Minutes
State Board of Investment
June 2, 2016

The State Board of Investment (SBI) met at 10:12 A.M. Thursday, June 2, 2016 in Room 106, Retirement Systems Building, 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 March 2, 2016 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 March 31, 2016 (Combined Funds 6.3% vs. Composite 6.1%) and had provided a real rate of return of 5.5% above inflation over the latest 20 year period (Combined Funds 7.6% vs. CPI 2.1%).

Mr. Perry said that assets decreased over the quarter (Combined Funds ending value of $57.6 versus a beginning value of $57.8 billion). The Combined Funds return was 70 basis points (bps) below the benchmark for the quarter (Combined Funds 0.5% vs. Composite 1.2%) and 80 bps below for the year (Combined Funds -1.1% vs. Composite -0.3%). The Combined Funds did outperform its target in all other time periods reported.

Mr. Perry reported that the domestic stock manager group underperformed its target for the quarter (Domestic Stocks 0.0% vs. Domestic Equity Asset Class Target 1.0%) and for the year (Domestic Stocks -1.9% vs. Domestic Equity Asset Class Target -0.3%). He said the international stock manager group underperformed its target for the quarter (International Stocks -1.4% vs. International Equity Asset Class Target -0.4%) and outperformed for the year and over longer time periods. Mr. Perry then stated that the bond segment matched its target for the quarter (Bonds 3.0% vs. Fixed Income Asset Class Target 3.0%), underperformed for the year (Bonds 1.9% vs. Fixed Income Asset Class Target 2.0%) but outperformed its target in all other time periods reported. He stated that the alternative investments detracted from performance for the quarter but contributed for the year (total return of -0.4% and 4.2%, respectively). Mr. Perry concluded his report noting that, as of March 31, 2016, the SBI was responsible for managing slightly under $80 billion of assets.

Governor Dayton noted that for the period ending March 31, 2016, the Domestic Equity program had underperformed its benchmark not only during the last quarter and year, but also had underperformed for the last three, five and ten year periods. Given this underperformance, the Governor questioned why the SBI does not just put the domestic equity into an index fund. Mr. Perry noted that the Combined Funds already has about one third of its assets invested passively, in an index fund. Mr. Perry noted that active managers have been struggling to outperform the index and that his goal was to increase the passive management to at least 50% over the next several quarters. Mr. Perry noted that he and the SBI staff would be reviewing active versus passive management in much more detail over the coming quarters and that their findings may lead to a further increase in passive management in the domestic equity space.

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, Mr. Perry commented on the legislative session and noted that one bill signed into law authorized the SBI to invest the assets of the Metropolitan Landfill Contingency Action Trust account and Pollution Control Agency would administer this account. Attorney General Swanson moved approval of the recommendation, which reads, **"The Executive Director of the State Board Investment recommends that the Board approve the investment of the Metropolitan Landfill Contingency Action Trust (MLCAT) assets in the SBI Internal Equity and Internal Bond pools with an asset allocation of 70% equities and 30% bonds**. The motion passed.

Mr. Perry stated that Tab B contained updated information for Sudan and Iran. Mr. Perry noted that there is currently no litigation involving the SBI.

Laurie Hacking, Executive Director of Minnesota Teachers' Retirement Association (TRA) and an Administrative Committee member provided a summary of the Administrative Committee meeting. She noted that the last Compensation Study was completed in 2008 and that the Committee was recommending an update to the Study. Governor Dayton moved that **Mr. Perry and his staff develop a proposal on how best to proceed with updating the 2008 Compensation Study, including cost estimates, for discussion at the next SBI meeting**. The motion passed.

Ms. Hacking provided background on the first action item in Tab C, which was a review of the Executive Director's Proposed Workplan for FY17. The recommendation reads: **"The Committee recommends that the SBI approve the FY17 Executive Director's Workplan. Further, the Committee recommends that the Workplan serve as the basis for the Executive Director's performance evaluation for FY17."**

Ms. Hacking detailed the second action item in the Administrative Committee Report, which was a review of the Budget Plan for FY17 and FY18. The recommendation reads: **"The Committee recommends that the SBI approve the FY17, and FY18 Administrative Budget Plan, as presented to the Committee, and that the Executive Director have the flexibility to reallocate funds between budget categories if the Executive Director deems necessary."**

Ms. Hacking proceeded to the third action item in the Administrative Committee Report, which was a review of the Continuing Fiduciary Education Plan. The recommendation reads: **"The Committee recommends that the SBI adopt the Continuing Education Plan."**

Ms. Hacking discussed the fourth action item in the Administrative Committee Report, which was a review of the Executive Director's Evaluation and Salary Process. After discussion, a modification to the language as underlined below was recommended by State Auditor Otto. The recommendation reads: **"The Committee recommends that the SBI adopt the following performance evaluation and salary process for the SBI Executive Director:**

- **The evaluation will be completed by October 1.**
- **The evaluation will be based on the results of the Executive Director's workplan for the fiscal year ending the previous June 30.**

- **The SBI deputies/designees will develop an appropriate evaluation form for use by each member.**

- **As Chair of the Board, the Governor (or his representative) will coordinate distribution of the evaluation forms. Board members will forward completed evaluations to the Executive Director with a copy to the Governor or the Governor's designee of the summary and are encouraged to meet individually with the Executive Director to review their own evaluation.**

- **Upon satisfactory performance evaluations from a majority of responding Board Members, the Executive Director's annual salary adjustment will be any Cost-of-Living Adjustment (COLA)/Across the Board (ATB)/General Salary Increase contained in the Managerial Plan for a Fiscal Year as approved by the Legislature to the extent that it is within the Executive Director's salary range. The adjustment shall be effective January 1 of the next calendar year."** State Auditor Otto moved approval of all four recommendations. The motion passed.

