

**Minutes
Investment Advisory Council
August 17, 2020**

Call to Order

The Investment Advisory Council (IAC) met at 12:00 P.M. on Monday, August 17, 2020. The Chair of the Minnesota State Board of Investment's Investment Advisory Council determined that an in-person meeting was not practical or prudent because of the current COVID-19 pandemic and ongoing peacetime emergency declared under Chapter 12 of Minnesota Statutes. As is permitted under the Open Meeting Law in these conditions, this meeting of the Investment Advisory Council was conducted via Zoom video conferencing software and over the phone. Attendance and all votes were conducted by roll call.

MEMBERS PRESENT: Denise Anderson, Doug Anderson, Ellen Brownell, Dennis Duerst, Kim Faust, Susanna Gibbons, Morris Goodwin Jr., Jennifer Hassemer (for Myron Frans), Peggy Ingison, Erin Leonard, Gary Martin, Dan McConnell, Malcolm McDonald, Nancy Orr, Carol Peterfeso, Martha Severson Rush, Jay Stoffel and Shawn Wischmeier.

MEMBERS ABSENT: None.

SBI STAFF: Mansco Perry, Patricia Ammann, Kailee Anderson, Paul Anderson, Shirley Baribeau, Nate Blumenshine, Cassie Boll, Tammy Brusehaver, Andy Christensen, Stephanie Gleeson, Aaron Griga, Andrew Krech, Steve Kuettel, Todd Lauf, John Mulé, Erol Sonderegger, Jonathan Stacy, Charlene Olson, Melissa Mader and Kelly Nordstrom.

OTHERS ATTENDING: Kristen Doyle and Katie Comstock, AON Hewitt Investment Consulting, Inc.; Allan Emkin, Neil Rue and Gordon Latter, Meketa Investment Group; Christie Eller, Attorney General's Office; Karl Procaccini, Governor's Office; Bibi Black, Secretary of State's Office; Ramona Advani, State Auditor's Office.

Members of the public attended the meeting, however due to the virtual nature of the meeting the SBI was unable to track attendee information.

Introduction of New Investment Advisory Council Members

Mr. Perry introduced and welcomed Ellen Brownell with Pohlad Companies and Martha Severson Rush with the Mounds View School District as the Governor's Appointee to the Investment Advisory Council.

Approval of Minutes

The minutes of the May 18, 2020 IAC meeting were approved unanimously by roll call vote.

Executive Director's Report

Mr. Perry, Executive Director, referred members to Tab A of the meeting materials and stated that as of June 30, 2020, the SBI was responsible for managing approximately \$102.4 billion of assets. Mr. Perry reported that the Combined Funds had outperformed its Composite Index over the ten-year period ending June 30, 2020 (Combined Funds 9.7% vs. Combined Funds-Composite Index 9.5%) and had provided a real rate of return of 4.3% above inflation over the latest 20 year period (Combined Funds 6.3% vs. CPI-U 2.0%).

Mr. Perry stated that the Combined Funds assets increased over the quarter (Combined Funds ending value of \$71.1 billion versus a beginning value of \$64.6 billion) primarily from net investment results. The Combined Funds outperformed the benchmark for the quarter (Combined Funds 11.1% vs. Combined Funds-Composite Index 10.6%) and outperformed for the year (Combined Funds 4.2% vs. Combined Funds-Composite Index 4.0%). The Combined Funds matched the five-year period and outperformed the benchmark in all other time-periods reported.

Mr. Perry referred members to the Combined Funds asset allocation mix and asset class performance summary. The public equity performance outperformed for the quarter (Public Equity 20.8% vs. Public Equity Benchmark 20.2%) and for the year (Public Equity 2.7% vs. Public Equity Benchmark 2.4%). The total fixed income segment outperformed for the quarter (Total Fixed Income 2.9% vs. Total Fixed Income Benchmark 1.7%) and matched the return for the year (Total Fixed Income 13.0% vs. Total Fixed Income Benchmark 13.0%). Mr. Perry reminded the members that the private markets return is reported one quarter in arrears with a -9.0% return for the quarter and -2.6% return for the year.

