Minutes
Investment Advisory Council
February 18, 2020

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

MEMBERS ABSENT: Malcolm McDonald

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

OTHERS ATTENDING: Kristen Doyle, AON Hewitt Investment Consulting, Inc.; Neil Rue and Gordon Latter, Meketa Investment Group; J. Adam Sorenson, Attorney General's Office; Karl Procaccini, Governor's Office; Bibi Black, Secretary of State's Office; Ramona Advani, State Auditor's Office; Edgar Hernandez, SEIU; Emily Moore, Divest-Invest Minnesota; Kent Mori and Carly Dusseau, Anti-War Committee; Ellen Kennedy, World Without Genocide; and David Blomquist, private citizen.

The minutes of the November 18, 2019 meeting were approved.

Executive Director's Report
Mr. Perry referred members to Tab A of the meeting materials and stated that as of December 31, 2019, the SBI was responsible for managing approximately $104 billion of assets. Mr. Perry reported that the Combined Funds had outperformed its Composite Index over the ten-year period ending December 31, 2019 (Combined Funds 9.8% vs. Combined Funds-Composite Index 9.6%) and had provided a real rate of return of 4.3% above inflation over the latest 20 year period (Combined Funds 6.5% vs. CPI-U 2.2%).

Mr. Perry stated that the Combined Funds assets increased over the quarter (Combined Funds ending value of $74.2 billion versus a beginning value of $70.7 billion) primarily from net investment results. The Combined Funds matched the benchmark for the quarter (Combined Funds 5.8% vs. Combined Funds-Composite Index 5.8%) and slightly outperformed for the year (Combined Funds 20.1% vs. Combined Funds-Composite Index 20.0%). The Combined Funds outperformed the benchmark return for the three year, matched it for the five year, and outperformed other time-periods reported. Next, Mr. Perry commented on the asset mix, which he stated was in line with the policy target.

Looking at the performance within each asset group, Mr. Perry stated that the combined public equity performance outperformed the benchmark for the year-end (Public Equity 28.0% vs. Public Equity Benchmark 27.7%). Breaking it down between domestic and international equities, domestic equities slightly underperformed its benchmark for the year (Domestic Equity 30.7% vs. Domestic Equity Benchmark 30.8%), matched the benchmark for the three-year period, and underperformed for all other time periods reported. The international equity manager group outperformed its target for the one-year period (International Equity 22.4% vs. International Equity Benchmark 21.5%), and for all other time periods reported. Mr. Perry continued with the core fixed income segment, which outperformed for the year (Fixed Income 9.7% vs. Fixed Income Benchmark 8.7%) and all other time-periods reported. He reported that the Treasury portfolio not only outperformed its target for the year (Treasuries 10.5% vs. Treasuries Benchmark 10.4%) but also the core fixed income segment. Mr. Perry stated that the Private Markets one year return was negatively impacted by Resources (Private Markets 2.4% and 6.6% for the quarter and the year, respectively).

Mr. Perry then referred members to the Strategic Allocation Category Framework, the Volatility Equivalent Benchmark and a comparison of the Combined Funds return and allocation versus the Trust Universe Comparison Service (TUCS) universe.

Mr. Perry referred members to Tab B of the meeting materials for the Administrative Report, which included the administrative budget and travel report for the fiscal year to date through December 31, 2019. He stated that the Office of the Legislative Auditor had no written findings or recommendations for the State Board of Investment (SBI); the 2019 Annual Report was distributed and also available on the SBI's website; and that the Administrative Report also provided the Iran and Sudan summary. There was no litigation during the quarter.

Mr. Perry referred members to the SBI's Environmental, Social and Governance (ESG) Report handout (see **Attachment A**), which is available on the SBI's website along with the Meketa Climate Risk Study. The SBI will periodically update its ESG activities and the impact of heightening our role in ESG on the website.

Mr. Perry referred members to Tab C of the meeting materials for the Stable Value Fund Program Review. Ms. Ammann and Mr. Sonderegger gave a brief overview of Galliard Capital Management, the Stable Value Fund Manager for the Minnesota Deferred Compensation Plan and other plans in the Participant Directed Investment Program. Ms. Ammann and Mr. Sonderegger also summarized the due diligence process used to develop a Bench List of potential stable value managers, which include T. Rowe Price and Invesco. Staff believes that reliance on a single stable value manager limits a plan sponsor's ability to replace the manager quickly and efficiently if there is cause to terminate the current manager. Mr. Goodwin moved to authorize the Executive Director to hire a stable value manager from the Bench List if at any time in the future the current stable value manager is given notice of termination. The motion passed.

