MINUTES OF THE

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

REGULAR MEETING

August 23, 2019

1. a. ROLL CALL: QUORUM PRESENT

A Regular Meeting of the New Mexico Educational Retirement Board was called to order on this date at 9:00 a.m. at the NMERB offices at 8500 Menaul Boulevard, Suite A-319, Albuquerque, New Mexico. A quorum was present.

Members Present:
Ms. Mary Lou Cameron, Chairwoman
Mr. H. Russell Goff, Vice Chairman
Mr. Larry Magid, Secretary
Mr. Adan Delgado, Deputy Secretary, PED
Dr. Donald W. Duszynski

Members Excused:
The Hon. Tim Eichenberg, New Mexico State Treasurer

Staff Present:
Ms. Jan Goodwin, Executive Director
Mr. Roderick Ventura, Deputy Director
Mr. Bob Jacksha, Chief Investment Officer
Ms. Susanne Roubidoux, General Counsel
Mr. Steve Neel, Deputy CIO, Alternative Assets
Ms. Key Chippeaux, Deputy CIO, Public Markets & Credit
Ms. Debbie O'Dell, Investment Operations Manager
Ms. Liz Lorang, Executive Assistant
Ms. Norma Henderson, Chief Financial Officer
Ms. Karla Leyba, Bureau Chief, Member Services
Ms. Monica Lujan, Director, Member Services

Others Present:
Mr. Allan Martin, NEPC
Mr. Joseph Simon, LESC
Ms. Judith Beatty, Board Recorder
[See sign-in sheet.]

b. Approval of Agenda

Mr. Goff moved approval of the agenda, as published. Dr. Duszynski seconded the motion, which passed unanimously.

c. **Approval of Minutes: June 28, 2019**

Mr. Goff moved for approval of the June 28 minutes, as submitted. Dr. Duszynski seconded the motion, which passed unanimously.

d. **Introduction of Guests**

Chairwoman Cameron welcomed staff and guests.

2. SWEARING IN OF NEW BOARD MEMBER (placeholder)

None.

3. ELECTION OF BOARD OFFICERS

Mr. Goff moved to nominate Mary Lou Cameron as Chair. Mr. Magid seconded the motion.

Nominations were closed.

The motion passed unanimously.

Dr. Duszynski moved to nominate Russell Goff as Vice Chair. Mr. Magid seconded the motion.

Nominations were closed.

The motion passed unanimously.

Mr. Goff moved to nominate Larry Magid as Secretary. Dr. Duszynski seconded the motion.

Nominations were closed.

The motion passed unanimously.

4. CONSENT AGENDA: BOARD TRAVEL

No requests.

5. INVESTMENT REPORTS: BOB JACKSHA, CIO

a. **Asset Allocation Review**

[Presenters: Kay Chippeaux and Steve Neel, and NEPC advisor Allan Martin]

Mr. Martin discussed the process that staff and NEPC followed in developing the proposed asset allocation, which received a recommendation of approval at yesterday's Investment Committee meeting.

Mr. Martin said about 92 percent of the return in the ERB portfolio will be determined by the percentage in each asset class, making it one of the most important decisions the board can make. He said it is typical with most public funds that this is a decision reserved for the board.

Mr. Neel noted that about 40 percent of the portfolio assets are liquid within a week, and 60 percent within 120 days.

Mr. Neel and Ms. Chippeaux discussed the recommended changes.

Ms. Chippeaux said that staff proposes to use some light leverage as an investment tool to increase capital efficiency. This can improve the risk and return profile of the portfolio by improving diversification, and it can also be used to provide timely rebalancing as well as to provide liquidity if there is a need for it. She said leverage would not be used for any speculative risk; and in fact, it would decrease the risk in the plan in moving through the process of diversifying. She said staff also wants to limit the use of leverage to 20 percent of the total portfolio before leverage, although they don't expect it to reach that limit.

Ms. Chippeaux said liquidity is a very important issue for the ERB, so if leverage is used, staff will be constantly monitoring the liquidity of the portfolio just to make sure they can meet all of the plan obligations. She said they primarily expect to use futures and options only on publicly traded assets for the leverage and would use it tactically in situations where they see opportunity or a need to rebalance the cash more effectively. She added that staff plans to use an external manager to help make the investment decisions and implement actual trading. While there is staff in Santa Fe that does equity and fixed income trading, no one has really done derivative trading and would like to have the ability to do that with the use of an external manager.