Mr. Perry referred members to the SBI Combined Funds Strategic Allocation Category Framework and explained that staff is working on moving the allocation towards the category ranges, which will be addressed more during the meeting. Mr. Perry continued to the Volatility Equivalent Benchmark Comparison, which showed the Combined Funds return exceeding the benchmark return for all time-periods listed. The members also reviewed the Trust Universe Comparison Service (TUCS) summary, which provides a comparison of the SBI's asset allocation and returns to public and corporate plans over \$1 billion in assets. Mr. Perry stated that for the last thirty years the Combined Funds return ranked in the first quartile and for the quarter and the year ending June 30, 2020 ranked in the second quartile.

Executive Director's Administrative Report

Mr. Perry referred members to Tab B of the meeting materials for the Administrative Report and stated that for the fiscal year the SBI was under budget, and will be returning over \$1 million back to the Statewide Retirement Systems. Lastly, Mr. Perry referenced the update on restrictions for Sudan and Iran and stated that the SBI was not involved in any litigation.

Update on Resolution Concerning Reduction of Investments Associated with Thermal Coal Production

Mr. Perry referred members to Tab C of the meeting materials for an update on the Board Resolution adopted on May 29, 2020, Concerning Reduction of Investments Associated with Thermal Coal Production. Mr. Perry informed the Council that there are 10 holdings in the Combined Funds portfolio of the 40 companies identified as deriving more than 25% of their revenue from thermal coal production. External managers have until December 31, 2020 to remove the 10 unauthorized holdings.

Response to Resolution Concerning Management of Combined Funds Asset Allocation and Liquidity

Mr. Perry referred members to Tab D, which provides staff's response to the Board Resolution Concerning the Management of the Combined Funds Asset Allocation and Liquidity passed on May 29, 2020. Mr. Perry noted that Tabs E-H of the meeting material (Tab E–Fixed Income Manager Recommendations; Tab F–Global Equity Manager Recommendations; Tab G–Cash Overlay Program and Manager Recommendation and Tab H–Currency Overlay Program and Manager Recommendation) were essentially appendices to Tab D. Mr. Perry reminded members that staff has discussed these modifications to the asset allocation policy with the IAC on a number of occasions and with the Board at its May 29, 2020 meeting. Mr. Perry requested that the IAC endorse the planned changes to the asset allocation outlined below in six separate actionable items.

The first action item of the resolution provides for the restructuring of the Total Fixed Income aggregate into three components: 20% allocation to Cash and Short Duration Treasury Ladder, 40% to Core/Core Plus and Return Seeking fixed income, and 40% to the current Treasury Protection allocation.

The second action item of the resolution is to expand the Combined Funds Fixed Income Program allocation from 20% to 25% by reducing the Public Equities allocation from 53% to 50% and includes the 2% transfer of the cash allocation into fixed income.

The third item pertains to the allocation target for Private Markets. The Board approved a resolution allowing the Combined Funds portfolio to hold private market investments up to the statutory maximum of market value level of 35%, despite retaining a target allocation of a market value level of 25%. In addition, the Board set a temporary policy for Market Value plus Unfunded Commitments to increase to a maximum of 45% from the current limit of 35%. Staff will present a recommendation for a permanent policy level by the end of the Fiscal Year 2021.

The fourth action item is to segregate the uninvested portion of the Private Markets allocation from the dedicated Combined Funds Public Equities Program. The uninvested amount referenced equals the amount by which the actual value of the Private Markets allocation lags the target Private Markets allocation, and will consist of public equities and a cash overlay strategy. The Executive Director may also utilize cash overlay strategies for the purposes of facilitating total portfolio rebalancing and enhancing portfolio liquidity. Additionally, the Executive Director is authorized to implement a currency overlay strategy to more effectively manage the portfolio non-dollar exposure.

