ND STATE INVESTMENT BOARD MEETING

Friday, January 27, 2017, 8:30 a.m.
Workforce Safety & Insurance
1600 E Century Avenue, Bismarck, ND

AGENDA

I. CALL TO ORDER AND ACCEPTANCE OF AGENDA

II. ACCEPTANCE OF MINUTES (November 18, 2016)

III. ELECTION OF CHAIR (Term December 15, 2016 - June 30, 2017)

IV. INVESTMENTS

A. Asset and Performance Review (previously reviewed on Nov. 18, 2016) - Mr. Hunter (enclosed) (5 min)
B. Improving Risk Adjusted Returns - Mr. Hunter (enclosed) (5 min)
C. Fixed Income Restructuring Memo - Mr. Schulz (enclosed) (15 min)
D. Fixed Income Manager Interview - Mr. Goldstein, Ms. Markowicz, Ms. Aparece (enclosed) (45 min)
E. Fixed Income Manager Recommendation - Mr. Chin (to follow) (15 min) **Board Action***

** Executive Session pursuant to NDCC §44-04-18.4(1), §44-04-19.1(9), & §44-04-19.2- to discuss confidential commercial and financial information and provide contract negotiating instructions to its attorney or negotiator.*

========================== Break from 10:00 to 10:15 a.m. ==========================

V. ADMINISTRATION

A. 2017-18 Board Meeting Schedule - Mr. Hunter (enclosed) (5 min) **Board Action**
B. State Risk Management Investment Policy Statements - Mr. Hunter (enclosed) (10 min) **Board Action**
C. ED/CIO Effectiveness Survey - Ms. Miller-Bowley (enclosed) (10 min)
D. Legacy and Budget Stabilization Advisory Board Update (enclosed) - Mr. Hunter (5 min)
E. AG Opinion (Legacy Fund) and Litigation Update - Ms. Murtha (Informational) (15 min)
F. Legislative Update - Mr. Hunter (enclosed) (10 min)
G. Contingency Request - Mr. Hunter (enclosed) (5 min) **Board Action**

VI. QUARTERLY MONITORING (enclosed) (15 min) **Board Acceptance**

A. Budget and Financial Condition - Ms. Flanagan
B. Executive Limitations / Staff Relations - Mr. Hunter
C. Investment Program - Mr. Schulz
D. Retirement Program - Ms. Kopp
E. Watch List Update - Mr. Schulz

VII. OTHER

Next Meetings: SIB Audit Committee meeting - February 23, 2017, 3:00 p.m. - Workforce Safety & Insurance
SIB meeting - February 24, 2017, 8:30 a.m. - Workforce Safety & Insurance

VIII. ADJOURNMENT

An individual who requires an auxiliary aid or service may contact the Retirement and Investment Office at 701-328-9885 at least three (3) days prior to the scheduled meeting.

NORTH DAKOTA STATE INVESTMENT BOARD
MINUTES OF THE
NOVEMBER 18, 2016, BOARD MEETING

MEMBERS PRESENT:	Drew Wrigley, Lt. Governor, Chair Mike Sandal, Vice Chair Clare Carlson, WSI Designee Lance Gaebe, Commissioner of Trust Lands Mike Gessner, TFFR Board Adam Hamm, Insurance Commissioner (TLCF) Rob Lech, TFFR Board Mel Olson, TFFR Board Kelly Schmidt, State Treasurer Yvonne Smith, PERS Board Tom Trenbeath, PERS Board
MEMBERS ABSENT:	Cindy Ternes, WSI Designee
STAFF PRESENT:	Eric Chin, Investment Analyst Connie Flanagan, Fiscal & Invt Ops Mgr Bonnie Heit, Assist to the SIB David Hunter, ED/CIO Terra Miller Bowley, Supvr Audit Services Cody Schmidt, Compliance Officer Darren Schulz, Dep CIO Susan Walcker, Invt Acct
GUESTS PRESENT:	Levi Erdmann, Dept. of Trust Lands Jan Murtha, Attorney General's Office Bryan Reinhardt, PERS Dave Thompson, Prairie Public Radio

CALL TO ORDER:

Lt. Governor Wrigley, Chairman, called the State Investment Board (SIB) meeting to order at 8:30 a.m. on Friday, November 18, 2016, at Workforce Safety & Insurance, 1600 E Century Ave, Bismarck, ND.

AGENDA:

IT WAS MOVED BY MR. OLSON AND SECONDED BY COMMISSIONER GAEBE AND CARRIED ON A VOICE VOTE TO ACCEPT THE AGENDA FOR THE NOVEMBER 18, 2016, MEETING AS DISTRIBUTED.

AYES: TREASURER SCHMIDT, MR. GESSNER, COMMISSIONER HAMM, MR. CARLSON, COMMISSIONER GAEBE, MS. SMITH, MR. LECH, MR. SANDAL, MR. TRENBEATH, MR. OLSON, LT. GOVERNOR WRIGLEY
NAYS: NONE
MOTION CARRIED

MINUTES:

IT WAS MOVED BY MR. SANDAL AND SECONDED BY MR. GESSNER AND CARRIED ON A VOICE VOTE TO ACCEPT THE OCTOBER 28, 2016, MINUTES AS DISTRIBUTED.

AYES: MS. SMITH, MR. SANDAL, MR. OLSON, MR. GESSNER, MR. LECH, MR. TRENBEATH, MR. CARLSON, COMMISSIONER HAMM, COMMISSIONER GAEBE, TREASURER SCHMIDT, LT. GOVERNOR WRIGLEY
NAYS: NONE
MOTION CARRIED

INVESTMENTS:

Asset and Performance Overview – Mr. Hunter reviewed SIB clients' assets under management as of September 30, 2016. Assets under management grew by approximately 12.2 percent or $1.27 billion in the last year with the Legacy Fund creating the largest asset growth of $742 million primarily due to tax collections. Assets exceeded $11.7 billion based on unaudited valuations as of September 30, 2016. Over the last five years, the Legacy Fund has generated over $75 million of excess return.

The Legacy Fund generated a net investment gain of 10.18 percent for the year ended September 30, 2016. Since inception, the Legacy Fund has generated a net annualized return of 3.49 percent (over the last 5 years) exceeding the performance benchmark of 2.62 percent.

The Pension Trust posted a net return of 9.43 percent in the last year. During the last 5 years, the Pension Trust generated a net annualized return of 9.44 percent exceeding the performance benchmark of 8.83 percent.

The Insurance Trust generated a net return of 7.04 percent in the last year. During the last 5 years, the Insurance Trust posted a net annualized return of 5.79 percent exceeding the performance benchmark of 4.38 percent.

Every Pension Trust client generated positive excess returns for the three and five-year periods ended September 30, 2016. The Public Employees Retirement System (PERS) excess return approximated to 0.66 percent and 0.60 percent over the last three and five year periods, respectively. The Teachers' Fund for Retirement (TFFR) excess return approximated to 0.68 percent for the last 3 years and 0.77 percent for the last five years.

Every Non-Pension Trust client generated positive excess returns for the five years ending September 30, 2016. All but one non-pension trust client (PERS Retiree Health Insurance Credit Fund) reported positive risk adjusted excess returns for the five years ended June 30, 2016.

SIB Highlights – Lt. Governor Wrigley stated one of the keys to the SIB's success is the long-term membership and continuity. He complimented RIO personnel recognizing their outstanding job of preparing materials and reports and keeping the trustees up to speed to enable them to make informed decisions. He also stated RIO personnel do a good job continuously working to ensure that reports are short and concise which assists in transparency. He also indicated if the trustees, legislators, public, or stakeholders need information, it is available from RIO personnel, RIO's website, the Treasurer's Office or the Treasurer's Office website.

During the last three years, management fees have declined from 0.65% to less than 0.45% of assets. Based on $10 billion of assets, this translates into $20 million of annual fee savings.

The Legacy Fund has generated $426 million of income with a net investment return of 3.5% per annum since mid-2014. For the quarter ending September 30, 2016, net investment income was $160 million (based on preliminary valuations, which are unaudited.

The SIB has utilized active management to increase investment income by $220 million over the last 5-years (after investment fees).

Callan Investment Review – Mr. Hunter and Mr. Schulz provided an economic update and reviewed Callan's performance measurement reports for the Pension Trust, Insurance Trust, and Legacy Fund for the quarter ending September 30, 2016.

Lt. Governor Wrigley thanked everyone and stated it has been a pleasure to work with everyone. He commended everyone for the work they have done and for the work they are going to continue to do up ahead.

Lt. Governor Wrigley left the meeting and Mr. Sandal presided over the remainder of the meeting.

IT WAS MOVED BY MR. TRENBEATH AND SECONDED BY MR. GESSNER AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE CALLAN PERFORMANCE MEASUREMENT REPORTS AS PRESENTED BY RIO PERSONNEL.

AYES: MR. TRENBEATH, TREASURER SCHMIDT, MR. OLSON, COMMISSIONER GAEBE, MR. LECH, MR. SANDAL, COMMISSIONER HAMM, MR. GESSNER, MS. SMITH, AND MR. CARLSON
NAYS: NONE
MOTION CARRIED
ABSENT: LT. GOVERNOR WRIGLEY

The Board recessed at 9:50 a.m. and reconvened at 10:03 a.m.

Client Investment Reviews – Mr. Hunter informed the SIB RIO personnel conduct annual reviews with the SIB clients which includes reviews of recent returns and the impact of any proposed organizational developments (such as changes in personnel, liquidity and/or risk/return expectations) on the existing investment policy statement. The reviews serve as the basis for staff recommendations to modify asset allocation guidelines.

Callan Fee Study – With the absence of Callan representatives, the Callan Fee Study review was tabled. Mr. Hunter did note however that management fees have declined on both a percent basis and absolute dollar basis in recent years. He also noted the return on investment fees has been meaningfully positive and exceeded 50 basis points per annum (or $220 million in aggregate) over the last five years thus; the SIB has been successful in prudently using active management to generate positive risk adjusted rates of return while significantly reducing fee levels for nearly all of the SIB clients.

Bank of North Dakota – Mr. Schulz informed the SIB RIO personnel invested approximately $40 million in short-term cash with the Bank of North Dakota (BND) in order to improve risk-adjusted rates of return for the SIB's clients. The BND will pay one-month LIBOR minus 0.10% on the cash deposits. The $40 million allocation includes $30 million in the Insurance Trust and $10 million in the Pension Trust.

Watch List – Mr. Hunter stated Adams Street Partners and RIO personnel have reached an understanding to obtain modified investment reporting. Upon receiving the modified reporting package for two consecutive quarters, RIO personnel will recommend that Adams Street Partners be removed from the Watch List. Adams Street Partners was placed on the Watch List at the October 28, 2016, meeting due to transparency concerns in addition the SIB temporarily paused investment into any new Funds.

GOVERNANCE:

Financial Audit Report – Mr. Hunter stated the SIB Audit Committee accepted the results of CliftonLarsonAllen's audit of RIO's financial statements as of June 30, 2016, which includes an unmodified (or clean) opinion. CliftonLarsonAllen's report notes the financial statements present fairly, in all material respects, the financial position of RIO as of June 30, 2016, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted. The opinion also states the combining and individual fund financial statements present fairly, in all material respects, the financial position of each of the individual funds of RIO as of June 30, 2016, and the respective changes in financial position for the year then ended.

The SIB expressed their gratitude to RIO personnel for all of their efforts and work throughout the year in order to receive a clean opinion of RIO's financial statements by CliftonLarsonAllen.

IT WAS MOVED BY MR. GESSNER AND SECONDED BY TREASURER SCHMIDT AND CARRIED BY A ROLL CALL VOTE TO ACCEPT RIO'S FINANCIAL AUDIT REPORT FOR THE PERIOD ENDING JUNE 30, 2016.

AYES: COMMISSIONER GAEBE, TREASURER SCHMIDT, MR. SANDAL, COMMISSIONER HAMM, MR. OLSON, MR. CARLSON, MR. GESSNER, MR. TRENBEATH, MR. LECH, AND MS. SMITH
NAYS: NONE
MOTION CARRIED
ABSENT: LT. GOVERNOR WRIGLEY

Mr. Hunter also informed the SIB the SIB Audit Committee discussed school districts that have repeated deficiencies. RIO personnel will be discussing their concerns with the Teachers' Fund for Retirement Board at their January 26, 2017, meeting, to review what if any options may be available to RIO to assist the school districts and staff.

Governance Manual Review - Mr. Hunter reviewed the second reading of the revised language in Section B-Policy Introduction/Amendment Passage.

IT WAS MOVED BY MR. TRENBEATH AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE SECOND READING TO SECTION B-POLICY INTRODUCTION/AMENDMENT PASSAGE.

AYES: MR. GESSNER, COMMISSIONER GAEBE, MS. SMITH, MR. CARLSON, TREASURER SCHMIDT, MR. LECH, COMMISSIONER HAMM, MR. OLSON, MR. TRENBEATH, AND MR. SANDAL
NAYS: NONE
MOTION CARRIED
ABSENT: LT. GOVERNOR WRIGLEY

OTHER:

The following SIB members will no longer be serving as trustees of the SIB: Lt. Governor Wrigley, Commissioner Hamm, and Mr. Trenbeath. On behalf of the RIO staff and the constituents of the SIB, thank you for your service.

The next meeting of the SIB is scheduled for January 27, 2017, at 8:30 a.m. at Workforce Safety & Insurance, 1600 E Century Ave., Bismarck, ND.

The next meeting of the SIB Audit Committee is scheduled for February 23, 2017, at 3:00 p.m. at Workforce Safety & Insurance, 1600 E Century Ave., Bismarck, ND.

ADJOURNMENT:

With no further business to come before the SIB, Mr. Sandal adjourned the meeting at 10:35 a.m.

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Mike Sandal, Vice Chair
State Investment Board

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Bonnie Heit
Assistant to the Board

AGENDA ITEM III.

TO: State Investment Board (SIB)

FROM: David Hunter (on behalf of Mike Sandal –Acting Chair and Elected Vice Chair)

DATE: January 20, 2017

RE: Election of Chair Due to Change in State Leadership – Jan. 2017 to June 2017

In accordance with the SIB Governance Policy B-7 on "Annual Board Planning Cycle", the SIB will conduct an "Election of Officers" each July. The relevant By-Laws and Governance Policy of the SIB are highlighted immediately below for reference purposes.

CHAPTER 3 - OFFICERS AND DUTIES

Section 3-1. The officers of the SIB are a Chair and Vice Chair, one of which must be an appointed or elected member of the TFFR or PERS Board. The officers will be elected by the SIB to a one-year term at the first regularly scheduled meeting following July 1 of each year. Vacancies will be filled by the SIB at the first scheduled meeting following the vacancy.

Section 3-2. Chair. The Chair will preside at all meetings of the SIB.

Section 3-3. Vice Chair. In the absence of the Chair, the Vice Chair will perform the duties of the Chair.

Section 3-4. Executive Director. An Executive Director will be retained by the SIB. The Executive Director will serve at the SIB's pleasure, be responsible for keeping the records of the SIB and TFFR Board actions, and perform such duties as the SIB prescribes. The Executive Director will make out and give out all notices required to be given by law, procedures, or rules and regulations of the two boards.

Policy Implemented: June 23, 1995.

The chairperson's primary responsibility is to insure the integrity of the board's process. The chairperson is the only board member authorized to speak for the board other than in specifically authorized instances.

1. The duty of the chairperson is to see that the board operates consistent with state law, administrative rules, and its own policies.

    A. The board agenda will be the responsibility and be coordinated by the chairperson.
    B. Meeting discussion content will only be those issues which, according to board policy, clearly belong to the board and not the executive director, or in a board member's opinion, may deal with fiduciary responsibilities.
    C. Deliberation will be fair, open, and thorough, but also efficient, timely, orderly, and brief.
    D. The chairperson shall appoint a parliamentarian.

SIB Asset and Performance Review

Overview of Investment Ends

For the periods ended September 30, 2016

Note: Investment Ends were previously reviewed at our November 18th SIB meeting. These materials are being re-distributed to ensure all board members are aware of our quarterly review of investment results during the current legislative session.

Dave Hunter, Executive Director / CIO

Darren Schulz, Deputy Chief Investment Officer

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)

Overview of SIB Client Assets Under Management

Fund Name	Market Values as of 9/30/16 [1]	Market Values as of 6/30/16 [2]	Market Values as of 9/30/15 [1]
Pension Trust Fund			
Public Employees Retirement System (PERS)	2,548,430,036	2,459,388,086	2,297,953,486
Teachers' Fund for Retirement (TFFR)	2,144,533,865	2,082,183,640	1,986,019,289
Job Service of North Dakota Pension			92,671,408
City of Bismarck Employees Pension	85,179,534	82,441,003	78,265,663
City of Grand Forks Employees Pension	58,778,547	57,975,758	54,988,439
City of Bismarck Police Pension	35,180,238	33,983,598	34,180,733
Grand Forks Park District	5,834,315	5,720,245	5,736,838
City of Fargo Employees Pension			1,250
Subtotal Pension Trust Fund	**4,877,936,536**	**4,721,692,330**	**4,549,817,105**
Insurance Trust Fund			
Workforce Safety & Insurance (WSI)	1,860,023,835	1,832,104,203	1,722,726,573
Budget Stabilization Fund	578,309,532	575,918,381	575,697,144
PERS Group Insurance Account	37,239,691	37,715,356	36,093,259
City of Fargo FargoDome Permanent Fund	35,386,219	38,782,721	37,545,105
State Fire and Tornado Fund	24,853,937	24,091,203	22,737,348
Petroleum Tank Release Compensation Fund	7,214,431	7,149,512	7,176,956
State Risk Management Fund	6,208,850	6,534,801	6,116,849
State Risk Management Workers Comp Fund	5,680,663	5,516,177	5,614,318
ND Association of Counties (NDACo) Fund	4,167,501	4,048,863	3,836,386
State Bonding Fund	3,329,117	3,296,372	3,186,910
ND Board of Medicine	2,248,565	2,208,667	2,138,284
Insurance Regulatory Trust Fund	1,232,868	1,085,836	2,567,559
Bismarck Deferred Sick Leave Account	661,908	642,265	850,301
Cultural Endowment Fund	398,147	386,452	366,207
Subtotal Insurance Trust Fund	**2,566,955,264**	**2,539,480,809**	**2,426,653,198**
Legacy Trust Fund			
Legacy Fund	4,070,189,950	3,809,485,177	3,328,631,897
PERS Retiree Insurance Credit Fund	105,505,466	101,623,224	92,663,350
Job Service of North Dakota Pension	96,325,192	96,588,333	
ND Tobacco Prevention and Control Trust Fund	52,785,217	54,366,538	47,300,013
Total Assets Under SIB Management	**11,769,697,625**	**11,323,236,410**	**10,445,065,563**

[1] *9/30/16 and 9/30/15 market values are unaudited and subject to change.*

[2] *6/30/16 market values as stated in the Comprehensive Annual Financial Report.*

- **SIB client assets grew by approximately 12% (or $1.3 billion) in the last year** with the Legacy Fund creating the largest asset growth of $742 million primarily due to tax collections.
- **The Pension Trust posted a net return of 9.43% in the last year. During the last 5-years, the Pension Trust generated a net annualized return of 9.44%, exceeding the performance benchmark of 8.83%.**
- **The Insurance Trust generated a net return of 7.04% in the last year. During the last 5-years, the Insurance Trust posted a net annualized return of 5.79%, exceeding the performance benchmark of 4.38%.**
- **The Legacy Fund generated a net investment gain of 10.18% for the year ended September 31, 2016, exceeding its performance benchmark. Since inception, the Legacy Fund has generated a net annualized return of 3.49% (over the last 5 years) exceeding the performance benchmark of 2.62%.**
- **SIB client assets exceeded $11.7 billion as of September 30, 2016, based on unaudited valuations.**

TFFR Investment Ends – September 30, 2016

SIB clients should receive investment returns consistent with their written investment policies and market variables. This "End" is evaluated based on comparison of each client's (a) actual net investment return, (b) standard deviation and (c) risk adjusted excess return, to the client's policy benchmark over 5 years.

	1 Qtr Ended 9/30/2016	1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016	Risk (as measured by Std. Dev.) 5 Yrs Ended 9/30/2016	Risk Adj Excess Return 5 Yrs Ended 9/30/2016
Net Investment Return	**3.69%**	**9.43%**	**6.14%**	**9.64%**	5.7%	**0.42%**
Policy Benchmark Return	3.52%	9.11%	5.45%	8.87%	5.5%	**(c)**
Excess Return	**0.17%**	**0.32%**	**0.68%**	**0.77%**	**104%**	
		$6.5 million	**$40 million**	**$65 million** (a)	**(b)**	

Key Point: TFFR investments have averaged over $1.75 billion during the last 5-years and Excess Return has averaged over **0.75%** per annum. Based on these values, **TFFR's use of active management has enhanced Net Investment Returns by $65 million for the 5-years ended Sep. 30, 2016** (or $1.75 billion x 0.75% = $13 million x 5 years = $65 million). This Excess Return has been achieved while adhering to prescribed **Risk** limits (e.g. **104%** versus a policy limit of 115%).

Current Policy Benchmark: 58% Equity (31% U.S., 21% Non-U.S., 6% Private); **23% Fixed Income** (13% U.S., 6% Non-U.S. 4% High Yield); **18% Real Assets** (10% Real Estate; 5% Infrastructure; 3% Timber); and **1% Cash.**

Pension Trust Return & Risk Summary – **Sep. 30, 2016**

Returns: Every Pension Trust client portfolio generated positive "Excess Return" and positive "Risk Adjusted Excess Return" for the 5-years ended September 30, 2016.

Risk: Every Pension Trust client investment portfolio was in compliance with prescribed risk levels (e.g. within 115% of the Policy Benchmark over the last 5-years).

	Current FYTD 9/30/2016	1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016	Risk 5 Yrs Ended 9/30/2016	Risk Adj Excess Return 5 Yrs Ended 9/30/2016
PERS - $2.55 billion						
Total Fund Return - Net	**3.68%**	**9.49%**	**6.12%**	**9.46%**	**5.7%**	**0.36%**
Policy Benchmark Return	3.61%	9.21%	5.46%	8.85%	5.5%	
Excess Return	**0.07%**	**0.28%**	**0.66%**	**0.60%**	**103%**	
TFFR - $2.15 billion						
Total Fund Return - Net	**3.69%**	**9.43%**	**6.14%**	**9.64%**	**5.7%**	**0.42%**
Policy Benchmark Return	3.52%	9.11%	5.45%	8.87%	5.5%	
Total Relative Return	**0.17%**	**0.32%**	**0.68%**	**0.77%**	**104%**	

1. **PERS and TFFR Net Investment Returns Exceed 9% for 1- and 5-years ended Sep. 30, 2016.**
2. **Active investment management has enhanced net returns of PERS and TFFR by $120 million for the 5-years ended September 30, 2016. This is based on average asset values of $4 billion x 0.60% of annual excess return = $24 million x 5 years = $120 million.**

Note: Current year returns are unaudited and subject to change.

Pension Trust Return & Risk Summary – **Sep. 30, 2016**

	Current FYTD 9/30/2016	1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016	Risk 5 Yrs Ended 9/30/2016	Risk Adj Excess Return 5 Yrs Ended 9/30/2016
BISMARCK EMPLOYEES PENSION						
Total Fund Return - Net	**3.33%**	**8.81%**	**5.91%**	**8.94%**	5.0%	**0.44%**
Policy Benchmark Return	3.21%	8.70%	5.30%	8.25%	4.8%	
Excess Return	**0.12%**	**0.11%**	**0.61%**	**0.69%**	**103%**	
BISMARCK POLICE PENSION						
Total Fund Return - Net	**3.53%**	**9.06%**	**5.87%**	**9.24%**	5.4%	**0.44%**
Policy Benchmark Return	3.48%	8.91%	5.27%	8.60%	5.3%	
Excess Return	**0.05%**	**0.15%**	**0.60%**	**0.65%**	**102%**	
JOB SERVICE PENSION PLAN						
Total Fund Return - Net	**0.92%**	**9.85%**	**6.36%**	**8.98%**	4.6%	**1.22%**
Policy Benchmark Return	2.18%	7.38%	4.91%	7.37%	4.4%	
Excess Return	**-1.27%**	**2.47%**	**1.45%**	**1.60%**	**104%**	
CITY OF GRAND FORKS PENSION PLAN						
Total Fund Return - Net	**3.61%**	**9.56%**	**6.07%**	**9.74%**	5.9%	**0.38%**
Policy Benchmark Return	3.64%	9.61%	5.61%	9.22%	5.8%	
Excess Return	**-0.03%**	**-0.05%**	**0.47%**	**0.52%**	**101%**	
GRAND FORKS PARK DISTRICT PENSION PLAN						
Total Fund Return - Net	**3.51%**	**9.23%**	**6.37%**	**10.04%**	5.9%	**0.59%**
Policy Benchmark Return	3.27%	9.03%	5.82%	9.39%	5.9%	
Excess Return	**0.24%**	**0.20%**	**0.55%**	**0.66%**	**101%**	

Risk Adjusted Excess Returns for the 5-years ended Sep. 30, 2016, were positive for all Pension Trust clients and generally exceeded 0.50% (or ½ percent).

Risk Adjusted Excess Return measures actual portfolio results versus a benchmark adjusted by its risk relative to a benchmark portfolio. This metric is positive if excess returns are due to "smart" investment decisions or negative if driven by excess risk.

Note: Current year returns are unaudited and subject to change.

Non-Pension Trust Return & Risk Summary – **Sep. 30, 2016**

LEGACY FUND	Current FYTD 9/30/2016	1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016	Risk 5 Yrs Ended 9/30/2016	Risk Adj Excess Return 5 Yrs 9/30/2016
Net Investment Return	**4.21%**	**10.18%**	**4.74%**	**3.49%**	**3.6%**	**0.53%**
Policy Benchmark Return	3.35%	8.85%	3.92%	2.62%	3.2%	
Excess Return	**0.85%**	**1.34%**	**0.82%**	**0.87%**	**OK**	
WSI						
Total Fund Return - Net	**2.82%**	**8.59%**	**6.15%**	**7.66%**	**3.5%**	**1.04%**
Policy Benchmark Return	1.99%	7.08%	4.94%	5.74%	3.1%	
Excess Return	**0.83%**	**1.51%**	**1.21%**	**1.92%**	**OK**	
BUDGET STABILIZATION FUND						
Total Fund Return - Net	**0.42%**	**1.97%**	**1.87%**	**2.03%**	**0.7%**	**0.78%**
Policy Benchmark Return	0.01%	1.14%	0.89%	0.69%	0.5%	
Excess Return	**0.41%**	**0.83%**	**0.98%**	**1.34%**	**OK**	

Returns and Risk: Every Non-Pension Trust client generated positive "Excess Return" and all but one Non-Pension Trust client generated positive "Risk Adjusted Excess Return" for the 5-years ended Sep. 30, 2016 (if applicable). These returns were achieved while adhering to reasonable risk levels which were consistentlly within 1% of policy levels. **Risk Adjusted Excess Return** measures a portfolio's excess return adjusted by its risk relative to a benchmark portfolio. This metric is positive if returns are due to "smart" investment decisions or negative if driven by excess risk.

Note: Current year returns are unaudited and subject to change.

Non-Pension Trust Return & Risk Summary – **Sep. 30, 2016**

	Current FYTD 9/30/2016	1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016	Risk 5 Yrs Ended 9/30/2016	Risk Adj Excess Return 5 Yrs Ended 9/30/2016
FIRE & TORNADO FUND - $24 million						
Total Fund Return - Net	**3.20%**	**9.11%**	**6.03%**	**8.52%**	**4.3%**	**0.50%**
Policy Benchmark Return	2.20%	7.44%	4.85%	6.59%	3.6%	
Excess Return	**1.00%**	**1.67%**	**1.18%**	**1.94%**	**OK**	
STATE BONDING FUND - $3.3 million						
Total Fund Return - Net	**1.02%**	**4.32%**	**3.12%**	**3.31%**	**1.8%**	**0.96%**
Policy Benchmark Return	0.30%	2.96%	2.26%	1.74%	1.5%	
Excess Return	**0.73%**	**1.36%**	**0.87%**	**1.58%**	**OK**	
INSURANCE REGULATORY TRUST FUND ($1.1 million)						
Total Fund Return - Net	**2.59%**	**6.83%**	**4.29%**	**6.40%**	**3.6%**	**0.27%**
Policy Benchmark Return	1.87%	5.66%	3.56%	5.15%	3.0%	
Excess Return	**0.71%**	**1.17%**	**0.73%**	**1.24%**	**OK**	
PETROLEUM TANK RELEASE COMPENSATION FUND - $7.1 million						
Total Fund Return - Net	**0.94%**	**3.94%**	**2.84%**	**2.97%**	**1.6%**	**0.89%**
Policy Benchmark Return	0.28%	2.72%	2.06%	1.59%	1.4%	
Excess Return	**0.66%**	**1.22%**	**0.78%**	**1.38%**	**OK**	
STATE RISK MANAGEMENT FUND - $6.5 million						
Total Fund Return - Net	**2.74%**	**9.60%**	**6.94%**	**9.07%**	**4.0%**	**0.67%**
Policy Benchmark Return	1.87%	8.01%	5.68%	6.91%	3.4%	
Excess Return	**0.86%**	**1.60%**	**1.26%**	**2.15%**	**OK**	

SIB Client Commentary:

The State Fire & Tornado Fund, State Bonding Fund, Insurance Regulatory Trust Fund, Petroleum Tank Release Compensation Fund, and State Risk Management Fund have all posted positive Risk Adjusted Excess Returns for the 5-years ended Sep. 30, 2016, including Excess Returns of 1.0% or more.

Note: Current year returns are unaudited and subject to change.

Non-Pension Trust Return & Risk Summary – **Sep. 30, 2016**

	Current FYTD 9/30/2016	1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016	Risk 5 Yrs Ended 9/30/2016	Risk Adj Excess Return 5 Yrs Ended 9/30/2016
STATE RISK MANAGEMENT WORKERS COMP FUND - $5.5 million						
Total Fund Return - Net	**3.01%**	**10.26%**	**7.40%**	**9.99%**	**4.6%**	**0.73%**
Policy Benchmark Return	2.22%	8.85%	6.18%	7.90%	4.0%	
Excess Return	**0.78%**	**1.41%**	**1.22%**	**2.09%**	**OK**	
ND ASSOCIATION OF COUNTIES FUND (NDACo) - $4.0 million						
Total Fund Return - Net	**2.98%**	**8.53%**	**5.61%**	**7.74%**	**3.9%**	**0.43%**
Policy Benchmark Return	1.95%	6.80%	4.44%	5.83%	3.2%	
Excess Return	**1.02%**	**1.74%**	**1.17%**	**1.91%**	**OK**	
CITY OF BISMARCK DEFERRED SICK LEAVE ACCOUNT - $1 million						
Total Fund Return - Net	**3.12%**	**9.19%**	**6.10%**	**8.26%**	**4.1%**	**0.49%**
Policy Benchmark Return	1.98%	7.21%	4.76%	6.08%	3.2%	
Excess Return	**1.13%**	**1.99%**	**1.34%**	**2.17%**	**OK**	
FARGODOME PERMANENT FUND - $39 million						
Total Fund Return - Net	**4.23%**	**10.44%**	**6.53%**	**10.10%**	**5.9%**	**0.71%**
Policy Benchmark Return	3.30%	8.91%	5.40%	8.41%	5.4%	
Excess Return	**0.91%**	**1.52%**	**1.13%**	**1.69%**	**OK**	
CULTURAL ENDOWMENT FUND $382,000						
Total Fund Return - Net	**3.96%**	**11.11%**	**7.70%**	**11.63%**	**6.1%**	**0.67%**
Policy Benchmark Return	3.25%	9.98%	6.65%	9.85%	5.6%	
Excess Return	**0.70%**	**1.13%**	**1.05%**	**1.78%**	**OK**	

SIB Client Commentary:

The State Risk Management Workers Comp. Fund, North Dakota Association of Counties, City of Bismarck Deferred Sick Leave Account, FargoDome Permanent Fund and Cultural Endowment Fund have all posted positive Risk Adjusted Excess Returns for the 5-years ended June 30, 2016, including Excess Returns of 1% or more.

Note: Current year returns are unaudited and subject to change.

Non-Pension Trust Return & Risk Summary – **Sep. 30, 2016**

	Current FYTD 9/30/2016	1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016	Risk 5 Yrs Ended 9/30/2016	Risk Adj Excess Return 5 Yrs Ended 9/30/2016
BOARD OF MEDICAL EXAMINERS - $2.2 million						
Total Fund Return - Net	**1.83%**	**5.23%**				
Policy Benchmark Return	1.17%	4.00%				
Excess Return	**0.65%**	**1.23%**				
PERS RETIREE HEALTH - $102 million						
Total Fund Return - Net	**3.62%**	**10.55%**	**6.21%**	**10.01%**	**6.6%**	**-0.74%**
Policy Benchmark Return	3.37%	10.08%	6.43%	9.85%	6.0%	
Excess Return	**0.25%**	**0.47%**	**-0.22%**	**0.16%**	**OK**	
PERS GROUP INSURANCE - $38 million						
Total Fund Return - Net	**0.06%**	**1.55%**	**0.52%**	**0.41%**	**0.5%**	**0.04%**
Policy Benchmark Return	0.03%	1.58%	0.55%	0.36%	0.5%	
Excess Return	**0.02%**	**-0.03%**	**-0.02%**	**0.05%**	**OK**	
TOBACCO CONTROL AND PREVENTION - $54 million						
Total Fund Return - Net	**0.32%**	**1.92%**				
Policy Benchmark Return	0.34%	2.03%				
Excess Return	**-0.02%**	**-0.11%**				

SIB Client Specific Commentary:

The **Board of Medical Examiners** became an SIB client less than two years ago noting they were previously investing in Certificates of Deposit.

Absolute returns for the **PERS Retiree Health Insurance Credit Fund** have been reasonable the last 5-years (10%) but disappointing on a risk adjusted basis.(-0.74%). We are re-examining SEI's benchmarks and risk and return profile.

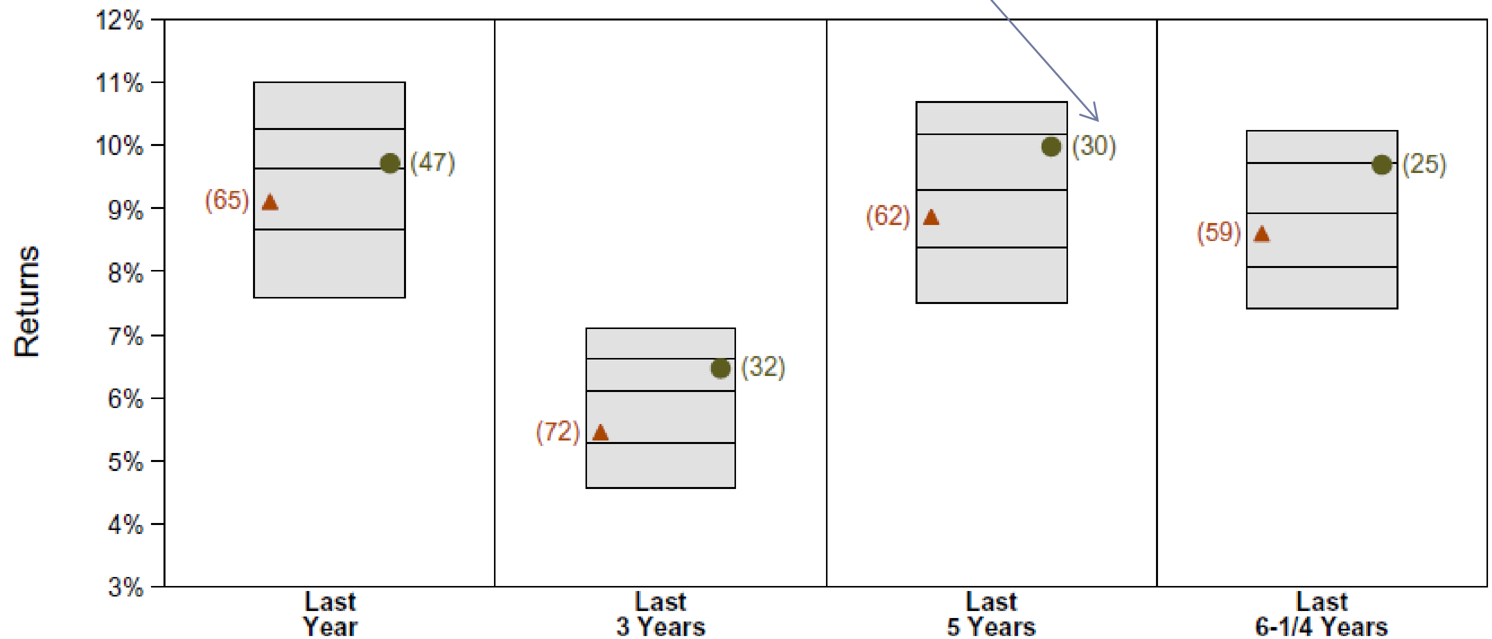
RIO implemented a new asset allocation policy **for PERS Group Insurance** in late-2105 in attempt to enhance returns and lower fees.

The **Tobacco Prevention and Control Trust Fund** became an SIB client on 9/30/15. First year returns of 1.92% are 0.11% below the Policy Benchmark, but exceed their actual returns prior to becoming an SIB client (of 0.10% per annum).

Note: Current year returns are unaudited and subject to change.

TFFR's "gross" returns were ranked in the 30th percentile for the 5-years ended Sep. 30, 2016, based on Callan's "Public Fund Sponsor Database".

CAI Public Fund Sponsor Database



	Last Year	Last 3 Years	Last 5 Years	Last 6-1/4 Years
10th Percentile	11.00	7.11	10.70	10.23
25th Percentile	10.26	6.61	10.19	9.73
Median	9.63	6.12	9.30	8.92
75th Percentile	8.67	5.29	8.38	8.08
90th Percentile	7.58	4.56	7.49	7.40
Total Fund ●	9.72	6.46	9.98	9.69
Policy Target ▲	9.11	5.45	8.87	8.61

* Current Quarter Target = 16.6% Russell 1000 Index, 16.0% MSCI World, 13.0% Barclays Aggregate Index, 11.8% MSCI EAFE, 10.0% NCREIF Total Index, 6.0% NDSIB TFFR - Private Equity, 6.0% Barclays Global Agg ex-US, 5.0% CPI-W, 4.8% Russell 2000 Index, 4.0% Barclays US HY Corp 2% Cp, 3.0% NCREIF Timberland Index, 2.8% MSCI EM and 1.0% 3-month Treasury Bill.

Investment Fees and Expenses – Summary

During the last three-years, investment management fees and expenses as a % of average assets under management declined from **0.65% in fiscal 2013** to **0.51% in fiscal 2014** to **0.48% in fiscal 2015** and to **approximately 0.42% in fiscal 2016.**

All State Investment Board Clients	Investment Fees and Expenses a	Average "Assets Under Management" b	% of "AUM" a / b
Fiscal Year Ended June 30, 2013	**$45 million**	**$6.9 billion**	**0.65%**
Fiscal Year Ended June 30, 2014	**$44 million**	**$8.6 billion**	**0.51%**
Fiscal Year Ended June 30, 2015	**$48 million**	**$10.1 billion**	**0.48%**
Fiscal Year Ended June 30, 2016	**$46 million**	**$10.9 billion**	**0.42%**

Key Point: Based on $10 billion of assets, this 20+ bps decline between fiscal 2013 and 2016 translates into over $20 million of annual savings.

➢ RIO will diligently work to prudently manage all SIB client investment fees and expenses, but acknowledges it will be challenging to reduce fees and expenses below 45 bps (0.45%) per annum in future years. Current fiscal years results were materially impacted by low incentive performance fees.

A basis point (or "bp") is equal to one one-hundredth of one percent (or 0.01%) such that 100 basis points ("bps") is equivalent to 1%.

Note: All amounts are deemed to be materially accurate, but are unaudited and subject to change.

Legacy Fund – Review of "Ends" for Net Investment Returns

Key Point: Active Management has Improved Net Investment Returns of the Legacy Fund by $85 million since inception on Sep. 7, 2011.

Investment Ends: SIB clients should receive investment returns consistent with their written investment policies and market variables. This "End" is evaluated based on comparison of each client's (a) actual net investment return versus the "Policy Benchmark" over five (5) years.

LEGACY FUND		1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016
Net Investment Return	**a**	**10.18%**	**4.74%**	**3.49%**
Policy Benchmark Return	**b**	8.85%	3.92%	2.62%
Excess Return	**a - b**	**1.34%**	**0.82%**	**0.87%**
Excess Return (in dollars)		***$49 million***	***$72 million***	***$85 million***

Excess Returns Calculation Estimates for the 1-, 3- and 5- years ended 9/30/2016

1-Year = $3.7 billion (Fund Assets) x 1.34% (Excess Return) = **$49 million**

3-Years = $3 billion (Fund Assets) x 0.82% (Excess Return) x 3 yrs. = **$72 million**

5-Years = $2 billion (Fund Assets) x 0.87% (Excess Return) x 5 yrs. = **$85 million**

The Policy Benchmark is 50% Equity, 35% Bonds and 15% Real Assets (including Real Estate and Infrastructure).

Note: Current year returns are unaudited and subject to change.

AGENDA ITEM IV.B.

TO: State Investment Board ("SIB")
FROM: RIO Investment Staff
DATE: January 23, 2017
SUBJECT: **Improving Risk Adjusted Returns by Increasing U.S. Centric Debt Mandates**

Background:

RIO has conducted extensive due diligence on over a dozen investment firms which specialize in providing senior, secured loans directly to middle market companies – a lending market which has become increasingly underserved following the 2008 recession largely due to government regulation. Middle market companies generally have a more difficult time accessing the public debt markets due to their smaller size making it unattractive to most major banks from a regulatory capital perspective. In short, the lack of competition from the major banking institutions has created an attractive risk adjusted return opportunity for those investors willing to accept a lack of liquidity in the private debt markets. During this same time frame, international debt has become increasingly less attractive due to unprecedented monetary policy by central banks (resulting in negative interest rates) and escalating foreign currency volatility due to uncertain geopolitical risks. **As a result, we recommend that our international fixed income investments be replaced with U.S. centric debt mandates.**

Given concern for a rising U.S. interest rate environment, we also recommend that our U.S. centric debt mandates be tilted towards floating rate exposure noting the direct lending sector is predominantly floating rate. These sector changes within fixed income were reviewed with Callan Associates without material concern while noting that Callan's Capital Market Assumptions support the reduction of our international fixed income mandates (as evidenced by a negative Sharpe Ratio in the table below). Callan's latest Capital Market Assumptions were used to demonstrate the impact of RIO's recommendation on Projected Return and Risk (see next page). RIO notes that JPMorgan's latest long-term capital market assumptions also support our recommendation to increase U.S. centric debt mandates using the Direct Lending sector.

2017 Capital Market Expectations—Return and Risk

Summary of Callan's Long-Term Capital Market Projections (2017 – 2026)

		PROJECTED RETURN			PROJECTED RISK		
Asset Class	Index	1-Year Arithmetic	10-Year Geometric*	Real	Standard Deviation	Sharpe Ratio	Projected Yield
Equities							
Broad Domestic Equity	Russell 3000	8.30%	6.85%	4.60%	18.25%	0.332	2.00%
Large Cap	S&P 500	8.05%	6.75%	4.50%	17.40%	0.333	2.10%
Small/Mid Cap	Russell 2500	9.30%	7.00%	4.75%	22.60%	0.312	1.55%
Global ex-U.S. Equity	MSCI ACWI ex USA	8.95%	7.00%	4.75%	21.00%	0.319	3.10%
International Equity	MSCI World ex USA	8.45%	6.75%	4.50%	19.70%	0.315	3.25%
Emerging Markets Equity	MSCI Emerging Markets	10.50%	7.00%	4.75%	27.45%	0.301	2.65%
Fixed Income							
Short Duration	Barclays G/C 1-3	2.60%	2.60%	0.35%	2.10%	0.167	2.85%
Domestic Fixed	Barclays Aggregate	3.05%	3.00%	0.75%	3.75%	0.213	3.50%
Long Duration	Barclays Long G/C	3.75%	3.20%	0.95%	10.90%	0.138	4.50%
TIPS	Barclays TIPS	3.10%	3.00%	0.75%	5.25%	0.162	3.35%
High Yield	Barclays High Yield	5.20%	4.75%	2.50%	10.35%	0.285	7.75%
Non-U.S. Fixed	Barclays Global Aggregate ex US	1.80%	1.40%	-0.85%	9.20%	-0.049	2.50%
Emerging Market Debt	EMBI Global Diversified	4.85%	4.50%	2.25%	9.60%	0.271	5.75%
Other							
Real Estate	Callan Real Estate	6.90%	5.75%	3.50%	16.35%	0.284	4.75%
Private Equity	TR Post Venture Cap	12.45%	7.35%	5.10%	32.90%	0.310	0.00%
Hedge Funds	Callan Hedge FOF Database	5.35%	5.25%	2.80%	9.15%	0.339	2.25%
Commodities	Bloomberg Commodity	4.25%	2.65%	0.40%	18.30%	0.109	2.25%
Cash Equivalents	90-Day T-Bill	2.25%	2.25%	0.00%	0.90%	0.000	2.25%
Inflation	CPI-U		2.25%		1.50%		

* Geometric returns are derived from arithmetic returns and the associated risk (standard deviation).

The Sharpe Ratio is a commonly used measure of risk-adjusted return. It is calculated by subtracting the risk-free return (usually the 3 month Treasury bill) from a portfolio's return and then dividing this excess return by the portfolio's standard deviation. The ratio thus represents the return gained per unit of risk taken with a higher positive number preferred over a smaller positive number or negative value. *Source: Callan College Glossary of Terms*

Overview of Proposed Asset Allocation Changes to Fixed Income Sectors:

The following **PENSION TRUST – Fixed Income** table demonstrates how RIO's recommendation to **increase U.S. Investment Grade by 3.0% (to 16.3%) and Diversified Credit by 2.4% (to 7.0%) will improve the Projected Returns for Fixed Income from 3.0% to 3.5% while reducing Projected Risk from 6.3% to 5.7%.** The 5.4% increase will be funded by reducing International Fixed Income mandates in a prudent, reasonable and timely manner.

(1) **Projected Return is 3.0%** in the **CURRENT** framework (top table in chart).
(2) **Projected Return is 3.5%** in the **PROPOSED** recommendation (bottom table).
(3) **Projected Risk is 6.3%** in the **CURRENT** framework (top table in chart).
(4) **Projected Risk is 5.7%** in the **PROPOSED** recommendation (bottom table).

PENSION TRUST - Fixed Income Only

Fixed Income Restructuring to Improve Returns and Reduce Risk

CURRENT Pension Trust	Target Allocation		Projected Return	Projected Risk	
U.S. Investment Grade	13.3%		3.0%	3.8%	
U.S. High Yield Debt	4.6%		4.8%	10.4%	
International Debt	**5.4%**		1.4%	9.2%	
Fixed Income	23.3%	(1)	**3.0%**	**6.3%**	(3)

PROPOSED Pension Trust	Target Allocation		Projected Return	Projected Risk		$4,834 Pension $ $4.8 billion
U.S. Investment Grade	16.3%		3.0%	3.8%		$788
Diversified Credit	7.0%		4.8%	10.4%		$339
International Debt (a)	**0.0%**		1.4%	9.2%		$0
Fixed Income	23.3%	(2)	**3.5%**	**5.7%**	(4)	**$1,127**

RIO's Fixed Income Recommendation:

If International Debt (a) is eliminated while U.S. Investment Grade and Diversified Credit are increased by 3% and 2.4%, respectively, Projected Return would increase from 3.0% (1) to 3.5% (2), while Projected Risk would decline from 6.3% (3) to 5.7% (4).

Key Point: RIO's Recommendation Increases Projected Returns 0.5% and Decreases Projected Risk 0.6% of "Fixed Income" in the Pension Trust.

KEY POINT: The overall impact on the Pension Trust is a 0.1% increase in Projected Return and a 0.1% decrease in Projected Risk. The impact on the Pension Trust is less than shown above since Fixed Income only represents 23% of the Pension Trust (versus 58% Equity and 19% Real Assets).

Agenda Item IV.C.

BOARD ACTION

TO: State Investment Board

FROM: Dave Hunter, Darren Schulz and Eric Chin

DATE: January 25, 2017

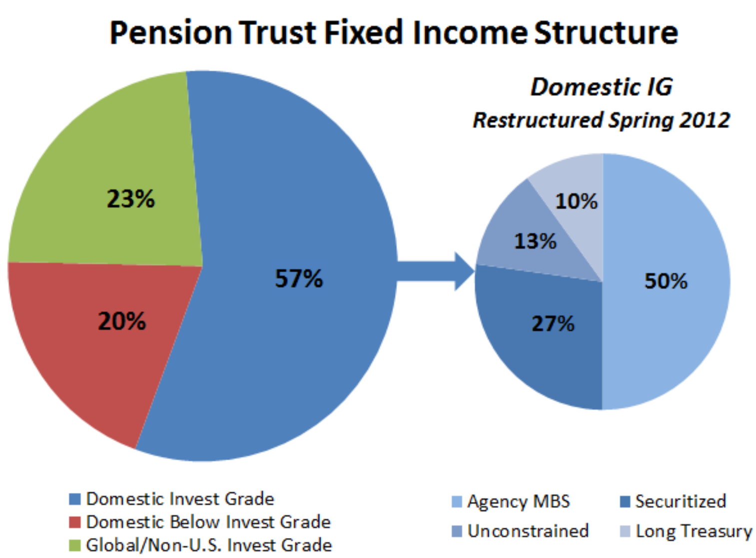
SUBJECT: Pension Trust Fixed Income Manager Restructuring

Summary:

In response to an evolving fixed income landscape, Staff is proposing a new fixed income manager framework for the Pension Trust that is designed to generate higher risk-adjusted returns and greater diversification. As explained in the body of the memo, the proposed structure explicitly segments the fixed income allocation according to the roles served within the portfolio by maintaining a principal allocation to U.S. investment grade core fixed income and expanding the non-investment grade asset class to include other high yield/loan alternatives. Additionally, given low expected returns for non-U.S. developed fixed income, Staff is recommending transitioning the international fixed income policy allocation to U.S. centric fixed income.

