South Carolina Retirement System Investment Commission
Meeting Minutes

March 4, 2021 9:30 a.m.
Capitol Center
1201 Main Street, 15th Floor
Columbia, South Carolina 29201
Meeting Location: Video Presentation

Commissioners Present:
Mr. William Hancock, Chair
Dr. Ronald Wilder, Vice-Chair
Ms. Peggy Boykin, PEBA Executive Director
Mr. William J. Condon, Jr.
Mr. Allen Gillespie
Mr. Edward Giobbe
Dr. Rebecca Gunnlaugsson
Mr. Reynolds Williams

I. Call to Order and Consent Agenda

Chair Mr. William H. Hancock called the meeting of the South Carolina Retirement System Investment Commission ("Commission") to order at 9:32 a.m. Dr. Ronald Wilder moved to approve the proposed agenda as presented, and Dr. Rebecca Gunnlaugsson seconded the motion, which was approved unanimously.

Mr. William J. Condon, Jr. made a motion to approve the minutes from the December 3, 2020 Commission meeting and the February 5, 2021 Commission meeting as presented. Dr. Gunnlaugsson seconded the motion, which was approved unanimously.

II. Actuarial Valuation Update – GRS Actuarial Consultants

Chair Hancock recognized Mr. Danny White and Mr. Joe Newton from GRS Actuarial Consultants for their presentation. Mr. White first provided a summary of changes since the July 1, 2020 actuarial valuation. He then reviewed the statutorily scheduled employer contributions rates that were amended by Act 135 of 2020. The change resulted in a delay in any contribution increases for one year due to the COVID-19 Pandemic ("Pandemic"). For the South Carolina Retirement System ("SCRS"), a 15.56 percent contribution rate continued for Fiscal Year 2020-21. However, as of July 1, 2021, the rate will be 16.56 percent, and the rate will continue to increase over time to 18.56 percent. He added that there were no changes in assumptions or methods in the July 1, 2020 actuarial valuation.

Mr. White then gave an overview of the projection information for SCRS. He pointed out that SCRS should be fully funded in 2040, but he explained that such assumes the scheduled contribution rate increases occur and the investments meet return assumptions over time. He then went into detail regarding the 2019 versus the 2020 projected unfunded liabilities, the recommended assumptions, including demographic and investment return assumptions, and the impacts of various assumptions.

Mr. White discussed the pause in contribution rate increases from 2020 and how such will affect the projected unfunded liability depending on whether a one percent versus a two percent contribution rate increase in fiscal year 2021 is implemented. Next, he gave an overview of projected contribution rates and the legislative decision-making process. He pointed out that the projections by GRS reflects the recommended demographic and economic assumptions starting in 2021 (including a 7 percent return assumption).

In closing, Mr. White stated that the Pension Reform Act of 2017 ("Pension Act") requires scheduled contribution rate increases through fiscal year 2023 but includes a margin to weather some adverse experiences. Projections, based on the valuation performed in 2020, continue to be sufficient to maintain a funding period as set forth in the Pension Act. However, Mr. White noted that there is less margin to weather future adverse experiences due to the pause. He stated that it is imperative that future scheduled increases in contribution rates occur.

The Chair inquired if any Commissioners had any questions. Mr. Allen Gillespie inquired as to what type of conversations were happening within the General Assembly regarding Plan funding and contribution rates. Mr. Hitchcock and Ms. Boykin discussed matters including the assumed rate of return and the issue of a one percent versus a two percent contribution increase. Ms. Boykin stated that the South Carolina Governor's ("Governor") budget did include the one percent increase, and the General Assembly House Ways and Means Committee adopted the 1 percent increase in its budget as well. She stated that the General Assembly is committed to the 1 percent increase but getting to an 18.56 percent contribution rate will take an additional year. Ms. Boykin noted that the South Carolina Public Employee Benefit Authority ("PEBA") is concerned about employer contributions as well as the relaxed earnings limitations. Mr. Gillespie asked additional questions regarding the possible impacts of the Pandemic on retirements and related issues.

