

**Minutes
State Board of Investment
March 4, 2015**

The State Board of Investment (SBI) met at 10:00 A.M. Wednesday, March 4, 2015 in Room 106, Retirement Systems Building, 60 Empire Drive, St. Paul, Minnesota. Governor Mark Dayton, State Auditor Rebecca Otto, Secretary of State Steve Simon, and Attorney General Lori Swanson were present. The minutes of the December 2, 2014 meeting were approved.

Executive Director's Report

Executive Director Mansco Perry referred members to Tab A of the meeting materials, and he reported that the Combined Funds had outperformed its Composite Index over the ten year period ending December 31, 2014 (Combined Funds 7.8% vs. Composite 7.5%) and had provided a real rate of return of 6.7% above inflation over the latest 20 year period (Combined Funds 9.0% vs. CPI 2.3%).

Mr. Perry said that assets increased over the quarter by 1.8% (Combined Funds ending value of \$60.0 versus a beginning value of \$58.9 billion), due to investment returns outweighing net outflows. He said that the asset allocation, which was slightly overweight domestic stocks and slightly underweight international stocks, was rebalanced back to target in January. The Combined Funds return was twenty basis points (bps) above the benchmark for the quarter (Combined Funds 2.5% vs. Composite 2.3%), but twenty bps below the benchmark for the year (Combined Funds 8.6% vs. Composite 8.8%). The Combined Funds outperformed for longer time periods.

Mr. Perry reported that the domestic equity manager group performed in-line with its target for the quarter (Domestic Equities 5.2% vs. Domestic Equity Asset Class Target 5.2%), slightly underperformed for the year (Domestic Equities 12.3% vs. Domestic Equity Asset Class Target 12.6%), and outperformed in longer time periods. He said the international stock manager group outperformed its target for the quarter (International Equities -3.3% vs. International Equity Asset Class Target -3.9%), underperformed for the year (International Equities -4.0% vs. International Equity Asset Class Target -3.9%), but outperformed over longer time periods. Mr. Perry stated that the bond segment slightly underperformed for the quarter (Fixed Income 1.7% vs. Fixed Income Asset Class Target 1.8%) and outperformed its target in all other time periods. He stated that the alternative investments continue to be a strong contributor to performance (1.1% for the quarter and 18.0% for the year). He concluded his report noting that, as of December 31, 2014, the SBI was responsible for managing more than \$80 billion of assets.

Mr. Perry referred members to Tab B of the meeting materials for the administrative report. He reported that fiscal year to date, the SBI was running below budget. Next, he stated that the legislative auditor would issue a letter noting that there were no findings in the audit. Board members will receive a copy of the audit letter when it becomes available. He then noted that approximately 97% of the Duluth Teachers' Retirement Fund assets had been transferred to the SBI. He expected the remaining assets to be transferred by the end of the fiscal year. Next, he stated that Sudan and Iran holdings updates were provided. Following that, he stated that the Minnesota State Retirement System (MSRS) and Public Employees Retirement Association

(PERA) are speaking with the legislature about changing the actuarial rate for those funds to 8%, while Teachers Retirement Association (TRA) hoped to remain unchanged.

Mr. Perry stated there is currently no litigation involving the SBI.

Mr. Perry then provided an update on staffing. He noted the SBI hired seven new members to the investment staff and one new member to the accounting staff. He also indicated that he may add to staff in the next budget cycle.

Mr. Perry moved on to the action items, beginning with the MSRS request regarding Target Date Funds. MSRS requested that the Board authorize the use of Target Date Funds for unclassified retirement plan participants. Attorney General Swanson moved approval of the recommendation, which reads:

“The Investment Advisory Council concurs with Staff’s recommendation that Unclassified Plan participants be allowed to invest in Target Date Funds, as currently provided by SSgA.” The motion passed unanimously.

