Legislative Oversight Committee
Summary Report on
South Carolina Retirement System Investment Commission
May 2023

Created in 2005, the South Carolina Retirement System Investment Commission (RSIC) is the state agency which has exclusive authority for investing and managing all assets held in trust for the participants and beneficiaries of the state's five defined benefit plans, collectively referred to as the "retirement system" or systems. RSIC's operations are overseen by a board of commissioners consisting of eight members appointed by the Governor, constitutional officers, and legislative leaders. Management should continually evaluate the performance outcomes, risk reductions, and fee savings associated with the modifications made during 2020 to the portfolio allocation of the pension funds to ensure that the simplified portfolio delivers expected results. For FYs 20-21 and 21-22, RSIC paid increased investment fees compared to previous years due to high performance in asset classes that utilize performance fee structures. The performance in asset classes that utilize performance fee structures should be closely monitored by RSIC staff to determine the best course of action if these alternative investments begin to moderate.

Agency at a Glance

The South Carolina Retirement System Investment Commission (RSIC) has exclusive authority for investing and managing all assets held in trust for the participants and beneficiaries of the state's five defined benefit plans, collectively referred to as the "retirement system" or systems.

Changes Made to Simplify the Investment Portfolio

At its meeting on April 16, 2020, the RSIC made substantial changes which took effect July 1, 2020, to its consolidated Annual Investment Plan and Statement of Investment Objectives and Policies (AIP/SIOP) in an effort to simplify the investment portfolio. Under the new portfolio allocation, the entire allocation to public stocks and bonds, comprising over seventy percent of the portfolio, is held in passively managed indexed investments.

- **(#1) Agency Recommendation: Management of the Retirement System Investment Commission should continually evaluate the performance outcomes, risk reductions, and fee savings associated with the modifications made during 2020 to the portfolio allocation of the pension funds to ensure that the simplified portfolio delivers expected results. At a minimum, these results should be reported to the Senate Finance Committee on an annual basis.**

Investment Fees

For FYs 20-21 and 21-22, RSIC paid increased investment fees compared to previous years. Over the previous year, fees paid for FY 20-21 increased over 151% and for FY 21-22 fees increased over 27%. The primary contributing factor to this increase was high performance in asset classes that utilize performance fee structures.

- **(#2) Agency Recommendation: Management of the Retirement System Investment Commission should monitor the performance in asset classes that utilize performance fee structures to determine the best course of action if these alternative investments begin to moderate.**

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I. Agency at a Glance

Mission

The South Carolina Retirement System Investment Commission (RSIC) has exclusive authority for investing and managing all assets held in trust for the participants and beneficiaries of the state's five defined benefit plans, collectively referred to as the "retirement system" or systems.

History

The history of the SC Retirement System including the changes to allow investment in domestic and foreign equities and the entities providing oversight of the funds are included in the table below.

History of the South Carolina Retirement System	
Year	**Event**
1945	The South Carolina Retirement System (SCRS) was officially established to create a cost-sharing multiple-employer defined benefit pension plan.
1950	The SC Budget and Control Board was created and began managing the retirement system which was invested in domestic fixed income only.
1962-1979	Plans were added to include: • Police Officers Retirement System (PORS). • General Assembly Retirement System (GARS). • South Carolina National Guard Retirement System (SCNG). • Judges and Solicitors Retirement System (JSRS).
1997	The Retirement Systems Investment Panel was created to advise and recommend an investment strategy for the Budget and Control Board, and voters approved a referendum allowing pension funds to be invested in equities (stocks).
2005	Act 153, the South Carolina State Retirement System Preservation and Investment Reform Act, created the Retirement System Investment Commission (RSIC) which was structured as a separate state agency reporting to a body of appointed and ex officio commissioners. Up to 70 percent of the plan was allowed to be invested in equities.

