

**MONTANA BOARD OF INVESTMENTS  
DEPARTMENT OF COMMERCE  
2401 Colonial Drive, 3<sup>rd</sup> Floor  
Helena, Montana**

**MINUTES OF THE MEETING  
October 4, 2012**

**BOARD MEMBERS PRESENT:**

Gary Buchanan, Chairman  
David Ageson  
Bob Bugni  
Karl Englund  
Mark Noennig  
Quinton Nyman  
Jack Prothero  
Jon Satre  
Jim Turcotte

**LEGISLATIVE LIAISONS PRESENT:**

Senator Ed Buttrey  
Representative Franke Wilmer – arrived 2:25 PM

**STAFF PRESENT:**

Jason Brent, CFA,  
Alternative Investments Analyst  
Polly Boutin, Accountant  
Geri Burton, Deputy Director  
Richard Cooley, CFA, Portfolio Manager,  
Fixed Income/STIP  
Dana Chapman, Board Secretary  
Frank Cornwell, CPA, Deputy  
Financial Manager  
Roberta Diaz, Accountant  
David Ewer, Executive Director  
Tim House, Investment Operations Chief  
Ethan Hurley, Portfolio Manager,  
Alternative Investments  
Ed Kelly, Alternative Investments Analyst  
Herb Kulow, CMB, Portfolio Manager,  
In-State Loan Program  
Tammy Lindgren, Accountant

April Madden, Accountant  
Gayle Moon, CPA, Financial Manager  
Rande Muffick, CFA, Portfolio Manager,  
Public Equities  
Chris Phillips DeFranco, CFA, Investment Staff  
Jon Putnam, CFA, FRM, Fixed Income  
Investment Analyst  
Nancy Rivera, Credit Analyst  
John Romasko, CFA, CPA, Fixed Income  
Investment Analyst  
Nathan Sax, CFA, Portfolio Manager,  
Fixed Income  
Clifford A. Sheets, CFA,  
Chief Investment Officer  
Steve Strong, Equity Investment Analyst  
Louise Welsh, Bond Program Officer  
Dan Zarling, CFA, Director of Research

**GUESTS:**

Jim Voytko, RV Kuhns and Associates  
Mark Higgins, RV Kuhns and Associates  
Kristin Finney-Cooke, CAIA, Senior Consultant, NEPC, LLC  
Kevin M. Leonard, Partner, NEPC, LLC  
Kris Wilkinson, Legislative Fiscal Division  
Angus Maciver, Legislative Audit Division  
Pat Murdo, Legislative Services  
Brad Sanders, Department of Administration, Procurement Bureau  
Paul Christofferson, CPA, Division Administrator, State Accounting Division

## **CALL TO ORDER**

Board Chairman Gary Buchanan called the regular meeting of the Board of Investments (Board) to order at 8:33 AM in the Board Room on the third floor at 2401 Colonial Drive, Helena, Montana. As noted above, a quorum of Board Members was present. Representative Franke Wilmer arrived at 2:25 PM. Chairman Buchanan welcomed Senator Ed Buttrey, the Board's newly appointed legislative liaison. Senator Buttrey is a weapons system designer by trade and has started and owned two electronics firms and other businesses over the years.

Chairman Buchanan called for any changes or revisions to the August Board Meeting Minutes.

Board Member Bob Bugni made a Motion to approve the Minutes of the August 22 and 23, 2012 Board Meeting; Member Jack Prothero seconded the Motion. The Motion was carried 9-0.

## **Public Comment**

Chairman Buchanan called for public comment on Board issues. There was no public comment.

## **Investment Consultant Finalist Interviews**

The final step, Step Two, of consensus scoring, Presentation/Oral Interview, for Investment Consultant Request for Proposal (RFP) #12-2189V was completed by the full Board. Presentations by the two finalists, RV Kuhns and Associates and NEPC, LLC, consisted of introductory remarks, responses to predetermined questions which both finalists received prior to the presentations, and a question and answer period. Each finalist was allotted 70 minutes for their presentation/interview. Jim Voytko, President, Chief Operating Officer, Director of Research, Senior Consultant, Principal and Mark Higgins, CFA, Associate Consultant, represented RV Kuhns and Associates. Kristin Finney-Cooke, CAIA, Senior Consultant and Kevin M. Leonard, Partner, represented NEPC, LLC.