Next, Mr. Hitchcock asked Mr. White and Mr. Newton whether it is more beneficial for the South Carolina Retirement Systems Group Trust ("Group Trust") to structure the Portfolio to achieve greater returns with more risk or whether it is more beneficial to structure for less return with greater certainty. Mr. Newton stated that there is risk in not taking risk and that it all depends on how you define risk. He stated that the Group Trust has a good funding policy with stable contributions, payouts are dependable, and cashflows are very consistent. Mr. Newton also noted the Group Trust's funded ratio, which puts the Group Trust in a beneficial leverage position.

Mr. Condon noted that, within the last two years, the Governor has proposed to close South Carolina's defined benefit plans to new entrants in favor of defined contribution plans. He inquired about the costs of doing so and whether members of the General Assembly have been properly informed. Mr. Hitchcock stated that he and Ms. Boykin have provided information on the impacts of closing the Group Trust to new entrants to members of the General Assembly. He added that he has worked to educate members of the General Assembly about the complexities of closing the Group Trust and how it will be cheaper to fully fund the Group Trust rather than to close it. Hearing no further questions, Chair Hancock thanked Mr. White and Mr. Newton for their presentation.

III. Chair's Report

Chair Hancock stated that he had nothing to report.

IV. Committee Reports

Chair Hancock reported that no Committee meetings had been held since the last Commission meeting, and there was nothing to report.

V. Capital Markets Expectations Review – Meketa Investment Group

Chair Hancock recognized Ms. Alli Wallace Stone and Mr. C. LaRoy Brantley from Meketa Investment Group ("Meketa") for their presentation on the 2021 Capital Markets Expectations. Mr. Brantley began by stating that Meketa updates their capital markets expectations ("CME") each year in January. He stated that, in 2020, yields went down, credit spreads tightened, and prices went up for riskier assets. As a result, the Commission's long-term expectations for the Portfolio declined from 7.22 percent to 6.56 percent. Then, Mr. Brantley provided some historical perspective. He noted that 2019 was a good year for the Portfolio. However, in March of 2020, the Pandemic began. Markets declined significantly in the first quarter of 2020, but markets rallied during the last three quarters of the year despite the pandemic. In June of 2020, Meketa revised their CMEs in light of the Pandemic and its impact on markets. Mr. Brantley noted that Meketa had only revised their CMEs during the middle of a year one other time—during the Global Financial Crisis of 2008.

Mr. Brantley outlined how Meketa sets CMEs. CMEs are the inputs needed to conduct mean-variance optimization ("MVO"), and MVO is a traditional starting point for determining asset allocation. Meketa typically sets CMEs once a year, and the process involves setting long-term expectations for over 80 asset classes, including return expectations, standard deviations, and correlations. He noted that Meketa's process relies on both quantitative and qualitative methodologies.

Mr. Brantley discussed asset class definitions, and more specifically, how Meketa determines which asset classes are worthwhile to include within the annual asset study. Meketa identifies the asset classes that are appropriate for long-term fund allocations and also which are investable. He stated that there are several factors that influence this process, including which asset classes have unique return behaviors, observable historical track records, and robust markets. In addition, Meketa will also incorporate certain asset classes based on client requests. Meketa then makes forecasts for each of the asset classes.

Mr. Brantley explained that each model is based on the key factors that drive returns for that asset class, and the common components include income, growth, and valuation. Oftentimes, three different time periods are forecasted by consultants, including ten-year, 20-year, and 30-year periods. The numbers tend to be more attractive the further out you project. Mr. Brantley explained that he has less confidence in the 30-year forecast and believes that the 20-year forecast is more reliable.

Then, Mr. Brantley reviewed the differences between the ten-year and 20-year forecasts. He stated that the next step in establishing Meketa's capital markets assumption is to combine the ten-year forecasts with projections for years 11 through 20 for each asset class. He noted that Meketa uses a risk premia approach to forecast ten-year returns. Each asset class is individually reviewed, and Meketa always seeks consistency with finance theory. In the final step, Meketa makes any qualitative adjustments. Mr. Hitchcock asked about the 20-year expectations versus the 30-year expectations. He stated that the 30-year expectation would match up better against the average work life of participants in the Group Trust. Mr. Brantley responded that the 30-year expectation is mostly a means to getting to the assumed rate of return number. He explained that the 20-year expectation provides a better sense of historical return performance.

