Minutes
State Board of Investment
June 14, 2018

The State Board of Investment (SBI) met at 10:06 A.M. Thursday, June 14, 2018 in G23 Senate Committee Room of the State Capitol, 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 1, 2018 meeting were approved.

Executive Director's Report

Executive Director Mansco Perry referred members to Tab A of the meeting materials. Mr. Perry reported that the Combined Funds had outperformed its Composite Index over the ten-year period ending March 1, 2018 (Combined Funds 7.6% vs. Combined Funds-Composite Index 7.2%) and had provided a real rate of return of 4.6% above inflation over the latest 20 year period (Combined Funds 6.8% vs. CPI 2.2%).

The assets decreased over the quarter (Combined Funds ending value of $67.8 versus a beginning value of $68.4 billion), due to negative net contributions that outweighed investment earnings. The Combined Funds outperformed the benchmark for the quarter (Combined Funds 0.1% vs. Combined Funds-Composite Index -0.2%) and outperformed the benchmark for the year (Combined Funds 12.7% vs. Combined Funds-Composite Index 12.0%). The Combined Funds matched the benchmark over the three-year period and outperformed in all other time periods reported.

Mr. Perry reported that the asset mix, adjusting for the private markets, is almost on target. He then reported that the public equity had outperformed the benchmark for the fiscal year-to-date (Public Equity 10.6% vs. Public Equity Benchmark 10.4%) and the one-year period (Public Equity 15.2% vs. Public Equity Benchmark 14.7%). Breaking it down between domestic and international equities, Mr. Perry said that the domestic equity manager group outperformed its benchmark for the quarter (Domestic Equity -0.3% vs. Domestic Equity Benchmark -0.6%) and for the year (Domestic Equity 14.3% vs. Domestic Equity Benchmark 13.8%), and underperformed or matched over all other time periods. He stated that the international equity manager group matched its target for the quarter (International Equity -1.2% vs. International Equity Benchmark -1.2%), and outperformed for the year (International Equity 17.4% vs. International Equity Benchmark 16.5%) as well as all remaining time periods shown. Mr. Perry indicated that the fixed income segment outperformed its benchmark for the quarter (Fixed Income -1.4% vs. Fixed Income Benchmark -1.5%) and the year (Fixed Income 1.7% vs. Fixed Income Benchmark 1.2%) and over all other time periods reported. He stated that the private market investments contributed to performance for the quarter and the year (Total Private Markets return of 4.6% and 17.7%, respectively) and also over the longer time periods. He concluded his report noting that the fund is a second quartile performer over the quarter and a top quartile performer over all other periods in the Trust Universe Comparison Service and that, as of March 31, 2018, the SBI was responsible for managing over $93.4 billion of assets.

Mr. Perry referred members to Tab B of the meeting materials for the administrative report and indicated that it included the current administrative budget and staff travel for the first quarter of 2018. Mr. Perry noted that the SBI was below budget on a fiscal year-to-date basis. Regarding legislation, he stated that the pension bill passed and that the SBI now has the authority to invest the proceeds from the 3M settlement. Mr. Perry stated that staff was in discussion with the Pollution Control Agency (PCA) and Department of Natural Resources (DNR) with respect to the best way to manage these assets and, given the relatively short investment time horizon of the Funds, they will likely be invested in bonds and cash. Mr. Perry then summarized the modification to the SBI Investment Beliefs Statement to reflect the additional investment programs under the responsibility of the SBI, as appropriate. State Auditor Otto moved approval of the recommendation in Tab B which reads: **"The Executive Director recommends that the Board adopt the SBI Investment Beliefs modified to include the following sentence which will be added at the end of the first paragraph of the SBI Investment Beliefs Statement: "When relevant, the SBI also uses these Beliefs as a guide when investing the assets of the other investment programs that it manages, as deemed appropriate."** The motion passed unanimously.

