SC PUBLIC EMPLOYEE BENEFIT AUTHORITY- BOARD OF DIRECTORS

Wednesday, June 19, 2013 – 1:00 P.M. [Minutes Adopted 7/17/13]

202 Arbor Lake Drive, Columbia SC, Main Conference Room 2nd Floor

Board Members Present:

Mr. Art Bjontegard, Chairman (in person)
Mr. Stephen Heisler (in person)
Mr. John Sowards (in person)
Mr. David Tigges (in person)
Mr. Frank Fusco (in person)
Ms. Stacy Kubu (in person)
Mr. Steve Matthews (in person)
Mr. Joe "Rocky" Pearce (in person)
Mr. Audie Penn (in person)

Others present for all or a portion of the meeting:

David Avant, Travis Turner, Lil Hayes, Stephen Van Camp, Matthew Davis, and Virginia Wetzel with the Public Employee Benefits Authority; Sarah Corbett and Hershel Harper with the SC Retirement Investment Systems; Brady O'Connell with Hewitt EnnisKnupp; Brooks Goodman from BCBSSC; Wayne Pruitt and Donald Tudor from the South Carolina State Retirees Association.

1. CALL TO ORDER; ADOPTION OF PROPOSED AGENDA

Chairman Bjontegard called the meeting to order at 1:00 p.m., and Mr. Pearce gave the invocation. Ms. Hayes confirmed meeting notice compliance with the Freedom of Information Act. Mr. Penn moved to adopt the agenda.

Chairman Bjontegard introduced the newest Board member, Steve Heisler. He also introduced Virginia Wetzel, the new Assistant Liaison.

2. MINUTES OF PREVIOUS MEETING – MAY 15, 2013

Chairman Bjontegard asked for amendments to the May meeting minutes. Mr. Fusco requested a minor adjustment of removing the word "highly-" found on page 3 of the minutes. Mr. Matthews moved to approve the May 15, 2013 minutes as amended with a second by Mr. Sowards. The minutes were unanimously approved as amended.

3. RETIREMENT SYSTEMS INVESTMENT COMMISSION (RSIC)/HEK

Brady O'Connell with Hewitt EnnisKnupp gave a presentation reviewing asset/liability study recommendations (in notebook materials) for the SC Retirement Investment Commission. He explained that there were no dramatic changes to the previous investment structure, but thinks that this new plan will result in higher returns. Discussion followed concerning alternative investments, with Mr. Sowards confirming that HEK is comfortable with a portfolio with this type of mix of investments and assets, because the different types would mean maximized returns. Mr. Avant said the actuaries were comfortable with the portfolio and did not think the changes would destabilize the actuarial assumptions.
Questions were asked about the targeted return rate and results from past years. Mr. Avant noted that the PEBA Board is not responsible for setting the rate of return; that is

the Legislature's role. The assumed rate of return is in the hands of the Legislature [because it is in statute]. Other discussion followed relating to rebalancing exercises, benchmarks, and investment strategies being related to a combination of factors tailored for this plan. Comparisons to other plans were questioned, with Mr. O'Connell saying that the unfunded liabilities make it hard to compare SC to other state's plans. Mr. O'Connell addressed the fact that SC was ranked 46th in terms of funding in the past. He is unaware of South Carolina's current ranking but noted that SC is taking action politically to improve this status.

4. COMMITTEE REPORTS/ OLD BUSINESS

RETIREMENT POLICY COMMITTEE

Mr. Sowards introduced staff, Mr. Matt Davis, who gave an Optional Retirement Program (ORP) Overview Presentation (in notebook materials). It was explained that Summit Strategies Group is the ORP investment consultant. Mr. Davis then stated his goal was for the Committee to be able to assume their responsibilities for the program as soon as possible, with Summit reporting quarterly to staff, and in the future staff would report to the Committee and the Committee would report to the full Board. Mr. Davis introduced Mr. Paul Staples with Summit [on speakerphone] and explained the co-fiduciary relationship Summit has with PEBA. Discussion followed on details of the ORP, with Mr. Sowards noting the Committee had done an extensive study on the program. He then re-introduced Paul Staples for a presentation of the Investment Policy Statement revisions (in notebook materials).

Action:
Chairman Bjontegard asked for a motion and Mr. Sowards moved to approve the Investment Policy Statement as amended. Mr. Fusco seconded. The Investment Policy Statement as amended was unanimously approved.

Further Committee Updates by Chairman Sowards:
<u>Deferred Compensation</u>:
The committee will begin reviewing the Deferred Compensation Program in depth during the month of September 2013.

<u>PORS Disability Review Board</u>
Senate Bill 484 has been passed and signed into law on June 13, 2013. It reverses changes made to the PORS Disability provisions found in Act 278 to add a Medical Review Board to review PORS disability decisions made by the Department of Vocational Rehabilitation.

<u>Mellon Case Settlement</u>
The settlement is now public. Mr. Avant provided a brief overview of the terms of the settlement.

HEALTH POLICY COMMITTEE

Committee Update by Chairman Pearce:
The Health Committee will be meeting on June 24, 2013 and will be reviewing the 2014 Employee Health Plan and the ACA regulations regarding non-permanent full-time employees. He will report any actions taken on those two issues to the Board at the July 2014 Board meeting.

Chairman Bjontegard announced that new member, Mr. Heisler has been placed on Health Care Policy Committee. He advised all member to submit a request should they want to serve on a different committee.

FINANCE, ADMINISTRATION, AUDIT & COMPLIANCE COMMITTEE

Committee Update by Chairman Matthews:
<u>Internal Auditor Position</u>
A draft job description has been created. PEBA staff and Ms. Boykin are putting together comparative data from other state's structures for best practices. The committee advised that the internal auditor's job descriptions/ tasks should be amended to remove task directly associated with the executive director. For example, overseeing execution of policy should fall under the Executive Director's tasks rather than the internal auditor. Mr. Avant reported that 15 entities from the National Association of Pension Fund Lawyers submitted their structure information back to us and several more have responded from the Association of Pension Fund Auditors. The committee will continue to work on this topic.

<u>Strategic Planning</u>
A draft strategic plan has been created by PEBA staff with the help of consultants at USC (in notebook materials). Suggested amendments from committee members have been provided. There are 4 major areas of concern: Establishing Board duties as part of a larger whole based on the compensation package that will most benefit SC constituents; Identify various stockholders; Maximum benefit for resources allocated to us; Request that all committees consider this plan (not just FAAC).

Action:
Mr. Fusco provided a motion to have the Board's strategic goals reviewed and approved by each subcommittee and then sent back to the Board for overall approval. Mr. Matthews seconded. The motion was unanimously approved.

5. NEW BUSINESS

Report from Interim Director David Avant:

<u>DeLoitte & Touche IT Risk Assessment:</u>

PEBA volunteered as 1 of 15 state agencies selected to conduct an IT risk assessment. This company is scheduled to perform their IT risk assessment in August 2013. Board members questioned if this audit was in line with the ISO certification. Mr. Avant will be meeting with the company in early July and will report back to the board exactly what will be included in the assessment.

Accountability Report:
It will be due to the Office of State Budget in September 2013. A draft will be presented to the Board at the August Meeting.

Legislative Update:
Mr. Avant introduced Gwen Bynoe, PEBA Legislative Liaison. A summary was provided of all legislative changes during the 2013 Legislative Session (in notebook material).

Other New Business:
Chairman Bjontegard reported that all PEBA Board Self Assessment Surveys have been collected and results compiled (in notebook material).

Chairman Bjontegard introduced the SC Retirees Association's new president, Donald Tudor. He thanked former president Wayne Bell for his services.

6. ROUND TABLE COMMENTS

There were no comments.

7. EXECUTIVE SESSION PURSUANT TO S.C. CODE OF LAWS

At 3:20 p.m., upon motion by Mr. Fusco and second by Mr. Heisler, the Board voted unanimously to enter into executive session.

Open meeting resumed at 3:55 p.m. following the Executive Session. No action was taken by the Board while in Executive Session.

8. ADJOURNMENT

There being no further business, Chairman Bjontegard adjourned the meeting at 4:00 p.m.

SC Public Employee Benefit Authority
Board of Directors Meeting

202 Arbor Lake Drive, Columbia SC, 29223 ♦Main Conference Room

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Wednesday, June 19, 2013 – 1:00 P.M.

AGENDA

1. **Adoption of Proposed Agenda**
2. **Minutes of Previous Meeting**
3. **Brady O'Connell, Hewitt EnnisKnupp, Inc./ Retirement Systems Investment Commission (RSIC):**
   Asset/Liability Study Recommendations
4. **Old Business**
   a. **Retirement Policy Committee**
   b. **Health Policy Committee**
   c. **Finance, Administration, Audit & Compliance Committee**
5. **New Business**
6. **Round Table Discussion**
7. **Executive Session Pursuant to SC Code of Laws §30-4-70(a)(1)**

SC PUBLIC EMPLOYEE BENEFIT AUTHORITY- BOARD OF DIRECTORS

DRAFT MINUTES

Wednesday, May 15, 2013 – 1:00 P.M.

