

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL Pierre, South Dakota August 26, 2019

1) Roll Call

The meeting was called to order at 8 a.m. on August 26, 2019 by Chair Loren Koepsell. Council members in attendance were Paul Bisson, Ryan Brunner, Josh Haeder, Mary Howard, Loren Koepsell, Greg Kulesa, Jeff Nelson, and Rob Wylie.

Others attending all or part of the meeting included Investment Council Staff members Matt Clark, Brett Fligge, Chris Nelson, Tammy Otten, Jeff Hallem, Laurie Riss and Christa Sites; SDRS staff members Jacquée Storm and Michelle Mikkelsen; Marty Guindon and Tim Flannery from the Department of Legislative Audit; and Jim Edman from the Bureau of Information and Telecommunications.

(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) Minutes (June 5/6, 2019)
- 4) Public Comment
- 5) Investment Performance FY 2019 & Incentive Summary
- 6) Department of Legislative Audit
- 7) Executive Board Meeting Review
- 8) Investment Update – FY 2020
- 9) Iran Divestiture – Policy Review & Update
- 10) Shareholder Activism–Policy Review & Update
- 11) Limited Partnerships–Private Equity & Real Estate
- 12) BIT Cyber Security Presentation
- 13) Audit Committee Update
- 14) Compensation Committee Update
- 15) CD Program 2019/2020
- 16) 529 Higher Education Savings Program
- 17) New/Old Business
- 18) Future Meeting Dates
- 19) Investment Officer Performance Evaluation
- 20) Adjournment

2) Introduction of New Council Member – Mary Howard

Chair Koepsell welcomed Mary J. Howard to the Investment Council. Ms. Howard gave a brief summary of her background and career. She is from Sioux Falls and is Senior Vice President and Financial Advisor with The Howard Group of Baird. She was appointed by the LRC Executive Board for a five-year term on the Investment Council effective 7/1/2019.

3) Minutes

ROB WYLIE MOVED, SECONDED BY GREG KULESA, TO APPROVE THE MINUTES OF THE JUNE 5 & 6, 2019 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

4) Public Comment

There were no public comments.

5) Investment Performance FY 2019 & Incentive Summary

Tammy Otten reviewed investment performance for Fiscal Year 2019. The South Dakota Retirement System (SDRS) performance analysis included an overview of the Capital Markets Benchmark (CMB) including returns for the equity, real estate, fixed income, and cash indexes used in the benchmark. The quarterly and year-end time-weighted rates of return of the Council's CMB were provided.

A comparison of the actual asset allocation as of June 30, 2019 to the CMB and permissible ranges was provided.

Otten reviewed the return attribution analysis of the SDRS net return relative to the CMB. The analysis detailed differences in performance resulting from the return within each asset category versus the market index for that category, as well as the impact of asset allocation resulting from using different allocations to asset categories than that of the CMB. The cumulative impact of the sources of added or detracted value was shown for the last 5 years and cumulatively for 5, 10 and 21 years when this detailed level of analysis began to be calculated for all asset categories.

A table was provided that compared the annualized returns for selected periods for the last 10 years to public pension universes.

Otten reviewed exhibits focused on major individual asset categories comparing the returns earned from each category to the respective benchmark for FY2019 and historical periods.

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

Clark reviewed the summary of the earned incentives by Investment Council staff for FY 2019 and described the support staff incentive program which is funded from the earned incentives. He reviewed details of the State Investment Officer's earned incentive and noted that the incentives would be paid following completion of the audit.

The Investment Council recessed at 9 a.m. to meet with the LRC Executive Board Subcommittee on the Investment Council, followed by the presentation to the full Executive Board at 10:25 a.m. General session reconvened at 11:40 a.m.

6) Department of Legislative Audit

Marty Guindon, Auditor General, joined the Council to give an overview of the history and responsibilities of the Department of Legislative Audit (DLA). He noted that DLA is a nonpartisan agency of the legislative branch. He reviewed DLA's mission and their responsibilities under state law.

Guindon discussed DLA's adherence to professional standards. He noted that DLA organizationally meets independence requirements, follows all applicable professional auditing standards, and is peer reviewed every three years as required by professional standards.

Guindon discussed DLA's responsibilities and services related to the Investment Council. DLA performs the annual audit of the cash flow fund and trust fund portfolios and prepares the quarterly agreed-upon procedures reports. He noted that SDRS's annual audit is performed by an outside CPA firm, and the draft report is reviewed by DLA before issuance.

In discussing DLA's commitment to the Investment Council, Guindon reviewed the additional training and certification completed by the auditors on the Council's audit. He reviewed the cross-training and the rotation of responsibilities that take place as part of quality controls.

The Council thanked Guindon for his presentation and expressed appreciation for the good work done by DLA.

7) Executive Board Meeting Review

The Council discussed the LRC Executive Board meeting that took place earlier in the day. The Council's presentation included FY 2019 investment performance and the Council's FY 2021 budget request, which the Executive Board approved. It was noted that the details of the State Investment Officer's earned incentive were reviewed with the Executive Board Subcommittee and provided to all Executive Board members.