Mr. Perry followed up on a request from the Board at its March 2018 meeting to report back on the use of a coal free policy benchmark and also to report on the SBI's investments in firearm manufacturers. He stated that the coal companies in the current policy benchmark represent an insignificant amount and would not have an impact on the tracking error of the portfolio. He also stated that there would be a cost to implementing a coal free benchmark and that doing so might also negatively impact the advantageous fees he had negotiated with the passive portfolio investment managers. Mr. Perry did not recommend changing to a coal free benchmark. Mr. Perry then confirmed that the SBI held six gun manufacturers representing less than $20 million out of the $70 billion that the SBI is responsible for managing at the end of 2017. He indicated that he had no recommendation regarding the SBI's gun manufacturer holdings. Mr. Perry then stated that Tab B included the Sudan and Iran legislative updates, and that the SBI was not in any litigation.

Mr. Perry referred members to Tab C of the meeting materials for an Investment Program Update. He stated that the SBI had successfully transitioned about four and a half billion dollars out of public equities and one and a half billion dollars out of the fixed income portfolios to complete the funding of the new U.S. Treasury portfolio. Mr. Perry noted that in the process of funding the U.S. Treasury portfolio the following three managers were terminated: McKinley Capital Management LLC (U.S. equity small-cap growth), State Street Global Advisors (international equity semi-passive), and Fidelity Institutional Asset Management (international equity semi-passive). Mr. Perry stated that the SBI's portfolio was now within the specified ranges of the new Strategic Allocation Category Framework. He also noted that the Combined Funds outperformed a passively managed stock and bond portfolio.

Mr. Perry referred members to Tab D containing the report from the SBI's Administrative Committee which met on April 6, 2018 to review the SBI's Fiscal Year 2019 Management and Budget Plan. He presented his Proposed Work Plan for Fiscal Year 2019 and highlighted three items: the revision of the SBI's investment policies, a review of investments for the Participant Directed Investment Program, and the development and issuance of an RFP for a private markets Investment consultant(s).

Attorney General Swanson moved approval of the recommendation in Tab D which reads: **"The Committee recommends that the SBI approve the FY19 Executive Director's Work Plan. Further, the Committee recommends that the Work Plan serve as the basis for the Executive Director's performance evaluation for FY19."** The motion passed unanimously.

Mr. Perry referred members to the budget plan for Fiscal Year 2019-2020 and indicated that it was set out differently than in the past wherein it now separately delineates the administrative budget, which details the personnel services and operating expenses, separately from the investment support services budget which details the accounting and consultant services fees. Secretary of State Simon moved approved of the recommendation in Tab D which reads: **"The Committee recommends that the SBI approve the FY19, and FY20 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."** The motion passed unanimously.

Mr. Perry then asked the Board to approve the Continuing Fiduciary Education Plan which allocates five-thousand dollars to each Board member to be used, as necessary, for educational purposes. State Auditor Otto moved approval of the recommendation which reads: **"The Committee recommends that the SBI adopt the attached Continuing Fiduciary Education Plan."** The motion passed unanimously.

Mr. Perry referred members to the next item for approval, the Executive Director's Evaluation Process. He stated that the only change in the process from the past was that, in addition to providing the completed evaluations to the Executive Director, the Board members should also provide a copy of the evaluation summary page to the Governor or the Governor's designee. Mr. Perry requested that the Governor's summary be provided to both the Executive Director and the Director of Investment Administration to file and implement any salary action. State Auditor Otto moved approval of the recommendation which reads: **"The Committee recommends that the SBI adopt the following performance evaluation and salary process for the SBI Executive Director:**

- **Evaluations by each Board member should be completed by October 1.**

- **The evaluations will be based on the results of the Executive Director's Work Plan for the fiscal year ending the previous June 30.**

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

- **As Chair of the Board, the Governor (or his/her Board designee) will coordinate distribution of the evaluation forms. Board members will forward completed evaluations to the Executive Director. Board members should also send a copy of the Overall Evaluation (summary page 1) to the Governor or the Governor's designee. Board members 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 Increases and/or any Performance-Based Salary Increases 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.**

- **The Governor (or his/her Board designee) will provide a letter to the Executive Director confirming the status of the Executive Director's evaluation results by November 1."** The motion passed unanimously.

