

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL

Pierre, South Dakota

September 9, 2014

1) Roll Call

The meeting was called to order at 9:15 a.m. on September 9, 2014 by Chair Jon Hunter. Council members in attendance were Lorin Brass, David Hillard, Jon Hunter, Vern Larson, Jim Means, Rich Sattgast and Rob Wylie. Council member Steve Kirby was absent. It was noted that Mr. Kirby was available for the originally scheduled date of the meeting but was unable to attend at the rescheduled time.

Others attending all or part of the meeting included Matt Clark, Brett Fligge, Tammy Otten, Sherry Nelson and Laurie Riss from the Investment Office; Jane Roberts, Michelle Mikkelsen, and Susan Jahraus from the South Dakota Retirement System; Jason Dilges and Jim Terwilliger from the Bureau of Finance and Management; and Aaron Olson from the Legislative Research Council.

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

2) Minutes

JIM MEANS MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE MINUTES OF THE JUNE 16 AND 17, 2014 AND JUNE 30, 2014 COUNCIL MEETINGS. MOTION PASSED UNANIMOUSLY.

3) LRC Executive Board Meeting Review

The Council discussed the meeting with the Executive Board Subcommittee on the Investment Council that took place immediately before this meeting. Items discussed with the Executive Board Subcommittee included FY 2014 investment performance, earned investment performance incentives, and the FY 2016 budget request.

4) Compensation Committee Update

Matt Clark reviewed the earned incentives for the Investment Office staff. The percentages and total dollar amounts were provided.

5) Investment Performance – FY 2014

Otten presented the investment performance for Fiscal Year 2014. The South Dakota Retirement System (SDRS) investment performance analysis presentation included an overview

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes
- 3) LRC Executive Board Meeting Review
- 4) Compensation Committee Update
- 5) Investment Performance – FY 2014
- 6) Investment Update – FY 2015
- 7) Iran Divestiture – Update
- 8) SDIC Shareholder Activism Policy (Sudan)
- 9) Investment Officer Performance Evaluation
Executive Session
- 10) Subcommittee Appointments
- 11) Blackstone Energy Partners II
- 12) Blackstone Energy Partners II Investment
- 13) Riverstone Global Energy VI investment
- 14) Recruitment Update
- 15) Audit Committee Update
- 16) Cash Flow Fund Portfolio-Statutory &
Policy Guidelines – Proposed Changes
- 17) Supplemental Retirement Plan 457
Investment Options Update
- 18) CD Program 2015
- 19) Higher Education Savings Program –
Update
- 20) New/Old Business
- 21) Future Meeting Dates
- 22) Adjournment

of the market environment during the four quarters of the fiscal year. Total returns for equity, real estate, fixed income, and commodity indexes were provided, as well as returns for various asset mixes.

Otten reviewed the Callan & Wilshire peer universe asset allocation comparisons. The net time weighted rates of return of SDRS and the Capital Markets Benchmark as of 6/30/14 were reported. The gross time weighted rates of return were ranked against peer universes which use gross returns. The risk and return graph analysis against the Callan Universe was reviewed for the 10 year period.

The total portfolio performance attributions to the Capital Markets Benchmark were reviewed. The exhibits showed the difference in return at the portfolio level (how the individual asset category returns compared to their respective index returns) and at the asset allocation level (how the asset allocation differed from the benchmark asset allocation using index returns). A 16-year performance attribution yearly history versus the Capital Markets Benchmark was provided. It highlighted that different asset classes contribute to the overall fund's performance at different times.

Otten reviewed exhibits comparing individual asset categories and the total fund to benchmarks for the last 10 years and since inception.

Otten then presented the return and attribution analysis for each of the four trust funds to their Capital Markets Benchmark.

The Investment Council recessed at 9:55 a.m. to meet with the LRC Executive Board. The Council meeting reconvened at 11:30 p.m.

6) Investment Update – FY 2015

Otten reviewed the Motions and Actions report that summarized the motions from the prior Council meeting and the resulting staff actions. She gave a report on the SDRS total fund performance for Fiscal Year 2015 to date. There was discussion about use of futures contracts to hedge equity exposure.

7) Iran Divestiture – Update

Otten reviewed a memo dated August 11, 2014 on the Iran Scrutinized Companies List and noted there were no changes to the information since the last Council review in June, 2014.

8) SDIC Shareholder Activism Policy (Sudan) – Update

Otten confirmed the Council received a copy of the report provided to the Legislative Research Council as required by law on the Shareholder Activism Policy. Included with the report was a memo outlining compliance with the policy, a copy of the policy, an updated Sudan company list and correspondence with Alstom in which the Council has a direct investment. Otten stated Alstom's response by letter explained their actions in Sudan. The objectives of the shareholder activism policy are kept in mind during the voting of proxies and company analysis.

9) Investment Officer Performance Evaluation – Executive Session

LORIN BRASS MOVED, SECONDED BY DAVID HILLARD, TO GO INTO EXECUTIVE SESSION PER SDCL 1-25-2(1) FOR THE PURPOSE OF THE STATE INVESTMENT OFFICER'S PERFORMANCE EVALUATION. MOTION PASSED UNANIMOUSLY.

The Council went into executive session from 11:50 a.m. to 12:20 p.m.

10) Subcommittee Appointments

Jon Hunter reviewed the changes to the Investment Council Subcommittees. Effective immediately, the Compensation Committee will include Jim Means as Chair, Jon Hunter and David Hillard. Following the completion of the audit in the next few weeks, the members of the Audit Committee will include David Hillard as Chair, Rich Sattgast and Steve Kirby.

