

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL

Pierre, South Dakota

August 19, 2013

1) Roll Call

The meeting was called to order at 9:15 a.m. on August 19, 2013 by Chair Hugh Bartels. Council members in attendance were Hugh Bartels, David Hillard, Jon Hunter, Vern Larson, Jim Means, and Rob Wylie. Council members Steve Kirby and Rich Sattgast were absent.

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

(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.)

Chair Bartels welcomed Vern Larson to the Investment Council. Bartels noted that the Governor appointed Vern as the Commissioner of School and Public Lands to fulfill the rest of the term through 2014.

2) Minutes

JIM MEANS MOVED, SECONDED BY VERN LARSON, TO APPROVE THE MINUTES OF THE JUNE 17 AND 18, 2013 COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

3) Investment Performance – FY 2013

Otten presented the investment performance for Fiscal Year 2013. 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.

Otten reviewed the Mellon & Wilshire peer universe asset allocation comparisons. The returns of SDRS and the Capital Markets Benchmark as of 6/30/13 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.

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes
- 3) Investment Performance – FY 2013
- 4) Compensation Committee Update
- 5) Investment Update – FY 2014
- 6) LRC Executive Board Meeting Review
- 7) Global Equity & Small/Mid Cap Portfolios Update
- 8) Iran Divestiture – Update
- 9) SDIC Shareholder Activism Policy (Sudan)
- 10) Potential Management of External Funds
- 11) Investment Officer Succession Plan Review
- 12) Investment Officer Performance Evaluation Executive Session
- 13) Audit Committee Update
- 14) Supplemental Retirement Plan 457 Investment Options Update
- 15) CD Program
- 16) Higher Education Savings Program – Update
- 17) New/Old Business
- 18) Future Meeting Dates
- 19) Adjournment

The total portfolio performance attributions to the Mellon Universe and the Capital Markets Benchmark were 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 15-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.

Otten 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.

Otten 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.

Jon Hunter asked whether the 20% carry is included in the real estate and private equity partnership IRR calculations. Otten described the difference between gross and net IRR calculations where the gross IRR is calculated by adding back management fees, but not the 20% carry, to the net IRR. She said that as part of the switch in emphasis to using only net returns, going forward, only net IRR's will be utilized.

4) Compensation Committee Update

Bartels stated that the Governor, Lt. Governor, and BFM Commissioner will be visiting the Investment Office on August 21. There will be a tour of the office, followed by discussion on the compensation study, the SDIC budget, and the proposed expanded incentive program. He stated that the model for the expanded incentive program will be discussed at the November Council meeting.

Bartels noted 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 2013 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 confirmed with the Council that they received a memo on the "Details of Changes to Investment Performance Incentive Plans effective FY 2014." This memo discussed changes relating to total fund performance being compared solely to the SDIC capital markets benchmark, as well as the use of net returns as opposed to gross returns.

5) Investment Update – FY 2014

Otten reviewed the Motions and Actions report that summarized the motions from the prior Council meeting and the resulting staff actions. She gave a report on the SDRS total fund performance for Fiscal Year 2014 to date.

Chris Nelson updated the Council on the private equity and real estate limited partnership projections over the next five years.

The Investment Council recessed at 10:20 a.m. to meet with the LRC Executive Board. The Council meeting reconvened at 1:25 p.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 2015. The budget request was approved contingent upon the Council adopting a new incentive pay structure. The Executive Board also approved the use of the SDIC capital markets benchmark as the sole comparison for the total fund beginning with FY 2014 performance, along with the use of total net time-weighted rates of return as opposed to gross returns.

7) Global Equity & Small/Mid Cap Portfolios Update

Brett Fligge discussed the FY 2013 performance of the internal global equity and small/mid cap portfolios. He reviewed the industry over and under weights that contributed to the outperformance, as well as the effect of portfolio managers' individual stock selections.

Fligge described the distribution of equity assets to the core portfolio and the individual manager portfolios. As well, he discussed the overall global equity research process.

8) Iran Divestiture – Update

Otten reviewed her memo dated July 24, 2013 on the Iran Scrutinized Companies List and noted that there were no changes to the information since the last Council review in June.

JIM MEANS MOVED, SECONDED BY DAVID HILLARD, TO REAFFIRM THE IRAN SCRUTINIZED COMPANIES LIST APPROVED AT THE FEBRUARY 6, 2013 COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

9) SDIC Shareholder Activism Policy (Sudan) – Update

Otten 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 Alstom in which the Council has a direct investment. Otten stated Alstom's response by letter explained their actions in Sudan. The objectives of the shareholder activism policy are kept in mind during the voting of proxies and company analysis.

10) Potential Management of External Funds – Update & Discussion

The Council discussed the potential of SDIC management of external funds. The Council asked senior staff to put together their thoughts on the issue and report back at the next Council meeting.

11) Investment Officer Succession Plan Review

Clark reviewed the Investment Officer Succession Plan. There were a couple modest changes to the plan relating to the national executive search firm and the annual review by the Council.

VERN LARSON MOVED, SECONDED BY ROB WYLIE, TO APPROVE THE INVESTMENT OFFICER SUCCESSION PLAN AS AMENDED. MOTION PASSED UNANIMOUSLY.

12) Investment Officer Performance Evaluation – Executive Session

JIM MEANS MOVED, SECONDED BY JON HUNTER, 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 Council went into executive session at 2:45 p.m. and general session reconvened at 3 p.m.

13) Audit Committee Update

Jon Hunter stated that the auditors from Department of Legislative Audit (DLA) are in the Investment Office this week and commented on what is included in the audit. He reported that DLA will be providing information to the new SDRS auditors, Eide Bailly.

14) Supplemental Retirement Plan 457 – Investment Options Update

Otten presented the summary of the Supplemental Retirement Plan Analysis for the period ended June 30, 2013. The report included a write-up of each investment option. She reported that the State Investment Officer was making no changes to the investment options. It was noted that, by law, the Investment Officer is responsible for the SRP investment options, so Council action is not necessary.

15) CD Program

Otten reviewed Sherry Nelson's 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.

JIM MEANS MOVED, SECONDED BY ROB WYLIE, TO APPROVE THE SOUTH DAKOTA CASH FLOW FUND CERTIFICATE OF DEPOSIT PROGRAM FOR ONE-YEAR CD'S TO MATURE 9/30/14, 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.

Otten noted that the CD Program rules and regulations will be updated to consolidate the state's financial institutions.

16) Higher Education Savings Program Update

Otten reviewed the quarterly compliance schedule, the quarterly conference call minutes and asset report as of 6/30/13 for the CollegeAccess 529 Plan. She noted that Allianz provided the scholarship money to the Dakota Corps Scholarship Program in July as has been done over the last several years.

Otten informed the Council that the Office will be pursuing a change to the HESP rules and regulations to update the IRS dates.

17) New/Old Business

Bartels noted that the next meeting will include a discussion on the new incentive model.

18) Future Meeting Dates

The next Investment Council meeting will be held in Sioux Falls on November 14, 2013.

19) Adjournment

JON HUNTER MOVED FOR ADJOURNMENT. ROB WYLIE SECONDED THE MOTION. MOTION PASSED UNANIMOUSLY.

Chair Bartels declared the meeting adjourned at 3:30 p.m.