Background:

In the Spring of 2012, following approval by the State Investment Board, Staff implemented a restructuring of the Pension Trust investment grade fixed income asset class, the outcome of which resulted in the following policy weights within the fixed income manager structure:



The restructuring achieved the following objectives:

- The reduction of equity-sensitive credit exposure and the optimization of sector exposures across Treasuries, Securitized, and Credit;
- The upgrade of quality and liquidity and reduction of interest rate sensitivity through the addition of an anchor allocation to Agency Mortgage Backed Securities;
- Interest rate sensitivity mitigation through the addition of Securitized and unconstrained mandates; and
- Risk-off protection through the addition of an allocation to Long U.S. Treasuries.

<u>Observations and Recommendations Regarding Current Fixed Income Structure</u>

Opportunities within credit markets and across the fixed income spectrum have evolved since the Great Recession, necessitating a comprehensive review of the fixed income manager structure by Staff over the past year, particularly as it relates to the non-investment grade and non-U.S./global fixed income manager structure of the Pension Trust. In addition to the ongoing due diligence of existing fixed income manager mandates across all three investment pools, Staff has engaged numerous fixed income solutions teams among our existing roster of fixed income managers to analyze risk and return of current and prospective NDSIB fixed income structures. These discussions have yielded frameworks for budgeting liquidity and structuring fixed income with a focus on options to consider for enhancing risk-adjusted returns and diversification.

The following considerations were pertinent to Staff's consideration of changes to the fixed income structure going forward:

- **Liquidity**: How much liquidity is actually needed to fund liabilities? Is there additional potential to harvest illiquidity premiums in less liquid strategies?

- **Diversification**: Are there complementary strategies to diversify a fixed income portfolio that consists of a more traditional allocation to Barclays Aggregate sectors such as Treasuries, government-related, investment grade corporate, and securitized bonds (Agency MBS, CMBS, ABS)?

- **Interest Rate Risk**: Given that rising rates erode the purchasing power of a fixed coupon bond, what strategies can be employed through floating rate structures to deliver returns that are not highly correlated with rates?

- **Opportunity**: Can opportunistic strategies be employed to tactically capitalize upon market dislocations or regulatory-driven changes within fixed income?

As part of the review, Staff reached the following conclusions regarding the current fixed income manager structure within the pension trust:

1. A review of the liquidity requirements of the Pension Trust as measured by net cash outflows (benefit payments and outstanding unfunded commitments plus contributions as a percentage of total plan assets) suggests that the pension trust is in a position to surrender additional liquidity in compensation for return enhancement and diversification. Furthermore, as the current credit cycle advances, investors are wise to explore varying exposures beyond public debt markets.

2. Staff believes that traditional high yield in the current stage of the credit cycle does not adequately compensate for the additional credit and interest rate risk undertaken when measured against other fixed income instruments such as leveraged loans. Floating rate in nature, leveraged loans are secured, usually by a first lien on the issuing company's assets, and get repaid before unsecured creditors' claims are satisfied (or sometimes subordinated, which means even further down the queue of creditors). As a result, loans recover, on average, twice as much as high yield bondholders, who are invariably unsecured, in the event of credit impairment. A convergence of yields between high yield and leveraged loans has effectively eliminated the risk premium associated with the fewer protections inherent in investing in high yield bonds. In short, when defaults and recovery rates revert to historical averages, the greater the relative advantage of loans over high yield bonds.

   In addition to the less attractive relative value of high yield debt, an acute dearth of liquidity due to post-crisis regulation has increased trading costs, resulting in a concentration of activity in the most liquid instruments and a move away from less liquid ones. Staff does not believe that high yield bonds adequately compensate investors for the illiquidity prevalent in today's market environment when compared to other high yield/loan alternatives, such as private credit.

3. The prevalence of negative interest policies adopted by central banks in developed sovereign markets abroad suggest paltry forward returns across the yield curve for non-U.S. sovereign debt. Additionally, the currency risk associated with unhedged non-U.S. sovereign debt dominates the total risk in relation to the low or negative yields of non-U.S. government bonds.

   Evidence of a low return forward outlook for non-U.S. fixed oncome is reflected in current benchmark yields and Callan's 2017 long-term capital market projections:

Data as of 12/31/16	**Yield to Maturity**	**Modified Duration**
Bloomberg Barclays U.S. Aggregate	2.61%	5.89
U.S. Treasury	1.89%	6.08
U.S. Treasury - Long	2.98%	17.44
U.S. Agency Mortgage Backed Securities	2.85%	4.62
Investment Grade Corporates	3.38%	7.30
Bloomberg Barclays Global Aggregate	1.60%	6.90
Bloomberg Barclays Global Aggregate ex US	0.72%	7.81
U.S. High Yield (Below Investment Grade)	6.46%	4.11
S&P/LSTA Leveraged Loans	4.77%	0.25

Callan Long-Term Capital Market Projections
Fixed Income Assumptions

Fixed Income	Index	Projected Return 10-Year Geometri	Projected Risk Standard Deviation	Sharpe Ratio	Projected Yield
Short Duration	Barclays G/C 1-3	2.60%	2.10%	0.167	2.85%
Domestic Fixed	Barclays Aggregate	3.00%	3.75%	0.213	3.50%
Long Duration	Barclays Long G/C	3.20%	10.90%	0.138	4.50%
TIPS	Barclays TIPS	3.00%	5.25%	0.162	3.35%
High Yield	Barclays High Yield	4.75%	10.35%	0.285	7.75%
Non-U.S. Fixed	Barclays Global Aggregate ex US	1.40%	9.20%	-0.049	2.50%
Emerging Market Debt	EMBI Global Diversified	4.50%	9.60%	0.271	5.75%

As a result, Staff recommends transitioning the Pension Trust's allocation to non-U.S./global fixed income into U.S. oriented fixed income.

4. Investors seeking diversification at this stage of the credit cycle, in a low yield environment, are rewarded for exploring less crowded and less liquid fixed income alternatives. One identifiable investment theme revolves around the concept of financial disintermediation and the financing void created by post-crisis regulation. Since the Great Recession, regulators have attempted to address areas considered to have caused the last crisis by heavily regulating financial institutions, mortgage lending, structured products, and derivatives. A stricter regulatory environment in the U.S. (Federal Reserve, Volcker Rule, Dodd-Frank, Leveraged Lending Guidelines of OCC/Fed/FCIC) and abroad for banks (Basel III, ECB) and problematic balance sheets among European banks has created a financing void as U.K and European banks deleverage and as U.S. banks significantly curtail or eliminate lending activities in areas that require high capital charges. Non-bank investors that are positioned to accept varying degrees of illiquidity have taken note of this sea change, seeing it as a way to harvest diversifying sources of return not available across traditional credit strategies.

Alternatives to Traditional Fixed Income: Why Private Credit?

The breadth of fixed income options has expanded considerably since the Great Recession, giving investors greater flexibility to construct fixed income structures tailored to meet expected return targets and risk tolerances. Today, the menu of options has evolved beyond the traditional "plus" sectors of a "core-plus" approach, such as high yield, into a broader group called "alternative credit", which can be simply defined as all credit which is not traditional investment grade government or corporate debt.

One particularly attractive investment opportunity within fixed income for investors able and willing to surrender liquidity is private credit. The primary participants in private credit are direct lenders or private funds that offer direct loans to small and medium-sized businesses that lack access to leveraged loan and high yield markets. Direct lending is an opportunity for non-bank investors to capitalize on the financing void created by post-crisis regulation. Historically, direct lending fell under the domain of financial institutions, but with regulatory-driven disintermediation they have become increasingly mainstream, more familiar and appealing to non-bank investors, particularly institutions with long investment horizons in a funding position to be adequately compensated for judiciously surrendering liquidity.

Direct loans commonly have a weighted average life of three years and carry a yield premium of 200 to 300 basis points over broadly syndicated loans. Middle-market loans via direct financing possess features similar to tradable leveraged loans, such as seniority in the capital structure and floating rate coupons, which can adjust upward as reference rates increase. Additionally, direct loans exhibit higher recovery rates in the event of default as compared to high yield.

The following example illustrates the return profile of a hypothetical direct lending program utilizing conservative leverage of $0.50 of debt per $1 of equity comprised of 100% first lien middle market loans:

Hypothetical Direct Lending Return Example

	Unlevered Equity	Leverage Impact	Levered Equity
Weighted Average Yield	7.00%	7.00%	
Upfront Fees and Other Income	0.60%	0.60%	
Weighted Average Yield	**7.60%**	**7.60%**	
Less:			
Cost of Leverage (3 Mo LIBOR+250 bp)	N/A	3.50%	
Management Fees	0.75%	0.75%	
Direct Expenses	0.25%	0.25%	
Assumed Net Credit Losses	0.50%	0.50%	
Fees and Expenses	**1.50%**	**5.00%**	
Weighted Average Net Investment Spread	**6.10%**	**2.60%**	
Leverage	N/A	0.5x	
Projected Net Return Before Performance Fees	**6.10%**	**1.30%**	**7.40%**
Less: Performance Fees			0.74%
Projected Net Return			**6.66%**

An important point to make concerning direct lending is that it is not intended to replace but rather complement a traditional allocation to fixed income. Whereas the more liquid and efficient traditional side of fixed income provides less opportunity for alpha and is more vulnerable to rising rates and inflation, direct loans are structured based on company-specific credit events, and allow for return enhancement through both manager skill and through the intrinsic illiquidity premium these strategies command.

Poor underwriting and weak structuring are risks in private credit loans lacking appropriate due diligence. For that reason, the following due diligence criteria are critical when evaluating direct lending managers.

- Depth and differentiation in credit origination and sourcing
- Time-tested track record across multiple credit cycles
- Industry reputation with private equity General Partners, financial advisors and borrowers
- Strong credit underwriting culture across the organization with an understanding of the loans underwritten and the associated risks
- Investment process and focus on risk management
- Meaningful portfolio management experience
- Workout experience in the event of default
- Prudent use of leverage in relation to seniority in the capital structure
- Technology infrastructure to perform loan administration services

RIO Staff Fixed Income Manager Structure Proposal

Staff is proposing a fixed income manager framework that seeks to achieve improvements in risk-adjusted return potential and diversification without increasing Pension trust plan-level risk. The proposed structure is a “bar belled” approach, explicitly segmenting the fixed income manager structure based on liquidity, quality, expected return potential and risk profile:

1. An anchor of low risk, high quality, highly liquid traditional fixed income beta exposures on one end of the credit risk spectrum to fulfill the role of capital preservation and high quality income generation. This anchor allocation is labelled “Conservative Core” and will comprised of core investment grade instruments to provide diversification from riskier assets such as equities. Staff is recommending 70% of the total fixed income exposure be invested in Conservative Core.

2. Staff is recommending complementing Conservative Core with moderate risk, less liquid, higher return potential alternative credit strategies for greater diversification and differentiated sources of return enhancement. This satellite allocation, labelled “Diversified Credit”, broadens the traditional high yield designation to include high yield/loan alternatives, the first phase of which is a recommendation to establish a strategic allocation to middle market direct lending. Staff is recommending that 30% of the total pension fixed income allocation be allocated to Diversified Credit. Staff is recommending that future direct lending commitments be funded from the existing traditional high yield mandate with Loomis Sayles.

3. Given the low expected return potential of non-U.S./global developed fixed income and the disproportionate currency risk contribution, Staff is recommending the transition of the pension trust’s non-U.S./global fixed income mandates into U.S. centric fixed income.

Current Pension Trust Fixed Income Manager Structure

As of 12/31/2016						
			Allocation (% of Total Portfolio)		Allocation (% of Fixed Income Portfolio)	
Managers		Market Value	Actual	Policy	Actual	Policy
TOTAL PENSION TRUST	**$**	**4,883,525,302**	**100.0%**	**100.0%**	**N/A**	**N/A**
PIMCO (DiSCO II)	$	98,464,369	2.0%	2.0%	8.97%	8.67%
State Street Long U.S. Treasury Index NL Fund	$	62,523,069	1.3%	1.3%	5.69%	5.70%
PIMCO Unconstrained	$	64,666,853	1.3%	1.7%	5.89%	7.30%
Declaration (Total Return)	$	87,951,963	1.8%	1.6%	8.01%	6.84%
JP Morgan Mortgage Backed Securities	$	121,248,064	2.5%	2.7%	11.04%	11.41%
PIMCO Agency MBS	$	180,755,902	3.7%	4.0%	16.46%	17.11%
Total Investment Grade Fixed Income	**$**	**615,610,220**	**12.6%**	**13.3%**	**56.1%**	**57.0%**
Loomis Sayles High Yield	$	189,930,786	3.9%	3.5%	17.30%	15.13%
PIMCO (BRAVO II)	$	48,870,991	1.0%	1.0%	4.45%	4.30%
GS Mezzanine Partners 2006 Offshore, L.P.	$	288,019	0.0%	0.0%	0.03%	0.03%
GS Mezzanine Partners V Offshore, L.P.	$	2,663,755	0.1%	0.1%	0.24%	0.23%
Total Below Investment Grade Fixed Income	**$**	**241,753,551**	**5.0%**	**4.6%**	**22.0%**	**19.7%**
Total Domestic Fixed Income	***$***	***857,363,770***	***17.6%***	***17.8%***	***78.1%***	***76.7%***
UBS Global (ex-US) Bond Strategy	$	99,777,972	2.0%	2.7%	9.09%	11.63%
Brandywine Global Opportunistic Fixed Income	$	140,965,008	2.9%	2.7%	12.84%	11.63%
Total Developed Investment Grade Int'l FI	**$**	**240,742,980**	**4.9%**	**5.4%**	**21.9%**	**23.3%**
Total International Fixed Income	**$**	**240,742,980**	**4.9%**	**5.4%**	**21.9%**	**23.3%**
TOTAL GLOBAL FIXED INCOME	***$***	***1,098,106,750***	***22.5%***	***23.2%***	***100.0%***	***100.0%***

ARES

ATTENDEES & BIOGRAPHIES FOR BOARD MEETING

Mitch Goldstein
Partner, Portfolio Manager, U.S. Direct Lending
New York

Mr. Goldstein is a Partner and Co-Head of the Ares Credit Group and a member of the Management Committee of Ares Management. He additionally serves as Co-President of ARCC, Vice President of American Capital Senior Floating, Ltd. (NASDAQ:ACSF), Vice President of Ivy Hill Asset Management, L.P. ("IHAM") and Vice President of Ivy Hill Asset Management GP, LLC, IHAM's General Partner. He is a member of the Investment Committee of ARCC's investment adviser, Ares Capital Management LLC, and select Ares Credit Group U.S. Direct Lending investment committees. He additionally serves on the IHAM Investment Committee and the Ares Commercial Finance Investment Committee. Prior to joining Ares Management in May 2005, Mr. Goldstein worked at Credit Suisse First Boston, where he was a Managing Director in the Financial Sponsors Group. At CSFB, Mr. Goldstein was responsible for providing investment banking services to private equity funds and hedge funds with a focus on M&A and restructurings as well as capital raisings, including high yield, bank debt, mezzanine debt, and IPOs. Mr. Goldstein joined CSFB in 2000 at the completion of the merger with Donaldson, Lufkin & Jenrette. From 1998 to 2000, Mr. Goldstein was at Indosuez Capital, where he was a member of the Investment Committee and a Principal, responsible for originating, structuring and executing leveraged transactions across a broad range of products and asset classes. From 1993 to 1998, Mr. Goldstein worked at Bankers Trust. He also serves on the Board of Managers of Ivy Hill Asset Management GP, LLC. Mr. Goldstein graduated summa cum laude from the State University of New York at Binghamton with a B.S. in Accounting, received an M.B.A. from Columbia University's Graduate School of Business and is a Certified Public Accountant.

Jana Markowicz
Partner, Head of Product Management and Investor Relations, U.S. Direct Lending
New York

Ms. Markowicz is a Partner in the Ares Credit Group and serves as Head of Product Management and Investor Relations, U.S. Direct Lending. Prior to joining Ares in 2005, Ms. Markowicz was an Analyst in the Global Power Investment Banking Group and the Leveraged Finance Group at Citigroup, where she focused on financings for companies across a broad range of industries. Ms. Markowicz holds a B.S. from the University of Pennsylvania in Engineering, with a concentration in Economic and Financial Systems.

Victoria Aparece
Vice President, Relationship Manager, North America
Los Angeles

Ms. Aparece is a Vice President and Relationship Manager, North America, in the Ares Relationship Management Group. Prior to joining Ares in 2016, Ms. Aparece was an Executive Director at JPMorgan in the Entertainment Industries Group, where she focused on debt financing for film, television, and music companies. Previously, Ms. Aparece was a Vice President at JPMorgan in Equity Capital Markets, where she focused on the healthcare industry, and an Analyst at JPMorgan in the Syndicated and Leveraged Finance Group. Ms. Aparece holds an A.B., summa cum laude, from Princeton University in Classics and an M.B.A. from Columbia University.

Ares Direct Lending

Presentation to North Dakota Retirement and Investment Office

January 27, 2017

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During the first quarter of 2016, Ares combined its Tradable Credit and Direct Lending Groups to form the Ares Credit Group. Effective July 1, 2016, we moved our Special Situations strategy from our Credit Group into our Private Equity Group. In this presentation, Ares may present historical AUM and other related information on a combined basis to reflect the Ares Credit Group and Ares Private Equity Group.

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1

Ares Management Overview

Overview of Ares Management

Three Complementary Investment Businesses

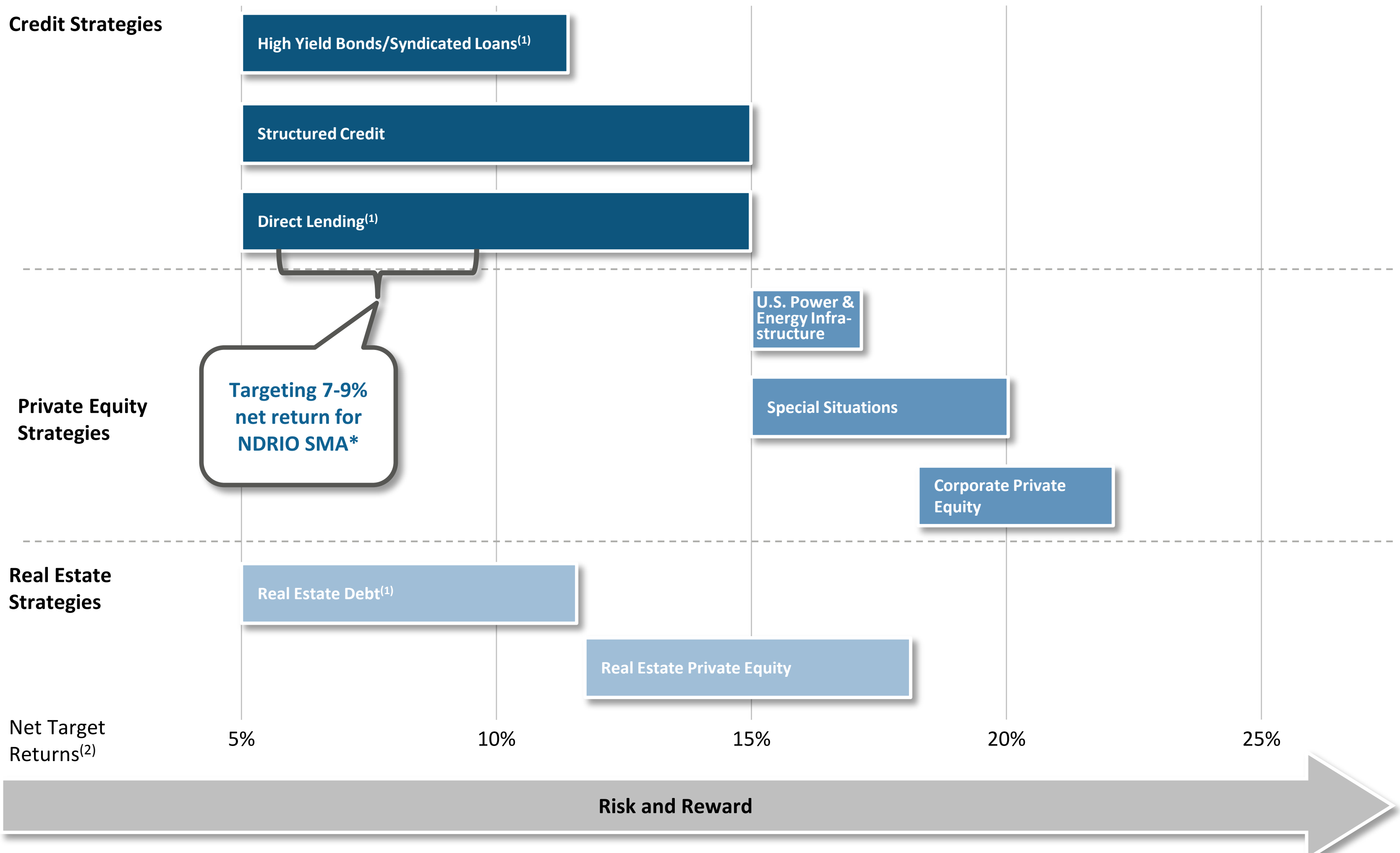
- **Ares Management, L.P. (NYSE: ARES) is a leading global alternative asset manager with approximately $97 billion of assets under management[(1)]**
  - Since our inception in 1997, we have adhered to a disciplined investment philosophy that focuses on delivering compelling risk-adjusted investment returns throughout market cycles
- **We have three distinct but complementary investment groups that have the ability to invest across the capital structure**
  - We believe each group is a market leader that has demonstrated a consistent investment track record

	CREDIT	PRIVATE EQUITY	REAL ESTATE
	A leading participant in the non-investment grade corporate credit markets	*One of the most consistent private equity managers in the U.S. with a growing international presence*	*A leading participant in the real estate private equity markets and a growing direct lender*
Assets Under Management	$62.0 billion	$24.9 billion	$10.4 billion
Key Strategies	High Yield Bonds/Syndicated Loans Structured Credit Direct Lending	Corporate Private Equity U.S. Power & Energy Infrastructure Special Situations	Real Estate Debt Real Estate Private Equity

1. As of September 30, 2016, AUM amounts include funds managed by Ivy Hill Asset Management, L.P., a wholly owned portfolio company of Ares Capital Corporation and a registered investment adviser.

What We Do…*the Strategies We Manage*

Wide range of alternatives strategies across the risk-reward spectrum



*There can be no guarantee that target returns will be achieved and actual returns may differ materially.

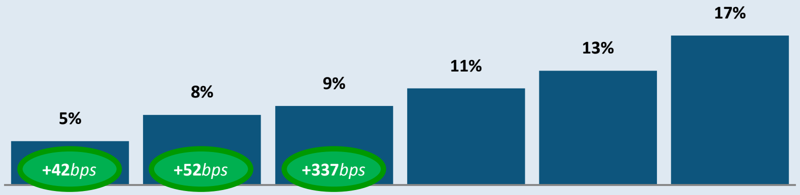
1. Comprised of investment vehicles with and without leverage.
2. Target returns are shown for illustrative purposes after the deduction of management fees, performance fees and carried interest, as applicable, and other expenses. No assurance can be made that targeted returns will be achieved and actual returns may differ materially. An investment in any of the mandates is subject to the execution of definitive subscription and investment documentation for the applicable funds.

Track Record of Performance

The power of our platform has led to attractive risk-adjusted returns across asset classes

Credit

Gross Annualized Returns Since Inception and Outperformance Versus Indices | Gross Asset Level Realized IRRs Since Inception | Gross Annualized Return Since Inception



Syndicated Loans | High Yield | Credit Opportunities | Europe Direct Lending (ACE I & II) | U.S. Direct Lending (ARCC) | Structured Credit

Investment experience of 15+ years in ***both*** *syndicated loans and high yield bonds*

Lender of the Year North America 2014 and 2015

Top Quartile Rankings for Several Funds

2013, 2014 and 2015 Mid-Market Lender of the Year North America

ARCC: BDC of the Year

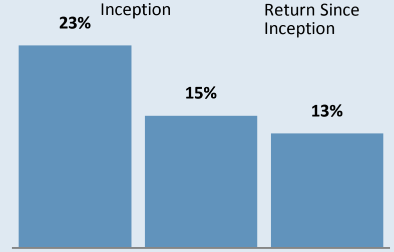
Largest BDC by market capitalization & total assets

Generated a 12% annualized total shareholder return since its 2004 IPO – outperforming S&P 500, syndicated loans and high yield by 430–740bps

EMEA Unitranche Lender of the Year, Co-Winner

Private Equity

Gross Asset Level IRRs Since Inception | Gross Annualized Return Since Inception



Corporate Private Equity (ACOF I-IV Aggregate) | U.S. Power and Energy Infrastructure (EIF Aggregate) | Special Situations (SSF I-IV Aggregate)

Most Consistent Performing U.S. Unlisted Infrastructure Fund Manager (2016 Global Infrastructure Report)

One of Most Consistent Performing Buyout Fund Managers (2013 Performance Monitor)

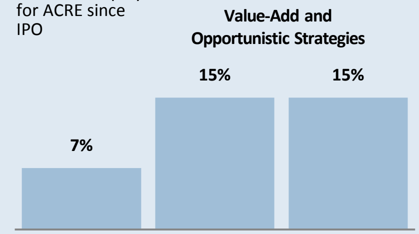
Manager of a Top 10 Buyout Fund for Vintages 2006 through 2010 (2013 Performance Monitor)

2012 North American Special Situations / Turnaround Firm of the Year

2013 Best Acquirer of Power Assets

Real Estate

Net Annual Return on Equity for ACRE since IPO | Gross IRRs Since Inception



Debt | U.S. Equity | Europe Equity

Investment track records of 15+ years in ***both*** *U.S. and European real estate private equity*

Top 15 Real Estate Manager Based on 2010-15 Equity Raised

Rated Servicing Platform 2015

NET PERFORMANCE RETURNS. Credit: 5% for U.S. Syndicated Loan funds, **7%** for U.S. High Yield funds, **7%** for Credit Opportunities funds and **12%** for Structured Credit funds. **Private Equity: 16%** for ACOF I-IV Aggregate, **11%** for EIF Aggregate and **8%** for SSF I-IV Aggregate. **Real Estate: 10%** for U.S. Equity and **8%** for Europe Equity.

Credit: Performance for Syndicated Loans is represented by the U.S. Bank Loan Aggregate Composite. Performance for High Yield is represented by the U.S. High Yield Composite. Performance for Credit Opportunities is represented by the Credit Opportunities Aggregate Composite. Performance for Europe Direct Lending is represented by all realized investments made by the Ares European direct lending team in its commingled middle market direct lending funds (ACE I and II), including investments in the ESSLP, a joint venture to which Ares and GE Commercial Bank SAS are parties. Performance for U.S. Direct Lending is represented by Ares Capital Corporation ("ARCC") performance statistics. Performance for Structured Credit is represented by the Structured Product Core Composite. **Private Equity:** Performance for Corporate Private Equity is represented by the ACOF I-IV Aggregate, comprised of ACOF I, ACOF II, ACOF III and ACOF IV. Performance for U.S. Power and Energy Infrastructure is represented by the EIF Aggregate, comprised of the Early Funds and the USPF Funds (USPF, USPF II Funds, USPF III and USPF IV). Performance for Special Situations is represented by the SSF I-IV Aggregate, comprised of SSF I, SSF II, SSF III and SSF IV. **Real Estate:** Performance for Debt is represented by Ares Commercial Real Estate Corporation ("ACRE") performance statistics. Performance for U.S. Equity is represented by an aggregate of our U.S. Equity Value-Add and U.S. Equity Opportunistic real estate strategies, comprised of VEF I, VEF II, VEF III, VEF IV, VEF V, VEF VI, US Fund VII, US Fund VIII, AREIF I, AREIF II, AREIF III, AREIF IV, AREIF V and AREOF. Performance for Europe Equity is represented by an aggregate of our European Equity Value-Add and European Equity Opportunistic real estate strategies, comprised of IF, EF II, EF III, EF IV, EPEP I and co-investments by third party investors alongside investments made by these funds.

Performance returns are as of September 30, 2016. Gross and net returns are rounded to the nearest whole number. Returns include the reinvestment of income and other earnings. Gross returns do not reflect the deduction of management fees, performance fees and carried interest, as applicable, or any other expenses that may be incurred in the management of the account. Net returns for the U.S. Bank Loan Aggregate and U.S. High Yield Composites are reduced by management fees; all other net returns are after giving effect to management fees, performance fees and carried interest, as applicable, and other expenses. The performance represented on this slide is considered representative of strategies currently available for investment. We believe aggregated performance returns reflect our overall performance returns in a strategy, but are not necessarily investable funds or products themselves. The performance does not represent all assets managed by Ares. The return earned by investors may vary materially from those presented. There can be no assurance that unrealized values or projected returns will be achieved. The performance, awards/ratings noted herein relate only to selected funds/strategies and may not be representative of any given client's experience and should not be viewed as indicative of Ares' past performance or its funds' future performance. All investments involve risk, including possible loss of principal.

Please refer to the Performance Notes on pages 39-43 for additional definitions, information and performance notes.

Power of the Ares Platform

Distinguishing features that together propel our investment performance

Significant Market Presence

- **Global Operations:** we have approximately 915 employees in 15+ offices across the U.S., Europe, Asia and Australia
- **Large and Diversified Portfolio:** our ~200 funds are invested in over 1,000 companies, ~500 structured assets and ~170 properties
- **High Quality Investor Base:** we have ~695 direct institutional relationships and a significant retail investor base
- **In-Depth Research:** we believe we have one of the largest in-house research teams, which produces proprietary research in over 50 industries

Highly Functional Organization

- **Collaborative Culture:** we effectively leverage ideas, relationships and experience across investment groups
- **Breadth, Depth and Tenure of Leadership:** each investment group has a senior team that averages ~24 years of experience
- **Talented and Committed Professionals:** we attract, develop and retain highly accomplished investment talent
- **Stakeholder Alignment**: our professionals have significant fund commitments, promote participation and ownership interests
- **ESG Considerations:** we have adopted a firm-wide ESG policy given the importance of ESG factors in our investment processes

Key Platform Advantages

Robust Sourcing Model	Differentiated Market Intelligence	Consistent Investment Approach	Comprehensive Multi-Asset Experience	Flexible Capital Mandates
✓ Local direct origination capacity ✓ Cross-sourcing among investment groups	✓ Proprietary research ✓ Insights exchanged across our platform	✓ Rigorous due diligence ✓ Maintain a disciplined, credit-oriented focus	✓ Relative value analysis ✓ Ability to evaluate the entire capital structure	✓ Creative solutions ✓ Active throughout market environments

Note: As of September 30, 2016. Fund count includes funds managed or co-managed by Ares. Also includes funds managed by Ivy Hill Asset Management, L.P., a wholly owned portfolio company of Ares Capital Corporation and a registered investment adviser.

2 Ares Credit Group Overview

ARES

Overview of Ares Credit Group

Scaled global platform is a key differentiator in the market

$62 billion AUM[1]

~30 Partners averaging 22 years of experience[2]

~215 dedicated investment professionals

Origination, Research & Investments[2]

10 portfolio managers
~55 research professionals
~110 direct origination professionals
6 distressed and restructuring specialists

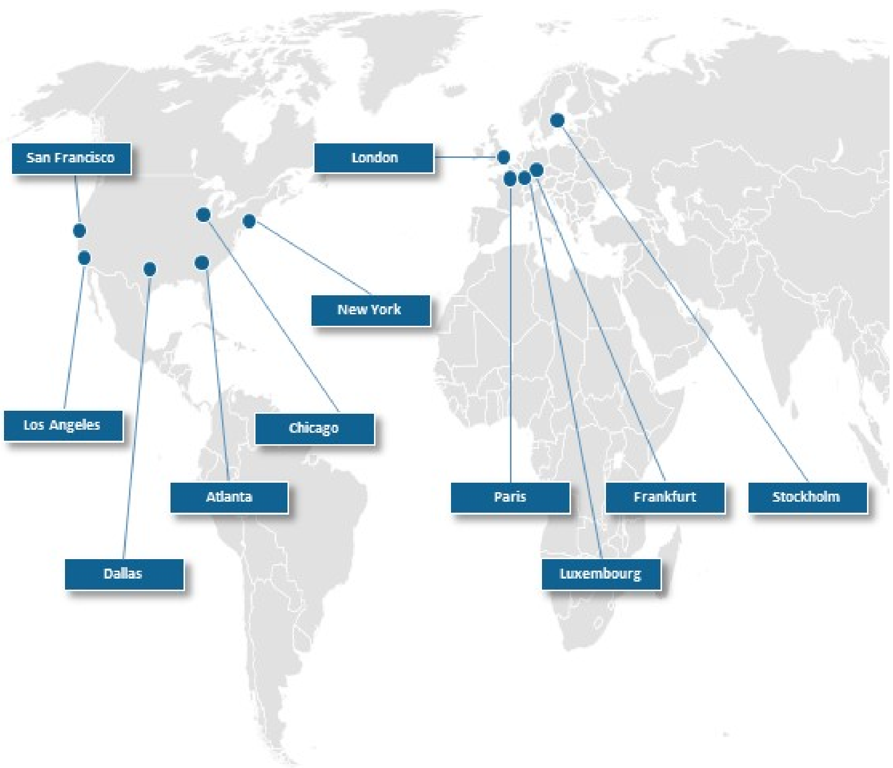
Syndication, Trading & Servicing

6 traders in the U.S. and Europe
5 dedicated loan syndications professionals
22 direct lending professionals focused on portfolio asset management

Investor Relations & Business Operations

Well-established investor service and business operations across the Americas, Europe, Asia, Australia and the Middle East

Local Market Presence Across 11 Offices



We have experienced teams across the platform that provide for excellence in investing and client service

Note: As of September 30, 2016, unless otherwise noted.

1. As of September 30, 2016, AUM amounts include funds managed by Ivy Hill Asset Management, L.P., a wholly owned portfolio company of Ares Capital Corporation and a registered investment adviser.
2. Effective July 1, 2016, we moved our Special Situations strategy from our Credit Group into our Private Equity Group. However, the Credit Group leverages the resources of the Special Situations team regularly and therefore they are reflected in the personnel figures stated herein.

ARES

Ares Credit Leadership Team

Long-tenured team with breadth of experience investing across the liquidity spectrum

Kipp deVeer
Global Head of Credit
21 years of experience

Mitch Goldstein
Co-Head of Credit
22 years of experience

Michael Smith
Co-Head of Credit
21 years of experience

HY Bonds / Syndicated Loans

U.S.

Seth Brufsky
26 years of experience

Americo Cascella
22 years of experience

Jennifer Kozicki
19 years of experience

John Leupp
27 years of experience

Laura Rogers
22 years of experience

Europe

Francois Gauvin
25 years of experience

Boris Okuliar
19 years of experience

Structured Credit

Keith Ashton
17 years of experience

Ujjaval Desai
20 years of experience

Jeffrey Kramer
29 years of experience

Direct Lending

U.S.

Mark Affolter
27 years of experience

Kevin Braddish
32 years of experience

Ryan Cascade
20 years of experience

Michael Dieber
29 years of experience

Daniel Katz
21 years of experience

Jana Markowicz
14 years of experience

Jim Miller
17 years of experience

Kort Schnabel
18 years of experience

Dave Schwartz
16 years of experience

Europe

Michael Dennis
18 years of experience

Blair Jacobson
21 years of experience

Eric Vimont
17 years of experience

Note: Represents Ares Credit Partners as of January 1, 2017. Includes employees of Ivy Hill Asset Management, L.P., a wholly owned portfolio company of ARCC.

Summary of Market Themes

Low Yield Environment Drives Demand	• The technical backdrop has been favorable for leveraged finance assets due to compressing yields for credit products globally; as a result, alternative credit experienced a meaningful rally beginning in mid-February • Demand for leveraged finance assets is robust and performance in 2016 was led by the CCC segment of the market
Muted Global & Earnings Growth	• In October, the International Monetary Fund reported that global growth is projected to slow to 3.1% in 2016 largely due to the British referendum and weaker-than-expected growth in the U.S.[1] • However, the U.S. remains a bright spot in the context of a weak global backdrop as 3rd quarter U.S. GDP growth jumped to 3.2%, the highest quarterly growth figure in two years[2] • Earnings from firms in the S&P 500 reported their seventh straight decline (year-over-year) - 3Q16 -1.5% / 2Q16 -8.4% / 1Q16 -12.9% / 4Q15 -15.4% / 3Q15 -14.4% / 2Q15 -8.0% / 1Q15 -1.6%
Central Banks Committed to Reflationary Monetary Policy	• In early March, the European Central Bank announced additional stimulative measures to further expand their QE programs and pursue negative interest rate policies • The Bank of England extended its QE program by £60 billion in August of 2016 • The U.S. is currently the only developed nation seeking to raise interest rates; on December 14 the Fed approved its 2nd rate increase in a decade and signaled interest rates would rise at a faster pace than previously projected
Commodities Show Signs of Stability	• Price per barrel of WTI increased ~107% as of December 31, 2016 after touching a low of $26 in mid-February[3] • Investors showing increased appetite for energy and energy related investments, reflecting stronger technicals in the market and a more balanced supply/demand picture • OPEC reached an agreement to cut production by 1.2 million barrels a day from the current 33.6 million barrels, an approximate 1% reduction in global production[4]
Regulatory Change	• Non-investment grade credit increasingly costly and less strategic for banks to hold • Capital markets activities are limited by new bank regulations and banks face burdensome operational and risk standards • The number of banks across the globe has declined due to consolidation

Note: Past performance is not indicative of future results.

Sources: 1) Source: IMF World Economic Outlook, October 2016; 2) The Wall Street Journal, "Corporate Earnings, U.S. GDP Experience Stout Expansions" November 29, 2016. 3) Source: Bloomberg 4) The Wall Street Journal "OPEC Reaches Deal to Cut Oil Production" November 30, 2016

3 Direct Lending Strategy Overview

Ares Credit – Direct Lending Platform

History of delivering strong risk-adjusted returns and operating with transparency

GLOBAL PLATFORM	• Ares Credit Group ("Ares Credit") manages $62 billion of assets under management as of September 30, 2016*[1] ◦ Includes direct lending strategies with $32 billion of assets under management[2], focused on directly originated loans to middle market companies in the U.S. and Europe
EXPERIENCED DIRECT LENDING FOCUSED TEAM	• 148 experienced investment professionals across seven U.S. and four European offices • Over 86% of senior investment professionals have been with Ares for at least five years • Platform supported by ~450 dedicated professionals across accounting, operations, legal, compliance and business development
DIFFERENTIATED STRATEGY	• Direct origination • Flexible capital with multi-asset class experience • Significant capital and scale advantages • Lead and active investor • Well positioned to take advantage of volatility in the market
STRONG HISTORICAL TRACK RECORD	• Demonstrated ability to deploy capital with attractive risk adjusted returns ◦ The group's inaugural vehicle in the U.S., Ares Capital Corporation ("ARCC"), has generated a 12% annualized total shareholder return since its 2004 IPO[3] ◦ ARCC generated a cumulative gross realized IRR to the fund of 13% on $14.0 billion of investments since inception investing across the capital structure in senior secured and junior assets[4] • Ares Direct Lending strategy in Europe has generated 11% gross asset-level returns since inception[5]

* As of September 30, 2016, AUM amounts include capital available to vehicles managed or co-managed by Ares, including funds managed by Ivy Hill Asset Management, L.P., a wholly owned portfolio company of Ares Capital Corporation and a registered investment adviser.
Note: All data as of September 30, 2016 unless otherwise noted. Please refer to Endnotes on page 37 for additional important information.

Large and Experienced Direct Lending Focused Team in the U.S.

Long tenured team with substantial investment experience and access to best-in-class deal flow

Investment Committee

Mark Affolter Partner 27 Years	Michael Arougheti Partner 23 Years	Kipp deVeer Partner 21 Years	Mitch Goldstein Partner 22 Years	Jim Miller Partner 17 Years	Kort Schnabel Partner 18 Years	Dave Schwartz Partner 16 Years	Michael Smith Partner 21 Years

New York

Jana Markowicz Partner	Paul Colatrella Managing Director	Alex Dashiell Managing Director	Karen De Castro Managing Director
Greg Galligan Managing Director	Brian Goldman Managing Director	Mark Liggitt Managing Director	Brian O'Connor Managing Director
Craig Shirey Managing Director	Chrissy Svejnar Managing Director	Chris York Managing Director	Damayra Cacho Principal
Alex Foreman Principal	Peter Ogilvie Principal	Mike Roth Principal	Damian Sclafani Principal
Andrew Stewart Principal	Nick Walters Principal	Dan DiBona Vice President	Dan Dirscherl Vice President
Andrea Kim Vice President	Justin Lawrence Vice President	Matthew Tworecke Vice President	Jonathan Barokas Senior Associate
Josh Bellet Senior Associate	Brooke Epstein Senior Associate	Joan Fang Senior Associate	Alexander Hughes Senior Associate
Joseph Koerwer Senior Associate	Hal MacKenzie Senior Associate	Arjun Misra Senior Associate	Brendan Renehan Senior Associate
Molly Shulman Senior Associate	Bojan Bajic Associate	Brendan Fox Associate	Jordan Graumann Associate
Ryan Helfrich Associate	Alexander Park Associate	David Ruffolo Associate	Zachary Schwartz Associate
Matt Welch Associate			

Chicago

Rajiv Chudgar Managing Director	Mark King Managing Director
Michael Marziani Managing Director	Steven Michau Managing Director
Brian Moncrief Managing Director	Doug Bolton Principal
Christine Campanelli Principal	Jeff Hasselman Principal
Andrew Kenzie Vice President	Amy Klemme Senior Associate
Ankur Patel Senior Associate	Robert Brown Associate
Eric Gomach Associate	Vida Miezlaiskiene Associate

Los Angeles

Jason Park Managing Director	Brian Kim Principal
Neil Laws Principal	James Granello Vice President
Matt Stoner Vice President	Tara Arens Senior Associate
Vishal Gandhi Senior Associate	Mason Turville Senior Associate
John Clark Associate	Edward Fisher Associate
Teddy Overton Associate	

Atlanta / Dallas / Menlo Park

Carl Drake Partner	Owen Hill Managing Director	Cindy Young Managing Director	Joseph Allio Vice President	Will Baker Associate

Ivy Hill Asset Management – New York*

Kevin Braddish Partner	Steven Alexander Managing Director	Shelly Cleary Managing Director	Stephanie Setyadi Managing Director
Michael Bedore Principal	Adam James Principal	Catherine Scaillier Principal	Jon Blum Vice President
Joseph Ehardt Senior Associate	Mary Jurgensen Senior Associate	Avi Ahuja Associate	Chris LaCosta Associate
Henry Luessen Associate	Brittany Kraff Analyst		

Portfolio Management – New York

Michael Dieber Partner & Co-Head	Daniel Katz Partner & Co-Head	Philip LeRoy Managing Director	Adam Ferrarini Principal
Stephen Chehi Senior Associate	Jordan McGroarty Senior Associate	Vily Sarbinska Senior Associate	Anthony Walters Senior Associate
Bevery Wong Senior Associate	Lauren DeMarzo Associate	Anton Ermolov Associate	Anthony Galli Associate
Amanda Harris Associate	Kathleen Holland Associate	Sean Joy Associate	Gina Luongo Associate
Joseph Mignoli Associate	Ryan Rattay Associate	Eric Tang Associate	

Key: Indicates 5+ years with the firm

As of January 2017. *Ivy Hill Asset Management is a wholly owned portfolio company of ARCC.

The European Direct Lending Group Investment Team

Investment Committee

Michael Arougheti **President, Co-Founder** 23 Years	**Michael Dennis** **Partner** 19 Years	**Ujjaval Desai** **Partner** 21 Years	**Kipp deVeer** **Partner and Head of Credit Group** 21 Years	**Blair Jacobson** **Partner** 20 Years	**John Kissick** **Partner** 40 Years	**David Sachs** **Partner** 35 Years	**Eric Vimont** **Partner** 18 Years

European Direct Lending Investment Team

Frankfurt	London			Paris	Stockholm
Kai Gebauer Managing Director 29 Years	**Michael Dennis** Partner 19 Years	**Blair Jacobson** Partner 20 Years	**Eric Vimont** Partner 18 Years	**Tyrone Cooney** Managing Director 25 Years	**Carl Helander** Managing Director 20 Years
Aileen Haller Principal 12 Years	**Daniel Sinclair** Managing Director 13 Years	**Allan Nielsen** Managing Director 15 Years	**Richard Oliver** Principal 11 Years	**Aurelien Loszycer** Managing Director 18 Years	**Carl Gustaf Ihre** Principal 14 Years
Jennifer Kröhl Principal 14 Years	**Graham Smith** Principal 11 Years	**James Cumming** Principal 11 Years	**William Grout** Vice President 10 Years	**Axel Cordonnier** Vice President 9 Years	**Anders Nordström** Associate 5 Years
Sebastian Lorenz Senior Associate 6 Years	**Alex Jones** Vice President 10 Years	**Anish Satija** Vice President 8 Years	**Gabriel Adebiyi** Associate 4 Years	**Arnaud Gayet** Vice President 10 Years	**Morten Tullin** Associate 3 Years
Dietrich von Stockum Senior Associate 5 Years	**Iryna Chakanava** Associate 5 Years	**David Michaelis** Associate 7 Years	**Associate** TBD	**Zineb Benkiran** Senior Associate 5 Years	
	Associate TBD			**Romain Goulet** Associate 5 Years	

PM*

Matt Theodorakis Managing Director 17 Years	**Marc-Olivier Lovis** Principal 16 Years	**Tom Weaver** Senior Associate 4 years	**Mani Nabi** Associate 4 years	**Emma Blakey** Associate 3 years

Key: **New in the LTM** **Near term hires**

- **34 dedicated** investment professionals
- We believe this is **the largest dedicated direct lending team** across the European market
- Responsible for **sourcing, performing due diligence, executing and monitoring**
- **Deep middle-market relationships** with companies, their stakeholders and advisors
- **Low historic turnover**
- Building out our dedicated **portfolio monitoring / restructuring resource**
- Average number of years experience at Principal level and above: **16**
- % of team with more than 10 years experience: **~60%**

Note: As of January 2017. Years referenced represents number of years of relevant experience.
* Portfolio Management team.

U.S. Direct Lending Team - Commercial Finance

Investment Committee

Michael Arougheti Partner 23 Years	Ryan Cascade Partner 20 Years	Mitch Goldstein Partner 22 Years	Jim Miller Partner 17 Years	Jeff Kramer Partner 30 Years	Michael Smith Partner 21 Years	James Franz Managing Director 30 Years	Matt Grimes Managing Director 25 Years	Gerard Hanabergh Managing Director 38 Years	John Nooney Managing Director 30 Years	Oleh Szczupak Managing Director 36 Years

Executive Team

Ryan Cascade Partner & President	Oleh Szczupak Managing Director	Gerard Hanabergh Managing Director
James Franz Managing Director	Matt Grimes Managing Director	John Nooney Managing Director
Fred Bubeck Principal		

Origination

David Braff Principal Western Region	William Drmacich Principal Southeast Region	Jerry Jansen Principal Southeast Region
Srid Kannan Principal Mid-Atlantic Region	Michael Keenan Principal Central Region	Mark Orlando Principal Western Region
Mark Pickering Principal Southeast Region	George Psomas Principal Northeast Region	Kelly Schuler Senior Associate Mid-Atlantic Region

Underwriting / Credit

Lawrence Chua Principal	Joseph Ciciola Principal
Fred Ernst Principal	Sean Spring Principal
Victor Verazain Principal	David Weinstein Principal
Sudhir Chaudry Vice President	Nigel Fabien Vice President
Brock Johnson Vice President	Gina Ogburn Vice President
Daniel Reilly Vice President	Jason Schumacher Vice President
Aaron Singh Vice President	Richard Lee Associate Vice President
Tim Sardinia Associate	

Operations

Ron Warnock Principal	Traci Brannon Vice President
Monica Schimoler Vice President	Marc Whelan Vice President
Roberto Noguera Associate Vice President	Christina Santullo Associate Vice President
Annette Glover Senior Associate	Victoria Gross Senior Associate
Patricia Hill Senior Associate	Nelum Lal Senior Associate
Howard McIntosh Senior Associate	Roxanne McNeiley Senior Associate
Shemeka Phillipson Senior Associate	Jancy Rahul Senior Associate
Ramon Reyes Senior Associate	Kelly Schuler Senior Associate
Clayton Tamura Senior Associate	Cindy Tartarian Senior Associate
Rick Ramlowtan Associate	Derek Fields Analyst
Daniel Tracy Analyst	

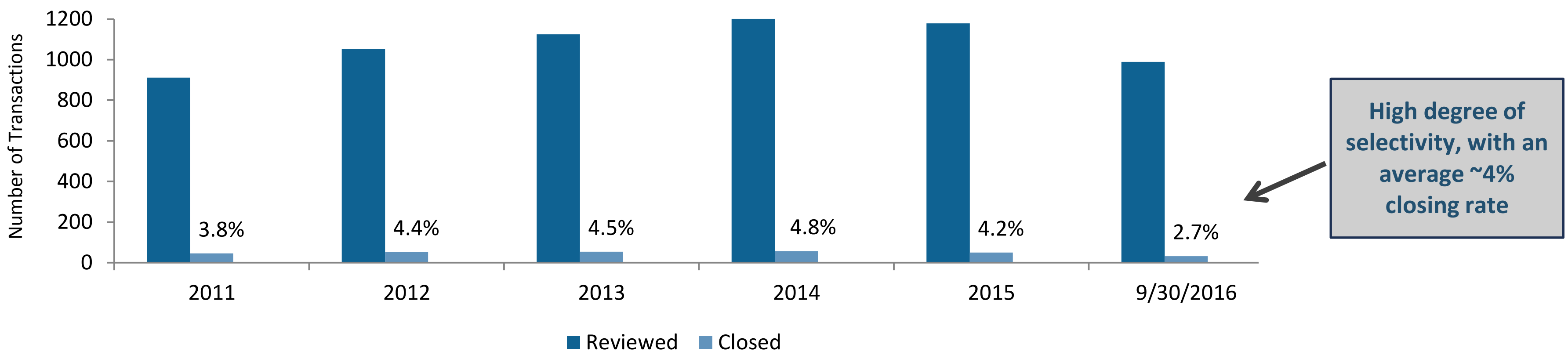
Key: Indicates 5+ years with the firm/predecessor. As of January 2017.

