

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL Sioux Falls, South Dakota November 21, 2019

1) Roll Call

The meeting was called to order at 8:30 a.m. on November 21, 2019 by Chair Loren Koepsell. Council members in attendance were Travis Almond, Paul Bisson, Ryan Brunner, Josh Haeder, Mary Howard, Loren Koepsell, Greg Kulesa, and Jeff Nelson.

Others attending all or part of the meeting included Rob Wylie, recently retired SDRS Executive Director; Investment Council Staff members Matt Clark, Brett Fligge, Chris Nelson, Tammy Otten, Jeff Hallem, Jan Zeeck, Renae Randall, Steve Schultz, Ross Sandine, Anne Cipperley, Lesyk Voznyuk, Cindy Pickering, Sami Rains, Krystal Seeley, Brandy Eisma, Christa Sites and Laurie Riss; and SDRS staff member Jane Beer.

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

AGENDA ITEMS:

- 1) Roll Call
- 2) Introduction of New Council Member
- 3) Rob Wylie Acknowledgement
- 4) Minutes (August 26, 2019)
- 5) Public Comment
- 6) SDIC FY 2019 Annual Report
- 7) Investment Update – FY 2020
- 8) Iran Divestiture Update
- 9) Internal Global Equity Presentation
- 10) Global Equity Portfolio Review
- 11) China Perspective
- 12) 529 Higher Education Savings Program
- 13) CD Program Review
- 14) Audit Committee Update
- 15) Compensation Committee Update
- 16) Subcommittee Appointments
- 17) Investment Council Policies – Review
- 18) Legislation for 2020 Legislative Session
- 19) Distressed Debt Update
- 20) Succession Planning
- 21) New/Old Business
- 22) Future Meeting Dates
- 23) Adjournment

2) Introduction of New Council Member – Travis Almond

Chair Koepsell welcomed Travis Almond to the Investment Council. Mr. Almond was hired as the Executive Director of the South Dakota Retirement System effective October 9, 2019, and, as such, is an ex-officio Investment Council member. Almond gave a brief summary of his background and his previous responsibilities with SDRS.

3) Rob Wylie Acknowledgement

Rob Wylie recently retired as Executive Director of SDRS, a position he has held since June of 2003. Matt Clark expressed his gratitude to Rob for everything he has accomplished and contributed over the years to both the SDRS and the Investment Council. He reviewed statistics on assets and investment performance since Rob joined the Council. A plaque was presented to Rob in recognition of his outstanding service.

Rob Wylie expressed his thoughts on his many years with SDRS and the great working relationship between SDRS and the Investment Council. He commented on the number of South Dakotans impacted by SDRS and all of the efforts made over the years focused on the sustainability of SDRS.

4) Minutes

GREG KULESA MOVED, SECONDED BY PAUL BISSON, TO APPROVE THE MINUTES OF THE AUGUST 26, 2019 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

5) Public Comment

There were no public comments.

6) SDIC FY 2019 Annual Report

The Council received a printed copy of the SDIC FY 2019 Annual Report. There were no major format changes from last year's report. The four Investment Accountants and Assistant Business Manager/Accountant who are responsible for compiling, generating, and formatting the report were introduced.

Matt Clark thanked the accountants for their good work in producing the report. He noted that the annual report, as well as the audit report, are posted on the SDIC website.

7) Investment Update – FY 2020

Tammy Otten updated the Council on the estimated fair value and fiscal year to date investment return of the various funds under management as of November 18, 2019. She also discussed the current asset allocation and equity-like risk.

8) Iran Divestiture Update

Tammy Otten reviewed a memo dated November 7, 2019 on the Iran Scrutinized Companies List. Staff recommended that one subsidiary company be added to the Council's list and two companies be removed as they no longer met the criteria.

JOSH HAEDER MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE THE CHANGES TO THE IRAN SCRUTINIZED COMPANIES LIST AS PRESENTED. MOTION PASSED UNANIMOUSLY.

9) Internal Global Equity Presentation

Steve Schultz, Senior Portfolio Manager-Global Equity, joined the Council to discuss the internal research process for global equity companies.

GREG KULESA MOVED, SECONDED BY PAUL BISSON, TO GO INTO EXECUTIVE SESSION PER SDCL 1-25-10 FOR THE PURPOSE OF RECEIVING AND DISCUSSING INVESTMENT INFORMATION THAT IS CONFIDENTIAL UNDER SDCL 1-27-1.6(5). MOTION PASSED UNANIMOUSLY.

Staff remaining to participate in and/or facilitate the discussion included Matt Clark, Brett Fligge, Steve Schultz, and Laurie Riss.

The Council went into executive session at 9:10 a.m.

10) Global Equity Portfolio Overview

Executive session continued for a presentation by Brett Fligge, Assistant Investment Officer, and Jan Zeeck, Senior Portfolio Manager, on the global equity core portfolio.

Staff remaining to participate in and/or facilitate the discussion included Matt Clark, Brett Fligge, Jan Zeeck, and Laurie Riss.

