

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL Sioux Falls, South Dakota November 15, 2012

1) Roll Call

The meeting was called to order at 9 a.m. on November 15, 2012 by Chair Wesley Tschetter. Council members in attendance were Hugh Bartels, David Hillard, Jon Hunter, Jarrod Johnson, Jim Means, Rich Sattgast, Wesley Tschetter and Rob Wylie.

Others attending all or part of the meeting included Matt Clark, Brett Fligge, Tammy Otten, Chris Nelson, Sherry Nelson, Cindy Pickering, Sami Kangas, Krystal Seeley, Brandi Eisma, Jarrod Edelen, Scott Hess, Randy Spinar, and Laurie Riss from the Investment Office; Jane Roberts, Michelle Mikkelsen and Susan Jahraus from the South Dakota Retirement System; Ryan Brunner from the Office of School and Public Lands; Keith Gelb, William Walton and Hank Midgley from the Rockpoint Group; and Chris Graham from the Starwood Capital Group.

Jarrod Johnson introduced his new Deputy Commissioner, Ryan Brunner.

(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 JARROD JOHNSON, TO APPROVE THE MINUTES OF THE AUGUST 20, 2012 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

3) SDIC FY 2012 Annual Report

The investment accounting department compiles and produces the annual report. The four Investment Accountants, Cindy Pickering, Sami Kangas, Krystal Seeley and Brandy Eisma, were introduced. Pickering presented an overview of the various sections of the FY 2012 Investment Council Annual Report. Matt Clark emphasized the transmittal letter changes and a new section with performance information for limited partnerships.

Wylie reminded the Council that the new GASB standards will require additional disclosure in the next one to two years including the impact of fees. The Council inquired about how performance comparisons to the corporate universe may be affected by liability driven investing.

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes
- 3) SDIC FY 2012 Annual Report
- 4) Audit Committee Update
- 5) Investment Update – FY 2013
- 6) Iran Divestiture Update
- 7) Sarbanes Oxley Compliance Checklist Review
- 8) Rockpoint Group – Real Estate Presentation
- 9) Compensation Committee Update
- 10) SDIC Subcommittee Appointments
- 11) Investment Policies - Review
- 12) Starwood Capital Grp – Real Estate Presentation
- 13) Real Estate Partnership Investments
- 14) Higher Education Savings Program
- 15) CD Program Update
- 16) New/Old Business
- 17) Future Meeting Dates
- 18) Adjournment

Clark stated that the different approach by many corporate funds in emphasizing bonds and hedge funds rather than equities is increasingly impacting performance comparisons. He said we will continue to think about the implications of that divergence.

The report and the annual audit report are posted on the SDIC website. As a result of the on-line access, only a limited number of reports were printed and mailed to Council members, legislators, various Pierre offices, the SDRS Board of Trustees, and past Council members.

4) Audit Committee Update

Hugh Bartels, Chair of the Audit Committee, reported that the audit was complete. He stated that the Audit Committee had talked with Department of Legislative Audit (DLA) a couple of times and asked that additional items be provided. He stated that the notes to the financial statements indicate there is no direct Council policy on handling foreign currency exposure. Fligge reviewed the global equity policy on cash exposure. Bartels stated the audit went well, and complimented staff on the clean audit.

Discussion continued on the proposed agreement with Legislative Audit to perform quarterly audits on select procedures. It was noted that Legislative Audit trains select staff members to audit the investments and related internal controls. Bartels discussed the fraud scenario risk rating analysis and list of procedures the Committee reviewed to come up with select procedures for DLA to perform quarterly. Hunter stated that the fraud analysis was helpful.

HUGH BARTELS MOVED, SECONDED BY JON HUNTER, THAT THE AUDIT COMMITTEE RECOMMEND TO THE FULL INVESTMENT COUNCIL THE LIST OF AUDIT PROCEDURES AS OUTLINED IN TAMMY OTTEN'S NOVEMBER 12, 2012 MEMO AS A STARTING POINT FOR THE QUARTERLY AUDITS BY THE DEPARTMENT OF LEGISLATIVE AUDIT. MOTION PASSED UNANIMOUSLY.