Mr. Perry stated that he provided the Administrative Committee with an update of the SBI's Business Continuity Plan, for which no action was required.

Mr. Martin, Chairperson of the Investment Advisory Council (IAC), referred members to Tab E and reviewed the proposed seven private equity investments and one real estate investment, all of which are with existing managers, as follows: AG Realty X & AG Asia Realty IV (Real Estate), Brookfield Capital Partners V (Private Equity), China-U.S. Industrial Partnership (Private Equity), Goldner Hawn Fund VII (Private Equity), Paine Schwartz Food Chain V (Private Equity), Thoma Bravo Fund XIII (Private Equity), Warburg Pincus Global Growth (Private Equity), and WCAS XIII (Private Equity). Secretary of State Simon moved approval of eight of the recommendations in Tab E 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 a combined $250 million in the aggregate, or 20% of each of AG Realty Fund X or AG Asia Realty Fund IV, whichever is less. Approval 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 Angelo, Gordon & Co. 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 Angelo, Gordon & Co. 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 $250 million, or 20% of Brookfield Capital Partners V, whichever is less. Approval 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 Brookfield Asset Management Inc. 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 Brookfield Asset Management Inc. 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 China-U.S. Industrial Cooperation Partnership, whichever is less. Approval 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 Goldman, Sachs & Co. 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 Goldman, Sachs & Co. 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 Goldner Hawn Fund VII, whichever is less, contingent on the aggregate fund size being at least $250 million. Approval 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 Goldner Hawn Johnson & Morrison 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 Goldner Hawn Johnson & Morrison 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 $150 million, or 20% of Paine Schwartz Food Chain Fund V, whichever is less. Approval 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 Paine Schwartz 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 Paine Schwartz 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 $150 million, or 20% of Thoma Bravo Fund XIII, whichever is less. Approval 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 Thoma Bravo 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 Thoma Bravo 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 $250 million, or 20% of Warburg Pincus Global Growth, whichever is less. Approval 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 Warburg Pincus 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 Warburg Pincus 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 $250 million, or 20% of WCAS XIII whichever is less. Approval 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 Welsh, Carson, Anderson & Stowe 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 Welsh, Carson, Anderson & Stowe or reduction or termination of the commitment." The motion passed unanimously.

Mr. Martin then referred members to the consideration of BlackRock's Long Term Private Capital Fund which is a hybrid between public and private markets. The Fund has an evergreen structure that allows for potentially indefinite holding periods of investments (with liquidity options to be negotiated) and is designed to invest in established businesses with strong, recurring revenues and stable growth potential over a long-term horizon. BlackRock expects deals within the fund to be originated primarily (though not exclusively) from family-owned or closely held businesses, private equity take-outs, asset recapitalizations, and friendly minority investments. BlackRock's target fund size is $12 billion dollars and the SBI is proposing to invest, as a cornerstone investor, with a commitment of up $2 billion, or 20%, whichever is less. Governor Dayton raised concerns about the size of this commitment relative to other private market deals, and had additional questions regarding the potential economic advantages and the uncertainty of some of the terms of the proposed deal. A discussion followed as Mr. Perry and the consultants responded to Board member questions about the Fund. State Auditor Otto, moved approval and the Governor made a motion to amend the original recommendation. After additional discussion, the Executive Director was asked to provide additional information. The members agreed that the additional information could be presented at a special meeting if the Executive Director determined that a resolution was needed before the September 14, 2018 SBI meeting.

Mr. Perry referred members to a hand-out not included in the published meeting materials, the subject of which was "Potential Secondary Sales of SBI Private Market Funds (see **Attachment A**)". He indicated that he was asking for authority to sell some private market funds, with an approximate current total value of a half a billion dollars, which had been on the books for some time and which, according to the Executive Director, will not grow any further. State Auditor Otto moved approval of the recommendation which reads: **"The SBI authorizes the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute the sale of certain Limited Partnership interests that Staff believes are substantially mature or otherwise do not represent the optimal use of capital going forward. Approval of this recommendation is not intended to be, and does not constitute in any way, a binding or legal obligation on the State Board of Investment to engage in any transaction. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations with respect to the terms and conditions of any potential sale will continue."** The motion passed unanimously.

