

# MINUTES

## SOUTH DAKOTA INVESTMENT COUNCIL Pierre, South Dakota August 20, 2012

### 1) Roll Call

The meeting was called to order at 8 a.m. on August 20, 2012 by Chair Wesley Tschetter. Council members in attendance were Hugh Bartels, David Hillard, Jon Hunter, Jarrod Johnson, Jim Means, Rich Sattgast, Wesley Tschetter and Rob Wylie.

Others attending all or part of the meeting included Matt Clark, Brett Fligge, Chris Nelson, Sherry Nelson and Laurie Riss from the Investment Office; Jane Roberts and Susan Jahraus from the South Dakota Retirement System; Steven Kohler from the Bureau of Finance and Management; Aaron Olson from the Legislative Research Council; and Dan Welker from JP Morgan Asset Management.

(Note: For sake of continuity, the following minutes are not necessarily in chronological order. Documents referenced are on file in the Investment Office, and public access is subject to the provisions of SDCL 1-27.)

#### AGENDA ITEMS:

- 1) Roll Call
- 2) Welcome New Council Member – David Hillard
- 3) Minutes
- 4) FY 2014 Amended Budget Request
- 5) Compensation Committee Update  
Summary of FY 2012 Performance Incentives
- 6) LRC Executive Board Meeting Review
- 7) Investment Performance – FY 2012
- 8) Investment Update – FY 2013
- 9) Iran Divestiture – Update
- 10) SDIC Shareholder Activism Policy (Sudan)
- 11) Investment Officer Performance Evaluation  
Executive Session
- 12) Audit Committee Update
- 13) CD Program
- 14) TCW Mortgage Fund Consolidation
- 15) Cinven – Private Equity Presentation
- 16) Private Equity Investments
- 17) Supplemental Retirement Plan 457  
Investment Options Update
- 18) Higher Education Savings Program – Update
- 19) New/Old Business
- 20) Future Meeting Dates
- 21) Adjournment

### 2) Welcome to New Council Member

Wesley Tschetter welcomed to the Investment Council David Hillard, Financial Advisor, Senior Vice President and Branch Director of RBC Wealth Management in Rapid City. Mr. Hillard was appointed by the LRC Executive Board to a five-year term on the Investment Council beginning July 1, 2012.

### 3) Minutes

JIM MEANS MOVED, SECONDED BY HUGH BARTELS, TO APPROVE THE MINUTES OF THE JUNE 18 AND 19, 2012 COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

### 4) FY 2014 Amended Budget Request

Tschetter discussed the meeting that he, Matt Clark and Rob Wylie attended with Lt. Governor Matt Michels, Jason Dilges and Tony Venhuizen on August 13, 2012. The meeting included discussions about the Investment Council's budget and long-term initiatives.

Clark reviewed the changes to the FY 2014 budget request from the request that was approved by the Council at the April meeting. He noted that the amended budget includes two new entry level investment positions and incentive funding at 100%. The flexibility for investment

research services was decreased to fund the requested increase in capital assets, travel, office space rent and auditing expenses.

ROB WYLIE MOVED, SECONDED BY JON HUNTER, TO APPROVE THE FY 2014 BUDGET REQUEST AS AMENDED. MOTION PASSED UNANIMOUSLY.

5) Compensation Committee Update & Summary of FY 2011 Performance Incentives

Tschetter stated the investment performance incentive for the state investment officer is on the agenda for the LRC Executive Board meeting today. Clark reviewed the investment incentive summary for the entire staff for FY 2012 investment performance. He also described the support staff incentive program which is funded by the earned incentives. It was noted that any incentive payouts will be processed after Legislative Audit confirms the calculations and supporting documentation.

Clark updated the Council on the compensation study which will begin as soon as the engagement letter and consultant contract are completed in the next few weeks.

*The Investment Council recessed at 8:30 a.m. to meet with the LRC Executive Board Subcommittee on the Investment Council, followed by a presentation to the full Executive Board. The Council meeting reconvened at 10:35 a.m.*

6) LRC Executive Board Meeting Review

The Council discussed the LRC Executive Board meeting. It was noted that the Executive Board unanimously approved the investment performance incentive for the State Investment Officer, as well as the Council's recommended budget request for FY 2014.