11) Blackstone Energy Partners II

Shawn Klimczak and Robert McMillan of Blackstone Energy Partners (BEP) joined the Council by conference call to discuss their Energy Partners II fund. Klimczak began the presentation by giving a history of the energy area as a part of Blackstone private equity. The area was carved out as it became such a large part of Blackstone private equity funds. He discussed BEP's returns on an absolute and relative basis across all energy investments to date. He reviewed their global network of private equity professionals and discussed their organic growth approach for their investment team.

Klimczak reviewed Blackstone's investment strategy. He discussed what differentiates them from other energy funds, including their global focus, ability to work across sectors, involvement in new and existing investments, and ability to be contrarian when assets are in distress.

Klimczak broke down the allocations to their energy investments by industry, region and strategy. He discussed the outlook for the energy area and their expectations for BEP II relating to new opportunities and related industries and regions. He noted that Blackstone's power investments have a low correlation with each other and with commodity prices.

Chair Hunter thanked Blackstone for their presentation. Council discussion continued.

12) Blackstone Energy Partners II – Investment

Clark reviewed staff's recommendation for an investment in Blackstone Energy Partners II. The recommendation was for the South Dakota Retirement System only, with the trust funds not being included because of the limited size available for this investment. He reviewed the levels currently invested in total for Blackstone funds, the current private equity total percentage and the expected amount of liquidations over the next year. The size of Blackstone's energy fund and its investment period were discussed.

JIM MEANS MOVED, SECONDED BY DAVID HILLARD, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST \$50 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM IN BLACKSTONE ENERGY PARTNERS II. MOTION PASSED UNANIMOUSLY.

13) Riverstone Global Energy and Power Fund VI – Investment

Clark discussed Riverstone's energy fund that was presented at the June 17, 2014 Council meeting. He reviewed staff's recommendation for an investment in Riverstone Global Energy and Power Fund VI for SDRS and the trust funds. The recommended amount for the trust funds took into account their not participating in the Blackstone Energy Fund II.

The Council discussed the performance of the current Riverstone investments, the target size of Riverstone Fund VI, its investment period, preferred return and fees.

ROB WYLIE MOVED, SECONDED BY DAVID HILLARD, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST \$150 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM PLUS \$22 MILLION PROPORTIONATELY AMONG THE DAKOTA CEMENT TRUST, HEALTHCARE TRUST, EDUCATION ENHANCEMENT TRUST AND SCHOOL AND PUBLIC LANDS IN THE RIVERSTONE GLOBAL ENERGY AND POWER FUND VI. MOTION PASSED UNANIMOUSLY.

14) Recruitment Update

Clark stated that three of the summer interns will be joining the Investment Office as permanent employees. One will be joining full time immediately, and the other two will be working part time during their final year of college and joining the office full time next spring. He briefly discussed the training that is planned for the new positions.

15) Audit Committee Update

Jim Means stated that the auditors from Department of Legislative Audit have wrapped up the on-site work at the Investment Office and indicated they should be done with the entire audit, including the incentive calculations review, by the end of September.

16) Cash Flow Fund Portfolio – Statutory & Policy Guidelines – Proposed Changes

Clark stated that there have been conversations among staff, the Governor's Office and the Bureau of Finance and Management about ways to get the most out of the Cash Flow Fund. He reviewed the topics and discussed the suggestions that came from these meetings.

Clark reviewed a couple suggested changes to SDIC 4-5-26. The first change involved cleaning up the language to remove reference to the Cement Plant retirement fund. The second change would allow the portfolio manager to hold onto a security if it was downgraded after purchase.

ROB WYLIE MOVED, SECONDED BY JIM MEANS THAT THE INVESTMENT COUNCIL SUPPORT THE PROPOSED CHANGES TO SDCL 4-5-26. MOTION PASSED UNANIMOUSLY.

Clark also indicated he planned to seek support at the December Council meeting for a change to how Investment Council expenses are allocated to the cash flow fund and a change in contracting requirements.

17) Supplemental Retirement Plan 457 – Investment Options Update

Sherry Nelson presented the summary of the Supplemental Retirement Plan Analysis for the period ended June 30, 2014. The report included a write-up of each investment option. She noted that no changes were being made to the investment options this year.

Clark noted that although the Investment Officer is responsible by law for choosing the investment options, this review is provided to the Investment Council as well as the SDRS Retirement Board for potential input and feedback.

18) CD Program – 2015

Nelson reviewed the memorandum on the CD Program which detailed the underlying information 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.

RICH SATTGAST MOVED, SECONDED BY LORIN BRASS, TO APPROVE THE SOUTH DAKOTA CASH FLOW FUND CERTIFICATE OF DEPOSIT PROGRAM FOR ONE-YEAR CD'S TO MATURE 9/30/15, 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.

19) Higher Education Savings Program Update

Nelson reviewed the quarterly compliance schedule, the quarterly conference call minutes and asset report as of 7/31/14 for the CollegeAccess 529 Plan. She noted that Allianz provided the scholarship money to the Dakota Corps Scholarship Program in July as has been done over the last several years.

20) New/Old Business

No new or old business was brought before the Council.

21) Future Meeting Dates

The next Investment Council meeting will be held in Sioux Falls on December 9, 2014.

19) Adjournment

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