Dave Bergstrom, Executive Director of the Minnesota State Retirement System (MSRS), referred members to Tab D of the meeting materials for a report on the Minnesota Deferred Compensation Plan (MNDCP). After discussion, State Auditor Otto moved approval of the recommendation to the Minnesota Deferred Compensation Plan, which reads, **"The Deferred Compensation Committee, in conjunction with the MSRS Board, recommends the following changes to the Minnesota Deferred Compensation Plan investments: 1) Transition the Fidelity Diversified International and T. Rowe Price Small Cap retail mutual fund shares into the lower priced institutional share classes. For any Deferred Compensation Plan option where a lower priced share class or vehicle becomes available, the Executive Director is authorized to transition into the lower priced option, if deemed appropriate. 2) Replace Janus Twenty with the Vanguard Dividend Growth Fund."** The motion passed.

Jeff Bailey, Chair of the Investment Advisory Council (IAC), referred members to Tab E of the meeting materials and provided an overview of the agenda items covered at the May 17, 2016 meeting. He noted that the SBI has already acted on two of the items which the IAC concurred with: the Deferred Compensation Plan Committee and the Administrative Committee recommendations. Mr. Bailey said that Mr. Perry would report on the third agenda item, the Asset Liability Study, which the IAC spent a considerable amount of time discussing.

Mr. Bailey reviewed the three alternative investment proposals brought to the IAC. One manager was an existing manager: IK Partners (Private Equity); and two were new managers: Rockwood Capital (Real Estate) and LBC Credit (Credit). State Auditor Otto moved approval of the three recommendations in Tab E of the meeting materials, which reads, **"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 IK VIII 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 IK Investment Partners 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 IK Investment Partners 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 Rockwood Capital Real Estate Partners Fund X, L.P., 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 Rockwood Capital, LLC 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 Rockwood Capital, LLC 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 LBC Credit Partners IV, L.P., 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 LBC Credit Management, L.P. 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 LBC Credit Management, L.P. or reduction or termination of the commitment. The motion passed.

Mr. Perry referred the members to Tab G of the meeting materials and reviewed the results of the 2016 Asset Liability Study conducted by Callan. After discussion, State Auditor Otto moved approval of all six recommendations, which reads: **"As a result of the 2016 Asset Liability Study, the Investment Advisory Council concurs with the SBI Executive Director's recommendations of the following as it relates to the Combined Funds Policy asset allocation:**

1) Adopt the Combined Funds Asset Allocation Policy shown below:

	Combined Funds Asset Allocation
Public Equity	**58%**
Domestic Bonds	**20%**
Private Markets	**20%**
Cash	**2%**
Total	**100%**

2) Allocate the un-invested Private Markets allocation to Public Equities.

3) **The Asset Class Target for Public Equities will be a composite index of the domestic equity asset class target, the Russell 3000 Index and the international equity asset class target, the MSCI ACWI ex USA Index. The current weighting of these two indices is 75% U.S. and 25% Non-U.S. The weightings will transition to a blend of 67% U.S. and 33% Non-U.S. by Fiscal Year 2018.**

4) **The U.S. equity portion of the Public Equities will continue to be benchmarked against the Russell 3000. The SBI will be authorized to invest in and benchmark U.S. Equity managers to the Russell 3000 Index or any of the Russell 3000 sub-indices that are segmented by market cap and by style such that the aggregation of the U.S. equity manager benchmarks are reflective of the Russell 3000 Index.**

5) **The Non-U.S. equity portion of the Public Equities will continue to be benchmarked against the MSCI ACWI ex USA Index. The SBI will be authorized to invest in and benchmark Non-U.S. equity managers to the MSCI ACWI ex USA (standard) Index or any of the MSCI ACWI ex USA sub-indices that are segmented by market cap, style, or geography such that the aggregation of the Non-U.S. equity manager benchmarks are reflective of the MSCI ACWI ex USA Index. Additionally, the SBI will be authorized to opportunistically invest in Non-U.S. equity managers that are benchmarked to the small cap segments of the MSCI ACWI.**

6) **Authorize the SBI to invest with Global Managers who invest in and are benchmarked to the MSCI ACWI or the MSCI World indices."** The motion passed.

The meeting adjourned at 10:57 a.m.

Respectfully submitted,

Mansco Perry III
Executive Director and
Chief Investment Officer