

# MINUTES

## SOUTH DAKOTA INVESTMENT COUNCIL Brookings, South Dakota April 29 & 30, 2013

### 1) Roll Call

The meeting was called to order at 3 p.m. on April 29, 2013 by Chair Wesley Tschetter. Council members in attendance were Hugh Bartels, Jon Hunter, Jarrod Johnson (4/30/13), Jim Means, Rich Sattgast (4/30/13), Wesley Tschetter and Rob Wylie. Council member David Hillard was absent.

Others attending all or part of the meeting included Matt Clark, Brett Fligge, Tammy Otten, Chris Nelson, Jan Zeeck, Renae Randall, Jarrod Edelen, Lee Mielke, Darci Haug, Randy Spinar and Laurie Riss of the Investment Office; Jane Roberts, Susan Jahraus and Michelle Mikkelsen of the South Dakota Retirement System; Senator Larry Tidemann; Representative Spencer Hawley; Aaron Olson of the Legislative Research Council; Steven Kohler from the Bureau of Finance & Management; Jeff Siekmann and Mike Holbeck from South Dakota State University; Lew Sanders and Frank Speno from Sanders Capital; Michael Vaccaro from Mercer Consulting; and Allan Holt, Adam Palmer and Francis Lolli from Carlyle Partners.

#### AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes
- 3) Sanders Capital – Lew Sanders
- 4) Mercer Compensation Study – Michael Vaccaro
- 5) Compensation Committee Update
- 6) Investment Update
- 7) GE Investment Update
- 8) Iran Divestiture Update
- 9) Audit Committee Update
- 10) Code of Ethics & Personal Investing Guidelines-SDIO Staff
- 11) Higher Education Savings Program
- 12) Legislative Wrap-Up Review
- 13) Carlyle Partners Fund VI – Presentation
- 14) Carlyle Partners VI Private Equity Investment
- 15) Future Meeting Dates
- 16) New/Old Business Agenda Items
- 17) Adjournment

(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

ROB WYLIE MOVED, SECONDED BY JARROD JOHNSON, TO APPROVE THE MINUTES OF THE FEBRUARY 6, 2013 INVESTMENT COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

### 3) Sanders Capital

Lew Sanders, CEO & Co-CIO of Sanders Capital, joined the Council meeting to discuss his views on the equity markets and economy. He gave a brief background of his history with Sanford Bernstein and his long-term focus on value investing.

Sanders discussed his views on the accelerating U.S. economy and the impact on the stock market, debt, the real estate recovery, the Federal deficit, and state and local government debt. He discussed the repression of interest rates and the high possibility of rate normalization in the near future. He commented on the economies, unemployment and growth in the rest of the world, and in particular China and Europe.

Sanders responded to a number of questions regarding the rising interest rate environment's impact on equity and bond markets, the leading indicators for a rise in interest rates, the actions by the central banks, and the risk of disruption if the rise in rates is not done properly. He also responded to questions on financial stocks, currencies, energy stocks, and emerging markets.

Chair Tschetter thanked Sanders for his presentation.

*The Investment Council recessed at 4:30 p.m. and reconvened at 8 a.m. on April 30, 2013.*

4) Mercer Compensation Study

Michael Vaccaro of Mercer Consulting presented the compensation study of investment positions in the Investment Office. He reviewed the project objectives and approach for the study. The tasks that were performed included meetings and interviews with staff, competitive market analysis, incentive and alternative rewards analysis, and conclusions and recommendations.

Vaccaro reviewed the positions that were involved in the interview process and the analysis. These included the senior investment positions and a sampling of some of the intermediate and newer positions. He noted that the benchmark comparisons include bank trust departments and mutual fund portfolio managers. The benchmark was also adjusted for Sioux falls cost of living.

Vaccaro confirmed that the SDIC compensation philosophy and incumbent job descriptions have remained relative consistent since 2006. In reviewing the main findings and recommendations, he stated that base salary competitiveness has fallen approximately 10% to 15% relative to market benchmarks in the last three years, and total cash compensation (TCC) is now 45% to 50% below median market TCC. Vaccaro noted that the Council has lost half the progress that was made after the 2006 study, and to close the gap back to a 30% discount would mean about a 25% increase. He described three related issues the Council could consider, including compensation philosophy, pay plan changes, and non-financial rewards.