Mr. Perry discussed the next action item, which relates to the Metropolitan Council’s (Met Council) Other Postemployment Benefits (OPEB) plans. The Met Council requested that the SBI manage a customized fixed income portfolio which would more directly match their liabilities of its OPEB plans, which are closed, with their assets. State Auditor Otto moved approval of the recommendations, which reads:

“The Investment Advisory Council concurs with Staff’s recommendation to establish a separate, OPEB sub-account for the Met Council that will be managed by the SBI and hold individual fixed income securities that are structured to meet the Met Council’s OPEB cash benefit outflow projections. The IAC also concurs with SBI Staff’s recommendation to approve the investment guidelines for the separate OPEB sub-account for the Met Council.” The recommendations passed unanimously.

Mr. Perry presented the investment guidelines which he noted are brought to the Board periodically (about every 5 years or so). He noted that in most years he would report any changes to the guidelines as part of his Annual Work Plan as has been past practice. State Auditor Otto moved approval of the recommendation, which reads:

“Staff recommends that the Board approve the Investment Manager Guidelines.”
The motion passed unanimously.

Mr. Perry proceeded to the topic of the Proxy Voting Committee. The members of this Committee are required to be re-authorized every two years. The current members of the committee are designees of the Board and are as follows: Emily Johnson Piper, Celeste Grant, Bert Black and Christie Eller. Attorney General Swanson moved approval of the recommendation, which reads:

“The Executive Director recommends that the SBI adopt the resolution which reauthorizes the Proxy Voting Committee and delegates proxy voting responsibilities

according to established guidelines.” The motion passed unanimously. The resolution is included as **Attachment A**.

Mr. Perry concluded the action items of his Administrative Report with the topic of Proxy Voting Guidelines. Similar to the Proxy Voting Committee, the Board must approve the guidelines on a periodic basis. After a brief discussion, Secretary of State Simon moved approval of the recommendation, which reads:

“The Proxy Voting Committee recommends that the Board reaffirm the Proxy Voting Guidelines.” The motion passed unanimously.

The Chair of the Investment Advisory Council (IAC), Jeff Bailey, reported on the agenda items covered in the February 17th IAC meeting. He detailed the six alternative investment proposals that are included in Tab C. Four were existing managers: Blackstone (Real Estate); EnCap Investments (Resource); Oaktree Capital Management (Yield Oriented); and Kohlberg Kravis Roberts (Yield Oriented), and two were new managers: Avenue Capital Group (Yield Oriented) and MHR Fund Management (Private Equity). State Auditor Otto moved approval of all recommendations in Tab C of the meeting materials, which read:

“The Investment Advisory Council concurs with Staff’s recommendation that the SBI authorize the Executive Director, with assistance from the SBI’s legal counsel, to negotiate and execute a commitment of up to \$150 million, or 20% of BREP VIII whichever is less. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the Investment Advisory Council, the State Board of Investment nor its Executive Director have any liability for reliance by Blackstone upon this approval. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations may result in the imposition of additional terms and conditions on Blackstone or reduction or termination of the commitment.

The Investment Advisory Council concurs with Staff’s recommendation that the SBI authorize the Executive Director, with assistance from the SBI’s legal counsel, to negotiate and execute a commitment of up to \$100 million, or 20% of EnCap X, whichever is less. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the Investment Advisory Council, the State Board of Investment nor its Executive Director have any liability for reliance by EnCap upon this approval. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations may result in the imposition of additional terms and conditions on EnCap or reduction or termination of the commitment.

The Investment Advisory Council concurs with Staff’s recommendation that the SBI authorize the Executive Director, with assistance from the SBI’s legal counsel, to negotiate and execute a commitment of up to \$50 million, or 20% of Opportunities

Fund X, whichever is less, and \$100 million, or 20% of Opportunities Fund Xb, whichever is less. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the Investment Advisory Council, the State Board of Investment nor its Executive Director have any liability for reliance by Oaktree upon this approval. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations may result in the imposition of additional terms and conditions on Oaktree or reduction or termination of the commitment.

The Investment Advisory Council concurs with Staff's recommendation that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$75 million, or 20% of KKR Lending Partners II, whichever is less. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the Investment Advisory Council, the State Board of Investment nor its Executive Director have any liability for reliance by KKR upon this approval. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations may result in the imposition of additional terms and conditions on KKR or reduction or termination of the commitment.

