

SPECIAL EDITION

YOUR VESTED INTEREST

North Dakota State Investment Board

July 2010

SIB Hires Interim Executive Director/CIO

The State Investment Board (SIB) recently hired LeRoy "Gil" Gilbertson as interim Executive Director and Chief Investment Officer (CIO) for the Retirement and Investment Office (RIO). With over 30 years of public pension investment experience, Gil is well qualified to serve the state until a permanent replacement for former CIO, Steve Cochrane, is hired.

Gil is a North Dakota native and received his Bachelors Degree from Minot State University, and Masters Degree from the University of North Dakota. He has held the positions of ND Banking Commissioner and CIO of the ND Public Employees Retirement System and the ND State Investment Board. Gil was also Administrator/CIO for Kern County, California Employees' Retirement Association, and Director

of the Arizona State Retirement System from which he retired in 2003.

Since his retirement, Gil has been a member of the AARP National Policy Council and has testified before various United States Congressional committees. He has also served on panels for the Financial Industry Regulatory Authority.

We are pleased that Gil has returned to North Dakota to oversee the state's investment program during this transition period.



*LeRoy "Gil" Gilbertson
Interim Executive Director/CIO*

SIB Announces Two Independent Audits

RIO will have two independent external audits conducted this summer – a financial audit and a performance audit.

The State Auditor's Office has contracted with Eide Bailly LLP to perform the annual financial audit of RIO. Fiscal year 2010 is the second year of the three year contract. The annual financial audit is an independent external audit which provides an opinion on the financial statements for the year ending June 30, 2010 and also reviews internal controls over financial reporting. The 2010 financial audit report is expected to be delivered in October.

In addition, the SIB, through its Audit Committee, also decided to have a performance audit conducted by an independent external auditor. With input from the State Auditor's Office and SIB Audit Committee, the State Procurement Office issued an RFP in May. The objective of the performance audit is to determine whether the former Executive Director/Chief Investment Officer (ED/CIO) complied with the policies of the SIB, state law and common industry practice, and whether there was any irregular financial activity or discrepancies related to that position. The performance audit will also include a review of the process of selecting, retaining, and compensating money managers, reasonableness of negotiated fees, and verification of investments into designated asset classes. The initial scope and time frame may be extended based on the audit firm's recommendations.

The SIB has selected Clifton Gunderson LLP to conduct the performance audit. Clifton Gunderson is one of the nation's largest certified public accounting and consulting firms and provides a wide range of assurance, tax and consulting services. The performance audit report is scheduled for delivery in late August.

The fall SIB newsletter will include a summary of findings and recommendations of both the annual financial audit and performance audit.

State Investment Board (SIB)

Lt. Governor Jack Dalrymple, *Chair*
Clarence Corneil, *TFFR Trustee, Vice Chair*
Jeff Engleson, *Acting Land Commissioner*
Levi Erdmann, *PERS Trustee*
Mike Gessner, *TFFR Trustee*
Adam Hamm, *State Insurance Commissioner*
Howard Sage, *PERS Trustee*
Mike Sandal, *PERS Trustee*
Kelly Schmidt, *State Treasurer*
Cindy Ternes, CPA, *(Alternate) WSI*
Bob Toso, *TFFR Trustee*

RIO Administrative Office

LeRoy Gilbertson, *Interim Exec. Dir./CIO*
Fay Kopp, *Deputy Executive Director/
Retirement Officer*
Shelly Schumacher, *Editor*

ND Retirement and Investment Office

1930 Burnt Boat Drive, P.O. Box 7100
Bismarck, ND 58507-7100
701-328-9885, Toll free: 1-800-952-2970
www.nd.gov/rio

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Observations from the Interim Executive Director/CIO

I have been serving as interim Executive Director and Chief Investment Officer (ED/CIO) of the Retirement and Investment Office (RIO) since May 10, 2010.

At RIO there has been a great deal of activity since that time.