202 Arbor Lake Drive, Columbia SC, Main Conference Room 2nd Floor

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Board Members Present:

Mr. Art Bjontegard, Chairman (in person)
Ms. Peggy Boykin (in person)
Mr. Frank Fusco (in person)
Ms. Stacy Kubu (in person)
Sheriff Leon Lott (in person)
Mr. Steve Matthews (in person)
Mr. Joe "Rocky" Pearce (in person)
Mr. Audie Penn (in person)

Others present for all or a portion of the meeting:

David Avant, Travis Turner, Lil Hayes, Stephen Van Camp, Justin Werner, Matthew Davis, Robbie Bell from the South Carolina Public Employee Benefit Authority (PEBA); Brooks Goodman from BCBSSC; Donald Tudor from the South Carolina State Retirees Association; Boyd Shealy, Susan Hance and Donna Foster from the Budget and Control Board; Alex Mullikin from Mullikin Law Firm.

1. CALL TO ORDER; ADOPTION OF PROPOSED AGENDA

Chairman Bjontegard called the meeting to order at 1:00 p.m., and Mr. Pearce gave the invocation. Ms. Hayes confirmed meeting notice compliance with the Freedom of Information Act. Mr. Matthews moved to adopt the agenda. Sheriff Lott seconded. Unanimously approved.

2. MINUTES OF PREVIOUS MEETING

Sheriff Lott moved to approve the minutes of the April 17, 2013 meeting as amended. Mr. Matthews seconded. Unanimously approved.

3. AGENCY HEAD SALARY COMMISSION PRESENTATION

Ms. Donna Foster with the State Agency Head Salary Commission was introduced. She began by explaining the history of the Commission. In 1985, the state government decided to implement a meaningful pay structure for agency heads and university presidents. The first step was to contact with Hay Associates, an international consulting firm specializing in executive pay. Based upon the "Hay formula," a pay range structure was established. This structure blends private sector pay data along with national public sector pay data. This structure was intended to reflect the duties, responsibilities, and performance. The intent of the Commission has been to conduct a study to adjust the ranges to keep up with trends in executive salary data. The minimum threshold reflects the market pay for someone with little or no experience in directing an organization. The mid-point reflects the market salary for someone with experience in leading an organization similar to this one. The Commission is composed of four appointees by the Chairman of the Senate Finance Committee, four appointees by the Chairman of the House Ways and Means Committee, and three appointees by the

Governor. Any decisions to hire an agency head above the minimum must be vetted by the Commission. To determine the performance measures for an agency head, the director proposes objectives to be approved/amended by the Board. The Board is responsible for determining whether the objectives have been met. The agency director submits a report to the Board explaining whether/how the objectives have been met, not met, or exceeded. The Board then compiles a report using this information and provides it to the AHSC. The Commission makes decisions to reward success of all agency heads based upon performance. There have been no increases for 6 years. A performance planning document would normally be created. The evaluation is good to do even when/if it is not required by the Commission. The crucial element to the process is to have Board members continually communicate progress to the agency head whether or not objectives are being met. She added that there is a benefit to successes being reflected in this process in that the agency's successes are brought to the attention of the House and Senate members with whom the agency may have business. Chairman Bjontegard introduced the process that will be used by PEBA. It is three-pronged. The Board will evaluate the agency head, the agency head will evaluate the Board, and the Board will evaluate itself. More on this will be discussed in executive session. He asked Ms. Foster whether there are mechanisms being used by other agencies to supplement the agency head's salary, such as grants. Ms. Foster responded that some do. For example, ETV has such a supplement. The entities that use this mechanism more are colleges and universities. The main goal of avoiding overuse of these mechanisms is to ensure the agency head is performing in the best interest of the state of South Carolina, not his own interests or those of a private party. Mr. Penn asked whether the two dates—the August 15 deadline for filing the Agency Head Evaluation document/survey composite score and the September 15 deadline for submitting the planning document—mentioned in the presentation are the only deadlines for the AHSC. Ms. Foster responded they are.

4. HIPAA TRAINING

Robbie Bell gave a brief explanation of the requirements of HIPAA Privacy and Security standards.

Health Policy Committee Report

5. STATE HEALTH PLAN BUDGET PROCESS

Mr. Pearce asked Mr. Avant to report on the status of the State Budget process. Mr. Avant explained that the Senate approved the administrative budget. For the Health Plan, they also required a 6.8% increase in the employer contribution and a 0.0% increase in the employee contribution. He added that they also included the provision that the PEBA Board may increase copays and/or deductibles by up to 20%, just as the House did.

Mr. Penn asked how the 20% increases to copays and deductibles affect grandfathering under ACA. Mr. Avant responded that this is the upper limit of increases while maintaining grandfathered status.

Mr. Van Camp then briefed the Board about the results of the Supreme Court case between employee associations and the B&C Board. He explained the budget process for the 2013 plan year resulted in a 6.8% increase to employer contributions with no employee contribution increase. The Governor approved the budget with this provision in it by not vetoing the item. When the State Health Plan went to the BC Board for approval of the Plan, the Board voted to change the contribution increase to a 4.6% increase on both employer and employee contributions. The Supreme Court ordered a stay on collecting the increase to employee contributions. They ultimately ruled that the B&C Board violated separation of powers by attempting to change what the legislature had done with regard to appropriations. He noted that this more clearly draws the bounds within which the PEBA Board may work with regard to premiums. Mr. Fusco asked how much money was not collected as a result of the stay. Mr. Van Camp responded that this was about $6M. Mr. Fusco then asked what PEBA is doing to collect those premiums retroactively. Mr. Van Camp responded that PEBA will begin collecting these back employer premiums around July or August. Mr. Avant added that employer groups were advised early on in the lawsuit that they should not count on the contribution increase not being 6.8%, so they would not spend this money. Mr. Matthews asked whether the final sentence of the proviso would allow the PEBA Board to change not only copays and deductibles but premiums midyear in the event of a catastrophic shortfall. Mr. Van Camp responded that the discussions between PEBA staff and the General Assembly involved this representing potential premium increases as well as plan feature changes. Ms. Kubu asked whether this means that copays and deductibles would jump much higher once the Plan losses grandfathered status. Mr. Van Camp responded that it could, but that the Board will be the ultimate decision-maker as to how the plan design will change to accommodate the added costs of ACA compliance. Mr. Penn added that he and Mr. Pearce had discussed developing a long-range plan to allow the Board to state where it would like to see the Plan in future years so it could be communicated to the GA in time to affect the budgeting process. Mr. Fusco agreed, adding that he believed the Board should be ready to provide a detailed proposal to the GA by October of the year prior to the start of the fiscal year. Mr. Van Camp agreed. Mr. Pearce then asked whether there had been a three-year proposal, like the one being developed now. Mr. Fusco responded that when he was the BC Board's Executive Director, EIP had begun a strategic plan to develop the three-year proposal process. Mr. Van Camp added that once this was decided on, ACA happened and made it difficult to make many changes. Mr. Pearce added that he believes changes needed to be contemplated to not only address increases in cost, but to drive costs down in the form of improved health outcomes. Mr. Fusco agreed, adding that this is one of the reasons for his suggestion to submit the proposal in October. Chairman Bjontegard concluded this discussion by directing the Health Policy Committee to work on having the proposal ready by October.

Mr. Turner then discussed the Pharmacy Benefit Manager Request for Proposal. He noted that the original RFP was cancelled because none of the responders met the requirements of the RFP. He added that it will be possible to get this finished before the plan year. Mr. Avant noted that the dates for this new RFP are designed such that, even with a protest, the new PBM will be in place by the beginning of the plan year. He mentioned that certain components of the RFP can implemented regardless of which responder is awarded the contract.

Mr. Pearce then introduced a proposal by MUSC to conduct a pilot project. This would be a Patient Centered Medical Home for just MUSC employees. Mr. Turner explained that a meeting was conducted with PEBA staff and MUSC executives to discuss this about two months ago. He continued by saying that there would need to be more details from MUSC before this can be considered.

He then began a discussion regarding S.290, which is proposed legislation begun by MUSC. Mr. Turner explained that the bill would require the SHP to pay for services rendered within a telemedicine program. Mr. Avant added that PEBA staff is consulting with the Senate to address issues PEBA may have with the bill. Mr. Pearce added that the Board does not need to perform any action today, but would like to refer the issue to the HCP. Ms. Boykin commented that this appears to potentially address the issue of improving the overall health of SHP members by increasing access to care in rural areas where specialists or a larger number of providers are not available. Mr. Matthews asked what the reasons might be for not wanting this bill to pass. Mr. Avant responded that it was more along the lines of the fee structure for such services and the fact that a new board would be created that would potentially overlap PEBA Board functions in certain areas.

FAAC Committee Report

Mr. Matthews noted that the Governor signed the Indemnification Bill.

He then mentioned that the Internal Auditor position is being worked on by the FAAC Committee and will be taken up in the next meeting.

The third matter he explained was the fact that many PEBA IT personnel will likely soon begin to retire and a need to bring in replacements will arise. He noted this is a concern because the IT job market is highly competitive. Mr. Penn asked whether any consideration had been given to outsourcing IT functions. Mr. Avant explained this is one of the considerations being made in the IT strategic plan. Mr. Bjontegard asked about the Governor's proposal for a statewide IT setup. Mr. Avant noted that there is still a lot of uncertainty regarding how this will look.

Retirement Policy Committee Report

Mr. Fusco reported that on May 8, 2013, the BC Board approved the five retirement system valuations.

He reminded the Board that the Deferred Compensation Program will come under the authority of the PEBA Board on January 1, 2014 and the Board needs to be educated on the DC program and what its duties will be.

He explained that the RCP received a briefing on the Optional Retirement Program (ORP) at its last meeting and will bring information to the Board regarding its responsibilities.

