

MINUTES OF THE
INVESTMENT POLICY COMMITTEE
MEETING HELD
Thursday, September 15, 2016 – 8:30 A.M.

Present:

Committee Members

Marc Levine
Mark Cozzi
Ezequiel Flores
Steven Powell
Shari Greco Reiches

Board Members

Senator James F. Clayborne (via
phone)
Treasurer Michael Frerichs
Mary Seminara-Schostok

Staff

William Atwood
Genette Bacon
Christopher Brannan
Johara Farhadieh
Karen Fitts
Tondalaya Lewis-Hozier
Katherine Pantano
Scott Richards
Alise White

Guests

Burke Burns & Pinelli
Sarah Boeckman

Courtland Partners
Steve Novick (via phone)
Michael Humphries, Andrew Mitro

Financial News
Amanda McCue

Hamilton Lane
Sean Barber, Andrea Kramer

Harrison Street
Chris Merrill, Geoff Regnery

Meketa Investment Group
Frank Benham, Paul Crele, Ali
Wallace

MXO Tech
Brandan Cabrera

Pensions & Investments
Barry Burr

Platinum Equity
Mark Barnhill

Public Attendees
Leando Lynch

State Street Global Advisors
Fredrik Axsater, Brendan Curran

Unite Here
Jim Bauer

Vanguard
John Croke, William LeBarge

Illinois Treasurers Office
Rodrigo Garcia (via phone)
Jay Rowell

Absent: Committee Members None

ROLL CALL

Chairman Levine called the meeting to order at 8:40 a.m. Mr. Brannan called the roll and noted that a quorum was present.

Ms. Boeckman noted that all members of the committee were not yet present, but were expected to arrive shortly. To accommodate absent members, Trustee Reiches made a motion to go out of the regular order of business. Trustee Flores seconded and the motion passed unanimously.

Trustee Cozzi entered the meeting.

REPORT OF REAL ESTATE CONSULTANT: COURTLAND PARTNERS

Real Estate Portfolio Construction

Courtland Partners ("Courtland") representatives were invited to join the meeting to discuss various matters involving the real estate portfolio. Mr. Novick from Courtland referred Members to their presentation materials, "Illinois State Board of Investment Real Estate Portfolio Update". (Official Minutes contain attachment). Mr. Novick reviewed ISBI's real estate portfolio and noted that recent transactions previously approved by the Board are moving the portfolio towards the long term goal of core and non-core assets.

Trustee Powell entered the meeting.

Real Estate Investment Pipeline

Mr. Novick then discussed the investment pipeline set forth in the Committee Members' materials, noting that a large portion of the pipeline involves debt investments, which may increase the income component of investment returns. Mr. Novick also noted that opportunities with emerging managers are increasing and that Courtland hopes to bring these opportunities for the Committee's consideration at upcoming Board meetings.

Separate Account Dispositions

Mr. Novick discussed the efforts of Courtland, Clarion, and ISBI Investment Staff ("Staff") in winding down the Clarion Separate Account. Mr. Novick discussed one asset that has been sold in 2016, two additional assets with sales in process, and three additional assets with 2016 planned dispositions, including the assets in the Williston portfolio. Chairman Levine pointed out that the Williston disposition is basically a write-off due to a lack of value that would be realized in a current sale. Chairman Levine confirmed with Courtland that Clarion is doing everything it can to maximize long-term value for ISBI and stated that there is value in holding currently worthless assets as a result of holding rights to potential appreciation. Trustee Cozzi confirmed that the drop in value was related to the drop in shale oil prices and stated that even though the asset is worth less than the accompanying loan, there is potential value to be realized if ISBI can hold this asset until energy prices rise. Trustee Reiches asked what the loss would be upon a sale. Mr. Novick stated that Courtland will provide a memo to the Committee with this figure. Trustee Cozzi instructed Mr. Brannan to talk to bankruptcy counsel to determine the cost of continuing to hold this asset.