- CURRENT TOTAL CASH: 1%/PROPOSED MIX: 1%

- Current Large Cap Equities: 16%/Proposed Mix: 14%
- Current Small/Mid Cap Equities: 3%/Proposed Mix: 3%
- Current Int'l Equities Unhedged: 5%/Proposed Mix: 5%
- Current Emerging Int'l Equities: 9%/Proposed Mix: 9%
- <u>Current Private Equity 13%/Proposed Mix: 15%</u>
- CURRENT TOTAL EQUITY: 46%/PROPOSED MIX: 46%

- Current Core Bonds: 6%/Proposed Mix: 6%
- Current EMD: 2%/Proposed Mix: 2%
- <u>Current Opportunistic Credit: 18%/Proposed Mix: 16%</u>
- CURRENT TOTAL FIXED INCOME: 26%/PROPOSED MIX: 24%

- Current Real Assets (Liquid): 0%/Proposed Mix: 0%
- Current REITs: 2%/Proposed Mix: 2%
- Current Core Real Estate: 1%/Proposed Mix: 1%

- Current Non-Core Real Estate: 4%/Proposed Mix: 5%
- Current Private Real Assets-Energy/Metals: 8%/Proposed Mix: 9%
- CURRENT TOTAL REAL ASSETS: 15%/PROPOSED MIX: 17%

- Current Absolute Return: 0%/Proposed Mix: 0%
- Current Other Diversifying Assets: 5%/Proposed Mix: 7%
- Current Global Asset Allocation: 4%/Proposed Mix: 2%
- Current Risk Parity: 3%/Proposed Mix: 3%
- CURRENT TOTAL DIVERSIFYING STRATEGIES: 12%/PROPOSED MIX: 12%

Mr. Magid moved to approve the asset allocation plan, as presented. Mr. Goff seconded the motion, which passed unanimously.

b. Investment Policy Statement Revision

[Presenter: Kay Chippeaux.]

Ms. Chippeaux reviewed amendments to the Investment Policy Statement, which included the following major changes:

- Under Investment Philosophy, adding: 8. Leverage can be used to meet portfolio asset allocation targets and tactically change the asset allocation within the ranges set under Appendix A, Asset Allocation. It can be also used to reduce portfolio concentration, to improve portfolio diversification and to improve the expected risk-return profile of the investment portfolio.

- Under Restrictions on Investments, Prohibited Securities and Transactions: Remove language prohibiting direct investment in Sudan. Adding: Portfolio leverage shall be limited to the use of derivatives and shall not exceed 20% of the total value of the portfolio excluding leverage.

- Newly amended Asset Allocation Policy on page 7, replacing the Cambridge PE Index benchmark with the ILPA Index.

Mr. Jacksha noted that the ERB's assumed overall rate of return on fund investments should be corrected to read 7.25 percent and not 7.75 percent as reflected on the top of page 7.

Mr. Magid moved for approval of the changes to the Investment Policy Statement. Mr. Goff seconded the motion, which passed unanimously.

c. Core Fixed Income Policy Revision

[Presenter: Kay Chippeaux.]

Mr. Jacksha said the Investment Committee reviewed these revisions at their meeting last month and recommended approval.

Ms. Chippeaux said this is for the internally managed portfolio. Two portfolio managers and an analyst do U.S. investment grade fixed income, and the current asset size is around $820 million of that portfolio.

Ms. Chippeaux stated that the changes being requested relate to index changes, as well as the changes in leverage adopted today by the board.

Highlights of recommended changes:

-- Policy benchmark is the Bloomberg Barclays Capital U.S. Aggregate Bond Index or any subsequent name changes.

-- Derivatives may ~~will not~~ be used to leverage the Fund.

-- A small change made in the amount of indexed bonds and non-indexed bonds. Instead of 70%/30% mixed, staff is requesting a 60%/40% mix.

-- Non-rated government agency bonds will be considered to carry the credit rating of the issuing agency.

-- Deletion of Sudan investment ban.

Mr. Magid moved approval of the changes to the Core Fixed Income Policy. Mr. Goff seconded the motion, which passed unanimously.

d. June 2019 Quarterly Performance Report

[Presenter: NEPC advisor Allan Martin.]

-- Over the past five years, the Fund returned 6.7 percent per annum, outperforming the policy index by 33 basis points and ranking in the 10th percentile of the Investment Metrics Public Funds > $1 Billion.

