

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL Sioux Falls, South Dakota November 17, 2015

1) Roll Call

The meeting was called to order at 9 a.m. on November 17, 2015 by Chair Jim Means. Council members in attendance were Lorin Brass, Ryan Brunner, David Hillard, Steve Kirby, Laura McNally, Jim Means, Rich Sattgast and Rob Wylie.

Others attending all or part of the meeting included Matt Clark, Brett Fligge, Tammy Otten, Chris Nelson, Sherry Nelson, Scott Hess, Candi Currier, Jarrod Edelen, Randy Spinar, Ross Sandine, Danielle Mourer, Anne Cipperley, Cindy Pickering, Krystal Seeley, Brandy Eisma, and Laurie Riss from the Investment Office; Jane Beer, Michelle Mikkelsen and Travis Almond from the South Dakota Retirement System; Dean Swedlund from Brookings; and Jonas Nilsson from Cinven. The internal equity/energy sector presentation was attended by several Investment Office investment team members.

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes
- 3) Cinven Private Equity Presentation
- 4) Investment Update – FY 2016
- 5) Iran Divestiture – Update
- 6) SDIC FY 2015 Annual Report
- 7) Audit Committee Update
- 8) Sarbanes Oxley-Compliance Checklist
- 9) Cash Flow Fund Intermediate-Term Portfolio Implementation
- 10) Legislation (SDIC, SDCFF, SDRS)
- 11) Succession Planning
- 12) Code of Ethics Policies – SDIC & Staff
- 13) Internal Equity Valuation-Energy Sector
- 14) Higher Education Savings Plan
- 15) CD Program - Update
- 16) New/Old Business
- 17) Future Meeting Dates
- 18) Adjournment

(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.)

2) Minutes

DAVID HILLARD MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE MINUTES OF THE AUGUST 24, 2015 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

3) Cinven Private Equity Presentation

Jonas Nilsson from Cinven provided an update on their private equity funds and presented information on Fund 6 for which they are currently fundraising. He gave a history of the firm and an overview of their performance since inception. He discussed Cinven's views on the current market environment for European private equity.

Nilsson provided details of their performance versus benchmarks for Funds 4 and 5 in which the Council is invested. He reviewed the status of these funds showing the assets that are full or partially realized, those held at cost and those at cost or above. He described their buy and build strategy, as well as exit strategy, using several different investments as examples.

Nilsson discussed the fundraising for Fund 6. He noted the strategy, team and terms remain the same as Fund 5.

The Council discussed several issues with Nilsson, including the European environment, the progress of funds 4 and 5, and the capacity and demand for Fund 6.

Chair Means thanked Nilsson for his presentation.

Following the Cinven presentation, the Council discussed an investment in Cinven Fund 6. Matt Clark reviewed staff's recommendation, and Chris Nelson reviewed private equity allocations and individual partnerships and projections for the next few years. He discussed the firm Cinven and his recent visit with them in New York.

Council discussion continued.

STEVE KIRBY MOVED, SECONDED BY LAURA McNALLY, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$200 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM PLUS UP TO AN ADJUSTED PROPORTIONATE AMOUNT FOR THE SCHOOL AND PUBLIC LANDS FUND, THE DAKOTA CEMENT TRUST, THE EDUCATION ENHANCEMENT TRUST, AND THE HEALTH CARE TRUST IN THE SIXTH CINVEN FUND. MOTION PASSED UNANIMOUSLY.

4) Investment Update – FY 2016

Tammy Otten presented the Motions and Actions report from the August 24, 2015 Council meeting. She noted that the Cash Flow Fund portfolio and policy changes were implemented by staff. Staff has also drafted legislation to make the suggested changes to SDCL 4-5-26. Estimated total asset values as of October 31, 2015 and November 13, 2015 were provided.

5) Iran Divestiture – Update

Otten discussed the Iran Scrutinized Companies List memo dated November 3, 2015 that had been previously provided to the Council. Staff recommended no changes to the current South Dakota scrutinized companies list. A report will be provided to the Executive Board of the Legislature in January as required by law.