Mr. Avant added that the RCP asked him to continue efforts on behalf of PEBA to impress upon the SCRSIC to have a standard protocol in place to ensure after an investment has been approved that the agreed funding is made. He noted that these are discussions that have been had in the past, but he continues to communicate with the RSIC to make this happen.

6. DIRECTOR'S REPORT

Mr. Avant mentioned the internal auditor position is not an effort to fill an empty position. He explained that there is currently an internal auditor, who is conducting auditing functions. He explained that the staff is highly credentialed and qualified, and works on auditing investment information from RSIC. PEBA also brings in external auditors to assess certain areas of operation. He also mentioned that there is a staff of four or five field auditors who travel to employers to ensure compliance with PEBA guidelines for administration of the insurance and retirement programs.

Mr. Avant then went on to discuss the Strategic Planning process. He invited the Board to participate in the planning process to ensure the agency's proposed plan does not conflict with the Board's goals.

Mr. Avant explained that the Accountability Report is due by September 13. He explained that the report is to help an agency assess itself. He added that the Board will be able to review the report before it is submitted to the Legislature. Chairman Bjontegard asked Mr. Avant for a deadline for the things he wants the Board to address. Mr. Avant responded that he would like to have them before the June meeting. He asked that these responses be submitted to staff by June 10.

7. ROUND TABLE COMMENTS

Ms. Boykin asked about progress regarding changing the monthly meeting requirement for the full Board to reduce the burden on staff and shift the responsibility to the committees. Mr. Avant responded that legislative staff advised him it would be better to focus on getting the Indemnification Bill passed before addressing such other issues.

Mr. Matthews mentioned that the FAAC Committee will also pursue a rider on the liability insurance for the Board.

Mr. Penn had nothing to add.

Chairman Bjontegard noted that the Board will finish its first year on June 30, 2013 and that would be a fitting time to resign, if they desired.

Mr. Pearce thanked PEBA staff and members of the HCP Committee for their patience while he acclimated himself to his position as Committee Chair.

Sheriff Lott had nothing to add.

Ms. Kubu had nothing to add.

Mr. Fusco explained that he has had difficulty using the Board's Extranet—both with the technical connection and finding specific documents. Mr. Avant acknowledged his concern, noting that staff is working with IT to attempt to improve the organization of the Extranet and to provide meaningful support to Board members in the use of the site.

8. EXECUTIVE SESSION PURSUANT TO S.C. CODE OF LAWS

At 3:04 p.m., upon motion by Mr. Pearce and second by Sheriff Lott, the Board voted unanimously to enter into executive session.

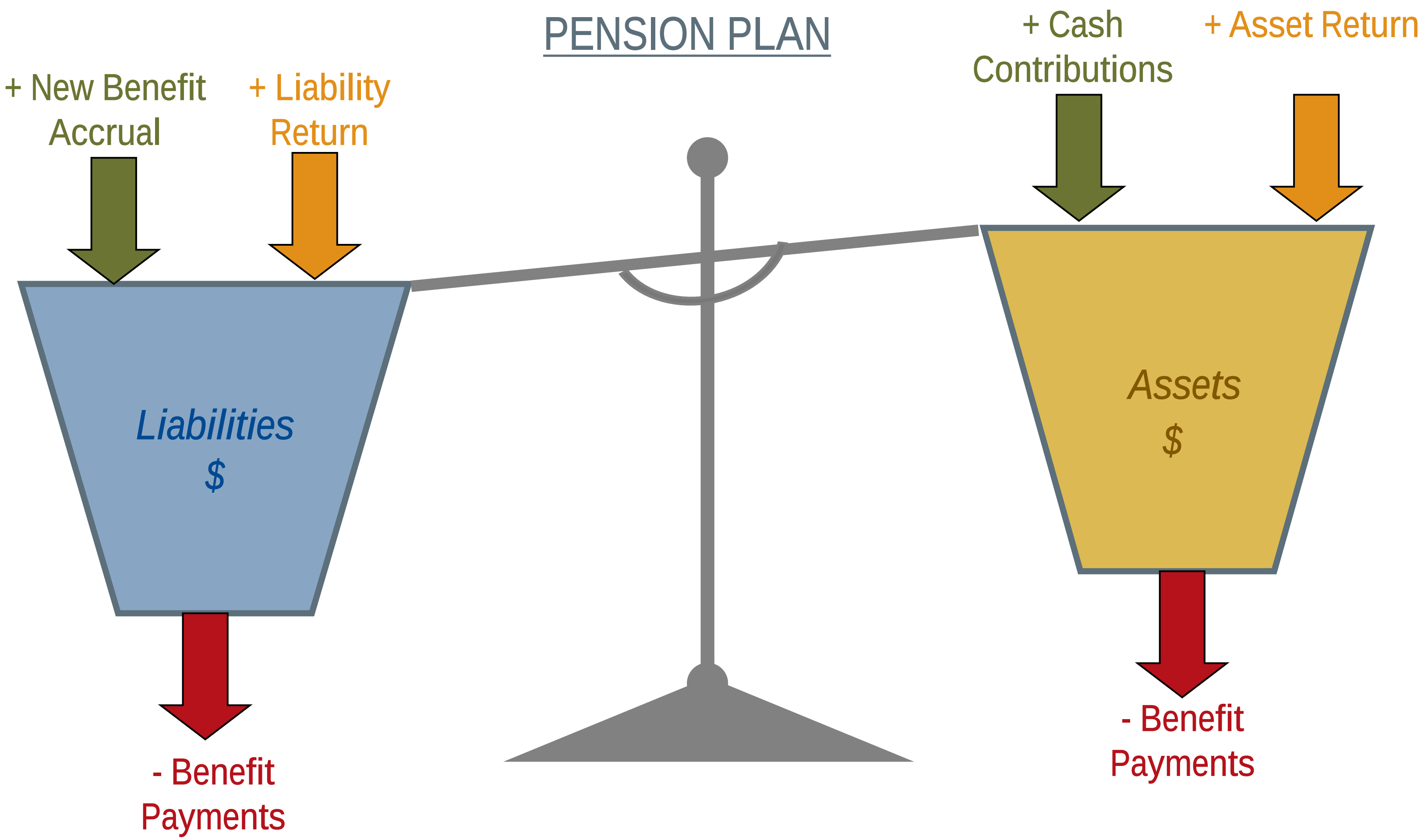
Open meeting resumed at 3:15 p.m. following the Executive Session. No action was taken by the Board while in Executive Session.

There being no further business, Chairman Bjontegard adjourned the meeting at 3:16 p.m.

Asset/Liability Study Recommendations
June 2013

Hewitt ennisknupp
An Aon Company

Pension – Balance of Liabilities and Assets



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Goals of Asset/Liability Study

- The key take-away from the asset-liability study is the allocation between equity ("more-risky") vs. fixed income ("less-risky")
- Major factors affecting the level of reasonable asset allocation are:
  - *Time horizon to fund the liability*: a longer time horizon supports more risk taking; the 30 year amortization to fund the deficit provides smoothing of possible large losses in a single year
  - *Characteristics of the liability*: a growing liability supports more risk taking; a liability sensitive to inflation would require more focus on inflation linked assets
    - H. 4967 caps the COLA increases to $500 (COLA is 1% automatic)
  - *Unfunded liability status*: the funded level impacts the appetite for risk
    - Potential excess return from equities or other risky assets can help reduce the current underfunding of the System
  - *Nature of cash flows*: a program with increasing near term claims may need additional liquidity and a more conservative policy – liquidity needs to be closely examined
    - Recent increases in SCRS contributions (for fiscal year 2013) can help alleviate liquidity needs
  - *Diversification:* Broad diversification among traditional and alternative assets can generate a more risk-efficient portfolio

Hewitt ennisknupp
An Aon Company

Summary of Recommendation Adopted in SOIP April 23rd

- Our asset/liability study was presented to the Retirement System Investment Commission on February 28th
- At the April 23rd meeting, the changes from the study were adopted as part of a revised Statement of Investment Objectives and Policies and Annual Investment Plan.
- These changes included:
  1. Modified target asset allocation
  2. Narrowed rebalancing ranges around target asset allocation
  3. Changes to some of the asset class benchmarks
- While the new asset allocation does not differ greatly from the previous target, we think it does offer the following benefits:
  – Better risk/return trade off: higher expected return with a modest increase in expected risk
  – For the next 10 years, the recommended portfolio has an expected return of 7.14%, while the previous allocation had an expected return of 7.00%
  – During the next 30 years, we expect the portfolio to provide a median return of 7.68% whereas the previous allocation had a 30-year return expectation of 7.55%
  – We are comfortable maintaining a portfolio heavy in alternatives
- As illustrated on the following slide, we looked at the possibility of using portfolios of just stocks and bonds, but those resulted in lower expected returns and higher expected volatility
- In addition to reviewing target allocations, we also recommended ranges around the targets, and also reviewed performance benchmarks and introduced some changes there.