The Council had a lengthy discussion about the compensation philosophy and the appropriate discount, after adjustment for cost-of-living, to retain talent. The process involved in gaining necessary support for the changes was discussed. It was decided the Compensation Committee would meet soon to plan the next step in this process.

5) Compensation Committee Update

Wes Tschetter, Chair of the Compensation Committee, discussed the State Investment Officer's FY 2014 compensation and the recommendation the Council will be making to the LRC Executive Board at their June meeting. It was noted that the FY 2014 budget includes a 4.8% increase in base salary for the state investment officer.

HUGH BARTELS MOVED, SECONDED BY JARROD JOHNSON, THAT THE COUNCIL RECOMMEND TO THE LRC EXECUTIVE BOARD AN INCREASE OF 4.8% FOR THE FY 2014 BASE SALARY FOR THE

STATE INVESTMENT OFFICER AND CONTINUATION OF THE INVESTMENT PERFORMANCE INCENTIVE PLAN WITH ANY EARNED INCENTIVES FOR FY 2014 INVESTMENT PERFORMANCE TO BE PAID IN FY 2015 FOLLOWING COMPLETION OF THE AUDIT. MOTION PASSED UNANIMOUSLY.

6) Investment Update

The Motions and Actions report from the February 6, 2013 meeting was reviewed by Tammy Otten. The 3/31/13 quarterly investment update will be provided to the Council the first part of May. Assets and estimated returns for funds under management as of 3/31/13 and 4/26/13 were presented.

An overview of the Education Enhancement Trust tobacco bond refinancing was reviewed. The additional contributions into the Cement Plant Retirement Fund were discussed.

Matt Clark discussed the asset allocation strategy and the market valuation levels that would likely trigger in a reduction of equity-like risk.

7) GE Investment Update

**GE China A Shares**

Brett Fligge discussed the GE China A Shares investment. He described the requirement to receive authorization from the Chinese Government to transfer money into China to invest in locally traded shares of Chinese companies and how GE is our vehicle for these investments. He noted that GE has additional availability within their China quota, and he asked for Council approval to be able to expand the Council's investment by up to 50% in the GE China A Share Fund. Council discussion continued.

JARROD JOHNSON MOVED, SECONDED BY JIM MEANS, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INCREASE THE COMMITMENT TO THE GE CHINA A SHARE FUND BY UP TO \$33 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM, SUCH AMOUNT TO INCLUDE UP TO A PROPORTIONATE AMOUNT FOR THE CEMENT PLANT RETIREMENT FUND. MOTION PASSED UNANIMOUSLY.

**GE Commodities**

Matt Clark stated that GE's commodity team has left the firm, and they do not plan to replace the team. He said GE has liquidated the fund and returned our money. He added we are not seeking another external manager for commodities at this time but will continue to explore internal involvement in the area. Before anything would be implemented, an email would be sent to the Council outlining our intentions.

8) Iran Divestiture Update

Tammy Otten reviewed the memo provided to the Council which included the quarterly scrutinized companies list for Iran based on the Colorado and Florida lists.

HUGH BARTELS MOVED, SECONDED BY RICH SATTGAST, TO REAFFIRM THE IRAN SCRUTINIZED COMPANIES LIST AS APPROVED AT THE FEBRUARY 6, 2013 COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

9) Audit Committee Update

Hugh Bartels, Chair of the Audit Committee, stated that the audit committee reviewed the quarterly procedures audit report through 12/31/12 provided by the Department of Legislative Audit. He said the audit went well and there were no adverse findings. The Committee would be meeting in the next month to review any recommended changes to the procedures audit and to the scope of the annual audit.

Rob Wylie reported that Eide Bailly was hired by the South Dakota Retirement Board of Trustees effective for the Fiscal Year 2013 SDRS audit.

