

ACTION SUMMARY

INVESTMENT COMMITTEE

July 21, 2016

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MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

July 21, 2016

1. a. CALL TO ORDER

A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at 12:00 p.m. in the Educational Retirement Board Conference Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

Members Present:

Mr. H. Russell Goff, Chair
Ms. Mary Lou Cameron [by phone]
Mr. Larry Magid

Members Excused:

None

Staff Present:

Ms. Jan Goodwin, Executive Director
Mr. Bob Jacksha, CIO
Mr. Pete Werner, Fixed Income Portfolio Manager
Ms. Susanne Roubidoux, Deputy General Counsel
Mr. Aaron Armstrong, Portfolio Manager
Ms. Marla Medina, Financial Analyst
Ms. Margaret Riquelmy, Executive Assistant

Others Present:

Mr. Kevin Tatlow, Top Tier [by phone]
Ms. Judith Beatty, Recorder

b. Approval of Agenda

Mr. Magid moved approval of the agenda, as published. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

c. Approval of Minutes: June 23, 2016

Ms. Cameron moved approval of the June 23 minutes, as submitted. Mr. Magid seconded the motion, which passed unanimously by voice vote.

d. Introduction of Guests

Ms. Goodwin introduced Susanne Roubidoux, the NMERB's newly hired Deputy General Counsel.

2. LIGHTYEAR FUND IV – PRIVATE EQUITY

[Presenters: Steve Neel and Top Tier consultant Kevin Tatlow, who was on the phone]

Mr. Neel presented staff's recommendation of a \$50 million commitment to Lightyear Fund IV. Lightyear Capital is targeting \$900 million with a hard cap of \$1.2 billion, to continue the firm's strategy of investing in North America-based middle market financial services companies.

- NMERB is invested in Fund III, which has returned a 20 percent net IRR with a 1.5x multiple.
- Lightyear is a financial services sector focused fund, which employs a flexible capital strategy within financial services. They break financial services down into asset management, banks, brokerage, financial technology, insurance and specialty finance.
- This is a lower volatility strategy. Lightyear employs less leverage than their peer buyout funds, which NMERB finds very appealing.
- Lightyear normally employs two partners per portfolio company for underwriting. Most firms will employ one partner and an associate.
- Lightyear has completed a generational transition from former managing partner Don Marron (who will assume an emeritus role) to Mark Vassallo.
- The fund will seek to build a diversified portfolio of 10 to 12 companies in financial service in areas where Lightyear believes industry trends will lead to compelling opportunities for the fund.
- Lightyear is targeting a fund size of \$950 million. The prior fund is \$954 million. If Fund IV reaches the hard cap of \$1.2 billion, it will be about 30 percent larger than the prior fund, which will allow Lightyear to continue to target investment opportunities of the same size as the prior fund.
- One of Lightyear's investments has a presence in New Mexico through First National Bank of Santa Fe and Bank of the Rio Grande.

Mr. Tatlow said the market environment continues to be interesting for the financial services platform, and there is a steady flow of carve-outs in the financial services sector, which are complicated deals that Lightyear has developed expertise in. Their better performing deals have in fact been carve-outs. The firm is able to generate significant proprietary deal flow despite the competitive market, due to their sector focus.

Mr. Tatlow said this is a lower risk, lower leverage approach to investing. The general partner is well aligned with investors, with 3 percent committed.

Lightyear managing directors Michael Doppelt and Stewart K.P. Gross appeared before the committee and made a presentation.

Ms. Goodwin asked what efforts are being made to promote diversity among the staff and partners. Mr. Doppelt responded that they do not have a formal program in place for diversity, but throughout their history, they have always had different ethnic and minority groups as members in the firm, with women in senior positions. He said it has never been an issue of any kind for them.

Mr. Gross added that Lightyear has just hired a senior woman from one of the consulting firms as part of expanding their universe of professional women. He added that it is very hard to find women in the field of private equity.

[Representatives left the meeting.]

Mr. Jacksha said this is a group that the NMERB knows quite well through sitting on their advisory board. The group is in a specialty area that the NMERB does not have a lot of coverage on, so from a portfolio standpoint it makes sense to add it. As a follow on investment, this is a group that has done what they said they would in the previous fund.