Mr. Perry introduced Mr. Krech and the private markets team to provide an update on how ESG factors are addressed in the investment portfolio and to respond to questions regarding the investment recommendations provided in Tab D. Mr. Krech started by highlighting the ESG narrative in the Manager Summary Profile for each investment under consideration and explained that staff is committed to providing the information as it evolves on an on-going basis. Next, Mr. Krech provided a high-level summary of how investment staff is including ESG questions as part of the due diligence process for both existing and prospective managers. Mr. Perry commented on potentially adding an ESG staff position to help establish a formal process and, more importantly, to track the information over time to see the progress managers are making. Lastly, Mr. Krech and the private markets team reviewed six recommended investments listed in the report. The six existing managers include: KKR Asian Fund IV SCSp; Audax Mezzanine Fund V, L.P.; Oaktree Real Estate Debt Fund III, L.P.; PGIM Capital Partners Fund VI, L.P.; CVI Credit Value Fund V, L.P.; and Oaktree Real Estate Opportunities Fund VIII, L.P. Mr. Krech and his team responded to questions from the committee members. After discussion, Mr. Duerst moved approval of the six recommendations. The motion passed.

Mr. Perry provided an update on the legislative progress of the proposed statutory language endorsed by the IAC and approved by the Board. Mr. Perry also informed the IAC that staff will issue a Private Markets Consultant Request For Proposal (RFP) before fiscal year end. The meeting ended with general investment discussions from the members that included clarification of the rebalancing process; the potential impact to the portfolio with the transition from the London Interbank Offered Rate (LIBOR) to the secured overnight financial rate (SOFR); the high equity exposure in the Combined Funds; and the importance of having liquidity in the portfolio.

The remainder of the reports included the Public Markets, Non-Retirement and Participant Directed Investment Programs Report in Tab E; Tab F contained the Market Environment Report prepared by AON; Tab G contained the Capital Markets Outlook & Risk Metrics Report prepared by Meketa; and Tab H included the SBI's Comprehensive Performance Report.

The meeting adjourned at 1:43 p.m.

Respectfully submitted,

Mansco Perry III

Mansco Perry III
Executive Director and
Chief Investment Officer

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MINNESOTA STATE BOARD OF INVESTMENT

ENVIRONMENTAL, SOCIAL, GOVERNANCE REPORT

INTRODUCTION

The Minnesota State Board of Investment (SBI) continues to enhance its approach to addressing Environmental, Social, and Governance (ESG) risks in the SBI investment portfolio. The SBI has adopted a core investment belief that emphasizes the importance of addressing ESG risk. Over the past five years, the SBI has supplemented its long history of engagement through proxy voting by increasing its participation in ESG coalitions and engagement efforts. These initiatives continue to gain momentum and lead to positive changes in the investment industry.

In addition to the SBI's efforts, several of the SBI's largest investment managers have aligned with the same coalitions as the SBI:

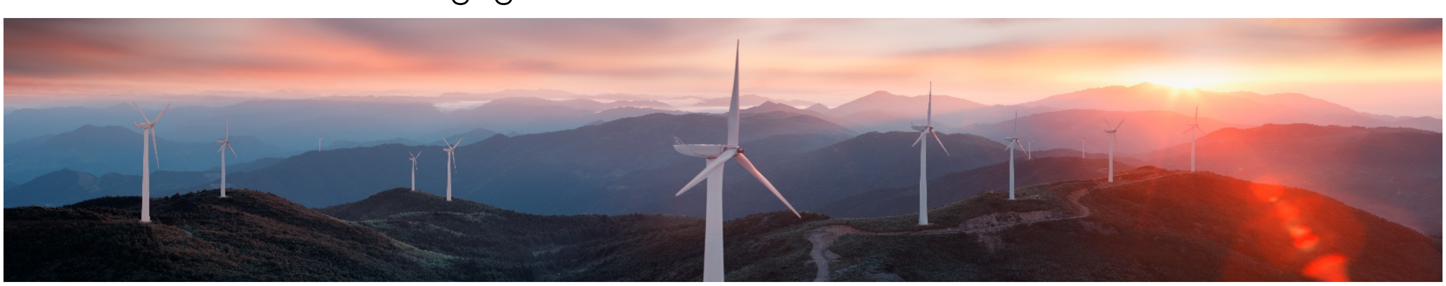
- BlackRock CEO, Larry Fink, recently announced that BlackRock, SBI's largest investment manager, joined the **Climate Action 100+** to enhance BlackRock's commitment to addressing long-term environmental risks.

- State Street Global Advisors, SBI's largest international developed and emerging markets manager, is a member of the **United Nations Principles for Responsible Investment (UNPRI)**, and maintains a robust engagement program based on the Principles.

- TPG, a manager for the SBI's private markets portfolio, partnered with the **Thirty Percent Coalition** to appoint 64 female directors to 53 company boards within TPG affiliated portfolios.