Executive session concluded at 10:25 a.m. and general session reconvened.

11) China Perspective

Rena Randall, Portfolio Manager-Global Equity, discussed her recent visit to China to attend the Pacific Pension Institute Winter Roundtable in Shanghai, China. She reviewed and provided her perspectives on topics discussed at the conference, including the China consumer, real estate, trade relations, private equity, and the internationalization of the China financial markets.

12) 529 Higher Education Savings Program

Sherry Nelson reviewed the CollegeAccess 529 Plan summary of accounts, the quarterly compliance schedule, and the minutes of the Allianz quarterly conference call.

Nelson discussed the recent rating CollegeAccess 529 received from Morningstar. Council discussion continued about the rating, cost to participants of the 529 program and the funds provided for scholarships.

Nelson reviewed the fund changes that Allianz Global Investors Distributors is proposing for the CollegeAccess 529 Plan. Matt Clark stated that Nelson had previously reviewed the proposed changes with him, and he believes them to be reasonable and recommends Council approval.

PAUL BISSON MOVED, SECONDED BY JEFF NELSON, TO APPROVE THE FUND CHANGES TO THE COLLEGEACCESS 529 PLAN PROPOSED BY ALLIANZ GLOBAL INVESTORS 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 CHANGES AS PRESENTED. MOTION PASSED UNANIMOUSLY.

13) CD Program 2019/2020

Sherry Nelson reviewed her memo summarizing the results of the 2019/2020 CD Program, including the CD rate calculation details and total program size. The summary also included a listing of the

participating South Dakota financial institutions along with the amounts offered and accepted for each. Historical statistics of the CD program were also provided.

14) Audit Committee Update

Jeff Nelson, Chair of the Audit Committee, stated that the FY 2019 audit was complete, and that it was a clean audit. He noted that he and Paul Bisson jointly signed the AUP letter which identified the areas of focus for FY 2020.

15) Compensation Committee Update

Loren Koepsell, Chair of the Compensation Committee, reported on the Compensation Committee meeting held recently to discuss the compensation study update using data from McLagan. He and Matt Clark discussed the study with the Council. Koepsell stated that the Compensation Committee is recommending the Council accept the study update at the next Council meeting.

16) Subcommittee Appointments

Loren Koepsell reviewed the changes to the Investment Council subcommittees. Effective immediately, the Compensation Committee will include Jeff Nelson as Chair, Loren Koepsell and Paul Bisson. The Audit Committee will include Paul Bisson as Chair, Greg Kulesa, and Josh Haeder.

17) Investment Council Policies – Review

Investment Policies

Matt Clark reviewed the Investment Policies for the Retirement System, the Trust Funds, and the Cash Flow Fund, as well as the Pre-Authorized Co-Investment Policy. He noted that there is a periodic review of these policies and that no changes were being recommended. In reviewing the External Manager Hire/Terminate/Rebalance Authorization Policy, Clark stated that there was a modest change regarding notification to the Council.

JEFF NELSON MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE THE UPDATED EXTERNAL MANAGER HIRE/TERMINATE/REBALANCE AUTHORIZATION POLICY AS PRESENTED. MOTION PASSED UNANIMOUSLY.

Council Member/Meeting Policies

Clark reviewed the SDIC Attendance Policy, SDIC Voting & Proxies Policy, and the Council Member Compensation Policy & Procedures. No changes were recommended.

18) Legislation for 2020 Legislative Session

Matt Clark and Rob Wylie discussed the intention of SDRS to seek repeal of the SDRS law prohibiting venture capital. They discussed the original intention of the prohibition which they believe was to prevent SDRS funds from being used for economic development purposes. They described

subsequent legislation which prohibits investment of SDRS assets for economic development or social investing purposes so that the venture capital prohibition is no longer needed.

Clark described how the venture capital prohibition complicates efforts to invest in private equity partnerships. He indicated that a small portion of buyout focused private equity partnerships, like those in which the Council invest, are sometimes invested in transactions on the borderline or that cross over into venture capital. This requires contemplation in all of the partnership agreements of how to identify and have the Council excluded from those investments. This also impacts real estate partnerships if there is an operating division of a real estate investment or a portion which could meet the definition of venture capital. He noted that this has happened only once for a real estate partnership, but every agreement must contemplate the possibility. This complicates the legal work and can cause partners to question whether to allow the Council to invest in the fund.

Clark said he does not anticipate a shift any time soon by the Council toward investing in venture capital focused funds given our focus on internal management and cash flow based long-term value. He said that could change down the road a few years if the area becomes less crowded and Council staff develop significant industry connections.

RYAN BRUNNER MOVED, SECONDED BY PAUL BISSON, THAT THE INVESTMENT COUNCIL SUPPORT SDRS'S PROPOSED LEGISLATION TO REMOVE THE VENTURE CAPITAL PROHIBITION. MOTION PASSED UNANIMOUSLY.

