

**NORTH DAKOTA STATE INVESTMENT BOARD
MINUTES OF THE
NOVEMBER 16, 2018, BOARD MEETING**

MEMBERS PRESENT: Brent Sanford, Lt. Governor, Chair
Rob Lech, TFFR Board, Vice Chair
Troy Seibel, PERS Board, Parliamentarian
Toni Gumeringer, TFFR Board
Adam Miller, PERS Board
Mel Olson, TFFR Board
Kelly Schmidt, State Treasurer
Jodi Smith, Commissioner of Trust Lands
Yvonne Smith, PERS Board
Cindy Ternes, WSI Designee

MEMBERS ABSENT: Jon Godfread, Insurance Commissioner

STAFF PRESENT: Eric Chin, Senior Investment Officer
Connie Flanagan, Chief Financial Officer
Bonnie Heit, Admin Svs Suprv
David Hunter, ED/CIO
Fay Kopp, Dep ED/CRO
Sara Sauter, Audit Svs Suprv
Cody Schmidt, Compliance Officer
Darren Schulz, Dep CIO
Susan Walcker, Investment Accountant

OTHERS PRESENT: Brian Barnett, APT, Inc.
Alex Browning, Callan LLC
Jeff Engleson, Dept. of Trust Lands
Paul Erlendson, Callan LLC
Paul Michaels, Invesco
Anders Odegaard, Attorney General's Office
Bryan Reinhardt, PERS
Max Swango, Invesco
Inga Sweet, Callan LLC

CALL TO ORDER:

Lt. Governor Sanford, Chair, called the State Investment Board (SIB) regular meeting to order at 8:35 a.m. on Friday, November 16, 2018, in the Peace Garden Room, at the State Capitol, Bismarck, ND.

AGENDA:

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY DR. LECH AND CARRIED BY A VOICE VOTE TO ACCEPT THE AGENDA FOR THE NOVEMBER 16, 2018, MEETING.

AYES: COMMISSIONER SMITH, TREASURER SCHMIDT, MR. MILLER, MR. OLSON, MS. TERNES, MS. GUMERINGER, MR. SEIBEL, DR. LECH, MS. SMITH, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GODFREAD

MINUTES:

IT WAS MOVED BY MR. OLSON AND SECONDED BY MS. SMITH AND CARRIED BY A VOICE VOTE TO ACCEPT THE MINUTES OF THE OCTOBER 26, 2018, MEETING AS DISTRIBUTED.

AYES: MS. GUMERINGER, COMMISSIONER SMITH, MS. SMITH, MS. TERNES, TREASURER SCHMIDT, DR. LECH, MR. OLSON, MR. SEIBEL, MR. MILLER, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GODFREAD

GOVERNANCE:

Audit Committee - Ms. Sara Sauter, Supervisor of Audit Services, updated the SIB on the activities of the SIB Audit Committee since their November 15, 2018, meeting.

CliftonLarsonAllen presented the results of the June 30, 2018, financial audit of RIO and also an update on the GASB 68 Schedule Audit. Mr. Hunter provided an educational segment on 1) regular monitoring of SIB client "Investment Ends"; and 2) the investment manager due diligence process. Ms. Sauter also provided an activities report for the period of July 1, 2018 - September 30, 2018.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE SIB AUDIT COMMITTEE REPORT.

AYES: MR. OLSON, MR. SEIBEL, COMMISSIONER SMITH, MS. GUMERINGER, MS. SMITH, MR. MILLER, TREASURER SCHMIDT, MS. TERNES, DR. LECH, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GODFREAD

Mr. Hunter stated the Internal Audit Division of RIO has been working on implementing a new work plan which was approved by the SIB Audit Committee at their September 27, 2018, meeting. As a result of this year's risk assessment conducted by Ms. Sauter, the Internal Audit Division of RIO is transitioning from a 95/5 split of time allocated between the Teachers' Fund for Retirement program and the State Investment Board program respectively to a 50/50 split.

Mr. Hunter also reviewed the financial audit of RIO for the period ending June 30, 2018. Mr. Hunter stated the report is about as clean as you can get and reflects the great work done by Ms. Flanagan and the fiscal division as well as the entire staff at RIO.

IT WAS MOVED BY MS. TERNES AND SECONDED BY DR. LECH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE JUNE 30, 2018, FINANCIAL AUDIT OF RIO.

