

# MINUTES

## SOUTH DAKOTA INVESTMENT COUNCIL

Madison, South Dakota

April 8, 2015

### 1) Roll Call

The Investment Council meeting was called to order at 8 a.m. on April 8, 2015 by Chair Jon Hunter. Council members in attendance were Lorin Brass, Ryan Brunner, David Hillard, Jon Hunter, Steve Kirby, Jim Means, Rich Sattgast and Rob Wylie.

Others attending all or part of the meeting included Matt Clark, Brett Fligge, Chris Nelson, Tammy Otten, Jeff Ellefson and Laurie Riss from the Investment Office; Senator Scott Parsley; Deputy S&PL Commissioner Mike Lauritsen; Jane Roberts, Michelle Mikkelsen, and Susan Jahraus from the South Dakota Retirement System; Dr. Kevin Streff, Dr. Josh Pauli, and Dr. Pat Engebretson from Dakota State University; Eric Buzz Hillestad from Helix Security; Vik Sawhney and Robert McMullan from Blackstone Capital Partners, and Andre Collin and Ben Sarly from Lone Star Real Estate.

#### AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes
- 3) Investment Update
- 4) Iran Divestiture Update
- 5) Compensation Committee Update
- 6) Audit Committee Update
- 7) Cyber Security Presentation - DSU
- 8) Legislation Wrap-Up Review
- 9) Blackstone Capital Partners
- 10) Private Equity & BCP VII Investment
- 11) Lone Star Real Estate IV
- 12) Real Estate & Lone Star RE IV Investment
- 13) Interns & Staffing Update
- 14) Higher Education Savings Program Update
- 15) New Old Business
- 16) Future Meeting Dates
- 17) 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

JIM MEANS MOVED, SECONDED BY DAVID HILLARD, TO APPROVE THE MINUTES OF THE FEBRUARY 5, 2015, INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

### 3) Investment Update

The Motions and Actions notes from the February 5, 2015 meeting were reviewed by Tammy Otten. The March 31, 2015 estimated asset fair values and total fund returns for the various funds under management were provided.

Otten also reviewed the U.S. Securities and Exchange Commission changes to U.S. money market mutual funds that will go into effect no later than October 2016. Staff is reviewing how these changes will affect the investments made in money market funds including reviewing additional funds.

Matt Clark discussed his recent work on the asset allocation modeling process.

Clark discussed the meetings he and the Bureau of Finance and Management had with finance officers from several state agencies to better understand the nature of their balances in the Cash Flow Fund.

4) Iran Divestiture Update

Otten reviewed the March 25, 2015 memo provided to the Council which included the updated scrutinized companies list for Iran based on the most recent Colorado and Florida public lists.

RYAN BRUNNER MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE UPDATED IRAN SCRUTINIZED COMPANIES LIST DATED APRIL 8, 2015, AS PRESENTED. MOTION PASSED UNANIMOUSLY.

5) Compensation Committee Update

Jim Means, Chair of the Compensation Committee, discussed the Committee's recent conference call regarding the compensation for the Investment Officer for fiscal year 2016. The FY 2016 budget includes a 3.8% increase in base salary which consists of the 2% state salary policy and an additional 1.8% per the long-term plan. He stated that the Compensation Committee is recommending the 3.8% increase be presented to the Executive Board of the LRC at their June meeting.

Clark reviewed the rationale for the long-term plan salary increases, as well as the adjustments that have been made over the years as a result of the compensation studies. Council discussion continued.

DAVID HILLARD MOVED, SECONDED BY ROB WYLIE, THAT THE INVESTMENT COUNCIL RECOMMEND TO THE LRC EXECUTIVE BOARD THAT TOTAL COMPENSATION FOR THE STATE INVESTMENT OFFICER PAYABLE IN FY 2016 BE COMPRISED OF A 3.8% INCREASE IN BASE SALARY AND CONTINUATION OF THE INVESTMENT PERFORMANCE INCENTIVE PLAN, WITH ANY EARNED INCENTIVES TO BE PAID FOLLOWING COMPLETION OF THE AUDIT. MOTION PASSED UNANIMOUSLY.