The fifth action item is to authorize the Executive Director to make contractual or investment guideline changes to build a better benchmarking framework and take such further action deemed necessary to implement the resolution.

The sixth, and last action item is for the Executive Director to bring before the IAC and Board any additional investment managers and vendor recommendations that will expeditiously implement these strategies. This includes the eleven investment manager recommendations listed in the meeting materials of which six are fixed income managers: Ashmore Investment Management, KKR (Kohlberg, Kravis, Roberts), Payden & Rygel, Prudential Global Investment Management (PGIM), Oaktree Capital, and The TCW Group, Inc; three global equity managers: Ariel Investments; LLC, Baillie Gifford & Co., and Martin Currie Inc.; one cash overlay manager: NISA Investment Advisors, LLC; and one currency overlay manager: Record Currency Management.

After discussion on strategy and investment manager due diligence, there was a motion for the IAC to endorse all six action items as outlined above and recommended by Staff. The motion was seconded and approved by roll call vote.

Private Markets Commitments for Consideration

Mr. Perry referred members to Tab I for the Private Markets Commitments for Consideration section of the meeting materials and asked Mr. Krech to review the one new and the six existing private markets investments listed in the report: Canyon Distressed Opportunity Fund III; Merit Capital Fund VII; MN Asia Investors, LP; Dyal Capital Partners Fund V; Nordic Capital Fund X; Thoma Bravo Fund XIV; and Whitehorse Liquidity Partners Fund IV. Mr. Krech and Ms. Boll responded to questions from the members. After discussion, a motion was made that the IAC endorse staff's recommendation to make an investment in the seven private market funds brought before the IAC. The motion was seconded and approved by roll call vote.

Update on the Private Markets and Alternatives Consulting Services Request for Proposal

Mr. Perry and Mr. Christensen updated the IAC members on the Request for Proposals for a private markets and alternatives services consultant(s), noting that the SBI is in the early evaluation stages and had received ten responses.

Other Meeting Materials

Lastly, Mr. Perry noted the other reports included in the meeting materials, the Public Markets Investment Program Report in Tab J; the Participant Directed Investment Program and Non-Retirement Program Report in Tab K; and the SBI's Environmental, Social, and Governance (ESG) Report; the Market Environment Report prepared by AON; the Capital Markets Outlook & Risk Metrics Report prepared by Meketa; and the SBI's Comprehensive Performance Report.

IAC Discussion: *Diversity, Equity and Inclusion*

Mr. Perry introduced one of the IAC members, Susanna Gibbons, who wrote a letter to Chair Martin and Mr. Perry, which was shared with IAC members, Board designees, and the SBI consultants to help initiate the discussion around Diversity, Equity and Inclusion (see **Attachment A**). To begin, Ms. Gibbons asked what action the IAC members might demand of their investment managers to support diversity and inclusion more broadly in the investment business. Members replied with the work they are currently doing and progressing towards with

regard to surveying, benchmarking, reporting, and tracking investment manager's efforts with diversity and inclusion. Members also discussed the importance of thinking through the goal setting and some challenges in setting targets for managers. Ms. Gibbons commended the work that SBI staff has incorporated into their due diligence process in this area and would propose that staff also request from its managers what their goals are in establishing diversity and inclusion practices and the progress towards meeting those goals. IAC members noted that it is important to understand the data collected in order to gauge what the manager looks like in terms of diversity and inclusion; this may include the manager's pay gaps, their gender and racial diversity, and their retention and promotion practices.

The Board designees also commented on being advocates to move this effort forward. As fiduciaries, if they believe it will lead to better results it is important to begin gathering the data.