AYES: TREASURER SCHMIDT, MR. GUMERINGER, MS. TERNES, COMMISSIONER SMITH, MS. SMITH, DR. LECH, MR. MILLER, MR. SEIBEL, MR. OLSON, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GODFREAD

Securities Litigation - Mr. Hunter updated the SIB on the activities of the Securities Litigation Committee since their November 5, 2018, meeting. Mr. Hunter stated the Securities Litigation Committee had met with several law firms considered to be leading experts in the securities litigation field. The Securities Litigation Committee has identified three firms the SIB could utilize if future legal representation would be needed: Bernstein Litowitz Berger & Grossman; Labaton Sucharow; and Grant & Eisenhower.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MS. SMITH AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE SECURITIES LITIGATION REPORT.

AYES: MR. SMITH, MR. MILLER, MR. OLSON, MS. GUMERINGER, DR. LECH, MR. SEIBEL, MS. TERNES, COMMISSIONER SMITH, TREASURER SCHMIDT, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GODFREAD

INVESTMENTS:

Asset/Performance Overview - Mr. Hunter highlighted assets and performance of the SIB portfolios for the period ending September 30, 2018. SIB client investments approached \$14.2 billion as of September 30, 2018, with the Pension Trust exceeding \$5.8 billion, Insurance Trust approaching \$2.2 billion, and Legacy Fund approaching \$5.9 billion.

The Pension Trust posted a net return of 7.7% in the last year. During the last 5-years, the Pension Trust generated a net annualized return of 7.8%, exceeding the performance benchmark of 7.0%.

The Insurance Trust generated a net return of 4.1% in the last year. During the last 5-years, the Insurance Trust posted a net annualized return of 5.2%, exceeding the performance benchmark of 3.9%.

Legacy Fund generated a net return of 6.0% last year, exceeding its policy benchmark. During the last 5-years, Legacy Fund earned a net annualized return of 6.3%, exceeding the performance benchmark of 5.4%.

RIO investment personnel conservatively estimate the SIB use of active management enhanced client returns by \$300 million for the 5-years ended September 30, 2018.

If SIB managers outperform their benchmark by 0.01% (or one basis point), after all fees & expenses, client returns improve by \$1.4 million per year (e.g. \$14 billion x 0.01% = \$1.4 million).

RIO's internal costs for administering their external investments is less than one basis point or 0.01% per year.

Every Pension Trust client posted positive excess returns of at least 0.50% per annum over the last 5-years, while adhering to approved risk levels and generating positive risk adjusted excess return for six of their seven pension clients (over the last five years).

Every Non-Pension Trust client generated positive excess returns of at least 0.60% per annum and positive risk adjusted excess returns for the 5-years ended June 30, 2018, with two exceptions for PERS Retiree Health Insurance Credit Fund (-0.09%) and PERS Group Insurance (-0.06%).

IT WAS MOVED BY MR. OLSON AND SECONDED BY MRS. GUMERINGER AND CARRIED BY A ROLL CALL VOTE TO ACCEPT THE ASSET AND PERFORMANCE REVIEW FOR THE PERIOD ENDING SEPTEMBER 30, 2018.

AYES: TREASURER SCHMIDT, MR. SEIBEL, MR. OLSON, COMMISSIONER SMITH, DR. LECH, MR. MILLER, MS. GUMERINGER, MS. SMITH, MS. TERNES, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GODFREAD

Real Estate - Mr. Schulz reviewed the Pension Trust real estate portfolio. The Pension Trust real estate portfolio is currently under-allocated in the non-core real estate sector within the Pension Trust by approximately \$140 million. The Pension Trust has been invested in four prior value-added real estate investment funds with Invesco over the past decade.

Invesco representatives, Mr. Michaels and Mr. Swango, provided an overview of Invesco, current SIB mandates managed by the firm, and also introduced the U.S. value-added Fund V for the SIB's consideration.

Mr. Schulz recommended a \$70 million commitment to Invesco's Value Added Fund V.

After discussion,

IT WAS MOVED BY DR. LECH AND SECONDED BY MS. TERNES AND CARRIED BY A ROLL CALL VOTE TO COMMIT \$70 MILLION TO INVESCO'S VALUE ADDED FUND V SUBJECT TO SATISFACTORY LEGAL REVIEW AND NEGOTIATION.

AYES: MS. TERNES, MR. OLSON, TREASURER SCHMIDT, COMMISSIONER SMITH, MR. SEIBEL, DR. LECH, MR. MILLER, MS. SMITH, MS. GUMERINGER, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GODFREAD

The Board recessed at 9:43 a.m. and reconvened at 10:06 a.m.

Callan LLC - Ms. Sweet updated the board on the organizational structure of Callan and also on succession and strategic planning.

Mr. Erlendson reviewed US and Foreign markets and the investment performance of the Pension Trust, Insurance Trust, and Legacy Fund for the quarter ending September 30, 2018. After the review,

IT WAS MOVED BY MS. TERNES AND SECONDED BY DR. LECH AND CARRIED BY A VOICE VOTE TO ACCEPT CALLAN'S INVESTMENT PERFORMANCE REVIEW FOR THE PERIOD ENDING SEPTEMBER 30, 2018.