The Presentation/Oral Interviews accounted for the remaining 25% of points available, determined by consensus of the voting members of the Board. The Department of Administration Procurement Bureau previously completed scoring for fees charged, accounting for 20% of the total points available, and MBOI staff previously completed consensus scoring for RFP sections 4.2.1 through 4.2.5, accounting for 55% of the total points available for each applicant.

At the conclusion of the two presentation/oral interviews, the Board discussed each presentation according to each of the three criteria included in the scoring:

- Thoroughness of the Presentation – 100 points
- Ability to Articulate the Offeror's Capabilities – 75 points
- Ability to Address Evaluation Committee Questions – 75 points

A roll call vote of individual scores awarded for each of the three sections by each of the nine voting Board members was conducted. Consensus scores for Step Two were 219 for RV Kuhns and Associates and 203 for NEPC, LLC.

Adding points for Step One and Step Two, the finalists' scores were 943 points for RV Kuhns and Associates and 854 points for NEPC, LLC.

Board Member Mark Noennig made a motion to authorize staff to proceed with contract negotiations with RV Kuhns and Associates. Member Jim Turcotte seconded the motion. The motion passed unanimously.

A complete record of the Investment Consulting Services' Request For Proposal process is on file at the State's Procurement Bureau.

Contract negotiations will be conducted by Executive Director David Ewer, Deputy Director Geri Burton, Chief Investment Officer Cliff Sheets and Brad Sanders of the Procurement Bureau. After a brief discussion regarding future expectations from RV Kuhns and Associates under the terms of the new contract, Member Satre suggested the need for communication with RV Kuhns and Associates expressing any areas where improvements could be implemented, such as an increase in educational presentations. Chairman Buchanan appointed Member Satre to the negotiation team and directed him to work with staff and Board members to compile a list of questions and concerns to discuss with RV Kuhns and Associates during the negotiations.

#### Public Comment

Chairman Buchanan called for public comment on Board issues. There was no public comment.

### **Private Asset Pool Reviews**

#### Private Equity (MPEP) and (MTRP)

Mr. Cliff Sheets, Mr. Dan Zarling and Mr. Ethan Hurley reported on the private equity and real estate pools. Mr. Sheets stated private equity and real estate have some advantages over stocks and bonds; however, there are additional risks with the asset classes. Private equity objectives include high returns, diversification, and the availability of unique strategies not otherwise available in traditional asset classes. The Board has been investing in private equity for over 20 years and the results have met the objectives. Our actual experience indicates we have enjoyed high returns with lower volatility vs. public equities. Mr. Hurley explained managers add value by revamping company fundamentals. These changes may entail reducing headcount, upgrading corporate governance, sales and marketing, and improving manufacturing efficiencies as well as changes in financing and management strategies, resulting in improvements in company performance. Some of the risks include financial leveraging, successful execution of management plans and the uncertainty of value realization until an actual transaction occurs that provides an exit from the investment. Compared with traditional investments, management fees are generally higher, although management fees on MBOI's direct fund commitments average 1.29% vs. peers at 1.65%. The majority of manager agreements for buyout funds require a minimum return hurdle of 8% and must return MBOI fees, expenses and capital before managers participate in profits. The Montana Private Equity Pool (MPEP) currently consists of venture capital (22.6%), buyouts (66.1%), distressed debt (9.7%) and mezzanine (1.6%). Of the 46 managers, 32 are key relationships which have performed consistent with expectations and would be considered for future commitments.