2007	The passage of a constitutional amendment was approved by voters which deleted the restriction on equity investment in foreign equities.
2008	The global financial crisis delivers a huge blow to pension systems nationwide, including SCRS. Actuarial assumptions were changed to smooth asset losses over a 10-year period instead of a 5-year period. Actuarial assumptions were changed to raise the assumed rate from 7.25% to 8%.
2012	Pension Reform Act 278 was enacted which created the Public Employee Benefit Authority (PEBA) combining the SCRS and the Employee Insurance Program to administer the various retirement plans under the umbrella of the retirement systems. The General Assembly lowered the expected return on investment from 8% to 7.5% and lawmakers limited COLA increases for retirees. The vesting period increased from 5 years to 8 years.
2014	The South Carolina Restructuring Act of 2014 eliminated the Budget and Control Board as of July 1, 2015, and created a successor entity, the State Fiscal Accountability Authority (SFAA). With oversight from the SC Office of the State Inspector General, Funston Advisory Services conducted a fiduciary performance audit of the RSIC. The purpose of the audit was to critically evaluate the fiduciary roles of the RSIC and the relationship with PEBA.
2016	The Joint Committee on Pension Systems Review was created to work on pension reform to meet the difficulties presented by the Great Recession of 2008.
2017	The Retirement System Funding and Administration Act of 2017 was passed to address the underfunded nature of the plan. This reform bill required that the unfunded accrued actuarial liability ("UAAL") amortization period for SCRS and PORS be reduced by one year each fiscal year until each plan reaches a twenty-year amortization period. In order to support meeting this requirement, the General Assembly significantly increased contributions into the SCRS and PORS. The assumed rate of return was reduced from 7.5% to 7.25%. Beginning with FY 21-22 and every four years thereafter, PEBA, in consultation with RSIC and the system actuary, will recommend an assumed annual rate of return for the subsequent four-year period. The General Assembly may accept, amend or reject the recommendation, but if it takes no action, the recommended rate goes into effect.
2018	Funston Advisory Services completed the 2018 fiduciary performance audit of the RSIC. While the primary purpose of the 2018 audit was to evaluate the progress made in implementing the recommendations resulting from the 2014 fiduciary performance audit of the RSIC, the SC Office of the State Auditor also requested that the review identify any areas of weakness in current operational policies and practices.
2020	The Retirement System Investment Commission made substantial changes to its consolidated Annual Investment Plan and Statement of Investment Objectives and Policies (AIP/SIOP) in an effort to simplify the investment portfolio. These changes took effect July 1, 2020.
2021	Consistent with S.C. Code §9-16-335(B), the assumed rate of return on the investments in the state's retirement systems was lowered to 7.0% from 7.25% on July 1, 2021, based on an actuarial recommendation.

Historical Analysis

The table below contains the investment portfolio performance and year-end value of the retirement funds which are invested by RSIC as reported in RSIC's annual investment reports.

FY	Investment Performance (Net of Fees)	Ending Value of the Portfolio (In billions)
FY 21-22	-0.97%	$38.3
FY 20-21	28.57%	$39.2
FY 19-20	-1.58%	$31.0
FY 18-19	5.84%	$31.98
FY 17-18	7.82%	$31.3
FY 16-17	11.88%	$30.1
FY 15-16	-0.39%	$28.0

Performance Measurement Comparisons

RSIC retains an investment consulting and advisory firm which serves as an independent fiduciary to assist its staff in making investment decisions. This firm presents comparisons which show RSIC's performance as measured against the portfolios of a peer group in materials presented to commission members at each board meeting and are included on the agency's website. The peer group includes public defined benefit plans with assets greater than $5 billion. For consistency, all returns are computed using figures which are net of fees.

The table below shows the performance comparisons for the most recent four fiscal years.

Comparison of Public Defined Benefit Plans With Assets Greater than $5 Billion				
Fiscal Year	**Net Return for RSIC**	**RSIC Percentile Ranking**	**Range of Net Returns**	**Number of Portfolios in Ranking**
FY Ending 6/30/22	-0.9%	13	-9.3% to 1.3%	23
FY Ending 6/30/21	28.6%	28	22.4% to 32.9%	24
FY Ending 6/30/20	-1.6%	94	-2.6% to 4.7%	26
FY Ending 6/30/19	5.8%	51	4.4% to 7.3%	30
FY Ending 6/30/18	7.8%	87	7.0% to 10.0%	19

As shown above, for the last five fiscal years, the percentile ranking for RSIC was between the 13th percentile and the 94th percentile. For these comparisons, the highest return in the group, or the best performance, is assigned to the 5th percentile and the lowest return, or the worst performance, is assigned to the 95th percentile. According to RSIC's CEO, falling in the middle of the percentile ranking would be the most preferable position, explaining that a plan which is consistently at the top of the ranking may be taking too much risk, while a plan consistently at the bottom may not be taking enough risk.

Actuarial Funded Ratio

Each year based on July 1st figures, actuarial valuations are prepared for PEBA by an actuarial consultant for all five plans under SCRS. Included in these valuations is the funded ratio for the plan which is a standard measure often widely reported where the actuarial value of the assets is divided by the actuarial accrued liability of the plan. The resulting percentage determines the level of assets to cover the liabilities. An increase or decrease in the funded ratio can occur due to the recognition of investment gains or losses or a change to the plan's assumed rate of return.