The Investment Advisory Council concurs with Staff's recommendation that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$100 million, or 20% of Avenue Energy Opportunities Fund whichever is less. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the Investment Advisory Council, the State Board of Investment nor its Executive Director have any liability for reliance by Avenue upon this approval. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations may result in the imposition of additional terms and conditions on Avenue or reduction or termination of the commitment.

The Investment Advisory Council concurs with Staff's recommendation that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to \$75 million, or 20% of MHR Fund IV, whichever is less. Approval by the SBI of this potential commitment is not intended to be, and does not constitute in any way, a binding or legal agreement or impose any legal obligations on the State Board of Investment and neither the State of Minnesota, the Investment Advisory Council, the State Board of Investment nor its Executive Director have any liability for reliance by MHR upon this approval. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations may result in the imposition of additional terms and

conditions on MHR or reduction or termination of the commitment.” The motion passed unanimously.

Mr. Bailey concluded his report by referring members to Tab D and explaining the streamlined quarterly reporting process. He detailed the reporting changes implemented, which were designed to remove unnecessary paper and focus on pertinent information from the preceding quarter.

Governor Dayton then introduced two citizen groups to discuss the SBI's Israeli bond position. Governor Dayton allowed each group fifteen minutes to speak before the Board and meeting attendees. First, Phil Benson, a representative from Break the Bonds, provided the Board with various petitions and also introduced Senator James Abourezk, the founder of the American-Arab Anti-Discrimination Committee. Senator Abourezk, a former U.S. Senator from South Dakota, read from prepared remarks [which are on file at the SBI office] on the issue of the Israeli bond held by the SBI. His position was that the SBI should not invest in Israel bonds. After Senator Abourezk finished, Steve Hunegs, Executive Director of the Jewish Community Relations Council of Minnesota and the Dakotas, addressed the Board. Mr. Hunegs described the history of the SBI's investment in international bonds and suggested that the SBI continue its investment in Israel bonds. He also suggested that the SBI consider making appropriate investments in Palestine and Palestinian businesses.

After the remarks, Governor Dayton made the following motion:

“That the State Board of Investment declines to divest of its holdings in its bonds issued by the State of Israel and will continue to invest in the fixed and floating rate bonds offered by the State of Israel subject to a determination by the Executive Director that the rate of return is competitive, and that the duration, terms, amount and risk of the investment are consistent with sound investment practices and the prudent investor fiduciary standard of care in Minnesota Statutes 11A.09 and Section 356A.04.”

After Secretary of State Simon seconded the motion, a discussion followed. Attorney General Swanson posed a series of questions to Mr. Perry. She noted that members of the Board have a fiduciary duty under a variety of Minnesota Statutes. Additionally, Attorney General Swanson noted that the Board as voting members, the Executive Director, and the SBI staff have a duty to follow the prudent person standard and act in the best interest of the active and retiree participants of the retirement plans, the taxpayers of the State of Minnesota and the State of Minnesota as a whole. Mr. Perry confirmed that was his understanding as well. Attorney General Swanson then noted that her understanding is that the law allows the State Board of Investment to invest in international securities. Mr. Perry agreed and noted that's been adjudicated, as well. Attorney General Swanson stated that the Court of Appeals specifically ruled that the State Board of Investment's investment in Israeli sovereign debt is consistent with the Minnesota Law provision that says we can invest in international securities. Mr. Perry confirmed that's his understanding. In response to questions from Attorney General Swanson, Mr. Perry indicated the State Board of Investment has had investments in Israeli sovereign debt since July of 1993 in seven different issues. He further indicated in responses to questions that the current rate of return on the current issue purchased in 2005 for the ten year period is 2.4% versus the benchmark bond the treasury

bills of 1.54%, the average iMoneyNet.com average of 1.50%, and the pension fund STIF account of 1.80%. He noted that the rate has been accretive to those indexes and has been a competitive rate of return relatively over the twenty-some years the investments have taken place. In response to Attorney General Swanson's question, Mr. Perry indicated there are a wide variety of products in the market now that are similar in terms of amount, term, duration, and rate of return to those in which the Board has invested over the last couple decades. He noted some would be comparable, some would not, but confirmed there are some in the market place which would be comparable in terms of the rate of return. The Attorney General stated that as she reads it, the latter clause of the Governor's resolution, it says "provided that Executive Director determines the rate of return is competitive and that the duration, terms, amount and risk of the investment are consistent with sound investment practices." Attorney General Swanson then stated to Mr. Perry that she reads the second half of the resolution to essentially state that if you believe that there's not a product in the market place that is consistent with prudent investment guidelines and standards, that you would not, under this resolution, be required then to make an investment. Mr. Perry confirmed that was his understanding as well. Attorney General Swanson then asked Governor Dayton to confirm it was consistent with his intent as well. Governor Dayton did so.

