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

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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 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.