The state's plans are described as mature, meaning that the annual amount of benefit payments exceeds the annual amount of contributions. The plans are also underfunded denoting that the net present value of the liabilities exceeds the value of the assets. The table below shows the funded ratio for all systems on a combined basis from FY 12-13 through FY 21-22. These figures are reported each year in PEBA's Annual Comprehensive Financial Report (ACFR).

FY	Funded Ratio
FY 21-22	56.3%
FY 20-21	55.1%
FY 19-20	54.1%
FY 18-19	55.4%
FY 17-18	56.1%
FY 16-17	57.1%
FY 15-16	60.3%
FY 14-15	62.8%
FY 13-14	63.5%
FY 12-13	63.2%

Governing Authority

RSIC's operations are overseen by a board of commissioners consisting of eight members, seven of whom have voting privileges. Commission members, except for the Executive Director of PEBA, serve for terms of four years and until their successors are appointed and qualify and may not be appointed to serve more than two consecutive full four-year terms. The Governor, constitutional officers, and legislative leaders are responsible for appointing commission members who must possess specific qualifications.

<u>Appointment and Qualifications of Commission Members</u>

According to S.C. Code §9-16-315(A), the eight commission members are appointed as follows:

Appointment of members to the Retirement System Investment Commission (RSIC)	
1	Two members appointed by the Governor, one of which is an active member of the South Carolina Retirement System, Police Officers Retirement System, the Judges and Solicitors Retirement System, or the National Guard Retirement System;
2	One member appointed by the State Treasurer;
3	One member appointed by the Comptroller General;
4	One member appointed by the Chairman of the Senate Finance Committee;
5	One member appointed by the Chairman of the House Ways and Means Committee;
6	One member who is a retired member of the South Carolina Retirement System, Police Officers Retirement System, Judges and Solicitors Retirement System, or National Guard Retirement System. This representative member must be appointed by unanimous vote of the voting members of the commission; and
7	The Executive Director of South Carolina Public Employee Benefit Authority, ex officio, without voting privileges.

Commission members must possess at least one of the following qualifications listed below.

Qualifications for appointment to the RSIC (must possess at least one)	
1	The Chartered Financial Analyst credential of the CFA Institute;
2	At least twelve years as a Certified Financial Planner credentialed by the Certified Financial Planner Board of Standards;
3	The Chartered Alternative Investment Analyst certification of the Chartered Alternative Investment Analyst Association;
4	At least twenty years professional actuarial experience, including at least ten as an Enrolled Actuary licensed by a Joint Board of the Department of the Treasury and the Department of Labor, to perform a variety of actuarial tasks required of pension plans in the United States by the Employee Retirement Income Security Act of 1974;
5	At least twenty years professional teaching experience in economics or finance, ten of which must have occurred at a doctorate-granting university, master-granting college or university, or a baccalaureate college as classified by the Carnegie Foundation;
6	An earned Ph.D. in economics or finance from a doctorate-granting institution as classified by the Carnegie Foundation;
7	The Certified Internal Auditor credential of The Institute of Internal Auditors;
8	At least twelve years of professional experience in the financial management of pensions or insurance plans; or
9	At least twelve years of professional experience as a certified public accountant with financial management, pension, or insurance audit expertise.

Commission Members Receive Salary

Section 9-16-315(J)(2) states that each commission member "shall receive an annual salary of twenty thousand dollars plus mileage and subsistence as provided by law for members of state boards, committees, and commissions." Membership on the commission does not make a member eligible to participate in a retirement system administered by RSIC.

Current Commission Members and Terms

The table below shows the commission members who are currently serving.

South Carolina Retirement System Investment Commission, 2022-2023					
Position	**Position Title**	**Current Members**	**Appointed By**	**Appointed Date**	**Expiration Date**
Seat 1	Member	William H. Hancock, CPA, Chairman	Curtis M. Loftis, Jr., State Treasurer	11/1/2017	6/30/2021
Seat 2	Retiree Representative	Holley Hewitt Ulbrich, Ph.D.	RSIC	6/28/2022	6/30/2026
Seat 3	Member	Kenneth F. Deon	Richard Eckstrom, Comptroller General	6/30/2022	6/30/2026
Seat 4	Member	William J. Condon, J.D., M.A., CPA	Governor Henry McMaster	9/21/2022	11/22/2025
Seat 5	Member	Edward N. Giobbe, MBA	Governor Nikki R. Haley	4/2/2015	6/30/2020