Performance Review

Mr. Mitro turned the Committee Members' attention to the Q1 2016 Performance Report Executive Summary in the Committee materials. (Official Minutes contain attachment). Mr. Mitro discussed the portfolio return breakout between asset appreciation and income returns. Mr. Mitro pointed out that income serves to mitigate risk, which is one attractive feature about the H/2 investment, which was approved at the June meeting. Mr. Mitro then discussed the overall percentage of leverage to market value of assets. The current real estate leverage percentage is very conservative and will rise in the future given non-core investment activity. Chairman Levine asked what leverage expectations ISBI has on the core and non-core assets. Mr. Mitro stated that the current goal is set as a high mark, but that the portfolio is unlikely to get there. Mr. Mitro discussed how managers want to leverage more due to very low interest rates, but that this would require increased monitoring to prevent variable rate exposure. Chairman Levine suggested the Committee have a "Real Estate" Education Day in which Courtland will present more information relating to ISBI's real estate portfolio benchmarking and the pipeline.

Harrison Street Real Estate Partners ("Harrison Street").

Mr. Mitro briefly discussed Courtland's recommendation to invest in Harrison Street Real Estate Partners Fund VI due to its resiliency during the last downturn. Harrison Street's alternative sector investments focus on real estate assets, such as student housing and medical care facilities, hold value and continue to produce income even during economic decline.

HARRISON STREET REAL ESTATE PARTNERS VI, L.P.

Representatives from Harrison Street were invited to join the meeting and referred Members to their presentation materials. (Official Minutes contain attachment). Harrison Street representatives noted that the proposed fund is seeking to invest in demographic and need based sectors. Instead of timing real estate cycles, Harrison Street seeks to invest in social infrastructure, such as facilities tied to education, healthcare, and storage. Most notably, Harrison Street focuses on off campus student housing and senior housing for individuals with health and memory issues. Justice Schostok joined the meeting. Following a review of the presentation materials and comments from Members, Chairman Levine thanked the representatives for their presentation to the Committee.

REPORT OF PRIVATE EQUITY CONSULTANT: HAMILTON LANE

Hamilton Lane representatives were invited to join the meeting to discuss their recommendation with respect to investing \$50 million with Platinum Equity Capital Partners ("Platinum"). Mr. Barber stated that Platinum is a top five firm in the private equity buyout space and that Hamilton Lane has had clients with Platinum since Fund I. Mr. Barber discussed Platinum's strength in value enhancement by improving operations and management of their portfolio companies. Trustee Reiches asked how Hamilton Lane determined its recommendation of Platinum and the \$50 million recommended investment versus other dollar amounts. Mr. Barber discussed ISBI's need to increase net investments in the private equity space due to its current asset allocation and that Hamilton Lane will discuss its methodology for selecting and recommending investments at the December meeting. Senator Clayborne joined the meeting via telephone. Trustee Cozzi made a motion to allow Senator Clayborne to participate in the meeting as a Board member via telephone due to matters relating to his employment pursuant to 7(a) of the Open Meetings Act. Chairman Levine seconded and the motion passed unanimously.

PLATINUM CAPITAL EQUITY PARTNERS IV, L.P.

Platinum representatives were invited to join the meeting to discuss their firm and their upcoming Fund IV. (Official Minutes contain attachment). Mr. Barnhill discussed Platinum's focus on hiring people with operations backgrounds across many industries who work directly with Platinum's deal team in finding value in potential investments. Senator Clayborne asked about Platinum's focus on diversity of its employees as well its selected vendors. Mr. Barnhill stated that Platinum believes that it is good business to be on the cutting edge in investing in companies that are owned and managed by minorities, females, and persons with disabilities. In addition, Platinum focuses on other socially conscious issues, such as raw material sourcing and overseas child labor. Following additional review of the presentation materials and comments from Members, Chairman Levine thanked Mr. Barnhill for his presentation to the Committee.