Alternative Portfolio Return and Risk Expectations

Asset Class	Current Target Policy (80% R-S)	Alternative 1: Proposed Solution (85% R-S)	Alternative 2: Same Risk Higher Return (91% R-S)	Alternative 3: Capped Private Market Investments (85% R-S)[6]	Alternative 4: No Alternative Investments (60% R-S)
Global Equity[1]	38%	40%	32%	42%	60%
Real Assets[2]	6%	8%	9%	6%	0%
Opportunistic[3]	15%	18%	27%	15%	0%
Diversified Credit[4]	21%	19%	23%	22%	0%
Fixed Income[5]	20%	15%	9%	15%	40%
Total	100%	100%	100%	100%	100%
10 Year Expected Return	**7.00%**	**7.14%**	**7.57%**	**7.06%**	**6.15%**
10 Year Expected Risk	12.52%	11.54%	12.52%	12.81%	12.98%
10 Year Sharpe Ratio	0.456	0.506	0.501	0.450	0.374
10 Year Expected Inflation	2.30%	2.30%	2.30%	2.30%	2.30%
30 Year Expected Return[6]	**7.55%**	**7.68%**	**8.04%**	**7.53%**	**6.79%**
30 Year Expected Risk	11.93%	11.04%	11.97%	12.17%	12.19%
30 Year Sharpe Ratio	0.415	0.460	0.454	0.405	0.344
30 Year Expected Inflation	2.30%	2.30%	2.30%	2.30%	2.30%

[1] Global Equity is comprised of Global Public Equity and Private Equity

[2] Real Assets is comprised of Real Estate and Commodities

[3] Opportunistic is comprised of Hedge Funds and Global Asset Allocation (GAA)

[4] Diversified Credit is comprised of High Yield Bonds, Bank Loans, Emerging Market Debt, and Private Debt/Opportunistic Credit

[5] Fixed Income is comprised of Core Fixed Income, International Bonds, Intermediate Credit, Short Credit, Short Gov't Bonds, and Cash

[6] Private Market Investments (Private Equity, Private Debt, and Real Estate) and Hedge Funds are capped at 20% of the total asset allocation.

1. Summary of Recommended Asset Allocation

Asset Class	Current Target	Proposed Target	Change
Global Equity:	38.5%	40%	+1.5%
• U.S. Stock (lg. + small-cap)	14		
• Non-U.S. Stock – Developed	8	31%*	+1%
• Emerging Markets Equities	8		
• Private Equity	8.5%	9%	+0.5%
Real Assets:	6%	8%	+2%
• Commodities	3	3*	-- --
• Real Estate	3	5	+2%
Opportunistic:	15%	18%	+3%
• GTAA/Risk Parity	10	10*	-- --
• Hedge Funds (low beta)	5	8*	+3%
Diversified Credit:	20.5%	19%	-1.5%
• Mixed Credit (HY, Loans, Structured)	6	6*	-- --
• Emerging Market Debt	6	6*	-- --
• Private Debt	8.5	7*	-1.5%
Conservative Fixed Income:	20%	15%	-5%
▪ Core Fixed Income (+IG Credit)	12	7%	-5%
▪ Global Fixed Income (hedged)	1	3	+2%
▪ Short Duration	4	3	-1%
▪ Cash (net of overlays)	3%	2%	-1%

***Asset classes in which hedge funds can be used, up to a maximum of 15% across the entire portfolio
**We recommend a secondary benchmark be used over longer periods: vintage year universe median returns

2. Summary of Recommended Rebalancing Ranges

Asset Class	Current Minimum	Current Maximum	Proposed Minimum	Proposed Maximum
Global Equity:			30%	45%
• U.S. Stock (lg. + small-cap)	0%	25/20%		
• Non-U.S. Stock – Developed	0%	25%	25%	37%
• Emerging Markets Equities	0%	20%		
• Private Equity	0%	15%	6%	12%
Real Assets:	0%	20%		
• Commodities	0	10%	0%	6%
• Real Estate	0	10%	2%	8%
Opportunistic:	0%	20%		
• GTAA/Risk Parity	0	20%	7%	13%
• Hedge Funds (low beta)	0	20%	5%	11%
Diversified Credit:				
• Mixed Credit (HY, Loans, Structured)	0	25%	3%	9%
• Emerging Market Debt	0	25%	3%	9%
• Private Debt	0	15%	4%	10%
Conservative Fixed Income:			10%	25%
▪ Core Fixed Income (+IG Credit)	0	50%	4%	10%
▪ Global Fixed Income (hedged)	0	25%	0%	6%
▪ Short Duration	0	100%	0%	6%
▪ Cash (net of overlays)	0	100%	0%	5%

- We recommend more narrow ranges across all asset class. In practice, the portfolio has not generally tested the minimums or maximums.

3. Recommended Asset Class Benchmarks

Asset Class	Current Benchmark	Recommended Benchmark
Global Equity:		
Global Public Equity	Blend of underlying sub-asset class benchmarks	**MSCI All-Country World Index**
Private Equity	80% Russell 3000 / 20% MSCI EAFE + 300 bps, on a 3-month lag	80% Russell 3000/20% MSCI EAFE + 300 basis points , on a 3-month lag
Real Assets:		
Commodities	Dow Jones-UBS Commodity Index	Dow Jones-UBS Commodity Index
Broad Real Estate	NCREIF Property Index	**NCREIF Open-end Diversified Core (ODCE) Index + 75 basis points**
Opportunistic:		
GTAA/Risk Parity	50% MSCI World / 50% S&P/Citi WGBI	50% MSCI World / 50% S&P/Citi WGBI
Hedge Funds (Low Beta)	HFRX Global Hedge Fund Index	**HFRI Fund Weighted Composite Index**
Diversified Credit:		
Mixed Credit (HY, Loans, Structured)	1/3 Barclays U.S. High Yield, 1/3 S&P/LSTA Leveraged Loan and 1/3 Barclays MBS Indices	1/3 Barclays U.S. High Yield - 2% Issuer Cap, 1/3 S&P/LSTA Leveraged Loan and 1/3 Barclays MBS Indices
Emerging Market Debt	50% JP Morgan EMBI Global / 50% JP Morgan GBI-EM Global	**50% JP Morgan EMBI Global Diversified (US Dollar denominated) / 50% JP Morgan GBIEM Global Diversified (local currency denominated)**
Private Debt	1/3 Barclays U.S. High Yield, 1/3 S&P/LSTA Leveraged Loan and 1/3 Barclays MBS Indices	**S&P/LSTA Leveraged Loan + 150 basis points on a 3-month lag**
Conservative Fixed Income:		
Core US Fixed Income	Barclays US Aggregate Bond Index	Barclays US Aggregate Bond Index
Global Fixed Income (Hedged)	Barclays Global Aggregate Bond Index	Barclays Global Aggregate Bond Index (Hedged)
Short Duration	ML US Treasuries 0-3 Year Index	**Barclays 1-3 Year Government/Credit Index**
Cash Equivalents	90 Day Treasury Bills	**Merrill Lynch 3-Month T-Bill**

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SOUTH CAROLINA RETIREMENT SYSTEM

INVESTMENT COMMISSION

ANNUAL INVESTMENT PLAN

FISCAL YEAR 2013-2014

as adopted by the Retirement System Investment Commission
on April 23, 2013; effective on July 1, 2013

TABLE OF CONTENTS

SECTION 1: OVERVIEW AND PURPOSE

Overview

Annually, the Commission adopts a Statement of Investment Objectives and Policies ("SIOP"), which provides the objectives, policies, and guidelines for investing the assets of the Retirement System. The SIOP provides the framework by which the RSIC, at the direction of the Chief Investment Officer ("CIO"), drafts a proposed Annual Investment Plan ("AIP"). South Carolina law requires the CIO to submit the proposed AIP to the Commission no later than April 1st of each year, and the Commission must adopt a final AIP no later than May 1st of each year for the following fiscal year which begins on July 1. The Commission may amend the AIP during the fiscal year as it deems appropriate.

Purpose

The purpose of the AIP is to provide a formal document for investing and managing the Retirement System's assets to achieve the Commission's investment objectives and mission as stated in the SIOP, which is incorporated therein.

SECTION 2: STRATEGIC INITIATIVES

The Commission retained Deloitte & Touche in 2011 to perform an enterprise-wide risk assessment and to assist with developing an internal audit and compliance function. Deloitte & Touche presented the results of the assessment to the Commission during the September 15, 2011 Commission meeting. Several key risks identified related to integrating systems and technology to improve the processes for operations, reporting, risk management, and due diligence. To the extent possible, Staff will continue to incorporate the recommendations from the Deloitte risk assessment.