- The North Dakota State Investment Board (SIB) retained an executive search firm, EFL Associates, to do a nationwide search for a permanent ED/CIO.
- The SIB retained an auditor, Clifton Gunderson, to conduct a performance audit.
- The North Dakota Teachers' Fund for Retirement (TFFR) is having a new asset allocation study completed.
- The North Dakota Public Employees Retirement System (PERS) is in the process of negotiating a contract for an asset allocation study.
- The annual financial audit performed by Eide Bailly LLP is also in process.

I have been holding meetings with investment managers and reviewing the portfolios they manage for the SIB. My observations after several meetings are:

- The SIB is carrying out its fiduciary responsibility.
- The North Dakota pension funds have fared no worse or no better than any other state pension fund across the nation. The stock market downturns in recent years took its toll on all pension funds. The problems North Dakota faces, however, are not insurmountable.
- The SIB does not invest in what some would refer to as "risky" investments. The SIB controls risk in the portfolios in several ways:

1. Diversifying the Portfolio

- The pension portfolio is invested in traditional investments such as stocks and bonds. This portfolio has a target allocation of 39% to U.S. stocks and 25% to U.S. fixed income.
- Because today's global economy offers investment opportunities and

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greater diversification, the pension portfolio has a target allocation of 18% to international stocks and 5% to international fixed income.

- Over the long term, real estate has proven to be an excellent hedge against inflation. The pension portfolio has a target allocation of 7% to diversified real estate.
- Because you don't want to put all your eggs in one basket, the pension portfolio also has a target allocation of 5% in alternative investments. These investments are expected, over time, to add value to the portfolio. Alternative investments actually reduce risk in a total portfolio because they provide diversification from the more traditional investments.
- The pension portfolio has a target allocation of 1% to cash equivalents securities which is used for short-term liquidity needs.
- In addition to the broad asset classes described above, the portfolios are further diversified through various investment strategies within each asset class.

2. Hiring Professional Investment Managers

- All investment managers are registered investment advisers.
- All investment managers have a proven track record when hired.
- All investment managers are continually monitored by RIO staff and an external consultant.

- The securities the funds invest in are kept in safe keeping in a nationally recognized custodial bank, The Northern Trust. No investment manager is given money to hold until they invest it.

3. Establishing Investment Guidelines and Policies

- Portfolios are not invested in hedge funds.
- Derivatives are not allowed to be used for speculation purposes. Investment managers use derivatives only as short term substitutes for normal equity or bond positions, such as S&P 500 futures, international stock futures, or bond futures. It is a low risk, cost effective way to maintain asset allocation exposure in the stock and bond markets. The goal is to stay within the asset allocation guidelines of the various funds.
- The international investment managers have guidelines that they utilize to control currency risk. The investment managers are not hired to speculate as to what a currency in any particular country, including the U.S. dollar, is going to do against another. The SIB uses a well known international benchmark. This allows the investment managers to hedge up to 50% of their portfolios to control currency risk.
- Investment managers are monitored to ensure they meet investment objectives and follow guidelines.

In conclusion, the members of the SIB are taking their responsibilities seriously and have given me their full support. That in itself makes my time here at RIO very productive and enjoyable. And finally, the RIO staff is very dedicated, professional, and knowledgeable which has been a tremendous benefit to me as I carry out my responsibilities. My thanks and appreciation goes out to the SIB members and RIO staff.

How Does the SIB Investment Program Work?

The SIB manages approximately \$5 billion of investments for 25 various pension and insurance trust funds. The program is administered by the Retirement and Investment Office. Under either statutory or contractual authority, the SIB invests the assets of 12 various state and 13 political subdivision funds. Examples include Public Employee Retirement System (PERS), Teachers' Fund for Retirement (TFFR), Job Service, and Workforce Safety and Insurance (WSI).

other governing authority. That policy statement is then presented to the SIB for acceptance and implementation.