PRESENTATIONS BY TARGET DATE FUND FINALISTS

Representatives of Meketa Investment Group ("Meketa") briefly discussed the Board's prior approval to conduct an RFP process to select a retirement target date fund for participants in ISBI's deferred compensation plan (the "DC Plan") that had an actively managed glide path utilizing passive investment strategies. Meketa noted that the DC Plan currently provides a target date fund option managed by T. Rowe Price with fees of 37 basis points. The two RFP finalists, The Vanguard Group and State Street Global Advisors, provide target date fund options with fees of 5 basis points and 6 basis points, respectively. Meketa representatives stated that it is their recommendation to choose Vanguard, as it is the largest target date fund provider in the world and provides for the lowest fee option.

State Street Global Advisors

Representatives from State Street Global Advisors ("SSGA") were invited to join the meeting. SSGA representatives referred Members to their presentation. (Official Minutes contain attachment). Representatives discussed SSGA's target date fund strategic asset allocation and passive investments. Chairman Levine thanked the State Street representatives for their presentation to the Committee.

The Vanguard Group

Representatives from the Vanguard Group ("Vanguard") were invited to join the meeting. Vanguard representatives referred Members to their presentation. (Official Minutes contain attachment). Vanguard representatives discussed how its target date funds utilize only five asset class funds, including types of fixed income, equity, and international funds. Vanguard representatives described that despite having fewer funds than most target date fund strategies, each fund has many securities, providing for more diversification at lower fees than target date funds utilizing more funds, but with less underlying securities. Chairman Levine asked the representatives to discuss the federal law change in 2006 that led to the large increase in target date fund assets under management. Representatives described how part of the Pension Protection Act of 2006 led to automatic enrollment in target date funds in various retirement plans. Chairman Levine thanked the Vanguard representatives for their presentation to the Committee.

REPORT OF DEFINED BENEFIT CONSULTANT: MEKETA INVESTMENT GROUP **Defined Benefit Portfolio Review**

Meketa representatives referred Members to their presentation, "Illinois State Board of Investment Pension Fund Quarterly Review". (Official Minutes contain attachment.) Meketa representatives discussed current asset allocations versus the respective targets. Chairman Levine stated that he would like Meketa to provide more information in the future about performance attribution between manager selection and asset allocation. Meketa representatives then discussed performance of asset classes versus their assigned benchmarks as of June 30, 2016. Meketa representatives noted that due to the time it takes to implement the asset allocation adopted January 2016, these performance figures are tied to the previous asset allocation.

Implementation Plan-Checklist

Meketa representatives referred Members to their presentation, "Asset Allocation Implementation Plan Checklist". (Official Minutes contain attachment.) Meketa representatives discussed progress made towards moving assets in line with the Board's approved asset allocation. The Committee thanked Meketa and ISBI Staff on the progress made on the approved asset allocation.

REPORT OF DEFERRED COMPENSATION CONSULTANT: MEKETA INVESTMENT GROUP

Deferred Compensation Plan Overview

Meketa representatives referred Members to their presentation, "Illinois State Board of Investment Deferred Compensation Plan Quarterly Review". (Official Minutes contain attachment.) Meketa representatives summarized the investment option allocations chosen by DC Plan participants as well as the investment options' performance versus each one's assigned benchmarks. Meketa representatives noted that all active managers in the DC Plan underperformed their benchmarks.

Deferred Compensation Plan Industry – Legal Presentation by Fiduciary Counsel

Ms. Boeckman discussed the legal landscape in regard to past and potential litigation against various DC Plan administrators. Most notably, the United States Supreme Court held in 2008 that to bring a lawsuit for breaches of fiduciary duties, there only needs to be harm to an individual participant resulting from such breach, as opposed to showing harm to the whole DC Plan. Furthermore, there are many recent cases holding breaches in DC Plan administrators' fiduciary duties for (i) retaining high cost and poor performing managers and (ii) providing too many options. Ms. Boeckman stated that these holdings reflect the need for DC Plan administrators to monitor performance and cost of the plans, as well as whether the number of options exceed what's practical for a participant to make an informed decision. Ms. Boeckman also noted the importance of effective communications to DC participants. She noted that Mr. Atwood is considering utilizing a communications consultant in order to assist in developing effective communications for DC participants.