Completed Strategic Initiatives:

- Reorganized the Investment Team for strategy and research, external manager research, and internal asset management
- Hired multiple experienced investment Staff, including a Deputy CIO
- Restructured the coverage of Strategic Partnerships, including naming a Director of Strategic Partnerships
- Created and filled an Operational Due Diligence position
- With the support and direction of the Commission, Staff instituted a review of the Strategic Partnerships by the Investment Consultant
- Expanded the scope of the Investment Consultant relationship to include regular involvement and review of the Strategic Partnerships
- Completed a rationalization plan for Strategic Partnerships, whereby Partnerships have been identified for closure, restructuring and retaining
- Developed and presented to the Commission a plan for internal asset management upon which ongoing analysis and consideration for greater emphasis on internal implementation will be relied
- A management dashboard was created to monitor progress toward mitigating risks identified in Deloitte's Strategic Risk Assessment

- A Customer Management System (or Client Relationship Management, "CMS" or "CRM") was successfully procured and is now in the implementation phase with an expected completion date of March 2013
- Formal initial and on-going Due Diligence Guidelines were adopted and implemented; investment Staff members have been trained, and the new guidelines are fully operational
- Revised Due Diligence Guidelines require a Sources and Conflicts Disclosure form to be completed by those who are involved in sourcing and/or due diligence of the investment
- Successful completion of an RFP for Investment Consulting which included an expanded scope of services for operational due diligence

Ongoing Strategic Initiatives:

- Finalize the asset-liability study with the Consultant
- Revise the asset allocation policy and transition to the new target weightings
- Issue RFPs for risk management, administrative services, and private markets systems
- Continue rationalization and transitioning of Strategic Partnerships
- Recruit and hire the Director of Risk and Senior Fixed Income/Credit Officer
- Reestablish investment intern program from which RSIC may draw when full time positions are available

New FY 2013-2014 Initiatives:

- Implement internal passive/enhanced indexing strategies using basket trades, Exchange Traded Funds, and synthetic securities
- Implement Global Equity and Global Fixed Income mandates consistent with recommendations from the Consultant
- Transition away from the Portable Alpha implementation
- Redesign the Strategic Partnership model and standardize policies, procedures, and budget guidelines as much as possible
- Rationalize, simplify, and consolidate external manager allocations and continue to review feasibility for internal asset management with an initial focus on enhanced passive strategies
- Design, build, and grow an internal capacity and process for investment research, strategy development, and asset allocation recommendations
- Make appropriate recommendations from the investment consultant's manager fee analysis and peer comparison

SECTION 3: INVESTMENT STRATEGIES AND TRANSITION

Strategic Partnerships

The Commission has approved several Strategic Partnerships, which are customized, flexible, and opportunistic investment mandates implemented via separate corporate structures or legal entities managed jointly by RSIC and an external investment manager. Each Strategic Partnership has an Investment Committee overseeing its operations and investment mandate. The Investment Committee in each case consists of several members from the general partner (the external manager) and either one or both of RSIC's Chief Investment Officer and Deputy Chief Investment Officer as delegated by the Commission and as outlined within each Strategic Partnership agreement. The Strategic Partnerships follow a similar approval process for each investment, which requires that each new investment undergo due diligence by the investment manager and RSIC Staff, be reviewed by the Commission's consultant, be approved by the RSIC's Internal Investment Committee, and then receive unanimous consent of the Strategic Partnership's Investment Committee. The governing body of each Strategic Partnership maintains and manages policies, procedures, and budgets for the respective entity.

Staff will be implementing approved changes by the Commission and recommending additional changes to the Strategic Partnerships during fiscal year 2014.

Asset Class Policy Targets and Commentary

Given the current under-funded status of the Fund, the consultant's asset/liability analysis, forward looking capital market conditions, and Staff's assessment of current and expected market opportunities, the recommended asset allocation policy for fiscal year 2014, as shown in the SIOP, will reflect an increase in return-seeking assets. The increases will be evident in Global Equity, Real Assets (primarily Real Estate), and Opportunistic strategies (primarily in public markets hedge funds). The increased allocations will be offset by a recommended smaller allocation to Global Credit in the return-seeking category, and by a 5 percent reduction in Conservative Fixed Income, the Fund's low risk/more liquid component. The Fund is fully allocated to Private Equity and Private Debt; thus, Staff expects these assets to be managed on a recycle basis (distributions are expected to offset most capital calls).

Staff manages the Fund's exposures within each asset class based in part on the composition of the policy benchmark. Staff will begin transitioning from the current policy asset allocation to the fiscal year 2014 asset allocation, as presented in the SIOP. Staff estimates that it will take approximately six months to effectuate this transition.

Global Equity

The Global Equity class will be managed across three categories: "Beta," "Alpha", and Private Equity. Beta is designated for passive or enhanced index equity market exposure that can be efficiently implemented internally by RSIC Staff. Alpha is designated for external public, liquid market equity managers where the fees will be justified by performance. The Beta and Alpha categories will be managed relative to the MSCI All Country World IMI Index.

Private Equity will continue to include extensive use of external managers and will be managed by the private equity team. The risks from either explicit or implied equity exposure will be accounted for within the Global Equity asset class.

The components of the Global Equity category will be managed within the approximate guidelines of an optimized (i.e. modeled) allocation of 25 percent Alpha (active management, both traditional and alternative strategies) and 75 percent Beta (efficient implementation in efficient markets). This portfolio construct is a significant change from the current approach and will require time to fully implement. Staff plans to begin this transition in March 2013, and expects this to be ongoing throughout 2014.

Real Assets

Real Estate and Commodities are the components of the Real Assets policy allocation. The recommended increase to Real Assets is affected in an increase to the Real Estate target from 3 percent to 5 percent, thus contributing to the shift toward return-seeking assets and aligning the Real Estate component with a realistic long term policy target.

With respect to the intended shift toward active Commodity exposure started in 2011-12, implementation has been challenging. Thus, Commodity exposure is expected to continue mostly in the form of passive and enhanced exposures with an opportunistic approach to alternative strategies. Staff continues to support the long term goal of a more optimal (i.e. higher returns and/or lower risk) implementation of the Commodity category through the inclusion and active management of low beta strategies.

Opportunistic

The Opportunistic asset class includes a dedicated hedge fund category intended for low beta exposure from alternative strategies. The category is expected to improve diversification (i.e. decrease risk) of the Fund as a result of asymmetric performance – reasonable positive contributions to the Fund while avoiding significant drawdowns.

The Opportunistic asset class will also include allocations to the previously separate asset class of GTAA/Risk Parity strategies, idiosyncratic strategies, strategies targeting narrow market opportunities or dislocated markets, and multi-strategy funds with flexible mandates around specific expertise. The asset class will contribute an incremental 3 percentage points to the intended increase in return-seeking assets.

Diversified Credit

The Credit category is included in return-seeking assets but the target allocation will decrease by 1.5 percentage points. The lower target reflects the fact that the Fund is fully allocated to the Private Debt/Opportunistic sub-category; further, market opportunities for High Yield/Banks Loans and Emerging Market Debt are less attractive relative to the opportunities in other return-seeking asset categories.

Conservative Fixed Income

The Conservative Fixed Income asset class is intended to provide the primary source of diversification as a lower risk, liquid, short duration, and/or high credit quality component of the fund. The category is also managed as the primary source of capital to pay benefit obligations. With the explicit goal of increasing return-seeking assets, the Conservative Fixed Income allocation will decrease by 5 percentage points. The primary impact will be from the Cash/Short Duration sub-category as the RSIC is more comfortable with the goal of deploying capital given recent market conditions. Within the Conservative Fixed Income class, Cash/Short Duration will decrease to 3 percent of the fund from the current target of 7 percent; Core Fixed Income (Investment Grade Credit) will decrease by 2 percentage points, and Global Fixed Income will increase by 3 percentage points.

PUBLIC EMPLOYEE BENEFIT AUTHORITY AGENDA ITEM

Wednesday, June 19, 2013 **Agenda 4**

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1. **Subject:** State Option Retirement Program (State ORP)

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2. **Summary:** Overview of the State Optional Retirement Program (ORP)

Background Information: The Committee was presented with a summary of the following:

- Contracts associated with the State ORP and key dates pertaining to these contracts.
- The Board's fiduciary duties related to the State ORP.
- Proposed changes to the Investment Policy Statement (IPS).
- The Managed Account feature, which is a way for participants to receive customized investment advice within the State ORP.

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3. What is Board asked to do? Receive contracts, fiduciary duties, and Managed Account features as information.

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4. Supporting Documents:

(a) List those attached:

1. State ORP Overview
2. State ORP Presentation

State ORP Overview **June 19, 2013**

The Defined Contribution Unit is responsible for ensuring the successful operation of the defined contribution retirement plans administered by the State of South Carolina. The plans that are currently overseen are the State Optional Retirement Program (State ORP) and the South Carolina Deferred Compensation Program (SCDCP). The Board of Directors of the South Carolina Public Employee Benefit Authority (PEBA) is now the plan sponsor for the State ORP and will become the plan sponsor for SCDCP, effective January 1, 2014.

The State ORP is an alternative to the South Carolina Retirement System (SCRS) retirement plan. It is a 401(a) qualified governmental plan that is governed by State statute under Title 9, Chapter 20. There are four vendors currently available to State ORP participants: **MassMutual, MetLife, TIAA-CREF, and VALIC**. The current investment consultant is **Summit Strategies Group**.

As of March 31, 2013, the number of participants in the State ORP was **36,055**. The total assets in the State ORP as of the same date were **$1,172,623,297**.

PEBA staff responsibilities related to oversight of the State ORP include:

- Ensuring contract compliance, including periodic meetings or calls to discuss open items.
- Ensuring accuracy of information provided via the PEBA website, relative to the State ORP. This includes posting quarterly updates of information related to investment options, fees, and performance.
- Monitoring communication pieces and forms developed by vendors for accuracy and reviewing delivery methods. This includes vendor websites.
- Working with investment consultant to monitor vendor compliance with Investment Policy Statement (IPS).
- Communicating with investment consultant to discuss recommended updates to the IPS, given industry trends and regulatory requirements.
- Following up on participant or employer issues that escalate to PEBA staff to ensure timely resolution.
- Preparing for and executing the annual State ORP meeting.
- Participating in annual strategic planning to address industry trends and best practices.
- Directing RFPs for investment consultant and vendors.
- Ensuring plan document and amendments are completed in a timely manner and in accordance with established guidelines.
- Ensuring plan compliance with IRS and DOL regulations.
- Ensuring all important documentation is saved in a logical manner on the network drives.