Mr. Hurley reviewed real estate. Real estate has many of the same risks as private equity, as business cycles are unpredictable, value is not realized until the transaction takes place and a high price is paid if liquidity is required. When MBOI entered the market in 2006, real estate values were at a cyclical high. Mr. Sheets added while new fund offerings were limited during the financial crisis, some fund commitments were made each year. In 2010 there was an aggressive, explicit timing decision to add to our core fund holdings. Mr. Hurley noted management costs for non-core closed end funds are comparable to private equity. The Montana Real Estate Pool (MTRP) currently includes core open-end funds (42.3%), timberland (5.8%), non-core value add (30.7%) and opportunistic funds (21.2%). Mr. Sheets noted real estate is a relatively new program for MBOI and provides significant diversification versus stocks, one of its primary objectives. Since inception returns have not fulfilled expectations, although market timing and the J curve effect on early closed-end fund commitments impacted the early days, causing an initial performance drag. Nevertheless, the long term outlook for this asset class is promising.

Mr. Hurley advised the MPEP strategy going forward will include a bias towards smaller market cap buyout and growth strategies since less efficiency here creates opportunity, and reaffirmed the reliance on fund-of-funds will be decreased. Mr. Sheets added exit strategies are always considered. Mega cap funds are not as flexible in how they realize investments, while small and mid caps offer more flexibility on exit strategies. The "natural liquidity" of the private equity pool, or

the distributions of income, profits and return of capital, has been strong and a positive year to date, therefore the pool has provided liquidity on a net basis. The opposite is true with real estate, as low distributions continue while the market is still in recovery.

Member Bugni inquired about the monitoring of private equity and if RV Kuhns could offer assistance with the attributes database for performing due diligence on new funds.

Mr. Zarling noted that due diligence checklists are utilized for both private equity and real estate, then went on to describe some of the many areas that are reviewed pursuant to a manager/fund decision. In 2011, staff had 51 meetings with general managers who came in for presentations and 2012 is on track for at least that amount. Potential new managers go through a rigorous screening process. After a side-by-side comparison of potential managers the analysts send out a spreadsheet requesting data to facilitate a common analytical approach to historical return information. The process can stop depending on the data received; otherwise a conference call is scheduled for team introductions and to gather information on the manager's organization structure and firm history. The next step is an onsite visit to MBOI for an interview. The GP is sent questions in advance which are addressed in the interview. The process can last eight weeks, and a second interview may be scheduled. The due diligence process also entails reference checks for both listed and off-list contacts.

Mr. Hurley advised all managers are monitored on an ongoing basis. When general partners come back with subsequent funds, a full scale review of each checklist item is performed as well as regular quarterly reviews. Staff sometimes attend annual meetings and managers often visit in our offices to provide updates.

Mr. Sheets noted the most important resource is internal staff, including three analysts: Mr. Ed Kelly, Ms. Teri Kolnik and Mr. Jason Brent. In addition to the analysts, Ethan as alternatives portfolio manager, and Dan as research director participate as the "alternatives team." In his role as CIO, Mr. Sheets attends most GP meetings, and ultimately decides on commitments and commitment amounts after considering staffs' recommendations. Private Edge is used as the administrator; they calculate performance of each individual fund. BOI uses outside counsel to conduct a legal review. BOI does not employ a specialist consultant for alternatives at this time, which would come at a considerable cost; however, RV Kuhns may assist staff in certain aspects of the overall programs such as with pacing studies. Mr. Sheets added while we have some risk by being internally dependent, for the most part we are not lacking by not having a specialty consultant.

## **CASH MANAGMENT**

Executive Director David Ewer, Gayle Moon, CPA, Financial Manager, Richard Cooley, CFA, STIP Portfolio Manager, and Paul Christofferson, CPA, Administrator, State Accounting Division reported on cash management. Mr. Christofferson noted that daily communication with Mr. Cooley relays cash flow needs. Policies with the agencies require them to liquidate STIP prior to incurring a negative cash status. Treasury manages 63 active bank accounts with a possibility more will be needed in the future. Member Prothero inquired if BOI could do anything to improve the procedures. Mr. Christofferson reported the team works well and BOI does a great job.

