

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL Sioux Falls, South Dakota November 15, 2016

1) Roll Call

The meeting was called to order at 9 a.m. on November 15, 2016 by Chair David Hillard. Council members in attendance were Ryan Brunner, David Hillard, Steve Kirby, Laura McNally, Jeff Nelson, Rich Sattgast and Rob Wylie. Lorin Brass was absent.

Others attending all or part of the meeting included Matt Clark, Brett Fligge, Tammy Otten, Chris Nelson, Sherry Nelson, Jarrod Edelen, Darci Haug, Scott Hess, Anne Cipperley, Danielle Mourer, Ross Sandine, and Laurie Riss from the Investment Office; Jane Beers and Michelle Mikkelsen from the South Dakota Retirement System; Joe Osness and Dan Hoevel from Silver Lake Partners; and E. Murphy Markham and Charles Bauer from Encap Investments.

(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.)

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes
- 3) Silver Lake Partners
- 4) EnCap Investments L.P.
- 5) Investment Update – FY 2017
- 6) Iran Divestiture – Update
- 7) SDIC FY 2016 Annual Report
- 8) Audit Committee Update
- 9) Internal Controls & Fraud Risk Assessment
- 10) Sarbanes Oxley – Compliance Checklist
- 11) SDIC Conflict Waiver Policy Revision
- 12) Compensation Committee Update
- 13) Legislation – 2017
- 14) Succession Planning/Internal Training Program
- 15) SMID/High Yield Portfolio Manager Changes
- 16) Higher Education Savings Program Update
- 17) CD Program Update
- 18) New/Old Business
- 19) Future Meeting Dates
- 20) Adjournment

2) Minutes

ROB WYLIE MOVED, SECONDED BY JEFF NELSON, TO APPROVE THE MINUTES OF THE AUGUST 29, 2016 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

3) Silver Lake Partners

Joe Osness, Manager Director & Investment Committee Member, and Dan Hoevel, Vice President of Marketing & Investor Relations joined the Council to discuss their private equity funds and present their next fund.

Osness discussed the history of Silver Lake and how they began participating in the technology investment area. He gave examples of the types of companies in which they invest, including the more traditional technology firms, as well as tech-enabled firms. He discussed Silver Lake's global platform and their collaborative partnerships with managements to build and implement value creation programs.

Osness reviewed the Silver Lake team and emphasized their long tenure and experience. He discussed the strength and depth of their network built over the years.

Osness gave examples of businesses they bought and transformed to create value. He stated that technology is the highest growth segment of the global economy with robust opportunities.

JEFF NELSON MOVED, SECONDED BY STEVE KIRBY, TO GO INTO EXECUTIVE SESSION PER SDCL 1-25-10 FOR THE PURPOSE OF DISCUSSING SILVER LAKE PARTNERS FINANCIAL AND COMMERCIAL INFORMATION THAT IS CONFIDENTIAL UNDER SDCL 1-27-1.6(5). MOTION PASSED UNANIMOUSLY.

The Investment Council went into executive session at 9:50 a.m. and reconvened general session at 10:25 a.m.

Chair Hillard thanked Silver Lake for their presentation.

Matt Clark and Chris Nelson updated the Council on the current and projected exposure to the private equity area and Silver Lake in particular. They discussed their recommendation of a \$200 million investment for SDRS and additional amounts for the trust funds. He reviewed how the trust fund amounts were determined.

Council discussion continued.

STEVE KIRBY MOVED, SECONDED BY LAURA McNALLY, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$200 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM, PLUS ADJUSTED PROPORTIONATE AMOUNTS FOR THE SCHOOL AND PUBLIC LANDS FUND, THE DAKOTA CEMENT TRUST, THE EDUCATION ENHANCEMENT TRUST, AND THE HEALTH CARE TRUST IN SILVER LAKE PARTNERS V. MOTION PASSED UNANIMOUSLY.

4) EnCap Investments L.P.