The SIB's Chief Investment Officer (CIO) provides research and recommendations to the SIB regarding investment managers and strategies to best maximize returns for the levels of risk stated in the policies. The Board also employs an investment consultant, Callan Associates, who provides additional input regarding investment

investment consultant and custodian bank. They also maintain separate accounting and reporting of each individual fund and monitor fund and manager guidelines and asset allocations.

The SIB utilizes 41 professional investment managers to implement 112 specific mandates or investment strategies to further diversify the portfolio. These investment managers make the day-to-day buy and sell decisions within the portfolios and report to RIO staff regularly. They also provide investment education to the SIB.

In addition to providing investment manager search services, the investment consultant also provides performance measurement services, education and assistance with special projects such as the investment fee study that they are currently conducting.

The Board also has a custodian bank relationship with The Northern Trust Company. They provide record-keeping and safe-keeping services for all the investment accounts as well as settlement of trades.

The SIB investment program is a highly sophisticated and complex operation. To help you better understand how your pension funds are invested, a list of frequently asked questions has been posted to the SIB website at <http://www.nd.gov/rio/SIB/FAQ.htm>.

Information regarding historical investment performance is included in the Frequently Asked Questions, however final performance data for the fiscal year ended June 30, 2010, is not available as this newsletter goes to print. Final reconciled data and rankings will be presented in the next SIB newsletter.

SIB Investment Program Overview

Asset Liability Analysis

- Individual board/client contracts with consultant to conduct asset liability study.
- With input from CIO, various optimal portfolios are developed by consultant, and considered by board.

Investment Policy Statement

- With input from CIO and RIO staff, investment policy statement is developed.
- Preferred target allocation is integrated into investment policy statement.

Board Approval and Acceptance

- Individual board/client approves investment policy statement.
- Investment policy statement is presented to SIB for acceptance and implementation.

SIB Implementation

- CIO provides research & recommendations to SIB regarding investment strategies & managers to best maximize returns for stated levels of risk based on investment policies.
- SIB makes investment hiring decisions.

RIO administration

- RIO administers investment strategy approved by SIB.
- RIO is "manager of managers" and is liaison between SIB and custodian bank, investment managers, and investment consultant.

The governing body of each fund is responsible for setting the investment goals, objectives and asset allocation. The individual pension fund board or other governing authority generally contracts with an external consulting firm to provide asset/liability analysis used in determining the appropriate asset allocation.

A Statement of Investment Policy, which includes the asset allocation chosen, is developed and approved by the individual pension board or

management firms and products. The SIB makes the final decisions on the hiring of individual investment managers. Similar funds are pooled together for cost effectiveness and efficiency of operations.

Once the investment managers are hired, it is the job of RIO staff to administer the daily operations of the investment program. On behalf of the SIB, RIO staff is a "manager of managers." They act as a liaison between the SIB, investment managers,



**NORTH DAKOTA
RETIREMENT AND
INVESTMENT OFFICE**
*Teachers' Fund for Retirement
State Investment Board*

1930 BURNT BOAT DRIVE
P.O. BOX 7100
BISMARCK, ND 58507-7100

PRESORTED
STANDARD
U.S. POSTAGE
PAID
PERMIT NO. 325
BISMARCK, ND
58501

SIB Hires Executive Search Firm

After a competitive bidding process conducted by the ND State Procurement Office and SIB Search Committee, the SIB has selected EFL Associates (EFL) to provide executive recruitment services to fill the position of Executive Director/Chief Investment Officer (CIO) for RIO.

EFL is a management consulting firm specializing solely and exclusively in executive searches. Mary Hobson, Executive Vice President and Leader of EFL Associates'

Pension Practice, in their Denver office, will lead the recruitment team. She has handled over 250 executive search assignments, including numerous Executive Director and CIO searches for public pension plans throughout the country.

Recruitment for the position began in July. Target date for hiring the new Executive Director/CIO is fall 2010.