Seat 6	Member	Reynolds Williams, J.D., CFP	Senator Hugh K. Leatherman, Sr., Chairman of the Senate Finance Committee	7/1/2013	6/30/2018
Seat 7	Member	Melissa B. Schumpert, CPA	Chairman G. Murrell Smith, Jr., House Ways and Means Committee	7/27/2021	6/30/2025
Ex-Officio	Executive Director of PEBA	Peggy G. Boykin, CPA			

Operations/Programs

The Retirement System Investment Commission was created by the General Assembly in 2005 to have the exclusive authority for investing and managing all assets held in trust for the South Carolina Retirement Systems. The funds and assets of the various state retirement systems are not funds of the State, but are instead held in trust as provided for in S.C. Code §9-16-20 and in accordance with the Internal Revenue Code.

The RSIC employs a Chief Executive Officer (CEO) who serves as the agency head and reports directly to the commission. The CEO is the central figure of accountability for the agency with oversight over all of the agency's functions. The CEO employs a Chief Investment Officer (CIO) who is primarily responsible for the investment function, subject to the CEO's oversight. Departments of the RSIC include public markets, private markets, investment administration, quantitative solutions, reporting, operational due diligence, human resources, and legal.

RSIC and PEBA are sister agencies who share responsibilities for the state's retirement funds. PEBA was created in 2012 and is governed by an 11-member board. While RSIC is responsible for the investment of the funds, PEBA is the state agency responsible for the administration and management of the various retirement systems, including the State Optional Retirement Program (State ORP) and the SC Deferred Compensation Program, as well as the state's employee insurance programs.

Finance

RSIC is self-sustaining and receives no appropriations of state general funds. According to S.C. Code §9-16-315(J)(1) the administrative costs of the RSIC must be paid from the earnings of the state retirement system. Similarly, PEBA is funded entirely from the trust fund.

The table below shows the revenues and expenditures by source for the last two fiscal years.

	FY 20-21		FY 21-22	
	Revenue	Expenditures	Revenue	Expenditures
	$	$	$	$
Other Funds	11,477,250	12,028,707	11,477,250	12,187,852
Refund Prior Year Expend.			3,780	
Sale of Surplus Property	567		210	
Earned Interest	70,929		52,907	
Total	11,548,746	12,028,707	11,534,147	12,187,852

Budget Request

For FY 23-24, RSIC requested no increase in operating revenue and had no capital or other requests. RSIC has requested authorization for total revenue of $15.3 million for the past several years. From these revenues, the agency is currently allocating $7.2 million to personal services, $6.1 million to other operating expenses, and $2 million to employer contributions.

RSIC participates in the budget process each year by submitting an agency budget plan to the Executive Budget Office and having staff appear before a Senate Finance subcommittee and House Ways & Means subcommittee. RSIC's budget is authorized under the "other funds" category in the state's appropriation act.

Staffing

As of February 28, 2023, RSIC had 40 filled positions out of an authorized 51 positions leaving 11 positions vacant. RSIC's executive leadership team updated its succession management plan and identified eleven positions which require succession planning. According to an agency official, the succession plan was presented in executive session on May 7, 2021, to the RSIC Human Resources and Compensation Committee, and was favorably received. No further updates or approvals are needed to the succession plan at this time.

II. Issues

Changes Made to Simplify the Investment Portfolio

At its meeting on April 16, 2020, the Retirement System Investment Commission approved substantial changes to its consolidated Annual Investment Plan and Statement of Investment Objectives and Policies (AIP/SIOP) in an effort to simplify the investment portfolio. These changes took effect July 1, 2020.

<u>Overview of the AIP/SIOP</u>

Section 9-16-330 of the South Carolina Code requires an Annual Investment Plan (AIP) be prepared and reviewed annually for the purpose of affirming or changing the plan. Under this law, the investment plan must include the following components:

1) General operational and investment policies.

2) Investment objectives and performance standards.

3) Investment strategies, which may include indexed or enhanced indexed strategies as the preferred or exclusive strategies for equity investing, and an explanation of the reasons for the selection of each strategy.

4) Industry sector, market sector, issuer, and other allocations of assets that provide diversification in accordance with prudent investment standards, including desired rates of return and acceptable levels of risks for each asset class.

5) Policies and procedures providing flexibility in responding to market contingencies.