E. Murphy Markham IV, Managing Partner, and Charles W. Bauer, Manager Director, joined the Council to discuss EnCap Investments L.P. and to present EnCap Energy Capital Fund XI.

Bauer began the presentation with an overview of EnCap which was founded in 1988 and is the leading provider of growth capital to the upstream and midstream sectors of the U.S. oil and gas industry. He discussed the investment model of EnCap and their management teams. The portfolio company life cycle of the investment, growth stage, and exit has a three to five year average life.

Markham discussed how EnCap creates value by partnering with the best teams, focusing on top quartile opportunities, capturing superior economic investment opportunities, and managing risk. He reviewed strategies to capture opportunities, including leasing acreage in the early and mid-stages, as well as acquiring and exploiting undeveloped reserves. Markham discussed EnCap's value creation formula tested through multiple industry cycles and the necessity of their teams to be flexible and adaptable to economic shifts and developing completion techniques.

Bauer concluded the general session portion of their presentation with a discussion on EnCap's professional investment team, emphasizing their depth and experience.

In response to Council members' questions, Markham discussed EnCap's continuity with their management teams, their competition in the industry, and the competitive landscape.

ROB WYLIE MOVED, SECONDED BY RICH SATTGAST, TO GO INTO EXECUTIVE SESSION PER SDCL 1-25-10 FOR THE PURPOSE OF DISCUSSING ENCAP INVESTMENTS L.P. FINANCIAL AND COMMERCIAL INFORMATION THAT IS CONFIDENTIAL UNDER SDCL 1-27-1.6(5). MOTION PASSED UNANIMOUSLY.

The Investment Council went into executive session at 11:30 a.m., and general session reconvened at 12:05 p.m.

Chair Hillard thanked EnCap for the presentation.

Clark reviewed exposure to private equity and projections going out the next few years including both a Silver Lake investment and a \$50 million investment to EnCap. He discussed the recommendation as the starting point with a new partnership.

Council discussion continued.

RYAN BRUNNER MOVED, SECONDED BY LAURA MCNALLY, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$50 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM IN ENCAP ENERGY CAPITAL FUND XI, L.P. MOTION PASSED UNANIMOUSLY.

5) Investment Update – FY 2017

Tammy Otten presented the Motions and Actions Notes. Completed investment motions included: 1) The updated Iran scrutinized companies list approved at the August meeting was provided to the internal and external portfolio managers. 2) The CD program was completed on September 30 and Sherry Nelson provided a memo with the details of the program. 3) The investment with Starwood Global Opportunity Fund XI was closed on September 15, 2016 and a total of \$150 million was invested. There were no uncompleted investment motions.

Total fund investment returns were provided for the quarter ended September 30, 2016. Estimated total fund returns and estimated benchmarks were provided as of October 31 and November 14, 2016.

6) Iran Divestiture – Update

Otten discussed the Iran Scrutinized Companies List memo dated October 27, 2016 that had been previously provided to the Council. Staff recommended no changes to the current South Dakota scrutinized companies list.

7) SDIC FY 2016 Annual Report

Otten presented the recently completed SDIC FY 2016 Annual Report. She highlighted the various sections of the report, and Clark provided an overview of the Transmittal Letter.

It was noted that the FY 2016 annual report and audit report are posted on the SDIC website.

8) Audit Committee Update

Steve Kirby, Chair of the Audit Committee, stated the FY 2016 Audit was complete and that it was a clean audit with no weaknesses or deficiencies identified. He added that he also received a letter from Legislative Audit which identifies items that auditing standards require be communicated to those charged with governance.

9) Internal Controls & Fraud Risk Assessment

Otten reviewed the changes to the updated Fraud Risk Assessment provided to the Council. Most of the changes were to incorporate the State Fraud or Theft in the Work Place Policy and the Statewide Conflict of Interest Policy for State Agencies. Clark indicated that the Assessment will continue to be reviewed as the State Board of Internal Controls moves forward per the law.

