

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL June 2, 2022

1) Roll Call

The meeting was called to order at 8:30 a.m. on June 2, 2022 by Chair Paul Bisson. Council members in attendance were Travis Almond, Paul Bisson, Josh Haeder, Mary Howard, Loren Koepsell, Greg Kulesa, and Steve Pietila. Jarrod Johnson was absent.

Others attending all or part of the meeting included Investment Council staff members Matt Clark, Tammy Otten, Chris Nelson, Sherry Nelson, Jan Zeeck, Dan Elmer, Sami Rains, Anne Cipperley, Renae Randall, John Richter and Laurie Riss; SDRS Board members James Johns, Eric Stroeder, Jim Terwilliger, Annette Brant, Jill Lenards, Karl Alberts, Kathy Greeneway, and Glen Vilhauer; SDRS staff members Jacque Storm, Doug Fiddler, and Michelle Mikkelsen; Ashlee Keyes and Brianna Neuhauser from DLA; Derek Johnson from BFM; and Kelly Meiners from First Fidelity Bank in Winner.

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes 4-7-2022
- 3) Public Comment
- 4) Paul Bisson Acknowledgement
- 5) SDRS Actuarial Update
- 6) Asset Allocation – SDRS & Trust Funds
- 7) Investment Update – FY 2022
- 8) Iran Divestiture Update
- 9) Investment Incentive Plan Changes-FY2023
- 10) 529 Higher Education Savings Plan Update
- 11) Audit Committee Update
- 12) Compensation Committee Update
- 13) FY 2024 SDIC Budget Request
- 14) Blackstone Real Estate Partners Fund X
- 15) Election of Officers – FY 2023
- 16) New/Old Business Agenda Items
- 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.)

Chair Bisson welcomed Kelly Meiners to the Investment Council. Mr. Meiners was appointed by the LRC Executive Board for a five-year term on the Investment Council to begin 7/1/2022.

2) Minutes

MARY HOWARD MOVED, SECONDED BY GREG KULESA, TO APPROVE THE MINUTES OF THE APRIL 7, 2022 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

3) Public Comment

There were no public comments.

4) Paul Bisson Acknowledgment

Paul Bisson will be completing his five years on the Investment Council effective June 30, 2022. Matt Clark thanked Paul for his contributions to the Council and reviewed some of the performance

statistics over the last five years. Bisson shared his thoughts regarding serving on the Council and working with the Investment Council staff.

5) SDRS Actuarial Update

Doug Fiddler presented an overview of the South Dakota Retirement System. He provided a breakdown of active members and benefit recipients, as well as member/employer contributions and SDRS disbursements. He discussed the FY 2021 investment gain and its impact on the COLA for July of 2022.

Fiddler discussed the statutorily required SDRS contribution rates and corrective actions if SDRS falls below 100% funded. He compared the SDRS funded ratio and pension contribution to those of other state funds. He outlined how the COLA is calculated and reviewed recent COLA ranges.

Fiddler provided an overview of the current and historical inflation rates in comparison to SDRS COLAs for the last several years. He discussed the preliminary likelihoods for July 2023 COLA ranges, primarily driven by FY 22 investment returns. He noted that actuarial assumptions will be revised for the 6/30/22 valuation based on an experience analysis.

6) 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 three years ago of the minimum level of equity-like risk. He discussed the reduction of absolute downside risk of the lower minimum during a severe decline and 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 FY2023 SDRS capital market benchmark allocations and minimum/maximum ranges for each asset category and compared to the benchmark allocations for fiscal years 2012 through 2022. The recommended change in the benchmark is to reduce public equity by 1.7%, fixed income by .2% and cash by .1% and increase real estate by 2.0%. The changes reflect removal of REITs from public equity benchmarks and shift to the real estate category. The benchmark changes tie to the risk mapping of REITs to estimated embedded equity, bond, and cash exposures.

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 a leading investment bank asset management division 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.

Rena Randall showed daily output from the valuation model which is used to monitor when transaction thresholds are reached. She showed an example of changing valuations and

thresholds using the March to September 2020 period when the equity allocation changed several times.

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 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 changes to the FY 2023 capital markets benchmark weights included reducing the public equity weight by 1% and increasing the REIT weight by 1%. No recommended changes were made to the min/max range. The proposed benchmark index for Public Equity to MSCI AC IMI ex REITs (3/4) and MSCI IMI US ex REITs (1/4), for the Dakota Cement Trust, Healthcare Trust, School and Public Lands Fund and Education Enhancement Trust. It was recommended that the equity-like risk target for the four trust funds remain at 90% of the equity-like risk for SDRS.

STEVE PIETILA MOVED, SECONDED BY JOSH HAEDER, TO APPROVE THE FISCAL YEAR 2023 CAPITAL MARKETS BENCHMARK, INDEXES, EQUITY-LIKE RISK, AND MAXIMUM/MINIMUM RANGES FOR THE SOUTH DAKOTA RETIREMENT SYSTEM AS PRESENTED. MOTION PASSED UNANIMOUSLY.