6) Procedures and policies for selecting, monitoring, compensating, and terminating investment consultants, equity investment managers, and other necessary professional service providers.

7) Methods for managing the costs of the investment activities.

8) A detailed description of the amount and extent of the final authority to invest made by the commission regarding a delegation of authority to invest to the chief investment officer.

In addition, according to S.C. Code §9-16-50(B), the RSIC must adopt a Statement of Investment Objectives and Policies (SIOP) for the retirement system which includes the desired rate of return on assets overall, the desired rates of return and acceptable levels of risk for each asset class, asset allocation goals, guidelines for the delegation of authority, and information on the types of reports to be used to evaluate investment performance. Under this statute, the commission must review the statement annually and either change it or reaffirm it. The AIP and the SIOP were consolidated into a single document to ensure consistency and agreement between the two documents.

New Portfolio Allocation

In April 2020 the Commission adopted a new portfolio allocation that reduced the number of asset classes from eighteen to five, effective July 1, 2020. The planning for this change began in early 2019 when RSIC officials initiated a review of the portfolio allocation to determine if decisions made in the low interest rate environment exposed the portfolio to any adverse effects, including:

• Frequent adjustments to the allocations of the portfolio into riskier asset classes.
• Over diversification into too many asset classes.
• Including a greater percentage of actively managed strategies that seek to outperform low-cost stock index funds.
• Creating an overly complex portfolio of smaller allocations whose returns can cancel each other out or suffer impairment during market turmoil.

After this review, an RSIC official described the determination which was made, as follows:

> We found that although we had a portfolio that was designed in good faith to achieve a long-term rate of return that exceeds the assumed annual rate of return, it did so with more complexity than was necessary. Additionally, we determined that we were using more actively managed strategies than we believe makes sense today. We determined that, despite our best intentions, we had developed a portfolio that was over diversified and that establishing a simpler path to achieving our investment goals would better support the long-term health of the Retirement System.

A more simplified portfolio with fewer asset classes and a simpler means of implementation was developed over the next year. Under the new portfolio allocation, the entire allocation to public stocks and bonds, comprising over seventy percent of the portfolio, is held in passively managed indexed investments. Since indexed investments are not actively managed, the management fees associated with them are considerably lower. RSIC estimates that the reduction to investment management fees will be over $40 million annually.

As of April 21, 2022, the asset classes and policy target weights for RSIC's portfolio are shown in the table below.

RSIC Simplified Portfolio Allocation	
Asset Class	**Policy Target**
Global Equity	46%
Bonds	26%
Real Assets (Real Estate & Infrastructure)	12%
Private Equity	9%
Private Debt	7%
Total Plan	100%
Source: RSIC's Consolidated AIP and SIOP	

According to the National Association of State Retirement Administrators (NASRA), based on the latest information from the Public Fund Survey, the average public pension fund asset allocation is as follows:

NASRA Average Public Pension Asset Allocation	
Asset Class	**Policy Target**
Public Equities	47.1%
Fixed Income	21.2%
Real Estate	6.8%
Alternative Investments	22.6%
Cash & Other	2.5%
Total Plan (rounded)	100.0%

According to an RSIC official, the new portfolio allocation would have weathered the economic and market turmoil related to the COVID-19 pandemic better than the plan which was in place. Transactions totaling over $13 billion were necessary to implement the revised asset allocation. This official disclosed that under the new asset allocation, the portfolio performance would have earned a higher return and would have met or exceeded the return of the majority of pension funds of similar size to South Carolina's fund. In addition, the new portfolio would have also achieved higher returns over the preceding three, five, and ten-year periods than the existing portfolio.

<u>Other Impacts on the State's Pension Fund</u>

During the global financial crisis beginning in 2008, the Federal Reserve lowered interest rates to near zero and only recently began raising interest rates in 2022. Historically, pension funds invested in low-risk investments like U.S. government bonds. The state's pension funds were only invested in domestic fixed income until a voter referendum in 1997 allowed for limited investment in equities. The ability to earn a return on low-risk investments has decreased dramatically under the sustained low interest rate environment. Pension funds have been forced to seek returns in riskier investments like stocks, high yield corporate bonds, and emerging market debt. State and local pension funds across the U.S. have experienced similar problems.

South Carolina's plan is considered to be a "mature" plan meaning that the contributions and earnings into the plan are less than the payments made from the plan. In addition, the plan is underfunded, meaning the discounted liabilities of the system exceed the actuarial value of the system's assets. In recent years, public pensions have been lowering the investment return assumption which increases a plan's unfunded actuarial liability. In 2012, the General Assembly lowered the expected return on investments from 8% to 7.5%, and in 2017 the assumed rate of return was reduced from 7.5% to 7.25%. Most recently the expected return was lowered to 7.0% in accordance with §9-16-335(B) on July 1, 2021.

