

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL

Pierre, South Dakota

August 24, 2015

1) Roll Call

The meeting was called to order at 8 a.m. on August 24, 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, Sherry Nelson and Laurie Riss from the Investment Office; Susan Jahraus, Jacquee Storm and Travis Almond from the South Dakota Retirement System; Governor Dennis Daugaard; Jason Dilges and Jim Terwilliger 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.)

2) Introduction of New Council Member

Chair Means welcomed Laura McNally to the Investment Council. Ms. McNally is the owner of Laura McNally CPA Prof. LLC in Belle Fourche. She was appointed to the Investment Council by the LRC Executive Board for a five-year term beginning July 1, 2015.

3) Minutes

DAVID HILLARD MOVED, SECONDED BY ROB WYLIE, TO APPROVE THE MINUTES OF THE JUNE 15 AND 16, 2015 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

4) Investment Performance Presentation – FY 2015

Tammy Otten reviewed investment performance for Fiscal Year 2015. The South Dakota Retirement System (SDRS) performance analysis included an overview of the market environment including returns for equity, real estate, fixed income, and commodity indexes. The return of the Council's Capital Markets Benchmark was also provided.

Otten reviewed the net and gross time weighted rates of return for SDRS assets for FY2015 and several multiyear periods. Comparison was provided to the universes of peer funds from across the nation. The focus is on net returns but gross returns are used for purposes of comparison to peer universes which utilize gross returns.

AGENDA ITEMS:

- 1) Roll Call
- 2) Introduction of New Council Member
- 3) Minutes
- 4) Investment Performance – FY 2015
- 5) Compensation Committee Update
- 6) Investment Update – FY 2016
- 7) Iran Divestiture – Update
- 8) SDIC Shareholder Activism Policy (Sudan)
- 9) Audit Committee Update
- 10) Subcommittee Appointments
- 11) Potential Change to SDCL 4-5-13—SDRS Representation on SDIC
- 12) Executive Board Subcommittee meeting review
- 13) Limited Partnerships Review
- 14) Recruitment Update
- 15) Supplemental Retirement Plan 457 Investment Options Update
- 16) CD Program 2016
- 17) Higher Education Savings Program – Update
- 18) Cash Flow Fund—Statutory & Policy Changes
- 19) SDIC Conflict Waiver Policy & Blanket Waivers
- 20) Executive Board Meeting Review
- 21) Investment Officer Performance Evaluation Executive Session
- 22) New/Old Business
- 23) Future Meeting Dates
- 24) Adjournment

The return attribution analysis relative to the Capital Markets Benchmark was reviewed. The analysis details differences in performance resulting from the return within each asset category versus the market index for that category and also the impact of asset allocation which results for utilizing different allocations to asset categories than the Capital Markets Benchmark. The cumulative impact of the sources of added or detracted value was shown by year and cumulatively for the past 17 years which is when this analysis began to be performed for all asset categories.

Otten reviewed exhibits focused on major individual asset categories comparing the returns earned from each category to the respective benchmark for FY2015 and historical periods.

Otten then presented the return and attribution analysis versus benchmarks for each of the four trust funds.

5) Compensation Committee Update

Clark reviewed the incentive program and the earned incentives for the Investment Office investment staff. He also reviewed the support staff incentive program which is funded from the earned incentives. The percentages and total dollar amounts were provided.

Clark presented a correction to the incentive plan memo for Zach Nipp which was approved at the last Council meeting. The revision clarified the intent of the original memo relating to the multi-year portions of the plan.

STEVE KIRBY MOVED, SECONDED BY LORIN BRASS, THAT THE INCENTIVE PLAN FOR ZACH NIPP BE APPROVED AS AMENDED PER THE 8/10/15 MEMO ENTITLED, "INVESTMENT PERFORMANCE INCENTIVE PLAN CHANGE EFFECTIVE FY 16 (AMENDED). MOTION PASSED UNANIMOUSLY.

6) Investment Update – FY 2016

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 2016 to date.

7) Iran Divestiture – Update

Otten reviewed a memo dated August 4, 2015 on the Iran Scrutinized Companies List and recommended that three companies be removed from the Council's list to reflect changes in the Colorado and Florida public lists.

RICH SATTGAST MOVED, SECONDED BY ROB WYLIE, TO APPROVE THE CHANGES TO THE IRAN SCRUTINIZED COMPANIES LIST AS PRESENTED. MOTION PASSED UNANIMOUSLY.

