP selection process for outside counsel, since it has been more than ten years since the last RFP market test. Our understanding is that Legal has commenced this process since the time of the FAS site visit.	Important	Medium	No	Yes	Attorney General
L5.3: RSIC should continue to consider engaging qualified, independent fiduciary counsel and consult with the Attorney General, when determined appropriate, regarding the extent to which the authority to engage fiduciary counsel is delegated.	Necessary	Medium	Depends on circumstances of retention	Yes	Attorney General
<i>F. Information technology</i>					
IT1.1: Enhancements with significant potential for the organization include:					
a. RSIC uses PowerBI in numerous areas, including risk and performance and is testing its usage on management fees analysis and reporting. For Business Intelligence and Data Mining applications a strong Excel programmer is needed with	Important	Medium	No	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
<p>training in the BI application. A third-party support firm may also be needed until the person is adequately trained. We encourage RSIC to devote appropriate resources to use these applications to their fullest extent.</p>					
<p>b. Now that the MS Dynamics platform has been purchased, RSIC will need additional resources to implement it. RSIC in the process of developing an RFP to hire a consultant for the build out of MS Dynamics. The IT business plan should describe short- and long-term goals for (PowerBI and) MS Dynamics, e.g., for CRM, ERP, BI, Accounting, etc.</p>	Critical	Difficult	No	No	
<p>IT2: RSIC may benefit from an application development team to leverage the full potential of the Data Warehouse (e.g., business intelligence, data mining, real-time dashboards, real-time reports), but without an IT plan and the respective business cases it is not likely that it will be able to justify them to the CEO or to the legislature. However, these positions could add significant value to support the investment team.</p>	Necessary	Medium	No	No	
<p>IT3.1: RSIC should develop more formal IT plans, including:</p>					
<p>a. RSIC should complete an overall IT strategic plan with clearly defined objectives, a full assessment of the current state of its systems and a timetable for completing needed improvements. The written IT Strategic Plan should address the key areas of:</p> <ul style="list-style-type: none"> • Technology Management and Information Security • IT Vendor Contracts & Oversight • Data Governance & Management • Business Continuity and Disaster Recovery 	Necessary	Easy	No	No	

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FAS Recommendation	Critical vs Important vs Necessary	Difficult vs Medium vs Easy to Accomplish	Commission involvement needed	Outside cooperation needed	If yes, who?
b. The COO and IT Director should meet to lay out a list of responsibilities and timeline for completion of the IT plan.	Necessary	Easy	No	No	
c. This team should consider the impact of the timing and completion of the overall business plan (see O3.6) but if the completion of that plan will be delayed further, then the matter should be escalated to the CEO for resolution. Nonetheless, the IT Director should strive to complete an overall IT plan and assessment with the components recommended and under available verbal and written direction, i.e., the RSIC Strategic Plan, plans for risk systems evolution, etc.	Necessary	Easy	No	No	
IT4.1: RSIC should engage with the General Assembly to seek authorization to procure investment systems under a modified procurement process that includes appropriate accountability (See also P5).	Critical	Difficult	No	Yes	General Assembly

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Appendix 3 – RSIC Letter of Response

RONALD P. WILDER, PH. D.
CHAIR

PEGGY G. BOYKIN, CPA
COMMISSIONER

WILLIAM (BILL) J. CONDON, JR. JD, MA, CPA
COMMISSIONER

EDWARD N. GIOBBE, MBA
COMMISSIONER



REBECCA M. GUNNLAUGSSON, PH. D.
VICE-CHAIR

ALLEN R. GILLESPIE, CFA
COMMISSIONER

WILLIAM (BILL) H. HANCOCK, CPA
COMMISSIONER

REYNOLDS WILLIAMS, JD, CFP
COMMISSIONER

November 16, 2018

Mr. Rick Funston
Managing Partner
Funston Advisory Services LLC
6632 Telegraph Road #225
Bloomfield Hills, MI 48301

Dear Mr. Funston,

We would like to convey our appreciation to Funston Advisory Services LLC (FAS) for conducting the 2018 South Carolina Retirement System Investment Commission (RSIC) Fiduciary Performance Audit. The professionalism and respectful approach towards the staff and the Commissioners demonstrated by your team, as well as your continued dedication to implement a complete and thorough process, is to be greatly commended.

Over the past four years, we have utilized the extensive recommendations contained in the 2014 Fiduciary Performance Audit as a prescription for progress, and we were eager to update FAS on our success in implementing the many recommendations for improvement. We are pleased to say that to date, 119 of the 126 recommendations from 2014 have been implemented and we continue to work towards implementing the remaining 7 recommendations.

The RSIC would also like to thank FAS for recognizing the agency's hard work in achieving the progress we have made over the past four years. We were pleased and humbled by your recognition of our efforts in the Executive Summary of the 2018 fiduciary audit when you indicated:

"...we are very impressed by the progress achieved by the RSIC over the past four years. The RSIC has emerged from a troubled and difficult situation to one of stability, with strong leadership, effective governance, and capable staff and operations."

We truly approached the 2018 fiduciary audit as opportunity to collaborate with a group of nationally recognized pension plan experts on how we can continue to move our agency further down the path towards best practice. We could not be more satisfied with the outcome. We greatly value the observations and new recommendations made by FAS for further improvements to our agency. We have already begun the process of implementing these new recommendations and look to have them completed in short order.

Finally, please accept our gratitude for the critical role FAS has played in our continuing efforts to better serve our many beneficiaries.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael Hitchcock".

Michael Hitchcock, CEO