Mr. Brantley reviewed the development of assumptions for different asset classes. He then explained that, in order to determine the appropriate standard deviation for each asset class, Meketa evaluates the trailing 15-year standard deviation as well as skewness. Historical standard deviation serves as the basis for the assumption, and if there is a negative skew, Meketa increases the volatility assumption based on the size of the historical skewness. Meketa also adjusts the private market asset classes with smoothed return streams. Mr. Brantley then discussed correlation explaining that Meketa uses a trailing 15-year correlation as the guide for each asset class.

Next, Ms. Stone reviewed the output by comparing the 2020 and 2021 expected returns for various asset classes. She started with fixed income and stated that there has been a decline in returns driven by lower yields in 2020, which has led to a more expensive fixed income environment. Private debt was much less impacted by interest rates as compared to other asset classes within fixed income. In equities, the price-to-earnings ratio is higher, and dividends are lower. Private equity experienced higher prices, but such prices were offset by lower borrowing costs. Ms. Stone stated that real assets experienced lower capitalization rates that were partially offset by lower borrowing costs. She further explained that, within alternative strategies, all asset classes experienced higher prices with lower yields. In summary, Ms. Stone stated that the foregoing resulted in the vast majority of Meketa's return assumptions declining for the 2021 asset study.

Ms. Stone then reviewed a peer study conducted by Horizon Actuarial Services, which publishes a survey of capital market assumptions. The study collected the capital markets assumptions from 39 respondents of whom the majority are investment consultants. Ms. Stone noted that the survey is a useful tool for the Commissioners to determine whether Meketa's expectations for returns and risk are reasonable. She explained that, based on the study, Meketa's assumptions fall within the range of expectations and are not significantly more aggressive or conservative than their peers.

She then turned to a discussion of risk noting that in today's environment investors can expect to receive less return when assuming the same level of risk as in the past. She stated that in order to achieve the returns that the Portfolio has in the past, RSIC would have to take on greater levels of risk.

Ms. Stone reviewed the Portfolio's current asset allocation stating that the five-asset class mix is expected to earn a 6.56 percent return based on 2021 capital markets assumptions as compared with the 7.22 percent projected return from 2020. She stated the Portfolio is very well designed and takes on prudent levels of risk.

Dr. Wilder asked if Meketa's future projections for private equity consider that the investment space seems to be more crowded than it was in the beginning of the private equity era. Ms. Stone stated that private equity expectations do consider such.

Break was taken from 11:07 a.m. to 11:17 a.m.

VI. CEO's Report

Chair Hancock recognized Mr. Hitchcock for the CEO's Report. Mr. Hitchcock reminded the Commissioners that RSIC is required by statute to adopt the Consolidated Annual Investment Plan and Statement of Investment Objectives and Policies ("AIP/SIOP") by May 1 of each year. He noted that per Commission practice, he was presenting Staff's suggested updates and revisions to the AIP/SIOP for consideration, but the Commission would not be asked to approve the AIP/SIOP until the Commission's April meeting. Mr. Hitchcock explained that most of the proposed changes were minor in nature, and there were no substantive changes to the Policy Portfolio.

Mr. Hitchcock began an overview of the changes including: (i) a reduction in the assumed rate of return, (ii) updated tables, (iii) an updated base case scenario for the Group Trust to reach fully-funded status, (iv) an updated projected amortization schedule for SCRS and the South Carolina Police Officers Retirement System, (v) and additional language acknowledging the time for the Group Trust to reach fully-funded status has been extended due to the General Assembly's suspension of the Fiscal Year 2021 rate increase.

He continued reviewing other proposed changes, which added language regarding setting maximum equity exposure at 70 percent, which would have RSIC at the maximum allowable allocation to equities by law. He stated that he felt it was necessary to constrain the Reference Portfolio to no more than 70 percent equities because that is the amount of risk for a diversified portfolio of assets needed to exceed the annual rate of return and have a no greater than five percent (5.0%) probability of requiring additional contributions.