5) Investment Update – FY 2013

Otten presented the Motions and Actions report from the August 20, 2012 Council meeting. The September 30, 2012 quarterly investment update and October 31, 2012 estimated asset and total return reports were previously provided to the Council.

The estimated asset and return information for SDRS, CPRF and the four trust funds through November 14, 2012, were provided.

6) Iran Divestiture Update

Otten discussed the Compliance with Iran Divestiture Law – Update memo dated 11/1/12 that had been previously mailed to the Council. She reported on the requirements and time table detailed in South Dakota and Federal laws and how the Council complied with each law. The current scrutinized companies list was provided.

RICH SATTGAST MOVED, SECONDED BY DAVID HILLARD, TO REAFFIRM THE CURRENT IRAN SCRUTINIZED COMPANIES LIST. MOTION PASSED UNANIMOUSLY.

7) Sarbanes Oxley Compliance Checklist Review

Otten reviewed the Sarbanes-Oxley compliance checklist. As a government agency, the Investment Council does not need to comply with Sarbanes Oxley, but the report outlines how we would compare if required. She highlighted the Audit Committee sections of the checklist.

8) Rockpoint Group, L.L.C. – Real Estate Presentation

Keith Gelb, Founding Managing Member, William Walton, Founding Managing Member, and Hank Midgley, Principal, from Rockpoint Group joined the Council to discuss opportunistic real estate and their Real Estate Fund IV for which they are currently fund raising.

Walton gave a history of the Rockpoint organization and described their investment focused value-based philosophy and hands-on execution. He spoke about Rockpoint's views on the current investment environment for commercial real estate, their experienced team, strategic approach, investment discipline, portfolio management and focus on distributions.

Hank Midgley presented a breakdown of their funds for the last 18 years which showed each fund's structure and performance.

Keith Gelb discussed in more detail their fundamental value and investment approach, as well as their geographical and product type focus. He summarized several of the recent and committed investments in Fund IV and described their investment rationale for the acquisition, key objectives, exit strategies and expectations.

Walton concluded the presentation with comments regarding their strong reputation, current opportunities in the distressed market, and key terms for Fund IV.

Tschetter thanked Rockpoint for their presentation.

9) Compensation Committee Update

Tschetter stated that the Compensation Committee will be holding a conference call next week with the Mercer consultant who will be completing the compensation study for investment positions. He noted the consultant is the same person that performed the last study in 2009/10, but is now with Mercer as opposed to Deloitte. Clark added that the contract is getting close to being finalized.

10) SDIC Subcommittee Appointments

Tschetter reviewed changes to the Council subcommittees. On the Compensation Committee will be Hugh Bartels as Chair, Wesley Tschetter and Jarrod Johnson. On the Audit Committee will be Jon Hunter, Jim Means and Rich Sattgast. Hugh Bartels will remain on the Audit Committee as Chair for the next several months to complete his involvement in the new quarterly audit procedures by the Department of Legislative Audit.

11) Investment Policies

Shareholder Activism Policy

The Council reviewed the Shareholder activism policy. Otten's memo dated 11/1/12 regarding the Shareholder Activism Policy related to Federal Divestiture Enactments outlined the policy requirements. The letter response dated 9/28/12 from Caterpillar Inc. in response to their inclusion on the Colorado list was provided. Since that date, Caterpillar was removed from the Colorado list and is not on the Florida list. Alstom is the only company on the current Colorado list that is directly held in the SDRS portfolio. A report per the policy will be provided to the Executive Board of the Legislature in early January, 2013.

Co-Investment Policy

The Council reviewed the Co-Investment Program Policy with no changes recommended.

Rebalance Policy

The Council reviewed the External Manager Hire, Rebalance and Terminate Authorization Policy. No changes were made at this time. Clark stated that there could be a recommended change to the policy in the near future regarding TCW and PIMCO distressed mortgage investments.