8) SDIC Shareholder Activism Policy (Sudan) – Update

Otten confirmed the Council received a copy of the Shareholder Activism Policy report provided to the Legislative Research Council as required by law. Included was a memo outlining compliance with the policy, a copy of the policy, and an updated Sudan company list. Correspondence from Alstom, in which the Council has a direct investment, was received after the report was sent. The response will be included in the next Legislative report. There were no recommended changes to the policy.

9) Audit Committee Update

David Hillard, Chair of the Audit Committee, stated that the auditors from Department of Legislative Audit would be in the Investment Office in September.

10) Subcommittee Appointments

Jim Means reviewed the changes to the Investment Council Subcommittees. Effective immediately, the Compensation Committee will include David Hillard as Chair, Jim Means and Steve Kirby. Following the completion of the audit in the next few weeks, the members of the Audit Committee will include Steve Kirby as Chair, Rich Sattgast, Lorin Brass, and Laura McNally.

11) Potential Change to SDCL 4-5-13 – SDRS Representation on SDIC

Clark reviewed proposed legislation to revise the composition of the Investment Council by defining the SDRS representation as the administrator of the SDRS.

DAVID HILLARD MOVED, SECONDED BY STEVE KIRBY, THAT THE INVESTMENT COUNCIL SUPPORT THE PROPOSED CHANGE TO SDCL 4-5-13 AS PRESENTED. MOTION PASSED UNANIMOUSLY.

The Council recessed at 9:20 am to meet with the LRC Executive Board Subcommittee on the Investment Council. General session reconvened at 10:05 a.m.

12) Executive Board Subcommittee Review

The Council discussed the meeting with the LRC Executive Board Subcommittee on the Investment Council. Items discussed with the Executive Board Subcommittee included FY 2015 investment performance, earned investment performance incentives, and the FY 2017 budget request.

13) Limited Partnership Review

Chris Nelson reviewed the real estate and private equity limited partnerships. The Council discussed the investments in the two areas and the percentage of assets in the limited partnerships.

14) Recruitment Update

Brett Fligge discussed the six student interns in the Investment Office for the summer. Two accepted offers of full-time positions. Matthew Carey is a USD graduate and will begin full time immediately following the internship. Makenzie Zomers will be completing her final semester with Northern State University this fall with on-line courses and will be working in the Investment Office on a part-time basis until full time in December.

15) Supplemental Retirement Plan 457 – Investment Options Update

Sherry Nelson presented the summary of the Supplemental Retirement Plan Analysis for the period ended June 30, 2015. The report included a write-up of each investment option. The

State Investment Officer has determined the Vanguard Prime Money Market Fund should be replaced with the Vanguard Federal Money Market Fund.

Clark noted that although the Investment Officer is responsible by law for choosing the investment options, this review is provided to the Investment Council as well as the SDRS Retirement Board for potential input and feedback.

The Council discussed the automatic enrollment into the SRP for new employees, the fund that contributions are initially invested into, the optional opt-out period, and the automatic contribution escalator feature.

16) CD Program 2016

Sherry Nelson reviewed the memorandum on the CD Program which included detailed 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.

LORIN BRASS MOVED, SECONDED BY RYAN BRUNNER, TO APPROVE THE SOUTH DAKOTA CASH FLOW FUND CERTIFICATE OF DEPOSIT PROGRAM FOR ONE-YEAR CD'S TO MATURE 9/30/16, 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 AN ADDITIONAL .25% FOR LIQUIDITY AND COLLATERAL RISK. MOTION PASSED UNANIMOUSLY.

17) Higher Education Savings Program - Update

Sherry Nelson reviewed the quarterly compliance schedule, the quarterly conference call minutes and asset report as of 7/31/15 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.

The Investment Council recessed at 11 a.m. to meet with the LRC Executive Board. The Council meeting reconvened at 1 p.m.

18) Cash Flow Fund – Statutory & Policy Changes

Governor Dennis Daugaard discussed the communications and meetings that have occurred over the last year regarding the Cash Flow Fund (CFF). He spoke about the efforts to establish better communications with participating agencies in the CFF to help understand varying cash flow needs and to identify opportunities to optimize earnings over the long term.