Next, he stated that he added language Mr. Condon had requested explaining the role of each asset class in the Portfolio. Mr. Hitchcock updated the return expectations based on the 2021 capital market expectations provided by Meketa, volatility, and the probability of meeting the annual rate of return. He also stated that he added language as to why the Commission believed that this decline in the expected rate of return would not prompt the Commission to make a change to the asset allocation and should not prompt RSIC to depart from its discipline.

Mr. Hitchcock explained that language was added clarifying that the Reference Portfolio was intended to be a risk barometer, not a risk limit. Mr. Condon asked a question regarding risk. He inquired about whether there is or should be a limit to the level of risk in the Portfolio and how often the Commission should assess that limit. Mr. Geoffrey Berg, Chief Investment Officer ("CIO"), discussed his views on risk and how the Commission has communicated risk limits. He then expressed his concerns about choosing a specific maximum volatility level. Mr. Berg explained that in an economic downturn, the Reference Portfolio, Policy Portfolio, and the Portfolio would exceed a risk limit designed for normal times because volatility would scale to heights that would require RSIC to sell assets to de-risk the Portfolio. Mr. Hitchcock surmised that the result of such would be RSIC having to sell assets at the most inopportune of times.

Mr. Condon asked additional questions about potential risk limits, which were addressed by Mr. Berg and Mr. Hitchcock. Mr. Condon then noted that his questions were based on his concern that the Reference Portfolio was structured with a very high level of risk due to the 70 percent equities limit. Mr. Condon inquired about how RSIC measures risk using a two-year trailing period and whether such was inconsistent with the way the Commission looked at risk when they were setting the Reference Portfolios and the Policy Portfolios. He also asked the appropriateness of the timing in which the Commission views risk. Mr. Berg stated that the two-year window is an attempt to be thoughtful as to what risk levels are in then-existing environments. Mr. Hitchcock noted, when looking back two years, there is more divergence than when looking back fifteen years. Mr. Hitchcock then reviewed the strategic initiatives for the upcoming year. After additional questions and comments, he concluded his review of the proposed changes to the AIP/SIOP.

Mr. Hitchcock then moved the discussion to a general governance and accountability report, which had been requested by Mr. Edward Giobbe. First, Mr. Hitchcock reviewed the history of the Commission and noted that its primary purpose was to set the strategic direction for an investment program that seeks to earn an investment return which, when combined with contributions, provides benefit payments to current and future retirees. He outlined the Commission's responsibilities, which include setting long-term strategic asset allocations, exercising oversight of the investment program and business affairs of RSIC, approving certain investments, ensuring legal and ethical integrity, and maintaining accountability.

Next, Mr. Hitchcock reviewed the responsibilities of the CEO. The CEO is employed by the Commission and serves as the primary figure of accountability for RSIC. The CEO's role is to carry out the Commission's mission, policies, and directives. He stated that the CEO is responsible for delegating the Commission's authority as necessary to manage RSIC and implement the Commission's decisions. Mr. Hitchcock noted that the CEO employs the CIO and other members of Staff who serve at the will of the CEO and that the CEO has been delegated by the Commission the final authority to close all investments.

Mr. Hitchcock then discussed the CIO's role in managing RSIC's investment function and its Investment Staff subject to CEO oversight. He stated that the CIO oversees the allocation of capital primarily to external investment managers to provide exposure to implement the Commission's strategic asset allocation. The CIO also is delegated the final authority to invest subject to established limits, manages the exposures of the

Portfolio within ranges set by the Commission, and oversees investment risk management and investment manager oversight.

The next topic Mr. Hitchcock examined was the primary staff committees. The Executive Leadership Team is composed of the CEO, CIO, Chief Operating Officer, and Chief Legal Officer. He stated that the Executive Leadership Team serves as RSIC's primary management committee and aids the CEO in making strategic, organizational, and operational decisions. He noted that RSIC also has an Internal Investment Committee ("IIC"), which is composed of senior staff appointed by the CEO and is chaired by the CIO. Mr. Hitchcock stated that the IIC's primary purpose is to vet and recommend new investments to the CIO for approval, advise the CIO on asset class baselines, and serve as a form the forum to challenge baselines.