State Auditor Otto indicated that the purpose of the SBI is to invest funds and the Board members are fiduciaries of those funds. She also described the policies and procedures that the Board has put in place to guide the SBI's investment decisions. State Auditor Otto said, "We also chose an Executive Director that we believed to be the best and we rely on him as an expert in investment matters. We also have a professional outside investment consultant coupled with the IAC. None of us on the Board were elected for our investment expertise. The system that we have put in place has served us well and has resulted in our investment success over time. Politics should not drive our decisions as we are fiduciaries."

Secretary of State Simon remarked that he was impressed with the SBI and Board's process. He stated that being insulated from political decisions has benefitted the SBI over the years and he wants that to continue. He stated that he was voting based on the fact that it is the fiduciary duty to grow the money in ways that are in the best interest of the people of Minnesota.

Attorney General Swanson stated that it is her belief that the vote can't be a vote based on political or societal considerations. She said that, under the statute, it has to be based upon the fiduciary duty as set forth by the legislature to the best interest of the active members, the retirees, the taxpayers, and the State of Minnesota.

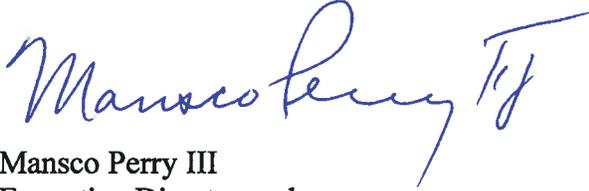
Governor Dayton again moved approval of the motion:

"That the State Board of Investment declines to divest of its holdings in its bonds issued by the State of Israel and will continue to invest in the fixed and floating rate bonds offered by the State of Israel subject to a determination by the Executive Director that the rate of return is competitive, and that the duration, terms, amount and risk of the investment are consistent with sound investment practices and the prudent investor fiduciary standard of care in Minnesota Statutes 11A.09 and Section 356A.04."

Attorney General Swanson, Secretary of State Simon and Governor Dayton voted in favor while State Auditor Otto opposed the motion. The motion passed.

The meeting adjourned at 10:57 a.m.

Respectfully submitted,

A handwritten signature in blue ink that reads "Mansco Perry III". The signature is written in a cursive style with a long horizontal line extending from the end of the name.

Mansco Perry III
Executive Director and
Chief Investment Officer

**RESOLUTION OF THE
MINNESOTA BOARD OF INVESTMENT
CONCERNING PROXY VOTING**

WHEREAS, as a stockholder, the Minnesota State Board of Investment (SBI) is entitled to sponsor and cosponsor shareholder resolutions and participate in corporate annual meetings by casting its votes by proxy or through direct attendance at the meetings; and

WHEREAS, the SBI has previously established a Proxy Committee:

NOW THEREFORE, BE IT RESOLVED THAT:

1. To advise and assist the SBI in the implementation of proxy voting guidelines previously adopted by the Board the SBI hereby authorizes and reaffirms the establishment of the SBI Proxy Committee composed of a representative selected by each member of the SBI to be chaired by the designee of the Governor and convened as necessary in accord with the Guidelines.
2. The SBI further authorizes the SBI Proxy Committee to review the Guidelines periodically and report to the SBI as necessary.
3. The SBI further directs its staff to advise and assist the Proxy Committee in the implementation of this resolution and directs its Executive Director to obtain such consulting and reporting services as may be necessary.
4. This resolution shall take effect immediately.

Adopted this 4th day
of March, 2015



Governor Mark Dayton
Chair, Minnesota
State Board of Investment