Mr. Cooley reviewed the daily STIP procedures. STIP's main client is the Treasurer's Fund. Each day US Bank Single Point is used to run a custom report which shows the beginning balance, or starting point, for investments for the day. Then the State Street Bank (SSB) forecast from the night before is input. Three million is left in the sweep account each night and liquidity minimums of \$150 million daily and \$250 million weekly are adhered to. With the minimums accounted for, excess cash is invested and the SSB wire is firmed up and authorized for accounting. At the end of the day and throughout the day as needed, Single Point is checked to be sure expected large wires have

come in, inform the Treasurer's Office, and by 10:00 a.m. the \$3 million minimum is left in the account. The Treasurer's Office and BOI are the only entities who can wire funds out.

Member Prothero asked what liability the Board would have if there was a problem with a transaction. Mr. Cooley stated he didn't believe the Board would face any liability. Mr. Christofferson added US Bank provides backup overdraft protection of \$25 million.

Ms. Gayle Moon reviewed the detailed cash movement procedures for STIP, Commercial Loans, Alternative Equities, Equity trades and the Sweep account. The daily SABHRS transactions are verified by Ms. Moon and Mr. Frank Cornwell.

Executive Director Ewer added the state's servers are housed in the new data center located in Helena and are backed up at the second new data center, located in Miles City. This setup allows the state system to operate on a dual system providing a secure backup.

### **SECURITIES LITIGATION**

Executive Director David Ewer, Tim House, Equity Analyst/Investment Operations Chief and Greg Gould, Luxan and Murfitt, PLLP, reported on securities litigation. Director Ewer advised that as a manager of \$13 billion in assets, there will be lawsuits. BOI is usually a participant on the recovery side in class action suits, however there are cases where the Board will take a lead role and recovery varies widely. Specific governance policies and guidelines related to securities litigation are followed. Custodial bank State Street Bank of Boston is contracted to handle securities litigation and has done a good job handling BOI participation in class action suits. BOI utilizes the services of primary general counsel Luxan and Murfitt, PLLP and two monitoring firms Barrack Rodos & Bacine and Bernstein, Litowitz, Berger & Grossman, LLP. In the recent case of Pfizer, the Board is exploring whether involvement at a higher level is warranted before going forward and entering into a class action.

Mr. House added class action dockets are available on My State Street which allows viewing of all lawsuit documents. Additionally, monthly reports from the two monitoring firms are provided.

Member Bugni commented the BOI has a long history with Luxan and Murfitt. He inquired if the Attorney General, who would usually defend cases for state agencies, but has no specific expertise in these types of cases, has any input in the way cases are handled.

Executive Director Ewer stated he has had no specific conversations with the Attorney General's office regarding securities litigation cases. Mr. Ewer added the Governor's Office Legal Review Committee has to approve any state agency seeking outside legal counsel. Requests requiring specialized legal expertise are normally approved.

Mr. Gould reviewed the type of legal work Luxan and Murfitt performs for BOI. Work includes legal contract work, leases, bond issues and specialized bond counsel as well as private equity partnership contracts. Securities litigation is extremely specialized and large cases are resource intensive, so class action suits are thoroughly reviewed to determine if a larger role is needed.

Member Bugni asked if our consultant RV Kuhns has a role in securities litigation.

Mr. Ewer advised in these cases they could offer another set of eyes.

Mr. Voytko added that while RV Kuhns are not attorneys, they would take a look at the investment theory of the losses with respect to foreign exchange issues that have been in the news lately and may be able to offer some insight.

Mr. Gould stated the Chicago Tribune case is a different kind of case as BOI is a defendant. The 150 page complaint states the Tribune bought back shares of stock then ended up in bankruptcy so creditors are suing all parties involved in the stock buyback on a fraudulent conveyance claim. The case is being watched closely and the option of joining in the class as defendants will be considered if it is determined to be advantageous.

#### Public Comment

Chairman Buchanan called for public comment on Board issues. There was no public comment.

#### Human Resource Committee Report

The Human Resource Committee met prior to the Board meeting. Committee Chair Karl Englund reported on revisions to the Exempt Staff Pay Plan Policy. The Committee approved the policy unanimously.