6) SDIC FY 2015 Annual Report

Clark presented the recently completed SDIC FY 2015 Annual Report, which is compiled and produced each year by the investment accountants. The investment accountants were introduced, including Cindy Pickering, Brandy Eisma and Krystal Seeley. The fourth accountant, Sami Rains, was not in attendance. Clark provided a brief overview of the report and transmittal letter.

It was noted that the FY 2015 annual report and audit report are posted on the SDIC website. Council members were provided a printed copy of the report.

7) Audit Committee Update

David Hillard, Chair of the Audit Committee, reported that the fiscal year 2015 audit was complete. He reviewed his closing discussion with Ashlee Keyes in the Department of Legislative Audit (DLA). He noted the audit went well and the auditors reported a clean opinion on the financial statements. He highlighted the percentage of financial position for which carrying values have been estimated by management in the absence of readily determinable market values. Hillard added that he was very impressed with the DLA staff.

The Council discussed the importance and proper governance of DLA's performance of interim reviews through the year in addition to the annual audit.

Wylie added that Eide Bailly was completing the SDRS audit for fiscal year 2015 and would provide their report to the SDRS Board of Trustees on December 3, 2015. He stated that no issues had been reported.

Clark reviewed the recommended changes to the Audit Committee Charter. These involved the composition of the Audit Committee to change from “three members” to “at least three members” and the reference to the SDRS audit to clarify that application is to investment related sections.

RICH SATTGAST MOVED, SECONDED BY RYAN BRUNNER, TO APPROVE THE UPDATED AUDIT COMMITTEE CHARTER AS PRESENTED. MOTION PASSED UNANIMOUSLY.

8) Sarbanes Oxley – Compliance Checklist Annual Review

Clark discussed the Sarbanes-Oxley compliance checklist that is updated by one of the investment accountants each year. As a government agency, the Investment Council is not legally required to comply with Sarbanes Oxley, but the report outlines how we would compare if required.

9) Cash Flow Fund Intermediate-Term Portfolio Implementation

Otten discussed implementation of the first tranche of the Cash Flow Fund intermediate-term portfolio. Discussion continued regarding the timeframe for full implementation.

10) Legislation (SDIC, SDCFF, SDRS)

Otten reviewed the proposed Council legislation to amend SDCL 4-5-26 legal list to include non-GNMA mortgages and specifically exempt School and Public Lands Fund investments from the legal list.

Wylie provided an overview of the legislation under consideration by the SDRS Board of Trustees.

Council members will receive a legislation update, at least weekly, after session begins on January 12, 2016.

Clark noted that he anticipated legislation will be introduced in the next legislative session on the Achieving Better Life Experience (ABLE) Act. He discussed the Council’s potential involvement and indicated he would keep the Council apprised.

11) Succession Planning

Clark discussed succession planning relating to the state investment officer position and the assistant investment officers. He discussed the near term as outlined in the Succession Plan document, as well as the long term addressed through development of new and mid-level staff. He reviewed his thoughts on each of the areas of real estate/private equity partnerships, global equity/high yield, investment accounting/controls, and asset allocation model maintenance/implementation.

Clark also addressed an outline of past and future leadership development efforts. Council discussion continued.

12) Code of Ethics Policies – SDIC & Staff

Clark reviewed the Code of Ethics and Personal Investing Guidelines for SDIC members. It was noted that, as part of the guidelines, Council members are asked each year to review and certify their understanding of and compliance with the guidelines.

Clark then reviewed the Code of Ethics and Personal Investing Guidelines for Staff members. Staff members also annually certify compliance. He proposed a modest change to the guidelines relating to the donation of securities.

ROB WYLIE MOVED, SECONDED BY STEVE KIRBY, TO APPROVE THE UPDATED CODE OF ETHICS & PERSONAL INVESTING GUIDELINES FOR SDIC STAFF AS PRESENTED. MOTION PASSED UNANIMOUSLY.

