



Retirement System Investment Commission

Discussion with Senate Finance Committee
December 2013

Hewitt ennisknupp

An Aon Company

Background on Hewitt EnnisKnupp

- Approximately 290 U.S. investment consulting professionals; more than 600 worldwide
- \$2 trillion in assets under advisement in the U.S.; more than \$4.6 trillion in global assets
- 477 U.S. investment consulting clients covering:
 - Public and Corporate Public Pension Plans
 - Defined Contribution Retirement Plans
 - Endowments and Foundations
 - Taft-Hartley Plans
- Work with 40 public pension funds, representing \$1.2 trillion in assets
- Independent and objective advice—100% of revenue derived from consulting clients
- Investment Manager and Capital Market Research structured as global practices
- More than 75 professionals dedicated to Investment Manager Research, including more than 35 dedicated to alternative strategies

#1 Industry Rankings

- Total U.S. Client Assets
- Number of 401(k) Plans
- Number of DB Plans
- Number of Corporate Clients
- Number of Plans >\$200 million

Sources: November 2012 issue of *Pensions & Investments* and Plan Sponsor 2012 survey

Experience

Depth of Resources

Analytical Capabilities

General Responsibilities of HEK with RSIC

- Works FOR the Commission and WITH Staff

- Major functions:
 - *Asset allocation, investment structure and asset/liability studies*
 - *Investment manager monitoring and evaluation*
 - *Performance reporting*
 - *Investment education, including thought leadership and best practices*
 - *Support on miscellaneous investment functions*

- Hewitt EnnisKnupp team led by:
 - Suzanne Bernard, CFA, CAIA – 25 years experience in investment consulting; all with Hewitt EnnisKnupp
 - Brady O’Connell, CFA, CAIA – 16 years experience in investment consulting; all with Hewitt EnnisKnupp

Supported by a team of over 20 professionals specializing in:

- Risk management
- Asset allocation
- Manager research
- Fiduciary practices
- Operational due diligence
- Reporting

Our role is to work collaboratively with the Commission and Staff to meet RSIC’s investment goals.

