

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL Teleconference June 3, 2021

1) Roll Call

The meeting was called to order at 8 a.m. on June 3, 2021 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, Tammy Otten, Chris Nelson, Brett Fligge, Jeff Hallem, Sherry Nelson, Renae Randall, John Richter, Laurie Riss, and Christa Sites; SDRS staff members Jacque Storm, Doug Fiddler, and Michelle Mikkelsen; SDRS Retirement Consultant Paul Schraeder; Ashlee Keyes and Brianna Neuhauser from DLA; Steve Pietila from Dakota National Bank Yankton, and Danish Khan and Kevin from Fundmap.

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes 4-22-21
- 3) Public Comment
- 4) Jeff Nelson Acknowledgement
- 5) Investment Update – FY 2021
- 6) Iran Divestiture Update
- 7) SDRS Actuarial Update
- 8) Asset Allocation – SDRS & Trust Funds
- 9) Compensation Committee Update
- 10) Audit Committee Update
- 11) Investment Incentive Plan Changes-FY2022
- 12) 529 Higher Education Savings Plan Update
- 13) FY 2023 SDIC Budget Request
- 14) Election of Officers – FY 2022
- 15) New/Old Business Agenda Items
- 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 Council office, and public access is subject to the provisions of SDCL 1-27.)

Chair Nelson welcomed Steve Pietila to the Investment Council. Mr. Pietila was appointed by the LRC Executive Board for a five-year term on the Investment Council to begin 7/1/2021.

Matt Clark welcomed legal counsel John Richter to the Investment Council staff and noted that the Council will be job sharing Richter with the Department of Revenue where he has worked as legal counsel for several years. Richter gave a summary of his background and his current responsibilities with the Department of Revenue.

2) Minutes

JOSH HAEDER MOVED, SECONDED BY MARY HOWARD, TO APPROVE THE MINUTES OF THE APRIL 22, 2021 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

3) Public Comment

There were no public comments.

4) Jeff Nelson Acknowledgment

Jeff Nelson will be completing his five years on the Investment Council effective June 30, 2021. Matt Clark thanked Jeff for his contributions to the Council during his term and for his extensive work while being the chair of the audit committee. Clark reviewed some of the performance results over the last five years.

5) Investment Update – FY 2021

Tammy Otten reported the estimated fiscal year-to-date return of the SDRS portfolio, and the upcoming distributions and contributions for the various funds. There were no finalized motions and resulting actions to report.

Matt Clark reviewed asset allocation moves. He updated the Council on the status of Bristow.

6) Iran Divestiture Update

Otten reported that since the last Council meeting, Florida had not updated the list used to determine the South Dakota list of Iran scrutinized companies. As a result, staff recommended no change to the current South Dakota scrutinized companies' list.

7) SDRS Actuarial Update

Doug Fiddler presented estimated funding status results for June 30, 2021. He provided an overview of the current and historical inflation rates in comparison to SDRS COLAs for the last several years. He also reviewed the impact of the FY 2021 investment return on the 2022 maximum COLA. He discussed the projected future COLA ranges and the likelihood of additional required corrective actions after one year based on the current estimated net investment return for FY 2021.

8) Asset Allocation

South Dakota Retirement System

Matt Clark discussed the asset allocation process, importance, and application to SDRS. He discussed the recommended benchmark allocation and ranges, expected return and standard deviations, asset category valuation, and the movement of category allocations within ranges based on valuation.

Clark discussed the recommended benchmark level of equity-like and bond-like risk to balance long-term potential returns with drawdown risk in difficult markets. He indicated this was for the benchmark which should represent what could be adhered to through thick and thin. He showed charts of historic returns noting the dominance of equity returns over the very long term and the diversification benefit during market downturns of mixing in some bonds. He

discussed the recommended range for equity-like risk and bond-like risk. He said the goal is to enter market downturns with below benchmark risk and increase toward maximum during the downturn to benefit from an eventual rebound. He added that after minimums or maximums are reached, markets will typically move further, which can be very painful. It is essential to be patient for at least another three to five years.