State Optional Retirement Program

Contracts Schedule

- **Investment Consultant – Summit Strategies Group**
  3-Year Contract with Two Optional 1-Year Renewals
  - **Current Contract Awarded:** July 1, 2012
  - **Next Contract Begins:** July 1, 2017 (Assuming Optional Renewals are Exercised)
  - **Must Bid By:** November 2016 (Assuming Optional Renewals are Exercised)
  - **Fee:** $130,000/Year (Guaranteed for First Three Years)
  - **Fee Payment:** Equal Installments Billed Quarterly In Arrears

- **Recordkeepers – MassMutual, MetLife, TIAA-CREF, and VALIC**
  3-Year Contract with Two Optional 1-Year Renewals
  - **Current Contract Awarded:** July 1, 2010
  - **Next Contract Begins:** July 1, 2015 (Assuming Optional Renewals are Exercised)
  - **Must Bid By:** November 2014 (Assuming Optional Renewals are Exercised)
  - **Fee:** All Revenue and Payments from Fund Companies
  - **Fee Payment:** Automatically Captured by Vendors

PEBA Board Fiduciary Duties

- Approve Amendments to and Restatements of Plan Document
- Approve Changes to Investment Policy Statement
- Approve Changes to Investment Options within the Program
- Approve Changes to Features Offered within the Program
- Review Performance of Investment Options on a Quarterly Basis
- Review Fees and Expenses for Reasonableness on an Annual Basis
- Review Plan-Level Reporting and Initiatives on an Annual Basis
- Ensure that the Program Remains in Compliance with Federal and State Regulations
- Ensure that the Program Adheres to Industry Best Practices as Appropriate

*** PEBA Board may Delegate Duties and Responsibilities to PEBA Staff and/or Third Parties as Appropriate. ***

South Carolina
PUBLIC EMPLOYEE BENEFIT AUTHORITY
PEBA

Defined Contribution Unit

State ORP Overview

Defined Contribution Unit

- **State Optional Retirement Program**
- **S. C. Deferred Compensation Program**
  - Effective January 1, 2014

State ORP Overview

- **Alternative to SCRS**
- **401(a) DC Plan**
- **Vendors:**
  - MassMutual, MetLife, TIAA-CREF, and VALIC
- **Investment Consultant:**
  - Summit Strategies Group

Statistics and Eligibility

- **Total Participants: <u>36,055</u>**
- **Total Assets: <u>$1,172,623,297</u>**

- **<u>Eligible Employers:</u>**
  - <u>State Agencies</u>
  - <u>K-12</u>
  - <u>Higher Education</u>

Enrollment Process

1) Select ORP.
2) Choose Vendor.
3) Notify PEBA and Open Account.
4) Employer Remits Contributions.
5) Chosen Vendor will Service Account.

Contribution Rates

- **Participant contributes the same percentage of salary as SCRS members**
  - Currently set at 7.5% for July 1, 2013
- **Employer contributes the same percentage of payroll as SCRS employers**
  - Currently set at 10.6% for July 1, 2013
    - 5% of compensation goes to the Participant's ORP Account and is immediately vested
    - Difference between SCRS rate and 5% (i.e., 5.6% of compensation) goes to PEBA for administrative expenses of ORP and to SCRS Plan

Open Enrollment

- January 1 – March 1
- May Switch Between Vendors
- May Convert to SCRS (if applicable)

PEBA Board – Scheduled Duties

- **Quarterly Duties:**
  - Review Investment Options
- **Annual Duties:**
  - Review Fees and Expenses
  - Review Plan-Level Reporting and Initiatives

PEBA Board – Ongoing Duties

- Approve Plan Document Changes
- Approve Investment Policy Changes
- Approve Investment Option Changes
- Approve Feature Changes
- Ensure Compliance to Regulations
- Ensure Adherence to Best Practices

Questions?

- <u>Contact</u>: Matthew Davis
  (803) 737-6900
  mdavis@peba.sc.gov

PUBLIC EMPLOYEE BENEFIT AUTHORITY AGENDA ITEM

Wednesday, June 19, 2013 **Agenda 5**

1. Subject: State Optional Retirement Program (ORP) Investment Policy Statement (IPS)

2. Summary: Periodically the Board will need to review the IPS to ensure that it adheres to industry best practices and complies with Federal and State Regulations.

3. What is Board asked to do?

The Board is being asked to adopt the new revised Investment Policy Statement (IPS)

4. Supporting Documents:

(a) Attached:
1. Summit Presentation on the IPS changes
2. Proposed Amended Investment Policy Statement

Summit Strategies Group
8182 Maryland Avenue, 6th Floor
St. Louis, Missouri 63105
314.727.7211

PEBA Board Update

SOUTH CAROLINA OPTIONAL RETIREMENT PROGRAM

June 19, 2013

INVESTMENT POLICY STATEMENT (IPS) BACKGROUND

- The existing Investment Policy Statement ("Statement") was last revised in January of 2010 and dates back to 2003.
- Given the creation of PEBA and changes to ORP staff, it was determined that a review of the IPS was appropriate.
  - Staff takes a very proactive approach to plan management.
- Summit took the following into consideration when making recommendations:
  - The Statement should serve as a general guide to plan administration and governance, it should not include a level of specificity that could result in an "accidental" violation if not strictly enforced.
  - The Statement should not make assertions or establish obligations of any party that cannot be reliably enforced.
  - The Statement does not need to specify the exact manner in which an obligation will be performed, just that the obligation is necessary.
  - It must treat all vendors fairly and establish a common set of expectations to which each can adhere.

SUMMARY OF PROPOSED IPS CHANGES

- Summit recently reviewed the Statement and suggested changes in the following areas:
  - Streamline language to make the Statement more concise and easier to understand.
  - Remove references to the (now dated) Pension Protection Act in favor of references to current Qualified Default Investment Alternative regulations.
  - Simplify language within the managed accounts portion and remove obligatory reporting requirements that were extremely specific in nature and, if not followed, could constitute a violation of the Statement.
  - Remove extensive language governing GICs.
    - As a guarantee backed by the overall credit worthiness and general account of the insurer, a review of the underlying holdings is not applicable and does not indicate a greater likelihood of meeting that guarantee.
      - References to minimum credit ratings and credit worthiness remain.
    - References to a target rate of return are no longer appropriate in this low rate environment.
    - Extreme specificity could result in violations of the Statement and a requirement to terminate the contract and trigger associated penalties.

Disclaimer: Although Summit Strategies Group (Summit) believes the modeling contained in this document to be reliable, the modeling of complex financial transactions has inherent limitations. Summit does not guarantee the results to be obtained by the use of this model. This model is developed by Summit based on information obtained from sources which Summit believes are reliable, but Summit does not warrant or guarantee the accuracy, completeness, or reliability of such information. Any information contained in or provided in connection with the model is for information purposes only, for the exclusive use by the client for which it was prepared, and is not intended and should not be construed to be an offer to buy or sell any securities, investment consulting or investment management services. No model can, in and of itself, be used to determine which securities or investments to buy or sell. All forward-looking projections are based on assumptions that Summit believes may be reasonable, but are subject to a wide range of risks, uncertainties and the possibility of loss. Accordingly, there is no assurance that any estimated performance projections of any model will occur in the amounts and during the periods indicated, or at all. Actual results and performance will differ from those expressed or implied by such forward-looking projections. Any decision to use or not use the model and any information accompanying or produced with the model remains solely with the client.

SOUTH CAROLINA STATE OPTIONAL RETIREMENT PROGRAM
INVESTMENT POLICY STATEMENT

Adopted October 10, 2003
Revised September 14, 2005
Revised April 21, 2008
Revised January 26, 2010
Revised June 19, 2013

I. INTRODUCTION

The South Carolina State Optional Retirement Program ("State ORP" or "Plan") is a defined contribution plan qualified under Section 401(a) of the Internal Revenue Code. The State ORP is exempt from the Employee Retirement Income Security Act (ERISA), but will attempt to adhere to certain provisions of ERISA, where administratively possible and appropriate to do so.

The State ORP has developed this Investment Policy Statement ("Policy") to:

- Ensure a broad range of investment options that allows each participant to create a portfolio well suited to their individual risk and return objectives.
- Control the number and types of options offered so participants can effectively exercise their discretion in managing Plan assets.
- Define the asset classes and types of options that can be offered to participants.
- Establish guidelines and minimum criteria for the initial selection and ongoing monitoring of investment options.
- Establish a protocol for investment options that fail to meet the criteria, including termination and replacement.
- Provide a written record of the guidelines and expectations for each Third Party Administrator ("Recordkeeper" or "Vendor") serving the State ORP.

II. PLAN PURPOSE

The Plan is a long-term savings vehicle for participants to accumulate assets for retirement. Investment options offered within the Plan should be appropriate for participants of varying age, total return needs, risk tolerance, and investment knowledge. Investment options are proposed by each Vendor in accordance with the guidelines set forth in the Policy. Participants select a Vendor and direct the investments within their account using education and guidance provided by the State ORP, each Vendor, the individual investment management companies, and other sources. The primary function of the South Carolina Public Employee Benefit Authority ("PEBA"), and that of the Investment Consultant, as it pertains to the State ORP is to set and monitor compliance with the guidelines set forth in the Policy.

III. SELECTION GUIDELINES

A Vendor may offer State ORP participants a single investment option in each of the following major asset classes. It is not necessary that Vendors offer a product or products in each category. To avoid possible confusion caused by a large number of investment options, no Vendor may offer more than sixteen core investment options.