ARES

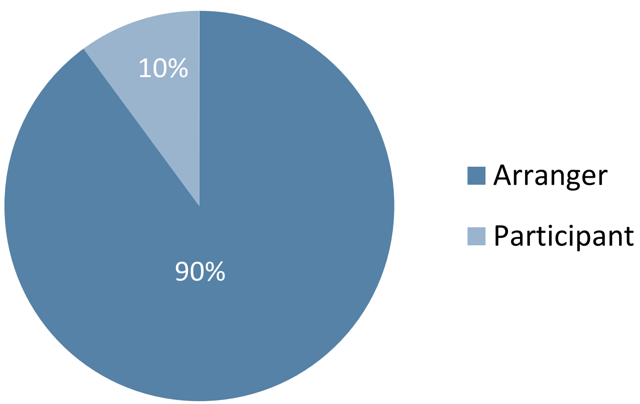
Direct Origination Focus

We believe that our scale, seasoned investment team and direct origination capabilities represent significant competitive advantages and allow for strong asset selectivity

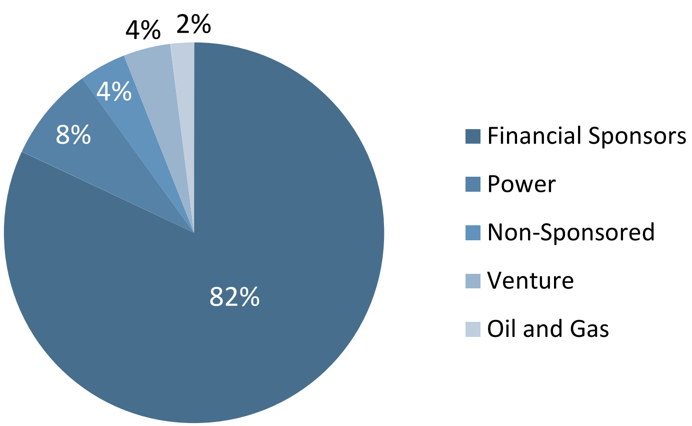
ARCC - Closing Conversion Rates*



ARCC's Underwriting Role**



Sourcing: Portfolio Composition**



*Calculation based on ARCC's reviewed and closed transactions with new portfolio companies (excludes any additional investments in existing portfolio companies) in each calendar year excluding equity-only investments and legacy investments from portfolio acquisitions.

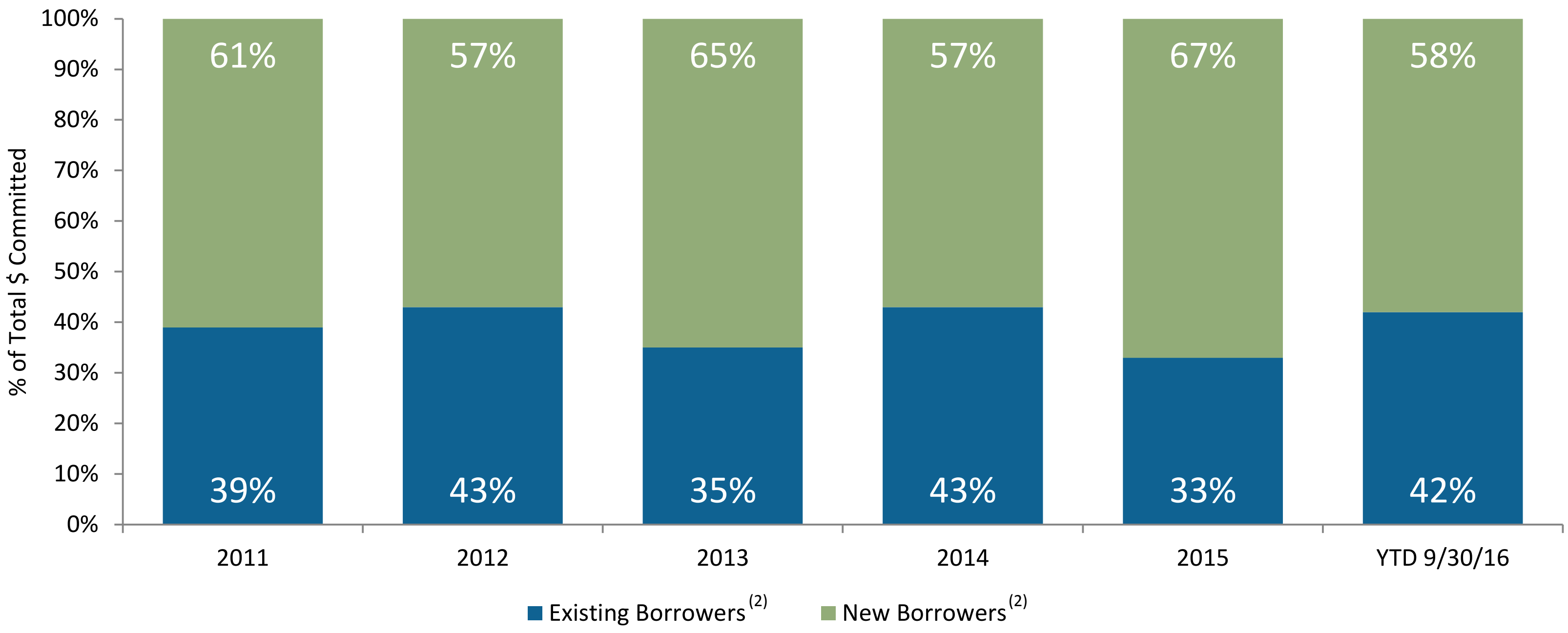
**Calculated based on the cost basis of ARCC's portfolio as of September 30, 2016, excluding equity-only investments and legacy investments from portfolio acquisitions.

Scale: The Benefits of Incumbency

Ares scale and growing portfolio has led to an increasing percentage of originations from existing borrowers

- Part of our strategy is to fund the growth of our best portfolio companies
- We believe incumbent relationships result in better knowledge of borrowers and better credit performance
- Over the last 5 years, approximately 40% of our yearly commitments have been to existing borrowers

Commitments to Existing Borrowers vs. New Borrowers [1]



1. Excludes investments acquired in the Allied acquisition.
2. Includes ARCC's investments in the SSLP subordinated certificates, of which the SSLP then made an investment in a new or existing borrower of the SSLP, respectively.

4 Investment Process

ARES

Investment Philosophy and Process

Key issuer characteristics*:

- EBITDA of $10 – $250 million for middle market cash flow deals
- Market-leading business
- Experienced management team
- Consistent performance
- Entrenched positions with customers
- Demonstrated competitive advantages
- Strong free cash flow generation and growth/significant collateral monitoring
- Alignment with management and equity sponsors
- High return on invested capital

Strategic considerations:

- Credit intensive analysis
- Protection of principal
- Long-term value creation
- Relative value analysis
- Risk-adjusted returns
- Flexibility in investment; multiple exits
- Lead agent or control in tranche

Process

- Opportunities progress from "Initial Review" to "In Diligence" to "Investment Committee"
- Process typically takes 3 - 6 months

Investment Universe*

Defensive Industry Orientation

—

Strong, Enduring Franchise with Barriers to Entry

—

Solid Credit Fundamentals with Nominal Risk of Valuation/Credit Deterioration

—

Appropriately Structured Security

—

Experienced, Properly Incentivized Management Team with Demonstrated Track Record

—

Return Opportunity that Compensates for Perceived Risk

—

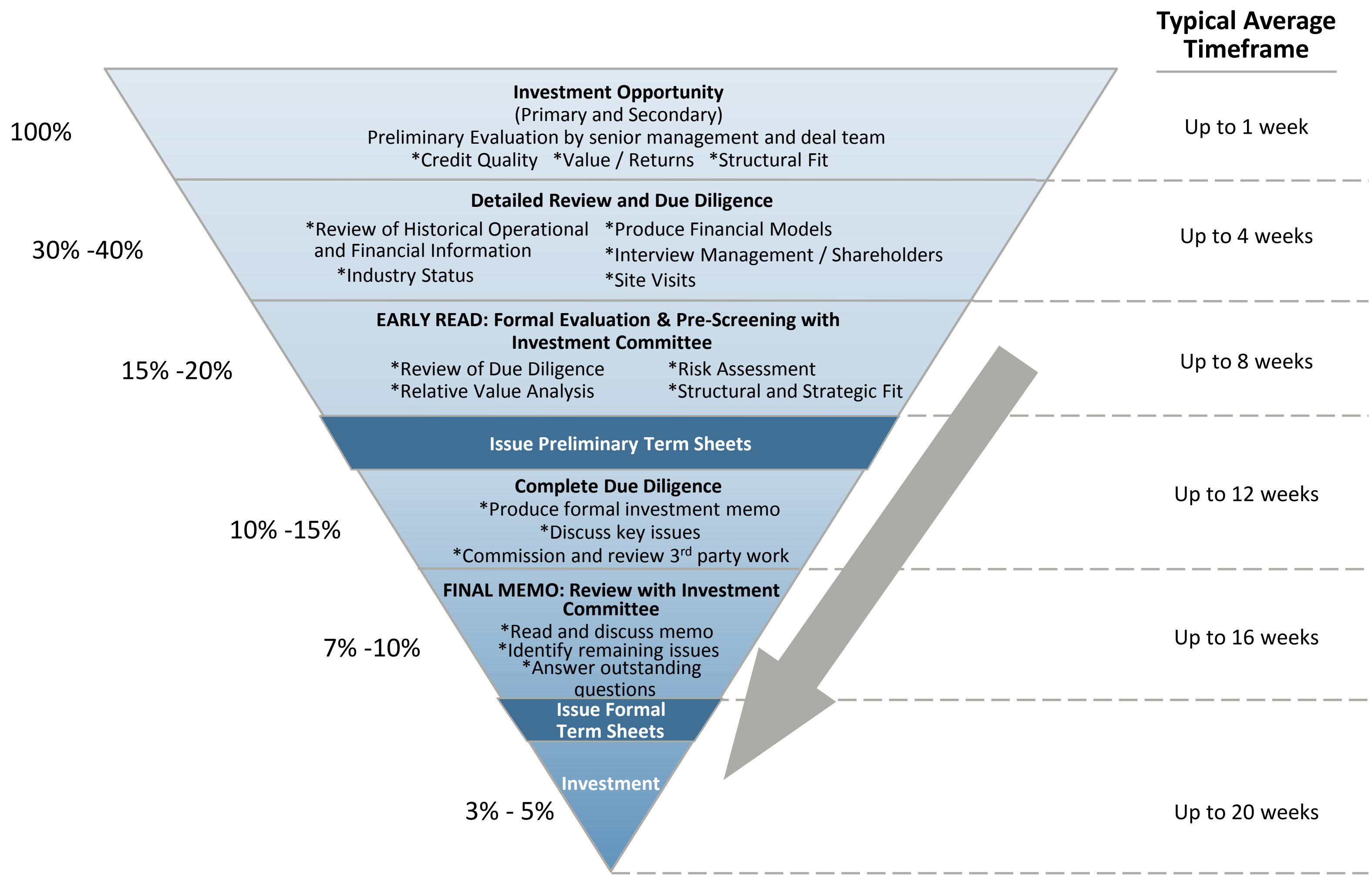
Strong Indenture/Credit Agreement and Covenant Package

Investments
~3-5% Closing Rate

*Ares Direct Lending Strategy typically reviews all of these investment criteria in evaluating potential investments; however, not every investment meets each criterion.

Indicative Investment Process / Pipeline Management

Our process is robust and often spans several months, allowing for thoughtful decision making



Direct Lending Strategy Track Record

Distinguished performance across Ares U.S. and European Direct Lending platforms

Ares Direct Lending Strategy / Assets Under Management as of 9/30/16

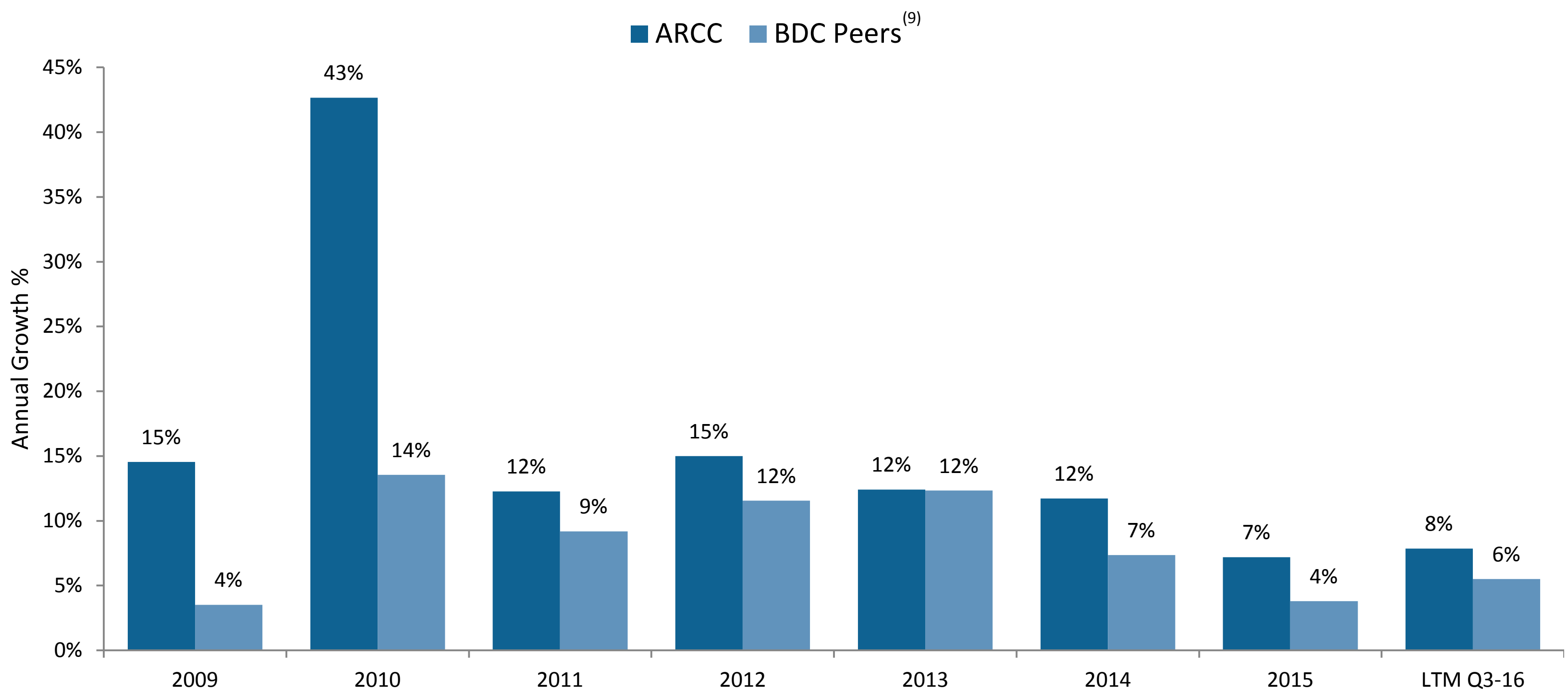
	U.S. Direct Lending- *$22.6 billion* [(1)]	**Europe Direct Lending -** *$9.9 billion* [(2)]
Performance Track Record	• **ARCC**: Our flagship fund, a publicly traded business development company called Ares Capital Corporation ("ARCC"), has generated a cumulative gross IRR to the fund on realized investments of **13%** since inception[(4)] **on $14.0 billion invested** ◦ ARCC's **cumulative realized investment gains have exceeded cumulative realized investment losses** by approximately $558 million since inception – As of 9/30/16, ARCC's investments on non-accrual status represented 2.3% and 1.2% of the portfolio based on amortized cost and fair value, respectively ◦ Since its IPO in 2004, **ARCC has achieved a 289% total shareholder return** versus the S&P 500 at 144% and Russell 1000 at 151% through Q3-16[(3)]	• Invested **€8.1 billion**[(6)] into **120 investments** since its inception through September 30, 2016[(7)] • **11%** European Direct Lending gross asset level returns, September 30, 2016[(5)] • ACE II and ACE III portfolio companies: total closing net leverage is **4.5x** with a **52%** equity cushion[(8)] • Relatively **low historic credit losses** • Developed **diversified portfolios** with strong **alignment of interest with LPs**

Note: ARCC data is shown as representative of the U.S. Direct Lending Strategy. Past performance is not indicative of future results.
Please refer to Endnotes on page 37 for additional important information.

ARCC Has Delivered NAV Growth and Dividend Performance

We believe this is one of the most meaningful metrics to evaluate ARCC’s performance

Annual NAV + Dividend Performance



BDC's Included	11	11	14	18	19	21	23	24

Note: Includes regular and special dividends. Dividends based on ex-dividend date. Please refer to Endnotes on page 37 for additional important information.

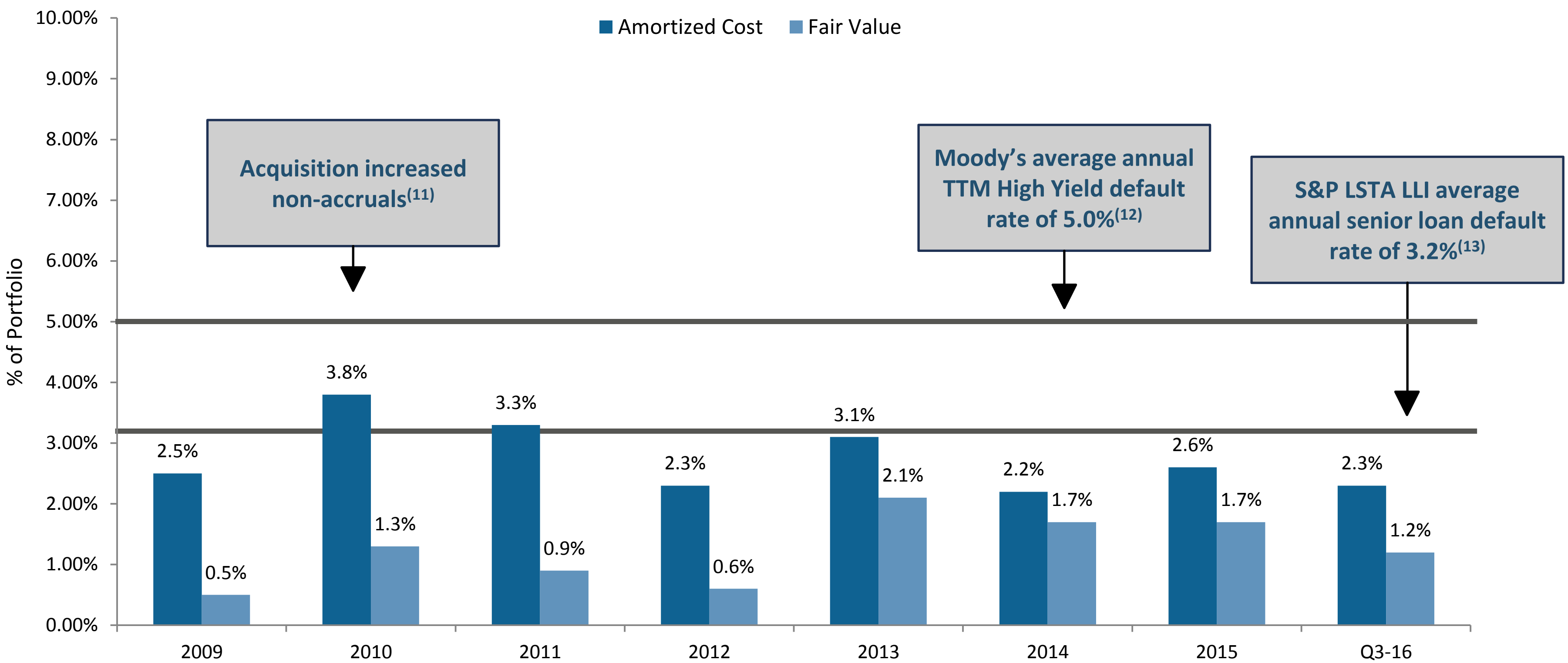
ARES

ARCC's Strong Historical Investment Track Record

ARCC has consistently generated a low level of non-accruals

- Our investment strategy highlights capital preservation as our highest focus
- Non-accruals have generally remained well below the industry average
- At September 30, 2016, 2.3% of the total portfolio at amortized cost and 1.2% at fair value were on non-accrual

Non-Accruing Investments as a % of Portfolio at Amortized Cost and Fair Value(10)



ARCC data shown as representative of the U.S. Direct Lending Group.
Note: Past performance is not indicative of future results. Please refer to Endnotes on page 37 for additional important information.

ARCC's Strong Historical Investment Track Record

ARCC had cumulative realized investment gains in excess of cumulative realized investment losses of $558 million since inception*

- ARCC investment philosophy is to manage underperforming companies to achieve favorable recoveries
- Low net realized losses on loans combined with net realized gains on equity positions have resulted in an average annualized net realized gain rate of +1.1%, with a net realized loss in only one fiscal year(14)(15)(16)
- Since IPO in October 2004 through September 30, 2016, cumulative internal rate of return to ARCC totaled 13%(4) on $14.0 billion invested since inception

ARCC and BDC Peers Net Realized Gain (Loss) Rate through 9/30/2016

	CY2006	CY2007	CY2008	CY2009	CY2010	CY2011	CY2012	CY2013	CY2014	CY2015	LTM 9/30/16
ARCC	3.1%	0.4%	0.3%	(2.0)%	1.3%	2.1%	0.9%	1.0%	1.2%	1.5%	1.1%
BDC Peer Group Average(9)	1.3%	(0.1)%	—%	(7.3)%	(5.8)%	(1.3)%	(0.5)%	(0.7)%	0.5%	(0.7)%	(1.7)%
Outperformance (%)	1.8%	0.5%	0.3%	5.3%	7.2%	3.4%	1.3%	1.7%	0.7%	2.2%	2.8%

Note: ARCC data is shown as representative of the U.S. Direct Lending Group. Past performance is not indicative of future results.
Please refer to Endnotes on page 37 for additional important information.
* From inception through September 30, 2016, excludes $196 million one-time gain on the acquisition of Allied Capital in Q2-10 and gains/losses from extinguishment of debt and sale of other assets.

5 Conclusion

Direct Lending Presents an Attractive Investment Opportunity

Direct lending is attractive and provides for significant investor benefits

- ✓ Floating rate assets
- ✓ Significant junior capital and/or equity behind senior secured debt
- ✓ Conservative structures with robust covenants packages
- ✓ Ability to control and re-price risk
- ✓ Diversification of portfolio
- ✓ Ability to invest across the debt capital structure
- ✓ Control over cash flows
- ✓ Information rights
- ✓ Enhanced ability to enforce creditor rights
- ✓ Middle market typically allows for less leverage
- ✓ Yield premium for illiquidity
- ✓ Lower defaults / high recoveries

Note: Not every investment meets each of these criteria.

Why is Ares the Right Long-Term Partner?

Scaled Platform with Experienced Team

114 investment professionals in the U.S.

We believe we are the **largest non-bank lender in the U.S**, with approximately **$23 billion** of AUM in U.S. Direct Lending(1)

Direct Origination Capabilities

Local presence across 5 offices in the U.S.

Active dialogue with over **450 financial sponsors**

Drives **asset selectivity** to optimize portfolio mix

Flexible Capital/Solution Provider

Ability to invest **across the balance sheet** - first lien, unitranche, second lien, mezzanine and equity co-investments

Enables us to act as a **problem solver** and seek **superior relative value** and **more investment opportunities**

Disciplined and Repeatable Investment Process

Preference as **lead** or **control lead investor**

Frequent reporting requirements and often **board observation rights**

Focus on minimizing credit losses

Strong Track Record

ARCC has **invested over $26.9 billion** across 785 transactions in the U.S. since inception(17)

ARCC generated a **gross realized IRR of 13%** on $14.0 billion of investments since inception(4)

Note: All data as of September 30, 2016 unless otherwise noted.

Past performance is not indicative of future results. Please refer to Endnotes on page 37 for additional important information.

6 Appendix: Market Opportunity

ARES

Evolution of U.S Direct Lending

- Historically, banks were meaningful underwriters / lenders to middle market companies. More recently, bank consolidation coupled with stringent banking regulations have significantly curtailed bank underwriting, with non-bank lenders filling the void
  - Today, banks are typically focused on fees (advisory, syndication, etc.) and have little desire or ability to retain significant investment exposure

Pre-Crisis
2004-2007

- **Consolidation wave** - large banks acquire smaller banks
- Capacity leaves market
- **Diminishing lending capabilities** of mid market banking platforms
- **Rise of non-bank lenders** and institutional investors

Credit Crisis and Fallout
2008-2012

- Regulators increase **capital and risk standards**
- **Banks refocus** towards lower risk lending
- Growing borrower **acceptance of non-bank lenders**

Era of Bank Regulation and DL Acceptance
2013+

- **Growing demand from borrowers** underserved by current banking system
- Global **demand from retail and institutional** investors
- Absolute returns in **pursuit of yield**

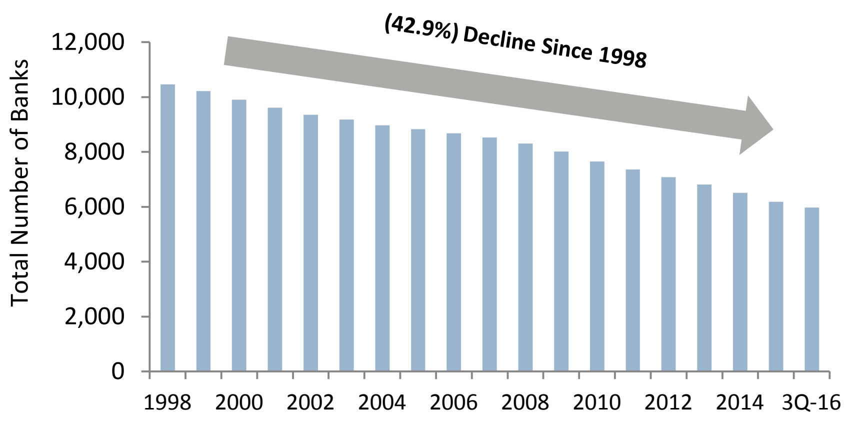
The U.S. opportunity has developed broadly over the last twenty years and is institutionalized

Current Market Environment

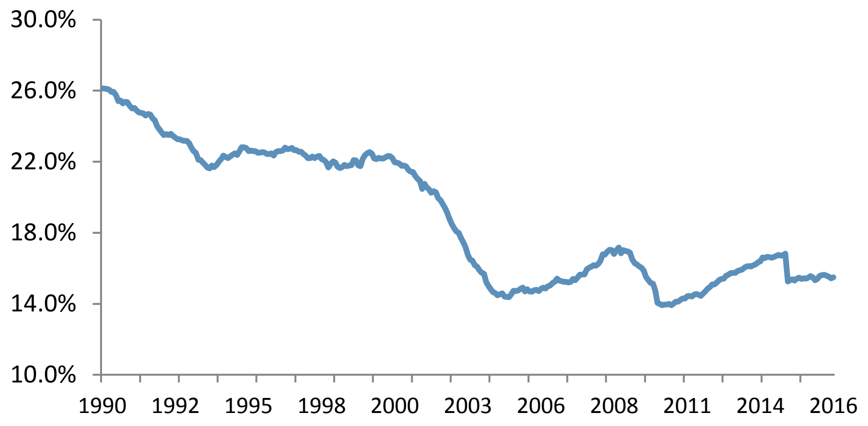
We believe the present market environment is a compelling investment opportunity

- We believe significant supply constraints in middle market lending are leading to higher yields and improved structural terms for investors
- Pre-crisis lending to small and middle-market companies was predominately done by banks
- Changes in market dynamics and new regulation has reduced banks' ability to provide long-term funding to corporates
  - Credit funds continue to take market share from banks

Total Number of U.S. Banks Continues to Decline[1]



% of Commercial Bank Loans and Leases Consisting of Commercial and Industrial ("C&I") Loans and Leases[2]



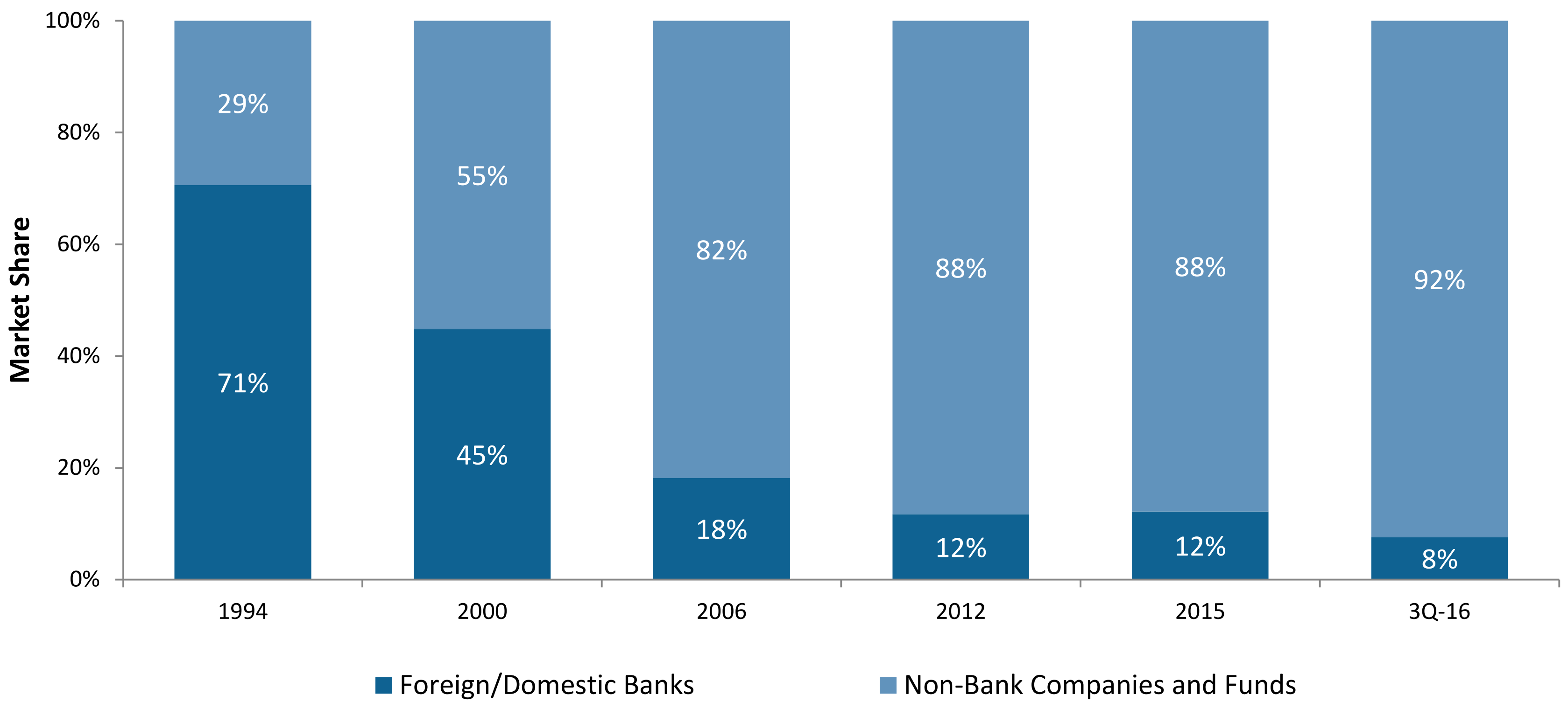
1. Source: Federal Deposit Insurance Corp.
2. Source: Federal Reserve H8 data as of September 2016 release.

ARES

Leveraged Loan Market Share

Banks' share of the global leveraged loan market continues to shrink

Percentage of Leveraged Loan Market Fundings by Entity(1)



1. S&P LCD Leveraged Lending Review Q3-16. Excludes left and right agent commitments (including administrative, syndication and documentation agent as well as arranger).

Changing U.S. Competitive Landscape

- Numerous middle market focused banks have disappeared over the last two decades, leaving a handful of large banks focused on large borrowers and smaller banks have de-emphasized cash flow lending

Select Bank Competitors in the 1990's	Consolidators
Continental Illinois; LaSalle Bank; ncnb; NationsBank; Barnett Bank; Summit Bank; Sovran Bank; Security Pacific Bank; Fleet; BankBoston; Merchants Bank; Bank of New England	Bank of America Merrill Lynch
Manufacturers Hanover; Bank One; Washington Mutual; First Chicago The First National Bank of Chicago; Chemical Bank; Chase	JPMorgan Chase & Co.
Foothills Capital Corp.; First Union; Wachovia; First Interstate Bank; Northwest Bank Commitment you can bank on.; Goldenwest; SouthTrust	Wells Fargo
Heller Bank AG; Merrill Lynch (Commercial Finance); Antares Private Equity	GE Capital

In 2014, GE Capital announced the sale of its sponsor finance business, eliminating one of the largest players in the market

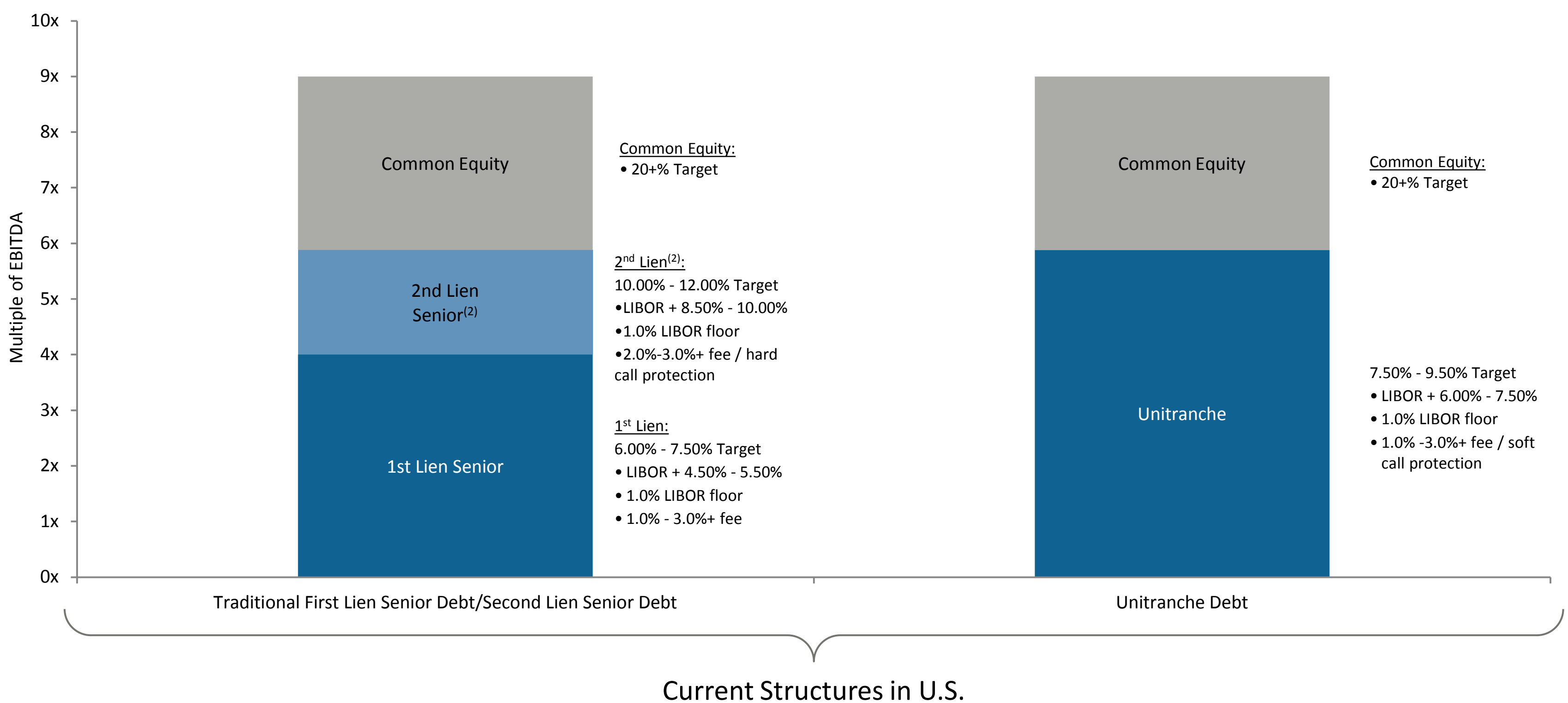
ARES

U.S. Middle Market Opportunity

Illustrative returns and capital structures

- In the U.S., first lien/second lien senior debt and unitranche are the predominant financing structures
- Current enterprise values for middle market companies in the U.S. typically range from 8x to 10x EBITDA

Illustrative Returns and Capital Structures of Primary Middle Market Buyouts(1)



1. Estimates by the Ares Direct Lending team as of September 30, 2016. Based on hypothetical transactions and a review of current market conditions. For illustrative purposes only and does not necessarily represent the average structure of transactions in the U.S. Direct Lending portfolio. The Direct Lending portfolio investments can differ materially from those discussed here.
2. Mezzanine may also be used in place of second lien debt. Illustrative mezzanine pricing ranges from 11.0%-14.0% with 2%-4% fee/2+ points average call protection.

Endnotes

Endnotes

(1) Includes capital that may be committed for investment both directly by Ares Capital Corporation ("ARCC") as well as by certain financial services portfolio companies of ARCC. ARCC and General Electric Capital Corporation and one of its affiliates co-invest through the SSLP. ARCC and GE co-invest in a transaction if both parties approve the co-investment. ARCC is only allowed to borrow amounts such that its asset coverage (as defined in the Investment Company Act of 1940) equals at least 200% after such borrowing. Certain amounts also subject to borrowing base restrictions.

(2) Includes $1.5 billion of assets under management through the European Senior Secured Loan Program ("ESSLP"), a joint venture to which Ares and GE Commercial Bank SAS are a party. Amounts for assets under management do not include approximately $0.76 billion which an Ares-managed vehicle has agreed to make available to the ESSLP.

(3) Source: SNL Financial. As of September 30, 2016. ARCC's stock price-based total return is calculated assuming dividends are reinvested at the end of the day stock price on the relevant quarterly exdividend dates. Total return is calculated assuming investors did not participate in ARCC's rights offering issuance as of March 20, 2008. Past performance is not indicative of future results.

(4) ARCC's performance statistics are shown as representative of the Ares U.S. Direct Lending strategy's long term performance track record. Based on original cash invested, net of syndications, of approximately $14.0 billion and total proceeds from such exited investments of approximately $17.1 billion. Internal rate of return is the discount rate that makes the net present value of all cash flows related to a particular investment equal to zero. Internal rate of return is gross of management fees and expenses related to investments as these fees and expenses are not allocable to specific investments. The effect of such management and other expenses may reduce, maybe materially, the IRR's shown herein. Investments are considered to be exited when the original investment objective has been achieved through the receipt of cash and/or non-cash consideration upon the repayment of ARCC's debt investment or sale of an investment, or through the determination that no further consideration was collectible and, thus, a loss may have been realized. These IRR results are historical results relating to ARCC's past performance and are not necessarily indicative of future results, the achievement of which cannot be assured.

(5) Performance for Europe Direct Lending is represented by all realized investments made by the Ares European direct lending team in its commingled middle market direct lending funds (ACE I and II), including investments in the ESSLP, a joint venture to which Ares and GE Commercial Bank SAS are parties. Internal rate of return is the discount rate that makes the net present value of all cash flows related to a particular investment equal to zero. Internal rate of return is gross of management fees and expenses related to investments as these fees and expenses are not allocable to specific investments. The effect of such management and other expenses may reduce, maybe materially, the IRR's shown herein. Investments are considered to be exited when the original investment objective has been achieved through the receipt of cash and/or non-cash consideration upon the repayment of a debt investment or sale of an investment, or through the determination that no further consideration was collectible and, thus, a loss may have been realized. Past performance is not indicative of future results, the achievement of which cannot be assured.

(6) Includes the Ares portion of the ESSLP; excludes the GECFB portion of ESSLP. Reflects funded capital from inception to September 30, 2016.

(7) Number of transactions done by the Ares Europe Direct Lending Group from inception to September 30, 2016, including the Barclays portfolio purchase which is considered a single transaction for these purposes.

(8) Based on closing equity weighted on September 30, 2016 funded exposure and exited deals weighted by original exposure.

(9) BDC peer group consists of BDCs with market capitalization or an investment portfolio of $500 million as of September 30, 2016 or greater or who are under common management with a BDC that meets these criteria. Peers include ACAS, AINV, BKCC, CPTA, FSC, FSFR, FSIC, GBDC, GSBD, HTGC, MAIN, MCC, NMFC, PFLT, PNNT, PSEC, SLRC, SUNS, TCAP, TCPC, TCRD, TICC and TSLX.

(10) All data as of December 31 of the respective years, excluding Q3-16, which is as of September 30, 2016.

(11) On April 1, 2010, ARCC completed the acquisition of Allied Capital.

(12) Source: Moody's U.S. Trailing 12-month issuer-weighted spec-grade default rate. Actual speculative grade default data taken from January 2000 to September 30, 2016.

(13) Source: S&P LCD data for LSTA Leveraged Loan Index ("LLI"). Calculated as average of rolling twelve month default rates for the LLI from January 2000 to September 30, 2016.

(14) From inception through September 30, 2016, excludes $196 million one-time gain on the acquisition of Allied Capital in Q2-10 and gains/losses from extinguishment of debt and sale of other assets.

(15) Calculated as an average of the historical annual net realized gain/loss rates (where annual net realized gain/loss rate is calculated as the amount of net realized gains/losses for a particular period from ARCC IPO in October 2004 to September 30, 2016 divided by the average quarterly investments at amortized cost in such period).

(16) For purposes of this calculation, SSLP sub certs are considered debt investments.

(17) Excludes $1.8 billion of assets acquired from Allied Capital on April 1, 2010.

Performance Notes

Performance Notes to Slide 7

Information respecting prior performance whether of a particular fund or investment strategy is not and should not be interpreted as a guaranty of future performance. Moreover, no assurance can be given that unrealized, targeted or projected valuations or returns will be achieved. Future results are subject to any number of risks and factors, many of which are beyond the control of Ares.

Credit

- Lipper Rankings reported in Lipper Marketplace Best Money Managers, September 30, 2016. Lipper Marketplace is the source of the long-only and multi-strategy credit rankings. Lipper's Best Money Managers rankings consider only those funds that meet the following qualification: performance must be calculated "net" of all fees and commissions; must include cash; performance must be calculated in U.S. dollars; asset base must be at least $10 million in size for "traditional" U.S. asset classes (equity, fixed income, and balanced accounts); and, the classification of the product must fall into one of the categories which they rank. Lipper defines Short Duration as 1-5 years. Lipper's Active Duration definition does not specify a time period but rather refers to an Active rather than Passive strategy. Ares Institutional Loan Fund was ranked 9 out of 63 for the 20 quarters ended September 30, 2016. Composites for Ares U.S. Bank Loan Aggregate and Ares U.S. High Yield additionally received rankings of 8 of 63 and 5 of 43, respectively, for the 20 quarters ended September 30, 2016.
- Performance for U.S. Syndicated Loans is represented by the U.S. Bank Loan Aggregate Composite which includes all actual, fully discretionary, fee-paying, portfolios that are benchmarked to the Credit Suisse Leveraged Loan Index and primarily invested in U.S. Dollar denominated banks loans. Portfolios may have limited allocations to high yield and structured securities. Portfolios in the U.S. Bank Loan Aggregate Composite have an emphasis on capital appreciation and income. For periods prior to January 1, 2010 the U.S. Bank Loan Aggregate Composite included the bank loan segments of multi-asset class portfolios. The inception date of the U.S. Bank Loan Aggregate Composite is November 1997. From January 1, 2000 through January 1, 2010, cash was allocated on a monthly basis to the bank loan segments based on relative assets. For periods prior to January 1, 2000 cash was not allocated to the bank loan segments. As of January 1, 2010 the U.S. Bank Loan Aggregate Composite no longer includes bank loan segments of multi-asset class portfolios. The benchmark for the U.S. Bank Loan Aggregate Composite is the Credit Suisse Leveraged Loan Index. The index is designed to mirror the investable universe of the U.S. Dollar-denominated leveraged loan market. Investment track record of 15+ years dates prior to composite inception when Ares managed syndicated loans and high yield assets as part of its CLO strategy.
- Performance for U.S. High Yield is represented by the U.S. High Yield Composite, which includes all actual, fully discretionary, fee-paying, separately managed portfolios that primarily invest in U.S. high yield fixed income securities and are benchmarked to the BofA Merrill Lynch US High Yield Master II Constrained Index. Portfolios in the U.S. High Yield Composite have an emphasis on capital appreciation and income. The benchmark for the U.S. High Yield Composite is the BofA Merrill Lynch US High Yield Master II Constrained Index, which tracks the performance of U.S. Dollar-denominated below investment grade corporate debt publicly issued in the U.S. domestic market with a maximum issuer exposure of 2%. The inception date of the U.S. High Yield Composite is May 2007. Investment track record of 15+ years dates prior to composite inception when Ares managed syndicated loans and high yield assets as part of its CLO strategy.
- Performance for Credit Opportunities is represented by the Credit Opportunities Aggregate Composite, which includes all actual, fully discretionary, fee-paying, portfolios that invest in U.S. syndicated loan, high yield, structured product, and equity securities with a total return focus. Portfolios in the Credit Opportunities Aggregate Composite may utilize derivatives, such as credit default swaps, for hedging, return enhancement, and limited leverage. The index shown for comparison purposes is the HFRI Fund Weighted Composite Index. The index is an equally weighted composite of over 2,200 hedge funds that is designed to reflect hedge fund industry performance. To be included in the index, a fund must have at least $50 million under management or have been actively traded for at least twelve months. The inception date of the Credit Opportunities Aggregate Composite is December 2008.
- Performance for Structured Credit is represented by the Structured Product Core Composite, which includes all commingled, closed-end, fully discretionary, fee-paying portfolios that invest in the debt and equity tranches of structured products such as CLOs and CDOs. Performance results of the Structured Product Core Composite from inception through November 2011 represent the results achieved by Indicus Advisors, which Ares acquired in 2011. No benchmark is presented as Ares Credit is not aware of any publically available index that is comparable to the Structured Product Core Composite strategy. The inception date of the Structured Products Core Composite is December 2011.
- Benchmark returns are provided to represent the investment environment existing during the time period shown. The returns for the BofA Merrill Lynch US High Yield Master II Constrained Index and the Credit Suisse Leveraged Loan Index include the reinvestment of income and other earnings, but do not include transaction costs, management fees or other costs. Returns for the HFRI Fund Weighted Composite Index are calculated using a time-weighted rate of return and are net of all fees.
- Gross performance for the U.S. Bank Loan Aggregate Composite, U.S. High Yield Composite, and Credit Opportunities Aggregate Composite does not reflect the deduction of investment advisory fees or any other expenses that may be incurred in the management of the account. Returns include the reinvestment of income and other earnings and reflect the deduction of all trading expenses. Net returns for the U.S. Bank Loan Aggregate Composite and U.S. High Yield Composite are net of model investment advisory fees and are derived by subtracting 1/12th of the highest applicable fee on a monthly basis from the gross returns. Net returns for the Credit Opportunities Aggregate Composite are net of actual management fees, performance fees and carried interest, as applicable, and other expenses allocated to investors. Performance fees and carried interest, as applicable, are accrued monthly.
- Gross performance for the Structured Product Core Composite is an annualized gross internal rate of return ("IRR") that is calculated using the combined capital draw dates from the fee-paying limited partners in each fund for the composite and a combined fund valuation for the composite as of the period end date. The inception date of the IRRs for the Structured Product Core Composite is August 11, 2008, which is the date of the first capital calls in the composite. IRRs include the reinvestment of income and other earnings and reflect the deduction of all trading expenses. IRRs are presented as annualized returns. The gross IRR does not reflect the deduction of management fees, performance fees and carried interest, as applicable, and operating and administrative expenses. Returns include the reinvestment of income and other earnings and reflect the deduction of all trading expenses. The net IRR reflects the deduction of management fees, performance fees and carried interest as if the composite was liquidated, and operating and administrative expenses. Actual expenses allocated to fee-paying limited partners are used in the net IRR calculation.