Matt Clark discussed the recommendation to carve out a portion of the current short-term fixed income portfolio to fund a new intermediate-term fixed income portfolio managed similarly to the SDRS investment grade fixed income portfolio. He described the recommended size of the portfolio and a phase-in period subject to market conditions. He described a possible moderate liquidity impact to the fund and a potential increase in market value volatility. He said he believed the changes were worthwhile for the long term. He said he believed that it was important that the Governor and executive branch fully understand the impact of the potential additional volatility on State of South Dakota financial statements and the potential moderate impact on liquidity for state operations. Clark said he believed these issues were well understood and he recommended going forward with the plan.

Governor Daugaard expressed his support for the recommended changes to the portfolio management of the CFF.

Sherry Nelson reviewed the characteristics and investment objectives of the Cash Flow Fund. She discussed several changes that have been recently implemented for the CFF.

Jason Dilges discussed the meetings that were held with state agencies and emphasized the benefits from this communication. He described the management tool that is currently being developed to provide access to daily balances for every fund and sub fund in the CFF.

Jim Terwilliger reviewed a chart of the CFF balance volatility showing the month-end, minimum, maximum, and average daily cash balances.

Otten reviewed the Intermediate-Term Fixed Income Portfolio Guidelines and how the Portfolio would be implemented. The portfolio benchmark would be the Citi Broad Investment Grade Index which includes U.S. treasury and agency debt, agency mortgages, and high grade corporate debt. The portfolio would be similar to the investment grade fixed income investment of the South Dakota Retirement System. It was recommended that the legal list statute be changed to allow the CFF to invest in mortgage-backed securities of the United States government sponsored enterprises. It was recommended by legal counsel that the proposed change to SDCL 4-5-26 also specifically exempt permanent school funds.

Nelson reviewed changes to the short-term fixed income portfolio guidelines including maximum limits for BBB securities and for securities rated below investment grade.

DAVID HILLARD MOVED, SECONDED BY STEVE KIRBY, TO APPROVE THE IMPLEMENTATION OF AN INTERMEDIATE TERM FIXED INCOME PORTFOLIO FOR THE CASH FLOW FUND, ALONG WITH THE PORTFOLIO GUIDELINES AND BENCHMARK AS PRESENTED. MOTION PASSED UNANIMOUSLY.

ROB WYLIE MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE UPDATED PORTFOLIO GUIDELINES FOR THE CASH FLOW FUND SHORT-TERM FIXED INCOME PORTFOLIO AND THE BENCHMARK AND MINIMUM/MAXIMUM RANGES AS PRESENTED. MOTION PASSED UNANIMOUSLY.

RYAN BRUNNER MOVED, SECONDED BY DAVID HILLARD, TO APPROVE THE INVESTMENT POLICY FOR SOUTH DAKOTA CASH FLOW FUND ASSETS AS REVISED AND PRESENTED. MOTION PASSED UNANIMOUSLY.

RICH SATTGAST MOVED, SECONDED BY RYAN BRUNNER, TO AUTHORIZE THE INVESTMENT OFFICER TO SUBMIT LEGISLATION TO AMEND SDCL 4-5-26 TO SPECIFICALLY EXEMPT PERMANENT SCHOOL FUNDS AND TO INCLUDE MORTGAGE BACKED SECURITIES OF THE US GOVERNMENT SPONSORED ENTERPRISES. MOTION PASSED UNANIMOUSLY.

19) SDIC Conflict Waiver Policy & Blanket Waivers

Clark discussed the changes that were made in the SDIC Conflict Waiver Policy that was approved at the last Council meeting. The primary changes included using \$200 as the limit for the small purchase blanket waiver and defining what is being waived when serving on certain for-profit boards.

STEVE KIRBY MOVED, SECONDED BY LORIN BRASS, FOR APPROVAL OF THE CHANGES TO THE SDIC CONFLICT WAIVER POLICY, THE BLANKET WAIVER FOR SMALL PURCHASE, AND THE BLANKET WAIVER FOR SERVING ON CERTAIN FOR-PROFIT BOARDS, AS PRESENTED. MOTION PASSED UNANIMOUSLY.

20) Executive Board Meeting Review

The Council discussed the meeting with the LRC Executive Board. It was noted that the Investment Officer's earned incentive was reviewed with the Executive Board and that they approved the Council's FY 2017 budget request.

21) Investment Officer Performance Evaluation

RICH SATTGAST MOVED, SECONDED BY DAVID HILLARD, 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 from 2:20 p.m. to 2:40 p.m.

22) New/Old Business

No new or old business was brought before the Council.

23) Future Meeting Dates

The next Investment Council meeting will be held in Sioux Falls on November 17, 2015.

24) Adjournment

Chair Means declared the meeting adjourned at 2:40 p.m.