Mr. Perry noted that the remaining information in the meeting materials were as follows: Public Markets Non-Retirement and Participant Direct Programs, the Market Economic Report prepared by AON, the Investment Market Risk Metrics Report prepared by PCA, and the Comprehensive Performance Report.

Mr. Perry stated that Jim Baker, from Private Equity Stakeholders Project, was present and wished to address the Board. Governor Dayton welcomed Mr. Baker who stated that he was also presenting on behalf of the Center for Popular Democracy and the United for Respect organization. Mr. Baker noted that the KKR Millennium Fund, invested in by the SBI, had owned Toys "R" Us until its recent bankruptcy which he attributed to the high debt burden placed on it by the private equity fund. Mr. Baker alleged that as a result, Toys "R" Us was closing 800 stores and terminating 33,000 employees across the U.S. While Toys "R" Us employees had requested severance pay out of private equity fees previously collected from Toys "R" Us, Mr. Baker noted that KKR had not responded. Mr. Baker requested that the SBI not make new commitments to KKR until the firm more properly aligns its interests with those of its investors and other stakeholders and pays a fair severance to the Toys "R" Us employees.

Governor Dayton expressed his concern that the situation alleged by Mr. Baker was very disturbing if the allegations are true. He stated that he wanted his staff to review the information. **Governor Dayton moved approval to suspend commitments to new KKR funds, but honor existing KKR contractual fund commitments, until the Board can further review the situation and decide a course of action.** Governor Dayton, Secretary of State Simon, Attorney General Swanson were in favor of the motion and State Auditor Otto was in opposition. The motion passed.

The meeting adjourned at 11:15 a.m.

Respectfully submitted,

Mansco Perry III
Executive Director and
Chief Investment Officer

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DATE: June 14, 2018

TO: Members, State Board of Investment

FROM: Mansco Perry III

SUBJECT: Potential Secondary Sales of SBI Private Market Funds

In recent years the market for secondary sales of Limited Partnership interests in private funds has changed significantly, becoming more robust and efficient as more and more capital enters the secondary market. Staff has observed these changes through our investment in funds which seek to purchase LP interests on the secondary market. However, the SBI has historically not been an active seller of LP interests on the secondary market. Staff believes that in the current market environment it would be prudent and appropriate to explore the possibility of selling certain fund interests.

The SBI's Private Markets portfolio includes a substantial amount of capital invested in funds that may be good candidates for liquidation via the secondary market. In many cases these funds are nearing the end of their contractual term, or have been extended beyond their initial term. In certain cases the Investment Manager and General Partner of the fund may no longer be a going concern, or do not have the confidence of SBI staff going forward. Some funds may simply not be a good fit for the SBI portfolio from a strategic perspective.

The SBI Staff believes that in many of these cases, the value of the underlying investments in the funds are unlikely to increase. By continuing to hold these funds until final liquidation the SBI is forgoing potential return from other investment opportunities that could be funded not only with the capital already invested, but also the undrawn capital that has been committed to these funds. In this sense, these older, mature funds represent a significant opportunity cost to the SBI.

Staff believes the SBI could benefit from exploring what options are available in the secondary market. Staff would seek to establish price expectations for LP interests by soliciting bids from secondary buyers, as well as potentially engaging a broker specializing in secondary transactions. Staff may ultimately reach the conclusion that a sale is unattractive due to pricing or other concerns, but we cannot make that determination without the ability to fully engage and negotiate in good faith with potential buyers.

RECOMMENDATION:

The SBI authorizes the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute the sale of certain Limited Partnership interests that Staff believes are substantially mature or otherwise do not represent the optimal use of capital going forward. Approval of this recommendation is not intended to be, and does not constitute in any way, a binding or legal obligation on the State Board of Investment to engage in any transaction. Until the Executive Director on behalf of the SBI executes a formal agreement, further due diligence and negotiations with respect to the terms and conditions of any potential sale will continue.