AYES: MS. TERNES, MR. OLSON, MR. MILLER, TREASURER SCHMIDT, MS. GUMERINGER, MS. SMITH, COMMISSIONER SMITH, DR. LECH, MR. SEIBEL, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GODFREAD

Callan LLC Fee Study - Mr. Browning reviewed results of Callan's fee study for the fiscal year ending June 30, 2018. RIO investment personnel believe the investment expenses are reasonable overall and that management fees have been trending downward on a % basis since fiscal year 2013. The return on investment fees has been positive and exceeded 50 bps per annum (or \$300 million in aggregate) over the last five years. 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 their clients.

IT WAS MOVED BY TREASURER SCHMIDT AND SECONDED BY MS. SMITH AND CARRIED BY A VOICE VOTE TO ACCEPT THE CALLAN FEE STUDY RESULTS FOR THE FISCAL YEAR ENDING JUNE 30, 2018.

AYES: DR. LECH, TREASURER SCHMIDT, MR. OLSON, COMMISSIONER SMITH, MR. SEIBEL, MR. MILLER, MS. GUMERINGER, MS. SMITH, MS. TERNES, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIOENR GODFREAD

Legacy Fund Earnings - Mr. Hunter provided a Legacy Fund earnings estimate for the remaining 2017-19 and upcoming 2019-21 biennia. NDCC 21-10-12 defines earnings as net income in accordance with generally accepted accounting principles, excluding any unrealized gains or losses. The definition of earnings is materially different than net investment return which includes both unrealized and realized gains and losses. The Legacy Fund generated over \$1.2 billion of net investment earnings since inception, as of September 30, 2018, whereas earnings as defined in accordance with NDCC 21-10-12 exceeded \$700 million during the same time period. RIO investment personnel, as of August 8, 2018, raised the transferrable earnings estimate for the Legacy Fund from \$300 million to \$350 million based on the expected strength and resiliency of the capital markets over the next year. However, in light of recently increasing downward price volatility in the capital markets, RIO investment personnel is reducing its' current transferrable earnings estimate back to \$300 million for the 2017-19 biennium while holding its' transferrable earnings estimate at \$300 million for the 2019-21 biennium. The \$300 million transferrable earnings estimate for the 2019-21 biennia is based on the Office of Management and Budget's (OMB) latest forecasted oil and gas tax deposits causing average Legacy Fund investments to approximate \$7.5 billion in the 2019-21 biennia while continuing to use the 2% average earnings rate (\$7.5 billion x 2% earnings rate = \$150 million x 2 years = \$300 million).

New Client - Mr. Hunter informed the board, RIO investment personnel were approached by the State Historical Society of North Dakota (SHS) inquiring about investment management services for their Endowment Funds which total over \$640,000. Mr. Hunter requested authorization to continue to work with the SHS to determine if they would be a viable client for the SIB.

IT WAS MOVED BY MR. OLSON AND SECONDED BY MS. GUMERINGER AND CARRIED BY A VOICE VOTE TO DIRECT STAFF TO CONTINUE WITH THE PROCESS OF DETERMINING WHETHER THE SHS WOULD BE AN APPROPRIATE CLIENT FOR THE SIB.

AYES: MS. TERNES, COMMISSIONER SMITH, MS. GUMERINGER, MS. SMITH, MR. SEIBEL, MR. MILLER, DR. LECH, MR. OLSON, TREASURER SCHMDIT, AND LT. GOVERNOR SANFORD

NAYS: NONE

MOTION CARRIED

ABSENT: COMMISSIONER GODFREAD

OTHER:

A meeting has been tentatively scheduled for the SIB on December 21, 2018, at 8:30 a.m. at the Retirement and Investment Office to address, if need be, any business prior to the start of the legislative session.

The next meeting of the SIB for regular business has been scheduled for January 25, 2019, at 8:30 a.m. at Workforce Safety & Insurance, 1600 E Century Ave.

The next meeting of the Securities Litigation Committee meeting is scheduled for February 14, 2019, at 3:00 p.m. at the Retirement and Investment Office.

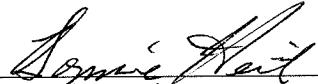
The next meeting of the SIB Audit Committee is scheduled for February 21, 2019, at 3:00 p.m. at the Retirement and Investment Office.

ADJOURNMENT:

With no further business to come before the SIB, Lt. Governor Sanford adjourned the meeting at 11:52 a.m.



Lt. Governor Sanford, Chair
State Investment Board



Bonnie Heit
Recorder