Core Options (Active or Passive)

- Fixed Income (no more than one option for each asset class)
    - Guaranteed Annuity or Stable Value (no more than one option in total)
    - Money Market
    - Core or Core Plus Bond
    - Inflation-Linked Fixed Income or Real Asset
- Equity (no more than one option for each asset class)
    - Large Cap Blend/Core
    - Large Cap Value
    - Large Cap Growth
    - Mid Cap Blend/Core
    - Small Cap Blend/Core
    - Small Cap Value
    - Small Cap Growth
    - Foreign Developed
    - Emerging Markets
- Specialty/Sector Options (no more than one option such as, Technology, Real Estate, or Healthcare)

Non-Core Options

- Asset Allocation Option (a "balanced strategy" with a static asset allocation)
- Target Maturity Options (a suite of options with asset allocations that evolve automatically)

Default Option Offering

In the event a participant fails to designate an investment election during the enrollment process, the member's contributions must be invested in an approved default option. The option offered should be consistent with a Qualified Default Investment Alternative (QDIA) as defined by current regulation.

Provision of Investment Advice to Participants

Subject to review and approval by PEBA and/or its Investment Consultant, Vendors may provide investment advice to State ORP participants. In the course of providing these services, vendors will be expected to:

1. Accept fiduciary responsibility in the provision of said advice to participants.
2. Incorporate a holistic approach to the participants' financial situation, taking into consideration their overall financial circumstances, retirement objectives, risk tolerance and additional sources of post-retirement income and other assets to the extent possible.
3. Ensure that its advisors are properly trained and possess adequate experience, certification, and licensing.
4. Provide adequate coverage across the State of South Carolina so that advisors are accessible to participants via personal meetings, group seminars, scheduled office hours, web access or telephone service.
5. Properly disclose to the State ORP and participant all fees associated with the service.

PEBA and/or its Investment Consultant will periodically review the advisory service to determine if the offering and fees are appropriate for the Program and competitive within the marketplace.

Prohibited Investments

The following investment options may not be offered by a vendor:

1. Options that have a front-end or deferred load or 12(b)-1 fees in excess of 25 bps
2. Options that are not daily valued
3. Any option added to the lineup after January 1, 2010 with a liquidity restriction at the individual participant, or total plan level, exceeding 12 months
4. Options that do not have at least a three-year live performance track record. Options with a performance track record that is associated with another option with a three-year track record are permitted. This includes other share classes of the same fund or strategies offered in other vehicles (separate accounts, commingled trusts)
5. Real Estate strategies that are a) value added or opportunistic in nature, b) closed-end funds or those with liquidity restrictions, c) concentrations in geography or property type, and d) strategies that utilize leverage in excess of 30 percent

Guaranteed Annuities and Stable Value Options

Guaranteed Annuity and/or Stable Value Options may be offered. These products must adhere to the following minimum guidelines:

1. A guarantee of preservation of principal and income supported by a reputable, financially secure insurance company with an A.M. Best rating of A or better, and/or a Moody's rating of A1 or better or its equivalent as determined by a nationally recognized statistical rating agency.
2. Adequate liquidity to support the plan's liquidity needs.
3. Crediting rates that are competitive with similar products in the marketplace.

Equity and Bond Funds:

Actively managed options will be measured on an absolute and relative basis. Relative comparisons will be based on the appropriate peer universe and benchmarks. Selection of universe and benchmark will be based on the investment manager's stated strategy and benchmark, as well as analysis conducted by PEBA and/or its Investment Consultant. In the case of stable value, insurance annuity products, money market options and target maturity options, a peer universe comparison may be waived if an investment's unique strategy and process, or composition of the peer universe, would not result in a meaningful analysis.

Passive or index options will be evaluated on their tracking error to their specific index, which is expected to be consistent with similar strategies.

Actively managed options proposed for inclusion in the State ORP must meet the following minimum criteria:

1. Have a total return that ranks in the top 60th percentile of its peer universe over at least two of the most recent 1-year, 3-year and 5-year trailing periods.
2. Outperform its benchmark, net of fees, over at least two of the most recent 1-year, 3-year and 5-year trailing periods.

3. Be managed by the same person(s) or substantially the same group for at least the past three years.
4. Have an Information ratio rank in the top 50^{th} percentile of peer universe over at least two of the most recent 1-year, 3-year and 5-year trailing periods.
5. For options added to the plan after January 1, 2010, investment expenses for any bond or equity option must not exceed the total in the following table. This expense includes all investment expenses such as the investment management expense ratio, 12(b)-1 fees, mortality charges, administrative charges or any other charge against the investment account of the participant.

Asset Class	**Maximum Expense Ratio**
Active Bond	0.75%
Bond Index	0.50%
Active Large Cap, Mid Cap, Target Maturity/Asset Allocation	1.25%
Small Cap	1.50%
Foreign Stock	1.50%
US and Foreign Equity Index	0.50%
Real Estate	1.50%

Target Maturity Options

Vendors may offer a series of target maturity options. In evaluating target maturity options, a number of factors including, but not limited to, the following will be considered:

1. The manager’s experience managing multi-asset class portfolios;
2. The asset allocation “glide path”;
3. The investment strategy and portfolio structure of the underlying products in the series, i.e., active or passive, extent of diversification across asset classes, and/or rebalancing procedures; and
4. The performance of the strategies relative to appropriate benchmark and peers.

Other Criteria

From those options that meet the basic requirements previously outlined for option selection, in making a final selection PEBA may consider, but is not limited to, the following criteria:

1. Assets under management
2. Tenure of management
3. Stability of organization
4. Management, 12(b)-l, and other fees
5. Relationship with recognized fund family
6. Administrative requirements of the Plan and Vendor
7. Number of options in the Plan with same or similar option family relationship
8. Performance as measured by various quantitative factors, some examples including but not limited to returns/holdings-based style analysis, Beta, Sharpe Ratio, sector distribution or duration

PEBA reserves the right to accept or reject any option proposed by any Vendor, or discontinue an option offered within the Plan, at any time, at its sole discretion.

IV. ONGOING EVALUATION OF ACTIVELY MANAGED INVESTMENT PRODUCTS

At the end of each calendar quarter or as deemed necessary by PEBA, the Investment Consultant will complete a comprehensive performance analysis. This analysis will include, but is not limited to, statistical measures of performance, risk, style consistency, characteristics, and other criteria used to evaluate the relative success of each investment option in meeting its objectives and PEBA's expectations. PEBA or its Investment Consultant will maintain a "Watch List" to efficiently track the performance of each investment option and determine if that option should remain in the Plan.

Existing actively managed options will be considered for retention based on the following criteria:

1. Primary Benchmarks:

   A. Performance exceeds the return of the independent benchmark appropriate for the respective asset class and category for at least two of the most recent 1-year, 3-year and 5-year trailing periods, ending with the most recently completed calendar quarter.

   B. Performance exceeds the 50th percentile return within the appropriate peer universe over the same time periods previously referenced. Due to the limited peer universe, target maturity strategies, stable value/GIC products, and money market funds are excluded from these criteria.

2. Secondary Benchmarks:

   A. The Information Ratio exceeds the 50th percentile return within the appropriate peer universe over the same time periods previously referenced.

   B. The Sharpe Ratio exceeds the 50th percentile return within the appropriate peer universe over the same time periods previously referenced.

3. Option Status:

Options will be classified as "Good" or placed on a "Watch List" according to the following table.

Primary Benchmarks	Secondary Benchmarks	Status
Both Pass	N/A	Good
Only 1 Passes	At Least 1 Passes	Good
Only 1 Passes	Both Fail	Watch List
Both Fail	N/A	Watch List

Passive Funds will be evaluated on their tracking error to the target benchmark. Tracking error should be consistent with that of similar strategies.

In addition to these quantitative assessments, PEBA and/or its Investment Consultant may also place options on this "Watch List", or may remove options from the plan entirely, at their discretion based on qualitative factors. Examples of these qualitative issues or events include, but are not limited to, the following:

1. Significant changes in firm ownership and/or structure
2. Loss of one or more key personnel
3. Significant loss of clients and/or assets under management
4. Shifts in the investment firm's philosophy or process
5. Changes in the investment strategy eliminating the need for a particular style or strategy
6. Any other issue or situation of which PEBA and/or its Investment Consultant become aware that is deemed material by them

PEBA and/or its Investment Consultant will notify the Vendors of the "Watch List" status of their respective offerings quarterly.

V. PROCEDURE FOR CLOSING OPTIONS

Options on the "Watch List" will be addressed in the following manner:

1. Once an investment option is placed on the watch list and remains there for eight sequential quarters or eight total (non-sequential) quarters in a rolling twelve quarter period, the Vendor will freeze the option to new contributions within a reasonable time period.
2. In the event the frozen investment option is replaced with an option of the same strategy or risk and return profile, existing assets in the frozen option will be mapped to the new option.
3. In the event the frozen investment option is not replaced with an option of the same strategy or risk and return profile, existing assets in the frozen option will be mapped to the default option offered within the Vendor's investment menu.
4. Under no circumstances should assets remain in the frozen investment option for greater than two quarters, unless the participant has the contractual right to retain those assets in the frozen option.
5. Frozen investment options will no longer fall under the governance of PEBA and are exempt from prospective monitoring.

VI. INVESTMENT POLICY CHANGES

PEBA retains the right to modify the above Policy as deemed necessary to meet its fiduciary responsibility for the Plan and to the participants.

Approval Date

The PEBA Board of Directors approved this policy on the date shown below:

____ ______________

Arthur M. Bjontegard, Jr. Date
Chairman

South Carolina Public Employee Benefit Authority
Strategic Plan
2013-2014

PART I – BASIC PRINCIPLES

Mission Statement

The mission of the South Carolina Public Employee Benefit Authority is to effectively offer and administer a comprehensive program of retirement and insurance benefits for public employees.