ARES

Performance Notes to Slide 7

Credit (continued)

- Actual fees of the portfolios in each composite may vary depending on, among other things, the applicable fee schedule and portfolio size. Composites may contain accounts with performance based fees. Investment management fees are described in Part 2 of the adviser's Form ADV. All returns are expressed in U.S. Dollars.
- Performance footnote for Europe Direct Lending Aggregate IRR: As of September 30, 2016. Represents the performance of all realized investments made by the Ares European direct lending team in its commingled middle market direct lending funds (ACE I and ACE II) since inception in July 2007, including investments in the ESSLP, a joint venture to which Ares and GE Commercial Bank SAS are parties, which are calculated based on capital contributed to the joint venture and do not reflect returns to the ESSLP from investments made by the joint venture. Internal Rate of Return is shown on an asset level and represents the cash flows to and from investments and is gross of management fees, performance fees and carried interest, as applicable, and expenses related to investments as these fees and expenses are not allocable to specific investments. The effect of such management and other expenses may reduce, maybe materially, the IRR's shown herein. IRR includes realized returns and excludes the impact of fund-level leverage where applicable. Investments are considered to be exited when the original investment objective has been achieved through the receipt of cash and/or non-cash consideration upon the repayment or sale of an investment, or through the determination that no further consideration was collectible and, thus, a loss may have been realized.
- ACE II is made up of two feeder funds, one denominated in U.S. Dollars and one denominated in Euros. The gross and net IRRs for the Euro denominated feeder fund are 13.4% and 10.1%, respectively. The IRR is an annualized since inception internal rate of return of cash flows to and from the fund and the fund's residual value at the end of the measurement period. The cash flow dates used in the IRR calculations are based on the actual dates of the cash flows. The gross IRRs reflect returns to all partners and are calculated before giving effect to management fees, performance fees as applicable, and other expenses. The net IRRs reflect returns to the fee-paying limited partners and if applicable, exclude interests attributable to the non-fee paying limited partners and/or the general partner who does not pay management fees or performance fees. The net IRRs are calculated after giving effect to management fees, performance fees as applicable, and other expenses. We are not showing the U.S. dollar denominated ACE II feeder fund gross and net IRRs here due to the U.S. GAAP mark-to-market reporting of the foreign currency hedging program in this feeder fund. It will be holding the foreign currency hedges until maturity, and therefore is expected to ultimately recognize a gain while mitigating the currency risk associated with the initial principle investments.
- Performance footnote for U.S. Direct Lending: As of September 30, 2016, Ares Capital Corporation ("ARCC") performance statistics are shown as representative of the Ares U.S. Direct Lending Group's long term performance track record. Based on original cash invested, net of syndications, of approximately $14.0 billion and total proceeds from such exited investments of approximately $17.1 billion. Internal rate of return ("IRR") is the discount rate that makes the net present value of all cash flows related to a particular investment equal to zero. Internal rate of return is gross of management fees, performance fees and carried interest, as applicable, and expenses related to investments as these fees and expenses are not allocable to specific investments. The effect of such management and other expenses may reduce, maybe materially, the IRR's shown herein. Investments are considered to be exited when the original investment objective has been achieved through the receipt of cash and/or non-cash consideration upon the repayment of ARCC's debt investment or sale of an investment, or through the determination that no further consideration was collectible and, thus, a loss may have been realized.
- ARCC generated a 12% annualized total shareholder return since its 2004 IPO–outperforming S&P 500, syndicated loans and high yield by 430–740bps; Source: SNL Financial. Total return as of September 30, 2016 on security or index with dividends; assumes dividends are reinvested at the closing price of the security on the ex-date of the dividend. ARCC stock price-based total return is calculated assuming dividends are reinvested at the end of day stock price on the relevant quarterly ex-dividend dates. Total return is calculated assuming investors did not participate in ARCC's rights offering issuance in March 2008. Syndicated loans and high yield performance comparisons refer to the Credit Suisse Leveraged Loan Index and the Merrill Lynch High Yield Master II Index, respectively, for the time period from ARCC's 2004 IPO through September 30, 2016.
- Private Debt Investor selected Ares Capital Corporation ("ARCC") as Business Development Company of the Year for 2014– Award based on an industry wide global survey across 37 categories conducted by Private Debt Investor. In the BDC of the Year category, ARCC was listed as one of the shortlisted firms (along with three additional short list competitors) as suggested by the editorial board of PEI Media. Over 3,000 survey participants voted independently and could not vote for their own firm. In addition, survey participants could nominate another firm not listed in the category.
- Private Equity International selected Ares Management as Mid-Cap Lender of the Year – North America for 2014 and Lender of the Year – North America for 2015 – Awards based on an industry wide global survey across 60 categories conducted by Private Equity International. In the Mid-Cap Lender of the Year in North America category (renamed to Lender of the Year in 2015), Ares Management was listed as one of three shortlisted firms as suggested by the editorial board of PEI Media. Survey participants voted independently. In addition, survey participants could nominate another firm not listed in the category.
- Private Debt Investor selected Ares Management as the co-winner of 2013 Unitranche Lender of the Year –EMEA; both in conjunction with the GE Capital joint venture. Private Debt Investor's first annual awards were presented for 29 categories, covering the Americas; Europe; the Middle East and Africa; and Asia-Pacific geographic regions. Winners were determined from more than 1,400 votes cast by eligible voters in the private debt community. Respondents were forbidden from voting for their own firm.
- The 2013, 2014 and 2015 M&A Atlas Awards for Mid-Market Lender of the Year-Americas were awarded to Ares Capital Corporation (versus five, three and three additional finalists, respectively) by Global M&A Network. Selection criteria for lenders providing financing primarily to private equity sponsored transactions in the Mid-market segment required a financing size ranging on average between $100 million to $5 million. Following an open nominations process, winners were chosen independently from the finalist circle based on identifiable set of criteria for individual award categories including performance metrics.
- Largest BDC by both market capitalization and total assets is measured using market capitalization and total assets as of September 30, 2016.

Performance Notes to Slide 7

Private Equity

- ACOF I-IV Aggregate, as of September 30, 2016, refers to the gross performance for the Ares Corporate Opportunities Funds Aggregate, comprised of ACOF I, ACOF II, ACOF III and ACOF IV (each defined below). The ACOF I-IV Aggregate is an annualized gross internal rate of return ("IRR") that is calculated on the basis of monthly inflows and outflows of cash to and from investments and Unrealized Values, assuming such inflows and outflows occurred as of month end and all remaining investments were sold at the values shown through the end of September 2016. The inception date of the IRRs for the ACOF I-IV Aggregate is May 2003 and is the date of the first investment. The net and gross returns reflect reinvestment of certain gains and other proceeds to the extent permitted under the applicable governing documents. IRRs are presented as annualized returns and do not take into consideration the timing of contributions and distributions to and from the funds. The "Unrealized Value" includes Ares' valuations of unrealized investments and accrued and unpaid cash interest as of September 30, 2016. The gross IRR does not reflect the deduction of management fees, carried interest and operating and administrative expenses, and is calculated using cash flows and investment valuations attributable to all partners. The net IRR for the same period was 16%. Net IRR reflects the deduction of management fees, carried interest as if the ACOF I-IV Aggregate was liquidated, and operating and administrative expenses, and is calculated using cash flows and investment valuations attributable to the fee-paying limited partners. Actual expenses allocated to fee-paying limited partners are used in the net IRR calculation. Performance for Ares Corporate Opportunities Fund V ("ACOF V") is not included in the ACOF I-IV Aggregate, as Ares has not yet made its first investment nor has it called any capital. ACOF I refers to Ares Corporate Opportunities Fund, L.P. (vintage 2003). ACOF II refers to Ares Corporate Opportunities Fund II, L.P. (vintage 2006). ACOF III refers to Ares Corporate Opportunities Fund III, L.P. (vintage 2008). ACOF IV refers to Ares Corporate Opportunities Fund IV, L.P. (vintage 2012). Gross IRRs for the period are 20% for ACOF I, 19% for ACOF II, 30% for ACOF III and 21% for ACOF IV. Net IRRs for the period are 14% for ACOF I, 14% for ACOF II, 22% for ACOF III and 13% for ACOF IV.
- Performance for U.S. power and energy infrastructure is represented by the EIF Aggregate, as of September 30, 2016, which includes the Early Funds and the USPF Funds, each as defined below. The Gross IRR for the EIF Aggregate is 15.4% and is calculated based on aggregate monthly cash flows to/from each investment, including the equity that was funded to the investment, cash flows attributable to any reinvestment of proceeds, and the unrealized value for all unrealized investments as of September 30, 2016. Gross IRR does not reflect the effect of management fees, carried interest, fund-level expenses or, in some cases, project-level expenses. The Net IRR for the EIF Aggregate is 11.0% and is calculated based on aggregate monthly cash flows to/from each fund's limited partners, plus each fund's net asset value as of September 30, 2016. Net IRR reflects the return to limited partners after giving effect to management fees, carried interest and other fund expenses, including the impact of the use of subscription financing. The Early Funds include Energy Investors Fund L.P., Energy Investors Fund II, L.P., and Project Finance Fund III, L.P., vintage years 1989, 1992, and 1995, respectively. The USPF Funds include United States Power Fund, L.P. ("USPF"), United States Power Fund II, L.P. and USPF II Institutional Fund, L.P. (together, the "USPF II Funds"), United States Power Fund III, L.P. ("USPF III") and EIF United States Power Fund IV, L.P. ("USPF IV"), vintage years 2002, 2005, 2007, and 2010, respectively. As of September 30, 2016, (i) Gross IRRs for the Early Funds, USPF, the USPF II Funds, USPF III and USPF IV are 18.2%, 29.4%, 8.6%, 9.3% and 14.6%, respectively, and (ii) Net IRRs for the Early Funds, USPF, the USPF II Funds, USPF III and USPF IV are 15.4%, 25.0%, 5.7%, 6.7% and 11.9%, respectively. Gross and Net IRRs for the Early Funds are presented on a pro forma basis and exclude twenty investments (representing 22.7% of the total equity invested by the Early Funds) of a type that Ares EIF no longer focuses on, and has not focused on since 2002 (i.e., investments in companies whose principal assets or operations were outside of the U.S. and Canada, as well as a waste water treatment facility). If such investments were included, the Gross and Net IRR for the Early Funds would be 16.6% and 10.5%, respectively.
- SSF I-IV Aggregate, as of September 30, 2016, refers to the gross performance for the Special Situations Funds Aggregate, comprised of SSF I, SSF I-B, SSF III and SSF IV (each defined below), which includes all closed-end commingled, fully discretionary, fee-paying portfolios that invest primarily in distressed debt, post-reorganization equities and other special situations instruments. Portfolios in the SSF I-IV Aggregate may invest in currency forwards to hedge currency risk and credit default swaps or options contracts to hedge industry or issuer risk. The SSF I-IV Aggregate is an annualized gross internal rate of return ("IRR") that is calculated using the combined capital draw dates from the fee-paying limited partners in each fund and a combined fund valuation as of the period end date. The inception date of the IRRs for the SSF I-IV Aggregate is June 2007, which is the date of the first capital calls. IRRs include the reinvestment of income and other earnings and reflect the deduction of all trading expenses. IRRs are presented as annualized returns. The gross IRR does not reflect the deduction of management fees, performance fees and carried interest, as applicable, and operating and administrative expenses. The net IRR reflects the deduction of management fees, performance fees and carried interest, as applicable, as if the SSF I-IV Aggregate was liquidated, and operating and administrative expenses. Actual expenses allocated to fee-paying limited partners are used in the net IRR calculation. Past performance is not indicative of future results. SSF I refers to Ares Special Situations Fund, L.P. (vintage 2007). SSF I-B refers to Ares Special Situations Fund I-B, L.P. (vintage 2009). SSF III refers to Ares Special Situations Fund III, L.P. (vintage 2010). SSF IV refers to Ares Special Situations Fund IV, L.P. (vintage 2015).
- Please refer to the 2013 Preqin Consistent Performers in Private Equity Report for a detailed description of the ranking methodology. ACOF III was awarded one of the Top 10 Buyout Funds for vintages 2006-2010. The rankings are based on a subset of buyout funds tracked by Preqin. Only funds for which Preqin has performance data and has assigned a quartile ranking have been considered for purpose of the rankings. As such, buyout funds with 2011, 2012 and 2013 vintage years have been excluded. Ares Management was awarded one of the most Consistent Performing Buyout Fund Managers. Only those fund managers that have raised at least three buyout funds of a similar strategy have been considered by Preqin for purposes of the rankings.
- The Power Finance & Risk's awards recognized excellence and innovation in the power project finance industry. The goal of the Power Finance & Risk awards is for peers to single out others for volume of activity, efficiency, leadership, and savvy in executed transactions. Each category is directly adjudicated by borrowers, investors, bankers and advisors active in the Americas in an online poll. Power Finance & Risk launches an online poll of power company officials, investors, bankers, lawyers and consultants to determine who were the leading players and top deals in the Americas. EIF was voted "Best Acquirer of Power Assets" in 2013 as part of Power Finance & Risk's 11th Annual Deals & Firms of the Year Awards.

Performance Notes to Slide 7

Private Equity (continued)

- Reference is made to the 2016 Preqin Global Infrastructure Report. Ares Management was ranked second as one of the Most Consistent Performing Unlisted Infrastructure Fund Managers and was the top-listed U.S. infrastructure fund manager in this league table. The rankings are based on a subset of funds tracked by Preqin. Preqin assigns each closed-end fund a quartile ranking based on its performance against other funds of the same geographic focus and vintage year. The methodology used to compile our consistent performing managers list looks at these quartile rankings; a top-quartile fund will be ascribed a score of one, a second-quartile fund a score of two and so on. Preqin only assigns quartile rankings to funds of more mature vintage years. Funds with vintages of 2013 or later are not considered. Furthermore, the table has been restricted to fund managers that have raised at least three funds, and is further narrowed down to include only active fund managers. Managers that have not launched a new fund since 2009 are excluded. The league table does not seek in any way to endorse these fund managers, but rather to illustrate those that have performed the most consistently in the past.
- Private Equity International winner of the 2012 North American Special Situations/ Turnaround Firm of the Year. Private Equity International's editorial board selected Ares to be on a short list of three nominees for the award. Ares was selected as the 2012 award winner through a voting process by readers of Private Equity International. The award may be based on subjective criteria and/or a limited candidate pool. Source: Private Equity International March 2013.

Performance Notes to Slide 7

Real Estate

- Performance returns presented herein are as of September 30, 2016 unless otherwise more specifically noted. The U.S. Equity aggregate and Europe Equity aggregate performance returns reflect real estate investment strategies that are focused on income and appreciation (for value-add) and primarily appreciation (for opportunistic). Performance returns are based on actual cash activities through September 30, 2016, with all remaining assets and liabilities of each respective fund or investment existing as of September 30, 2016 assumed to be liquidated at the estimated values indicated in the respective financial statements with proceeds therefrom assumed to be distributed accordingly. Performance returns presented do not include funds where the initial investment was made less than two years prior to September 30, 2016.
- Gross IRR is an internal rate of return generally based on aggregate periodic cash flow activities between a specific fund and its respective investments (or portfolio of investments, as applicable), including cash flows attributable to any sales, dispositions, reinvestment of proceeds, financing and/or refinancing and operating activities. Gross IRRs do not reflect or include the impact of applicable management fees, performance fees or carried interest, fund level expenses, working capital, use of subscription financing and other expenses. Net IRR is an internal rate of return generally based on aggregate periodic cash flow activities and generally reflects and includes the impact of applicable management fees, performance fees or carried interest as if the funds or investments in existence as of September 30, 2016 were liquidated at estimated fair values and proceeds distributed accordingly, fund level expenses, working capital, use of subscription financing and other expenses. The General Partner and any of its affiliates that do not bear management fee or carried interest are excluded for purposes of calculating the net IRR.
- As of the period indicated, the U.S. Equity aggregate gross IRR is 15% and the net IRR is 10%. The U.S. Equity aggregate reflects the U.S. Equity Value-Add and U.S. Equity Opportunistic real estate strategies and includes investments in and the results of the following funds: (a) U.S. Equity Value-Add Funds: Value Enhancement Fund I, L.P. (“VEF I,” vintage 1993), Value Enhancement Fund II, L.L.C. (“VEF II,” vintage 1995), Value Enhancement Fund III, L.L.C. (“VEF III,” vintage 1997), Value Enhancement Fund IV, L.P. (“VEF IV,” vintage 1999), Value Enhancement Fund V, L.P. (“VEF V,” vintage 2001), Value Enhancement Fund VI, L.P. (“VEF VI,” vintage 2005), Ares US Real Estate Fund VII, L.P. and Ares US Real Estate Fund VII 892, L.P. (collectively, "US Fund VII," vintage 2007), and Ares US Real Estate Fund VIII, L.P. ("US Fund VIII," vintage 2013); and (b) U.S. Equity Opportunistic Funds: Apollo Real Estate Investment Fund I, L.P. (“AREIF I,” vintage 1993), Apollo Real Estate Investment Fund II, L.P. (“AREIF II,” vintage 1995), Apollo Real Estate Investment Fund III, L.P. (“AREIF III,” vintage 1997), Apollo Real Estate Investment Fund IV, L.P. (“AREIF IV,” vintage 1998), Apollo Real Estate Investment Fund V, L.P. (“AREIF V,” vintage 2004) and Ares US Real Estate Opportunity Fund, L.P. (“AREOF,” vintage 2008). Please note that AREIF I-IV were global funds, with the ability to invest both within and outside of the U.S. AREIF I and II had no geographic investment limitations; AREIF III and IV were permitted to invest up to 30% of their aggregate commitments to deals outside of the U.S. The cash flow activities of AREIF I-IV (including investments made outside of the U.S.) are included in the gross and net IRRs of the U.S. Equity Value-Add and U.S. Opportunistic strategies. The gross and net IRRs of the U.S. Equity Value-Add and U.S. Opportunistic strategies presented herein do not include the investments in or the performance results of (a) funds with strategies other than value add and opportunistic, (b) single-investor investment accounts, and (c) co-investments made by third party investors alongside the U.S. Equity Value-Add and U.S. Opportunistic funds.
- As of the period indicated, the Europe Equity aggregate gross IRR is 15% and the net IRR is 8%. The Europe Equity aggregate reflects the European Equity Value-Add and European Equity Opportunistic real estate strategies and includes investments in and the results of the following funds and co-investments: (a) European Equity Opportunistic Funds: Ares European Real Estate Fund I (EU), L.P. and Ares European Real Estate Fund I (IF), L.P. (collectively, “IF,” vintage 2001), Ares European Real Estate Fund II, L.P. and Ares European Real Estate Fund II (Euro), L.P. (collectively, “EF II,” vintage 2004), Ares European Real Estate Fund III, L.P. and Ares European Real Estate Fund III (Euro), L.P. (collectively, “EF III,” vintage 2007) and Ares European Real Estate Fund IV, L.P. and Ares European Real Estate IV (Euro), L.P. (collectively, “EF IV,” vintage 2013); (b) European Equity Value-Add Funds: AREA European Property Enhancement Program, L.P. (“EPEP I,” vintage 2012); and (c) co-investments made by third party investors alongside investments made by IF, EF II, EF III, EF IV and EPEP I. For purposes of calculating aggregate gross IRRs and net IRRs for the European Equity Value-Add and Opportunistic strategies, the periodic cash flows for funds and co-investments that were denominated in currencies other than United States Dollars (USD) were converted to USD using a constant exchange rate based on the respective average spot rate over the life-to-date of such funds and co-investments.
- The performance data for Ares Commercial Real Estate Corporation (“ACRE”) shown herein does not include all debt-related assets and strategies managed by the Ares Real Estate Group. The return shown for ACRE is the average annualized return on equity for the period since IPO of the company through September 30, 2016 and is calculated as the average of net income divided by common equity (excluding minority interests) at the end of each fiscal quarter for the applicable period on an annualized basis. The return on equity reflects the implicit costs of un-invested capital, as well as the leverage utilized by ACRE, management fees, administrative fees reimbursed to manager as well as other expenses and costs incurred by ACRE or shareholders of the company.
- Standard & Poor’s servicing rating of Above Average applies to Commercial Special Servicer (as of March 2015): Ares Commercial Real Estate Servicer, LLC, a subsidiary of Ares Commercial Real Estate Management, LLC, the external manager for ACRE.
- PERE 50: Ranking applies to the Ares Real Estate Group related to selected funds managed therein, some of which were previously managed by AREA Property Partners (“AREA”) prior to Ares Management LLC’s acquisition of AREA in July 2013. The PERE 50 measures equity raised between January 1, 2010 and the end of March 2015 for direct real estate investment through closed-ended, commingled real estate funds and co-investment vehicles that invest alongside those funds. The vehicles must give the general partner discretion over capital and investment decisions and excludes club funds, separate accounts and joint ventures where the general partner does not have discretion over capital and investments. Also excluded are funds with strategies other than real estate value-added and opportunistic (such as core and core-plus), funds not directly investing in real estate (such as fund of funds and debt funds) and funds where the primary strategy is not real estate focused (such as general private equity funds).

ARES

ARES

AGENDA ITEM V.A.

BOARD APPROVAL REQUESTED

TO: State Investment Board

FROM: Dave Hunter, Executive Director/CIO

DATE: January 20, 2017

SUBJECT: State Investment Board Meeting Schedule for 2017-18

Recommendation:

RIO requests the SIB approve the proposed board meeting schedule for the period from July 1, 2017 to June 30, 2018

As in the past, meetings are held on the fourth Friday morning of each month with the exception of June, November and December. The November meeting has historically been moved up to the third Friday (due to Thanksgiving), while no meeting has been scheduled in June or December in recent years. As consistent with last year, we intend to conduct a ½-day governance session in July of 2017.

State Investment Board 2017-18 Meeting Schedule

July 28, 2017 (Election of Officers - Reserved for Governance Review Session at BSC Energy Center)

August 25, 2017

September 22, 2017

October 27, 2017

November 17, 2017

December – No Meeting

January 26, 2018

February 23, 2018

March 23, 2018

April 27, 2018

May 25, 2018

June – No Meeting

AGENDA ITEM V.B.

BOARD ACTION REQUESTED

TO: State Investment Board

FROM: Dave Hunter and Darren Schulz

DATE: January 20, 2017

SUBJECT: **State Risk Management Investment Policy Statements** – Cover Memo

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RIO routinely conducts annual reviews with our clients which includes a review of recent returns and the impact of any proposed organizational developments (such as changes in personnel, liquidity and/or risk/return expectations) on the existing investment policy statement. These reviews serve as the basis for Staff recommendations to modify asset allocation guidelines.

On **November 23rd**, RIO reviewed recent investment performance including the current investment policy statement of the **State Risk Management Fund and State Risk Management Workers Compensation Fund** with Tag Anderson – Risk Management Division Director. Mr. Anderson appeared to be pleased with the service provided by the SIB and RIO. In addition, Mr. Anderson graciously agreed to adopt conforming language in the Investment Policy Statements of the States two Risk Management Funds in order to make them consistent with terminology used by other SIB clients such as PERS, TFFR and the Legacy Fund (among others). As a result, **RIO requests the SIB accept the revised Investment Policy Statements for the State Risk Management Fund and State Risk Management Workers Compensation Fund as presented on the following pages.** There were no changes recommended to the asset allocation policies at this time.

The primary substantive changes are highlighted in **blue boldface**.

STATE RISK MANAGEMENT FUND

INVESTMENT POLICY STATEMENT

PLAN CHARACTERISTICS AND FUND CONSTRAINTS

To address the State's loss of sovereign immunity, the 1995 North Dakota Legislature created a new chapter of the North Dakota Century Code (NDCC), 32-12.2. That Chapter established the Risk Management Fund (the Fund) to administer claims against the State and state employees for personal injury, death, or property damage caused by the State or a state employee acting within the scope of the employee's employment. The Fund is directed by the Office of Management and Budget (OMB).

Each entity of the State is required to participate in the Fund. Contributions to the Fund are determined by the Director of OMB based on an actuarial review of the financial status of the Fund. This results in a fluctuation of contributions made to the Fund from one biennium to another. **The actuarial assumed rate of return on assets is 3%.**

The amount of money damages the Fund may pay is limited for State court actions to a total of $250,000 per person and $1,000,000 per occurrence. These liability caps may not be recognized in Federal Court actions or in actions filed in other states. The Fund's excess carrier provides coverage up to $10,000,000 for those exposures not covered by the Tort Claims Act.

Significant claims paid from the Fund are usually somewhat predictable and take a period of time to resolve. A person bringing a claim or lawsuit against the State or a state employee must give notice to the OMB Director within 180 days after the alleged injury is discovered or reasonably should have been discovered. If the claim is one for death, the notice must be provided within one year after the alleged injury resulting in the death.

The Risk Management Division's operating expenses including loss control activities are paid from the Fund as incurred.

RESPONSIBILITIES OF THE STATE INVESTMENT BOARD (SIB)

The Fund is charged by law under NDCC 21-10-02.1 with the responsibility of establishing policies on investment goals and asset allocation of the Fund. The SIB is charged with implementing these policies and asset allocation and investing the assets of the Fund in a manner consistent with the prudent investor rule as provided in NDCC 21-10-07. Under this rule, the fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.

At the discretion of the SIB, the Fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification, restrictions, and performance objectives appropriate to the prudent investor rule and objectives of the funds participating in the pools.

Management responsibility for the investment program not assigned to the SIB in Chapter 21-10 of the North Dakota Century Code (NDCC) is hereby delegated to the SIB, who must establish written policies for the operation of the investment program, consistent with this investment policy.

The SIB may delegate investment responsibility to professional money managers. When a money manager has been retained, the SIB's role in determining investment strategy and security selection is supervisory, not advisory.

At the discretion of the SIB, the Fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification, restrictions, and performance objectives appropriate to the prudent investor rule and the objectives of the funds participating in the pools.

The SIB is responsible for establishing criteria and procedures and making decisions with respect to hiring, maintaining, and terminating money managers. This responsibility includes selecting performance measurement services, consultants, and report formats and determining the frequency of meetings with managers.

The SIB will implement changes to this policy as promptly as is prudent.

INVESTMENT OBJECTIVES

The Fund's investment objectives are expressed in terms of reward and risk expectations relative to investable, passive benchmarks. The Fund's policy benchmark is comprised of policy mix weights of appropriate asset class benchmarks as set by the SIB:

1) **The Fund's rate of return, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.**

2) **The Fund's risk, measured by the standard deviation of net returns, should not exceed the risk of the policy benchmark by more than 1% over a minimum evaluation period of five years. For example, if the risk of the policy benchmark is 4%, the Fund's risk should not exceed 5% over a five-year period.**

3) **The risk adjusted performance of the Fund, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.**

POLICY ASSET MIX

The asset allocation of the Fund is established by the SIB, with input from the OMB. Asset allocation is based upon the appraisal of projected liquidity and income requirements, and estimates of the investment returns likely to be achieved by the various asset classes over the next five years.

In recognition of these factors, the following allocation is deemed appropriate for the Fund:

Large Cap Domestic Equity	22.5%
Small Cap Domestic Equity	7.5%
Fixed Income	65.0%
Cash Equivalents	5.0%

While the Fund recognizes fluctuations in market values will lead to short-term deviations from policy targets, the Fund does not intend to engage in tactical asset allocation.

Rebalancing of the Fund to this allocation will be done in accordance with the SIB's rebalancing policy.

RESTRICTIONS

While the SIB is responsible for establishing specific quality, diversification, restrictions, and performance objectives for the investment vehicles in which the Fund's assets will be invested, it is understood that:

a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.
b. Derivative use will be monitored to ensure that undue risks are not taken by the money managers.
c. No transaction shall be made which threatens the tax exempt status of the Fund.
d. All assets will be held in custody by the SIB's master custodian or such other custodians as are acceptable to the SIB.
e. No funds shall be borrowed.
f. No unhedged short sales or speculative margin purchases shall be made.
g. Social investing is prohibited unless it meets the Exclusive Benefit Rule and it can be substantiated that the investment must provide an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.

   For the purpose of this document, Social Investing is defined as "The investment or commitment of public fund money for the purpose of obtaining an effect other than a maximized return to the intended beneficiaries."

h. Economically targeted investing is prohibited unless the investment meets the Exclusive Benefit Rule.

   For the purpose of this document economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved, as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

   Also, for the purpose of this document, the Exclusive Benefit Rule is met if the following four conditions are satisfied:

   (1) The cost does not exceed the fair market value at the time of investment.
   (2) The investment provides the Fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
   (3) Sufficient liquidity is maintained in the Fund to permit distributions in accordance with the terms of the plan.
   (4) The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity are equivalent, the Fund's policy favors investments which will have a positive impact on the economy of North Dakota.

INTERNAL CONTROLS

A system of internal controls must be in place by the SIB to prevent losses of public funds arising from fraud or employee error. Such controls deemed most important are the separation of responsibilities for investment purchases from the recording of investment activity, custodial safekeeping, written confirmation of investment transactions, and established criteria for broker relationships. The annual financial audit must include a comprehensive review of the portfolio, accounting procedures for security transactions and compliance with the investment policy.

EVALUATION AND REVIEW

Investment management of the Fund will be evaluated against the Fund's investment objectives. Evaluation should include an assessment of the continued feasibility of achieving the investment objectives and the appropriateness of the Investment Policy Statement for achieving those objectives.

Performance reports will be provided to the Fund periodically, but not less than annually. Such reports will include asset returns and allocation data as well as information regarding all significant and/or material matters and changes pertaining to the investment of the Fund, including but not limited to:

1) A list of the advisory services managing investments for the board.

2) A list of investments at market value, compared to previous reporting period, of each fund managed by each advisory service.
3) Earnings, percentage earned, and change in market value of each fund's investments.
4) Comparison of the performance of each fund managed by each advisory service to other funds under the board's control and to generally accepted market indicators.
5) All material legal or legislative proceedings affecting the SIB.
6) Compliance with this investment policy statement.

Approved by:

OFFICE OF MANAGEMENT AND BUDGET	**STATE INVESTMENT BOARD**
______________________________	______________________________
Pam Sharp	**David Hunter**
Director	**Executive Director / CIO**
Date: ________________________	**Date:** ____________________________

Approved by the NDSIB:
Approved by OMB:

STATE RISK MANAGEMENT WORKERS' COMPENSATION FUND

INVESTMENT POLICY STATEMENT

PLAN CHARACTERISTICS AND FUND CONSTRAINTS

The 2001 North Dakota Legislature established a single workers' compensation account for state entities, N.D.C.C. § 65-04-03.1. N.D.C.C. § 65-04-03.1(2) directs that workers' compensation premiums from state entities must be deposited in the Risk Management Workers Compensation Fund (Fund) and the State Investment Board is directed to invest the Fund in accordance with chapter 21-10.

The Risk Management Division of the Office of Management and Budget is responsible for administering the Fund to include promulgating rules, collecting and dispersing funds, and establishing an internal workers' compensation return-to-work program. Each entity of the State is required to participate in the program unless exempted by the director of the Office of Management and Budget. Contributions to the Fund are determined by Workforce Safety & Insurance (WSI) based on an actuarial review of combined payroll, premium, and loss history of agencies to determine experience rates, assessments, and premiums. **The actuarial assumed rate of return on assets is 3%.**

The Risk Management Workers Compensation Program charges the entity the first $250 ($0 if a designated medical provider is used for treatment) of each accepted claim and pays disability and medical benefits of up to $100,000 dollars per claim. Dollar amounts for claims in excess of $100,000 are paid for by WSI. In turn the Program pays WSI approximately $1.7 million per year in premiums.

RESPONSIBILITIES OF THE STATE INVESTMENT BOARD (SIB)

The Fund is charged by law under NDCC 21-10-02.1 with the responsibility of establishing policies on investment goals and asset allocation of the Fund. The SIB is charged with implementing these policies and asset allocation and investing the assets of the Fund in a manner consistent with the prudent investor rule as provided in NDCC 21-10-07. Under this rule, the fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.

At the discretion of the SIB, the Fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification, restrictions, and performance objectives appropriate to the prudent investor rule and objectives of the funds participating in the pools.

Management responsibility for the investment program not assigned to the SIB in Chapter 21-10 of the North Dakota Century Code (NDCC) is hereby delegated to the SIB, who must establish written policies for the operation of the investment program, consistent with this investment policy.

The SIB may delegate investment responsibility to professional money managers. When a money manager has been retained, the SIB's role in determining investment strategy and security selection is supervisory, not advisory.

At the discretion of the SIB, the Fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification,

restrictions, and performance objectives appropriate to the prudent investor rule and the objectives of the funds participating in the pools.
The SIB is responsible for establishing criteria and procedures and making decisions with respect to hiring, maintaining, and terminating money managers. This responsibility includes selecting performance measurement services, consultants, and report formats and determining the frequency of meetings with managers.

The SIB will implement changes to this policy as promptly as is prudent.

INVESTMENT OBJECTIVES

The Fund's investment objectives are expressed in terms of reward and risk expectations relative to investable, passive benchmarks. The Fund's policy benchmark is comprised of policy mix weights of appropriate asset class benchmarks as set by the SIB:

1) **The Fund's rate of return, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.**

2) **The Fund's risk, measured by the standard deviation of net returns, should not exceed the risk of the policy benchmark by more than 1% over a minimum evaluation period of five years. For example, if the risk of the policy benchmark is 4%, the Fund's risk should not exceed 5% over a five-year period.**

3) **The risk adjusted performance of the Fund, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.**

POLICY ASSET MIX

The asset allocation of the Fund is established by the SIB, with input from the OMB. Asset allocation is based upon the appraisal of projected liquidity and income requirements, and estimates of the investment returns likely to be achieved by the various asset classes over the next five years.

In recognition of these factors, the following allocation is deemed appropriate for the Fund:

Large Cap Domestic Equity	27.75%
Small Cap Domestic Equity	9.25%
Fixed Income	60.0%
Cash Equivalents	3.0%

While the Fund recognizes fluctuations in market values will lead to short-term deviations from policy targets, the Fund does not intend to engage in tactical asset allocation.

Rebalancing of the Fund to this allocation will be done in accordance with the SIB's rebalancing policy.

RESTRICTIONS

While the SIB is responsible for establishing specific quality, diversification, restrictions, and performance objectives for the investment vehicles in which the Fund's assets will be invested, it is understood that:

a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.
b. Derivative use will be monitored to ensure that undue risks are not taken by the money managers.
c. No transaction shall be made which threatens the tax exempt status of the Fund.

d. All assets will be held in custody by the SIB's master custodian or such other custodians as are acceptable to the SIB.
e. No funds shall be borrowed.
f. No unhedged short sales or speculative margin purchases shall be made.
g. Social investing is prohibited unless it meets the Exclusive Benefit Rule and it can be substantiated that the investment must provide an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.

   For the purpose of this document, Social Investing is defined as "The investment or commitment of public fund money for the purpose of obtaining an effect other than a maximized return to the intended beneficiaries."

h. Economically targeted investing is prohibited unless the investment meets the Exclusive Benefit Rule.

   For the purpose of this document economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved, as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

   Also, for the purpose of this document, the Exclusive Benefit Rule is met if the following four conditions are satisfied:

   (1) The cost does not exceed the fair market value at the time of investment.
   (2) The investment provides the Fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
   (3) Sufficient liquidity is maintained in the Fund to permit distributions in accordance with the terms of the plan.
   (4) The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity are equivalent, the Fund's policy favors investments which will have a positive impact on the economy of North Dakota.

INTERNAL CONTROLS

A system of internal controls must be in place by the SIB to prevent losses of public funds arising from fraud or employee error. Such controls deemed most important are the separation of responsibilities for investment purchases from the recording of investment activity, custodial safekeeping, written confirmation of investment transactions, and established criteria for broker relationships. The annual financial audit must include a comprehensive review of the portfolio, accounting procedures for security transactions and compliance with the investment policy.

EVALUATION AND REVIEW

Investment management of the Fund will be evaluated against the Fund's investment objectives. Evaluation should include an assessment of the continued feasibility of achieving the investment objectives and the appropriateness of the Investment Policy Statement for achieving those objectives.

Performance reports will be provided to the Fund periodically, but not less than annually. Such reports will include asset returns and allocation data as well as information regarding all significant and/or material matters and changes pertaining to the investment of the Fund, including but not limited to:

1) A list of the advisory services managing investments for the board.

2) A list of investments at market value, compared to previous reporting period, of each fund managed by each advisory service.
3) Earnings, percentage earned, and change in market value of each fund's investments.
4) Comparison of the performance of each fund managed by each advisory service to other funds under the board's control and to generally accepted market indicators.
5) All material legal or legislative proceedings affecting the SIB.
6) Compliance with this investment policy statement

Approved by:

OFFICE OF MANAGEMENT AND BUDGET	**STATE INVESTMENT BOARD**
________________________________	________________________________
Pam Sharp	**David Hunter**
Director	**Executive Director / CIO**
Date: _________________________	**Date:** _____________________________

Approved by the NDSIB:
Approved by OMB:

AGENDA ITEM V.C.

To:	**State Investment Board**
From:	**Dave Hunter, Executive Director / CIO**
Date:	**January 20, 2017**
RE:	**Executive Director / CIO Effectiveness Survey – Cover Memo**

Background, Scope and Results Summary:

The background, scope and results of the annual Executive Director / CIO Effectiveness Survey are summarized and detailed on the following ten pages.

Overview of the Executive Director / CIO Employee Opinion Survey Results:

I am pleased to report that 86% of the survey responses indicated that they "Agree" or "Strongly Agree" with the overall effectiveness of the ED/CIO, for which I am sincerely grateful. This is a moderate decline from last year in which 91% of the survey responses were recorded as "Agree" or "Strongly Agree", but remains a marked improvement from 78% two years ago. **The most significant area of improvement over the last two years occurred in "Leadership" which improved to 93% in 2016** (versus 89% in 2015 and 63% in 2014). I am also pleased to report that **"Valuing Employees" remained high at 93%** (although down from 96% in 2015). **I clearly need to improve my "Communication" rating which declined to 74% in 2016 from 89% in 2015** (versus 63% in 2014) and have developed a plan to enhance overall office communication which is in the process of being rolled out this month. RIO team members provided a great deal of constructive feedback which demonstrates a high level of engagement and sincere desire for further improvements. I take all constructive comments and recommendations to heart. As such, I endeavor to continue to improve upon my own overall effectiveness in the upcoming year.

SIB Review of the Executive Director/CIO:

RIO's Supervisor of Audit Services, Terra Miller-Bowley, is in the process of finalizing the Executive Limitations Audit for 2016 and will present the findings to the SIB Audit Committee and SIB in February. **SIB Governance Manual C-4 on "Monitoring Executive Performance" states that "Each March the board will conduct a formal evaluation of the ED/CIO. This evaluation will be based on accomplishments of *Ends* and *Compliance with Executive Limitations*. At the February board meeting, the chairperson will appoint a three-member committee to review the board's evaluation and make a recommendation to the full board concerning the salary for ED/CIO."** Terra will also be available to assist the Executive Review Committee as needed. In prior years RIO's Audit Services Division has surveyed members of the SIB on behalf of the Executive Review Committee as a part of the evaluation process of the Executive Director/CIO.

Attachments: Executive Director / CIO Effectiveness Survey

Executive Limitations: Staff Relations / Survey Results

Three-Year Trend Analysis:	2014	2015	2016	Approval Rating (Strongly Agree or Agree / Total Responses)
Leadership 1	78%	80%	**89%**	The ED/CIO provides a clear sense of purpose and direction, roles and responsibillities, for me and our team as a whole.
Leadership 2	78%	87%	**89%**	The ED/CIO have confidence in the ED/CIO.
Leadership 3	94%	100%	**100%**	The ED/CIO demonstrates integrity and sets an example for others to follow.
Communication 1	89%	93%	**78%**	**The ED/CIO takes time to understand other perspectives and is open to changing his position.**
Communication 2	39%	93%	**83%**	The ED/CIO keeps employees informed about what is occurring throughout the organization.
Communication 3	61%	80%	**61%**	**Information and knowledge are shared openly within this organization.**
Valuing Employees 1	61%	87%	**83%**	The ED/CIO seeks input from all team members.
Valuing Employees 2	100%	100%	**94%**	The ED/CIO shows genuine concern for team members.
Valuing Employees 3	100%	100%	**100%**	The ED/CIO treats employees with respect.
Overall Approval Rating	**78%**	**91%**	**86%**	**The Overall Approval Rating remained good at 86%, although it declined by 5% (from 91%) in the prior year.**

	2014	2015	2016
Leadership Average	**83%**	**89%**	**93%**
Communication Average	**63%**	**89%**	**74%**
Valuing Employees Average	**87%**	**96%**	**93%**

The Leadership rating improved to 93% in 2016, while the Communication rating declined from 89% to 74% last year. Valuing Employees remained good at 93%.

Proposed Action Plan:

1. **Review and discuss the results of the ED/CIO survey at the January office meeting.**
2. **Invite input on the recent elimination of the Office Calendar and its impact on office information sharing.**
3. **Request managers to hold team meetings to learn of new ways to improve office communication.**

North Dakota Retirement and Investment Office

Audit Services

Executive Director/CIO Effectiveness Survey Results

January 4, 2017

Background

The Audit Services Division of the Retirement and Investment Office (RIO) on an annual basis reviews the Executive Director/CIO's level of compliance with State Investment Board (SIB) Governance Manual Executive Limitation policies A-1 through A-11. Executive Limitation policy A-2 references staff relations. In an effort to gain insight into the relationship which exists between the Executive Director/CIO and staff an organization wide employee opinion survey is conducted annually to provide employees the opportunity to evaluate the effectiveness of the Executive Director/CIO in the areas of leadership, communication, and valuing employees. The results of this survey are then used to determine the Executive Director/CIO's compliance with Executive Limitation policy A-2.

Scope

The survey is comprised of nine multiple choice questions and one open ended question. The multiple choice questions focus on the areas of leadership, communication, and valuing employees with three questions dedicated to each area. Staff are presented with a statement and asked to select the option which best reflects how strongly they agree or disagree with the statement. Available options include strongly agree, agree, neither agree or disagree, disagree, and strongly disagree. The open ended question provides staff with the opportunity to provide comments and constructive feedback pertaining to their overall satisfaction with the job being done by the Executive Director/CIO, what the Executive Director/CIO has done well, and what the Executive Director/CIO could do better in the future.

Results Summary

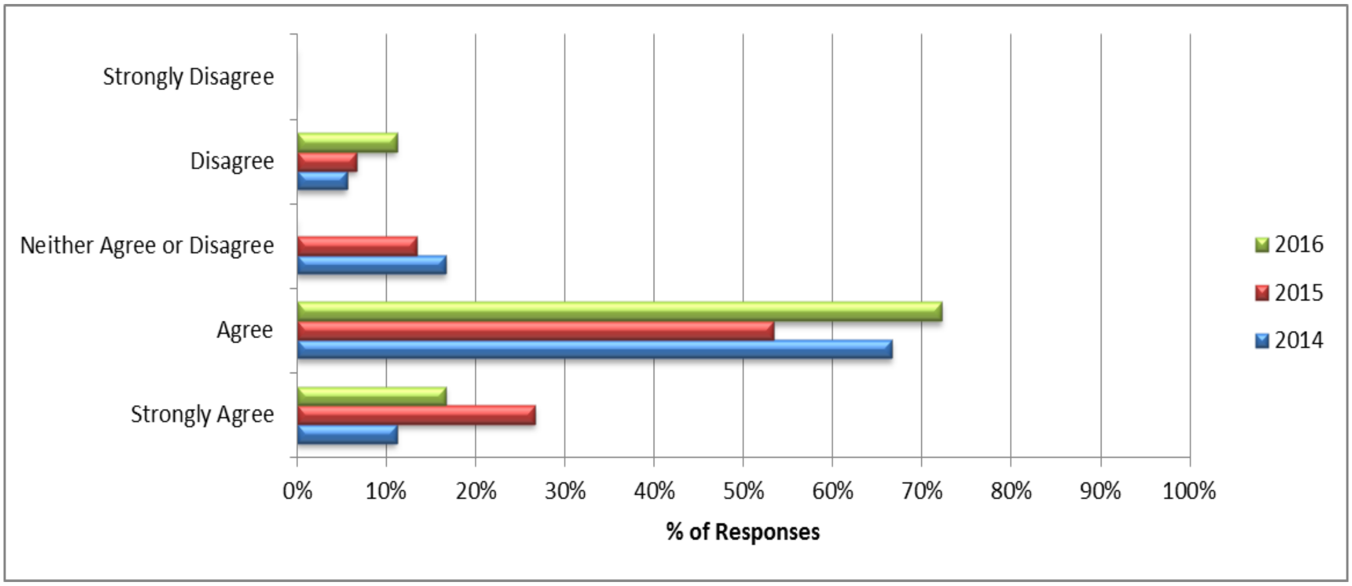
Survey participation increased in 2016, responses were received from all eighteen employees. This is consistent with 2014 participation levels and an improvement over 2015. Overall survey responses continued to trend positive although some minor dissent was noted. Employees continue to provide the Executive Director/CIO with high marks with regards to leadership. The Executive Director/CIO continues to provide a clear sense of purpose and direction and defines roles and responsibilities for team members. The confidence employees have in the Executive Director/CIO continues to increase year after year and employees overwhelming believe the Executive Director/CIO demonstrates integrity and sets an example for others. Communication continues to be an area where employees find opportunity for improvement. However responses received regarding communication were contradictory in nature. An increased number of employees indicated that they do not believe the Executive Director/CIO takes time to understand other perspectives and is open to changing his mind. There is also less belief that information and knowledge are shared openly within the organization. However more employees do believe that the Executive Director/CIO keeps employees informed about what is occurring throughout the organization and seeks input from all team members. Consistent with prior years the Executive Director/CIO received favorable responses in the area of valuing employees. Staff overwhelmingly agrees that the Executive Director/CIO shows genuine concern for staff and treats everyone with respect.

The responses to the open ended question were very positive with a majority of employees indicating that they are very satisfied with the job being done by the Executive Director/CIO. Comments indicate that the Executive Director/CIO provides great leadership to RIO. Numerous employees indicated that Executive Director/CIO is open, approachable, professional, and respectful, exhibits a positive attitude, and genuinely cares for employees. Many employees indicated that they are very appreciative of the efforts which have been made for staff over the last year including more jeans days, increased flex scheduling, gift cards, improved working conditions, office lunches, etc. Employees also indicated that they believe efforts have been made to improve communication throughout the office during the past year and would encourage the Executive Director/CIO to continue those efforts in the coming year. Several employees did express concern regarding the phasing out of the office calendar and its effect on communication in the future. A number of employees also expressed concern regarding decreased morale throughout the office during the last year and decreasing participation in office activities. A few employees also indicated concern regarding the equitable treatment of employees, expressing a sentiment that some employees and/or divisions are favored over others.