GREG KULESA MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE THE FISCAL YEAR 2023 CAPITAL MARKETS BENCHMARK, INDEXES, EQUITY-LIKE RISK, AND MAXIMUM/MINIMUM RANGES FOR THE DAKOTA CEMENT TRUST, HEALTH CARE TRUST, EDUCATION ENHANCEMENT TRUST, AND SCHOOL & PUBLIC LANDS AS PRESENTED. MOTION PASSED UNANIMOUSLY.

MARY HOWARD MOVED, SECONDED BY LOREN KOEPEL, 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.

7) Investment Update – FY 2022

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 updated the Council on the status of Bristow.

8) Iran Divestiture Update

Sami Rains reported that since the last Council meeting, Florida updated the list used to determine the South Dakota list of Iran scrutinized companies. There were no changes reported. As a result, staff recommended no change to the current South Dakota scrutinized companies' list.

9) Investment Incentive Plan Changes – FY 2023

Matt Clark discussed changes for several investment team members' portfolio responsibilities and related changes to their incentive plans for FY 2023 payable in FY 2024. He discussed Darci Haug's move from SMID to REITS. He noted that Melissa Woidyla is now part time and has switched her focus to the Core Portfolio. Zach Nipp has moved from high yield to SMID. Payton Larsen and Taylor Gubbrud have been assigned global equity sector portfolio responsibilities for FY 2023.

GREG KULESA MOVED, SECONDED BY TRAVIS ALMOND, TO APPROVE THE INCENTIVE PLAN CHANGES AS PRESENTED AND DETAILED IN THE FOUR MEMORANDUMS DATED MAY 19, 2022, DETAILING THE FY 2023 INVESTMENT PERFORMANCE INCENTIVE PLAN CHANGES FOR DARCI HAUG, MELISSA WOIDYLA, ZACH NIPP, TAYLOR GUBBRUD AND PAYTON LARSEN. MOTION PASSED UNANIMOUSLY.

10) 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.

Nelson stated that at an upcoming meeting she will be discussing a potential change to the 529 allocation advisor due to SEC sanctions against the current advisor, Allianz, unrelated to the Council's 529 program.

11) Audit Committee Update

Mary Howard, Chair of the Audit Committee, noted that the Audit Committee is meeting with Legislative Audit following this Council meeting to discuss the annual audit engagement that will be starting soon for the trust funds and the cash flow fund.

12) Compensation Committee Update

Greg Kulesa, Chair of the Compensation Committee, noted that the Council's recommended total compensation for the State Investment Officer for FY 2023 was approved by the Executive Board at their May 16, 2022 meeting.

Kulesa reviewed the recent Compensation Committee call. He noted that the McLagan compensation data was received, and the compensation study was updated by Matt Clark. He reviewed the results of the study which showed additional slippage since the last study was

done in 2019. Council discussion continued including the compensation target and cost of living adjustment, the portion of compensation tied to incentives, the mix between short-term and long-term incentives, and changing workforce environment including remote work.

It was the consensus of the Council that Matt Clark work up potential changes to the incentive plan that would result in moving total compensation closer to the Council's target.

13) FY 2024 Budget Request

Matt Clark reviewed the FY 2022 budget authorization 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.

Clark reviewed the budget request for FY 2024 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.

Discussion continued regarding the personal services budget for FY 2024 and the impact of a potential change to the incentive plan.

Clark reviewed the operating portion of the FY 2024 budget request. He discussed the changes proposed in the contractual budget for investment and administrative services. He discussed the upgrade to the investment accounting software, the increase expected upon the office lease renewal, and changes among investment research services. No changes were proposed for travel, supplies, or capital assets.

It was the consensus of the Council that a Council teleconference meeting would be held in July to discuss and decide upon the incentive and personal services portion of the budget. Final action on the total FY 2024 budget request would take place at that time.

14) Blackstone Real Estate Partners Fund X Investment

Matt Clark discussed the presentation made by Blackstone Real Estate Partners at the April 2022 Council meeting. He reviewed the amount of BREP distributions since then and discussed staff's recommendation for an investment in BREP X.

Chris Nelson discussed BREP's investment performance. He reviewed the Council's level of commitment and ceilings for real estate and for Blackstone partnership investments.

LOREN KOEPEL MOVED, SECONDED BY TRAVIS ALMOND, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$300 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 BLACKSTONE REAL ESTATE PARTNERS X. MOTION PASSED UNANIMOUSLY.

15) Election of Officers – FY 2023

STEVE PIETILA MOVED, SECONDED BY LOREN KOEPEL, TO ELECT GREG KULESA AS CHAIR AND MARY HOWARD AS VICE CHAIR OF THE INVESTMENT COUNCIL FOR FISCAL YEAR 2023. MOTION PASSED UNANIMOUSLY.

16) New/Old Business Agenda Items

No new/old business agenda items were discussed.

17) Future Meeting Dates

The next Investment Council meeting will be held by teleconference to be scheduled for July. The Council will be polled to determine a date.

18) Adjournment

Chair Bisson declared the meeting adjourned at 4:10 p.m.