13) Internal Equity Valuation – Energy Sector

Several Investment Office equity and high yield portfolio managers gave a presentation on the energy industry.

Jarrold Edelen, Small/Mid-Cap Portfolio Manager, began the presentation with a discussion on oil price history and production. He provided an overview of where we are in the energy cycle and compared it to past energy cycles. The drivers of future prices were discussed.

Randy Spinar, Global Equity Portfolio Manager, presented an overview of the oil price normalization process. He discussed differences in oil and gas costs, operating costs, cost structures for selected oil companies, replacement cost of resources, and inflation adjustment.

Scott Hess, Small/Mid-Cap Portfolio Manager, described the equity valuation process. He discussed the process through Continental Resources, which is a US E&P company with activities in North Dakota and Oklahoma.

Candi Currier, Global Equity Portfolio Manager, presented an overview of the oil services industry and discussed rig counts, industry trends and cost deflation. She gave a brief overview of Halliburton, a large global oil services company.

High Yield Portfolio Managers Danielle Mourer, Anne Cipperley, and Ross Sandine, presented an overview of high yield energy debt. Mourer discussed the energy industry high yield opportunities and current portfolio weights compared to benchmark and maximum weighting. Cipperley presented the price to value of energy industry opportunities compared to other industries. Sandine showed some examples of large high yield portfolio positions.

The Council thanked the portfolio managers for their presentation. Discussion continued on the energy industry relating to bankruptcy and debt default rates probabilities, impact of oil prices on portfolio positions, and the normalization process.

14) Higher Education Savings Plan

Sherry Nelson reviewed the Higher Education Savings Plan summary of accounts, the quarterly compliance schedule, and the minutes of the Allianz third quarter conference call that had previously been provided to the Council. She noted that the Program Management Agreement requires Council approval of the auditor selected by Allianz.

ROB WYLIE MOVED, SECONDED BY DAVID HILLARD, TO APPROVE PRICEWATERHOUSECOOPERS AS THE AUDITOR FOR COLLEGEACCESS 529 PLAN FOR THE YEAR ENDING DECEMBER 31, 2015. MOTION PASSED UNANIMOUSLY.

Nelson discussed the leadership change at AllianzGI. She reviewed their proposal to reduce the age-based and static fund lineup for the program from 27 funds to 14 funds and discussed their rationale for the proposed changes. She indicated staff believed the changes were reasonable.

LORIN BRASS MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE PORTFOLIO CHANGES TO THE COLLEGEACCESS 529 PLAN PROPOSED BY ALLIANZ GLOBAL INVESTORS DISTRIBUTORS LLC AND PRESENTED TO THE INVESTMENT COUNCIL ON THIS DAY AND TO AUTHORIZE THE STATE INVESTMENT OFFICER TO EXECUTE THE NECESSARY DOCUMENTS AND TAKE ANY OTHER ACTIONS DEEMED NECESSARY TO CARRY OUT THE PORTFOLIO CHANGES AS PRESENTED. MOTION PASSED UNANIMOUSLY.

15) CD Program - Update

Sherry Nelson reviewed her memo summarizing the results of the CD Program. Forty-two banks, two savings associations and four credit unions participated this year, a decrease of ten institutions versus last year. The total accepted was \$30.554 million, a decrease a \$4.446 million. The rate of .626% increased versus .37% last year and was based on the one-year Treasury note yield of .376% on 9/28/15 plus a liquidity premium of .25%. A listing of the participating financial institutions and a report on program statistics were provided.

16) New/Old Business

No new or old business was brought before the Council.

17) Future Meeting Dates

The tentative date for the next Investment Council meeting is February 4, 2016 and will be confirmed with the Council after the Appropriations Committee Budget Hearing schedule is set.

18) Adjournment

Chair Means declared the meeting adjourned at 2:45 p.m.