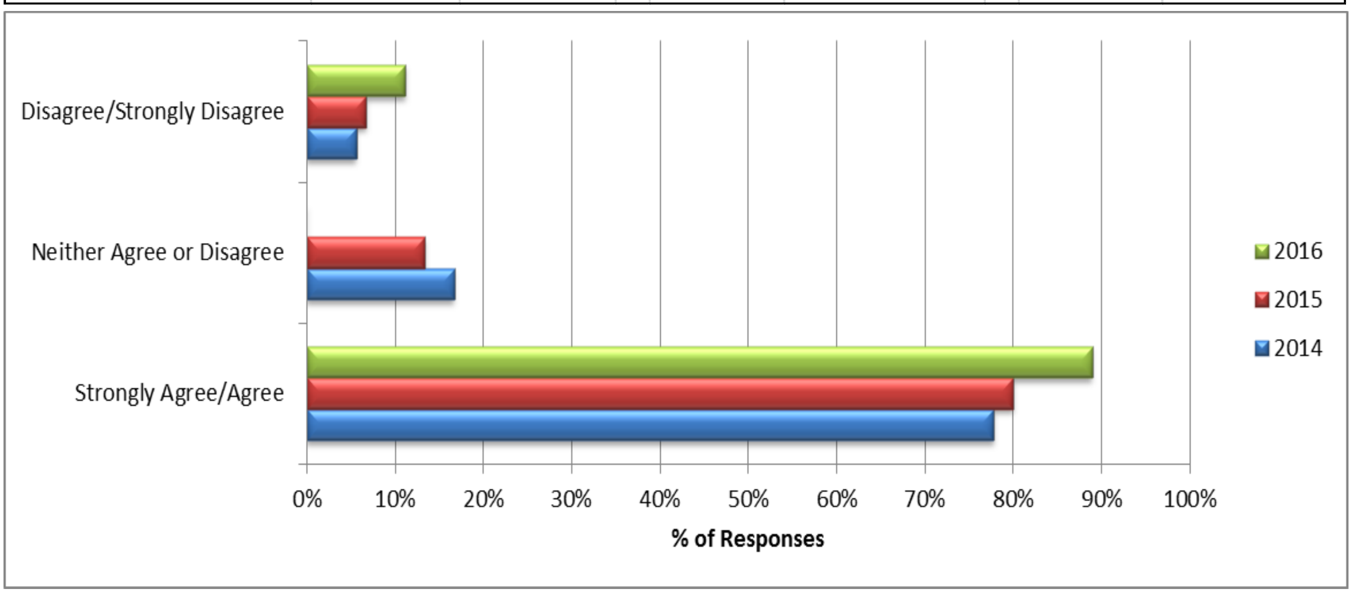
Executive Director/CIO Effectiveness - Leadership

Question 1: *The Executive Director/CIO provides a clear sense of purpose and direction, roles and responsibilities, for me and our team as a whole.*

Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree	2	11.11%	4	26.67%	3	16.67%
Agree	12	66.67%	8	53.33%	13	72.22%
Neither Agree or Disagree	3	16.67%	2	13.33%	0	0.00%
Disagree	1	5.56%	1	6.67%	2	11.11%
Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



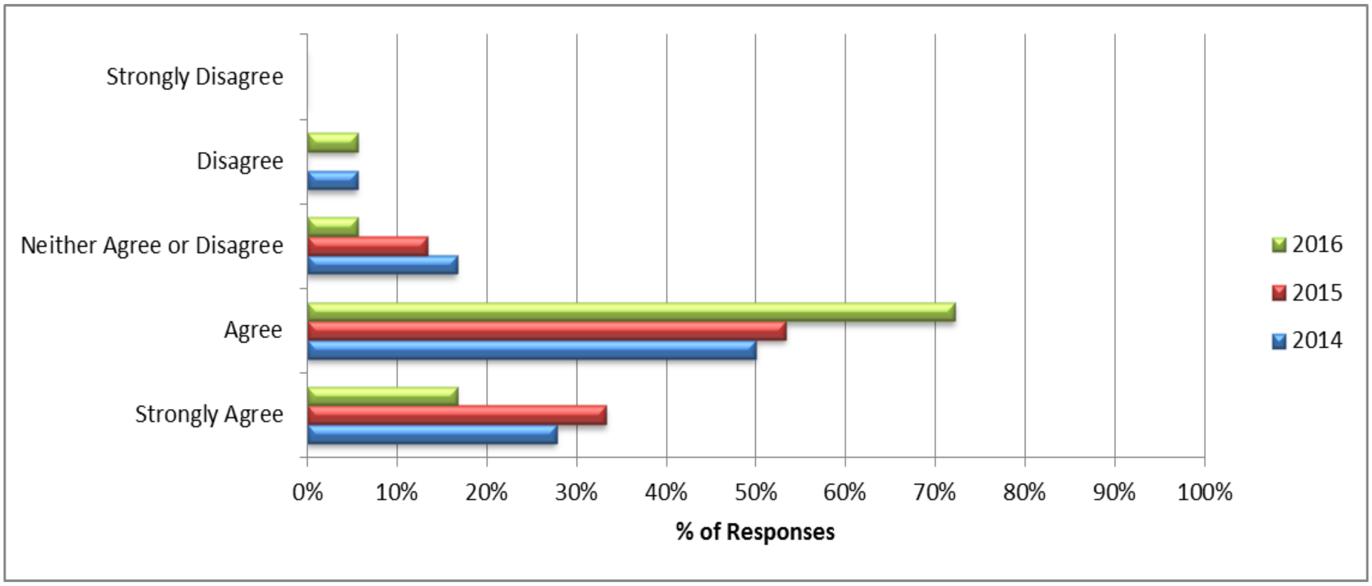
Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree/Agree	14	77.78%	12	80.00%	16	88.89%
Neither Agree or Disagree	3	16.67%	2	13.33%	0	0.00%
Disagree/Strongly Disagree	1	5.56%	1	6.67%	2	11.11%
	18	100.00%	15	100.00%	18	100.00%



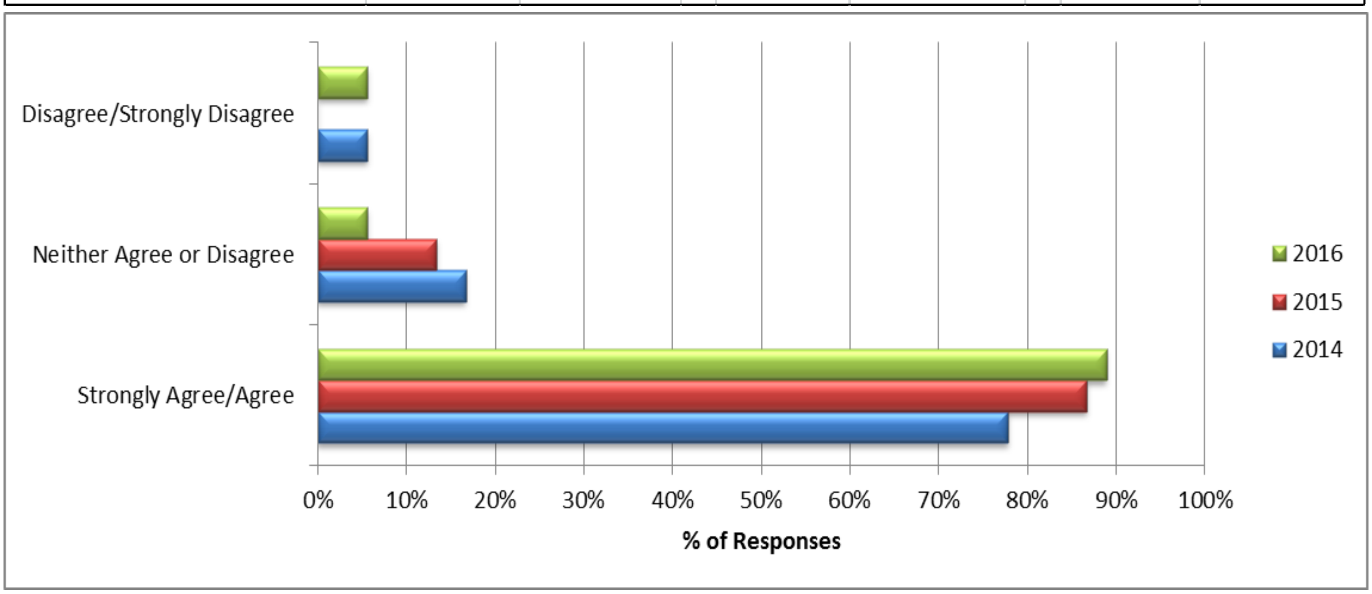
Executive Director/CIO Effectiveness – Leadership

Question 2: *Employees have confidence in the Executive Director/CIO.*

Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree	5	27.78%	5	33.33%	3	16.67%
Agree	9	50.00%	8	53.33%	13	72.22%
Neither Agree or Disagree	3	16.67%	2	13.33%	1	5.56%
Disagree	1	5.56%	0	0.00%	1	5.56%
Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



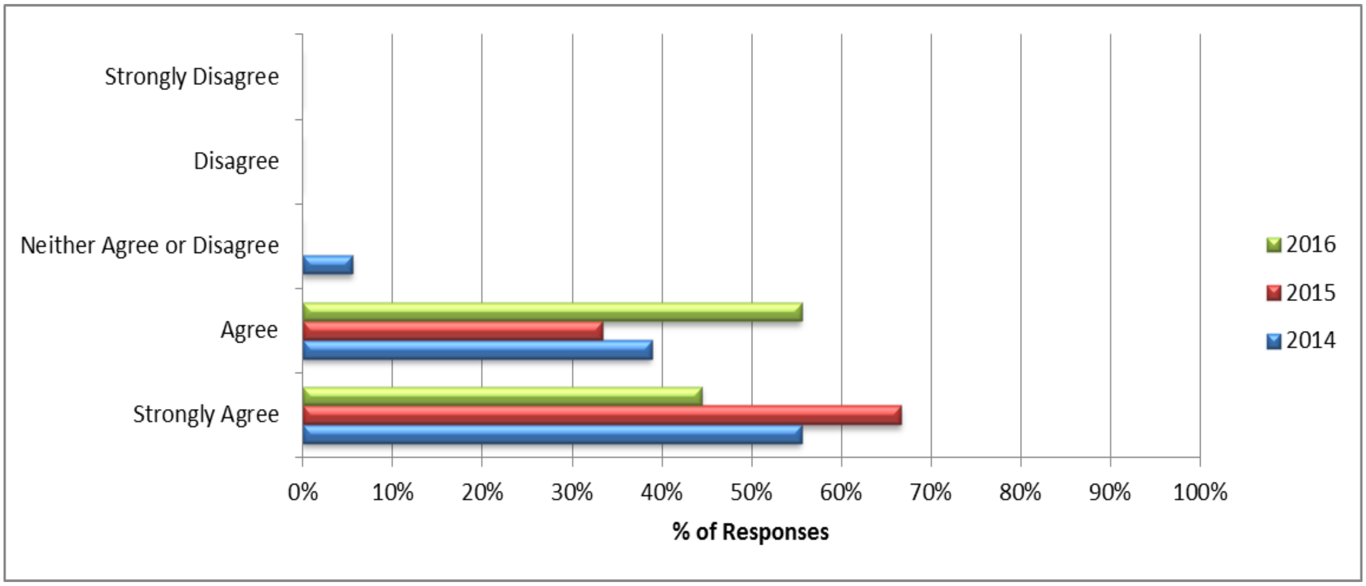
Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree/Agree	14	77.78%	13	86.67%	16	88.89%
Neither Agree or Disagree	3	16.67%	2	13.33%	1	5.56%
Disagree/Strongly Disagree	1	5.56%	0	0.00%	1	5.56%
	18	100.00%	15	100.00%	18	100.00%



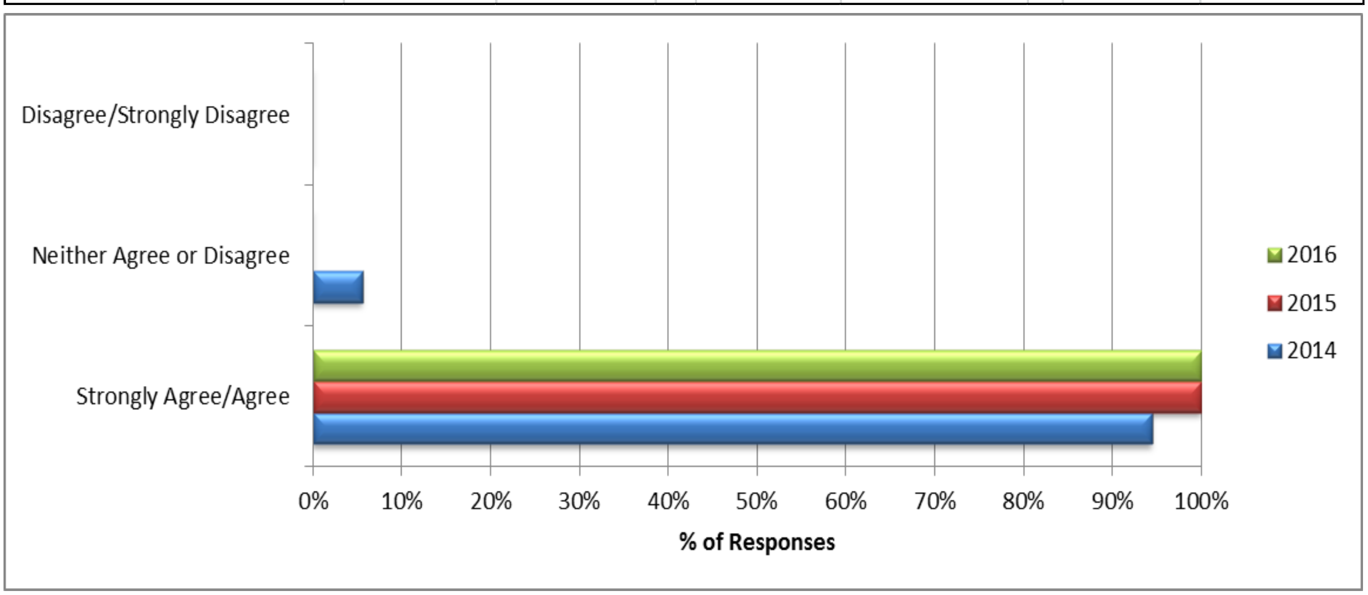
Executive Director/CIO Effectiveness - Leadership

Question 3: *The Executive Director/CIO demonstrates integrity and sets an example for others to follow.*

Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree	10	55.56%	10	66.67%	8	44.44%
Agree	7	38.89%	5	33.33%	10	55.56%
Neither Agree or Disagree	1	5.56%	0	0.00%	0	0.00%
Disagree	0	0.00%	0	0.00%	0	0.00%
Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



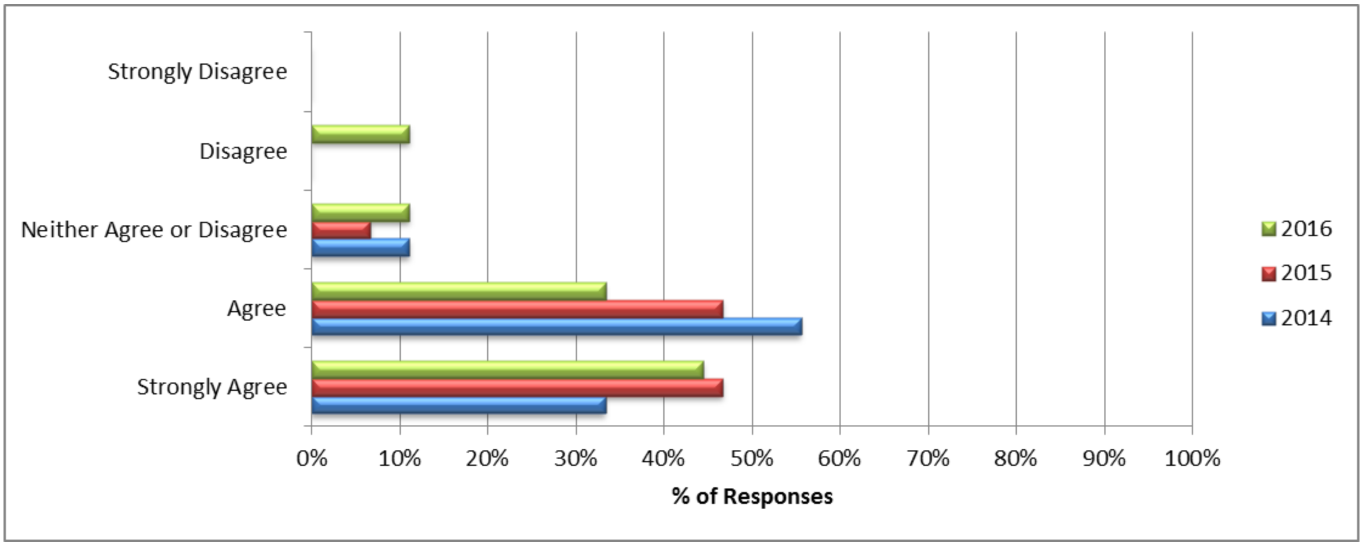
Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree/Agree	17	94.44%	15	100.00%	18	100.00%
Neither Agree or Disagree	1	5.56%	0	0.00%	0	0.00%
Disagree/Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



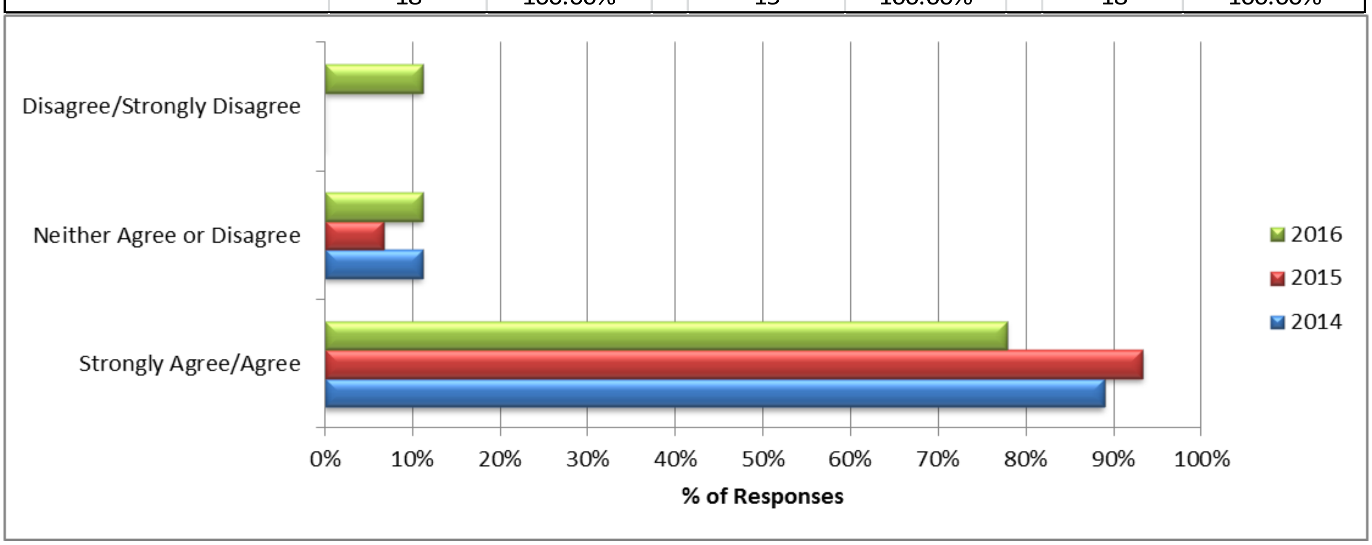
Executive Director/CIO Effectiveness – Communication

Question 4: *The Executive Director/CIO takes time to understand other perspectives and is open to changing his position.*

Answer Choices	2014 Responses	2014 % Responses	2015 Responses	2015 % Responses	2016 Responses	2016 % Responses
Strongly Agree	6	33.33%	7	46.67%	8	44.44%
Agree	10	55.56%	7	46.67%	6	33.33%
Neither Agree or Disagree	2	11.11%	1	6.67%	2	11.11%
Disagree	0	0.00%	0	0.00%	2	11.11%
Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



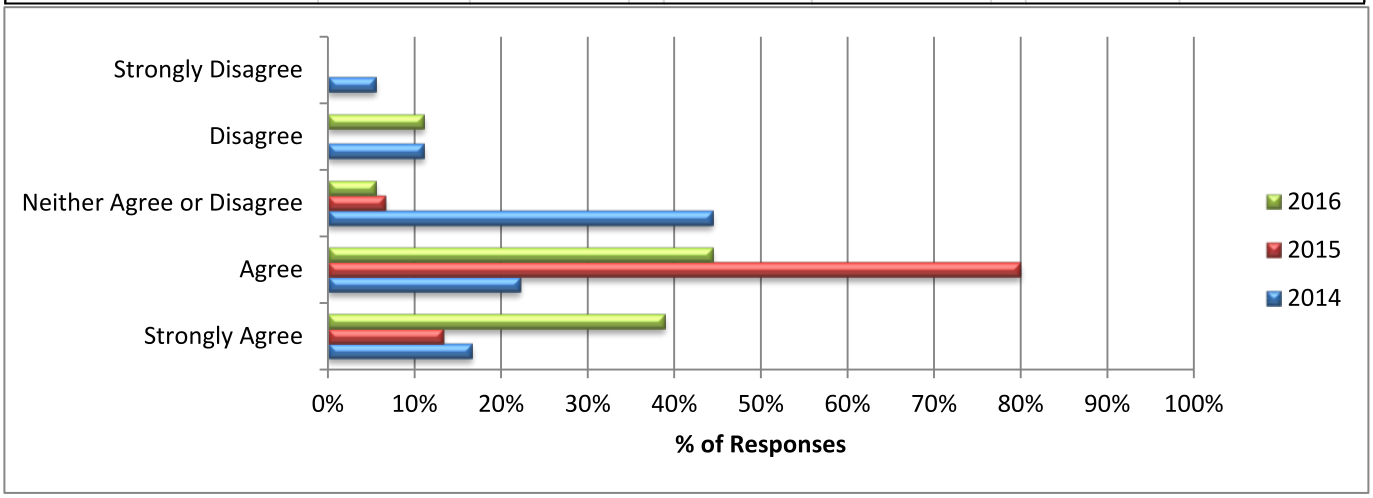
Answer Choices	2014 Responses	2014 % Responses	2015 Responses	2015 % Responses	2016 Responses	2016 % Responses
Strongly Agree/Agree	16	88.89%	14	93.33%	14	77.78%
Neither Agree or Disagree	2	11.11%	1	6.67%	2	11.11%
Disagree/Strongly Disagree	0	0.00%	0	0.00%	2	11.11%
	18	100.00%	15	100.00%	18	100.00%



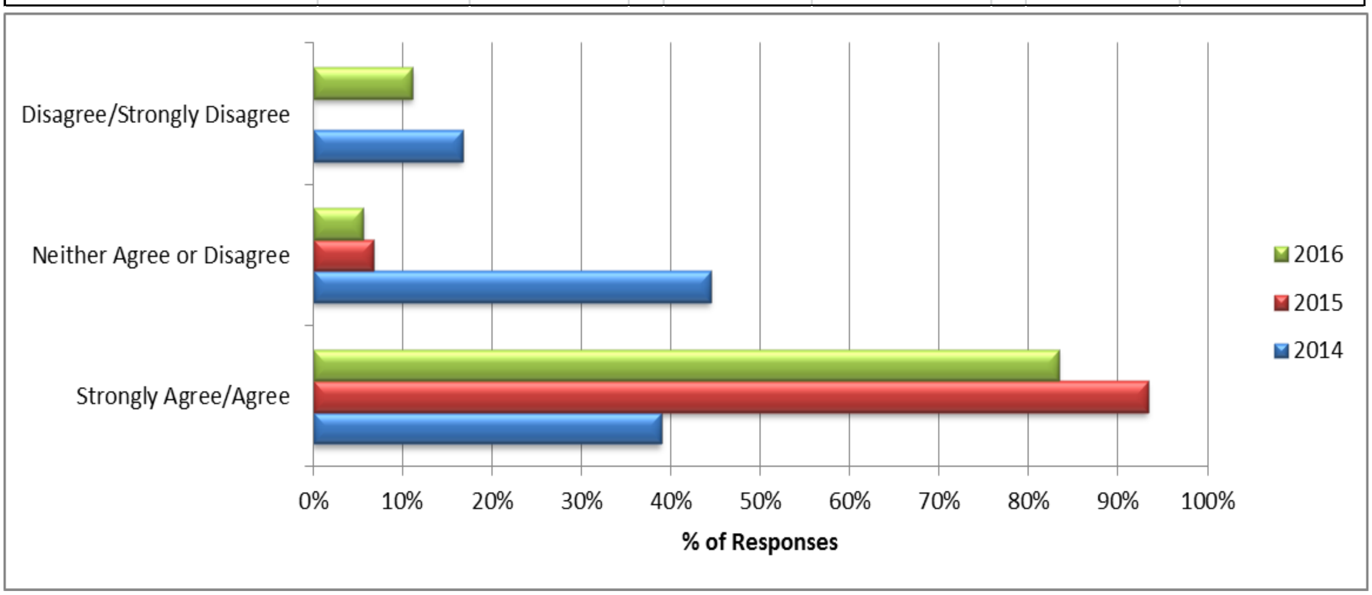
Executive Director/CIO Effectiveness - Communication

Question 5: *The Executive Director/CIO keeps employees informed about what is occurring throughout the organization.*

Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree	3	16.67%	2	13.33%	7	38.89%
Agree	4	22.22%	12	80.00%	8	44.44%
Neither Agree or Disagree	8	44.44%	1	6.67%	1	5.56%
Disagree	2	11.11%	0	0.00%	2	11.11%
Strongly Disagree	1	5.56%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



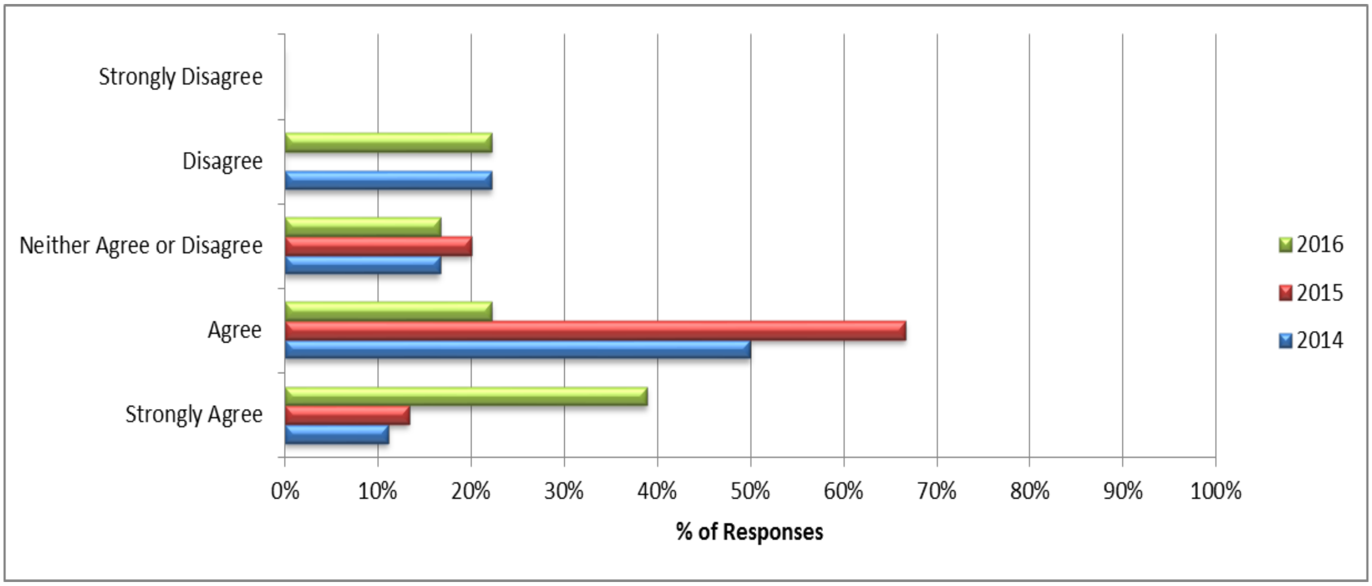
Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree/Agree	7	38.89%	14	93.33%	15	83.33%
Neither Agree or Disagree	8	44.44%	1	6.67%	1	5.56%
Disagree/Strongly Disagree	3	16.67%	0	0.00%	2	11.11%
	18	100.00%	15	100.00%	18	100.00%



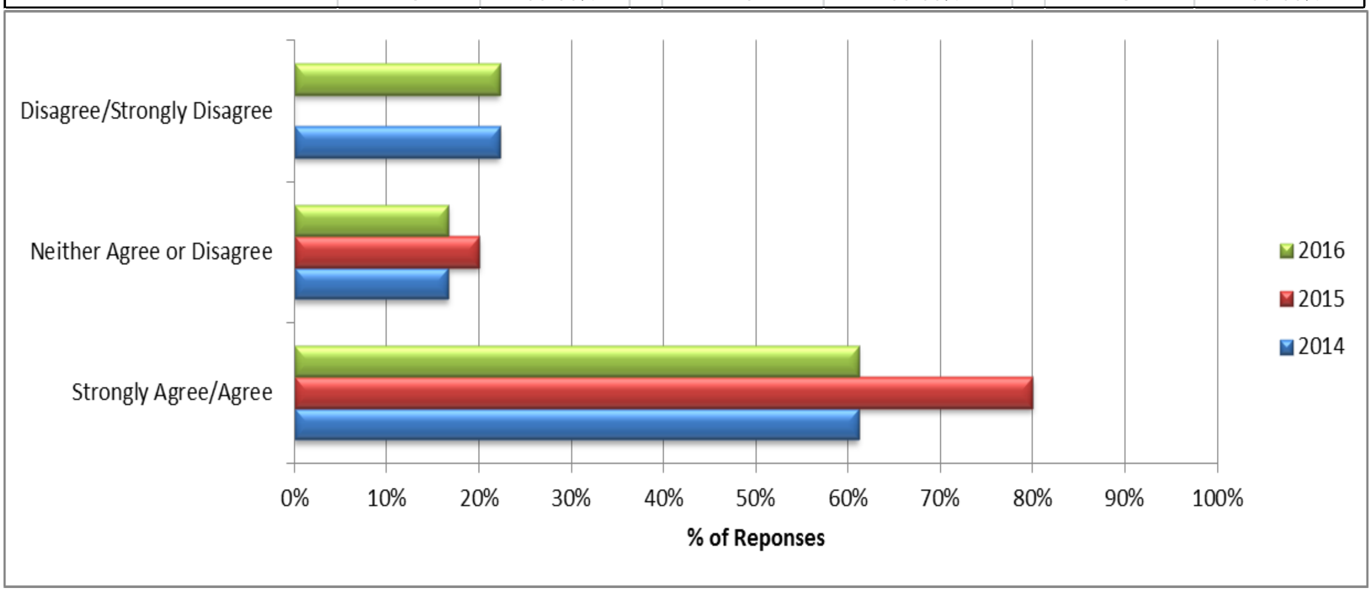
Executive Director/CIO Effectiveness - Communication

Question 6: *Information and knowledge are shared openly within this organization.*

Answer Choices	2014 Responses	2014 % Responses	2015 Responses	2015 % Responses	2016 Responses	2016 % Responses
Strongly Agree	2	11.11%	2	13.33%	7	38.89%
Agree	9	50.00%	10	66.67%	4	22.22%
Neither Agree or Disagree	3	16.67%	3	20.00%	3	16.67%
Disagree	4	22.22%	0	0.00%	4	22.22%
Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	1



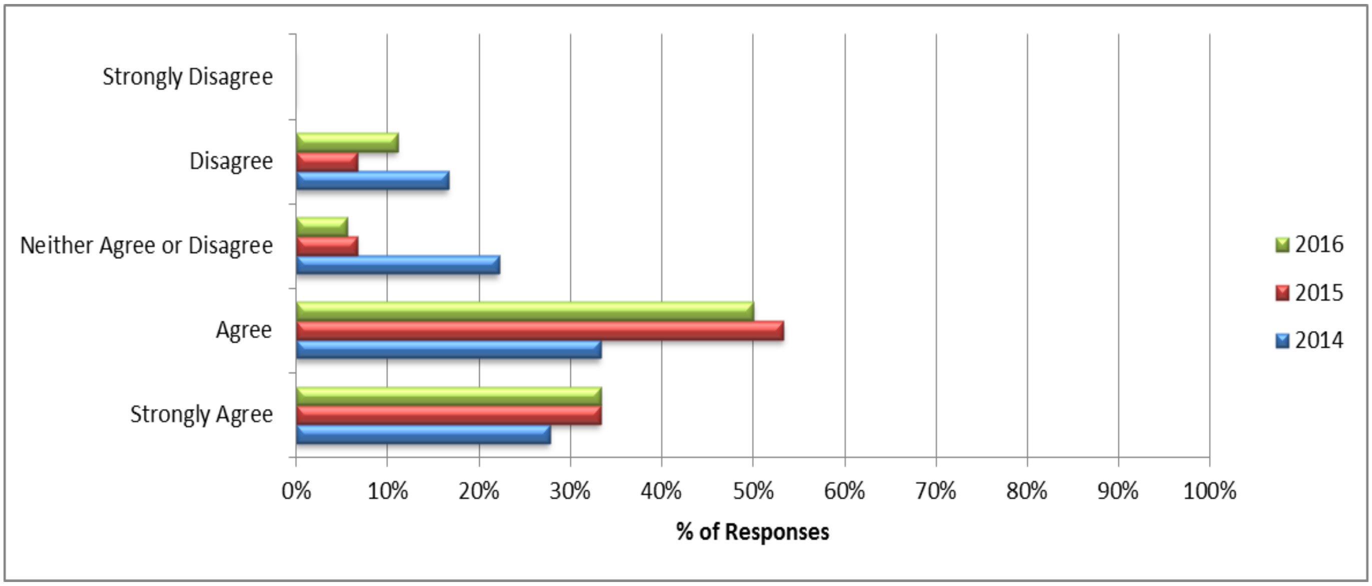
Answer Choices	2014 Responses	2014 % Responses	2015 Responses	2015 % Responses	2016 Responses	2016 % Responses
Strongly Agree/Agree	11	61.11%	12	80.00%	11	61.11%
Neither Agree or Disagree	3	16.67%	3	20.00%	3	16.67%
Disagree/Strongly Disagree	4	22.22%	0	0.00%	4	22.22%
	18	100.00%	15	100.00%	18	100.00%



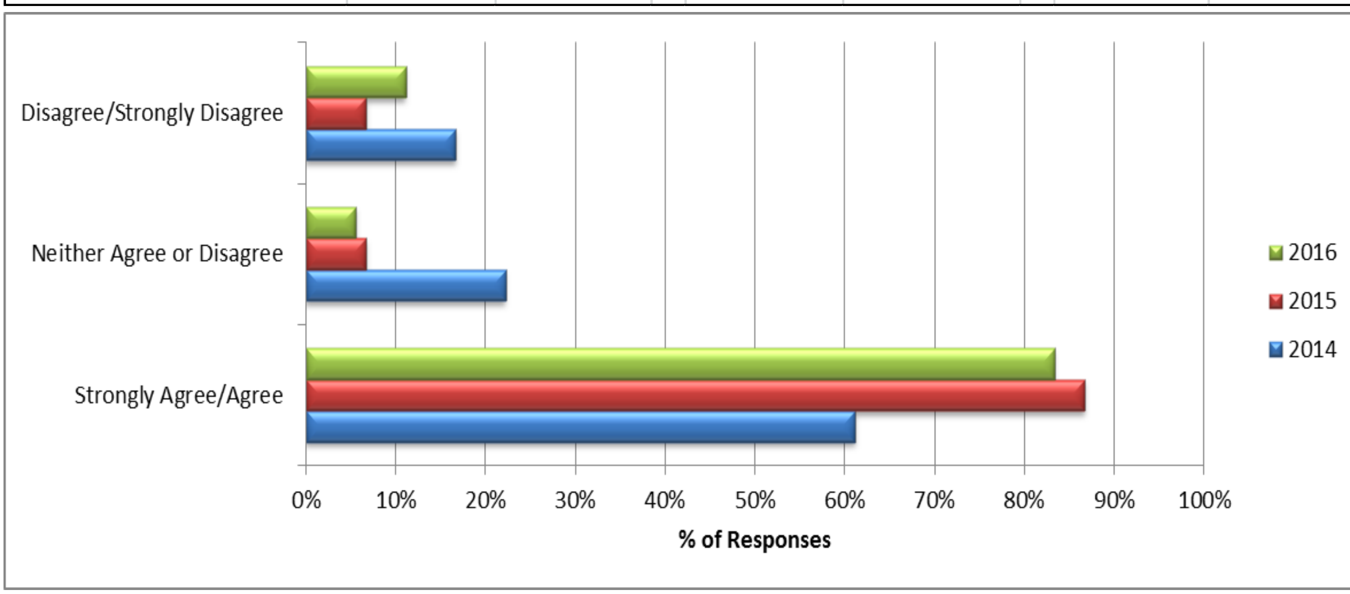
Executive Director/CIO Effectiveness – Valuing Employees

Question 7: *The Executive Director/CIO seeks input from all team members.*

Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree	5	27.78%	5	33.33%	6	33.33%
Agree	6	33.33%	8	53.33%	9	50.00%
Neither Agree or Disagree	4	22.22%	1	6.67%	1	5.56%
Disagree	3	16.67%	1	6.67%	2	11.11%
Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



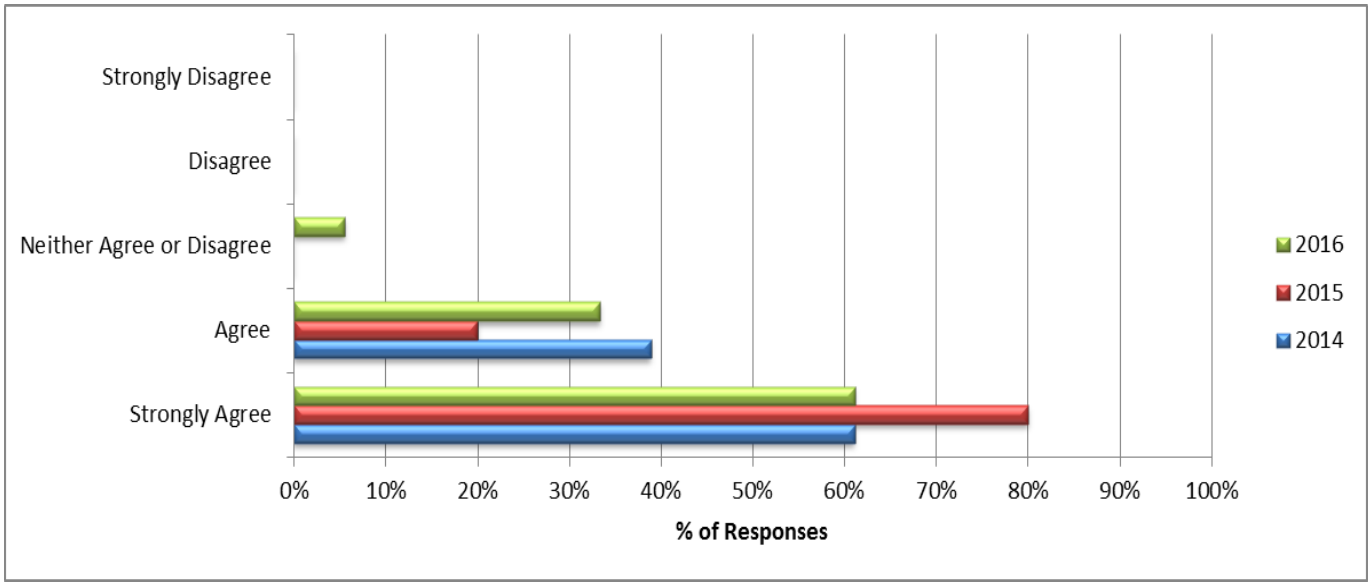
Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree/Agree	11	61.11%	13	86.67%	15	83.33%
Neither Agree or Disagree	4	22.22%	1	6.67%	1	5.56%
Disagree/Strongly Disagree	3	16.67%	1	6.67%	2	11.11%
	18	100.00%	15	100.00%	18	100.00%



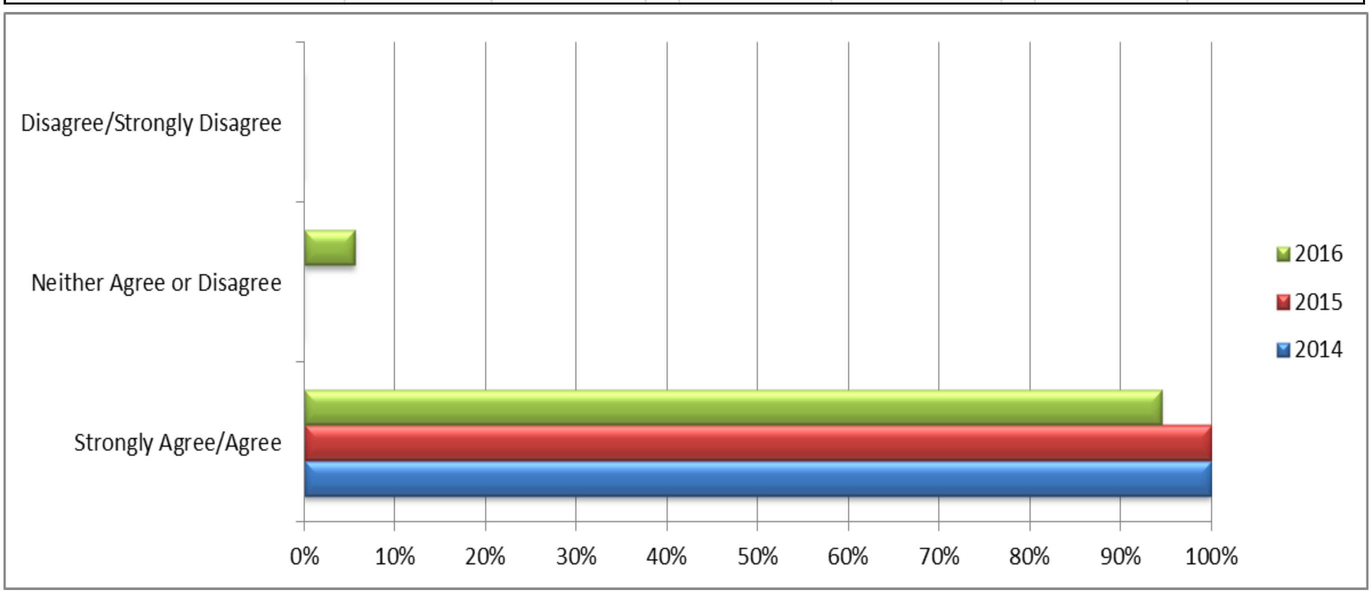
Executive Director/CIO Effectiveness – Valuing Employees

Question 8: *The Executive Director/CIO shows genuine concern for team members.*

Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree	11	61.11%	12	80.00%	11	61.11%
Agree	7	38.89%	3	20.00%	6	33.33%
Neither Agree or Disagree	0	0.00%	0	0.00%	1	5.56%
Disagree	0	0.00%	0	0.00%	0	0.00%
Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



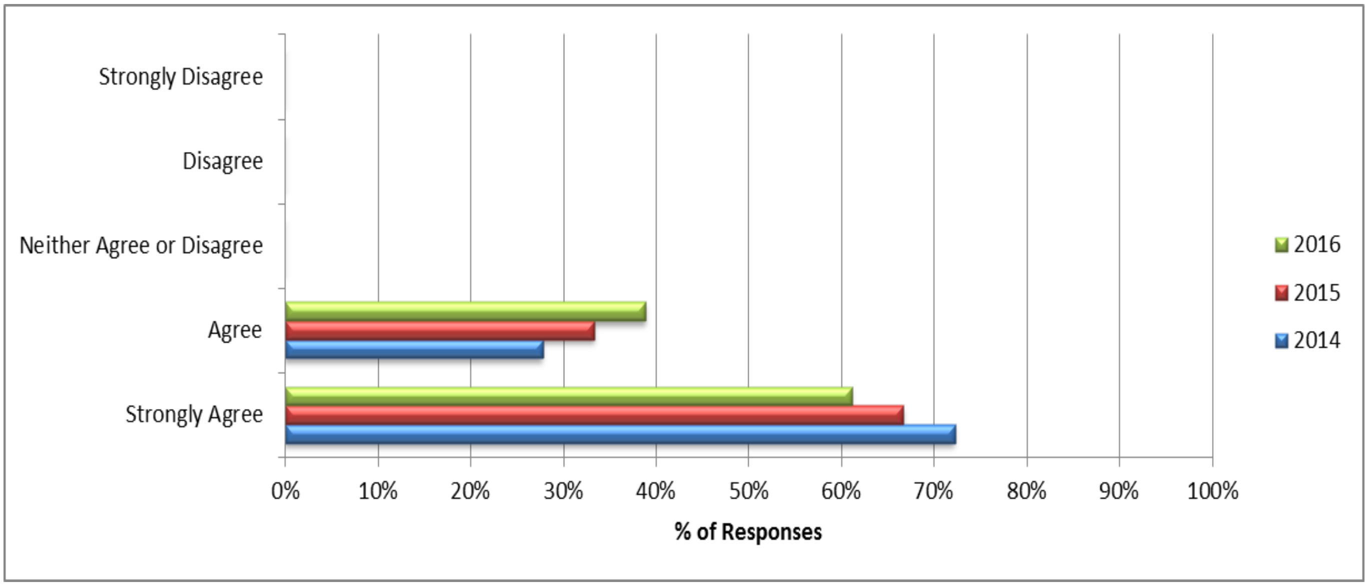
Answer Choices	*2014 Responses*	*2014 % Responses*	*2015 Responses*	*2015 % Responses*	*2016 Responses*	*2016 % Responses*
Strongly Agree/Agree	18	100.00%	15	100.00%	17	94.44%
Neither Agree or Disagree	0	0.00%	0	0.00%	1	5.56%
Disagree/Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



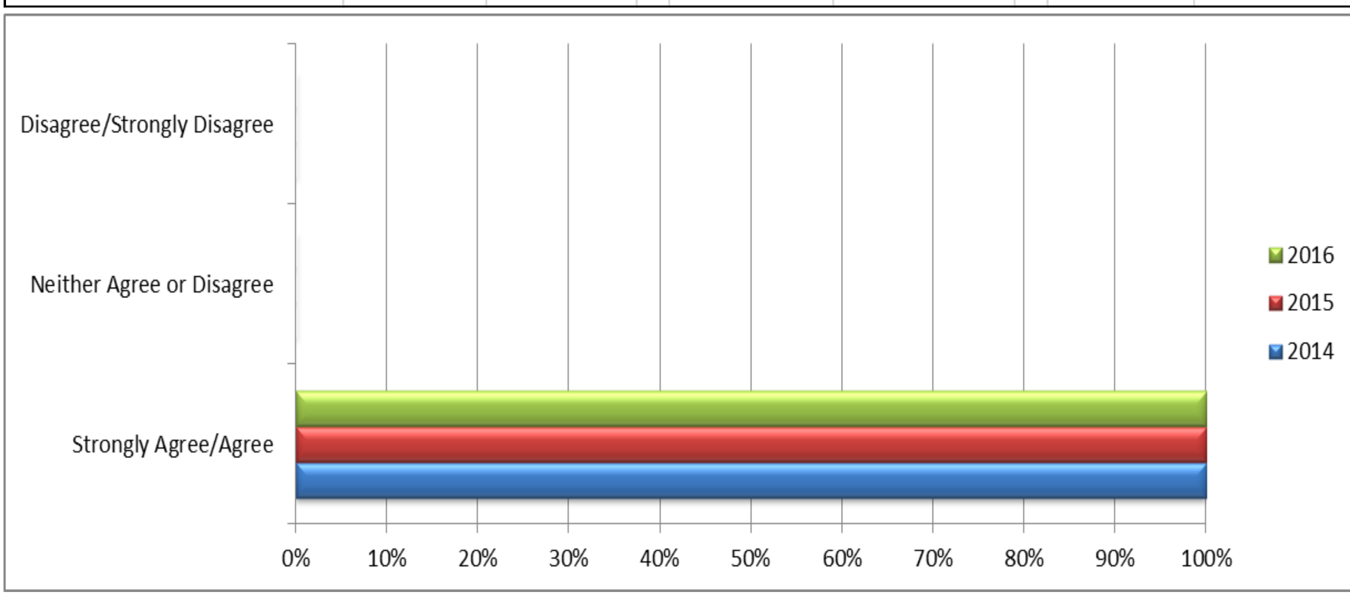
Executive Director/CIO Effectiveness – Valuing Employees

Question 9: *The Executive Limitation/CIO treats employees with respect.*

Answer Choices	2014 Responses	2014 % Responses	2015 Responses	2015 % Responses	2016 Responses	2016 % Responses
Strongly Agree	13	72.22%	10	66.67%	11	61.11%
Agree	5	27.78%	5	33.33%	7	38.89%
Neither Agree or Disagree	0	0.00%	0	0.00%	0	0.00%
Disagree	0	0.00%	0	0.00%	0	0.00%
Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



Answer Choices	2014 Responses	2014 % Responses	2015 Responses	2015 % Responses	2016 Responses	2016 % Responses
Strongly Agree/Agree	18	100.00%	15	100.00%	18	100.00%
Neither Agree or Disagree	0	0.00%	0	0.00%	0	0.00%
Disagree/Strongly Disagree	0	0.00%	0	0.00%	0	0.00%
	18	100.00%	15	100.00%	18	100.00%



Agenda Item V. D.

Legacy and Budget Stabilization Fund Advisory Board

December 5, 2016

Dave Hunter, Executive Director/CIO

Darren Schulz, Deputy Chief Investment Officer

ND Retirement & Investment Office (RIO)

State Investment Board (SIB)

Agenda

- **Budget Stabilization Fund**
  - Investment Balances – Impact of Transfers to General Fund and Legacy Fund
  - Asset Allocation – September 30, 2016
  - Actual versus Expected Results – September 30, 2016
  - Investment Returns – June 30, 2016
  - Investment Fees and Expenses – June 30, 2016
  - Investment Policy Statement – August 3, 2016

- **Legacy Fund**
  - Investment Balances – Impact of BND Match Loan CD Transfer to Legacy Fund
  - Asset Allocation – September 30, 2016
  - Actual versus Expected Results – September 30, 2016
  - Investment Returns – June 30, 2016
  - Investment Fees and Expenses – June 30, 2016
  - Investment Policy Statement – August 3, 2016

- **Appendix**
  - This section is provided for reference purposes only.

Note: Interim amounts and estimates are unaudited and subject to change.

Budget Stabilization Fund

RIO Update

Budget Stabilization Fund – Investment Balances

Funding, Income and Disbursement History

Budget Stabilization Fund

Through September 30, 2016

	New Money In	Net Increase	Income Distributions Out	Net Assets End of Period
FY2006 (Initial Funding - Sept. 2005)	99,472,631	3,611,730	(3,207,845)	99,876,516
FY2007	-	4,980,987	(4,981,500)	99,876,003
FY2008	100,527,369	122,430	(1,688,532)	198,837,270
FY2009	-	(8,736,058)	-	190,101,212
FY2010	124,936,548	21,464,258	(11,385,172)	325,116,846
FY2011	-	12,031,101	(11,474,863)	325,673,084
FY2012	61,414,562	7,867,160	-	394,954,806
FY2013	-	7,239,388	(1,036,797)	401,157,397
FY2014	181,060,584	10,966,393	(7,183,404)	586,000,970
FY2015	-	10,992,146	(23,332,755)	573,636,701 [1]
FY2016	-	10,684,659	(8,606,169)	575,715,191
FY2017	-	2,375,843	-	578,091,034
	567,411,694	83,600,037	(72,897,037)	
Net Increase - Inception to Date	83,600,037		2,375,843	
Income Distributions Taken	(72,897,037)			
Income Retained in Fund	10,703,000			
September 30, 2016 Market Value	578,309,532			

1 - GASB 68 Implementation Restatement ($23,660)

The Budget Stabilization Fund grew to exceed $578 million as of Sep. 30, 2016.

Note: Amounts are preliminary, unaudited and subject to change.

Budget Stabilization Fund – Investment Balances

Impact of Transfers to the General Fund and Legacy Fund – Oct. 31, 2016

October Update: RIO transferred $375 million to the General Fund in October which reduced the Budget Stabilization Fund to approximately $203.6 million at October 31, 2016.

Key: RIO has commenced the transfer of the BND Match Loan CD Program to the Legacy Fund in October and will complete the transition in the next several months.

	October-16			Current FYTD Returns	
		Allocation			
	Market Value	Actual	Policy	Gross	Net
TOTAL BUDGET STABILIZATION FUND	**203,625,307**	**100.0%**	**100.0%**	**0.53%**	**0.50%**
POLICY TARGET BENCHMARK				*0.01%*	*0.01%*
Bank of ND Match Loan CDs	**47,592,959**	**23.4%**	**23.4%**	**3.08%**	**3.01%**
CASH EQUIVALENTS					
Northern Trust (1)	2,285,285			0.05%	0.05%
Bank of ND	3,369,736			N/A	N/A
TOTAL CASH EQUIVALENTS	***5,655,021***	***2.8%***	***2.8%***	***0.07%***	***0.07%***
90 Day T-Bill				***0.12%***	***0.12%***
SHORT TERM FIXED INCOME					
Barings (formerly Babson Capital)	77,240,843	37.9%	36.9%	0.95%	0.91%
BC 1-3 Year US Gov't Index				***-0.16%***	***-0.16%***
JP Morgan	73,136,484	35.9%	36.9%	-0.02%	-0.05%
BC 1-3 Year Gov/Credit Index				***-0.01%***	***-0.01%***
TOTAL SHORT TERM FIXED INCOME	***150,377,326***	***73.9%***	***73.9%***	***0.48%***	***0.44%***
BC 1-3 Year US Gov't Index (1)				***-0.16%***	***-0.16%***

See green text on page 18.

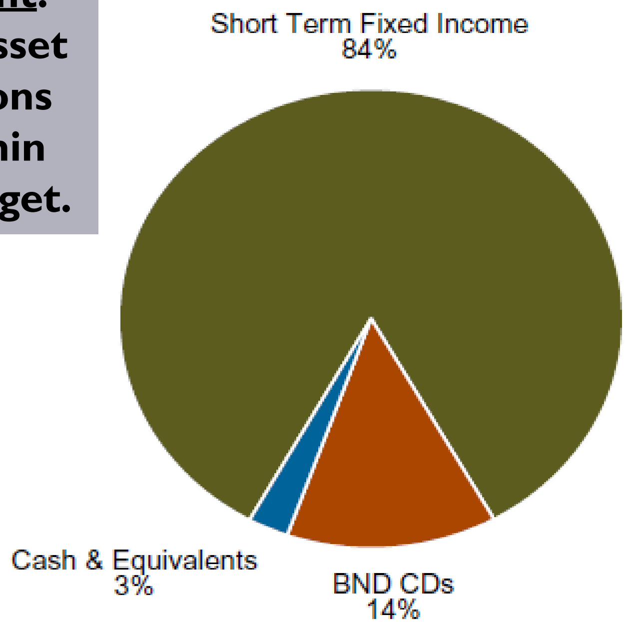
NOTE: Monthly returns and market values are preliminary and subject to change.

Budget Stabilization Fund - Asset Allocation

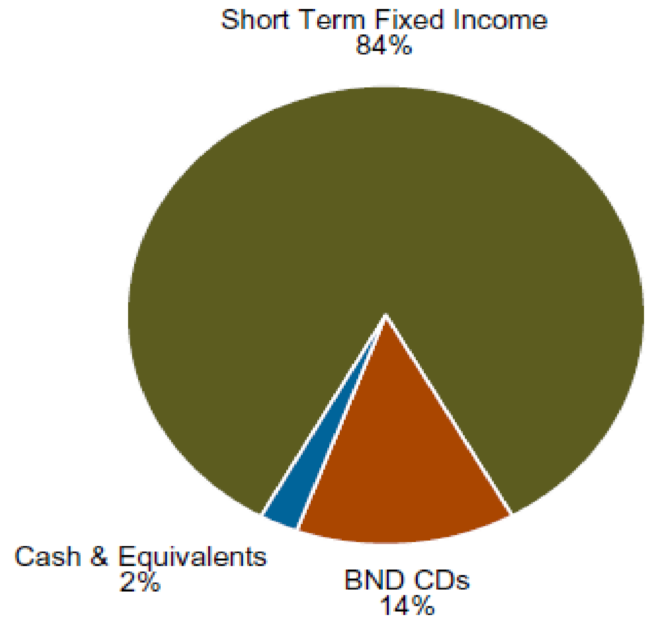
Market Valuations as of September 30, 2016

Key Point: Actual asset allocations are within 1% of Target.