Vision Statement

Our vision is to efficiently operate in the public interest an insurance and retirement plan that best serves the needs of public retirees and employees, and governmental employers.

Core Values

- **Quality Customer Services and Products –** We consistently provide outstanding products and excellent customer services, as defined by our customers, and we strive for continuous improvement.
- **Innovation** – We are receptive to and flexible with the changing environment and the evolving world of technology. We welcome challenges, embrace innovation, and encourage creativity.
- **Leadership** – We strive to lead government through strategic and visionary approaches that are proactive, fair, and ethical.
- **Professionalism** – We perform our work with honesty, integrity, and loyalty. We are committed to performance that is credible, thorough, competent, and worthy of customer confidence.
- **Employee Well-Being and Engagement** – We respect the individual contributions of each employee and endeavor to empower them with the needed resources for teamwork, shared pride, and continuous learning.

Overarching Strategic Objectives

At the broadest level, PEBA's overarching strategic objectives are to:

- Create an organization driven by the pursuit of excellence in all areas.
- Design and implement an updated health care plan that focuses on improving health outcomes and reducing costs.

- Provide for the efficient and cost effective administration of the retirement systems for active and retired members of the systems.
- Ensure the highest fiduciary, legal and ethical standards are known and applied across the organization.

Expected Results

PEBA expects that, by pursuing the goals and objectives set out in this and future strategic plans, it will achieve the following results:

- Satisfied participants, members, beneficiaries and stakeholders
- Engaged employees
- Improved fiscal and financial positions of the plans and programs administered by PEBA
- Long-term success for PEBA as an organization and for the plans and programs administered by PEBA

PART II – SPECIFIC INITIATIVES

I. STRATEGIC PLANNING

This Section addresses how PEBA pursues strategic planning and how PEBA will implement the strategies and goals developed during the process.

Strategic Issue: Strategic Planning: PEBA should establish a robust, ongoing strategic planning process. Ultimately, PEBA intends to apply for, and receive, the Governor's Quality Award and the national Malcolm Baldrige Award.

Goal:

1. Annually, PEBA will conduct an organized process to put together a comprehensive strategic plan for the coming years.

Broad Strategies

1. Conduct a learning phase to identify the key stakeholders in PEBA's activities and to analyze the expectations of those stakeholders for PEBA and PEBA's expectations for those stakeholders.

2. Conduct an analysis of PEBA's strengths, weaknesses, opportunities, and threats, both in the near- and long-term.

3. Develop strategic issues, goals, strategies, and action plans based upon those analyses.

4. Deploy the strategic plan through:

    - Communication

- Workforce planning/education
- Performance reviews
- Detailed action plans for all key areas

The 2013-2014 strategic plan was developed, and will be deployed, under the process set out in this section. An action plan for 2013-2014 has been developed based on the issues, goals and strategies identified in this plan with the appropriate departments of PEBA tasked with necessary action steps.

II. LEADERSHIP AND GOVERNANCE

This section addresses how PEBA's Board of Directors and executive management define PEBA's mission, purpose, future vision, and the values by which PEBA will be managed.

For the 2013 – 2014 plan, the following goals and strategies have been established:

Strategic Issue: Governance: PEBA operates in a complex statutory scheme that involves multiple governmental bodies, including the PEBA Board of Directors, the General Assembly, the Budget and Control Board, and the South Carolina Retirement System Investment Commission. It is important that PEBA satisfies all of its statutory and fiduciary duties responsibilities and effectively manages its relationships with other governmental entities.

Goals

1. The fiduciary responsibilities of the Board and its committees are clearly defined and they are able to satisfy them.
2. The PEBA Board is provided with education regarding its role as a Board of Trustees, and the Board focuses on policy-level activities under their authority.
3. The PEBA Board has confidence in the administrative abilities of the PEBA staff.
4. The PEBA Board has a unified set of goals for insurance and retirement.
5. The PEBA Board speaks with one voice through the Board or committee chairs so as to not to dilute its authority
6. The PEBA Board develops creative, proactive solutions to public employee insurance and retirement plans
7. PEBA maintains a proactive relationship with the South Carolina Retirement System Investment Commission, the Budget and Control Board, and the General Assembly

Broad Strategies

1. Conduct regular and consistent Board training.
2. Develop fiduciary responsibility matrix.
3. Develop and periodically review committee by-laws and charters.
4. Refine communication process between Board, committee chairs, and PEBA staff.
5. Prioritize goals.
6. Develop the agency's governmental relations functions
7. Continue to enhance the relationship between PEBA and the RSIC to ensure that all necessary information is exchanged.

III. CUSTOMER FOCUS

This Section addresses how PEBA intends to provide the best quality service to its members, participants, beneficiaries and stakeholders.

Strategic Issue: Communication: PEBA stakeholders do not have a full understanding of the issues surrounding the provision of benefits to public employees in South Carolina.

Goals

1. Stakeholders understand the rationale behind policy decisions PEBA products and services.
2. Members are educated on the nature of their benefits in order to make sound decisions regarding their benefit plans.
3. Internal staff is informed of policy decisions and understand the impact on their work.

Broad Strategies

1. Evaluate current mechanisms of communication with stakeholders.
2. Utilize various, cost-effective mechanisms of communications.
3. Begin monthly management meetings with line managers and summarize and share results with employees.
4. Notify internal staff of the availability of Board meeting minutes; summarize important issues

Strategic Issue: Service: PEBA strives for continuous improvement of the level of service provided to members and benefits administrators.

Goals

1. Members and benefits administrators are able to receive services through a "one-stop shop".

2. PEBA is viewed as the resource for public employee benefits in the state.

3. PEBA services are rated both cost effective and of high quality.

Broad Strategies

1. Benchmark services to identify gaps.

2. Cross-train employees.

3. Have one office location.

4. Enhance communication regarding value of benefits.

5. Seek feedback from members regarding plans provided and allocation of benefits.

6. Ensure adequate technical knowledge by providing education and training of PEBA employees to stay current on trends and issues.

7. Offer flexible service and communication mechanisms

IV. PLAN MEASUREMENT AND ANALYSIS

This section addresses how PEBA measures the performance and funding of the plans and programs it administers. The Section also addresses how PEBA analyzes performance data in order to make decisions regarding future directions for the plans and programs.

Strategic Issue: Funding and Quality of the Plans: PEBA is under pressure from its stakeholders to control public employee benefit costs while providing maximum benefits. The cost to members and taxpayers is impacted by investment performance, member behavior, and their willingness to pay.

Goals

1. Provide the maximum benefit within the available resources.

2. Plans are equitable.

3. Funding mechanisms established for the plans are fiscally sound.

4. There is progress toward 100% funding.

5. Contributions are predictable and reasonable.

6. ORP participants are retirement-ready

7. PEBA Board will be ready to assume Deferred Compensation duties on January 1, 2014

Broad Strategies

1. Conduct experience studies to set reasonable assumptions.

2. Conduct annual valuations.

3. Obtain audited financial statements.

4. Coordinate and communicate with RSIC on liquidity needs and liability requirements.

5. Pilot patient-centered medical homes (PCMH)

6. Make appropriate changes to health plan design to improve health outcomes and reduce costs.

7. Have appropriate contracts in place and monitor vendor and provider performance for both the insurance and retirement plans.

8. Ensure plans are in compliance with applicable federal and state rules and regulations.

9. Develop rolling three-year plan for health insurance plans.

10. Develop internal capability to collect and analyze health care data.

11. Ensure employer and member compliance with plan requirements.

12. Focus education for ORP participants on retirement readiness

13. Adopt best practices concerning plan ORP offerings and structure

14. PEBA Board of Directors assumes trustee role for South Carolina Deferred Compensation Program

V. WORKFORCE PLANNING

This Section addresses how PEBA intends to build a strong workforce, slot people in the right positions, train them, and keep them motivated or engaged to consistently achieve high performance.

Strategic Issue: <u>Workforce Planning:</u> Like many organizations, PEBA is faced with staffing challenges brought on by loss of staff due to retirement and new skills requirements due to advances in technology. PEBA has the additional challenge of integrating separate work units into one agency.

Goals

1. PEBA has the ability to recruit and maintain a stable, sufficient, and proficient workforce to carry out the strategic goals of the agency.

2. PEBA employees see themselves as one agency.

3. Integrate EIP and Retirement staff's functions and responsibilities as appropriate.

Broad Strategies

1. Develop a workforce plan.

2. Initiate employee engagement activities

3. Initiate employee training related to improving systems and processes.

VI. OPERATIONS MANAGEMENT

This Section addresses how PEBA will improve its work systems. Work systems consist of both human resources and technological elements. The human resource elements and processes have been addressed in Sections III and V above. For information technology, PEBA's plan for 2013 – 2014 is as follows:

Strategic Issue: <u>Information Technology:</u> The agency is currently operating two separate, aging information systems- one for the retirement system and one for the insurance program.

Goals

1. PEBA will have a new, integrated system that improves efficiency in operations and effectiveness in service delivery.

2. PEBA will, at all times, ensure that its information technology resources are deployed in the most safe and secure manner feasible.

Broad Strategies

1. Educate policy makers on needs and costs of system

2. Conduct IT assessment

3. Implement assessment recommendations

4. Develop internal capability to collect and analyze health care data.