Mr. Magid moved that the Investment Committee approve a commitment of \$50 million to Lightyear Fund IV, L.P. The commitment is subject to New Mexico State Law, Educational Retirement Board policies, Educational Retirement Board approval for placement agents and negotiation of final terms and conditions, and completion of appropriate paperwork. In addition, the Investment Committee grants staff discretion to invest an additional amount, not to exceed \$10 million, in secondary partnership interests offered by other limited partners in the fund, should they become available from time to time, under the Right of First Refusal of the limited partnership agreement for this fund. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

3. CORE FIXED INCOME REVIEW

Mr. Jacksha stated that, during FY13, the NMERB Board of Trustees approved an initiative to move \$1 billion in externally managed fixed income assets back in-house to be managed by internal staff. The rationale was cost reduction to NMERB versus external management; better control over assets and liquidity; to put NMERB at the leading edge of an industry trend; and develop a professional investment network in New Mexico.

Mr. Jacksha said cost savings were originally estimated at about \$500,000 per year, which was based on a projected lower amount of 6 percent of assets. He said actual savings have been greater at about \$1 million, due to a larger core bonds allocation.

Mr. Werner made a presentation to the committee.

Mr. Werner noted that, while it is rather difficult to earn a respectable return in the current rate environment, portfolio returns currently exceed 5 percent; up until about two weeks ago, they were beating the S&P.

Mr. Jacksha stated that Mr. Werner is the sole portfolio manager at the current time, and NMERB is currently recruiting. Mr. Jacksha noted that the salary being offered is about \$50,000 less than what is available elsewhere, but the higher amount is part of the NMERB's exempt plan.

Mr. Jacksha commented that recruiting from out of state is particularly frustrating because NMERB is not permitted to pay for a candidate's plane ticket, hotel, and other expenses, including moving expenses.

Committee members agreed that work currently underway to look at future statutory upgrades should include changes in this area.

Mr. Jacksha presented operational highlights:

- NMERB has authorization to hire a research analyst this fiscal year, and will focus on that after bringing the portfolio manager on board.

- With respect to derivatives implementation, staff is working on swap agreements with two counterparties. This is challenging because of the specifics of New Mexico laws.

- Staff continues to look for operational efficiencies. A group that does consulting for State Street's clients came in and did a best practices review. One item that was suggested is a trade order management system that is done electronically rather than manually. NMERB needs only a small part of the capabilities of this otherwise expensive system and hopes to negotiate a lower price that would justify the expense in the long run.

- Staff is also looking at systems for due diligence and monitoring. All of the due diligence notes, presentations, emails, etc. can be stored in one place, which allows for much better organization and efficiency.

In closing, Mr. Jacksha stated, "We came to the board with an idea, got authorization, we formulated a plan to move these assets internally, got all the approvals, *et cetera*. We executed that plan and met the original objectives." He thanked Kay Chippeaux and Pete Werner for their work.

4. Q4 2015 PE PERFORMANCE

[Presenters: Mr. Neel and Top Tier consultant Kevin Tatlow.]

Mr. Neel and Mr. Tatlow presented this report, with the following highlights:

- The New Mexico ERB Private Equity Portfolio experienced a positive fourth quarter return of 1.8 percent and a one-year return of 11.0 percent.

- The portfolio has achieved a since-inception return of 12.6 percent and multiple on invested capital of 1.35x.

- At year-end, the portfolio has \$2.3 billion in net commitments to 59 private equity funds with 41 different managers.

- The NMERB Private Equity Portfolio is 100 basis points better than the Russell 3000 index.
- In NEPC's peer universe, the portfolio is in the top quartile for the 1-year, 3-year and 5-year time periods, and is #1 in the universe for the 5-year period.

5. OTHER INVESTMENT REPORTS AND DISCUSSION

Mr. Jacksha distributed a list of recent buys and sells.

Mr. Jacksha said June returns are expected to be positive (40-90 basis points), or about 2 percent to 2.1 percent for the year.

6. NEXT MEETING: THURSDAY, AUGUST 25, 2016

Meeting was scheduled from 12:00 to 3:30 p.m.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 2:15 p.m.

Accepted by:



H. Russell Goff, Chairman