Actual Asset Allocation



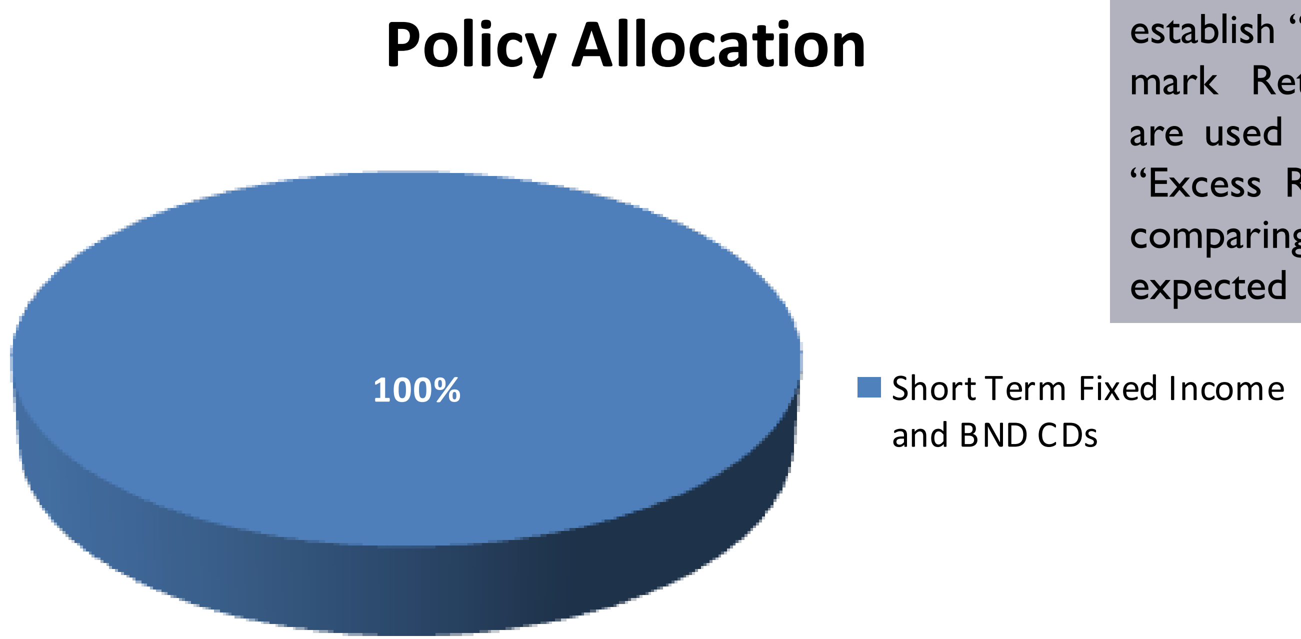
Target Asset Allocation



Asset Class	$000s Actual	Weight Actual	Target	Percent Difference	$000s Difference
Short Term Fixed Income	485,201	83.9%	83.9%	0.0%	(1)
BND CDs	78,098	13.5%	13.7%	(0.2%)	(1,073)
Cash & Equivalents	15,011	2.6%	2.4%	0.2%	1,074
Total	578,310	100.0%	100.0%		

Note: Interim amounts and estimates are unaudited and subject to change.

Budget Stabilization Fund (Fund)
Asset Allocation - Strategic



<u>Key</u>: The Fund's asset allocation serves to establish "Policy Benchmark Returns" which are used to determine "Excess Return" when comparing actual and expected results.

Note: The asset allocation of the Bank of North Dakota Match Loan Certificates of Deposit program will be transferred to the Legacy Fund on or before June 30, 2017, as approved by the Advisory Board and acknowledged by the SIB earlier this year.

Budget Stabilization Fund – Actual vs Expected Results

Net Returns Exceed Policy Benchmark - September 30, 2016

		Current FYTD 9/30/2016	1 Year Ended 9/30/2016	3 Years Ended 9/30/2016	5 Years Ended 9/30/2016	Risk 5 Yrs Ended 9/30/2016	Risk Adj Excess Return 5 Yrs 9/30/2016
BUDGET STABILIZATION FUND							
Total Fund Return - Net	**a**	**0.42%**	**1.97%**	**1.87%**	**2.03%**	**0.66%**	**0.78%**
Policy Benchmark Return	**b**	0.01%	1.14%	0.89%	0.69%	**0.47%**	**OK**
Excess Return	**a - b**	**0.41%**	**0.83%**	**0.98%**	**1.34%**	**OK**	
			$4.5 million	**$15 million**	**$30 million**		

1. **For the 1-Year Ended 9/30/16**, the Fund generated a **Net Return of 1.97%** exceeding the Policy Benchmark (of 1.14%) and creating **Excess Return of 0.83%.** Actual net returns exceed the Policy Benchmark Return by approximately **$4.5 million for the 1 year ended 9/30/16.**

2. **For the 5-Years Ended 9/30/16,** the Fund earned a **Net Return of 2.03%** exceeding the Policy Benchmark (of 0.69%) and creating **Excess Return of 1.34%.** Actual net returns exceed the Policy Benchmark Return by approximately **$30 million for the 5 years ended 9/30/16.**

3. **The returns were achieved while adhering to approved investment guidelines for Risk and Risk Adjusted Excess Returns for the 5-years ended 9/30/16.**

Note: Interim amounts and estimates are unaudited and subject to change.

Budget Stabilization Fund

Gross Return Attribution for 1- and 5-years ended Sep. 30, 2016

One Year Relative Attribution Effects

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return
BND CDs	15%	15%	2.59%	2.59%	0.00%	(0.00%)	(0.00%)
Short Term Fixed Income	83%	83%	2.03%	0.89%	0.96%	0.00%	0.96%
Cash & Equivalents	2%	2%	0.18%	0.27%	(0.00%)	0.00%	(0.00%)
Total			**2.09% =**	**1.13% +**	**0.96% +**	**(0.00%)**	**0.96%**

Five Year Annualized Relative Attribution Effects

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return
BND CDs	20%	20%	3.14%	0.69%	0.54%	(0.00%)	0.54%
Short Term Fixed Income	78%	78%	1.89%	0.72%	0.90%	(0.00%)	0.90%
Cash & Equivalents	2%	2%	0.13%	0.10%	0.00%	0.00%	0.00%
Total			**2.13% =**	**0.69% +**	**1.44% +**	**(0.00%)**	**1.44%**

* Current Quarter Target = 83.9% BB Barclays Gov 1-3 Yr, 13.7% NDSIB Budget - Bond CDs and 2.4% 3-month Treasury Bill.

Note: Fund performance as of September 30, 2016, is unaudited and subject to change. *Source: Callan*

Investment Results – June 30, 2016

Fund Performance Exceeds Policy Benchmarks for the 1-, 3- and 5-years ended June 30, 2016

Green = Actual Net Returns are better than Benchmark Index Returns	September-16					Prior Year FY16		3 Years Ended		5 Years Ended	
Yellow = Actual Net Returns are worse than Benchmark Index Returns		Allocation		Quarter		Returns		6/30/2016		6/30/2016	
	Market Value	Actual	Policy	Gross	Net	Gross	Net	Gross	Net	Gross	Net
TOTAL BUDGET STABILIZATION FUND	**578,309,532**	**100%**	**100%**	***0.45%***	***0.42%***	**1.97%**	**1.82%**	**1.99%**	**1.88%**	**2.00%**	**1.91%**
POLICY TARGET BENCHMARK				*0.01%*	*0.01%*	*1.50%*	*1.50%*	*0.95%*	*0.95%*	*0.69%*	*0.69%*
Excess Return					**0.41%**		**0.33%**		**0.93%**		**1.22%**
Bank of ND Match Loan CDs	**78,097,841**	**13.5%**	**13.5%**	**0.64%**	**0.64%**	**2.61%**	**2.61%**	**2.70%**	**2.70%**	**3.23%**	**3.23%**
CASH EQUIVALENTS											
Northern Trust (1)	8,305,402			0.04%	0.04%	0.12%	0.12%	0.05%	0.05%	N/A	N/A
Bank of ND	6,705,377			N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
TOTAL CASH EQUIVALENTS	***15,010,779***	***2.6%***	***2.6%***	***0.06%***	***0.06%***	***0.12%***	***0.12%***	***0.05%***	***0.05%***	***0.13%***	***0.13%***
90 Day T-Bill				***0.10%***	***0.10%***	***0.19%***	***0.19%***	***0.09%***	***0.09%***	***0.09%***	***0.09%***
SHORT TERM FIXED INCOME											
Barings (formerly Babson Capital)	244,394,856	42.3%	41.9%	0.77%	0.73%	1.95%	1.73%	2.30%	2.14%	N/A	N/A
BC 1-3 Year US Gov't Index				***-0.10%***	***-0.10%***	***1.31%***	***1.31%***	***1.00%***	***1.00%***		
JP Morgan	240,806,056	41.6%	41.9%	0.08%	0.05%	1.82%	1.67%	1.46%	1.33%	N/A	N/A
BC 1-3 Year Gov/Credit Index				***0.02%***	***0.02%***	***1.59%***	***1.59%***	***1.45%***	***1.45%***		
TOTAL SHORT TERM FIXED INCOME	***485,200,912***	***83.9%***	***83.9%***	***0.43%***	***0.39%***	***1.88%***	***1.70%***	***1.88%***	***1.74%***	***1.61%***	***1.48%***
BC 1-3 Year US Gov't Index (1)				***-0.10%***	***-0.10%***	***1.31%***	***1.31%***	***1.00%***	***1.00%***	***0.75%***	***0.75%***

NOTE: Monthly returns and market values are preliminary and subject to change.

Effective July 1, 2013, net of fee returns are calculated on a cash basis in the month paid. Prior years were accrual based and split evenly over the 12 months of the fiscal year.

Note: Fund performance are net of fees and unaudited and subject to change.

Budget Stabilization Fund (Fund)
Investment Fees and Expenses – June 30, 2016

	FY 2016				FY 2015			
	Average Market Value	Fees in $	Fees in %	Contribution to Total Fees	Average Market Value	Fees in $	Fees in %	Contribution to Total Fees
Investment managers' fees:								
Short-term fixed income managers	479,196,968	669,381	0.14%	0.14%	478,363,794	660,665	0.14%	0.13%
Cash & equivalents managers	10,312,590	13,406	0.13%	0.00%	7,565,653	9,835	0.13%	0.00%
Total investment managers' fees	**489,509,558**	**682,786**	**0.14%**		**485,929,447**	**670,500**	**0.14%**	
Custodian fees		41,892	0.01%	0.01%		40,150	0.01%	0.01%
Investment consultant fees		23,556	0.00%	0.00%		26,509	0.01%	0.01%
Total investment expenses	[2]	**748,234**	**0.15%** [1]		[5]	**737,159**	**0.15%** [1]	
Actual Investment Performance (Net of Fees)			**1.82%**				**1.86%**	
Policy Benchmark			**1.50%**				**0.75%**	
Outperformance		[3]	**0.32%**			[6]	**1.11%**	
			$1.5 million [4]				**$5 million** [7]	

- **Investment management fees and expenses for the Fund remained constant during the past two fiscal years at approximately 0.15%[1].**
- **The Fund realized a meaningful return on investment dollars for last fiscal year as $748,234 [2] of Investment Fees and Expenses generated $1.5 million[4] (or 0.32%[3]) of Outperformance (excess return after fees & expenses).**
- **In the prior fiscal year, the Fund generated approximately $5 million[7] of Outperformance (or Excess Return of 1.11%[6]) based on $737,159 [5] of investment management fees and expenses.**

Note: All amounts are deemed to be materially accurate, but are unaudited and subject to change.

A basis point is equal to one one-hundredth of one percent (or 0.01%) such that 100 basis points is equivalent to 1%.

BUDGET STABILIZATION FUND
INVESTMENT POLICY STATEMENT

1. FUND CHARACTERISTICS AND CONSTRAINTS.

The Budget Stabilization Fund (Fund) is a special fund created in 1987 under Chapter 54-27.2 of the North Dakota Century Code used to deposit general fund moneys in excess of appropriations. Notwithstanding the provisions of sections 54-27.2-01 and 54-27.2-02, $124,936,548 was required to be transferred by the state treasurer to the budget stabilization fund from the general fund on July 1, 2009 along with $61,414,562 on July 1, 2011 and $181,060,584 on July 1, 2013. These transfers provide over $580 million in the budget stabilization fund as of May 31, 2016. The statutory cap for the 2015-17 biennium is $572,485,454. The state investment board shall supervise investment of the budget stabilization fund in accordance with chapter 21-10.

Any interest or other budget stabilization fund earnings must be deposited in the fund. Any amounts provided by law for deposit in the fund and any interest or earnings of the fund which would bring the balance in the fund to an amount greater than five percent of the current biennial state general fund budget, as finally approved by the most recently adjourned special or regular session of the legislative assembly, may not be deposited or retained in the fund but must be deposited instead in the state general fund.

If the director of the office of management and budget projects that general fund revenues for the biennium will be at least two and one-half percent less than estimated by the most recently adjourned special or regular session of the legislative assembly, and if the governor orders a transfer, the state treasurer shall transfer the appropriate funds from the budget stabilization fund to the state general fund to offset the decrease in general fund revenues. The amount transferred from the budget stabilization fund upon order of the governor may not exceed the difference between an amount two and one-half percent below the general fund revenue projections for the biennium and the general fund revenue projections for the biennium by the director of the office of management and budget.

2. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD (SIB).

The Fund is charged by law under NDCC 21-10-02.1 with the responsibility of establishing policies on investment goals and asset allocation of the Fund. The SIB is charged with implementing these policies and asset allocation and investing the assets of the Fund in a manner consistent with the prudent investor rule as provided in NDCC 21-10-07.

At the discretion of the SIB, the Fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification, restrictions, and performance objectives appropriate to the prudent investor rule and objectives of the funds participating in the pools.

The SIB may delegate investment responsibility to professional money managers. When a money manager has been retained, the SIB's role in determining investment strategy and security selection is supervisory, not advisory. In accordance with this Investment Policy Statement, the Fund's assets may be invested directly or through collective investment vehicles.

The SIB is responsible for establishing criteria and procedures and making decisions with respect to hiring, maintaining, and terminating money managers. This responsibility includes selecting performance measurement services, consultants, and report formats and determining the frequency of meetings with managers.

The SIB will implement changes to this policy as promptly as is prudent.

3. INVESTMENT OBJECTIVES.

The investment objectives of the Fund reflect the relatively unknown life-span and the moderate risk tolerance of the Fund. Operating and statutory considerations shape the Fund's policies and priorities as outlined below:

Objective: Sufficient liquidity is to be maintained to meet known or anticipated financial obligations and preserve the value of the surplus. Cash equivalent investments will be used to achieve this objective.

4. STANDARDS OF INVESTMENT PERFORMANCE.

The Fund's investment objectives are expressed in terms of reward and risk expectations relative to investable, passive benchmarks. The Fund's policy benchmark is comprised of policy mix weights of appropriate asset class benchmarks as set by the SIB:

a. The Fund's rate of return, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.

b. The risk-adjusted performance of the Fund, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.

5. POLICY AND GUIDELINES.

The asset allocation of the Budget Stabilization Fund is established by the SIB, with input from the Legacy and Budget Stabilization Advisory Board ("Advisory Board"). Asset allocation is based upon the appraisal of projected liquidity and income requirements, and estimates of the investment returns likely to be achieved by the various asset classes over the next five years.

In recognition of these factors, the following allocation is deemed appropriate for the fund:

Short-term Fixed Income & BND CDs	Minimum of 90%
Bank Loans w/floating yield	Maximum of 5%
Absolute Return Strategies	Maximum of 5%

Bank of North Dakota Match Loan Certificates of Deposit Program ("BND CD") limit of 35%. On June 15, 2016, the Advisory Board acknowledged RIO's stated intent to transfer the BND CD investment to the Legacy Fund on or before July 1, 2017. The latter date was based on preliminary budget guidance provided by OMB, although the transfer may occur in late-2016.

Rebalancing of the Fund to this target will be done in accordance with the SIB's rebalancing policy.

While the SIB is responsible for establishing specific quality, diversification, restrictions, and performance objectives for the investment vehicles in which the Fund's assets will be invested, it is understood that:

a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation

b. Derivative use will be monitored to ensure that undue risks are not taken by the money managers.

c. All assets will be held in custody by the State Investment Board's master custodian or such other custodians as are acceptable to the State Investment Board.

d. No funds shall be borrowed excluding a SIB approved securities lending program.

e. No unhedged short sales or speculative margin purchases shall be made.

f. Social investing is prohibited unless it meets the Exclusive Benefit Rule and it can be substantiated that the investment must provide an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.

For the purpose of this document, Social Investing is defined as *"The investment or commitment of public pension fund money for the purpose of obtaining an effect other than a maximized return to the intended beneficiaries."*

g. Economically targeted investing is prohibited unless the investment meets the Exclusive Benefit Rule. For the purpose of this document economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved, as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

Also, for the purpose of this document, the Exclusive Benefit Rule is met if the following four conditions are satisfied:

(1) The cost does not exceed the fair market value at the time of investment.
(2) The investment provides the Fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
(3) Sufficient liquidity is maintained in the Fund to permit distributions in accordance with the terms of the plan.
(4) The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity are equivalent, the Fund's policy favors investments which will have a positive impact on the economy of North Dakota.

6. EVALUATION AND REVIEW.

Investment management of the Fund will be evaluated against the Fund's investment objectives and investment performance standards. Evaluation will be conducted quarterly by the SIB through its review of funds participating in the Insurance Trust.

Money managers will be evaluated by the SIB quarterly. In-state meetings will be held with the money managers at least annually.

Approved by:

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD STATE INVESTMENT BOARD

Rep. Keith Kempenich

Representative Keith Kempenich
Chairman

Date: 8-3-16

NORTH DAKOTA STATE INVESTMENT BOARD

David Hunter
Executive Director/CIO, RIO

Date: 8-3-16

Approved by the NDSIB: 7/22/2016
Approved by the LBSFAB: 6/15/2016

Legacy Fund

RIO Update

Legacy Fund – Investment Balances

Funding, Income and Disbursements – Sep. 30, 2016

Legacy Fund

Through September 30, 2016

	New Money In	Net Increase	Distributions Out	Net Assets End of Period
FY2012 (Initial Funding - Sept. 2011	396,585,658	2,300,225	-	398,885,883
FY2013	791,126,479	4,216,026	-	1,194,228,388
FY2014	907,214,971	113,153,662	-	2,214,597,021
FY2015	1,011,343,040	99,895,650	-	3,325,835,711
FY2016	434,853,950	45,851,680	-	3,806,541,341
FY2017	99,753,378	160,940,094	-	4,067,234,813
	3,640,877,476	426,357,337	-	

Net Increase - Inception to Date	426,357,337
September 30, 2016 Market Value	4,070,189,950

The Legacy Fund exceeded $4 billion as of Sep. 30, 2016.

Note: Amounts are preliminary, unaudited and subject to change.

Legacy Fund Investment Balances

Impact of BND Match Loan CD Transfers to Legacy Fund as of October 31, 2016

RIO transferred $29.6 million of BND Match Loan CD's to the Legacy Fund (from the Budget Stabilization Fund) in October.

RIO commenced investing short-term cash deposits with the Bank of North Dakota in September in order to enhance risk adjusted returns.

	October-16			Current FYTD
		Allocation		Returns
	Market Value	Actual	Policy	Net
TOTAL LEGACY FUND	**4,042,795,797**	**100%**	**100%**	**2.71%**
POLICY TARGET BENCHMARK	**Total Net Return was 2.75%, not 2.71%.**			*1.60%*
TOTAL LARGE CAP DOMESTIC EQUITY	***856,302,872***	***21%***	***22%***	***1.96%***
Russell 1000				***2.00%***
TOTAL SMALL CAP DOMESTIC EQUITY	***321,264,926***	***8%***	***8%***	***4.05%***
Russell 2000				***3.86%***
TOTAL INTERNATIONAL EQUITY	***805,112,166***	***20%***	***20%***	***7.54%***
MSCI World Ex US (2)				***7.59%***
Western Asset	434,786,202	11%	11%	0.94%
Prudential	156,912,190	4%	3%	0.96%
PIMCO (DiSCO II) (1)	42,401,128	1%	1%	5.14%
PIMCO (BRAVO II) (1)	23,902,923	1%	1%	3.80%
Declaration (Total Return) (1)	105,186,246	3%	3%	2.04%
State Street	192,114,850	5%	5%	-0.59%
Wells Capital	433,774,857	11%	11%	1.71%
Bank of ND Match Loan CDs	29,628,419	1%	1%	N/A
TOTAL FIXED INCOME	***1,418,706,815***	***35%***	***35%***	***1.22%***
BC Aggregate				***-0.31%***
TOTAL DIVERSIFIED REAL ASSETS	***382,508,904***	***9%***	***10%***	***-0.09%***
Benchmark **Diversified Real Assets CFYTD net return at Oct. 31, 2016 was 0.27%, not -0.09%.**				***-0.18%***
TOTAL REAL ESTATE	***248,881,435***	***6%***	***5%***	***1.75%***
NCREIF Total Index				***2.36%***
Northern Trust (1)	4,048,710			0.05%
Bank of ND	5,969,970			N/A
TOTAL CASH EQUIVALENTS	***10,018,680***	***0%***	***0%***	***0.07%***
90 Day T-Bill				***0.12%***

Initial funding September 7, 2011.

NOTE: Monthly returns and market values are preliminary and subject to change.

Legacy Fund - Policy Timeline

April 2013

- New strategic asset allocation for the Legacy Fund approved

June 2013

- SIB approved a transition plan to fully implement the new policy allocation over a period of 18 months

July 2013

- SIB approved the implementation of the new policy allocation through the use of existing managers within the Insurance Trust

August 2013

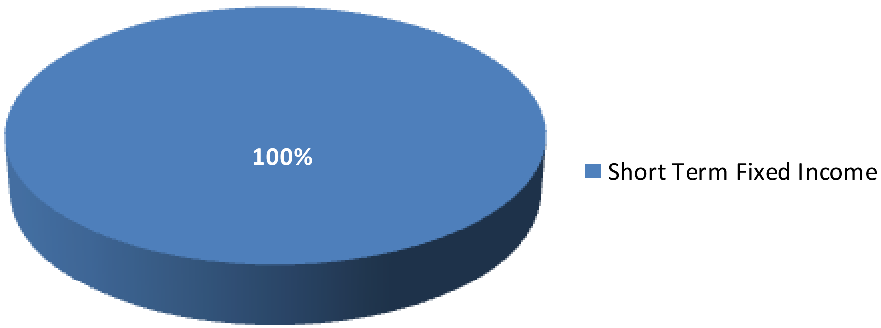
- RIO initiated the 18 month transition plan

January 2015

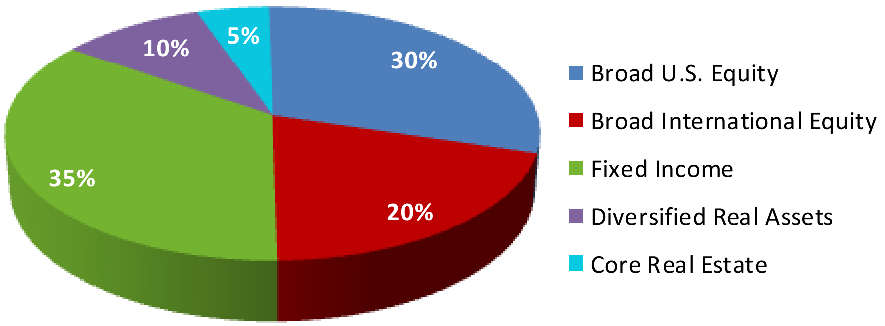
- Transition to new policy allocation fully implemented

Legacy Fund Strategic Asset Allocation

Actual Allocation
8/1/2013



Policy Allocation
January 31, 2015 to Current



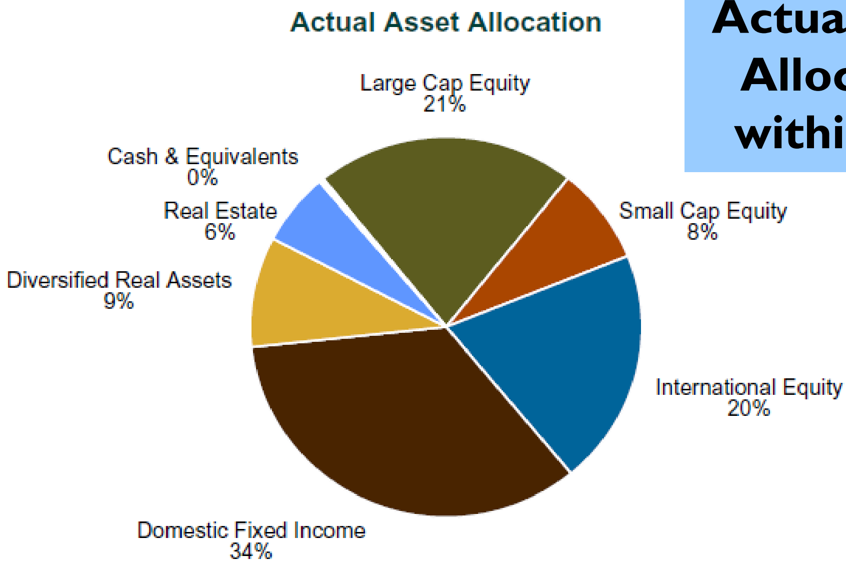
Note: Amounts are preliminary, unaudited and subject to change.

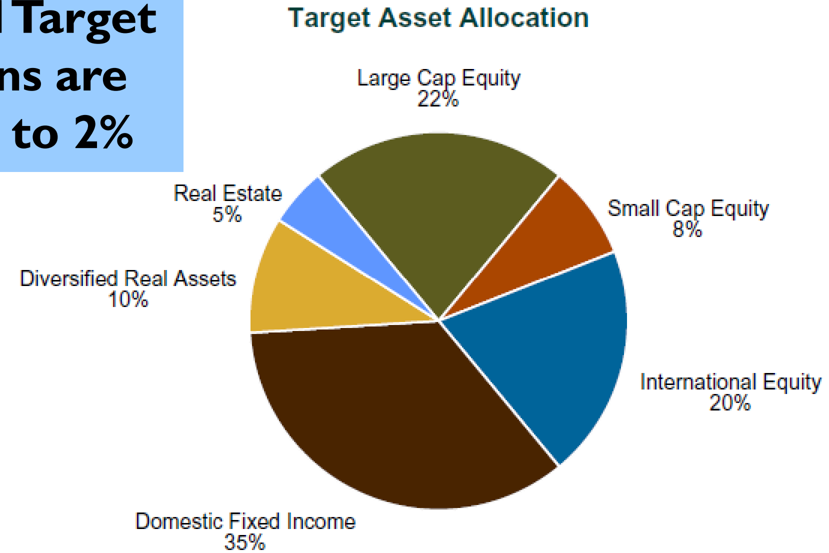
NOTE: All data included in this "Preview of Investment Returns" as of June 30, 2015, is unaudited and subject to change.

Legacy Fund - Asset Allocation

Market Valuations as of September 30, 2016

Key Point:
Actual and Target Allocations are within 1% to 2%





Asset Class	$000s Actual	Weight Actual	Target	Percent Difference	$000s Difference
Large Cap Equity	873,301	21.5%	22.0%	(0.5%)	(22,140)
Small Cap Equity	335,594	8.2%	8.0%	0.2%	9,979
International Equity	817,674	20.1%	20.0%	0.1%	3,636
Domestic Fixed Income	1,396,414	34.3%	35.0%	(0.7%)	(28,153)
Diversified Real Assets	383,439	9.4%	10.0%	(0.6%)	(23,580)
Real Estate	246,518	6.1%	5.0%	1.1%	43,008
Cash & Equivalents	17,249	0.4%	0.0%	0.4%	17,249
Total	4,070,190	100.0%	100.0%		

* Current Quarter Target = 35.0% BB Barclays Aggregate Idx, 22.0% Russell 1000 Index, 20.0% MSCI EAFE, 10.0% NDSIB Legacy DRA Weighted Benchmark, 8.0% Russell 2000 Index and 5.0% NCREIF Total Index.

Legacy Fund – Actual vs Expected Results

Net Returns Exceed Policy Benchmark - September 30, 2016

LEGACY FUND		1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016	Risk 5 Yrs Ended 9/30/2016	Risk Adj Excess Return 9/30/2016
Net Investment Return	a	10.18%	4.74%	3.49%	3.6%	0.53%
Policy Benchmark Return	b	8.85%	3.92%	2.62%	3.2%	
Excess Return	a - b	1.34%	0.82%	0.87%	OK	
Excess Return (in dollars)		*$49 million*	*$72 million*	*$85 million*		

1. **For the 1-Year Ended 9/30/16**, the Legacy Fund generated a **Net Return of 10.18%** exceeding the Policy Benchmark (of 8.85%) and creating **Excess Return of 1.34%.** Actual net returns exceed the Policy Benchmark Return by approximately **$50 million for the 1 year ended 9/30/16.**
2. **For the 5-Years Ended 9/30/16,** the Fund earned a **Net Return of 3.49%** exceeding the Policy Benchmark (of 2.62%) and creating **Excess Return of 0.87%.** Actual net returns exceed the Policy Benchmark Return by approximately **$85 million for the 5 years ended 9/30/16.**
3. **The returns were achieved while adhering to approved investment guidelines for Risk and Risk Adjusted Excess Returns for the 5-years ended 9/30/16.**

Note: Interim amounts and estimates are unaudited and subject to change.

Legacy Fund

Gross Return Attribution for 1- and 5-years ended Sep. 30, 2016

One Year Relative Attribution Effects

Note: Fund performance as of September 30, 2016, is unaudited and subject to change.

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return
Large Cap Equity	22%	22%	14.03%	14.93%	(0.19%)	(0.04%)	(0.23%)
Small Cap Equity	8%	8%	17.50%	15.47%	0.14%	0.01%	0.15%
Domestic Fixed Income	35%	35%	7.98%	5.19%	0.97%	(0.07%)	0.90%
Real Estate	6%	5%	9.69%	9.22%	0.02%	(0.02%)	0.00%
International Equity	19%	20%	10.28%	6.38%	0.77%	(0.05%)	0.72%
Diversified Real Assets	10%	10%	6.68%	5.60%	0.11%	(0.01%)	0.10%
Cash & Equivalents	0%	0%	0.17%	0.17%	0.00%	(0.02%)	(0.02%)
Total			**10.45% =**	**8.84% +**	**1.82% +**	**(0.21%)**	**1.61%**

Five Year Annualized Relative Attribution Effects

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return
Large Cap Equity	12%	12%	-	-	0.07%	(0.05%)	0.02%
Small Cap Equity	4%	4%	-	-	0.05%	(0.03%)	0.02%
Domestic Fixed Income	18%	18%	-	-	0.26%	(0.01%)	0.25%
Real Estate	3%	3%	-	-	0.01%	0.01%	0.02%
International Equity	10%	11%	-	-	0.19%	(0.03%)	0.16%
Diversified Real Assets	4%	4%	-	-	0.06%	(0.00%)	0.06%
Short Term Fixed Income	45%	46%	-	-	0.52%	0.00%	0.53%
Cash & Equivalents	4%	3%	0.11%	0.11%	0.01%	(0.03%)	(0.02%)
Total			**3.65% =**	**2.62% +**	**1.17% +**	**(0.13%)**	**1.04%**

* Current Quarter Target = 35.0% BB Barclays Aggregate Idx, 22.0% Russell 1000 Index, 20.0% MSCI World ex US, 10.0% NDSIB Legacy DRA Weighted Benchmark, 8.0% Russell 2000 Index and 5.0% NCREIF Total Index.

Legacy Fund

Investment Manager Level Account Balances and Net Investment Returns for Domestic and International Equity

As of Oct. 31, 2016 and Prior Fiscal Year Ended June 30, 2016

U.S. Large Cap Equity and International Equity underperformed their respective benchmarks, while U.S. Small Cap Equity outperformed the Russell 2000 index benchmark.

Green = Actual Net Returns are better than Benchmark Index Returns / Yellow = Actual Net Returns are worse than Benchmark Index Returns	October-16 Market Value	Allocation Actual	Allocation Policy	Current FYTD Returns Net	Prior Year FY16 Returns Net
LEGACY FUND - NET RETURN	4,042,793,631	100%	100%	2.74%	1.06%
POLICY TARGET BENCHMARK				*1.60%*	*1.01%*
EXCESS RETURN				1.14%	0.04%
LARGE CAP DOMESTIC EQUITY					
Los Angeles Capital	254,303,700	6.3%	6.6%	0.26%	4.73%
Russell 1000 Growth				***2.13%***	***3.02%***
LSV	259,782,316	6.4%	6.6%	4.67%	-3.17%
Russell 1000 Value				***1.88%***	***2.86%***
Los Angeles Capital	171,045,071	4.2%	4.4%	0.80%	5.67%
Russell 1000				***2.00%***	***2.94%***
Clifton Group	171,171,785	4.2%	4.4%	1.71%	4.70%
S&P 500				***1.96%***	***3.99%***
TOTAL LARGE CAP U.S. EQUITY	***856,302,872***	***21.2%***	***22.0%***	***1.96%***	***2.52%***
Russell 1000				***2.00%***	***2.94%***
SMALL CAP DOMESTIC EQUITY					
PIMCO RAE (fka Research Affiliates)	147,460,044	3.6%	4.0%	4.37%	-3.98%
Clifton	173,804,881	4.3%	4.0%	3.78%	-5.76%
TOTAL SMALL CAP U.S. EQUITY	***321,264,926***	***7.9%***	***8.0%***	***4.05%***	***-4.99%***
Russell 2000				***3.86%***	***-6.73%***
INTERNATIONAL EQUITY					
LSV	328,243,038	8.1%	8.0%	8.49%	-11.30%
MSCI EAFE				***4.26%***	***-10.16%***
William Blair	319,430,355	7.9%	8.0%	6.71%	N/A
MSCI ACWI ex-US IMI (Net)				***5.37%***	
DFA	79,716,091	2.0%	2.0%	9.64%	-9.28%
Vanguard (1)	77,722,682	1.9%	2.0%	4.99%	-7.27%
S&P/Citigroup BMI EPAC < $2BN				***5.06%***	***-3.37%***
TOTAL INTERNATIONAL EQUITY	***805,112,166***	***19.9%***	***20.0%***	***7.54%***	***-10.73%***
MSCI World Ex US (2)				***7.59%***	***-10.16%***

NOTE: Current monthly and fiscal year to date (FYTD) returns are preliminary and subject to change.

Legacy Fund

Investment Manager Level Account Balances and Net Investment Returns for Fixed Income, Real Assets and Cash

As of Oct. 31, 2016 and Prior Fiscal Year Ended June 30, 2016

Fixed Income and Diversified Real Assets outperformed their respective benchmarks, while Real Estate underperformed the NCREF index benchmark.

Green = Actual Net Returns are better than Benchmark Index Returns	October-16			Current FYTD	Prior Year FY16
Yellow = Actual Net Returns are worse than Benchmark Index Returns		Allocation		Returns	Returns
	Market Value	Actual	Policy	Net	Net
FIXED INCOME					
Western Asset	434,786,202	10.8%	11.2%	0.94%	6.56%
Prudential	156,912,190	3.9%	2.8%	0.96%	7.24%
PIMCO (DiSCO II) (1)	42,401,128	1.0%	1.0%	5.14%	4.39%
PIMCO (BRAVO II) (1)	23,902,923	0.6%	0.6%	3.80%	7.02%
BC Aggregate				***-0.31%***	***6.00%***
Declaration (Total Return) (1)	105,186,246	2.6%	2.6%	2.04%	2.59%
3m LIBOR				***0.27%***	***0.49%***
State Street	192,114,850	4.8%	4.9%	-0.59%	6.68%
BC Gov/Credit				***-0.57%***	***6.70%***
Wells Capital	433,774,857	10.7%	11.2%	1.71%	6.97%
BC Credit Baa				***1.22%***	***6.93%***
Bank of ND Match Loan CDs	29,628,419.22	0.7%	0.7%	N/A	N/A
TOTAL FIXED INCOME	***1,418,706,815***	***35.1%***	***35.0%***	***1.22%***	***6.40%***
BC Aggregate				***-0.31%***	***6.00%***
DIVERSIFIED REAL ASSETS					
Western	284,266,271	7.0%	7.6%	-0.09%	2.58%
BC Global Inflation Linked Index				***-0.24%***	***2.55%***
Grosvenor CIS II	9,295,111	0.2%	0.2%	-0.89%	6.10%
JP Morgan (Infrastructure)	88,947,522	2.2%	2.2%	1.39%	3.97%
CPI				***0.09%***	***0.64%***
TOTAL DIVERSIFIED REAL ASSETS	***382,508,904***	***9.5%***	***10.0%***	***0.20%***	***3.14%***
Benchmark				***-0.21%***	***2.00%***
JP Morgan	129,552,405	3.2%	2.5%	1.90%	9.03%
Invesco	119,329,030	3.0%	2.5%	1.59%	10.59%
TOTAL REAL ESTATE	***248,881,435***	***6.2%***	***5.0%***	***1.75%***	***9.79%***
NCREIF Total Index				***2.36%***	***10.64%***
TOTAL CASH EQUIVALENTS	***10,016,514***	***0.2%***	***0.0%***	***0.06%***	***0.13%***

NOTE: Current monthly and fiscal year to date (FYTD) returns are preliminary and subject to change.

Legacy Fund – Investment Fees and Expenses

Fiscal 2016 vs Fiscal 2015

		FY 2016					FY 2015			
		Average Market Value	Fees in $		Fees in %	Contribution to Total Fees		Average Market Value	Fees in $	Fees in %	Contribution to Total Fees
Investment managers' fees:											
Domestic large cap equity managers		778,006,246	2,095,229		0.27%	0.06%		657,310,185	1,280,864	0.19%	0.04%
Domestic small cap equity managers		279,004,042	1,204,775		0.43%	0.03%		240,214,984	1,043,694	0.43%	0.03%
International equity managers		686,819,896	2,752,321		0.40%	0.08%		587,722,699	2,397,207	0.41%	0.07%
Domestic fixed income managers		1,261,572,841	3,376,076		0.27%	0.09%		985,960,253	2,910,709	0.30%	0.08%
Diversified real assets managers		355,643,550	1,485,125		0.42%	0.04%		249,618,003	599,955	0.24%	0.02%
Real estate managers		208,482,344	1,347,554		0.65%	0.04%		151,340,748	1,125,359	0.74%	0.03%
Short-term fixed income managers		-	-		0.00%	0.00%		152,806,876	202,772	0.13%	0.01%
Cash & equivalents managers		14,048,537	20,951		0.15%	0.00%		15,892,632	21,374	0.13%	0.00%
Total investment managers' fees	3	**3,583,577,456**	**12,282,031**	4	**0.34%**		6	**3,040,866,380**	**9,581,934**	**0.32%**	
Custodian fees			355,571		0.01%	0.01%			313,311	0.01%	0.01%
Investment consultant fees			198,884		0.01%	0.01%			152,627	0.01%	0.01%
Total investment expenses	2		**12,836,486**		**0.36%**	1			**10,047,873**	**0.33%**	
Total Performance Fees Paid			**1,988,561**		**0.06%**				**1,754,110**	**0.06%**	
Actual Investment Performance (Net of Fees)					**1.06%**					**3.31%**	
Policy Benchmark					**1.01%**					**2.37%**	
			Outperformance	5	**0.05%**				**Outperformance** 7	**0.94%**	
			Average Market Value (3) x Outperformance (5)		*$1.8 million*				*Average Market Value (6) x Outperformance (7)*	*$28 million*	

➢ **Investment management fees & expenses increased to 0.36% from 0.33% in the last year as the approved asset allocation strategy was implemented. Performance fees remained flat at approximately 0.06%.**

➢ **The use of active management paid minimal returns for the Legacy Fund in Fiscal 2016 as we paid $12.8 million in fees to earn 1.06% (or $38 million) and only outperformed our benchmark by 0.05% (or $1.8 million).**

NOTE: The next slide reveals the estimated impact of active management on Legacy Fund earnings since inception.

Legacy Fund

Active Management has Improved Net Investment Returns by $85 million since inception on Sep. 7, 2011.

LEGACY FUND		1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016
Net Investment Return	**a**	**10.18%**	**4.74%**	**3.49%**
Policy Benchmark Return	**b**	8.85%	3.92%	2.62%
Excess Return	**a - b**	**1.34%**	**0.82%**	**0.87%**
Excess Return (in dollars)		***$49 million***	***$72 million***	***$85 million***

Excess Returns Calculation Estimates for the 1-, 3- and 5- years ended 9/30/2016

1-Year = $3.7 billion (Fund Assets) x 1.34% (Excess Return) = $49 million

3-Years = $3 billion (Fund Assets) x 0.82% (Excess Return) x 3 yrs. = $72 million

5-Years = $2 billion (Fund Assets) x 0.87% (Excess Return) x 5 yrs. = $85 million

Note: All amounts are unaudited and subject to change.

Legacy Fund Net Earnings at Sep. 30, 2016 versus NDCC 21-10-02 "Earnings" Comparison

Net Earnings (in millions)	Fiscal year ended June 30	NDCC 21-10-02 "Earnings"
$2 million	June 30, 2012	$2,571,475
$4 million	June 30, 2013	$15,949,089
$113 million	June 30, 2014	$50,033,655
$100 million	June 30, 2015	$95,143,905
$46 million	June 30, 2016	$65,326,673
$161 million	Sep. 30, 2016	$59,571,470
$426 million		$288,596,267

Per NDCC 21-10-02: For the purposes of section 26 of article X of the Constitution of North Dakota, the term "earnings" means net income in accordance with generally accepted accounting principles, excluding any unrealized gains or losses.

Note: Interim amounts and estimates are unaudited and subject to change.

NORTH DAKOTA LEGACY FUND

INVESTMENT POLICY STATEMENT

1. PLAN CHARACTERISTICS AND FUND CONSTRAINTS

The North Dakota legacy fund was created in 2010 when the voters of North Dakota approved a constitutional amendment--now Article X, Section 26, of the Constitution of North Dakota--to provide that 30 percent of oil and gas gross production and oil extraction taxes on oil and gas produced after June 30, 2011, be transferred to the legacy fund. The principal and earnings of the legacy fund may not be spent until after June 30, 2017, and any expenditure of principal after that date requires a vote of at least two-thirds of the members elected to each house of the Legislative Assembly. Not more than 15 percent of the principal of the legacy fund may be spent during a biennium. The Legislative Assembly may transfer funds from any source to the legacy fund, and such transfers become part of the principal of the fund. The State Investment Board (SIB) is responsible for investment of the principal of the legacy fund. Interest earnings accruing after June 30, 2017, are transferred to the general fund at the end of each biennium. North Dakota Century Code Section 21-10-11 provides that the goal of investment for the legacy fund is principal preservation while maximizing total return.

2. FUND MISSION

The legacy fund was created, in part, due to the recognition that state revenue from the oil and gas industry will be derived over a finite timeframe. The legacy fund defers the recognition of 30 percent of this revenue for the benefit of future generations. The primary mission of the legacy fund is to preserve the real inflation-adjusted purchasing power of the money deposited into the fund while maximizing total return.

3. RESPONSIBILITIES AND DISCRETION OF THE STATE INVESTMENT BOARD

The Legacy and Budget Stabilization Fund Advisory Board (the "Advisory Board") is charged by law under Section 21-10-11 with the responsibility of recommending policies on investment goals and asset allocation of the legacy fund. The SIB is charged with implementing policies and asset allocation and investing the assets of the legacy fund in the manner provided in Section 21-10-07--the prudent institutional investor rule. The fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income.

Management responsibility for the investment program not assigned to the SIB in Chapter 21-10 is hereby delegated to the SIB, which must establish written policies for the operation of the investment program consistent with this investment policy.

The SIB may delegate investment responsibility to professional money managers, which are also required to employ investment strategies consistent with the investment policy. Where a money manager has been retained, the SIB's role in determining investment strategy and security selection is supervisory not advisory.

At the discretion of the SIB, the fund's assets may be pooled with other funds. In pooling funds, the SIB may establish whatever asset class pools it deems necessary with specific quality, diversification, restrictions, and performance objectives appropriate to the prudent investor rule and the objectives of the funds participating in the pool.

The SIB is responsible for establishing criteria, procedures, and making decisions with respect to hiring, retaining, and terminating money managers. The SIB investment responsibility also includes selecting performance measurement services, consultants, report formats, and frequency of meetings with managers.

The SIB shall notify the Advisory Board within 30 days of any substantial or notable changes in money managers; performance measurement services; and consultants, including hiring or terminating a money manager, performance measurement service, or a consultant.

The SIB, after consultation with the board, will implement necessary changes to this policy in an efficient and prudent manner.

4. RISK TOLERANCE

The Advisory Board's risk tolerance with respect to the primary aspect of the legacy fund's mission is low. The Advisory Board is unwilling to undertake investment strategies that might jeopardize the ability of the legacy fund to maintain principal value over time. The Advisory Board recognizes that the plan will evolve as the legacy fund matures and economic conditions and opportunities change.

5. INVESTMENT OBJECTIVES

The Advisory Board's investment objectives are expressed in terms of reward and risk expectations relative to investable, passive benchmarks. The legacy fund's policy benchmark is comprised of policy mix weights of appropriate asset class benchmarks as set by the SIB:

a. The legacy fund's rate of return, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.

b. The legacy fund's risk, measured by the standard deviation of net returns, should not exceed 115 percent of the policy benchmark over a minimum evaluation period of five years.

c. The risk-adjusted performance of the legacy fund, net of fees and expenses, should at least match that of the policy benchmark over a minimum evaluation period of five years.

6. POLICY ASSET MIX

After consideration of all the inputs and a discussion of its own collective risk tolerance, the Advisory Board approved the following policy asset mix for the legacy fund as of April 2, 2013:

Asset Class	Policy Target Percentage
Broad US Equity	30%
Broad International Equity	20%
Fixed Income	35%
Core Real Estate	5%
Diversified Real Assets	10%

Rebalancing of the fund to this target will be done in accordance with the SIB's rebalancing policy, but not less than annually. The SIB approved an 18-month implementation strategy which completed in January of 2015. On June 15, 2016, the Advisory Board acknowledged RIO's stated intent to transfer the Bank of North Dakota Match Loan Certificates of Deposit Program ("BND CD") to the Legacy Fund on or before July 1, 2017. The BND CD investment will be limited to the lesser of $200 million or 5% of the Legacy Fund (and represent a sector allocation within fixed income). The Advisory Board approved this future change in the Legacy Fund's asset allocation without exception. BND will be requested to guarantee a minimum 1.75% investment return. The minimum return requirement will be periodically reviewed in connection with the Legacy Fund's overall asset allocation framework. BND CD's were rated AA by S&P as of June 15, 2016.

7. RESTRICTIONS

While the SIB is responsible for establishing specific quality, diversification, restrictions, and performance objectives for the investment vehicles in which the legacy fund's assets will be invested, it is understood that:

a. Futures and options may be used to hedge or replicate underlying index exposure, but not for speculation.

b. Derivatives use will be monitored to ensure that undue risks are not taken by the money managers.

c. No transaction may be made that would threaten the tax-exempt status of the legacy fund.

d. All assets will be held in custody by the SIB's master custodian or such other custodians as are acceptable to the SIB.

e. No unhedged short sales or speculative margin purchases may be made.

f. Social investing is prohibited unless it meets the exclusive benefit rule, and it can be substantiated that the investment provides an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk. For the purpose of this document, social investing is defined as the consideration of socially responsible criteria in the investment or commitment of public fund money for the purpose of obtaining an effect other than a maximized return to the Fund.

g. Economically targeted investing is prohibited unless the investment meets the exclusive benefit rule.

For the purpose of this document, economically targeted investment is defined as an investment designed to produce a competitive rate of return commensurate with risk involved as well as to create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy.

Also, for the purpose of this document, the exclusive benefit rule is met if the following four conditions are satisfied:

- The cost does not exceed the fair market value at the time of investment.
- The investment provides the legacy fund with an equivalent or superior rate of return for a similar investment with a similar time horizon and similar risk.
- Sufficient liquidity is maintained in the legacy fund to permit distributions in accordance with the terms of the plan.

- The safeguards and diversity that a prudent investor would adhere to are present.

Where investment characteristics, including yield, risk, and liquidity, are equivalent, the Advisory Board's policy favors investments which will have a positive impact on the economy of North Dakota.

8. INTERNAL CONTROLS

A system of internal controls must be in place by the SIB to prevent losses of public funds arising from fraud or employee error. Such controls deemed most important are the separation of responsibilities for investment purchases from the recording of investment activity, custodial safekeeping, written confirmation of investment transactions, and established criteria for investment manager selection and monitoring. The annual financial audit must include a comprehensive review of the portfolio, accounting procedures for security transactions, and compliance with the investment policy.

9. EVALUATION AND REVIEW

Investment management of the legacy fund will be evaluated against the fund's investment objectives and investment performance standards. Emphasis will be placed on 5-year and 10-year results. Evaluation should include an assessment of the continued feasibility of achieving the investment objectives and the appropriateness of the investment policy statement for achieving those objectives.

Performance reports will be provided to the Advisory Board periodically, but not less than quarterly. Such reports will include asset returns and allocation data. Additionally, not less than annually, reports will include information regarding all significant and/or material matters and changes pertaining to the investment of the legacy fund, including:

- Changes in asset class portfolio structures, tactical approaches, and market values.
- Loss of principal, if any.
- Management costs associated with various types of investments.
- All material legal or legislative proceedings affecting the SIB.
- Compliance with this investment policy statement.
- An evaluation of the national economic climate.
- A forecast of the expected economic opportunities and dangers.
- Management of risk by the SIB.

In addition to the quarterly and annual evaluation and review process, the SIB shall notify the Advisory Board within 30 days of any substantial or notable deviation from the normal management of the legacy fund, including any anomalies, notable losses, gains, or liquidation of assets affecting the fund.