Next, Mr. Hitchcock outlined RSIC's Internal Audit ("IA"), Enterprise Risk Management ("ERM"), and Compliance functions. He stated that the Internal Audit function is governed by the Commission's Audit and Enterprise Risk Management Committee. The purpose of the IA Function is to provide independent, objective assurance and recommendations to add value and improve operations. He stated RSIC employs a co-sourced IA model that provides independence from Staff via an external service provider. He then turned to a review of RSIC's ERM and Compliance functions. Mr. Hitchcock stated that RSIC's goal for ERM is to mitigate organizational risks for which RSIC is not compensated. RSIC does has a dedicated, internal resource that aids the CEO and management in risk mitigation and manages compliance with RSIC's policies and applicable laws. Mr. Hitchcock stated that an ERM dashboard has been developed, which provides a one-page overview of RSIC's various enterprise risks. He concluded this discussion by adding that ERM is currently developing key risk indicators and key performance indicators in coordination with RSIC's external audit resource.

Lastly, Mr. Hitchcock reviewed additional internal improvements that RSIC has made over the past few years that have improved governance and accountability. These improvements include: (i) adding the Bank of New York Mellon's ("BNYM") capital call management service, which has improved cash management process; (ii) the outsourcing of cash and short duration management, which has reduced enterprise risk; (iii) enacting portfolio simplification, which has reduced active investment risk and shifted focus to parts of the Portfolio that provide consistent sources of excess return; (iv) implementing a performance reporting framework that provides the Commission with more look-through and the ability to better judge major investment decisions; and (v) taking a more long-term perspective as well as implementing a five-year schedule for asset allocation review, which should benefit performance.

VII. CIO's Report

Chair Hancock recognized Mr. Berg for the quarterly performance update through December 31, 2020. Mr. Berg reported that RSIC had a very good quarter with the Portfolio up approximately 10.4 percent, which is 1.66 percent ahead of the Policy Benchmark. He also noted that, for the first six months of the fiscal year, the Portfolio was up 15.9 percent and ended the quarter with a value of $35.6 billion. In the first half of the fiscal year, the Portfolio paid out $289 million in net benefits and received a $110 million from legislative inflows. Mr. Berg noted that investment returns represented growth of over $4.9 billion in Portfolio value during the first half of the fiscal year. Mr. Berg also noted that the Portfolio remained within the allowable ranges in all asset classes and in compliance with all constraints outlined in the AIP/SIOP.

Mr. Berg then turned to an in-depth review of quarterly performance. He reminded the Commissioners that the performance framework highlighted three impacts. He first noted that the impact of employing a diversified investment strategy versus the simplest bond/stock portfolio had been negative over the past few years, including the most recent quarter, due to global equity's strong performance. Second, Mr. Berg reported that the impact of decisions that RSIC made to look different than the Policy Benchmark had been positive for each of the trailing time periods and were driven by very strong recent performance. Third, Mr. Berg noted that the impact of manager selection was positive for the quarter, but the longer-term impacts from manager selection were still negative. He stated that this was due in part to asset classes and strategies that are no longer a part of the Portfolio.

Mr. Berg summarized the Portfolio's performance during the quarter. He noted that the Portfolio had been positioned for the market recovery to continue with an underweight to core bonds and an overweight in public equity as well as different forms of credit. The portable alpha portfolio had added considerable value at the Plan level. He observed that there had been a significant rebound in listed real assets, especially listed infrastructure and real estate investment trusts ("REITs"), which had outperformed the benchmark. Mr. Berg indicated that the principal factor driving underperformance for the quarter was the Plan's overweight to private debt. However, he noted that the asset class was up over 4 percent during the period.

Mr. Berg then reviewed the impact of Portfolio Structure decisions. He reminded the Commissioners that Portfolio Structure denotes top-down decisions that make the Portfolio look different than the Policy Benchmark. He stated that hedge funds accounted for the single largest impact and were followed by the strong recovery in REITs and listed infrastructure. Next, he reviewed the impact of manager selection noting that almost every asset class had outperformed in the quarter with the bonds portfolio providing the single biggest impact. In assessing performance over the last four quarters, Mr. Berg noted that, after a frustrating first quarter of 2020, the Portfolio had benefited from being positioned for the recovery.