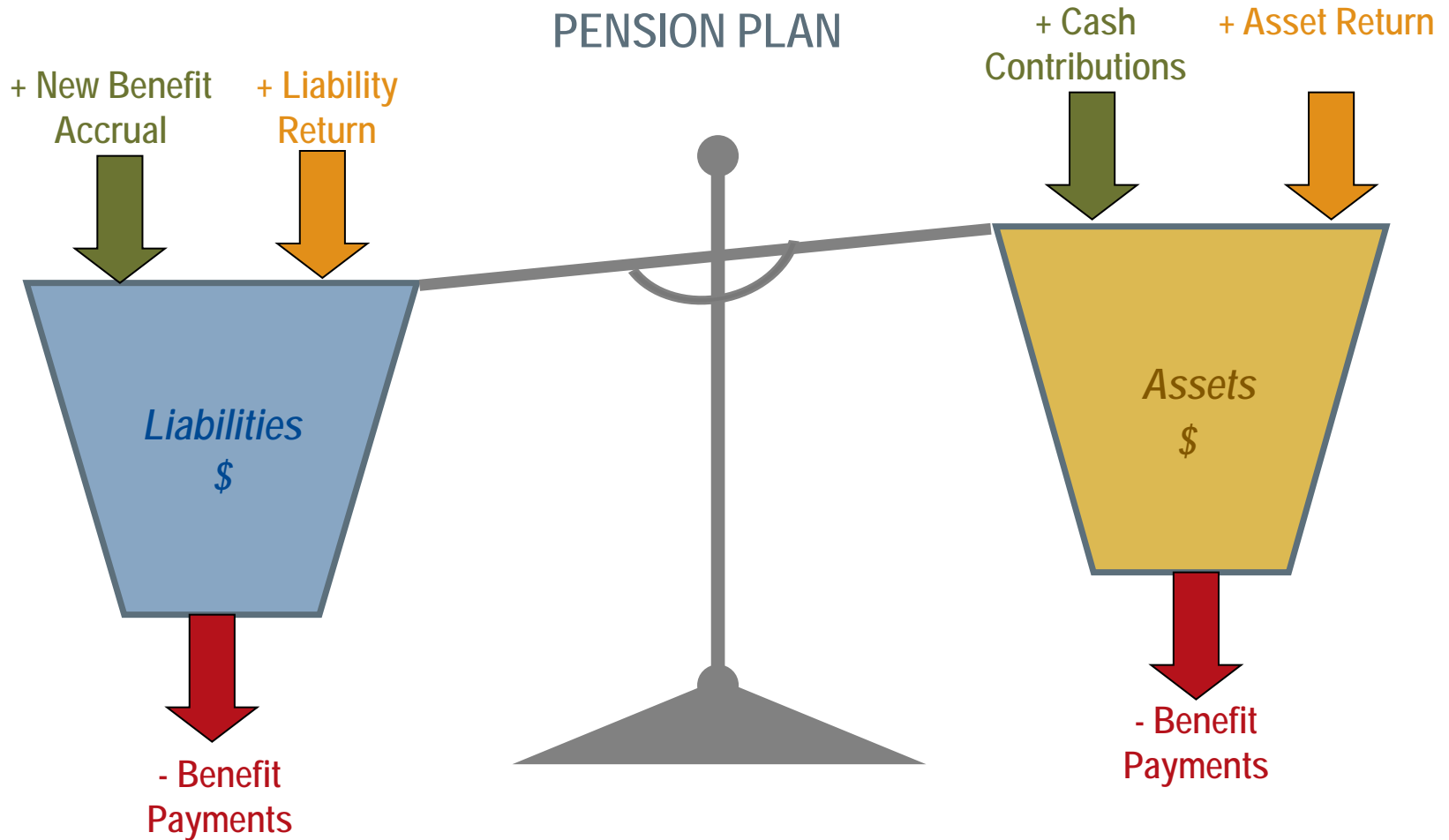
HEK Work With RSIC

- Formally began our relationship in October 2012

- Major work to-date:
 - *Asset/Liability study and asset allocation recommendations*
 - *Review of all investment managers and strategic partnerships*
 - *Review and suggested revisions of investment policies*
 - *Introduction of a comprehensive quarterly private markets performance report to the Commission/Staff in conjunction with ongoing reporting*
 - *Review of investment manager fees paid by the fund*

- Ongoing work:
 - *Continued implementation of new asset allocation targets*
 - *Annual asset allocation review*
 - *Recommendations on managers/investment areas of interest*
 - *Manager selection assistance*
 - *Operational due diligence support*
 - *Independent reporting of success of investment program*

Pension – Balance of Liabilities and Assets



Goals of an Asset/Liability Study

- Major factors affecting the asset allocation recommendations in an asset/liability study are:
 - *Time horizon to fund the liability*: long vs. short?
 - *Characteristics of the liability*: growing vs. frozen?
 - *Unfunded liability status*: underfunded vs. well-funded?
 - *Nature of cash flows*: high vs. moderate need for liquidity?
 - *Ability to Effectively Invest in Alternatives*: desire for additional diversification/alpha vs. desire for simplicity?

- Changes we recommended in our February asset allocation included:
 1. Modified target asset allocation
 2. Narrowed rebalancing ranges around target asset allocation
 3. Changes to some of the asset class benchmarks

- These enhancements offer the following benefits:
 - Better risk/return trade off: higher expected return with a modest increase in expected risk
 - Enhanced risk control (through tighter rebalancing ranges)

- Several other asset allocation combinations were considered – the recommended allocation was deemed the best fit by the Commission.

2013 Retirement System Investment Commission Asset / Liability Study

Alternative Portfolio Return and Risk Expectations

Asset Class	Current Target Policy	Alternative 1: Proposed Solution	Alternative 2: Same Risk Higher Return	Alternative 3: Capped Private Market Investments ⁶	Alternative 4: No Alternative Investments
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 Return⁶	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.

2013 Retirement System Investment Commission Asset / Liability Study

Summary of Recommended Rebalancing Ranges

Asset Class	Current Minimum	Current Maximum	Proposed Minimum	Proposed Maximum
Global Equity:			30%	45%
<ul style="list-style-type: none"> • U.S. Stock (lg. + small-cap) • Non-U.S. Stock – Developed • Emerging Markets Equities • Private Equity 	0%	25/20%	25%	37%
	0%	25%		
	0%	20%		
	0%	15%		
Real Assets:	0%	20%		
<ul style="list-style-type: none"> • Commodities • Real Estate 	0	10%	0%	6%
	0	10%	2%	8%
Opportunistic:	0%	20%		
<ul style="list-style-type: none"> • GTAA/Risk Parity • Hedge Funds (low beta) 	0	20%	7%	13%
	0	20%	5%	11%
Diversified Credit:				
<ul style="list-style-type: none"> • Mixed Credit (HY, Loans, Structured) • Emerging Market Debt • Private Debt 	0	25%	3%	9%
	0	25%	3%	9%
	0	15%	4%	10%
Conservative Fixed Income:			10%	25%
<ul style="list-style-type: none"> ▪ Core Fixed Income (+IG Credit) ▪ Global Fixed Income (hedged) ▪ Short Duration ▪ Cash (net of overlays) 	0	50%	4%	10%
	0	25%	0%	6%
	0	100%	0%	6%
	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.

Closing Remarks

- Program's investments are well-positioned to meet obligations over time
- Knowledgeable Commission members
- High caliber Staff
- Constructive and collaborative relationship between Staff and HEK
- Good dialogue between Commission members and HEK
- All of our recommendations have been addressed to date