10) Sarbanes Oxley – Compliance Checklist

Otten discussed the Sarbanes-Oxley compliance checklist that is updated by one of the investment accountants each year. As a government agency, the Investment Council is not legally required to comply with Sarbanes Oxley, but the report outlines how we would compare if required. The major update this year was to reference the State's conflict of interest laws, SDIC Conflict waiver policy, and the State Board of Internal Controls.

11) SDIC Conflict Waiver Policy Revision

Clark reviewed a revision made to the SDIC Conflict Waiver Policy as was recommended by Jeff Hallem at the last Council meeting. The change clarifies that SDCL 3-16-8, which relates to the acceptance of gifts/favors/rewards in exchange for recommending/influencing the award of a state contract, applies to Investment Council members. Clark noted that the law also applies to SDIC staff which was already included in the policy.

JEFF NELSON MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE REVISED SDIC CONFLICT WAIVER POLICY AS PRESENTED. MOTION PASSED UNANIMOUSLY.

12) Compensation Committee Update

There was no report from the Compensation Committee at this time.

13) Legislation - 2017

Rob Wylie discussed the SDRS Board of Trustees actions taken at their most recent meeting and the legislation being drafted as a result. Three major issues were addressed by the Board of Trustees relating to economic assumptions, cost of living allowance and late-career compensation.

14) Succession Planning/Internal Training Program

Matt Clark discussed succession planning for the state investment officer position and other senior staff. He reviewed the near-term plan as outlined in the current Succession Plan, as well as the long-term planning which is being addressed through development of younger and mid-level staff. Clark discussed leadership development that has taken place so far, as well as his thoughts on development going forward.

Jarroed Edelen, Darci Haug, Scott Hess, Anne Cipperley, Danielle Mourer, and Ross Sandine joined the meeting to discuss employee recruitment and training. The internship recruitment and intern evaluation processes were reviewed. The training process for new permanent employees and examples of training guides were also discussed.

15) SMID/High Yield Portfolio Manager Changes

Brett Fligge discussed the portfolio manager changes for high yield and SMID. He noted two new portfolio managers have joined the three current high yield managers with new portfolios starting October 1, 2016. The current three-person SMID team has added one new person with a new portfolio starting January 1, 2017. The appropriate level of staff to research and manage those portfolios was discussed.

16) Higher Education Savings Program Update

Sherry Nelson reviewed the Higher Education Savings Plan summary of accounts, the quarterly compliance schedule, and the minutes of the Allianz third quarter conference call that had previously been provided to the Council. She also reviewed a letter from Allianz which reviewed the changes implemented in February of 2016, as well as their subsequent program performance.

The rating of the program by Morningstar and efforts in the past couple years to improve the program and rating were discussed.

Nelson noted that the Program Management Agreement requires Council approval of the auditor selected by Allianz.

RICH SATTGAST MOVED, SECONDED BY RYAN BRUNNER, TO APPROVE ALLIANZ GLOBAL DISTRIBUTORS' RECOMMENDATION OF PRICEWATERHOUSECOOPERS AS THE AUDITOR FOR COLLEGEACCESS 529 PLAN FOR THE YEAR ENDING DECEMBER 31, 2016. MOTION PASSED UNANIMOUSLY.

17) CD Program Update

Sherry Nelson reviewed her memo summarizing the results of the CD Program. Forty banks, one savings association and five credit unions participated this year. The total accepted was \$29.211 million, a decrease a \$1.343 million. The rate of .9% increased versus .626% last year and was based on the one-year Treasury note yield of .65% on 9/28/16 plus a liquidity premium of .25%. A listing of the participating South Dakota financial institutions and a report on program statistics were provided.

18) New/Old Business

No new or old business was brought before the Council.

19) Future Meeting Dates

The next meeting of the Investment Council will be held by conference call on February 2, 2017.

20) Adjournment

Chair Hillard declared the meeting adjourned at 3:20 p.m.