7) Investment Performance Presentation – FY 2012

Clark presented the investment performance for Fiscal Year 2012. The South Dakota Retirement System (SDRS) investment performance analysis presentation included an overview of the market environment during the four quarters of the fiscal year. Total returns for equity, real estate, fixed income, and commodity indexes were provided, as well as returns for various asset mixes.

Clark reviewed the Mellon and Callan peer universe asset allocation comparisons. The returns of SDRS and the Capital Markets Benchmark as of 6/30/12 were compared and ranked against peer universes. The risk and return graph analysis against the Mellon Universe was reviewed for the 5 years and 10 years.

The Council discussed the changes in corporate pension plans in recent years and how that impacts the performance comparisons to the corporate plan universe. The importance of comparing to different benchmarks was discussed, as well as the importance of using relevant benchmarks.

The total portfolio performance attribution to the Mellon Universe and the Capital Markets Benchmark was reviewed. The exhibits showed the difference in return at the portfolio level (how the individual asset category returns compared to the individual index returns) and at the asset

allocation level (how the asset allocation differed from the benchmark asset allocation using index returns). A 14-year performance attribution yearly history versus the Capital Markets Benchmark was provided. It highlighted that different asset classes contribute to the overall fund's performance at different times.

Clark reviewed exhibits with comparisons of the individual asset categories and total fund to their respective benchmarks for the most recent year and the last 10 years, as well as the annualized return comparisons since inception.

Clark then presented the attribution analysis of the Capital Markets Benchmark comparison for the South Dakota Cement Plant Retirement Fund. The four trust fund presentations followed with a review of the attributions and total returns for each fund.

Clark briefly reviewed the quarterly investment update for the period ending 6/30/12 which had been previously provided to the Council.

8) Investment Update – FY 2013

Clark gave a report on the SDRS total fund performance for Fiscal Year 2013 to date. He reviewed the Motions and Actions report that summarized the motions from the prior Council meeting and the resulting staff actions.

The Council briefly discussed the investment return assumption for SDRS and the recent actions taken by the SDRS Board of Trustees.

9) Iran Divestiture – Update

Clark reviewed Tammy Otten's memo on the Iran Scrutinized Companies List and noted that no new information has been received since the last Council review in June.

JIM MEANS MOVED, SECONDED BY RICH SATTGAST, TO REAFFIRM THE CURRENT IRAN SCRUTINIZED COMPANIES LIST. MOTION PASSED UNANIMOUSLY.

10) SDIC Shareholder Activism Policy (Sudan) – Update

Clark confirmed that the Council received a copy of the report provided to the Legislative Research Council as required by law on the Shareholder Activism Policy. Included with the report was a memo outlining the Council's compliance with the policy, a copy of the policy, an updated Sudan company list and correspondence with two of the companies on the list in which the Council has direct investments. Clark stated their responses, one by letter and one by phone, explained their actions in Sudan. He added that the objectives of the shareholder activism policy are kept in mind during the voting of proxies and company analysis.

11) Investment Officer Performance Evaluation – Executive Session

JON HUNTER, MOVED, SECONDED BY JIM MEANS, TO GO INTO EXECUTIVE SESSION PER SDCL 1-25-2(1) FOR THE PURPOSE OF THE STATE INVESTMENT OFFICER'S PERFORMANCE EVALUATION. MOTION PASSED UNANIMOUSLY.

The Investment Council went into executive session at 12:30 p.m. and general session reconvened at 1 p.m.

12) Audit Committee Update

Hugh Bartels stated that the auditors from Legislative Audit are in the Investment Office this week and commented on what is included in the audit. He discussed working on a program to start phasing in the quarterly audits after completion of the current audit.

13) CD Program

Sherry Nelson reviewed her memorandum on the CD Program which detailed the underlying information for this year's CD program, including the size of the program, the time and date for setting the rate, the method of determining the interest rate, the terms and reallocations. She discussed the recommended adjustment to the premium for liquidity and collateral risk.

DAVID HILLARD MOVED, SECONDED BY HUGH BARTELS, TO APPROVE THE SOUTH DAKOTA CASH FLOW FUND CERTIFICATE OF DEPOSIT PROGRAM FOR ONE-YEAR CD'S TO MATURE 9/30/13, IN ACCORDANCE WITH SOUTH DAKOTA LAW AND THE CD PROGRAM ADMINISTRATIVE RULES, AT \$35 MILLION WITH THE INTEREST RATE BASED ON THE 1-YEAR TREASURY NOTE WITH A FLOOR OF 0% PLUS .25% FOR LIQUIDITY AND COLLATERAL RISK. MOTION PASSED UNANIMOUSLY.