Committee Chairman Englund made a motion to approve the revised Exempt Staff Pay Plan Policy, Member Satre seconded the motion.

Chairman Buchanan called for discussion.

Senator Buttrey inquired if the changes have any impact on funding and commented that the 2012 McLagan Salary Survey and 2011 Bank Salary Survey (Montana/Wyoming) would suggest the need to increase the pay scales. Chairman Englund advised the policy does not commit the money and the surveys establish ranges only, the salaries can be determined within those ranges.

Executive Director Ewer added there is an absolute dollar amount for the Board's budget for fiscal year 2013 of \$4.8 million which must be adhered to and is part of the consideration when determining salaries.

Member Noennig added the policy states "may" which leaves room for discretionary choices.

Chairman Englund revised his motion to approve the Exempt Staff Pay Plan Policy, revising one word on page 1 under "Establishment of Pay Ranges" revising the word **should** to read "A salary survey of organizations similar to the board **will** be conducted periodically to assist the Board in establishing "market" pay rates for comparable positions." The motion passed unanimously.

Chairman Englund moved to approve the updated salary survey table in the Exempt Staff Pay Plan Policy based on the 2012 McLagan Salary Survey and 2011 Bank Salary Survey (Montana/Wyoming). Member Aageson seconded the motion. The motion passed unanimously.

### EXECUTIVE DIRECTOR'S REPORT

#### Budget Follow Up

Executive Director Ewer reviewed the FY14 and FY15 budget submission. The amounts submitted by the Department of Commerce are \$5,109,144 for the BOI Internal Service Fund. The ISF is the Investment side, and \$1,658,269 for the BOI Enterprise Fund which is the Bond Program side. The new Governor has until January 7 to make any changes before the appropriations process begins with the Legislative Appropriations Committee.

Private Equity Fund of Funds Management Fee – Follow Up

Executive Director Ewer reported, at the direction of the Board at its August meeting, staff obtained Fund of Funds management fees paid for calendar year 2011. The fees totaled \$3.947 million, substantially less than the CEM Survey estimate.

Chairman Buchanan inquired if the Fund of Funds fees needed to be reported. Mr. Ewer advised, as an indirect cost, they are not required to be booked under state or Board financial guidelines. Ms. Moon added the costs would not be recorded on the state accounting system.

Chairman Buchanan noted it would be beneficial to lower the fees each year if possible.

Mr. Sheets added that CEM should be given the fee information as obtained. He also stated the fees are a best estimate, and are not derived from audited financial statements.

Member Satre inquired of Mr. Hurley how difficult obtaining the fee information had been. Mr. Hurley stated some information was readily available and all requested information was provided within three weeks of the request to the managers.

To Do List

Chairman Buchanan called for items to add to the to do list. Member Prothero suggested information on upcoming training continue to be provided when available. Executive Director Ewer noted he would continue to pass along relevant information to the Board as he receives it.

Chairman Buchanan suggested that an out of town meeting be added to the 2013 Board Meeting Schedule and proposed holding the May meeting in Billings at the newly renovated Northern Hotel. Local banking representatives and other community members may want to attend. Other communities could also be considered for future meetings if desired.

Deputy Director Geri Burton advised the draft 2013 Board Meeting Schedule will be on agenda for the November Board meeting and will be presented at that time.

**ADJOURNMENT**

There being no further business, Chairman Buchanan adjourned the meeting at 4:49 PM.

Next Meeting

The next regular meeting of the Board will be Tuesday and Wednesday, November 13 and 14, 2012 in Helena, Montana.

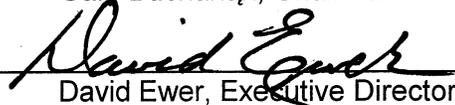
*Complete copies of all reports presented to the Board are on file with the Board of Investments.*

**BOARD OF INVESTMENTS**

APPROVE: \_\_\_\_\_

  
Gary Buchanan, Chairman

ATTEST: \_\_\_\_\_

  
David Ewer, Executive Director

DATE: \_\_\_\_\_

November 13, 2012