-- Over the past three years, the Fund returned 9.1 percent per annum, underperforming the policy index by 15 basis points and ranking in the 33rd percentile of the peer group.

-- For the year ending June 30, 2019, the Fund experienced a net investment gain of $922.9 million, which includes a net investment gain of $413.6 million in the quarter. Assets increased from $12.9 billion 12 months ago to $13.3 billion on June 30, 2019, with $480 million in net distributions during the year. The Fund returned 7.3 percent, exceeding the assumed rate. The Fund ranked in the 8th percentile of its peers.

e. Investment Committee Report

[Presenter: Bob Jacksha]

Mr. Jacksha reported on actions taken at yesterday's Investment Committee meeting:

-- Approved two investments to Banner Ridge: $100 million to Banner Ridge Fund III, a secondary fund; and $40 million in a second fund designed to make fund-of-fund investments in distressed managers.

-- Approved $40 million in ZMC III, a follow-on fund to Fund II, which the ERB is invested in. ZMC invests in media companies.

-- Reviewed the asset allocation and investment policy.

-- Approved the continuation of three investment manager contracts: Waterfall, PIMCO and Emso.

-- The committee received notification of the Executive Director's approval of small investment-related purchases. Per the Procurement Policy, the Executive Director approves these once a year and the committee is provided with a summary of the purchases.

-- Accepted the Proxy Voting Report.

-- Reviewed the quarterly commission reports on equities and fixed income (informational item).

f. Other Investment Reports

None.

6. BUDGET: NORMA HENDERSON, CFO

a. FY19 Budget Overview

Ms. Henderson presented the budget overview for FY 2019.

b. FY 21 Budget Appropriation Request

Ms. Henderson presented the FY 2021 appropriation request, which was a total of $31,926,000. She noted that the amount requested was basically flat, at $6,000 less than FY 2020's operating budget of $31,932,4000, and was $356,700 less than the FY 2019 operating budget. This represented a 1 percent decrease.

Ms. Henderson said there are currently 11 vacancies, which includes six new positions approved in the budget. There were four vacancies at the beginning of the fiscal year.

Mr. Magid moved approval of the FY 21 Budget Appropriation Request. Mr. Goff seconded the motion, which passed unanimously.

7. DISABILITY RETIREMENTS: KARLA LEYBA, MEMBER SERVICES BUREAU CHIEF

Ms. Leyba reported that there were four disability retirements during June and July.

Ms. Leyba reported that, since January 1, 2015, when Managed Medical Review Organization (MMRO) contracted with the ERB, there have been 240 applications. Their four-year contract ends on December 31, 2019, and staff is in the process of reviewing an RFP to issue in the fall. She commented that staff is very satisfied with MMRO.

Mr. Goff moved for approval. Mr. Magid seconded the motion, which passed unanimously.

8. AGE & SERVICE RETIREMENTS: MONICA LUJAN, MEMBER SERVICES DIRECTOR

Ms. Lujan reported that, during the two-month period of June and July 2019, there were five disability retirement applications under age 60. There were 27 reciprocity retirements, and a total of 443 regular retirements processed, for a total of 475 applications processed during the two-month period.

Addressing a question asked by Mr. Goff at the last board meeting about whether there has been an increase in retirees working 30 years and over, Ms. Lujan said the number has remained relatively stable since 2014 and makes up about 10 percent of retirees who are retiring.

Mr. Magid moved for acceptance. Mr. Goff seconded the motion, which passed unanimously.

9. DIRECTOR'S REPORT: JAN GOODWIN, EXECUTIVE DIRECTOR

a. Retirement Season Update

Responding to questions from Mr. Delgado, Ms. Goodwin said the impact on the number or type of retirements as a result of the rule changes has been minimal.

Ms. Goodwin said that, during the past fiscal year ended June 30, 2019, there were 932 July 1 retirements. Most of the retirements are in July, which coincides with the end of the school year, and there is a smaller cohort in December at the universities. The number of retirements continues to decline: For the same period last year, there were 1,037 retirements, and in FY 2017, there were 1,145 July 1 retirements. She said that there is a fairly decent proportion of ERB members who are eligible to retire at any point, and there are a lot of people who work past their initial eligibility date because the ERB retirement benefit, unlike the PERA benefit, does not max out, which means that ERB members are inherently incentivized to work for as long as they want.