Approved by:

LEGACY AND BUDGET STABILIZATION FUND ADVISORY BOARD	STATE INVESTMENT BOARD
Rep. Keith Kempenich	
Representative Keith Kempenich Chairman	David Hunter Executive Director / CIO
Date: 8-3-16	Date: 8-3-16

Approved by the NDSIB: 7/22/2016
Approved by the LBSFAB: 6/15/2016

Appendix

- SIB Client Assets Under Management
- Net Investment Return Summary
- Investment Consultants and Professional Service Providers
- SIB Members and Processes
- RIO Transparency Enhancements
- ND Century Code Chapter 21-10 State Investment Board
- Legacy Fund Highlights – September 30, 2016

State Investment Board – Client Assets Under Management

Fund Name	Market Values as of 9/30/16 [1]	Market Values as of 6/30/16 [2]	Market Values as of 9/30/15 [1]
Pension Trust Fund			
Public Employees Retirement System (PERS)	2,548,430,036	2,459,388,086	2,297,953,486
Teachers' Fund for Retirement (TFFR)	2,144,533,865	2,082,183,640	1,986,019,289
Job Service of North Dakota Pension			92,671,408
City of Bismarck Employees Pension	85,179,534	82,441,003	78,265,663
City of Grand Forks Employees Pension	58,778,547	57,975,758	54,988,439
City of Bismarck Police Pension	35,180,238	33,983,598	34,180,733
Grand Forks Park District	5,834,315	5,720,245	5,736,838
City of Fargo Employees Pension			1,250
Subtotal Pension Trust Fund	**4,877,936,536**	**4,721,692,330**	**4,549,817,105**
Insurance Trust Fund			
Workforce Safety & Insurance (WSI)	1,860,023,835	1,832,104,203	1,722,726,573
Budget Stabilization Fund	578,309,532	575,918,381	575,697,144
PERS Group Insurance Account	37,239,691	37,715,356	36,093,259
City of Fargo FargoDome Permanent Fund	35,386,219	38,782,721	37,545,105
State Fire and Tornado Fund	24,853,937	24,091,203	22,737,348
Petroleum Tank Release Compensation Fund	7,214,431	7,149,512	7,176,956
State Risk Management Fund	6,208,850	6,534,801	6,116,849
State Risk Management Workers Comp Fund	5,680,663	5,516,177	5,614,318
ND Association of Counties (NDACo) Fund	4,167,501	4,048,863	3,836,386
State Bonding Fund	3,329,117	3,296,372	3,186,910
ND Board of Medicine	2,248,565	2,208,667	2,138,284
Insurance Regulatory Trust Fund	1,232,868	1,085,836	2,567,559
Bismarck Deferred Sick Leave Account	661,908	642,265	850,301
Cultural Endowment Fund	398,147	386,452	366,207
Subtotal Insurance Trust Fund	**2,566,955,264**	**2,539,480,809**	**2,426,653,198**
Legacy Trust Fund			
Legacy Fund	4,070,189,950	3,809,485,177	3,328,631,897
PERS Retiree Insurance Credit Fund	105,505,466	101,623,224	92,663,350
Job Service of North Dakota Pension	96,325,192	96,588,333	
ND Tobacco Prevention and Control Trust Fund	52,785,217	54,366,538	47,300,013
Total Assets Under SIB Management	**11,769,697,625**	**11,323,236,410**	**10,445,065,563**

[1] *9/30/16 and 9/30/15 market values are unaudited and subject to change.*

[2] *6/30/16 market values as stated in the Comprehensive Annual Financial Report.*

- **SIB client assets grew by approximately 12% (or $1.27 billion) in the last year** with the Legacy Fund creating the largest asset growth of $742 million primarily due to tax collections.
- **The Legacy Fund generated a net investment gain of 10.18% for the year ended September 31, 2016**, exceeding its performance benchmark. Since inception, the Legacy Fund has generated a net annualized return of 3.49% (over the last 5 years) exceeding the performance benchmark of 2.62%.
- The Pension Trust posted a net return of 9.43% in the last year. **During the last 5-years, the Pension Trust generated a net annualized return of 9.44%, exceeding the performance benchmark of 8.83%.**
- The Insurance Trust generated a net return of 7.04% in the last year. **During the last 5-years, the Insurance Trust posted a net annualized return of 5.79%, exceeding the performance benchmark of 4.38%.**
- SIB client assets exceeded $11.7 billion as of September 30, 2016, based on unaudited valuations.

ND RETIREMENT AND INVESTMENT OFFICE
ND STATE INVESTMENT BOARD
INVESTMENT PERFORMANCE SUMMARY
AS OF SEPTEMBER 30, 2016

		Investment Performance (net of fees)																
		Quarter Ended					Fiscal Years ended June 30					Periods ended 6/30/16 (annualized)						
Fund Name	Market Values as of 9/30/16	9/30/16	12/31/16	3/31/17	6/30/17	FYTD 2017	2016	2015	2014	2013	2012	3 Years	5 Years	10 Years	15 Years	20 Years	25 Years	30 Years
Pension Trust Fund																		
Teachers' Fund for Retirement (TFFR)	2,144,533,865	3.69%				3.69%	0.28%	3.52%	16.53%	13.57%	-1.12%	6.55%	6.32%	4.45%	5.51%	6.48%	7.48%	7.73%
Public Employees Retirement System (PERS)	2,548,430,036	3.68%				3.68%	0.28%	3.53%	16.38%	13.44%	-0.12%	6.51%	6.48%	4.81%	5.84%	6.88%	7.86%	7.89%
City of Bismarck Employees Pension	85,179,534	3.33%				3.33%	0.82%	3.69%	14.56%	12.41%	1.57%	6.20%	6.46%	5.16%	5.84%	6.86%	7.79%	*
City of Bismarck Police Pension	35,180,238	3.53%				3.53%	0.32%	3.56%	15.27%	13.03%	1.31%	6.19%	6.52%	5.02%	5.73%	6.71%	7.68%	*
City of Grand Forks Employees Pension	58,778,547	3.61%				3.61%	0.11%	3.53%	16.33%	14.01%	1.09%	6.43%	6.80%	*	*	*	*	*
Park District of the City of Grand Forks Pension	5,834,315	3.51%				3.51%	0.36%	4.22%	16.44%	14.43%	0.86%	6.80%	7.05%	*	*	*	*	*
Subtotal Pension Trust Fund	4,877,936,536																	
Insurance Trust Fund																		
Workforce Safety & Insurance (WSI)	1,860,023,835	2.82%				2.82%	3.58%	3.26%	11.71%	8.31%	6.17%	6.11%	6.56%	5.66%	5.58%	6.78%	7.39%	*
State Fire and Tornado Fund	24,853,937	3.20%				3.20%	2.67%	3.16%	12.78%	10.59%	4.93%	6.10%	6.75%	5.87%	5.65%	6.43%	6.58%	*
State Bonding Fund	3,329,117	1.02%				1.02%	3.48%	1.25%	4.06%	2.96%	5.31%	2.92%	3.40%	2.07%	3.24%	4.60%	5.17%	*
Petroleum Tank Release Compensation Fund	7,214,431	0.94%				0.94%	3.17%	1.13%	3.68%	2.47%	4.84%	2.65%	3.05%	1.82%	2.97%	4.47%	*	*
Insurance Regulatory Trust Fund	1,232,868	2.59%				2.59%	1.46%	2.04%	9.88%	8.49%	2.82%	4.39%	4.88%	4.63%	4.75%	5.67%	5.68%	*
State Risk Management Fund	6,208,850	2.74%				2.74%	4.46%	4.08%	12.29%	10.19%	7.63%	6.88%	7.68%	6.59%	5.86%	*	*	*
State Risk Management Workers Comp Fund	5,680,663	3.01%				3.01%	4.21%	4.57%	13.68%	11.61%	7.40%	7.40%	8.23%	6.74%	*	*	*	*
Cultural Endowment Fund	398,147	3.96%				3.96%	2.18%	5.22%	16.94%	15.58%	4.65%	7.93%	8.75%	6.33%	*	*	*	*
Budget Stabilization Fund	578,309,532	0.42%				0.42%	1.82%	1.86%	1.94%	1.87%	2.03%	1.88%	1.91%	2.11%	*	*	*	*
ND Association of Counties (NDACo) Fund	4,167,501	2.98%				2.98%	2.76%	2.77%	11.61%	9.46%	1.69%	5.63%	5.58%	4.73%	4.97%	*	*	*
Bismarck Deferred Sick Leave Account	661,908	3.12%				3.12%	3.26%	2.95%	12.32%	9.83%	5.69%	6.09%	6.75%	6.08%	5.86%	*	*	*
City of Fargo FargoDome Permanent Fund	35,386,219	4.23%				4.23%	1.19%	3.38%	16.34%	13.46%	3.14%	6.76%	7.33%	5.97%	*	*	*	*
State Board of Medicine Fund	2,248,565	1.83%				1.83%	1.63%	2.70%	*	*	*	*	*	*	*	*	*	*
PERS Group Insurance Account	37,239,691	0.06%				0.06%	1.49%	0.01%	0.06%	0.27%	0.24%	0.52%	0.41%	1.25%	1.64%	*	*	*
Subtotal Insurance Trust Fund	2,566,955,263																	
Legacy Fund	4,070,189,950	4.21%				4.21%	1.06%	3.31%	6.64%	1.15%	*	3.65%	*	*	*	*	*	*
Job Service of North Dakota Pension	96,325,192	0.92%				0.92%	5.45%	3.30%	13.54%	11.71%	3.09%	7.34%	7.33%	6.00%	6.11%	7.57%	*	*
Tobacco Control and Prevention Fund	52,785,217	0.32%				0.32%	*	*	*	*	*	*	*	*	*	*	*	*
PERS Retiree Health Insurance Credit Fund	105,505,466	3.62%				3.62%	0.72%	3.06%	16.53%	12.71%	2.62%	6.55%	6.95%	5.13%	5.23%	6.40%	7.17%	*
Total Assets Under SIB Management	$ 11,769,697,624																	

* These funds do not have the specified periods of history under SIB management.

Note: Asset allocation largely drives investment performance. Each fund has a unique allocation that takes into consideration return objectives, risk tolerance, liquidity constraints, and unique circumstances. Such considerations must be taken into account when comparing investment returns. **All figures are preliminary and subject to revision.**

NDRIO – Consulting and Professional Services (June 30, 2016)

Actuary

The Segal Company
Chicago, Illinois

Auditor

CliftonLarsonAllen LLP
Baltimore, Maryland

Legal Counsel

Attorney General's Office
Bismarck, North Dakota

Ice Miller
Chicago, Illinois

K&L Gates
Boston, Massachusetts

Information Technology

Advent Software, Inc.
San Francisco, CA

CPAS Systems Inc.
Toronto, Ontario

Master Custodian

The Northern Trust Company
Chicago, Illinois

Investment Consultant and Performance Measurement

Callan Associates Inc.
San Francisco, California

Mercer LLC
Chicago, Illinois

Novarca North America LLC
Palo Alto, California

Adams Street Partners, LLC
Chicago, Illinois

Investment Managers

Adams Street Partners, LLC
Chicago, Illinois

Investment Managers (cont.)

Axiom International Investors
Greenwich, Connecticut

Babson Capital Management LLC Boston, Massachusetts

Brandywine Asset Management
Wilmington, Delaware

Callan Associates
San Francisco, California

Capital Group
Los Angeles, California

Corsair Capital
New York, New York

Declaration Mgmt & Research, LLC
McLean, Virginia

Dimensional Fund Advisors
Chicago, Illinois

EIG Energy Partners
Los Angeles, California

Epoch Investment Partners, Inc.
New York, New York

Goldman Sachs Asset Mgmt
New York, New York

Grosvenor Capital Management
New York, NY

Hearthstone Homebuilding Investors, LLC
Encino, California

INVESCO Realty Advisors
Dallas, Texas

InvestAmerica L&C, LLC
Cedar Rapids, Iowa

J.P. Morgan Invest. Mgmt, Inc.
New York, New York

Loomis Sayles & Company
Boston, Massachusetts

Los Angeles Capital Management
Los Angeles, California

LSV Asset Management
Chicago, Illinois

Matlin Patterson Global Advisers LLC
New York, New York

Investment Managers (cont.)

Northern Trust Asset Management
Chicago, Illinois

Parametric Portfolio Associates
DBA The Clifton Group
Minneapolis, Minnesota

PIMCO
Newport Beach, California

Prudential Investment Management
Newark, New Jersey

Quantum Energy Partners
Houston, Texas

Quantum Resources Mgmt, LLC
Denver, Colorado

Research Affiliates, LLC
Newport Beach, California

SEI Investments Management Co.
Oaks, Pennsylvania

State Street Global Advisors
Boston, Massachusetts

Timberland Investment Resources, LLC
Atlanta, Georgia

UBS Global Asset Management
Chicago, Illinois

The Vanguard Group
Valley Forge, Pennsylvania

Wellington Trust Company, NA
Boston, Massachusetts

Wells Capital Management, Inc.
Menomonee Falls, Wisconsin

Western Asset Management Co.
Pasadena, California

Note: William Blair replaced Capital Group as an international equity investment manager on May 31, 2016.

State Investment Board Members – Dec. 5, 2016

The SIB includes 11 members with Lieutenant Governor Drew Wrigley serving as Chairman and includes **State Treasurer Kelly Schmidt**, the **Commissioner of University and School Lands Lance Gaebe**, the **Director of Workforce Safety and Insurance designee Cindy Ternes**, the **Insurance Commissioner Adam Hamm**, plus three TFFR board members and three PERS board members.

The TFFR representatives include **Michael Gessner, Rob Lech** and **Mel Olson** noting that Mr. Lech also serves as the board parliamentarian.

The PERS representatives include **Mike Sandal, Tom Trenbeath** and **Yvonne Smith** noting that Mr. Sandal also serves as *Vice Chairman* of the SIB.

North Dakota Retirement & Investment Office – Background

RIO is an agency of the State of North Dakota. The agency was created by the 1989 Legislative Assembly to capture administrative and investment cost savings in the management of two important long-standing state programs – the retirement program of the Teachers' Fund for Retirement (TFFR) and the investment program of the State Investment Board (SIB).

The SIB is responsible for setting policies and procedures guiding the investment of over $11 billion in assets for seven pension funds and 16 other insurance-type funds. Their investments are divided into two investment trust funds and two individual investment accounts. Individual investment guidelines for each fund can be found in the Investment Section. These guidelines include goals and objectives, risk tolerance, liquidity constraints, asset allocation and portfolio restrictions specific to each fund's unique circumstances. When creating investment pools to implement the asset allocations for each client fund, the SIB takes all of these guidelines into consideration in order to best meet the objectives of each fund and safeguard fund assets.

The pension investment pool is made up of only qualified pension funds whose monies must be invested exclusively for the benefit of their participants. The insurance investment pool is made up of mainly insurance-type funds, but also includes other funds that do not qualify as pension funds and would like to benefit from the cost savings of being pooled with other funds' assets. All of these funds are invested in accordance with the "Prudent Investor Rule."

An important aspect of the prudent investor rule is that individual investments are considered not in isolation but in the context of the trust portfolio as a whole. Some new opportunities may appear risky when viewed alone. However, when part of a diversified mix of investments in stocks, bonds and other assets, they can increase returns often without increasing the overall portfolio risk and, in some cases, may help decrease the overall portfolio's risk.

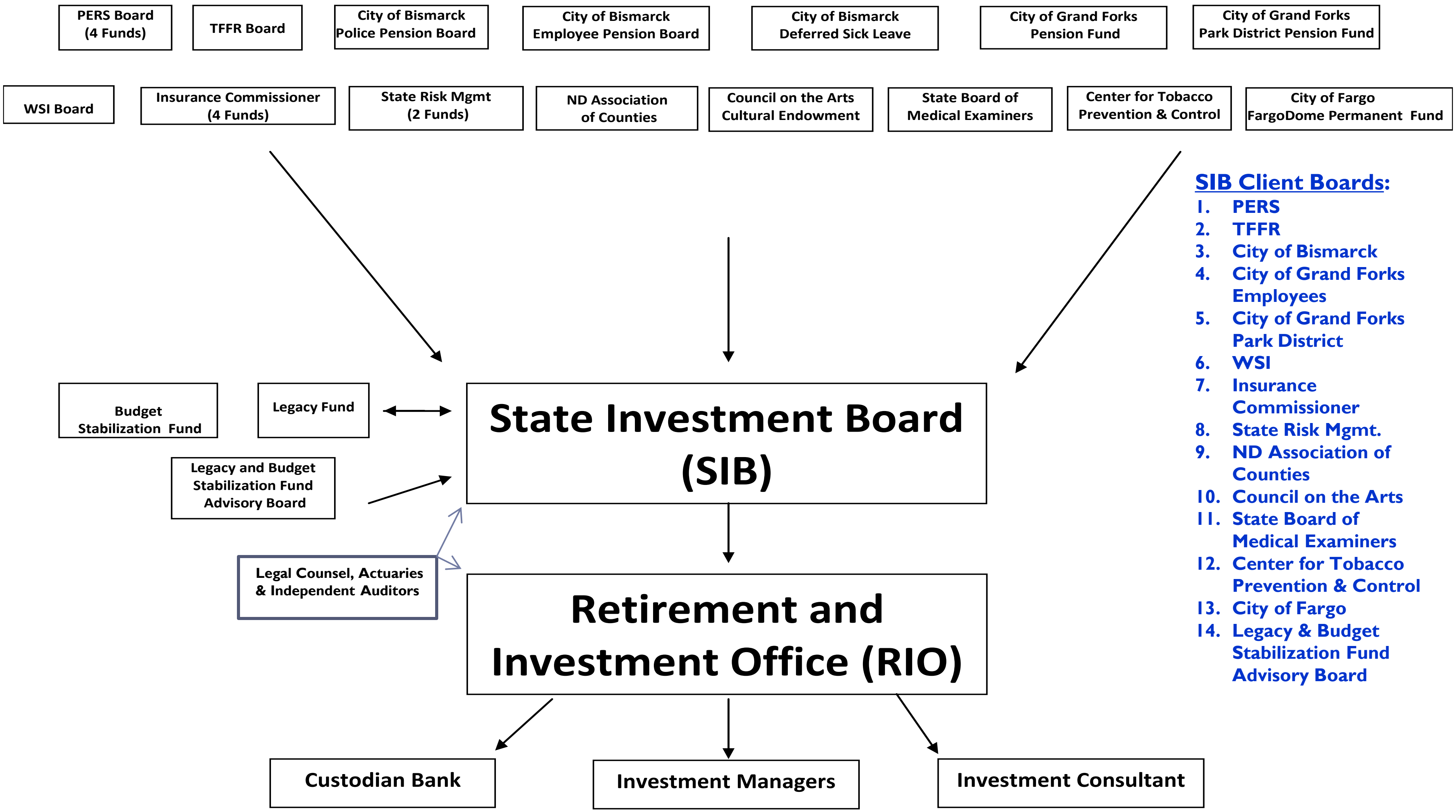
North Dakota Retirement & Investment Office – Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to RIO for its comprehensive annual financial report for the fiscal year ended June 30, 2015. This was the eighteenth consecutive year that RIO has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

TFFR also received the 2015 Public Pension Standards Award for Funding and Administration from the Public Pension Coordinating Council. To receive the award, the retirement system must certify that it meets specific professional standards for a comprehensive benefit program, actuarial valuations, financial reporting, investments, communications to members, and funding adequacy.

State Investment Board Process



SIB Client Boards:

1. PERS
2. TFFR
3. City of Bismarck
4. City of Grand Forks Employees
5. City of Grand Forks Park District
6. WSI
7. Insurance Commissioner
8. State Risk Mgmt.
9. ND Association of Counties
10. Council on the Arts
11. State Board of Medical Examiners
12. Center for Tobacco Prevention & Control
13. City of Fargo
14. Legacy & Budget Stabilization Fund Advisory Board

State Investment Board Process

Client Responsibilities: (Per NDCC 21-10-02.1) The governing body of each fund (client) shall establish policies on investment goals and objectives and asset allocation that must include:

- Acceptable rates of return, liquidity and levels of risk
- Long-range asset allocation goals

State Investment Board Responsibilities: (Per NDCC 21-10):

- Accept and implement client asset allocations
- Apply Prudent Investor Rule when investing for fund under its supervision
- Approve general types of securities for investment
- Set policies and procedures regulating securities transactions on behalf of the clients
- Select custodian servicer
- Select investment director and/or investment consulting service
- Create investment pools

State Investment Board Process

Retirement and Investment Office Staff Responsibilities (on behalf of SIB):

- Administer overall investment strategy
- Advise SIB on ways to maximize risk/return opportunities within each asset class
- Act as liaison between SIB and managers, consultant and custodian
- Monitor individual clients' investment guidelines and asset allocations
- Maintain separate accounting for client accounts

Investment Manager Responsibilities:

- Accept and implement specific mandates or "investment missions"
- Make buy/sell decisions based on investment guidelines
- Report to RIO Staff on regular basis
- Provide education to SIB

State Investment Board Process

Custodian Bank Responsibilities:

- Safe-keep assets
- Settle trades
- Record-keeper

Investment Consultant Responsibilities:

- Performance measurement of investment managers
- Manager search assistance
- Provide education to SIB

Special projects

Others Experts:

- Legal Counsel
- Independent Actuaries and Auditors
- Specialists in custody and fee reviews and/or transaction cost analyses

Transparency Enhancement Update – 2016

Strategic Investment Belief / Goal:

Although SIB meetings are open to the public and RIO is committed to adhering to all applicable open records laws, a transparency enhancement initiative was commenced in mid-2015 in order to make it easier for interested parties to gain access to information on RIO's website. RIO believes these actions support our desire to foster trust, understanding and support within our community.

RIO's Stated Action Plan (as stated in our SIB Meeting Materials in 2015 and 2016):

1) Enhance public access to our SIB Governance Manual by adding a new hyperlink on our RIO website (hyperlink accessed by clicking on "SIB Governance Manual" under the "SIB / Board" section); http://www.nd.gov/rio/SIB/Board/GovernanceManual/default.htm
2) Enhance public access to our SIB Meeting Materials by adding a new hyperlink on our RIO website (hyperlink accessed by clicking on "Meeting Materials" under the "SIB / Board" section); http://www.nd.gov/rio/SIB/Board/SIB%20Meeting%20Materials/default.htm
3) Enhance public access to our SIB's Audit Committee Charter and Meeting Materials by adding a new hyperlink on our RIO website (hyperlinks accessed by clicking on "SIB Audit Charter" or "Meeting Materials" under the "SIB Audit" section). http://www.nd.gov/rio/SIB%20Audit/Board/default.htm

NDCC Chapter 21-10 State Investment Board

21-10-01. State investment board - Membership - Term - Compensation – Advisory council.

The North Dakota state investment board consists of the governor, the state treasurer, the commissioner of university and school lands, the director of workforce safety and insurance, the insurance commissioner, three members of the teachers' fund for retirement board or the board's designees who need not be members of the fund as selected by that board, two of the elected members of the public employees retirement system board as selected by that board, and one member of the public employees retirement system board as selected by that board. The director of workforce safety and insurance may appoint a designee, subject to approval by the workforce safety and insurance board of directors, to attend the meetings, participate, and vote when the director is unable to attend. The teachers' fund for retirement board may appoint an alternate designee with full voting privileges to attend meetings of the state investment board when a selected member is unable to attend. The public employees retirement system board may appoint an alternate designee with full voting privileges from the public employees retirement system board to attend meetings of the state investment board when a selected member is unable to attend. The members of the state investment board, except elected and appointed officials and the director of workforce safety and insurance or the director's designee, are entitled to receive as compensation one hundred forty-eight dollars per day and necessary mileage and travel expenses as provided in sections 44-08-04 and 54-06-09 for attending meetings of the state investment board.

The state investment board may establish an advisory council composed of individuals who are experienced and knowledgeable in the field of investments. The state investment board shall determine the responsibilities of the advisory council. Members of the advisory council are entitled to receive the same compensation as provided the members of the advisory board of the Bank of North Dakota and necessary mileage and travel expenses as provided in sections 44-08-04 and 54-06-09.

21-10-02. Board - Powers and duties.

The board is charged with the investment of the funds enumerated in section 21-10-06. It shall approve general types of securities for investment by these funds and set policies and procedures regulating securities transactions on behalf of the various funds. Representatives of the funds enumerated in section 21-10-06 may make recommendations to the board in regard to investments. The board or its designated agents must be custodian of securities purchased on behalf of funds under the management of the board. The board may appoint an investment director or advisory service, or both, who must be experienced in, and hold considerable knowledge of, the field of investments. The investment director or advisory service shall serve at the pleasure of the board. The investment director or advisory service may be an individual, corporation, limited liability company, partnership, or any legal entity which meets the qualifications established herein. The board may authorize the investment director to lend securities held by the funds. These securities must be collateralized as directed by the board. The board may create investment fund pools in which the funds identified in section 21-10-06 may invest.

NDCC Chapter 21-10 State Investment Board

21-10-02.1. Board - Policies on investment goals and objectives and asset allocation.

1. The governing body of each fund enumerated in section 21-10-06 shall establish policies on investment goals and objectives and asset allocation for each respective fund. The policies must provide for:
   a. The definition and assignment of duties and responsibilities to advisory services and persons employed by the board.
   b. Rate of return objectives, including liquidity requirements and acceptable levels of risk.
   c. Long-range asset allocation goals.
   d. Guidelines for the selection and redemption of investments.
   e. Investment diversification, investment quality, qualification of advisory services, and amounts to be invested by advisory services.
   f. The type of reports and procedures to be used in evaluating performance.
2. The asset allocation and any subsequent allocation changes for each fund must be approved by the governing body of that fund and the state investment board. The governing body of each fund shall use the staff and consultants of the retirement and investment office in developing asset allocation and investment policies.

21-10-03. Cooperation with Bank of North Dakota.

Repealed by S.L. 1987, ch. 190, § 14.

21-10-04. Board - Meetings.

The state investment board shall select one of its members to serve as chair, one to serve as vice chair, and shall meet at the call of the chair or upon written notice signed by two members of the board.

21-10-05. Investment director - Powers and duties.

Subject to the limitations contained in the law or the policymaking regulations or resolutions adopted by the board, the investment director may sign and execute all contracts and agreements to make purchases, sales, exchanges, investments, and reinvestments relating to the funds under the management of the board. This section is a continuing appropriation of all moneys required for the making of investments of funds under the management of the board. The investment director shall see that moneys invested are at all times handled in the best interests of the funds. Securities or investments may be sold or exchanged for other securities or investments.
The investment director shall formulate and recommend to the investment board for approval investment regulations or resolutions pertaining to the kind or nature of investments and limitations, conditions, and restrictions upon the methods, practices, or procedures for investment, reinvestment, purchase, sale, or exchange transactions that should govern the investment of funds under this chapter.

NDCC Chapter 21-10 State Investment Board

21-10-06. Funds under management of board - Accounts.

1. Subject to the provisions of section 21-10-02, the board shall invest the following funds:
    a. State bonding fund.
    b. Teachers' fund for retirement.
    c. State fire and tornado fund.
    d. Workforce safety and insurance fund.
    e. Public employees retirement system.
    f. Insurance regulatory trust fund.
    g. State risk management fund.
    h. Budget stabilization fund.
    i. Health care trust fund.
    j. Cultural endowment fund.
    k. Petroleum tank release compensation fund.
    l. Legacy fund.
    m. A fund under contract with the board pursuant to subsection 3.
2. Separate accounting must be maintained for each of the funds listed in subsection 1. The moneys of the individual funds may be commingled for investment purposes when determined advantageous.
3. The state investment board may provide investment services to, and manage the money of, any agency, institution, or political subdivision of the state, subject to agreement with the industrial commission. The scope of services to be provided by the state investment board to the agency, institution, or political subdivision must be specified in a written contract. The state investment board may charge a fee for providing investment services and any revenue collected must be deposited in the state retirement and investment fund.

21-10-06.1. Board - Investment reports.

The board shall annually prepare reports on the investment performance of each fund under its control. The reports must be uniform and must include:

1. A list of the advisory services managing investments for the board.
2. A list of investments at market value, compared to previous reporting period, of each fund managed by each advisory service.
3. Earnings, percentage earned, and change in market value of each fund's investments.
4. Comparison of the performance of each fund managed by each advisory service to other funds under the board's control and to generally accepted market indicators.

NDCC Chapter 21-10 State Investment Board

21-10-06.2. Investment costs.

The amounts necessary to pay for investment costs, such as investment counseling fees, trustee fees, custodial fees, performance measurement fees, expenses associated with money manager searches, expenses associated with onsite audits and reviews of investment managers, and asset allocation expenses, incurred by the state investment board are hereby appropriated and must be paid directly out of the funds listed in section 21-10-06 by the fund incurring the expense.

21-10-07. Legal investments.

The state investment board shall apply the prudent investor rule in investing for funds under its supervision. The "prudent investor rule" means that in making investments the fiduciaries shall exercise the judgment and care, under the circumstances then prevailing, that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not in regard to speculation but in regard to the permanent disposition of funds, considering probable safety of capital as well as probable income. The retirement funds belonging to the teachers' fund for retirement and the public employees retirement system must be invested exclusively for the benefit of their members and in accordance with the respective funds' investment goals and objectives.

21-10-08. Reserves - Percentage limitations.

In order to meet claims and liabilities, reserves must be established and maintained in each of the funds in accordance with the investment policy and asset allocation established for each fund.

21-10-09. Personal profit prohibited - Penalty.

No member, officer, agent, or employee of the state investment board may profit in any manner from transactions on behalf of the funds. Any person violating any of the provisions of this section is guilty of a class A misdemeanor.

21-10-10. State investment board fund - Cost of operation of board.

Repealed by S.L. 1989, ch. 667, § 13.

NDCC Chapter 21-10 State Investment Board

21-10-11. Legacy and budget stabilization fund advisory board.

The legacy and budget stabilization fund advisory board is created to develop recommendations for the investment of funds in the legacy fund and the budget stabilization fund to present to the state investment board. The goal of investment for the legacy fund is principal preservation while maximizing total return. The board consists of two members of the senate appointed by the senate majority leader, two members of the house of representatives appointed by the house majority leader, the director of the office of management and budget or designee, the president of the Bank of North Dakota or designee, and the tax commissioner or designee. The board shall select a chairman and must meet at the call of the chairman. The board shall report at least semiannually to the budget section. Legislative members are entitled to receive compensation and expense reimbursement as provided under section 54-03-20 and reimbursement for mileage as provided by law for state officers. The legislative council shall pay the compensation and expense reimbursement for the legislative members. The legislative council shall provide staff services to the legacy and budget stabilization fund advisory board. The staff and consultants of the state retirement and investment office shall advise the board in developing asset allocation and investment policies.

21-10-12. Legacy fund - Earnings defined.

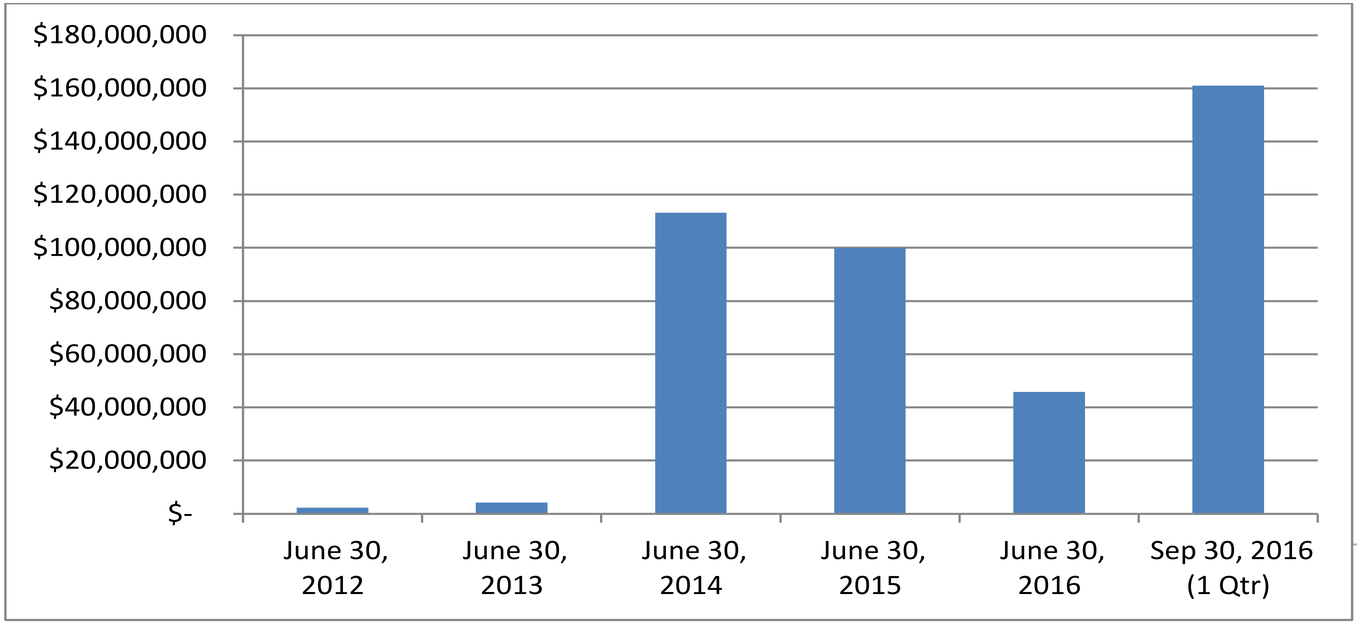
For the purposes of section 26 of article X of the Constitution of North Dakota, the term "earnings" means net income in accordance with generally accepted accounting principles, excluding any unrealized gains or losses.

Legacy Fund Earnings Top 10%

Strong performance in equities (up 13%), bonds (up 8%) and real assets (up 7%) drove the Legacy Funds Net Investment Return to approximately 10.18% for the 1-year ended 9/30/2016 surpassing its Investment Policy Benchmark (of 8.85%).

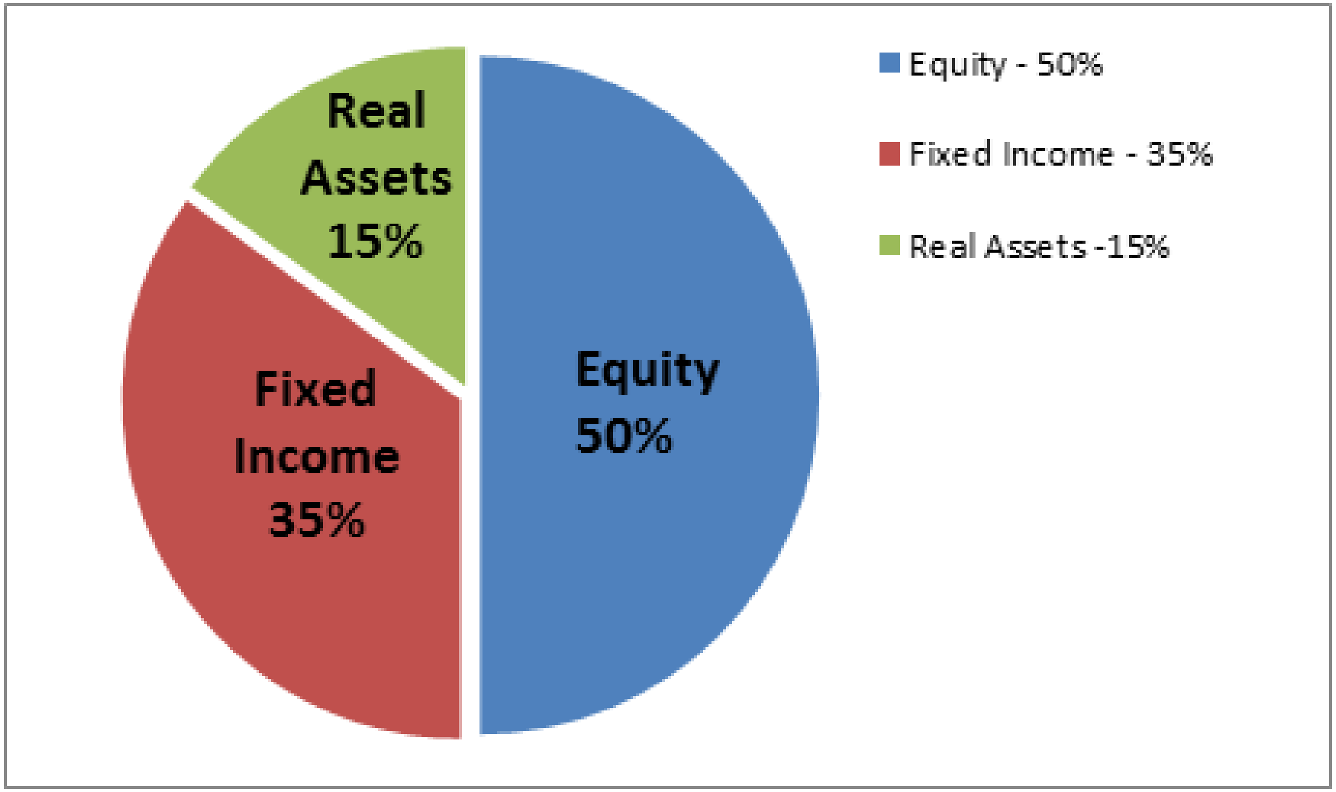
LEGACY FUND	1 Yr Ended 9/30/2016	3 Yrs Ended 9/30/2016	5 Yrs Ended 9/30/2016
Net Investment Return	**10.18%**	**4.74%**	**3.49%**
Policy Benchmark Return	8.85%	3.92%	2.62%
Excess Return	**1.34%**	**0.82%**	**0.87%**
Excess Return (in dollars)	***$50 million***	***$75 million***	***$85 million***

Since inception, the Legacy Fund generated $426 million of income with a Net Investment Return of 3.49% per annum noting the fund was largely invested in fixed income prior to mid-2014. **Net income by fiscal year is shown in the chart below.** For the 1 quarter ended Sep. 30, 2016, net investment income was $161 million (based on preliminary unaudited valuations).



Legacy Fund Asset Allocation:

The current asset allocation is 50% Equity, 35% Fixed Income and 15% Real Assets as approved by the State Investment Board and Legacy Fund Advisory Board. Asset allocation is the primary driver of investment results and used to determine the Investment Policy Benchmark Return.



Legacy Fund Growth Enhances Fee Savings Initiatives by $20 million/year

SIB client assets under management have doubled during the past five years and the growth of the Legacy Fund had played an important role in improving SIB's ability to reduce investment fees. During the last three years, management fees have declined from 0.65% to less than 0.45% of assets. Based on $10 billion of assets, this translates into $20 million of annual fee savings (e.g. $10 billion x 0.20% = $20 million/year).

Note: Interim amounts and estimates are unaudited and subject to change.

SIB Legislative Update
January 20, 2017

HB 1022 – RIO Budget
Introduced by: Appropriations Committee
http://www.legis.nd.gov/assembly/65-2017/documents/17-0507-01000.pdf

HB 1082 – RIO Budget
Introduced by: Appropriations Committee (at the request of the Governor)
http://www.legis.nd.gov/assembly/65-2017/documents/17-8143-01000.pdf

HB 1022 and HB 1082 both contain the budget authority and continuing appropriations for the Retirement and Investment Office (RIO) administrative expenses for operating the retirement program for the TFFR Board and the investment program for the SIB. There are two RIO budget bills. While both start with base level amounts, HB 1082 includes former Governor Dalrymple's executive budget adjustments, while the former Governor's adjustments are excluded from HB 1022..

HB 1022 and HB 1082 were assigned to the House Appropriations - Government Operations Division. Dave, Connie and Fay attended a committee hearing on 1/5. Many questions revolved around Legacy Fund earnings and returns which Dave addressed. Other questions related to TFFR funding, plan design, and contributions to which Fay responded.

Another committee meeting on HB 1022 was held on 1/16 which was attended by Connie, Fay and Dave. RIO's budget proposal was presented with no specifics issued noted.

On 1/17, OMB requested (on behalf of the Governor) reductions to Rio's budget of an additional $110,000 for the 2017-19 biennium. After a careful review of all budget areas, RIO proposed the following expense reductions:

1) **Reduced "Temporary Salaries" (and related fringe benefits) by $20,000 (thereby eliminating the internship position);**
2) **Reduced "Travel" by $53,000 for both Board members and RIO Staff;**
3) **Reduced our "Contingency" line item by $28,000 (to $52,000); and**
4) **Eliminated a $9,000 copier purchase in the 2017-19 biennium.**

The new "Contingency" amount of $52,000 approximates the average contingency amount used by RIO the last four biennia.

HB 1175 - SIB Membership
Introduced by: Representatives Kreidt, Delzer, Devlin, Kempenich and Senator Klein
http://www.legis.nd.gov/assembly/65-2017/documents/17-0409-01000.pdf

HB 1175 adds two members to the SIB, one selected by the House Majority Leader and one selected by the Senate Majority Leader, thereby increasing the number of SIB members to 13.

The bill was assigned to the Political Subdivisions Committee. **The hearing was scheduled for 1/19, but was postponed since the "bill carrier" was unable to attend. Dave attended the scheduled hearing and let Committee Chairman Lawrence Klemin know that he was available to address any SIB process questions, but did not intend to provide testimony either "for" or "against" HB 1175.**

OTHER BILLS OF INTEREST:

HB 1088 – Data Breach Response and Remediation Costs
Introduced by: Government and Veterans Affairs Committee (at the request of OMB)
http://www.legis.nd.gov/assembly/65-2017/documents/17-8014-01000.pdf

HB 1088 would allow the State's Risk Management fund to cover state agencies for certain 1st party costs associated with a data breach including notification of affected parties, credit counseling, etc. A related OMB bill (HB1075) also includes special fund appropriation authority for self-insurance remediation costs, i.e. fixing the issues related to hardware and software. Please be reminded that RIO had originally included funds in an optional budget package for cyber insurance which was not included in the former Governor's Executive Budget recommendation.

HB 1088 was assigned to House GVA Committee. A committee hearing was held on 1/05. The committee gave the bill a do pass recommendation 14-0-0. The House approved the bill on 1/10 by a vote of 91 – 1. The bill will now move to the Senate.

HB 1154 - Budget Stabilization Fund
Introduced by: Representatives Delzer, Brandenburg, Kempenich, Pollert, Streyle and Senator Wanzek
http://www.legis.nd.gov/assembly/65-2017/documents/17-0100-01000.pdf

HB 1155 – Transfers and Expenditures from Budget Stabilization Fund
Introduced by: Representatives Delzer, Bellew, Carlson, Monson and Streyle
http://www.legis.nd.gov/assembly/65-2017/documents/17-0101-01000.pdf

HB 1154 increases the Budget Stabilization Fund to 15% of the current biennial state general fund budget versus 9.5% currently. HB 1155 changes the rules which govern transfers and expenditures from the budget stabilization fund to the general fund.

The House Appropriations Committee scheduled a Committee hearing for HB 1154 and HB 1155 fora1/18 at 3:00 and 3:15 pm, respectively, in the Roughrider Room.

HB 1317 – Transfers of Legacy Fund Earnings - Intent
Introduced by: Representatives Steiner and Toman and Senator Sorvaag
http://www.legis.nd.gov/assembly/65-2017/documents/17-0065-02000.pdf

HB 1317 introduces a new section to NDCC 54-27 relating to the transfer of legacy fund earnings to the general fund with "the intent of the legislative assembly that earnings of the legacy fund be used for tax relief programs."

The House Appropriations Committee scheduled a Committee hearing for HB 1317 for 1/26 at 2:15 pm in the Roughrider Room.

AGENDA ITEM V.G.

BOARD ACTION REQUESTED

To: State Investment Board

From: Dave Hunter, Executive Director / CIO

Date: January 20, 2017

RE: Contingency Request

RIO requests the SIB to approve the use of $9,000 from our "Contingency" line item to fund the purchase of a new copier for our office. The existing copier (purchased for $11,000 in 2007) to be replaced has passed its useful life (generating over 1.6 million copies). RIO originally requested this capital expenditure in our 2017-19 budget, but given budget pressures we desire to accelerate the purchase to this biennium in order to improve office efficiency. It is important to note that we have not used any of our $82,000 "Contingency" line item this biennium.

BUDGETING / FINANCIAL CONDITION

AS OF DECEMBER 31, 2016

	2015-2017 BUDGET	ADJUSTED APPROPRIATION	EXPENDITURES BIENNIUM TO DATE ACTUAL	BUDGET AVAILABLE	% BUDGET AVAILABLE	% OF BIENNIUM REMAINING
SALARIES AND BENEFITS	$ 4,340,551.00	$ 4,342,556.31	$ 3,143,709.52	$ 1,198,846.79	27.61%	25.00%
OPERATING EXPENDITURES	990,874.00	990,874.00	521,791.46	469,082.54	47.34%	25.00%
CONTINGENCY	82,000.00	82,000.00	0.00	82,000.00	100.00%	25.00%
TOTAL	$ 5,413,425.00	$ 5,415,430.31	$ 3,665,500.98	1,749,929.33	32.31%	25.00%

EXPENDITURE REPORT

QUARTER ENDED DECEMBER 31, 2016

	INVESTMENT	RETIREMENT	QUARTERLY TOTALS	FISCAL YEAR TO - DATE	BIENNIUM TO - DATE
CONTINUING APPROPRIATIONS					
INVESTMENT EXPENDITURES (SEE ATTACHED DETAIL)	$ 6,655,625.01	$ 0.00	$ 6,655,625.01	$ 14,959,483.25	$ 47,221,242.87
MEMBER CLAIMS					
1. ANNUITY PAYMENTS	0.00	47,867,646.49	47,867,646.49	95,127,023.45	274,830,799.65
2. REFUND PAYMENTS	0.00	1,591,687.39	1,591,687.39	3,067,988.80	9,320,558.30
TOTAL MEMBER CLAIMS	0.00	49,459,333.88	49,459,333.88	98,195,012.25	284,151,357.95
OTHER CONTINUING APPROPRIATIONS	54,972.45	57,247.66	112,220.11	225,461.27	702,825.66
TOTAL CONTINUING APPROPRIATIONS	6,710,597.46	49,516,581.54	56,227,179.00	113,379,956.77	332,075,426.48
BUDGETED EXPENDITURES					
1. SALARIES & BENEFITS					
SALARIES	198,161.73	203,013.27	401,175.00	803,763.83	2,326,295.16
OVERTIME/TEMPORARY	0.00	0.00	0.00	4,185.00	8,021.25
TERMINATION SALARY & BENEFITS	0.00	0.00	0.00	0.00	0.00
FRINGE BENEFITS	59,258.20	79,300.39	138,558.59	276,017.86	809,393.11
TOTAL SALARY & BENEFITS	257,419.93	282,313.66	539,733.59	1,083,966.69	3,143,709.52
2. OPERATING EXPENDITURES					
DATA PROCESSING	3,131.95	15,789.08	18,921.03	32,373.00	110,775.75
TELECOMMUNICATIONS - ISD	814.17	1,416.37	2,230.54	3,758.95	13,034.13
TRAVEL	2,796.46	6,454.74	9,251.20	18,691.18	58,967.74
IT - SOFTWARE/SUPPLIES	0.00	0.00	0.00	128.85	503.90
POSTAGE SERVICES	789.50	9,305.35	10,094.85	19,876.78	64,014.89
IT - CONTRACTUAL SERVICES	319.06	35,544.19	35,863.25	36,514.00	42,130.20
BUILDING/LAND RENT & LEASES	5,174.16	8,373.54	13,547.70	41,993.10	123,879.30
DUES & PROF. DEVELOPMENT	28.00	1,887.00	1,915.00	10,889.00	33,168.50
OPERATING FEES & SERVICES	498.13	270.36	768.49	1,891.46	25,266.07
REPAIR SERVICE	0.00	25.00	25.00	103.00	115.50
PROFESSIONAL SERVICES	1,000.71	1,774.29	2,775.00	5,880.00	16,661.00
INSURANCE	184.92	321.72	506.64	638.79	1,269.56
OFFICE SUPPLIES	122.54	850.80	973.34	1,017.52	3,042.42
PRINTING	236.61	(150.79)	85.82	6,842.44	22,351.05
PROFESSIONAL SUPPLIES & MATERIALS	399.22	363.62	762.84	762.84	1,410.18
MISCELLANEOUS SUPPLIES	4.00	6.95	10.95	148.72	928.91
IT EQUIPMENT UNDER $5000	0.00	0.00	0.00	0.00	2,182.38
OTHER EQUIPMENT UNDER $5000	0.00	0.00	0.00	0.00	472.00
OFFICE EQUIPMENT & FURNITURE UNDER $5000	53.98	6.00	59.98	59.98	1,617.98
TOTAL OPERATING EXPENDITURES	15,553.41	82,238.22	97,791.63	181,569.61	521,791.46
3. CONTINGENCY	0.00	0.00	0.00	0.00	0.00
TOTAL BUDGETED EXPENDITURES	272,973.34	364,551.88	637,525.22	1,265,536.30	3,665,500.98
TOTAL EXPENDITURES	$ 6,928,598.35	$ 49,823,885.76	$ 56,864,704.22	$ 114,645,493.07	$ 335,740,927.46

INVESTMENT EXPENDITURE DETAIL

FEES PAID DURING THE QUARTER ENDED DECEMBER 31, 2016

FOR QUARTER ENDED 9/30/16

PENSION DEVELOPED INTERNATIONAL EQUITY POOL		
Northern Trust	21,638.34	
Wellington	178,732.28	
William Blair	124,958.67	
TOTAL PENSION INTERNATIONAL EQUITY		325,329.29
PENSION GLOBAL EQUITY POOL		
Epoch	559,367.82	
LSV	114,627.00	
TOTAL PENSION GLOBAL EQUITY		673,994.82
PENSION BELOW INVESTMENT GRADE FIXED		
Loomis Sayles		235,203.25
PENSION INVESTMENT GRADE FIXED INCOME POOL		
JP Morgan	56,859.92	
PIMCO	148,459.52	
State Street	7,294.09	
TOTAL PENSION INVESTMENT GRADE FIXED INCOME		212,613.53
PENSION INFRASTRUCTURE POOL		
JP Morgan		264,815.68
PENSION LARGE CAP EQUITY POOL		
LA Capital		216,138.22
PENSION SMALL CAP EQUITY POOL		
Atlanta Capital		211,273.00
PENSION REAL ESTATE		
JP Morgan (Special & Strategic)	433,132.49	
Invesco	214,096.38	
TOTAL PENSION REAL ESTATE		647,228.87
PENSION INTERNATIONAL FIXED INCOME		
Brandywine	142,772.10	
UBS	88,190.71	
TOTAL PENSION INTERNATIONAL FIXED INCOME		230,962.81
INSURANCE FIXED INCOME POOL		
Prudential	74,108.90	
State Street	12,314.41	
Western Asset	104,585.46	
TOTAL INSURANCE FIXED INCOME		191,008.77
INSURANCE LARGE CAP EQUITY POOL		
LA Capital	54,246.47	
LSV	55,194.00	
TOTAL INSURANCE LARGE CAP		109,440.47
INSURANCE SMALL CAP EQUITY POOL		
PIMCO RAE		23,151.09
INSURANCE INT'L EQUITY		
LSV	73,990.00	
William Blair	65,020.40	
TOTAL INSURANCE INT'L EQUITY		139,010.40
INSURANCE DIVERSIFIED REAL ASSETS		
JP Morgan	140,800.94	
Western Asset	39,280.08	
TOTAL INSURANCE DIVERSIFIED REAL ASSETS		180,081.02
INSURANCE REAL ESTATE		
Invesco	54,440.01	
JP Morgan	180,692.35	

INVESTMENT EXPENDITURE DETAIL

FEES PAID DURING THE QUARTER ENDED DECEMBER 31, 2016

TOTAL INSURANCE REAL ESTATE		235,132.36
INSURANCE SHORT TERM FIXED		
Babson		104,445.95
LEGACY FIXED INCOME		
Prudential	105,474.94	
State Street	16,574.08	
Western Asset	145,856.33	
TOTAL INSURANCE FIXED INCOME		267,905.35
LEGACY LARGE CAP EQUITY		
LA Capital	196,132.46	
LSV	193,385.00	
TOTAL INSURANCE LARGE CAP		389,517.46
LEGACY SMALL CAP EQUITY		
PIMCO RAE		98,424.15
LEGACY INT'L EQUITY		
LSV	323,263.00	
William Blair	322,464.57	
TOTAL INSURANCE INT'L EQUITY		645,727.57
LEGACY DIVERSIFIED REAL ASSETS		
JP Morgan	149,744.57	
Western Asset	98,815.25	
TOTAL INSURANCE DIVERSIFIED REAL ASSETS		248,559.82
LEGACY REAL ESTATE		
Invesco	103,302.36	
JP Morgan	331,087.58	
TOTAL INSURANCE REAL ESTATE		434,389.94
PERS RETIREE HEALTH INSURANCE CREDIT FUND		
SEI		75,267.68
JOB SERVICE FUND		
SEI		65,944.71
TOBACCO PREVENTION & CONTROL TRUST FUND		
STATE STREET		4,514.65
CUSTODIAN		
Northern Trust		281,550.00
CONSULTANT		
Adams Street	16,651.00	
Callan	100,822.33	
Novarca	19,603.00	
TOTAL CONSULTANT		137,076.33
TOTAL FOR QUARTER ENDED 9/30/16		**6,648,707.19**
FOR QUARTER ENDED 12/31/16		
PENSION CASH		
Northern Trust		6,917.82
TOTAL FOR QUARTER ENDED 12/31/16		**6,917.82**
TOTAL FEES PAID DURING QUARTER ENDED 12/31/2016		**6,655,625.01**

NORTH DAKOTA RETIREMENT AND INVESTMENT OFFICE

QUARTERLY MONITORING REPORT

Quarter Ended December 31, 2016

EXECUTIVE LIMITATIONS / STAFF RELATIONS

The Executive Limitation "Staff Relations" deals with the treatment of staff at RIO. The executive director "shall not cause or allow any condition or any communication which is unfair, undignified, or disrespectful." This Executive Limitation lists six specific limitations that range from personnel policies to exit interviews. All the limitations are intended to protect staff from unfair, undignified, or disrespectful treatment by management.