12) Starwood Capital Group – Real Estate Presentation

Chris Graham, Managing Director and Head of East Coast U.S. Acquisitions at Starwood Capital Group, joined the Investment Council to discuss Starwood's Distressed Opportunity Funds. He provided an overview of the Starwood organization, their long-tenured experienced senior management team, historic portfolio execution and capital market expertise.

Graham discussed the guiding principles they use today as the criteria for all purchases. He reviewed the opportunities they are targeting including distressed debt purchases, value added and income assets, corporate opportunities and hospitality. He discussed the strong supply of loan sales in the U.S. and the expectation for a wave of loan sales in Europe.

Graham discussed the details and terms of Starwood Distressed Opportunity Fund IX. He noted that Fund IX will be very similar to Fund VIII, and they will continue to execute the same successful fundamental strategies. Graham reviewed several of the investments in Fund IX, which were all bought at deep discounts to replacement cost through distressed situations.

Graham reviewed Starwood's real estate performance since inception by each fund. He discussed his views on the real estate market and the opportunities he feels exist in the distressed debt area in the U.S. and in Europe. He emphasized their focus on risk/reward.

Tschetter thanked Graham for his presentation.

13) Real Estate Partnership Investments

Following the Rockpoint and Starwood presentations, Council discussion continued on distressed real estate.

Chris Nelson reviewed the current and projected exposure to the real estate area, as well as projected distributions.

Clark discussed the current attractiveness of the distressed real estate area. He reviewed his recommendation for investments in Rockpoint and Starwood and the resultant percentage exposure to real estate.

Discussion continued on the desired exposure to real estate. The impact of additional cash flows coming back from existing real estate funds and other real estate funds which will be fundraising in the next year were considered. Partnership fees and potential returns were also discussed.

DAVID HILLARD MOVED, SECONDED BY JARROD JOHNSON, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST \$75 MILLION IN ROCKPOINT REAL ESTATE FUND IV AND TO INVEST \$50 MILLION IN STARWOOD DISTRESSED OPPORTUNITY FUND IX FOR THE SOUTH DAKOTA RETIREMENT SYSTEM. MOTION PREVAILED WITH SEVEN VOTING IN FAVOR AND ONE OPPOSED.

14) Higher Education Savings Program

Sherry Nelson presented an update on the CollegeAccess 529 Higher Education Savings Plan. She provided an update on assets, accounts, and the compliance schedule. She noted the Program Management Agreement requires Council approval of the auditor selected by Allianz.

RICH SATTGAST MOVED, SECONDED BY HUGH BARTELS, TO APPROVE PRICEWATERHOUSE-COOPERS AS THE AUDITOR FOR COLLEGEACCESS 529 PLAN FOR THE YEAR ENDING DECEMBER 31, 2012. MOTION PASSED UNANIMOUSLY.

Rich Sattgast informed the Council that he is on the Board for the College Savings Plan Network and also attended the Savingforcollege.com 529 Conference and Boot Camp in New Orleans this fall.

15) CD Program Update

Sherry Nelson reviewed her memo summarizing the results of the CD Program. Forty-eight banks, one savings and loan and two credit unions participated this year, six fewer than last year. The total accepted was \$20.977 million, a decrease of \$1.475 million. The rate of .46% was based on the one-year Treasury note yield of .21% on 9/26/12 plus a risk and liquidity premium of .25%. A listing of the participating financial institutions and a report on program statistics were provided.

16) New/Old Business

Tschetter stated that Matt Clark received the Stoddard Award at the 2012 National Association of State Investment Officers' conference. The award is presented by NASIO in recognition of a person's outstanding contributions to the investment of public funds.

Matt Clark noted that Tammy Otten is being presented a Distinguished Service Award from the USD Beacom School of Business.

17) Future Meeting Dates

The next Investment Council meeting will be held in Pierre in conjunction with the Appropriations Hearing. The date will be provided to the Investment Council as soon as the budget hearings are scheduled.

18) Adjournment

Chair Tschetter declared the meeting adjourned at 3:40 p.m.