Ms. Goodwin stressed that, even though there were fewer July 1 retirements, the effort expended by staff in Member Services under the direction of Karla Leyba and Monica Lujan was huge. She said staff was working late at night and over the weekends to ensure that everyone would get their check on July 1.

b. Audit Update

Ms. Goodwin reported that representatives from every area of the agency met with auditors Moss Adams two weeks ago about the upcoming audit. This morning, the Audit Committee met with Moss Adams for the entrance conference, so everything is on schedule.

c. Retiree Health Care Update

Ms. Goodwin stated that the NMRHCA held its annual retreat in July and approved the premium increased for next year. Pre-Medicare premiums will be going up by 7 percent and the Medicare premiums will go up by 5 percent, effective January 1, 2010.

d. <u>Other</u>

Ms. Goodwin referred the NMERB Activity Report by Department.

Ms. Goodwin clarified for Mr. Delgado the reasons behind HB 360, which eliminated one of the ways that retirees can work in retirement. There was a potential problem with the IRS because some of the people who were using the $15,000 option hadn't had a bona fide termination because they were working more than .25 FTE.

With respect to the upcoming rule hearing, Ms. Roubidoux stated that the ERB published the Notice of Public Rule Hearing on August 13 in the New Mexico Register and also on the Sunshine Portal and the ERB website to notify the public about the October 18 rule hearing, allowing for approximately 60 days of public comment and giving the public ample time to review the proposed rules and submit written comments or prepare for making oral comment. The information about the upcoming rule hearing, as well as the proposed rules, has been widely published.

Ms. Roubidoux said three written comments have been received to date.

Mr. Delgado asked if it were possible to calculate the .25 FTE quarterly or annually, since that would be very beneficial to the District. Ms. Roubidoux responded that the IRS specifies weekly, monthly or quarterly, but not annually. Ms. Goodwin said the problem she sees with quarterly is that someone can work the last three weeks of one quarter and the first three weeks of the next, so they would be working full time for six weeks during a four-month period. She commented that this goes against the intent of the limits imposed on people working in retirement. She pointed out that people can still do the one-year layout and then can work as much as they want, making the ERB one of the most flexible and accommodating retirement systems in the United States.

Ms. Goodwin commented that one of the problems is that many potential retirees seem wedded to the idea of getting two paychecks, and retire early with the idea that they will not just get their monthly pension check, but also can earn a second check by continuing to work.

Ms. Goodwin stressed that a better process of planning is needed so there are not these gaps in the district areas. She said people have to get more creative on how substitute positions are staffed; for example, there is one district in New York State that has a pool of people who do nothing but substitute teach.

10. BOARD DIVESTMENT POLICY DISCUSSION: JAN GOODWIN, EXECUTIVE DIRECTOR

Ms. Goodwin read the following statement:

"Over the past year, the ERB has received a number of inquiries about our investments in two companies involved in the housing of migrants and their children. The two companies are CoreCivic and the GEO Group. ERB holds both of these companies as part of our internally managed S&P 400 (mid cap) index fund.

"As of June 30, 2019, ERB's total investment in these companies was valued at approximately $865,000, or 0.021% of ERB's allocation to public entities and 0.006% of our total market value. It is important to note that ERB staff does not exercise discretion over these holdings as their representation within the S&P 400 index is determined by the index provider, the Standard & Poor's Corporation. The authority for initial index composition as well as on-going rebalancing belongs to the index provider.

"If ERB were to exclude one or more companies from the index, we would incur additional trading costs as well as a tracking error since our holdings would no longer be identical to the S&P 400. A one basis point (0.01% or 0.0001) degradation in tracking error in our S&P 400 index fund would be $30,000 and $200,000 in our S&P 500 index fund. Such a tracking error would also hinder our ability to compare our investment performance to that of other public pension plans as many of them invest in the entire S&P 400 index. From a fiduciary perspective it is likely that these additional costs of excluding these companies would be considered unnecessary and inconsistent with the board and staff's fiduciary duty.

"Should our members, stakeholders and the public at large think that our board and staff have no concern or, or are insensitive to, the plethora of social and political challenges posed by the any of the thousands of individual equity and debt security positions maintained by ERB? Of course not. However, we have to balance our individual sentiments and philosophies with our responsibility to act is fiduciaries to the fund. ERB does not have the resources to maintain an active corporate governance program, unlike large plans like CalSTRS and CalPERS. Accordingly, this fiduciary responsibility can be evidenced in our proxy voting activities and engagement with management, preferably in coordination with other public pension funds, when appropriate.

