Minutes
State Board of Investment
February 23, 2017

The State Board of Investment (SBI) met at 10:29 A.M. Thursday, February 23, 2017 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 December 1, 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 December 31, 2016 (Combined Funds 6.1% vs. Composite 5.9%) and had provided a real rate of return of 5.3 percentage points above inflation over the latest 20 year period (Combined Funds 7.4% vs. CPI 2.1%).

Mr. Perry stated that assets increased slightly over the quarter (Combined Funds ending value of $59.9 versus a beginning value of $59.5 billion) and that they were on target in terms of the new asset allocation weights which were approved at the June 2016 SBI meeting. The Combined Funds matched the benchmark for the quarter (Combined Funds 1.5% vs. Composite 1.5%) and were 70 bps below the benchmark for the year (Combined Funds 7.6% vs. Composite 8.3%). The underperformance extended into the three-year period but the Combined Funds outperformed its benchmark in all other time periods reported.

Mr. Perry reported that public equities lagged their benchmark for the quarter, primarily due to the performance of international stocks. Mr. Perry then added that the domestic stock manager group outperformed its benchmark for the quarter (Domestic Stocks 4.3% vs. Domestic Equity Asset Class Target 4.2%) and underperformed for the year (Domestic Stocks 11.5% vs. Domestic Equity Asset Class Target 12.7%) and all remaining time periods. He stated that the international stock manager group underperformed its benchmark for the quarter (International Stocks -1.7% vs. International Equity Asset Class Target -1.3%) and for the year (International Stocks 2.6% vs. International Equity Asset Class Target 4.5%), but outperformed its benchmark for the remaining time periods. Mr. Perry then stated that the bond segment outperformed its benchmark for the quarter (Bonds -2.6% vs. Fixed Income Asset Class Target -3.0%) and the year (Bonds 3.6% vs. Fixed Income Asset Class Target 2.6%), and in all other time periods reported. He stated that the alternative investments continue to add to the portfolio (with performance for the quarter and the year of 3.0% and 7.6%, respectively). Mr. Perry concluded his report noting that, as of December 31, 2016, the SBI was responsible for managing close to $83 billion of assets. Governor Dayton commented on the underperformance of the domestic stock manager group over all time periods, despite every best effort. Mr. Perry responded that he would address this point in Tab C.

Mr. Perry referred members to Tab B of the meeting materials for the Executive Director's Administrative Report. He reported for the fiscal year-to-date, the SBI is coming in under budget. He stated that the SBI had received a clean opinion following the audit by the Legislative Auditor, and a copy of the SBI's Fiscal Year 2016 Annual Report was published in January 2017. Mr. Perry briefly updated members on four legislative items of interest to the SBI. The first item concerned cities and counties which are seeking authority to invest in equities through either mutual funds or the SBI. Mr. Perry indicated that while the SBI is capable of managing these equity investments, he has certain concerns regarding investors' beliefs that equity markets always go up. Mr. Perry noted that these investors would be required to certify and acknowledge that they understand the risks of investing in equities. State Auditor Otto articulated similar concerns related to recent amendments to the bill that define city and county assets as long-term without specifying the length of time the assets were able to be invested. In addition, she noted that the legislation provided that the SBI would be required to set up policies and procedures for these equity investments. State Auditor Otto questioned whether the SBI had any responsibility to make the cities and counties whole if either their equity investments were to lose value or if the policies and procedures developed by the SBI inadvertently contributed to losses for the cities and counties. Mr. Perry stated that it was his understanding that the SBI would not have legal liability with respect to the investments made by the cities and counties. State Auditor Otto also expressed concern about the potential reputational risk to the SBI. She noted that while the SBI and other long-term investors can invest in higher risk assets such as equities given their longer investment periods, investors like cities and counties, with the potential for unanticipated cash needs in emergency situations and the resulting shorter investment periods, have a limited ability to invest in higher risk, equity assets. Governor Dayton agreed with State Auditor Otto and added his concern that the number of investment options be limited, so as to not add too much administrative burden to the SBI. Mr. Perry clarified that these investors would have access to the SBI's non-retirement equity, bond and cash pools only.

Mr. Perry indicated that the second legislative item the SBI is following is an initiative to have all vendors certify that they do not discriminate against the State of Israel. Mr. Perry said that he was uncertain as to the status of this initiative. The third legislative item being followed by the SBI concerns counties attempting to create trusts into which they can deposit proceeds from payment in lieu of property taxes. The legislation states that the assets would be managed by the SBI. Mr. Perry indicated that the SBI could manage the assets and he recommended placing an upper limit on the amount of any one withdrawal while further stating that the SBI could not be the administrator of the trusts. The final piece of legislation that the SBI is following is a sustainability bill introduced by the Teachers Retirement Association (TRA) to address their under-funded status. Mr. Perry indicated that he expected the other retirement agencies to put forth similar bills and that nothing in the current bill impacted the SBI at this time.

