

ACTION SUMMARY

INVESTMENT COMMITTEE

February 26, 2015

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MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

February 26, 2015

1. a. Call to Order

A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at 1:00 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
Mr. Larry Magid
Dr. Beulah Woodfin

Members Excused:

None.

Staff Present:

Ms. Jan Goodwin, Executive Director
Mr. Bob Jacksha, CIO
Mr. Steve Neel, Deputy CIO
Mr. Mark Canavan, Real Assets Portfolio Manager
Mr. Russell Mills, Investment Financial Analyst
Mr. Robert Quinlan, UNM Intern

Others Present:

Ms. Judith Beatty, Recorder [by phone]

b. Approval of Agenda

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

c. Approval of Minutes of 1/22/15

Dr. Woodfin moved approval of the minutes of the January 22, 2015 meeting, as submitted. Mr. Magid seconded the motion, which passed unanimously by voice vote.

d. Introduction of Guests

Mr. Jacksha introduced Russell Mills, who was previously at DFA and will be handling alternative investments in the Operations group.

Mr. Neel introduced Robert Quinlan, intern from UNM Business School.

2. PRIVATE EQUITY CONSULTANT SELECTION

Mr. Jacksha stated that staff issued an RFP for Private Equity Consulting Services in September 2014. From the eleven responses received, Mr. Canavan and Mr. Neel narrowed the field down to two. Mr. Jacksha commented that he was very comfortable in saying that the two finalists, Caledon Capital Management and Top Tier Capital, were the best in that pool.

Mr. Jacksha referred to the TUCS comparison of private equity returns for December 31, 2014, and noted that the ERB's private equity fund has done well both on a relative basis and on an absolute basis. On a relative basis, the ERB's private equity fund has been in the upper quartile for most of the time periods for public funds in general. He commented that this is obviously something the ERB wants to continue, and the new consultant will be held to that standard.

Mr. Neel stated that the ERB has been in private equity since 2007, has an established process, and likes how it approaches the market. It has done relatively well, and a key element in looking at the finalists is how they actually dovetail with what the ERB is already doing in this program.

Mr. Neel commented that, as private equity programs mature, they go from a fund-of-funds platform to investing directly into individual buyout funds. Later in the program's lifecycle, there are specialty strategies such as distressed and mezzanine. He said what the ERB is looking at now is toward the mature stage of the lifecycle of a private equity program, which incorporates co-investments and secondaries with high quality investments and high quality growth managers. He said a question the Investment Committee should ask is how the candidates can help the ERB private equity program move effectively down that path.

Mr. Neel discussed the due diligence process followed by ERB in reviewing the finalists. He said seven submissions made the first cut, and on-site visits were completed in December and January. The review committee further reduced the number of submissions to three, where further work was completed to select the final two candidates.

Caledon Capital Management

Mr. Neel introduced Caledon partners David Rogers, Martin Day and Jean Potter, who made a presentation.

-- Founded in 2006 by David Rogers, previously head of private equity at Ontario Municipal Employees Plan (OMERS)

-- Provides customized private markets investment solutions and portfolio management services acting as an extension of the client's internal team

- Managed by former pension fund fiduciaries with deep appreciation of governance needs of institutional investors

- Currently implementing investment programs representing over \$5 billion of assets for North American institutional investors

- 13 investment professionals based in Toronto with over 140 years of combined private markets fund and co-investment experience

- Employee-owned firm and not affiliated with third party, no pooled investment products or general consulting services

Mr. Jacksha asked Caledon to comment on any “holes” it might see in the ERB’s existing strategy or things it should be doing in the portfolio that it is not doing now.

Mr. Potter responded that the portfolio is in a fairly North American-centric or even a U.S.-centric commitment base and deployment cycle. He commented that it is natural for a private equity program to start with a home bias and build out from there, which is how Caledon built its own program and programs with other institutions. He said they have talked about adding a little bit of European exposure and then, over time, looking at Asia and the rest of the world.

Mr. Potter also noted that there are some managers that were committed in the 2006 to 2008 timeframe where there haven’t been re-ups, and Caledon would engage in a dialogue about whether to let them continue to wind down or whether it would be advantageous to look into secondary sale opportunities.

Mr. Day elaborated that there are situations where, when the ERB is committing to a new private equity fund, sometimes there might be an opportunity to also buy a position in one of their older funds where an earlier investor is looking to exit that fund. He said that is a very nice situation because the ERB would have a diversified exposure to that manager, especially if it is a new manager.

Mr. Rogers commented that Caledon has very little allocation to venture capital among its existing clients because of the volatility of the returns in certain cycles. With its clients, Caledon has agreed to a venture capital allocation anywhere from zero to 20 percent of the portfolio, but to reduce some of that volatility, they do more technology buyout funds. This gives the technology exposure but without the early stage venture capital technology exposure. He said this would be a good conversation to have with ERB, which has limited exposure to venture.