● (#1) Agency Recommendation: Management of the Retirement System Investment Commission should continually evaluate the performance outcomes, risk reductions, and fee savings associated with the modifications made during 2020 to the portfolio allocation of the pension funds to ensure that the simplified portfolio delivers expected results. At a minimum, these results should be reported to the Senate Finance Committee on an annual basis.

Investment Fees

For FYs 20-21 and 21-22, RSIC paid increased investment fees compared to previous years. Over the previous year, fees paid for FY 20-21 increased over 151% and for FY 21-22 fees increased over 27%. Information in the table below was included in the agency's most recent Annual Investment Report.

RSIC Investment & Administrative Expenses					
(Amounts expressed in thousands)	**FY 17-18**	**FY 18-19**	**FY 19-20**	**FY 20-21**	**FY 21-22**
Total Plan Assets	$31,306,135	$31,979,716	$30,982,968	$39,158,484	$38,287,487
Investment Management Expenses:					
Management Fees	182,184	186,834	179,346	174,816	209,658
Performance Fees	139,223	93,245	1,487	332,698	426,152
Other Fees	37,548	30,163	36,726	38,828	60,459
Total Investment Management Fees & Expenses	$358,955	$310,243	$217,560	$546,341	$696,269
Bank Fees and Investment Expense	3,414	5,493	2,336	589	(1,403)
Administrative Expenses	11,600	12,279	11,702	12,029	12,188
Total Investment and Administrative Expenses	$373,970	$328,015	$231,599	$558,958	$707,054
Total Expenses as a Percentage of Total Assets	1.19%	1.03%	0.75%	1.43%	1.85%
Brokerage Fees	5,338	4,433	5,934	1,214	1,028
Brokerage Fees as a Percentage of Total Assets	0.02%	0.01%	0.02%	0.00%	0.00%
(Totals may contain rounding)					
Source: RSIC Annual Investment Reports					

There are usually three categories of investment management fees and expenses as explained in the table below.

Investment Costs		
Name of Fee	**How Calculated**	**Paid to and reason**
Investment Management Fees	Generally, a percentage fee based on the assets under management.	Paid to the manager of the fund for providing the service of investing the assets.
Performance Fees, including Carried Interest Allocation	As a percentage (carried interest is a share of a private equity or fund's profits for performance above a designated level.)	Paid to the manager and are a share of the profits from an investment or fund to create an alignment of interests.
Other Investing Expenses	Vary based on the investment type.	Can include organizational costs in limited partnership structures.

RSIC reports all three types of fees and has hired Albourne Partners to assist its staff in verifying the fees charged by investment managers. Albourne develops a mathematical model of the individual fee structure for each investment and recalculates all fees. Any material discrepancies in fees are thoroughly investigated by Albourne with the investment manager and the results are documented.

Increase in Performance Fees

As stated in RSIC's Annual Investment Report, the reason for the FY 21-22 increase in investment management fees and expenses was:

> The primary contributing factor to this increase was high performance in asset classes that utilize performance fee structures.

According to an official with RSIC, management fees have decreased and are at a stable level, and performance fees now drive the difference in total cost. Performance fees are paid on alternative investments, including private equity, private debt, real assets, and portable alpha hedge funds. While RSIC paid higher fees on the alternative investment classes, during the most recent two fiscal years, these alternative asset classes outperformed traditional assets such as public stocks and bonds.

According to calculations provided by RSIC concerning the impact of including alternative investments over the last two fiscal years, additional plan value of approximately $6 billion was realized and the two-year annualized return difference was a positive 8.6%. RSIC maintains that this benefit from using alternative investments has been demonstrated over two significantly different market environments. Regarding the lowering of investment expenses, RSIC provided the following data points:

- The goal of lowering investment expenses should be to enhance return.
- RSIC could lower fees by using less alternatives but will earn less return.
- Alternatives' dramatic outperformance of traditional assets will moderate.

The performance in asset classes that utilize performance fee structures should be closely monitored by RSIC staff to determine the best course of action if these alternative investments begin to moderate.

● **(#2) Agency Recommendation: Management of the Retirement System Investment Commission should monitor the performance in asset classes that utilize performance fee structures to determine the best course of action if these alternative investments begin to moderate.**