Clark discussed the law passed last year prohibiting inclusion of indemnification provisions in agreements entered into by State entities. He described proposed legislation to permit inclusion of indemnification in agreements entered into by the Council in certain circumstances.

JOSH HAEDER MOVED, SECONDED BY MARY HOWARD, THAT THE INVESTMENT COUNCIL SUPPORT THE PROPOSED LEGISLATION TO PERMIT INDEMNIFICATION IN CERTAIN CIRCUMSTANCES. MOTION PASSED UNANIMOUSLY.

Clark discussed proposed legislation to add investment options to the Cash Flow Fund legal list in SDCL 4-5-26.

JEFF NELSON MOVED, SECONDED BY GREG KULESA, TO SUPPORT THE PROPOSED LEGISLATION ON CHANGES TO THE CASH FLOW FUND LEGAL LIST AS PRESENTED. MOTION PASSED UNANIMOUSLY.

Clark reviewed proposed legislation to update and clarify conflict of interest restrictions of Council members in SDCL 4-5-14.

PAUL BISSON MOVED, SECONDED BY GREG KULESA, TO SUPPORT THE PROPOSED LEGISLATION ON CHANGES TO SDCL 4-5-14 ON COUNCIL MEMBER QUALIFICATIONS AND RESTRICTIONS. MOTION PASSED UNANIMOUSLY.

19) Distressed Debt Update

High Yield team members Ross Sandine, Anne Cipperley, and Lesyk Voznyuk joined the Council. Matt Clark confirmed with the Council that they had received previous emails regarding the Bristow high yield investment. He reviewed the background of the investment and bankruptcy process.

The high yield team discussed insights gained from involvement with the investment, especially the opportunity to better understand what happens inside a company. The high yield team discussed how the experience increased sensitivities to governance and management motivations.

Clark described the participation of the high yield team in the selection of the post-bankruptcy initial independent members of the board of directors. He also reviewed the process for selection of the two directors which we were entitled to select by the shareholders agreement. This included a discussion of the timetables under which decisions needed to be made, the criteria applied in selecting the two directors, and updates to the Council Chair and others. The criteria included that directors, (1) share our investment philosophy of creating shareholder value over the long term, (2) share our philosophy of the role of a Board, (3) share our views on management compensation and performance evaluation, (4) have relevant experience, (5) have significant time available if required, (6) have aggressiveness and/or persuasiveness needed for the situation, and (6) be willing to dig into information and ask hard questions.

Clark discussed the reasons the two selected directors, Lorin Brass and Mark Mickelson, both from South Dakota, were viewed favorably under the criteria. He also discussed how involvement with the selection of independent directors provided good insights and reference points helpful to the selection of the two directors we were entitled to select.

20) Succession Planning

Matt Clark discussed the plan for replacing Jeff Hallem, legal counsel. Hallem has indicated a desire to retire from his one quarter time position next summer. He may continue for a time in a much further reduced role if helpful for transition issues.

Clark stated that a consulting agreement has been established with Aaron Scheibe of Mareno & Bachand law firm in Pierre to take over the legal counsel responsibilities that Hallem has been performing. Scheibe previously served as Deputy and Chief Legal Counsel for the Governor's Office of Economic Development. This provided experience with state legal requirements.

Clark also discussed the need for part-time legal help for the high yield/distressed debt team. He said the legal issues for that area are unique especially for bankruptcy and restructuring situations. He described why he thought it made sense to meet these legal needs separately. He said Matt Michels has accepted the role and has been hired as a .15 employee. He said he viewed Michels as an excellent fit given his experience, familiarity with the high yield team, and passion for the Council.

Clark stated that Laurie Riss, the business manager, plans to retire next summer. He said she has agreed to continue after that on a part-time basis to help ease the transition for a year or maybe two. He said Tammy Otten might consider doing the same a year or two later. Otten co-manages fixed income and implements asset allocation shifts. She also oversees investment accounting and handles some compliance and other issues.

Clark said the staffing plan for FY 2020 had provided for an internal full-time attorney. He said the idea had been that the attorney position would take on some of the compliance type responsibilities handled by Otten and Riss, as more narrowly defined legal work would likely be half time or less. He said we had thought a CFO type position might be needed a couple years from now to address oversight of investment accounting, budgetary accounting, and internal controls.

Clark said subsequent thoughts led to the view that we would not have a full-time attorney but rather meet the legal needs as just previously discussed. He said that allows the full-time position to be used for the CFO position. He added that given the likely timetables for retirement of Riss and Otten, it makes sense to address the CFO position next fiscal year. Clark said he has discussed these matters with BFM.

Clark said succession plans for investment positions would be discussed at a subsequent meeting.

21) New/Old Business Agenda Items

No new or old business agenda items were introduced.

22) Future Meeting Dates

The next Investment Council meeting will be held by conference call on February 6, 2020.

23) Adjournment

JOSH HAEDER MOVED, SECONDED BY MARY HOWARD, FOR ADJOURNMENT. MOTION PASSED UNANIMOUSLY.

The meeting adjourned at 3:05 p.m.