Mr. Berg then reviewed the Portfolio's three-year performance results. He reminded the commissioners that RSIC decided in 2020 to move the Portfolio's public equity exposure almost entirely to passive index funds because of dissatisfaction with the asset class' results, costs, and complexity. Mr. Berg reported that the change accounted for more than half of the performance gap between the Portfolio's actual return and the Policy Benchmark. He noted that in the bonds portfolio, the trailing three-year return was skewed by the decision to be overweight cash and underweight core bonds in late 2019 and into early 2020, which negatively impacted performance. Mr. Berg indicated that in private equity, the Portfolio was still seeing the negative effects of having under-committed to such assets between 2012 and 2017. However, he noted that, in recent years, the pace of commitments had picked up, and RSIC's co-investment program had already become a bright spot for the Portfolio. As to private debt, Mr. Berg reminded the Commissioners that RSIC had been converting its allocation from a more aggressive, opportunistic approach to a lower-risk portfolio with the goal of more consistently outperforming the listed credit markets. He stated that, notwithstanding the benchmark's significant fluctuations over the last year, the investments made over the past three, four, and five years have been performing well. Mr. Berg noted that the real assets portfolio continues to perform well while the portable alpha portfolio has been improving.

Mr. Berg gave a brief overview of the Portfolio's positioning at the end of the quarter, which focused on the equity and bond portfolios. He then discussed the risk statistics as of December of 2020. He noted that the Portfolio's positioning, along with the use of portable alpha, caused the Implementation Benchmark and the actual Portfolio to be higher risk than the Policy Benchmark. He reminded the Commission that RSIC's methodology looked at the volatility of the portfolios over the past two years, and that if the Commission looked at the same portfolios at a different point in time, a different relationship between the numbers would be seen. Mr. Berg then concluded his presentation.

VIII. Delegated Investment Report

Chair Hancock then recognized Mr. Berg for the delegated investment report. The following delegated investments were closed by Staff since the December 3, 2020 Commission meeting.

Asset Class	Investment	Investment Amount	Closing Date
Private Equity	Aberdeen US PE Fund IX	$100 M plus any additional amount not taken by other LPs to reach Fund's hard cap, but in no event to exceed 25% of the Fund	December 8, 2020
Private Equity	Mill Point II	$50 M	December 22, 2020
Private Equity	Peak Rock Capital Fund III	Up to $50 M	January 4, 2021
Private Equity	Hillhouse Focused Growth V	$30 M	January 27, 2021
Private Debt	Golden Tree Structured Products VII	$25 M	February 6, 2021
Private Equity	KKR Asian IV	$100 M	February 26, 2021

IX. Executive Session

Mr. Gillespie moved to recede into Executive Session to discuss investment matters pursuant to S.C. Code Sections 9-16-80 and 9-16-320, including a comprehensive review of the bonds portfolio performance and a discussion of various underlying holdings, a review of the Co-Investment Program's performance and a discussion of various program investment, and a review of potential investments in the due diligence process; and to receive advice as needed from legal counsel pursuant to S.C. Section 30-4-70(a)(2) related to potential investment matters. Dr. Wilder seconded the motion, which was unanimously approved.

X. Potential Action Resulting from Executive Session

Upon return to open session, Mr. Hitchcock noted that the Commission did not take any action while in Executive Session.

XI. Adjournment

There being no further business, Mr. Gillespie moved that the Commission meeting adjourn. Dr. Wilder seconded the motion, which was unanimously approved. The meeting adjourned at 1:11 p.m.

[Staff Note: In compliance with S.C. Code Section 30-4-0, public notice of and the agenda for this meeting was delivered to the press and to parties who requested notice and were posted at the entrance, in the lobbies and near the 15th Floor Presentation Center at 1201 Main Street, Columbia, S.C., 12:17 p.m. on March 2, 2021]