He informed members that Tab B included updated information for Sudan and Iran and he noted that the SBI is not currently involved in any litigation.

Mr. Perry informed the members that every two years they are required to pass a resolution providing for the authorization of the Proxy Committee to vote proxies on behalf of the SBI's investments as well as the Proxy Voting Guidelines themselves.

Secretary of State Simon moved approval of the first proxy-related recommendation in Tab B, which reads: **"The Executive Director recommends that the SBI adopt the resolution which reauthorizes the Proxy Committee and delegates proxy voting responsibilities according to**

established guidelines." The motion passed unanimously. The resolution is included as **Attachment A**.

State Auditor Otto moved approval of the second proxy-related recommendation in Tab B, which reads: **"The Proxy Committee recommends that the Board reaffirm the Proxy Voting Guidelines."** The motion passed unanimously.

Mr. Perry referred members to Tab C and provided them with an update on the transition of the fund to the new asset allocation policy. He stated that at the beginning of calendar year 2017, the fund achieved the 20% target in fixed income. Mr. Perry stated that the SBI is currently in the process of funding the six emerging markets managers that the Board approved last quarter. He indicated that when that was done, the fund would be considerably closer to its new target 67% U.S./30% Non-U.S. equity split. He anticipates being at the 67% U.S./30% Non-U.S. equity split by the next Board meeting. Mr. Perry reported to the members that the amount of equity assets being passively managed was still at the 55% level, but that he anticipated reaching the 60% to 70% level via rebalancing and additional active manager reductions and future terminations. He added that while there has been some discussion as to whether or not active equity management is poised to outperform, the long term track record of under-performance supports the decision to move more publically-traded equity assets to passive management.

In response to a question from Governor Dayton, Jeff Bailey, Chair of the Investment Advisory Council (IAC) stated that there is a wide range of opinion in the investment community regarding the advantages of passive and active management and that there was consensus on the issue. He said that while certain members of the IAC are running funds that are all actively managed, others are running funds that are all passively managed, such as the fund for which he has responsibility at Target. Mr. Bailey acknowledged that the circumstances of the SBI are different than a smaller organization, that there are good reasons why the SBI would have a large component of passive management, and that the IAC endorsed Mr. Perry's initiative.

Mr. Bailey, provided an overview of the agenda items covered at the February 13, 2017 IAC meeting. He referred members to Tab D of the meeting materials, which contained a recommendation to replace State Street Global Advisors (SSgA) as the domestic equity manager in the Worker's Compensation Assigned Risk Plan with the SBI Internal Stock Pool.

State Auditor Otto moved approval of the recommendation in Tab D which reads: **"The Investment Advisory Council concur with Staff's recommendation to terminate the relationship with SSgA as the domestic equity portfolio manager of the Assigned Risk Plan and that the assets remain invested in the Internal Stock Pool."** The motion passed unanimously.

Mr. Bailey moved on to Tab F and reviewed the four alternative investment proposals brought to the IAC. All four of the firms are existing private equity managers: Adams Street Partners GSF6, KKR Asia Fund III, Silver Lake Partners Fund V, and Vestar Capital Partners Fund VII.

Secretary of State Simon moved approval of all four recommendations in Tab F 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 $100 million, or 20% of Adams Street Global Secondary Fund 6, 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 Adams Street 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 Adams Street 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 KKR Asian Fund III, 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 Kohlberg Kravis Roberts & 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 Kohlberg Kravis Roberts & Co. 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 Silver Lake Partners V, 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 Silver Lake 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 Silver Lake Partners 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 Vestar Capital Partners VII, 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 Vestar Capital 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 Vestar Capital Partners VII reduction or termination of the commitment." The motion passed unanimously.

Mr. Bailey then announced his retirement from the IAC due to his upcoming retirement from Target Corporation. He shared his history with the IAC, starting with his hiring as an SBI Staff member in 1979, and joining the IAC as a Committee member in 2006. He thanked the members for the dedication that they have taken in overseeing the funds. Governor Dayton and other members thanked Mr. Bailey for his outstanding leadership and service. Responding to a question from Governor Dayton, Mr. Perry indicated that he would be surveying IAC members for Mr. Bailey's successor.

The meeting adjourned at 10:55 a.m.

Respectfully submitted,

Mansco Perry III

Mansco Perry III
Executive Director and
Chief Investment Officer

This page intentionally left blank.

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 23rd day
of February, 2017

Governor Mark Dayton
Chair, Minnesota
State Board of Investment