Mr. Perry introduced Mr. Mulé, who provided a brief summary of the SBI's efforts with diversity and inclusion. One effort is the SBI's active participation in different coalitions of investors like the Thirty Percent Coalition and the Midwest Investors Diversity Initiative that focus on diversity and inclusion. Other organizations that the SBI is involved in: United Nations Principles for Responsible Investment (PRI); Council of Institutional Investors; and Ceres, are also making a larger effort in this area. Secondly, in terms of engagement, the SBI has historically leveraged its institutional size with its proxy voting and has sponsored or co-sponsored applicable resolutions. Going forward, staff is reviewing additional ideas that work towards the ESG resolution passed by the Board in February 2020 to support initiatives to increase diversity and inclusion. This would include working directly with the investment managers, in both public and private markets, in gathering metrics and discussing their diversity and inclusion efforts. Staff is hopeful that they can get the resources to dedicate to this effort in the future.

Mr. Perry introduced Mr. Krech to summarize the engagement his team is having with the managers in private markets. Mr. Krech stated that private markets tend to recruit from a small pool of people in the investment banking and consulting world and from a handful of educational institutions. Mr. Krech referenced one large firm that the SBI has been in discussions with that announced a change from their recruiting and hiring process to include candidates from state, and historically black colleges and universities. Mr. Perry commented on the staffing resources that he is working towards in order to effectively develop and track metrics when benchmarking manager's efforts.

Adjournment of Meeting

A motion to adjourn the meeting was made and seconded and approved by roll call vote. The meeting adjourned at 3:09 p.m.

Respectfully submitted,



Mansco Perry III
Executive Director and
Chief Investment Officer

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To: Members of the Investment Advisory Council

From: Susanna Gibbons

Re: Diversity, Equity & Inclusion

CC: Mansco Perry

Date: August 5, 2020

A few weeks ago, I attended the CFA Society's virtual conference "Race and Inclusion Now: An Investment Industry Call to Action." This call to action is consistent with the MSBI resolution passed in February directing us "to promote efforts for greater diversity and inclusion on corporates boards and within the investment industry." I think that, as an organization, the MSBI has done an excellent job so far of bringing these issues to light as part of its broader ESG agenda, and I applaud staff on their ongoing efforts. However, the murder of George Floyd and subsequent demonstrations are forcing all of us to confront the persistent and insidious racism that remains firmly imbedded in our economic systems. I think greater action is needed. I am hoping we can get some time on the August agenda to discuss what form that might take.

Some specific ideas I am hoping we might consider include:

1. Establish specific goals around diversity for all Investment Managers with which the MSBI does business. We have heard for too many years from asset managers that they really want to support diversity and inclusion, but they simply cannot find the talent. I have never believed this to be true, a view shared on the CFA Society webcast. It is time to put pressure on them to deliver results. Once it becomes an economic imperative, I think we will start to see action.
2. Further develop our proxy voting guidelines around Board diversity, with achievable objectives in mind.
3. Through our investment managers, encourage the companies in which we invest to begin reporting on diversity across the career pipeline. We have all seen the narrowing of the funnel as diverse talent fails to achieve promotion alongside white male peers. We have been told for decades that the disparity would self-correct with the mere passage of time. This passive approach has been unsuccessful, and providing data to investors on both numbers and wage gaps can be the first step in ensuring that diverse talent rises to the top.
4. Review the work of the Intentional Endowments Network, which primarily targets University Endowments, to identify additional strategies and networks that can support these efforts.
5. Ask the MSBI to consider signing the IEN 2020 belonging pledge, which states: *"We commit to discussing racial equity at our next investment committee meeting. We will move our agenda forward on this. We will share our next steps and results (perhaps privately), so that we can help to identify industry-wide barriers and the technical resources required to advance the practice of investing with a racial equity lens."*

I am sure there are many other ideas; these are just a few to start. As participants in the investment industry, we have an outsized voice in our society. I would like us to use it to the greatest extent possible to achieve greater equity. In order to do this, we need to establish specific goals and hold ourselves accountable. I realize it is not the role of the IAC to take decisions on these matters, but I do think we can provide valuable input, which will help the MSBI and its staff take action.