During the past quarter, there were no exceptions to this Executive Limitation.

The Executive Director/CIO held three full office meetings and three manager meetings during the fourth calendar quarter of 2016 in order to promote an open and collaborative work environment while enhancing team member communication, awareness and engagement.

RIO is fully staffed as of December 31, 2016.

Quarterly Report on Ends
Q2:FY17

Investment Program

Continuing due diligence conducted on the following organizations:

Adam Street (private equity)	JP Morgan (infrastructure)
Axiom (emerging market equity)	Loomis Sayles (domestic fixed income)
BlackRock (private equity)	Manulife (domestic fixed income)
Brandywine (global fixed income)	PIMCO (domestic fixed income)
Corsair (private equity)	Timberland Investment Resources (timberland)
Epoch (global equity)	UBS (international fixed income)
Grosvenor (infrastructure)	Wells (domestic fixed income)

Initial due diligence conducted on the following organizations:

AllianceBernstein (direct lending)	Golub (direct lending)
Antares (direct lending)	Highbridge (direct lending)
Ares (direct lending)	KKR (direct lending, opportunistic credit)
Bain (direct lending)	Pantheon (private equity)
Carlyle (direct lending)	Pathway (private equity)
Cerberus (direct lending)	PIMCO (private credit)
Crescent (direct lending)	TPG Specialty Lending (direct lending)
Goldman Sachs (direct lending)	

Following the Board's selection at the March SIB meeting of BlackRock Private Equity Partners to manage a fund-of-one private equity program within the Pension Trust, Staff completed a legal contract review and commenced the investment period of the mandate.

Staff is continuing its review of the current fixed income manager structure within the pension trust and recommended changes will be submitted to the Board at January's SIB meeting. Staff is currently conducting due diligence on a number of private credit managers and will be advancing finalists to present to the Board.

Staff completed its review of third-party total plan risk management providers with the selection of BlackRock Solutions Aladdin system. Staff began the implementation process in September.

Staff attended meetings with the following entities: TFFR Board, NDPERS Board, NDPERS Investment Subcommittee, ND Board of Medicine, ND Cultural Endowment, ND Tobacco Prevention & Control, ND Insurance Department, Legacy and Budget Stabilization Fund Advisory Board.

Staff continues to conduct preliminary due diligence on possible managers/products for future consideration.

Staff continues to monitor each client’s asset allocation monthly and makes rebalancing decisions based on rebalancing policy and cash flow requirements.

Quarterly Monitoring Report on TFFR Ends
Quarter ended December 31, 2016

Retirement Program

This report highlights exceptions to normal operating conditions.

- TFFR's actuary presented 2016 annual actuarial valuation report, funding projections, and GASB 68 information to TFFR Board and the Legislative Employee Benefits Programs Committee.
- TFFR received 2016 Public Pension Standards Award for Administration. This award is designed to recognize and commend public employee retirement systems that meet professional standards for pension plan administration.
- No legislative proposals impacting TFFR were pre-filed for the 2017 session.
- TFFR staff has expanded its member and employer outreach programs to include Group Benefits Counseling for members and New Business Manager Training Workshops for employers. Staff has also created several informational webcasts for members and employers that are available on our website.

AGENDA ITEM VI.E.

TO: State Investment Board ("SIB") Clients

FROM: Dave Hunter, Darren Schulz and Eric Chin

DATE: January 20, 2017

SUBJECT: Watch List Commentary – NO CHANGES RECOMMENDED

RIO routinely reviews investment manager performance, organizational structure, investing philosophy/style and fund flows of specific investment mandates and the overall operations of our investment firms. These reviews serve as the basis for Staff recommendations to add, maintain or remove individual investment strategies (and/or management firms) from our Watch List.

TO: State Investment Board ("SIB") Clients

FROM: Retirement and Investment Office – Dave Hunter, Darren Schulz and Eric Chin

DATE: January 20, 2017

SUBJECT: **SIB Client Watch List Update – NO CHANGES**

RIO routinely reviews manager performance, organizational structure, investing philosophy/style and fund flows of specific strategies and the firms overall operations. These reviews serve as the basis for Staff recommendations to add, maintain or remove managers from our Watch List.

There are four firms currently on our Watch List including PIMCO (2 strategies), JPMorgan, UBS and Adams Street Partners, all within the Pension Trust.

PIMCO	MBS	$181 million	**JPMorgan**	MBS	$121 million
PIMCO	Unconstrained	64 million	**UBS**	International	101 million

PIMCO has been on Watch since October of 2014 largely due to significant organizational changes including the departure of PIMCO's founder, Bill Gross, in late-September of 2014, and the prior departure of Mohamed El-Arian, PIMCO's former CEO. Since then, there have been additional turnover including the latest announcement that Douglas Hodge, who served as PIMCO's CEO since Mohamed El-Arian left in early-2014, will now step aside so as to allow Emmanuel Roman to become its next CEO on November 1, 2016. Mr. Roman was previously CEO of Man Group Plc, the world's largest publicly traded hedge fund manager, since February 2013.

Despite of the above senior management turnover, PIMCO has generally performed in a satisfactory manner with strong results in less liquid strategies (e.g. DiSCO and Bravo) and moderate results in the public sector mandates. As a result, RIO has advised the SIB to keep PIMCO's public mandates on Watch the last two years. During this time, the MBS strategy ($181 million) has generally provided above benchmark returns (after fees), while the Unconstrained Bond mandate has underperformed expectations (net returns of 2.8% per annum) although recent performance has been encouraging with a 6.3% net return for the 1-year ended 12/31/2016. Given this mixed performance, **Staff recommends that both PIMCO strategies remain on Watch until RIO completes its fixed income manager review in the Pension Trust in the next few months.**

The JPMorgan Mortgage Backed Securities (MBS) mandate was placed on Watch at the April 22, 2016, board meeting following the departure Henry Song as Co-Portfolio Manager. This event followed the earlier departure of Doug Swanson as Portfolio Manager in September 2015. Although JPMorgan generally maintains strong bench strength across the board, the departure of two highly tenured portfolio managers within eight months is highly unusual. Since April, RIO has met with the new JPMorgan MBS portfolio management team in addition to Henry Song at his successor firm. Staff continues to believe there is no immediate risk to the overall management of this strategy given JPM's bench strength and relatively conservative risk profile of this specific mandate. As such, **RIO recommends that JPMorgan MBS strategy remain on Watch until Staff completes its fixed income manager review in the next few months.** As of 12/31/2016, the JPMorgan MBS strategy has provided above benchmark performance since inception (+0.20%) and improved results (MBS Index +0.50%) over the last year.

UBS International Debt strategy was placed on Watch in early-2015 when trailing 1-, 3-, and 5-year returns were over 30 bps below benchmark. During the last year, UBS performance improved such that inception to date results and 1-year returns now approximate the benchmark (after fees). **RIO continues to recommend that UBS remain on Watch until Staff completes it fixed income manager review in the next few months.**

Adam Street Partners ("Adams Street" or "ASP")

As a result of increasing concerns over the transparency provided by Adams Street, the SIB placed Adams Street Partners on Watch and confirmed Staff's recommendation to pause future investments with ASP until further notice. ASP performance is updated quarterly in arrears with a one quarter lag.

Pension Trust Private Equity
As of June 30, 2016
($ in millions)

							Internal Rates of Return (IRR)				
							Net Returns				
Adams Street Partnerships (ASP)	Vintage Year	Commitment	Unfunded Commitment	Net Asset Value	% Total Pension	1-year	3-years	5-years	10-years	Inception
1998 BPF Trust Subscription	1998	$ 23.7	$ 0.9	$ 1.6	0.0%	(3.5%)	2.5%	1.2%	6.8%	5.0%
1999 BPF Non-U.S. Trust Subscription	1999	$ 24.5	$ 0.6	$ 3.3	0.1%	4.3%	6.6%	1.4%	9.8%	12.0%
1999 BPF Trust Subscription	1999	$ 24.5	$ 1.1	$ 2.4	0.1%	(2.4%)	3.7%	2.6%	6.8%	6.0%
ASP 2008 Non-US Fund	2008	$ 10.0	$ 1.7	$ 7.6	0.2%	4.7%	13.5%	9.5%	-	8.9%
ASP 2010 Direct Fund	2010	$ 1.5	$ 0.1	$ 1.4	0.0%	4.8%	16.5%	14.1%	-	12.6%
ASP 2010 Emerging Markets Fund	2010	$ 1.5	$ 0.4	$ 1.3	0.0%	4.6%	14.5%	10.2%	-	9.6%
ASP 2010 Non-US Developed Fund	2010	$ 4.5	$ 1.4	$ 2.8	0.1%	7.9%	8.6%	7.9%	-	7.3%
ASP 2010 US Fund	2010	$ 7.5	$ 2.3	$ 5.8	0.1%	8.1%	16.3%	14.2%	-	14.6%
ASP 2015 Global Fund	2015	$ 30.0	$ 28.6	$ 1.7	0.0%	-	-	-	-	26.0%
ASP 2016 Global Fund	2016	$ 30.0	$ 30.0	$ (0.0)	0.0%	-	-	-	-	-
Brinson Venture Partnership Fund III	1993	$ 3.0	$ -	$ -	0.0%	-	-	6.1%	17.2%	29.6%
BVCF III	1993	$ 3.0	$ -	$ -	0.0%	-	-	(4.1%)	(28.5%)	40.4%
BVCF IV	1999	$ 25.0	$ -	$ 3.8	0.1%	(1.6%)	20.7%	28.9%	25.7%	7.7%
Direct Co-Investment	2006	$ 20.0	$ 0.9	$ 5.8	0.1%	10.6%	18.8%	12.6%	-	5.8%
Institutional Venture Capital Fund II	1989	$ 5.0	$ -	$ -	0.0%	-	-	(18.6%)	29.7%	21.3%
Total ASP Private Equity		$ 213.7	$ 67.9	$ 37.5	0.8%	5.8%	13.6%	9.4%	10.4%	10.9%

Adams Street Partners Update:

At our October 28, 2016, board meeting, the SIB placed Adams Street Partners on Watch due to transparency concerns and temporarily paused future investments. Based on discussions with ASP the past three months, RIO is pleased to report that it has reached an understanding with Adams Street to obtain modified investment reporting. Upon receiving the modified reporting package for two consecutive quarters, RIO looks forward to recommending that Adams Street Partners be removed from the Watch List.

NDSIB Watch List

Data as of 12/31/2016

PIMCO MBS (Pen.)		$180,755,902	
	Returns	Index[1]	Excess
1 Year	3.89	1.67	2.21
3 Year	3.76	3.07	0.69
Inception*	2.53	2.05	0.48

*Funded 3/31/2012

PIMCO Unconstrained (Pen.)		$64,666,853	
	Returns	Index[2]	Excess
1 Year	6.36	0.75	5.62
3 Year	2.76	0.42	2.33
Inception*	2.79	0.39	2.40

*Funded 3/12/2012

JP Morgan MBS (Pen.)		$121,248,064	
	Returns	Index[1]	Excess
1 Year	2.48	1.67	0.80
Inception*	2.52	2.21	0.31

*Funded 09/30/2014

UBS International Fixed (Pen.)		$99,777,972	
	Returns	Index[3]	Excess
1 Year	1.64	1.49	0.16
3 Year	(2.73)	(2.59)	(0.14)
Inception*	5.80	5.51	0.29

*Funded 07/01/1989

[1] **Barclays Mortgage Index**
[2] **Libor 3-Month**
[3] **Barclays Global Aggregate ex-US**

Note: Return data is gross of fee due to data availability

BOARD LEADERSHIP

INNOVATIVE APPROACHES TO GOVERNANCE

NUMBER 148, NOV.–DEC. 2016

www.boardleadershipnewsletter.com

Linking Governance and Management

by Gerry Moulds

Retired governance consultant Gerry Moulds looks back on his experience and shares his thoughts on how best to build an accountability framework that links governance and management.

DURING MY CAREER as a Policy Governance® consultant, I found that, although boards had genuinely accepted the principles of the model, the process of implementation was often frustrated by the tendency of CEOs to continue providing the board with copious reports on means. CEOs often welcomed the fact that their board had accepted Policy Governance, but failed to recognize that their role had also changed.

It seemed to me that, unless there was a complementary change in the way that the relevant organization was managed, the whole endeavor could be jeopardized. John Carver's assertion that board problems are not so much about people as they are about process[1] certainly has a lot of validity. However, if staff don't have the capacity to support the processes adopted by the board, things are bound to go awry.

My concern is that it is too easy for boards and their staff to become disconnected from each other, and this is what took me toward developing what I have called a "Policy Management" system to complement the Policy Governance system. My intent with Policy Management is to provide a framework for the CEO and their staff to transition to a viable means to support the board's use of Policy Governance.

Like Policy Governance, Policy Management utilizes four quadrants (see Table 1, page 2).

The following illustrates the kind of Policy Management documents I have created to help CEOs.

The first document sets out the overall Policy Management Framework:

THE POLICY MANAGEMENT FRAMEWORK

What Is to Be Achieved

The AnyPlace Society operates consistent with the Policy Governance system as developed by John Carver. Therefore, AnyPlace Society believes that it exists solely to create certain benefits for certain people at a certain worth. The Society has established the following "Ends" statement to represent what it exists to accomplish, and therefore what it is accountable for:

(continued on page 2)

ALSO IN THIS ISSUE

EVENTS

FEBRUARY 24–25, 2017

IPGA Consultants' Forum

— Las Vegas, Nevada, USA

This is the main opportunity for Policy Governance Consultants and board and staff members with extensive experience in using the system to get together to discuss a range of issues of mutual interest. This forum will include a particular focus on the meaning and implications of governance as "ownership one step down."

For more information, please go to http://www.policygovernanceassociation.org or contact: ceo@policygovernanceassociation.org

BOARDSOURCE

Throughout the year, BoardSource organizes a range of webinars and training events for US nonprofit board leaders.

For more information, see http://bit.ly/BdSourceEvents

HARVARD BUSINESS SCHOOL

The HBS programs on governance can be seen here: http://www.exed.hbs.edu/programs/Pages/program-finder.aspx?HBSTopics=Governance

HAINES CENTRE

The Haines Centre for Strategic Management is a team of strategic

(continued on page 8)

Linking Governance

(continued from front page)

> *"The AnyPlace Society is a non-profit organization that exists so that AnyPlace residents with disabilities are able to participate fully in the community life of AnyPlace.*
>
> *This includes but is not limited to:*
>
> - *Residents with disabilities are valued by the community;*
> - *Residents with disabilities enjoy quality support*
>
> *These outcomes to be produced at a cost comparable to that incurred by other similar organizations."*

This statement is an instruction to the CEO regarding what the organization is to accomplish. The board has developed this statement to a level of specificity that permits it to accept "any reasonable interpretation" made by the CEO.

How It Is to Be Achieved

Regarding how these outcomes are to be accomplished, the board confines itself to setting boundaries of ethics and prudence around the CEO's potential choices. The rationale for this approach is based on the following:

1. For effective delegation, those who are made responsible for accomplishing a result need to be accorded the right to choose the most appropriate means for achieving that result. If the board chooses the means and the means do not produce the Ends, the CEO cannot be held accountable for accomplishing the Ends.
2. As a group authority with a limited amount of time in which to do its job, the board must delegate in order to get things done with optimal speed.
3. CEOs are recruited because they have the requisite expertise to determine the best means to achieving the Ends. Board members do not necessarily have the expertise.

As with the process of *prescribing* Ends, the board starts at the broadest level first by making an all-encompassing statement that *proscribing* will not be tolerated:

> *The CEO shall not cause or allow any practice, activity, decision or organizational circumstance, which is either imprudent or in violation of commonly accepted business and professional ethics.*

Table 1: The Four Quadrants

The Four Quadrants of Policy Governance	The Four Quadrants of Policy Management
ENDS	ENDS; Management Accountability for
EXECUTIVE LIMITATIONS	MANAGEMENT LIMITATIONS
GOVERNANCE PROCESS	MANAGEMENT PROCESS
BOARD-CEO LINKAGE	CEO-MANAGEMENT TEAM LINKAGE

Apart from the common management limitations, individual managers might be restricted in ways entirely specific to their own experience, skills, or demonstrated trustworthiness.

Again, in recognition that such a statement represents instruction to the CEO, the board goes on to expand that general statement to a level of specificity that permits them to accept "any reasonable interpretation" by the executive director. Those more specific statements are referenced as Executive Limitations.

Making Reasonable Interpretations

The CEO's accountability to the board is thus phrased in a succinct way:

> *Achieve any reasonable interpretation of the Ends described by the board's Ends Policies and use any reasonable interpretation of the board's Executive Limitations policies to avoid imprudent or unethical situations, activities, and decisions*

The CEO's interpretation must clarify the board's instructions by translating them into "operational definitions" that provide defensible measures and standards against which policy achievement can be assessed. In accordance with the latest International Policy Governance Association (IPGA) *Policy Governance Consistency Framework Report*, defensible measures and standards are those that:

1. Are objectively verifiable (e.g., through research, testing, and/or credible confirmation of observable phenomena).
2. Are relevant and conceptually aligned with the policy criteria and the board's policy set.
3. Represent an appropriate level of fulfillment within the scope of the policy.[2]

Thus, the CEO's interpretations can be phrased as "Operational Outputs" for all management personnel and provide transparent criteria for job evaluation. It is the CEO's interpretations, rather than the board policies themselves, that directly impact staff performance.

Delegating Operational Outputs

Given that the CEO cannot personally accomplish all the operational outputs, he or she must determine which of them are to be delegated. Consistent with Policy Governance principles of delegation, it makes sense to empower senior managers as much as possible, retaining direct responsibility only for those outputs unique to the CEO role or unable to be assumed by others (due to workload or lack of requisite skills).

Operational Outputs that can be delegated are assigned to appropriate Managers and Job Outputs are negotiated as "values added." Jobs exist so that life is different for someone else or some group outside the job. The reader will note that the organization was defined as existing "solely to create benefits for certain people at a certain worth." As a parallel, jobs throughout the organization also exist to produce some benefit for someone else.

Sometimes the someone else (for whom the production is generated) is the employee's superior, but sometimes the someone else is a co-worker who needs his or her colleague's value-adding production in order to complete his or her own job. The paramount "someone else" are those for whom the organization exists, that is, those designated as beneficiaries by the board. The CEO, therefore, differentiates between the productive focuses of managers as follows:

1. **Line managers (program directors and managers):** Those who are primarily concerned with creating value-added products that lead directly to accomplishing the Ends the board has prescribed, in other words, to directly supporting the realization of benefits for those the whole organization exists to support; and
2. **Staff managers (directors of HR, Finance, Operations, Development, etc.):** Those who are primarily concerned with creating value-added products that contribute to the line manager's capacity to produce Ends; for example, administering, tabulating, safeguarding, maintaining, or otherwise controlling aspects of the organization.

Consistent with the board's example, I recommend that the CEO delegates authority by establishing the limits within which managers can operate by publishing his or her "reasonable interpretation" of the board's executive limitations as management limitations. The management limitations are common across all managers and include what are generally referred to as standard operating procedures. Thus, procedural integrity is imposed and harmonious work across the organization is facilitated.

Apart from the common management limitations, individual managers might be restricted in ways entirely specific to their own experience, skills, or demonstrated trustworthiness. Consequently, the CEO can build the description in the individual's job (value-added job outputs) by adding appropriate individualized restrictions. Once the individual value-added job outputs and any specific limitations have been established for each line manager, the roles of staff managers can be developed and described.

Having progressively deduced the expectations of the board, the CEO, and his or her management team will have created a clear and rational way in which to be accountable to the board for the fulfillment of its instructions. The members of the team will be aware of the limits within which they have the responsibility to provide benefits for someone. They will also understand that they are accountable for their own behavior and cumulatively responsible for the behavior of all subordinates.

Meeting the needs of individual beneficiaries involves further consideration. One of my clients (an organization akin to the *AnyPlace Society* referred to above) has developed a *Person Centered Planning* process through which beneficiaries, along with their family and friends, can establish the "Outcomes" (conditions and goals) that must be met in their particular situation in order to satisfy the aggregate of individual needs of the beneficiaries referenced in the board Ends.

The individual's Outcomes are a subset of the benefits to be achieved in the board's Ends. Each Outcome includes what is to be accomplished, by whom, by when (specific date), and at what cost. Each identified Outcome is supported by a series of necessary Action Steps. The Action Steps are developed, as part of the process, with individuals and their family and friends, and may be changed frequently in order to allow for experimentation with other approaches.

The organization then assigns a program manager as responsible for accomplishing the Outcome(s) that have been chosen by the individual and identified in his/her Plan. In assuming that responsibility, the program manager accepts that they are accountable to the beneficiary and/or their personal network and to a program director. The organization also assigns someone (usually a member of the program manager's staff) to be responsible for undertaking the Action Steps designated in the Plan in order to accomplish the chosen Outcome.

By inductively aggregating the degree to which individual Outcomes have been achieved within the Ends and management limitations, the organization can:

- Focus on the needs identified by the individual and/or their personal network.
- Measure the degree to which it has been accountable to its beneficiaries.
- At least in part, measure the degree to which the organization has achieved the board's Ends and stayed within management limitations.
- Ensure that the beneficiaries and/or their personal networks are integral to determining the degree to which the Outcomes have been achieved.

To summarize, I believe that the whole Policy Management system, as described above, can:

1. Describe a management system wherein accountability accumulates.
2. Establish Job Outputs for the CEO and line managers, and

(continued on page 8)

Distinguishing Governance

by Caroline Oliver, Chair of the UK Policy Governance Association (UKPGA)

Synopsis of a contribution to the Shaking the Foundations of Governance—Ownership *Discussion Forum, hosted by UKPGA and The CRSA Forum, supported by Mazars LLP, held on November 1, 2016, London, UK.*

Here, Caroline Oliver makes the case for distinguishing governance as a unique discipline and suggests that governance is best understood as "ownership one step down, not management one step up." She starts from the meaning of accountability and the location of the board in the accountability chain. She reviews the board's position from an ethical and practical perspective. Finally, she questions whether the future of governance lies in taking a more systematic approach than we typically do today.

WE CAN'T HOLD anyone to account for anything unless we can secure their agreement as to what they are to be accountable for. I suggest that accountability in governance is largely missing because, so far, we have failed to agree what it is for and who is to do it. My main evidence for this assertion is twofold. First, many people talk about governance as if it is everyone's job, which, in terms of accountability, is another way of saying that it is no one's job. Second, when it comes to deciding who to hold to account when things go wrong, we seem to have no road map to help us make consistent and clear determinations.

I am proposing that responsibility and accountability can be thought of as different things. There may be lots of people who have different responsibilities in an organization and, in the end, you could say that all of those responsibilities are to do with governance because governance is about the "proper" (and we need to come back to the meaning of that word!) running of *everything*. But does this perspective help us with establishing accountability for governance? Not at all.

> If you delegate your authority, whatever happens as a result is still happening with your authority, and so you remain accountable for it.

FOOD FOR THOUGHT

"There is nothing quite so useless as doing with great efficiency something that should not be done at all."

Peter Drucker in "What Executives Should Remember," *Harvard Business Review*, Vol. 84, No. 2, February 2006

It is, of course, fair enough to say that everyone in an organization is involved in that organization's governance. However, it is not fair to say that everyone in an organization is accountable for governance. Workers on the front line can be made responsible and accountable for doing their part within the governance system, but they cannot be made accountable for the overall development and operation of the governance system itself.

In other words, you cannot be held accountable for something you have no authority over. And the fact is that front-line workers have no authority over the overall development and operation of their organization's governance system.

It is true that whatever authority you have, you can delegate to others. Indeed, no organization could run without such delegation. However, if you delegate your authority, whatever happens as a result is still happening with your authority, and so you remain accountable for it. So, of course, boards and executives have to delegate to get things done, but they remain accountable, and it is critical that we are clear what their respective accountabilities are if organizations are to be accountable. The current mish-mash in which we don't know who to hold accountable for what is not serving us.

Today, I want to suggest that we need to build the Foundations of Governance on far firmer ground and that finding that ground requires developing a clear defining of the role of the board as the accountable body for the overall development and operation of their organization's governance system. I suggest that the board's accountability for governance is unique—and that uniqueness lies in the fact that governance is *ownership one step down, not management one step up*.

What does this mean?

It means that the subject of today's discussion forum is crucial. For it means that the board's unique role starts from its definition of, and connection to, its owners. No single employee, shareholder, executive, customer, stakeholder, and no groups thereof are ultimately accountable to organizational owners for the overall development and operation of their organization's governance system—only the board is. So who those owners are, what their purpose is, and what their best interests are in the accomplishment of their purpose provides the most fundamental foundation of all for the board's work. I am not expressing any opinion on how ownership should be defined; I am simply saying that establishing the chain of organizational accountability starts with defining organizational ownership.

The fact that governance is ownership one step down, not management one step up, also means that boards are not there to second-guess managers in the fulfillment of their jobs. Boards are there to define what the management job is in terms of what it is to achieve and what ethical and prudential risks it is to avoid, and then to hire the very best person they can to get the job done. Yes, it is critical that boards monitor that the job is getting done and assure course correction as needed, but board members are not there to do managers' jobs for them. Indeed, when board members do attempt to do managers' jobs for them, any possibility of being able to hold managers' cleanly to account for anything is gone. The board has just given up its authority in return for the highly dubious benefits of becoming part of the management team.

From an ethical perspective, distinguishing governance from management is also vital. To be ethical, you have to know what your obligations are to whom. Only then can you determine if your behavior, or indeed anyone else's, is properly aligned. Only then can you examine if any departure from your default obligations can be justified in any particular circumstance. Board members' obligations are to serve the best interests of their organizations' ownership; managers' obligations are to fulfill the terms of their employment as established by the board. These obligations are not the same, and we muddy accountability and worse, obscure potential conflicts of interest if we treat them as if they are.

I believe the future for effective governance of organizations lies in understanding that organizational governance is not a naturally occurring phenomenon but a human construct. It is something we are designing and, right now, that design is nothing like as thoughtful as it could be. I hope that we may have future forums to examine what a better design could look like, but today's examination is the most important of all. If we don't get the ownership foundations right, we have no hope of building good governance design—no hope of establishing the boards proper roles as the ultimately accountable bodies for the overall development and operation of their organizations' governance systems. ❑

Caroline Oliver can be contacted at coliver@goodtogovern.com

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And you can find more about *Board Leadership* and some free "taster" articles at www.boardleadershipnewsletter.com. ❑

WHEN WE SAY ...

Board Leadership's mission is "to discover, explain, and discuss innovative approaches to board governance with the goal of helping organizations achieve effective, meaningful, and successful leadership to fulfill their missions."

Board Leadership aims to fulfill this mission by engaging its readers in a lively and illuminating inquiry into how board governance can be made more effective. This inquiry is based on three key assumptions:

- Boards exist to lead organizations; not merely monitor them.
- Effective board governance is not about either systems, structures, processes, theories, practices, culture, or behaviors—it is about all of them.
- Significant improvements are likely to come only through challenging the status quo and trying out new ideas in theory and in practice.

Uniquely among regular publications on board governance, *Board Leadership* primarily focuses on the job of board leadership as a whole, rather than on individual elements of practice within the overall job.

Over time, *Board Leadership* will provide a repository of different approaches to governance created through its regular "One Way to Govern" feature.

Here's what a few of the key terms we use mean to us:

- **Innovative:** Creating significant positive change.
- **Approaches to:** principles, theories, ideas, methodologies, and practices.
- **Board governance:** The job of governing whole organizations. ❑

For Your Bookshelf …

Reviewed by Jannice Moore

Jannice Moore is president of The Governance Coach™, specializing in coaching boards to apply Policy Governance principles for optimum effectiveness.

The Handbook of Board Governance: A Comprehensive Guide for Public, Private, and Not-for-Profit Board Members, 1st edition

by Richard Leblanc (Editor)
John Wiley & Sons, 2016

Richard Leblanc has tackled a massive task in bringing together this 859-page compendium of current governance thinking. Selecting from a multiplicity of sources, he has included a wide variety of authors, providing perspectives from the United States, Canada, Europe, the United Kingdom, Australia, and New Zealand. A number of the authors also draw on wider international experience. There are articles by board chairs, CEOs, and directors, as well as academics, researchers, consultants, shareholder advisors, and corporate counsel.

This is not a book to sit down and read cover to cover. Rather, it is an excellent resource into which to dip when you want to obtain a cross section of current thinking and issues related to a specific governance topic. Many authors also address their perceptions of where governance is going in the next five to ten years. Articles in each of the eight sections of the book are grouped around a given theme. In a short review it is impossible to do justice to individual articles, and I regret not being able to reference more than a few chapter authors. Richard LeBlanc provides a twenty-two-page editor's précis of the book's contents. The length of the précis is a good indicator of the wide-ranging scope of the book. I will provide a bird's-eye view, occasionally briefly "landing" in a chapter for a closer look, and adding a few comments from my perspective as a governance consultant with twenty-five years' experience working with a wide range of boards primarily in public-sector and large not-for-profit organizations.

The opening section addresses the board's responsibilities. Authors Useem, Cary, and Charan tackle building more engaged leadership in the boardroom and the implications for recruitment of new board members. Indeed, one could write an entire book on the meaning of "engaged leadership" and how that plays out in different types of boards. This topic left me wanting more. The authors' reference to Warren Buffett's comment that "… collegiality trumped independence [and a] certain social atmosphere presides in boardrooms where it becomes impolitic to challenge the chief executive" made me wish that the book had included an article by Buffett himself, whose annual shareholder letters, with significant governance relevance, are widely read.

> This is not a book to sit down and read cover to cover. Rather, it is an excellent resource into which to dip when you want to obtain a cross section of current thinking and issues related to a specific governance topic.

Chris Pierce provides a cogent summary of ten trends in corporate governance: increased use of corporate governance codes; higher levels of regulation and enforcement; greater board diversity, including independent directors, gender, ethnicity, and age diversity; more focus on strategy, value creation, and corporate responsibility; increased emphasis on the governance of risk; greater emphasis on information governance; greater emphasis on compensation governance; greater emphasis on accountability and responsibility to shareholders and other stakeholders; increased use of board evaluations; and director and board development. In subsequent sections of the book, many of these trends are addressed in more depth.

A chapter on the nonexecutive chairman is pertinent to corporate boards (by which I mean for-profit boards) but has less relevance for not-for-profit and public-sector boards, where the usual lack of insider board members makes this largely a nonissue. In general, noncorporate boards will find information that can be applied with some tweaks throughout the book, but the underlying premise for most articles appears to be governance of for-profit corporations. Two chapters on CEO succession and succession planning, with valuable content for all boards, round out the first section.

Section II addresses the question, "What makes for a good board?" Dr. Leblanc offers the first chapter here, addressing the importance of director independence, competency, and behavior. He identifies ten director behaviors that should be assessed: independent judgment, integrity, organizational loyalty, commitment, capacity to challenge, willingness to act, conceptual thinking skills, communication skills, teamwork skills, and influence skills. In another chapter Solange Charas emphasizes the critical importance of recognizing that the board is a team, and cites research showing that "team intelligence" correlates with firm performance. Attention to the critical area of director behavior is all too often neglected; these chapters are highly relevant to boards in all sectors.

Section III provides several chapters on the governance of risk. More specific content here includes director duties and liabilities, parent and subsidiary governance, governance of risk management, internal audit, and directors and officers (D&O) insurance. Section IV addresses the rise of shareholder accountability, an increasingly high profile area. In Section V, the thorny issue of CEO compensation is tackled, with articles on proposed new approaches to CEO compensation, the function of an effective compensation committee, and the alignment of performance with long-term value and its impact on design of incentives. In Sections VI and VII, two areas of increasing importance are addressed: governance of information technology, including cybersecurity, and governance of sustainability.

The final section is titled "Governance of Different Forms." This section appears to be a potpourri of everything else that didn't fit in the previous sections. It includes one chapter each on nonprofit boards, start-up boards, small-cap companies, family firms, succession in family businesses, and corporate governance in the Middle East and North Africa.

It is at this point that I must comment on a serious omission. The book is titled *The Handbook of Board Governance: A Comprehensive Guide for Public, Private, and Not-for-Profit Board Members*. The author's introductory comments indicate that it is intended for boards of all types: "public and private companies, nonprofit organizations, family businesses, and state-owned enterprises." In relation to this stated intention I find the compendium incomplete: only one chapter out of 39 specifically addresses issues faced by nonprofit boards, two address family businesses, and none specifically examines the unique issues of state-owned enterprises. Treating these boards that make up a major sector of the governance landscape as if they are simply an add-on of a "different form" does not acknowledge the real differences in their needs. Most of them do not have the deep pockets of corporations with which to hire specific expertise, but they still have the same fiduciary responsibilities. Of course, not-for-profit and public-sector boards can learn much of value from corporate boards, and there is much good meat in the chapters for a corporate audience that can be applied in other sectors. However, the inverse is also true: corporate boards can learn much of value from not-for-profit boards, in particular those who use a systematic approach to governance. Giving this sector such short shrift overlooks the fact there were over 1.5 million not-for-profit organizations in the United States, all with governing boards, accounting for 5.3 percent of gross domestic product (GDP) in 2014 and 9.2 percent of all wages and salaries. Statistics cited by Imagine Canada show 170,000 charitable and not-for-profit organizations in Canada contributing more than 8.1 percent of total GDP—more than the retail trade industry and close to the value of the mining and oil and gas extraction industries combined. A compendium purporting to address the needs of this large group of boards could have included something more specific to their unique issues.

The foreword characterizes the book as a "who's who gallery of thought leaders in the corporate governance field." However, there is a glaring absence of even one article by John Carver, a recognized governance thought leader of our time, and one of the most published, if not *the* most published author on the subject of governance. Information about his integrated system of governance, in successful use by thousands of boards around the world, is completely missing. There is one very oblique reference to his work in one footnote that includes several other citations, in the not-for-profit article by Eugene Fram. Other than that, there is not even a citation in the reference list for any other article. While a majority of boards that have adopted his system are in the not-for-profit and state-owned sectors, the principles are equally applicable in the corporate world. Even if one chooses to disagree with his model, completely ignoring its existence does an injustice to the many boards that continue to benefit from it, and the many more that could do so.

Ironically, John Carver's Policy Governance system, developed over thirty years ago, provides systematic principles that effectively address a multitude of issues that have littered the corporate governance landscape for a number of years as scandal has followed scandal. The importance of the board maintaining a connection with shareholders to understand their values and expectations, well before the advent of activist shareholders? Check! The accountability of the board to someone other than itself? Check! The importance of risk management and clear governance-level policy to ensure unethical and imprudent activities do not undermine shareholder value? Check! The need to hold CEOs accountable for results? Check! The connection of CEO compensation to actual performance? Check! I could go on, but I think I've made the point. Not only does his model address these issues in theory, but, if applied, it provides a systematic way of ensuring they happen in practice. Dr. Leblanc, thank you for the massive amount of work you have done in pulling together this compendium. Please give serious consideration to addressing the missing component in future writing. ❑

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Thinking of publishing in* Board Leadership *? Contact managing editor Caroline Oliver for criteria at coliver@goodtogovern.com

Events

(continued from front page)

management consultants, whose work is based in Systems Thinking. http://hainescentre.com/training/public-workshops/

Holacracy

Holacracy is not a system for the work of boards but does bring structure and discipline to a peer-to-peer workplace. HolacracyOne offers a range of events from free introductory webinars to advanced immersive trainings.

For more information, see http://events.holacracy.org/

National Coalition for Dialogue & Deliberation (NCDD)

NCDD also regularly provides useful training events. For more information, see http://ncdd.org/events/ncdd2014

National Council for Voluntary Organisations (NCVO)

NCVO provides a range of programs across the United Kingdom and online. Topics relevant to boards include understanding financials, mentoring (for new board members) and outcome measurement.

For more information, see https://www.ncvo.org.uk/training-and-events ❑

Linking Governance

(continued from page 3)

then staff managers, through deductively making reasonable interpretations of the board's instructions to the CEO.

3. Establish Job Outputs of staff responsible for responding to the needs of beneficiaries.
4. Establish a means to aggregate the degree to which the organization has responded to the needs of individuals, or groups of beneficiaries, to measure, in part, the degree to which the organization has achieved the board's Ends.
5. Establish, within the roles of the CEO and line managers, a means to integrate and link the processes of making (a) deductive interpretations of the board's instructions and (b) inductive inferences of the degree to which the needs of beneficiaries have been satisfied.
6. Establish an Information Management System.
7. Define a means to cumulatively integrate staff performance so that the performance of the CEO is synonymous with organizational performance.
8. Determine the criteria reference and the process against which the CEO provides reliable reports to the board on the degree to which he or she is in compliance with the board's instructions.
9. Define a framework within which any organization can measure the degree to which it is accountable to its ownership, to its other stakeholders, and to its designated beneficiaries. ❑

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Notes

1. Carver, J. *Boards That Make a Difference: A New Design for Leadership in Nonprofit and Public Organizations*, 3rd ed. (San Francisco: Jossey-Bass, 2006).

2. *What Makes an Interpretation Reasonable and What Are the Expectations for Operational Definition?* IPGA Policy Governance® Consistency Framework Report Number 2, June 11, 2016. http://www.policygovernanceassociation.org/images/IPGA-Consistency-Framework-Committee-Report-2.pdf

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INNOVATIVE APPROACHES TO GOVERNANCE

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The AMBACHTSHEER Letter
Sustainable Pension Design • Effective Pension Management

December 2016

GOOD GOVERNANCE REALLY MATTERS:

NEW EVIDENCE

"Firms in which long-term investors own a greater stake improve managerial behavior and corporate governance…… Overall, long-term investors increase shareholder value by both increasing profitability and decreasing risk."

"Do Long-Term Investors Improve Corporate Decision-Making?"
Harford, Kecskes, and Mansi, July 2016

"Representation on U.S. public pension fund boards by state officials or those appointed by them….is strongly and negatively related to the performance of private equity investments made by the fund."

"Political Representation and Governance:
Evidence from the Investment Decisions of Public Pension Funds"
Andonov, Hochberg, and Rauh, September 2016

"U.S. public pension funds with a higher level of underfunding per participant, as well as funds with more politicians and elected plan participants serving on the board, take more risk and use higher liability discount rates. This increased risk-taking is negatively related to their performance."

"Pension Fund Asset Allocation and Liability Discount Rates"
Andonov, Bauer, and Cremers, September 2016

Why Good Governance Should Matter

It is tempting to simply summarize the findings of the three new studies cited above[i] and conclude that they indicate that good organizational governance really matters. Academics call this inductive reasoning. Instead, this *Letter* starts with a deductive reasoning question: why should good governance matter?

A one-page handout created by strategic management professor David Beatty at the Rotman School of Management, and used as course material in the Rotman-ICPM Board Effectiveness Program (BEP) for pension organizations, answers the question succinctly[ii]: In addition to hiring the CEO, the jobs of a BOARD are based on 3 lines of sight:

Table 1 A BOARD'S THREE LINES OF SIGHT

PAST: HINDSIGHT	PRESENT: OVERSIGHT	FUTURE: FORESIGHT
* Ensure accounts are accurate	* Oversee organization	* Involved with strategy and risk
* Report to stakeholders	* Set compensation regimes	* Involved with talent pool
	* Approvals inside 'boundary markers'	

Source: Prof. David Beatty, Rotman School of Management, University of Toronto

Prof. Beatty warns of the danger for boards getting their time allocation wrong: spending too much time on hindsight and too little on foresight. Stating the deductively obvious, organizations blessed with boards that see (and can effectively execute!) their job as set out above in the '3 lines of sight' chart, are much more likely to generate long-term 'value for stakeholders' than organizations with boards that march to different drummers.

The Long-Term Investor Study

Having established the strong prior that good governance should positively impact organizational performance, let's have a closer look at the findings of the three new studies cited on the front page. The first one is titled "Do Long-Term Investors Improve Corporate Decision-Making?" To strengthen the link in this new study to pension fund governance, recall that John McLaughlin and I found a strong positive correlation between perceived pension fund governance quality and perceived effectiveness of long-term investment programs in a 2014 international survey of senior executives in 81 different pension funds. In short, well-governed funds are perceived to do a better job investing pension assets for the long-term.[iii]

The new study by Harford, Kecskes, and Mansi confirms this perception empirically. It asks two different questions: do long-term investors positively impact the governance quality of the corporations they invest in? Further, does improved governance quality lead to better corporate results? They address these two questions with an ingenious research design:

- Create a unique corporate database of 95,463 firm-year observations involving 11,206 U.S. firms between 1985 and 2012 from multiple sources.
- Create a unique institutional investor database over this period from multiple sources.
- Create a portfolio turnover metric for the institutional investor sample, and define long-term investors as those having a 3-year turnover rate of less than 35%, which is about the bottom quartile of the sample, ranked by investor turnover.
- Investor horizon metrics at the firm level were calculated by aggregating the respective ownership proportions of long-term and short-term investors in each of the firms.
- They note that both the turnover metrics for investors and the investor horizon metrics for corporations were relatively stable over the observation period.

Key study findings were:

- Long-term investor ownership increases the number of shareholder proposals made to the firms in the sample.
- Long-term investor ownership improves the quality of the board of directors (e.g., increased independence and experience).
- Long-term investor ownership lowers takeover defenses.
- Long-term investor ownership reduces managerial misbehaviors.
- Long-term investor ownership reduces capital, R&D, and acquisition expenditures, but increases the quality and quantity of firm innovation, both relative to investment and in absolute terms.
- Long-term investor ownership reduces firm balance sheet and off-balance sheet debt issuance.
- Long-term investor ownership increases payouts in the forms of dividends and share repurchases.
- Long-term investor ownership increases firm profitability by amounts unanticipated by market participants.
- Long-term investor ownership reduces sales, costs, and earnings volatility.
- Long-term investor ownership reduces the negative skewness and extremeness of stock returns.
- Firms with high long-term ownership proportions outperformed firms with high short-term ownership proportions by an average 3.5%/yr.

In conclusion, the Harford, Kecskes, and Mansi study provides definitive answers to the two questions they posed. Long-term investors do indeed positively impact the governance quality of the corporations they invest in…..and improved governance quality does indeed lead to better corporate financial results. Even better, the market is surprised by these better corporate financial results…thus generating positive excess returns for long-term investors. The cited study by Ambachtsheer and McLaughlin completes the governance loop: good long-term investing in turn requires good governance at investing institutions.

The Two Board Composition Studies

The long-term investor study affirmed the value-creating power of good governance. The other two new governance studies pose the reverse question: does poor governance lead to the destruction of value? More specifically, do the conflicting interests of politicians or other people elected to pension boards of trustees of U.S. public sector pension funds through some form of political process lead to poor governance and destruction of pension fund value? Though they differ in a number of ways, these are questions that both the Andonov, Hochberg, Rauh, and the Andonov, Bauer, Cremers studies address.

The collective essence of their research designs was:

- Hand-collect data on the board composition of U.S. public sector pension funds. Divide board composition into three broad categories: 1. Politicians/politically-affiliated, 2. Plan member-elected/appointed, and 3. General public/tax-payer-related. There is wide diversity in board composition across these categories, but great stability in fund board structure and selection processes across time.
- Collect biographical information on each board member related to education, union membership, executive experience, financial experience, and investment experience. Also determine amounts of political donations received by Category 1 board members.
- Create a database on the demographics, financial policies, and investment performance of U.S. public sector pension funds, including their proportions of retirees, asset allocations, funded ratios, and liability discount rates. The database covers of 850 funds over the 1990-2012 period. Establish a control group of U.S. corporate funds and non-U.S. funds for comparative purposes.
- Create a database of private equity (PE) investments made by U.S. public sector pension funds between 1990-2011.

Key findings of the studies were:

- On average, U.S. public sector pension funds with higher proportions of Category 1 and 2 members allocate higher proportions to risky assets, use higher liability discount rates, and generate lower risk-adjusted investment returns net of costs than the control group.
- The performance of U.S. public sector fund PE investments is negatively correlated to higher Category 1 board membership. Drivers of this negative performance include the use of expensive 'fund of funds' services, over-weighting in-state venture capital investments, and the presence of higher political contributions to board members. PE performance was also negatively correlated to higher Category 2 membership where board members tend to lack requisite broad business/financial expertise.

These findings lead the researchers to conclude "the presence of politicians on boards appears to work against pension funds' primary objective of delivering the benefits promised to the participants as efficiently as possible for taxpayers". To a lesser degree, this is also true due to the presence of member/union-appointed board members who lack broad business/financial expertise.

Board Composition and 'Fiduciary Duty'

The three new studies strongly support the deductive logic that there should be a relationship between governance quality and organizational performance. Good governance should lead to strong organizational performance, and that was indeed the case in the Harford, Kecskes, and Mansi study. Weak governance should lead to poor organizational performance, and that was indeed the case in the Andonov, Hochberg, Rauh, and the Andonov, Bauer, Cremers studies.

Where should this empirically-validated logic lead us? The most recent offering of the Rotman-ICPM Board Effectiveness Program provides a powerful answer. One of its modules features a conversation with one of the globe's foremost experts on the evolving meaning of 'fiduciary duty'. Prof. Ed Waitzer opens the conversation in this module with the five assertions reproduced in Table 2.[iv]

Table 2 PLACING 'FIDUCIARY DUTY' IN A 21ST CENTURY CONTEXT

- Doctrine of reasonable expectations and rapidly evolving fiduciary obligations inform trajectory of the law
- Ex post compliance failures have become the norm (i.e., liability for actions previously viewed as lawful and/or standard market practices)
- Concentrated institutional ownership is focusing attention on systemic impacts and accountability
- Taking "long-term" views will become an enforceable stewardship obligation
- Need/opportunity to reassert social utility of financial markets and services

Source: Prof. Ed Waitzer, Osgoode Hall Law School and Schulich School of Business, York University, Toronto

His essential message is that through 'the trajectory of the law', courts have become the primary interpreters of the meaning of 'fiduciary duty' through the application of the 'reasonable expectations' doctrine. In that context, I assert it is a 'reasonable expectation' that the selection processes through which the boards of pension organizations are created should reflect current 'best practices' to that end. Current 'best practices' ensure that board members of pension organizations are public-minded, unconflicted, and have the requisite collective skills/experience sets to perform the tasks set out in Table 1 on the front page in a pension organization context.

Arguably, any board selection process that does not meet this 'best practices' standard runs the risk of legal action under the "ex post compliance failure" clause in Table 2 above (i.e. "we've always done it this way" is not a reasonable defence). Does your current board selection process meet a reasonable 'best practices' standard?

Keith Ambachtsheer

Endnotes:

i. *All three studies received financial support from the International Centre for Pension Management (ICPM) at the Rotman School of Management, University of Toronto.*

ii. *David Beatty is Adjunct Professor of Strategic Management at the Rotman School of Management, University of Toronto, and Conway Director, Clarkson Centre for Business Ethics and Board Effectiveness. He is a faculty member of the Rotman-ICPM Board Effectiveness Program (BEP) for board members of pension and other long-horizon investment organizations. The BEP course has been offered nine times thus far, creating 250 program 'graduates'. BEP10 is scheduled for April 3-7, 2017. Go to the Rotman ICPM website for more information.*

iii. *See Ambachtsheer and McLaughlin (2015), "How Effective Is Pension Fund Governance Today? and Do Pension Funds Invest for the Long-Term? Findings from a New Survey", KPA Advisory Services Ltd.*

iv. *Ed Waitzer holds the Jarislowsky Dimma Mooney Chair in Corporate Governance at Osgoode Hall Law School and the Schulich School of Business (York University) and is a senior partner (and former Chair) of Stikeman Elliott LLP. He is also a faculty member of the Rotman-ICPM BEP program.*

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