8) Investment Update – FY 2020

Otten gave a report on the SDRS total fund performance for Fiscal Year 2020 to date.

9) Iran Divestiture – Policy Review & Update

Otten reviewed a memo dated August 8, 2019 on the Iran Scrutinized Companies List. Staff recommended that three subsidiary companies be added to the Council's list.

RYAN BRUNNER MOVED, SECONDED BY PAUL BISSON, TO APPROVE THE CHANGES TO THE IRAN SCRUTINIZED COMPANIES LIST AS PRESENTED. MOTION PASSED UNANIMOUSLY.

10) SDIC Shareholder Activism – Policy Review & 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 scrutinized companies list. Otten stated that Florida recently reported that the change in the government of Sudan in April of 2019 could alter Florida's Sudan divestment activities. There were no recommended changes to the policy.

11) Limited Partnerships – Private Equity & Real Estate

JOSH HAEDER MOVED, SECONDED BY ROB WYLIE, 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, Chris Nelson, Brett Fligge, Tammy Otten, Jeff Hallem, Laurie Riss and Christa Sites.

The Council went into executive session at 12:52 pm and general session reconvened at 1:25 pm.

12) BIT Cyber Security Presentation

Jim Edman, Chief Information Security Officer for the South Dakota Bureau of Information and Telecommunications, joined the Council to discuss cyber security. He reviewed important steps and training to help address cyber risk.

Edman reviewed a list of governmental organizations across the country that have recently been compromised and described some of the vulnerabilities that were exploited. He described many of the reasons that cyber security is so important and discussed several common email compromise scams. Edman reviewed cyber securities defenses used by BIT, including technology, employee cyber security training, regular assessments, and audits.

In response to Council questions, Edman discussed the kinds of information that are most sensitive and the number and training of BIT employees focused on cyber security.

Chair Koepsell thanked Jim Edman for his presentation.

13) Audit Committee Update

Jeff Nelson, Chair of the Audit Committee, reported that the annual audit is under way. The audit is expected to be completed by September 30 and will be reported at the next meeting. He added that the calculations for the investment performance incentives are also being reviewed by DLA. Nelson stated that AUP topics will be soon finalized for the first quarter of FY 2020.

Nelson reported that all staff and Council members have completed their annual certification of compliance with the Code of Ethics & Personal Investing Guidelines.

Council discussion took place on the trade order management system (OMS) and how it relates to the audit. Clark discussed the benefits of the OMS and noted a target implementation date of October 1.

14) Compensation Committee Update

Loren Koepsell, Chair of the Compensation Committee, noted that the update to the compensation study is in process and will be reviewed with the Compensation Committee this fall. The results will then be reported at the next Council meeting.

15) CD Program 2019/2020

Matt Clark reviewed the two memorandums previously provided to the Council that provided a history of the CD program and details 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. He recommended continuing the program.

RYAN BRUNNER MOVED, SECONDED BY JOSH HAEDER, TO APPROVE THE SOUTH DAKOTA CASH FLOW FUND CERTIFICATE OF DEPOSIT PROGRAM FOR ONE-YEAR CDs TO MATURE SEPTEMBER 30, 2020, 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.

16) 529 Higher Education Savings Program

Matt Clark reviewed the report of assets in the CollegeAccess 529 Plan as of 7/31/19. The minutes of the quarterly conference call with Allianz and the compliance schedule were provided.

Clark stated that the Program Management Agreement requires the Council to approve the auditor selected by Allianz, which is PricewaterhouseCoopers (PWC). He discussed the requirement in the Program Management Agreement for the use of a national auditing firm and reviewed PwC's practice of rotating partners on the audit. He recommended approval.

JEFF NELSON MOVED, SECONDED BY PAUL BISSON, TO APPROVE ALLIANZ GLOBAL INVESTORS' RECOMMENDATION OF PRICEWATERHOUSECOOPERS AS THE AUDITOR FOR THE COLLEGEACCESS 529 PLAN FOR THE YEAR ENDING DECEMBER 31, 2019. MOTION PASSED UNANIMOUSLY.

17) New/Old Business Agenda Items

Rob Wylie indicated that current plans are for SDRS to introduce legislation to eliminate the venture capital prohibition. He noted he will provide an update at the next Investment Council meeting for the Council's consideration of support.

18) Future Meeting Dates

The next Investment Council meeting will be held in Sioux Falls on November 21, 2019.

19) Investment Officer Performance Evaluation – Executive Session

JOSH HAEDER MOVED, SECONDED BY PAUL BISSON, TO GO INTO EXECUTIVE SESSION PER SDCL 1-25-2(1) TO DISCUSS ITEMS RELATING TO PERSONNEL. MOTION PASSED UNANIMOUSLY.

The Council went into executive session at 3 p.m. and general session reconvened at 3:29 p.m.

20) Adjournment

GREG KULESA MOVED, SECONDED BY JOSH HAEDER, FOR ADJOURNMENT. MOTION PASSED UNANIMOUSLY.

The meeting adjourned at 3:30 p.m.