Mr. Jacksha asked what kind of access Caledon has to the top shelf venture funds. He commented that if an investor can’t get into the top early stage venture funds, it is generally better not to invest in venture at all.

Mr. Rogers responded that Caledon has limited access to the top 20 players, and venture managers want to see a long-term commitment from investors. If in a year or two Caledon’s clients decide to allocate 10 percent of their portfolio to venture, Caledon will approach these funds. Mr.

Day added that most venture funds aren't interested in small investors, either, which creates another challenge.

Mr. Rogers reviewed Caledon's three private equity mandates.

Ms. Goodwin asked what size commitment Caledon would be advising the ERB to make in its private equity portfolio. Mr. Potter responded that, depending on the size and scope of the manager and the ERB's familiarity with the strategy, they feel a range of \$40-\$70 million would be appropriate.

Ms. Goodwin asked what percent of Caledon's advisory is private equity as opposed to infrastructure. Mr. Rogers responded that one-third is in private equity. They have five infrastructure mandates and three private equity mandates.

Mr. Day said they have made 10 co-investments on the infrastructure side and two co-investments on the private equity side.

[Representatives left the meeting.]

[Break.]

Top Tier Capital

Mr. Neel introduced managing director David York and director Kevin Tatlow, who made a presentation.

- Private equity asset management of over \$3.1 billion of commitments across 40 institutional investors
- Offices in San Francisco and New York, major centers of the private equity industry
- Exclusively focused on private equity investing: founded as the fund of funds practice within Paul Capital in 1999; became an independent firm in 2011
- Trusted and collaborative partner with GPs and LPs
- Firm's activities include primary fund investing since 1999; secondary investments since 2001; co-investments since 2009; customized solutions since 2014

Mr. York said Top Tier is open to buying secondaries as a means to get access to a company through a co-investment. They have done 13 co-investments to date, nine of which have had a secondary component.

Ms. Goodwin asked Mr. Tatlow to comment on the ERB's private equity portfolio in terms of how he might structure it differently.

Mr. Tatlow responded that the ERB's private equity portfolio is focused on domestic, and there is a good opportunity to invest in European buyout funds. In the U.S. portfolio, the ERB has to

continue to be concerned about the J-curve and not going backward in performance, as there is a lot of uncalled capital in the portfolio. He said the J-curve can be mitigated through secondaries, for instance. He stated that the ERB is light in the venture and technology space, as well, although it is very hard to get access. He added that an important piece is to continue to drive the process in order to have value add through manager selection. He said it is a bit more complex because of re-ups, because those funds need to be subjected to a rigorous process.

Ms. Goodwin asked what kind of commitment size Mr. Tatlow would recommend.

Mr. Tatlow responded that the ERB has been committing \$50 million at a time recently, which makes sense, but the ERB has to weigh whether that amount is preventing it from participating in some parts of the market. He said that is an issue with venture capital and small buyouts.

Mr. Jacksha noted that Top Tier's history is working in venture, and asked how Top Tier's setup lends itself to exposure in other sectors, and whether they plan to add staff.

Mr. York responded that they plan to add two associates this summer with MBA type experience in this space. He added that the other three managing directors have been across various parts of the market at any given time, in addition to his own experience. He said Top Tier does not plan to reinvent the process for making investment decisions, as it is an extension of what they do.

[Representatives left the room.]

Discussion, scoring and vote

Mr. Jacksha noted that both firms filled out the proper paperwork for placement agents, and neither firm had any. In addition, no campaign contributions were reported.

Comments on the pluses and minuses of each candidate by staff:

-- The ERB's existing book doesn't have significant exposure to venture. The ERB team has worked with Kevin Tatlow (Top Tier) before on the private equity portfolio, and to some extent he has had influence on the portfolio's very good performance. The fact that he'd be focusing more on venture isn't a concern; this is fairly transferable.

-- On the minus side, ERB would be Top Tier's first client in its Custom Solutions advisory side. It looks like a natural evolution of what they have been doing with fund of funds, so that helps to mitigate it.

-- The ERB has familiarity with Caledon's work on the infrastructure side, and an additional plus is that ERB investment staff is very satisfied with their back office.

-- A big plus for Caledon is that they have a fiduciary background. They have sat in the same chairs that ERB staff have. In addition, they have had very little turnover across their platform, which speaks to great management. They are also very good distressed and special situations managers.

-- The biographies of Top Tier management are very impressive with respect to having strong engineering and technology backgrounds.

-- Both firms can help with co-investments and secondaries. Caledon's come from Canadian funds, which have been more internal, and over time perhaps they can help ERB look at some of that.

-- Caledon does not have the venture relationships that Top Tier does, so ERB wouldn't get the same venture exposure with Caledon.

-- Top Tier's advantage is in secondaries and co-investments. "It's in their DNA."