6) Audit Committee Update

David Hillard, Chair of the Audit Committee, stated that the Audit Committee reviewed the quarterly procedures audit report through 12/31/14 provided by the Department of Legislative Audit (DLA). He said the audit went well and there were no adverse findings. He added that he discussed with Ashlee Keys from DLA changes to the procedures audit and she provided a few items for the Committee's consideration. He will be working to incorporate some of these recommendations in the quarterly audits. Hillard also reviewed the updated fraud risk assessment report.

7) Cyber Security Presentation - DSU

Dr. Kevin Streff, Dr. Josh Pauli, and Dr. Pat Engebretson from Dakota State University, and Eric Buzz Hillestad from Helix Security in Madison, spoke to the Investment Council about cyber security.

Drs. Pauli and Engebretson began the presentation with a discussion about Dakota State University's national recognition and association with the NSA. They reviewed the technology degrees being offered at DSU at the undergraduate, masters and doctorate levels.

Dr. Streff and Buzz Hillestad discussed cyber security threats that are prevalent in this technology age. Hillestad discussed the security firm, Helix Security, which was founded by Dr. Streff. He reviewed the work Helix does with businesses to develop strategies and tools to assist them in complying with federal and state regulations and guarding non-public assets against cyber attack and identity theft.

Following DSU's presentation, Hunter reviewed the meetings he, Matt Clark and other staff have had with BIT regarding cyber security measures for the Investment Office. Clark highlighted some of the measures that have been or are in the process of being implemented.

8) Legislative Wrap-Up Review

Otten reviewed the final legislative report. The three bills submitted by the Investment Council were signed by the Governor and go into effect on July 1, 2015. The five bills sponsored by the SDRS Board of Trustees passed and were signed by the Governor. HB 1208 for the FY 2016 budget passed and included the Investment Council budget as recommended by the Governor. SB 52 repealed the extra proration calculation for the general fund effective for FY 2015. HB 1064 prohibiting self-dealing by state officers and employees passed, and staff will develop a proposed policy to comply.

9) Blackstone Capital Partners

Vik Sawhney, Senior Managing Director and Chief Operating Officer, and Robert McMullan, Senior Managing Director, of Blackstone Capital Partners, joined the Council to discuss Blackstone's private equity funds and their new BCP VII fund.

Vik Sawhney began the presentation with a review of their performance for the last 27 years. He emphasized the consistency that comes from their single global investment committee, the benefits of Blackstone's global network, and the success from their well-defined investment philosophy. He discussed in more detail their post-crisis track record and more recent performance.

In discussing BCP's investment philosophy, Sawhney discussed the importance of their core discipline relating to company intervention, leverage and deal sourcing. He reviewed BCP's core investment themes relating to growth platforms, transformational operating interventions, mismatches between requirement for capital and supply, and cyclical opportunities. He went into depth about the key drivers of BCP intervention and the support provided to CEOs by their functional experts and strategic support groups.

Sawhney discussed the advantages of Blackstone relating to their business model, investment culture and process, deep sector experience, and unique opportunities produced by global scale and Blackstone brand. He discussed Blackstone's organization management and efforts to produce great talent while creating a balance of long-tenured and younger people.

Jon Hunter thanked Blackstone for their presentation.

10) Private Equity & Blackstone Capital Partners Fund VII Investment

Chris Nelson updated the Council on the current total exposure to private equity, as well as the long-term projections for capital calls and distributions. He also discussed the current exposure and maximum allowed to Blackstone specifically.

Clark discussed the staff's recommendation of \$100 million to BCP VII for SDRS plus additional amounts for the trust funds. He confirmed that including the recommended investment to BCP VII, the Council's exposure falls within the limits for both Blackstone and private equity overall. Council discussion continued.