"By maintaining our ownership in, and our place at the table with CoreCivic and GEO Group, will be able to engage with other public pension funds and like-minded organizations to encourage the improvement of conditions and the treatment of people held at the facilities owned and operated by these companies."

Ms. Goodwin said she sent board members two different divestment policies from two very different pension plans. CalSTRS (California State Teachers Retirement System), which has $236 billion in assets, advocates for the pension fund and believes it is their job as fiduciaries to take social positions and divest when they think it's appropriate. In contrast, Colorado PERA, a $52 billion fund, believes that the retirement system's job is to administer retirement benefits and that it is the prerogative of the legislature to make those social investment decisions about divestment.

Ms. Goodwin asked for the board's input on which direction the ERB should go in so it can prepare a divestment policy that is in line with the board's philosophy.

Mr. Jacksha noted that, in addition to having $236 billion in assets, CalSTRS has a large staff of about 200 personnel in a department devoted to corporate governance, proxy voting, communicating with corporations, etc. The ERB does not have the staff for that.

Ms. Goodwin said she met with a couple of activists from the Dreamers Project this summer, who were very unhappy with the ERB's position, and the Interfaith group in Albuquerque has also recently expressed concern and she is in the process of arranging to meet with one of their representatives.

Ms. Goodwin commented that a problem with divestment is that it can be a slippery slope, with an increasing number of sectors being targeted as socially unacceptable, e.g., oil, opioid manufacturers, cigarettes, Walmart and so on, and she was not sure the Board of Trustees wanted to be making those decisions.

Ms. Goodwin noted that CalPERS (California Public Employees Retirement System) recently quantified all of their various divestment choices and calculated that divestment from tobacco cost them several billion dollars, and now they are looking at divesting from oil & gas. She commented that one could make an argument against every investment in the S&P 500. She stressed that the ERB needs to have an investable universe.

Mr. Jacksha said an investment by CalSTRS or CalPERS is ten to twenty times the size of an investment the ERB might make, so it makes a big impact. By comparison, the ERB holds a very small amount of anybody's securities, so if it wants to make an impact, it would have to be part of a group of other pension funds.

Mr. Jacksha pointed out that the immigrant prison issue is really a policy issue; and while the federal government has not yet set a rational policy about it, that is where it needs to be addressed.

Responding to Mr. Delgado, Ms. Goodwin said she personally prefers the Colorado PERA approach, since it is more appropriate for a fund of the ERB's size, and agreed that the ERB would make a bigger impact by joining forces with other pension funds. In addition, by maintaining ownership, the ERB gets to vote its opinions as a shareholder through the proxy voting process. In fact, because of shareholder concerns expressed through proxy votes, GEO Group agreed to do a report on conditions, and CoreCivic has agreed to do a similar report. She feels this is a more cost effective way to achieve the goals.

Mr. Martin said it is not part of the Board of Trustees' fiduciary duty to tell a fund manager to get rid of a fund because it is doing bad things is a very different path from determining that investments in a given enterprise create risks for the ERB Fund, but it does take staff resources to make those decisions. He said CalPERS' decision to divest from tobacco cost them $3 billion. Were he a retiree under that system, he would sue them for that because that is his retirement money.

Ms. Goodwin asked board members how staff should proceed. If the board prefers the Colorado PERA option, which is to defer to the legislature to impose investment limits based on social policy goals, she would want the ERB to be reimbursed for any harm done to the Fund based on any divestment directives. She questioned whether the legislature would want to make divestment decisions.

Dr. Duszynski said he thought the board would be remiss to begin setting a "Hobby Lobby kind of policy" on what kind of investments to make. He agreed this is a very slippery slope.

Ms. Goodwin stated that staff would draft a policy to reflect sentiments expressed today.

11. REVIEW OF PROCESS AND TIMELINES FOR EXECUTIVE DIRECTOR EVALUATION: BOARD CHAIR

Chairwoman Cameron distributed the Evaluation Committee Charter adopted by the board last year, and said she would appoint committee members at the October board meeting, as called for in the charter.

12. NEXT MEETING: FRIDAY, OCTOBER 18, 2019 -- ALBUQUERQUE

Its business completed, the Educational Retirement Board adjourned the meeting at 12:00 p.m.

Mary Lou Cameron

Mary Lou Cameron, Chairwoman

ATTEST:

Larry Magid, Secretary