Trustee Reiches moved that the Committee moves into Executive Session pursuant to Section 2(c)(7) of the Open Meetings Act to discuss specific investment contracts related to the previous presentations. Trustee Cozzi seconded the motion and it was called to a Roll Call vote. All in Favor were: Trustees Cozzi, Flores, Reiches, Powell and Chairman Levine. The motion passed unanimously.

Guests and Staff were excused from the meeting with the exception of Director Atwood, Ms. Farhadieh, Mr. Brannan, Ms. Boeckman, Meketa representatives, Hamilton Lane representatives, and Courtland Representatives.

Trustee Reiches moved to return to the open meeting. Trustee Flores seconded and the motion passed unanimously.

After returning to the open meeting, Trustee Cozzi moved, consistent with the recommendation of Hamilton Lane, to invest \$50 million in Platinum Equity Capital Partners IV, L.P., subject to legal review and contract negotiations. Trustee Reiches seconded and the motion passed unanimously.

Trustee Flores moved, consistent with the recommendation of Courtland, to invest \$50 million in Harrison Street Real Estate Partners VI, L.P., subject to legal review and contract negotiations. Trustee Reiches seconded and the motion passed unanimously.

Trustee Powell moved, consistent with the recommendation of Meketa and ISBI Staff, to select The Vanguard Group as the Target Date Fund provider for the DC Plan. Trustee Reiches disclosed to the Committee that her firm uses Vanguard funds for her clients, but does not receive any fees from Vanguard. In addition, Trustee Reiches stated that she previously disclosed this to ISBI's General Counsel and Fiduciary Counsel. Ms. Boeckman and Mr. Brannan agreed that it was their legal opinion that it was unnecessary for Ms. Reiches to recuse herself from voting. Chairman Levine seconded and the motion passed unanimously.

Trustee Reiches moved to approve the Committee's open meeting meeting minutes from the June 15, 2016 and June 16, 2016 meetings of the Investment Policy Committee. (Official Minutes contain attachment for the open meeting minutes approved). Chairman Levine seconded and the motion passed unanimously. Trustee Reiches moved to approve the Committee's closed session minutes from the June 15, 2016 and June 16, 2016 meetings of the Investment Policy Committee and to keep those minutes closed, as recommended by Fiduciary Counsel, as they contain pending confidential matters. Chairman Levine seconded and the motion passed unanimously.

RECESS

At 12:15 p.m., Trustee Powell made a motion for a brief recess in order to permit ISBI's auditor to present on schedule during the Audit and Compliance Committee Meeting. Trustee Reiches seconded and the motion passed unanimously.

ROLL CALL

Chairman Levin reconvened the meeting at 12:50 p.m. Mr. Brannan called the roll and noted that a quorum was present.

Trustee Powell moved that the Committee moves into Executive Session pursuant to Section 2(c)(7) of the Open Meetings Act to discuss specific investment contracts related to. Trustee Cozzi seconded the motion and it was called to a Roll Call vote. All in Favor were: Trustees Cozzi, Flores, Reiches, Powell and Chairman Levine. The motion passed unanimously.

Guests and Staff were excused from the meeting with the exception of Director Atwood, Ms. Farhadieh, Mr. Brannan, Ms. Boeckman, and the Meketa representatives.

Trustee Powell moved to return to the open meeting. Trustee Reiches seconded and the motion passed unanimously. Treasurer Frerichs joined the meeting.

Trustee Flores moved, consistent with the recommendation of Meketa and ISBI Staff, to terminate Lombardia's Non-US Large Cap Equity strategy and transition the assets to the Ariel International Equity portfolio. Trustee Cozzi seconded and the motion passed unanimously.

Chairman Levine moved, consistent with the recommendation of Meketa and ISBI Staff, to terminate Decatur's Large Cap Equity portfolio and transition the assets to S&P 500. Trustee Reiches seconded and the motion passed unanimously.