STEVE KIRBY MOVED, SECONDED BY JIM MEANS, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$100 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM AND 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 BLACKSTONE CAPITAL PARTNERS VII PRIVATE EQUITY FUND. MOTION PASSED UNANIMOUSLY.

11) Lone Star Real Estate IV

Andre Collin, President, and Ben Sarly, Director, of Lone Star Funds, joined the Council by conference call to provide an update on their real estate funds and to present Lone Star Real Estate Fund IV for the Council's consideration.

Collin gave a brief history of the firm and reviewed Lone Star's organization structure. He discussed the benefits of the dedicated asset management relationship with Hudson Advisors and described the division of responsibilities of Lone Star and Hudson throughout the investment process. Collin reviewed actual and projected performance of Lone Star Funds I, II and III. He provided information on Fund IV including the target fund size and target investment returns, the investment strategy and expected capital allocations.

Collin gave an investment overview for the regions of the Americas, Europe and Japan. For each region, he reviewed the investment opportunities, as well as Lone Star's strategies, focus, synergies and competitive advantages.

Hunter thanked Lone Star for their presentation.

12) Real Estate & Lone Star Real Estate Fund IV Investment

Nelson discussed the current exposure to real estate limited partnerships. Clark discussed the differences between Lone Star real estate and Blackstone real estate. He noted that staff intended to recommend between \$175 and \$200 million for SDRS plus additional amounts for the trust funds all subject to adjustment as a result of the presentation and discussion. Discussion of updated staff thoughts supported an increase in the recommended amounts. Clark noted that it was expected that Lone Star would likely trim back any submitted amounts due to oversubscription. Chris Nelson noted the next threshold for a fee break was at the level of \$300 million submitted in total including the trust funds. Council discussion continued.

The distressed debt component of the Lone Star funds was discussed. It was noted that the previous Lone Star funds have been split 50/50 to distressed debt and real estate for asset allocation purposes. After discussion, it was decided to continue the 50/50 split.

DAVID HILLARD MOVED, SECONDED BY STEVE KIRBY, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$300 MILLION IN AGGREGATE, AT ADJUSTED PROPORTIONATE AMOUNTS, FOR THE SOUTH DAKOTA RETIREMENT SYSTEM, THE SCHOOL AND PUBLIC LANDS FUND, THE DAKOTA CEMENT TRUST, THE EDUCATION ENHANCEMENT TRUST, AND THE HEALTH CARE TRUST IN THE LONE STAR REAL ESTATE FUND IV. MOTION PASSED UNANIMOUSLY.

13) Interns & Staffing Update

Clark stated that six students have been hired as summer interns. He noted that three previously vacant positions were filled with interns from last year's summer internships. There is one vacant position remaining plus the two new FTE's approved in the budget for FY 2016.

14) Higher Education Savings Program Update

Otten reviewed the compliance schedule and the Summary of Shareholder Positions and Accounts for the CollegeAccess529 Plan through March 31, 2015. She noted that the compliance schedule was up to date and that the audit opinion was nonqualified.

15) New/Old Business

***NASIP***

Otten informed the Council that the Investment Office was hosting the 18<sup>th</sup> annual conference for the National Association of State Investment Professionals the end of April in Sioux Falls.

***Berkshire Hathaway***

The Berkshire Hathaway annual meeting will be in Omaha on May 2. The Investment Office will have credentials for any Council member who is interested in attending.

***LRC Executive Board & Appropriations East River Tour***

The Executive Board will be holding their June meeting in Sioux Falls on June 9. The Appropriations Committee East River Tour will be June 10 & 11 and will be visiting the Investment Office as part of the tour. The Council will be apprised of details when known.

16) Future Meeting Dates

The next Investment Council meeting will be in Sioux Falls on June 15 and 16, 2015.

The Executive Board has recently set their meeting schedule, and to coordinate the August Council meeting with the Executive Board meeting in Pierre, the August Council meeting date has been changed to August 24, 2015.

17) Adjournment

Chair Hunter declared the meeting adjourned at 3:05 p.m.