

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL Teleconference August 27, 2020

1) Roll Call

The meeting was called to order at 9 a.m. on August 27, 2020 by Chair Jeff Nelson. 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 Investment Council Staff members Matt Clark, Brett Fligge, Chris Nelson, Tammy Otten, Jeff Hallem, Darci Haug, Jan Zeeck, Taylor Gubbrud, Payton Larsen, Laurie Riss and Christa Sites; legal counsel Aaron Schiebe; SDRS staff members Jacquee Storm, Doug Fiddler and Jane Beer; Barry Sternlicht, Lanhee Yung and Leander McCormick from Starwood; and Jim Baker and Pilar Sorensen from Private Equity Stakeholder Project.

AGENDA ITEMS:

- 1) Roll Call
- 2) Starwood Distressed Opportunity Fund XII
- 3) Minutes (June 4, 2020)
- 4) Public Comment
- 5) Council Member Appointment
- 6) Starwood Distressed Opportunity Fund XII
- 7) Investment Performance FY 2020
- 8) Investment Update – FY 2021
- 9) Iran Divestiture Update
- 10) Shareholder Activism Update
- 11) Compensation Committee Update
- 12) Audit Committee Update
- 13) CD Program 2020/2021
- 14) 529 Higher Education Savings Program
- 15) Budget Request – FY 2022
- 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 Council office, and public access is subject to the provisions of SDCL 1-27.)

2) Starwood Distressed Opportunity Fund XII

Barry Sternlicht, Chairman & CEO, and Lanhee Yung, Global Head of IR & Fundraising, joined the Council to discuss their real estate activities and strategies for the current funds and to present Starwood Distressed Opportunity Fund XII.

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 ON A ROLL CALL VOTE.

The Council went into executive session at 9:07 a.m. Remaining to participate in or facilitate the presentation and discussion included staff members Matt Clark, Chris Nelson, Brett Fligge, Tammy Otten, Jeff Hallem, Christa Sites and Laurie Riss and legal counsel Aaron Scheibe.

Open session reconvened at 10:35 a.m. (Action taken on Starwood under agenda item #6.)

3) Minutes

LOREN KOESELL MOVED, SECONDED BY MARY HOWARD, TO APPROVE THE MINUTES OF THE JUNE 4, 2020 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

4) Public Comment

Pilar Sorensen from Private Equity Stakeholder Project spoke on their opposition to Starwood's eviction practices during the Coronavirus pandemic. Matt Clark stated he would follow up with Starwood on this issue.

5) Council Member Appointment

Jeff Nelson advised that the LRC Executive Board reappointed Loren Koepsell for a five-year term commencing July 1, 2020. Koepsell had previously been appointed to complete a partial term.

6) Starwood Distressed Opportunity Fund XII

Matt Clark reviewed staff's recommendation of up to \$150 million in total for SDRS and the trust funds. He stated that before anything was finalized, he would follow up with Starwood on their eviction practices.

GREG KULESA MOVED, SECONDED BY PAUL BISSON, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$150 MILLION IN AGGREGATE, IN 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 STARWOOD DISTRESSED OPPORTUNITY FUND XII. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

7) Investment Performance FY 2020

Tammy Otten reviewed investment performance for Fiscal Year 2020. 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, 2020 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. Otten highlighted the asset allocation changes since March due to the market volatility. The cumulative impact of the sources of added or detracted value was shown for the last 6 individual years and cumulatively for 5, 10, 20 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 1, 3, 5, 10 and 30 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 FY2020 and historical periods.

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

Brett Fligge discussed equity performance. He stated the Council has historically leaned toward a value style of equity investing. He showed superiority of value versus growth styles over the long term. He showed the difference over rolling ten-year periods and highlighted that value underperformed over the last ten years by as much as the ten years ending in 1999 which had been the largest underperformance for that data which goes back to 1970.

Fligge showed the valuation model that had been developed to assess relative valuation of the value and growth styles. This showed that value has become meaningfully expensive but still a ways from being as expensive as in 1999. He noted that growth started cheap at the beginning of the most recent ten years so some of the underperformance may have been justified.