14) TCW Mortgage Fund Consolidation

Clark reviewed the current three tranches of mortgage investments with TCW, their structure, balances and fees. He noted that the first fund is approaching the end of its life, and TCW will be selling of the remaining investments. He discussed his recommendation for rolling the proceeds of this fund to a separate account, consolidating the second fund into the separate account, and increasing the amount in the fund for the Cement Plan Retirement Fund.

Brett Fligge discussed the nature of the mortgage investments and the outlook for competitive returns.

JIM MEANS MOVED, SECONDED BY JARROD JOHNSON, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO TRANSFER THE REMAINING ASSETS OF THE TCW SPECIAL MORTGAGE CREDITS MASTER FUND, L.P.-SERIES A (FUND I) AND THE TCW/SD SPECIAL MORTGAGE CREDITS INVESTMENT LIMITED PARTNERSHIP (FUND II) INTO THE TCW SD OPPORTUNISTIC MORTGAGE-BACKED SECURITIES FUND AND TO INCREASE THE CEMENT PLANT RETIREMENT FUND INVESTMENT IN THIS FUND TO \$2 MILLION. MOTION PASSED UNANIMOUSLY.

15) Cinven – Private Equity Update

Andrew Joy, Partner, and Jonas Nillson, Principal, of Cinven provided an update to the Council on their current investment, as well as information on Cinven's private equity Fund 5 for which they are seeking an investment. Joy gave a history of Cinven and the relationship with the

SDIC that started in 2006 with an investment in Fund 4. He discussed their private equity strategy, their track record since 1988, and performance comparisons to their private equity benchmark.

Nillson discussed the importance of the sector model and sector expertise to the Cinven strategy. He described the changes in the composition of sectors from Fund 3 to Fund 4 and 5, as well as the exit pipeline for those funds. He reviewed expected size for Fund 5, the investment period, the terms and fees, as well as the GP participation.

Joy discussed several investments in Cinven Fund 4 as examples of attractive opportunities as well as struggles during the market downturn. He emphasized Cinven's operational focus is aligned around building European companies into global leaders. He discussed his views on the European economy and opportunities in the private equity area.

Chair Tschetter thanked Cinven for their presentation.

16) Private Equity Investments

The Council discussed their relationships with all of the private equity managers, and in particular, Cinven and Riverstone. The current and projected exposure to the private equity category was reviewed and discussed. Clark outlined his recommendation for investments in Cinven and Riverstone.

ROB WYLIE MOVED, SECONDED BY RICH SATTGAST, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$100 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM, PLUS UP TO AN 80% PROPORTIONATE AMOUNT FOR THE CEMENT PLANT RETIREMENT FUND, IN CINVEN FUND 5. MOTION PASSED UNANIMOUSLY.

HUGH BARTELS MOVED, SECONDED BY DAVID HILLARD, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$75 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM, PLUS UP TO AN 80% PROPORTIONATE AMOUNT FOR THE CEMENT PLANT RETIREMENT FUND, IN RIVERSTONE GLOBAL ENERGY AND POWER FUND V. MOTION PASSED UNANIMOUSLY.

17) Supplemental Retirement Plan 457 – Investment Options Update

Nelson reviewed the summary of the Supplemental Retirement Plan Analysis for the period ended June 30, 2012. The report included a write-up of each investment option. She reviewed the three funds that the Investment Officer is recommending be removed from the line-up of SRP options, as well as the three funds that are being added to the line-up as replacements. It was noted that, by law, the Investment Officer is responsible for the SRP investment options, so Council action is not necessary.

18) Higher Education Savings Program – Update

Nelson reviewed the quarterly compliance schedule, the quarterly conference call minutes and asset report as of 6/30/12 for the CollegeAccess 529 Plan. She noted that Allianz provided the scholarship money to the Dakota Corps Scholarship Program in July.

19) New/Old Business

No new or old business was presented for the next meeting agenda.

20) Future Meeting Dates

The next Investment Council meeting will be held in Sioux Falls on November 15, 2012.

21) Adjournment

Chair Tschetter declared the meeting adjourned at 3:40 p.m.