Investment manager alignment directly benefits the SBI by enhancing the evaluation of ESG risk across the SBI's portfolio. In addition, alignment through ESG coalitions has contributed to a number of positive outcomes, including a commitment from Duke Energy to be carbon neutral by 2050.

The following sections summarize the SBI's proxy voting program, ESG related coalitions, and current ESG related engagement efforts.



Investment Belief: ESG is a Core Part of SBI Risk Analysis

Utilizing engagement initiatives to address environmental, social, and governance related issues can lead to positive portfolio and governance outcomes

In addition to specific engagement strategies the SBI might apply, proxy rights attached to shareholder interests in public companies are also "plan assets" of the SBI and represent a key mechanism for expressing SBI's positions relating to specific ESG issues. By taking a leadership role in promoting responsible corporate governance through the proxy voting process, SBI can contribute significantly to implementing ESG best practices which should, in turn, add long-term value to SBI's investments.

SBI Proxy Voting – Exercising Shareholder Rights

Proxy Voting

- The SBI currently votes all proxy rights for domestic equities internally. Non-U.S. rights are voted by external investment managers.
- The SBI establishes a Proxy Committee to review and vote proxies as necessary. The Board sets proxy voting guidelines.
- Most proxies are voted according to established precedents.

Proxy Highlights: 2019

- During the 2019 proxy season, the SBI voted proxies in over 1,900 annual meetings and cast votes on over 26,000 ballot items.
- The SBI voted **for** all shareholder proposals requiring a report on reducing the company's **greenhouse gas emissions**.
- The SBI voted **for** 78% of shareholder proposals on **environmental issues**.

Coalition and Membership Highlights: Aligning for Progress

United Nations Principles for Responsible Investment (UNPRI)

- SBI became a signatory in 2019.
- UNPRI works to achieve a global sustainable financial system that benefits the environment and society as a whole.
- SBI participates in UNPRI sponsored engagements and educational opportunities.
- Beginning in 2021, the SBI will report on climate related risks to the SBI's portfolio based on the reporting framework developed by the Taskforce on Climate-Related Financial Disclosures.

Ceres Investor Network

- SBI became a member in 2016.
- Ceres is a coalition of various institutional investors that provides resources and advocacy in addressing environmental investment risk.
- The SBI leverages Ceres organized engagements, educational opportunities, and research.
- Ceres provides its members with opportunities to engage through the Climate Action 100+, of which SBI is also a member.

Climate Action 100+

- SBI joined Climate Action 100+ in 2019.
- The coalition is investor-led and seeks to engage with companies to further the Paris Agreement, with support from Ceres and UNPRI.
- The SBI participates in company engagements with other members of the coalition.
- The coalition seeks commitments from companies to implement practices to address risks related to climate change.

Council of Institutional Investors (CII)

- SBI was a founding member.
- In recent years, the SBI has signed on to several letters regarding shareholder rights and governance issues addressed to the Security Exchange Commission (SEC) and United States Congress.
- SBI participates in CII organized events, conferences, and engagement opportunities.

Midwest Investors Diversity Initiative

- SBI joined the coalition in 2019.
- The coalition is a network of institutional investors located in the Midwest that seek broader diversity on corporate boards.
- The coalition engages with companies in the Midwest to promote diverse gender, racial, and ethnic participation on corporate boards.
- The SBI participates in coalition engagements and meetings.

Thirty Percent Coalition

- SBI joined the coalition in 2019.
- The coalition is a network of investors seeking to increase diversity on corporate boards, primarily by increasing the number of woman directors.
- The SBI participates in coalition engagements and meetings.

Recent Sign-on Efforts

- ❖ 2018 Global Investor Statement to Governments on Climate Change
- ❖ Investor Expectations on Deforestation (Ceres)
- ❖ Institutional Limited Partners Association (ILPA) Letter to SEC on Fiduciary Duty
- ❖ Climate Action 100+ Letter to General Motors
- ❖ Letter to Target Corporation Regarding Greenhouse Reduction Goals
- ❖ Investor Statement Regarding the Need for Corporate Gender Equity Transparency
- ❖ CII Letters Opposing Proposed Regulation of Proxy Advisory Firms
- ❖ Investor Statement on Pay Ratio Disclosure

Engagement Efforts

The SBI has currently undertaken two engagement initiatives for the 2020 proxy season:

Utilities: The SBI is actively participating in engagements with electrical utilities to promote transition to carbon neutral energy in order to mitigate climate risk along with financial and transition risks.

Board Diversity: The SBI is currently participating in engagements with specific companies to emphasize the material financial advantage of a diverse board. The SBI encourages companies to adopt a rule requiring at least one woman and one racial minority interviewed as part of the board candidate pool.

MINNESOTA STATE BOARD OF INVESTMENT

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