Fligge showed performance against an adjusted benchmark which reflects the typical leaning toward value. He also showed performance against the benchmark when further adjusted for additional leaning toward energy and financial industries.

8) Investment Update – FY 2021

Otten reviewed the completed Council motions from the April 2020 Council meeting. She provided an estimate of the SDRS total fund performance for Fiscal Year 2021 to date. She indicated that the SEC reported on August 26, 2020 a change in definition of entities allowed to purchase 144A securities to also include government entities like the trust funds and cash flow fund.

Clark updated the Council on the Bristow merger.

9) Iran Divestiture Update

Otten reviewed a memo dated August 12, 2020 on the Iran Scrutinized Companies List. Staff recommended no change to the current list.

10) SDIC Shareholder Activism

The Council received a copy of the Shareholder Activism Policy report provided to the Legislative Research Council on July 13, 2020 as required by law. The report included the policy and a Sudan scrutinized companies list.

11) Compensation Committee Update

Jeff Nelson, Chair of the Compensation Committee, noted that the state salary policy of 2% was implemented effective July 1, 2020. He noted that the separate long-term plan increase for investment positions was deferred. Matt Clark discussed his thoughts behind deferring the extra increase.

12) Audit Committee Update

Paul Bisson, 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 a future Council meeting. He added that the calculations for the investment performance incentives are also being reviewed by DLA. Bisson stated that AUP topics for fiscal year 2021 have been finalized.

Greg Kulesa noted that an invitation has been extended to the new Auditor General, Russ Olson, to speak to the Council at the November 2020 meeting.

13) CD Program 2020/2021

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.

LOREN KOESELL 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, 2021 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 ON A ROLL CALL VOTE.

14) 529 Higher Education Savings Program

Matt Clark reviewed the report of assets in the CollegeAccess 529 Plan as of 7/31/20. 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.

PAUL BISSON MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE ALLIANZ GLOBAL INVESTORS' RECOMMENDATION OF PRICEWATERHOUSECOOPERS AS THE AUDITOR FOR THE COLLEGEACCESS 529 PLAN FOR THE YEAR ENDING DECEMBER 31, 2020. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

Clark stated that Allianz is shifting parts of their retail business to Virtus. Their intention is for this to include the SDIC 529 program. He noted that staff will be performing due diligence regarding Virtus and will update the Council and make a recommendation at a future Council meeting. Any changes that would take place would require Council approval. He discussed the amount of time remaining on the current contract with Allianz.

15) Budget Request – FY 2022

Matt Clark reviewed the year-end budget summary for FY 2020 which detailed the budget received versus actual expenditures for the year. He discussed the areas that made up the unexpended budget noting that those funds will offset next year's budget authorization. He added that the budget is funded by assets under management and funds are drawn a couple times a year as needed.

Clark reviewed the budget request for FY 2022. He noted that the personal services budget includes increases for investment positions transitioning over 18 to 20 years from entry level to senior portfolio managers after which time the long-term plan increase is used. He described the salary increase percentages incorporated into the long-term plan for investment positions. The budget that will be submitted to the Executive Board, Governor/BFM and Appropriations will not include salary policy, as general salary policy for the state will be applied at the end of the process. Clark reviewed the unit cost summary and noted that to reflect a total picture of expenditures, the unit cost includes an assumed salary policy.

Clark reviewed the operating portion of the FY 2022 budget request. He outlined the changes proposed in the contractual budget for investment and administrative services. No changes were proposed for supplies, travel and capital assets.

RYAN BRUNNER MOVED, SECONDED BY MARY HOWARD, TO APPROVE THE FISCAL YEAR 2022 BUDGET REQUEST AS PRESENTED. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

16) New/Old Business Agenda Items

No new/old business agenda items were discussed.

17) Future Meeting Dates

It was the consensus of the Council that virtual meetings continue at least through the end of the calendar year and that a mid-October meeting be added to the schedule. This would allow the October and November meetings to be half-days and take the place of the normal full-day meeting.

18) Adjournment

Chair Nelson declared the meeting adjourned at 1 p.m.