10) Code of Ethics & Personal Investing Guidelines-SDIO Staff

Matt Clark noted that the new Code of Ethics & Personal Investing Guidelines for SDIO Staff had been previously provided to the Council for their review and input. After discussion, the Council commented on the thoroughness of the policy and made no recommended changes.

ROB WYLIE MOVED, SECONDED BY HUGH BARTELS, TO APPROVE THE NEW CODE OF ETHICS & PERSONAL INVESTING GUIDELINES FOR SDIC STAFF AS PRESENTED. MOTION PASSED UNANIMOUSLY.

11) Higher Education Savings Program

Otten reviewed the Higher Education Savings Plan summary of accounts with asset values as of 3/31/13.

12) Legislative Wrap-Up Review

Otten reviewed the final legislative report. The four bills sponsored by the SD Retirement Board of Trustees passed and were signed by the Governor. The two scholarship bills provided \$3 million dollars to the Education Enhancement Trust in March. The FY 13 and FY 14 appropriations bills provided additional contributions for the Cement Plant Retirement Fund.

13) Carlyle Partners Fund VI – Presentation

Allan Holt, Co-Head & Managing Director; Adam Palmer, Managing Director, Aerospace, Defense & Government Services; and Francis Lolli, Managing Director, Investor Relations Mid-West Region, joined the Investment Council to provide an update on their current private equity funds and to discuss their Fund VI for which they are currently fundraising.

Allan Holt provided an overview of the Carlyle Partners organization, their long-term investment performance, disciplined investment strategy, broad geographic footprint and competitive advantages through their One Carlyle platform. He discussed their sector-focused senior

leadership team and their years of private equity experience, as well as the buyout teams and investment committees.

Holt reviewed the investment performance for Carlyle Partners Fund I, vintage year 1990, through their current Fund V. The Investment Council is invested in Funds IV and V. He talked about the effect of the recession and the current projections for Fund IV. He noted that all of Carlyle's fully invested funds have consistently generated top quartile returns and outperformed the S&P 500. He showed a graph of their partially realized and fully realized transactions to demonstrate their successful track record of disciplined investing.

Adam Palmer continued the presentation with a discussion of Carlyle's investment strategy. He discussed their six targeted industries, their approach to transaction size and expected number of portfolio companies. He described Carlyle's global network and noted that 75% of their investments are sourced by proprietary or limited competitor processes.

Holt discussed Carlyle's focus on long-term value creation and gave examples of the value creation actions for two of the companies in Funds IV and V. He reviewed the terms for Fund VI and noted that Carlyle Partners and employees will be the biggest investor in this fund.

In response to Council questions, Holt discussed currency, the competitiveness of the private equity industry, past troubled investments, the pipeline of opportunities for Funds V and VI, as well as exit strategies.

Chair Tschetter thanked Carlyle for the presentation.

14) Carlyle Partners VI Private Equity Investment

Chris Nelson reviewed the levels of the current investments with Carlyle in Funds IV and V and their performance. He reviewed the current investment size and projection looking out several years for each of our private equity relationships and in total.

Matt Clark discussed his and the team's views regarding private equity and desired exposure to the area and their recommendation for an investment in Carlyle Partners VI of between \$100 million and \$125 million.

Council discussion continued on the recommended investment in Carlyle Partners VI.

HUGH BARTELS MOVED, SECONDED BY RICH SATTGAST, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$100 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM AND UP TO A PROPORTIONATE AMOUNT FOR THE CEMENT PLANT RETIREMENT FUND, THE SCHOOL AND PUBLIC LANDS FUND, THE DAKOTA CEMENT TRUST, THE EDUCATION ENHANCEMENT TRUST, AND THE HEALTH CARE TRUST IN CARLYLE PARTNERS VI, L.P. PRIVATE EQUITY FUND. MOTION PASSED UNANIMOUSLY.

15) Future Meeting Dates

The next Investment Council meeting will be held in Sioux Falls June 17 & 18, 2013.

16) New/Old Business Agenda Items

Jarrod Johnson announced that he was resigning as the Commissioner of School and Public Lands effective 8/15/13, and as a result would cease to be a member of the Council at that time.

17) Adjournment

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