Mr. Jacksha commented that, in general, he could go with either Top Tier or Caledon. He said he had a very slight preference for Caledon. He, Mr. Canavan and Mr. Neel met earlier to try to come up with a consensus recommendation, but were unable to, and decided to simply list the pluses and minuses of each firm and let the Investment Committee make the decision.

Mr. Neel commented that he is proud of what the ERB has built in its private equity portfolio. Performance is very good with one exception, which is in venture. At the current time, only 10 percent of the private equity portfolio is allocated to venture, although the range is zero to 40 percent. While he could not envision reaching that level, this is an area where the ERB needs help. He noted that Top Tier's net performance in venture (Cambridge Associates) was a net 25 percent last year.

Mr. Neel added that the ERB needs less help in buyouts, which is where Caledon shows strength.

Dr. Woodfin stated that most new ventures seem to be related to biotech or healthcare, which Top Tier seems to be strong in.

Investment Committee members completed and turned in their scoring sheets.

Top Tier received the highest scores among three of the four Committee members.

Dr. Woodfin moved that the Investment Committee approve a four-year investment services contract for private equity consultant services with Top Tier. This recommendation is subject to New Mexico State Law, Educational Retirement Board policies, Educational Retirement Board approval for placement agents, negotiation of final terms and conditions, and completion of appropriate paperwork, Mr. Magid seconded the motion, which passed unanimously by voice vote.

3. ROBECO INVESTMENT GUIDELINE – EMERGING MARKETS EQUITY

Mr. Jacksha stated that Robeco has requested two fairly minor changes that would allow them to do a bit more concentration in the portfolio. They have been doing this for other clients, and it has worked well.

Mr. Jacksha said staff recommends approval of these changes: 1) requiring the minimum number of issuers in the portfolio be reduced from 100 to 80; and 2) moving the country exposure from plus or minus 5 percent relative to the benchmark to plus or minus 10 percent.

Ms. Cameron moved that the Investment Committee approve the investment guideline to change the minimum number of issuers to 80 and to limit country exposure to ± 10 percent relative to the benchmark for the Robeco Institutional Asset Management US, Inc. contract beginning April 1, 2015. Mr. Magid seconded the motion, which passed unanimously by voice vote.

4. PROXY VOTING REPORT

Mr. Jacksha reported that, in general, all of the items called for in the policy were voted in accordance with policy. Where there were exceptions, Mr. Jacksha said those items were voted on in what he believed were in the best interest of the ERB.

Ms. Cameron moved acceptance of the Proxy Voting Report. Mr. Magid seconded the motion, which passed unanimously by voice vote.

5. PRIVATE EQUITY FEE DISCUSSION

Mr. Jacksha said this item was on the agenda at the request of Dr. Woodfin. There was an article in *The Wall Street Journal* about KKR refunding some fees to investors after the SEC found the firm wrongly charged investors for some expenses and failed to properly notify them of certain fees it had collected.

Mr. Neel stated that, while ERB has no exposure to KKR, the issue of fees with regard to general partners in private equity has been very topical in the last few months. He reviewed some of the things the ERB does around fee issues, including completion of a questionnaire with relevant questions. In addition, the ERB sends a memo to general partners prepared by the ERB's general counsel that addresses several questions about fees. Also, the ERB sends an annual data request to the general partners, asking them about their providers, information with respect to the SEC, etc. Finally, the ERB visited its general partners and provided a questionnaire specific to these issues.

Dr. Woodfin asked how an investor can overcharge fees if the fee has been negotiated.

Mr. Jacksha responded that management fees are negotiated and are always very clear; however, expenses of the fund are a different thing and are part of the partnership expenses that may be paid by the fund. In addition, fees collected by the partnership from rendering services to portfolio companies are often credited back to the investors under terms of the limited partnership agreement. Mr. Neel explained that KKR had combined purchasing agreements, and the rebates were going back to KKR and not benefiting the fund.

6. FIXED INCOME TRANSITION UPDATE

Mr. Jacksha reported that the fixed income transition takes place today.

7. QUARTERLY COMMISISON REPORT

[Informational item.]

8. OTHER INVESTMENT REPORTS AND DISCUSSIONS

Mr. Jacksha stated that, at the last meeting the committee discussed a policy change with respect to electronic trading because there might be an issue with that in the interim. He said that issue went away when one of the electronic trading partners opened their own brokerage and funded it to facilitate peer-to-peer trading.

Mr. Jacksha reported that, for the 12 months ending December 31, returns were at 7.80 percent, slightly exceeding 7.75 percent. He said January returns will be up about 20 basis points, notwithstanding a down market.

8. NEXT MEETING: THURSDAY, MARCH 26, 2015

The committee agreed to schedule the meeting at noon.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 4:50 p.m.

Accepted by:

A handwritten signature in cursive script, appearing to read "H. Russell Goff", is written over a horizontal line.

H. Russell Goff, Chairman