Chairman Levine moved, consistent with the recommendation of Meketa and ISBI Staff, to eliminate the *Active Large Cap Value* asset class allocation, and consequentially, terminate *LSV Value Equity* and map the applicable assets to *Vanguard Institutional Index*, to be implemented by Investment Staff after a reasonable and prudent period of time, including the proper notification of Plan participants. Trustee Reiches seconded and the motion passed unanimously.

Chairman Levine moved, consistent with the recommendation of Meketa and ISBI Staff, to eliminate the *Passive Mid Cap Core* asset class allocation, and consequentially, terminate *Northern Trust S&P 400* and map the applicable assets to *Northern Trust Russell 2000*, to be implemented by Investment Staff after a reasonable and prudent period of time, including the proper notification of Plan participants. Trustee Cozzi seconded and the motion passed unanimously.

Chairman Levine moved, consistent with the recommendation of Meketa and ISBI Staff, to eliminate the *Active SMID-Cap Value* asset class allocation, and consequentially, terminate Ariel Investments and map the applicable assets to *Northern Trust Russell 2000*, to be implemented by Investment Staff after a reasonable and prudent period of time, including the proper notification of Plan participants. Trustee Cozzi seconded and the motion passed unanimously.

Chairman Levine moved, consistent with the recommendation of Meketa and ISBI Staff, to eliminate the *Active Small Cap Growth* asset class allocation, and consequentially, terminate Franklin Templeton and map the applicable assets to *Northern Trust Russell 2000*, to be implemented by Investment Staff after a reasonable and prudent period of time, including the proper notification of Plan participants. Trustee Cozzi seconded and the motion passed unanimously.

Trustee Cozzi moved, consistent with the recommendation of Meketa and ISBI Staff, to eliminate the *Active Non US Large Cap Growth* asset class allocation, and consequentially, terminate *INVESCO International Growth* and map the applicable assets to *Northern Trust MSCI ACWI ex. US index*, to be implemented by Investment Staff after a reasonable and prudent period

of time, including the proper notification of Plan participants. Chairman Levine seconded and the motion passed unanimously.

Trustee Reiches moved, consistent with the recommendation of Meketa and ISBI Staff, to eliminate the *Active Non US Small Cap Growth* asset class allocation, and consequentially, terminate *William Blair International Small Cap Growth* and map the applicable assets to *Northern Trust MSCI ACWI ex. US index*, to be implemented by Investment Staff after a reasonable and prudent period of time, including the proper notification of Plan participants. Trustee Cozzi seconded and the motion passed unanimously.

Chairman Levine moved, consistent with the recommendation of Meketa and ISBI Staff, to eliminate the *Active US Balanced* asset class allocation, and consequentially, terminate *Fidelity Puritan* and map the applicable assets to a similar target date fund, to be implemented by Investment Staff after a reasonable and prudent period of time, including the proper notification of Plan participants. Trustee Reiches seconded and the motion passed unanimously.

Chairman Levine moved, consistent with the recommendation of Meketa and ISBI Staff, to eliminate the *Active Core Fixed Income* asset class allocation, and consequentially, terminate *T Rowe Price Bond Trust* and map the applicable assets to *Vanguard Total Bond Market Index* to be implemented by Investment Staff after a reasonable and prudent period of time, including the proper notification of Plan participants. Trustee Powell seconded and the motion passed unanimously.

NEW BUSINESS/OLD BUSINESS

None.

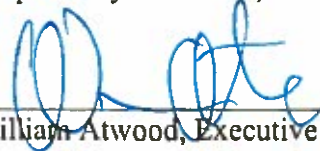
PUBLIC COMMENT

None.

NEXT MEETING AND ADJOURMENT

Chairman Levine stated that the next meeting of the Investment Policy Committee would be scheduled for December 14 at 1:00 P.M., official notices to be distributed at a later date. At 1:55 p.m., there being no further business to come before the Committee, Trustee Powell moved to adjourn the meeting. Trustee Cozzi seconded and the meeting was adjourned.

Respectfully submitted,



William Atwood, Executive Director