Clark discussed the lowering a couple years ago of the minimum level of equity-like risk. Doug Fiddler discussed the reduction of absolute downside risk of the lower minimum during a severe decline. Brett Fligge discussed the increased underperformance risk of the lower minimum when very expensive markets continue to go up.

Clark discussed equity-like and bond-like risk mapping for all asset categories. He discussed specific asset categories to be included in the benchmark which are those that are significant and passively implementable. He discussed other niche or skill-based categories which are not in the benchmark but have a permitted range. He presented the recommended FY2022 SDRS capital market benchmark allocations and minimum/maximum ranges for each asset category and compared to the benchmark allocations for fiscal years 2011 through 2021.

Clark showed SDRS historical levels of equity-like allocation. He reviewed the asset allocation risk/return analysis. The first portion focused on long-term mean expected returns, expected standard deviations, and asset correlations provided by JP Morgan Asset Management as a proxy for conventional expectations. The incremental return and standard deviation impact of each asset class was shown. The analysis was shown again using internal asset category expected returns and internal adjusted risk measures.

Clark discussed additional risk measures and risk control. He reiterated that the focus is on equity-like risk and bond-like risk which includes embedded equity and bond risk for all categories. He said statistical measures of risk, such as standard deviation and correlation, are adjusted to reflect higher real-world frequency and magnitude of adverse outlier events. Behavior of some assets in a crisis can vary depending on whether the crisis is rooted in inflation or deflation concerns. Clark discussed how risk is managed by broad diversification and by reducing amounts invested in expensive assets. Adequate liquidity is maintained to avoid liquidation of depressed assets in a crisis and to allow rebalancing. He stated that participation in the economic system is necessary to get the highest long-term rewards and that short-term ebbs and flows must be endured. He added that strength and determination are important to be able to handle tough markets. Strong funding built up in good markets and a flexible benefit design are very helpful.

Clark then discussed asset category valuation. Equity category valuation is based on estimated future cash flows using normal earnings and growth rates and a risk impacted discount rate. The model is similar to the model used to value individual companies. He discussed adjustments to fair value based on monetary conditions and corporate earnings strength. He discussed valuation processes for bonds, real estate and high yield.

Clark showed the current and historical valuations of each asset class and historical efficacy of the valuation process. He discussed the plan for adjusting allocations within permitted ranges based on valuation.

Trust Funds

Tammy Otten discussed asset allocation for the four trust funds: Dakota Cement Trust, Healthcare Trust, Education Enhancement Trust, and School and Public Lands. The presentation provided reviewed the establishment of each fund, the Constitution and laws that direct the investment of the assets, and the annual distribution calculation.

Otten reviewed the asset allocation analysis which shows the long-term mean expected return and standard deviation for each fund. The analysis used the standard deviations and correlations with fat tail adjustments. The expected return and standard deviation compared to select prior year benchmark allocations were shown.

Staff proposed no changes to the FY 2022 capital markets benchmark weights, min/max range or benchmark indexes for the Dakota Cement Trust, Healthcare Trust or School and Public Lands Fund. Staff proposed a change in the benchmark for the Education Enhancement Trust by decreasing the tax-exempt debt weight by 2% to 6% and increasing the investment grade debt by 2% to 24% to reflect the amount remaining in the tax-exempt debt portfolio. It was recommended that the equity-like risk target for the four trust funds remain at 90% of the equity-like risk for SDRS.

LOREN KOESELL MOVED, SECONDED BY PAUL BISSON, TO APPROVE THE FISCAL YEAR 2022 CAPITAL MARKETS BENCHMARK, INDEXES, EQUITY-LIKE RISK, AND MAXIMUM/MINIMUM RANGES FOR THE SOUTH DAKOTA RETIREMENT SYSTEM AS PRESENTED. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

GREG KULESA MOVED, SECONDED BY RYAN BRUNNER, TO APPROVE THE FISCAL YEAR 2022 CAPITAL MARKETS BENCHMARK, INDEXES, EQUITY-LIKE RISK, AND MAXIMUM/MINIMUM RANGES FOR THE DAKOTA CEMENT TRUST, HEALTHCARE TRUST, EDUCATION ENHANCEMENT TRUST, AND SCHOOL AND PUBLIC LANDS FUND AS PRESENTED. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

