

INVESTMENT ADVISORY COUNCIL

Minutes Investment Advisory Council November 20, 2012

The Investment Advisory Council (IAC) met at 12:00 Noon Tuesday, November 20, 2012 in the Board Room – First Floor, 60 Empire Drive, St. Paul, Minnesota.

MEMBERS PRESENT: Jeff Bailey, Dave Bergstrom, John Bohan, Dennis Duerst, Kim Faust, Doug Gorence, Laurie Hacking, Kristin Hanson (for Jim Schowalter), Judy Mares Lazar, Gary Martin and Elaine Voss.

MEMBERS ABSENT: Denise Anderson, Kerry Brick, Jay Kiedrowski, Malcolm McDonald and Mary Vanek.

SBI STAFF: Howard Bicker, Jim Heidelberg, LeaAnn Stagg, Paul Anderson, Tammy Brusehaver, Patricia Ammann, Stephanie Gleeson, Mike Menssen, Ryan Hill, John Griebenow, J.J. Kirby, Aaron Griga, Debbie Griebenow, Charlene Olson and Melissa Mader.

OTHERS ATTENDING: State Auditor Rebecca Otto; Ann Posey, John Jackson, Callan Associates Inc.; Micah Hines; Jim Gelbmann; Christie Eller; Edgar Hernandez, SEIU; Margaret Martin, House Majority Research; Don Leathers, REAM.

The minutes of the August 21, 2012 meeting were approved.

Executive Director's Report

Mr. Bicker, Executive Director, 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 September 30, 2012 (Combined Funds 8.7% vs. Composite 8.6%) and had provided a real rate of return over the latest 20 year period (Combined Funds 8.3% vs. CPI 2.5%).

Mr. Bicker reported that the Combined Funds' assets increased 3.4% for the quarter ending September 30, 2012 due to positive market performance. He said that the asset mix is essentially on target, and he stated that the Combined Funds outperformed its Composite Index for the quarter (Combined Funds 4.5% vs. Composite 4.3%) and for the year (Combined Funds 18.1% vs. Composite 17.7%).

Mr. Bicker reported that the domestic stock manager group matched its target for the quarter (Domestic Stocks 6.2% vs. Domestic Equity Asset Class Target 6.2%) and outperformed for the year (Domestic Stock 30.3% vs. Domestic Equity Asset Class Target 30.2%). He said the international stock manager group outperformed for the quarter (International Stock 7.7% vs. International Equity Asset Class Target 7.4%) and for the year (International Stock 14.9% vs.

International Equity Asset Class Target 14.5%). Mr. Bicker stated that the bond segment outperformed its target for the quarter (Bonds 2.4% vs. Fixed Income Asset Class Target 1.6%) and for the year (Bonds 7.5% vs. Fixed Income Asset Class Target 5.2%). He stated that the alternative investments returned 0.3% for the quarter and 6.1% for the year. He concluded his report with the comment that, as of September 30, 2012, the SBI was responsible for over \$62 billion in assets.

Mr. Bicker referred members to Tab B of the meeting materials for an update on the budget and travel for the quarter. He reported that the Legislative Auditor is working on the financial audit of the SBI's operations for FY12 and that members will receive a copy of their report when it becomes available. He added that a draft of the SBI's FY12 Annual Report will also be distributed by early December. He also noted the tentative meeting dates for calendar year 2013. He stated that updated information on Sudan and Iran is also included in Tab B.

Mr. Bicker asked Ms. Eller, Deputy Attorney General for an update on litigation. Ms. Eller reported that the Minnesota Court of Appeals had affirmed the dismissal of the lawsuit brought by the Break the Bonds group, which challenged the SBI's investment in Israeli bonds. She stated that it's possible that the plaintiffs may file a petition to review with the Minnesota Supreme Court and that the Supreme Court decides whether they will hear the case.

Mr. Bicker referred members to Tab C of the meeting materials and briefly reviewed the process used by the Master Custodian Review Committee to evaluate responses to the SBI's request for proposal for master custody services. He noted that the SBI hosted a question and answer session for potential responders and stated that five firms participated. He added that the SBI received responses from State Street Bank and Trust and Bank of NY Mellon. Mr. Martin stated that he was a member of the review committee, and he said that he was surprised that there were only two responses received. Mr. Martin noted that State Street's fee proposal was attractive and that the SBI has been satisfied with State Street's performance as a custodian. In response to a question from Mr. Gorence, Mr. Bicker stated that the securities lending terms are slightly better under the new proposal. A brief discussion followed. Mr. Bohan moved approval of the Committee's recommendation, as stated in Tab C of the meeting materials, to retain State Street Bank and Trust as the SBI's custodian. Ms. Hacking seconded the motion. The motion passed.

Mr. Bicker gave a brief update to members on the upcoming search for a new Executive Director. He stated that the Board will establish a search committee made up of seven members and that the committee will approve an RFP for the retention of an executive search firm. In response to questions, Mr. Bicker confirmed that staff expect to have the RFP approved by Minnesota Management & Budget before the committee meets in March 2013. Ms. Voss commented that she is comfortable with the search process being put in place.

Mr. Bicker referred members to Tab D of the meeting materials and stated that staff had added comments on each of the manager's performance sheets. A brief discussion followed on various aspects of manager performance and active management in general. Members agreed that any major policy changes should take place after the new Executive Director comes on board.

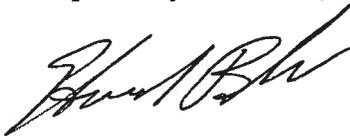
Mr. Griebenow referred members to Tab E of the meeting materials and briefly reviewed the new investments with two existing private equity managers, Warburg Pincus and Chicago Growth Partners, one existing resource manager, EnCap Investments and one new private equity manager, Public Pension Capital. Mr. Bohan moved approval of the three recommendations with existing managers, as stated in Tab E of the meeting materials. Ms. Voss seconded the motion. In response to questions from Mr. Duerst and Mr. Gorence, Mr. Griebenow briefly discussed the due diligence done on Warburg Pincus and changes in management fees. The motion passed.

Perry Golkin and Michael Tokarz of Public Pension Capital (PPC) gave a presentation on their organization and the PPC Fund. A question and answer session took place after the presentation. Mr. Bergstrom moved approval of the recommendation regarding a new investment in the PPC Fund, as stated in Tab E of the meeting materials. Ms. Voss seconded the motion. The motion passed.

Ms. Stagg led a brief discussion on swaps. Mr. Bailey asked members to come prepared to discuss how they use swaps in their portfolio at the February 2013 meeting.

The meeting adjourned at 2:25 P.M.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Howard Bicker", written in a cursive style.

Howard Bicker
Executive Director