MARY HOWARD MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE THAT ASSET ALLOCATION ADJUSTMENTS IN THE RETIREMENT AND TRUST FUNDS MAY BE IMPLEMENTED IN THE CASH AND/OR DERIVATIVES MARKETS. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

9) Compensation Committee Update

Paul Bisson, Chair of the Compensation Committee, noted that the Council's recommended total compensation for the State Investment Officer for FY 2022 was approved by the Executive

Board at their June 2, 2021 meeting.

10) Audit Committee Update

Greg Kulesa, Chair of the Audit Committee, reported that the Agreed Upon Procedures work was completed for the quarter ended March 31, 2021. There were no exceptions reported as result of the procedures. He reported the Audit Committee will meeting again prior to the August meeting for any changes to the Agreed Upon Procedures. He noted that the annual audit engagement will be starting soon for the trust funds and the cash flow fund.

11) Investment Incentive Plan Changes – FY 2022

Matt Clark discussed the changes to the incentive plan for FY 2022, payable in FY 2023, relating to Senior Portfolio Manager Renae Randall and investment team members Taylor Gubbrud and Payton Larsen. He discussed Renae Randall's transition to the global core equity portfolio and related changes to her incentive plan to match the structure of others in the assigned area. He noted that Taylor Gubbrud and Payton Larsen will be assigned portfolio responsibility for FY 2022.

LOREN KOESELL MOVED, SECONDED BY MARY HOWARD, TO APPROVE THE INCENTIVE PLAN CHANGES AS DETAILED IN THE MAY 21, 2021 MEMORANDUMS ENTITLED, "*INVESTMENT PERFORMANCE INCENTIVE PLAN CHANGES EFFECTIVE FISCAL YEAR 2022*". MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

12) 529 Higher Education Savings Plan Update

Sherry Nelson reviewed the CollegeAccess 529 Plan summary of accounts, the compliance schedule, and minutes of the quarterly Virtus Distributors conference call. She indicated the process to change the custodian and transfer agent from SS&C to BNY Mellon is expected to be completed by the third quarter of 2021.

13) FY 2023 Budget Request

Matt Clark reviewed the FY 2021 budget received versus actual expenditures estimated through the rest of the fiscal year. He discussed the areas that made up the unexpended budget noting that those funds will offset next year's budget authorization, essentially reverting to the funds under management. He noted a change in FTEs due to repurposing positions due to retirement transitions.

Clark reviewed the budget request for FY 2023 and the unit cost summary. 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 increases are used. The budget that will be submitted to the Executive Board, Governor/BFM and Appropriations will not include salary policy, as a general salary policy for the state will be

applied at the end of the process. To reflect a total picture of expenditures, the unit cost summary does include an assumed salary policy.

Clark reviewed the operating portion of the FY 2023 budget request. He discussed the changes proposed in the contractual budget for investment and administrative services and described increases for an investment accounting software upgrade and investment research services. No changes were proposed for travel and supplies.

GREG KULESA MOVED, SECONDED BY RYAN BRUNNER, TO APPROVE THE FISCAL YEAR 2023 BUDGET REQUEST AS PRESENTED. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

14) Election of Officers – FY 2022

LOREN KOEPEL MOVED, SECONDED BY RYAN BRUNNER, TO ELECT PAUL BISSON AS CHAIR AND GREG KULESA AS VICE CHAIR OF THE INVESTMENT COUNCIL FOR FISCAL YEAR 2022. MOTION PASSED UNANIMOUSLY ON A ROLL CALL VOTE.

15) New/Old Business Agenda Items

No new/old business agenda items were discussed.

16) Future Meeting Dates

The next Investment Council meeting will be held in Pierre on August 31, 2021, in conjunction with the LRC Executive Board meeting.

17) Adjournment

Chair Nelson declared the meeting adjourned at 12:40 p.m.