

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

ACTION SUMMARY

February 26, 2016

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MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
REGULAR MEETING

February 26, 2016

1. CALL TO ORDER: QUORUM PRESENT

A Regular Meeting of the New Mexico Educational Retirement Board was called to order on this date at 9:00 a.m. in the Educational Retirement Board Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico. A quorum was present.

Members Present:

Ms. Mary Lou Cameron, Chairwoman [by telephone, joining at 9:45 a.m.]
Mr. H. Russell Goff, Vice Chairman
Mr. Hipolito J. Aguilar, Secretary
The Hon. Tim Eichenberg, State Treasurer
Mr. Larry Magid
Dr. Beulah M. Woodfin

Members Excused:

None.

Staff Present:

Ms. Jan Goodwin, Executive Director
Mr. Rick Scroggins, Deputy Director
Mr. Bob Jacksha, CIO
Mr. Chris Bulman, General Counsel
Mr. Roderick Ventura, Deputy General Counsel
Ms. Dianne Rossbach, CFO
Ms. Monica Lujan, Member Services Director
Mr. Lawrence Esquibel, IT Director
Ms. Margaret Riquelmy, Executive Assistant

Others Present:

Mr. Dan LeBeau, NEPC
Ms. Judith Beatty, Recorder
Mr. Fred Rose, UNM
Ms. Ann Harrike- Ortiz, LFC

b. Approval of Agenda

Dr. Woodfin moved approval of the agenda, as published. Mr. Magid seconded the motion, which passed unanimously by voice vote. [Not present during the vote: Mr. Aguilar.]

c. Approval of Minutes – December 11, 2015

Mr. Eichenberg moved approval of the minutes of the December 11, 2015 meeting, as submitted. Dr. Woodfin seconded the motion, which passed unanimously by voice vote. [Not present during the vote: Mr. Aguilar.]

d. Introduction of Guests

Staff and guests introduced themselves.

2. SWEARING IN OF NEW BOARD MEMBER

[Deferred until appointment of new board member by the Governor.]

3. BOARDEFFECT TRAINING

Ms. Riquelmy introduced Pam Nason, Client Advocate for BoardEffect, who joined the meeting by telephone and presented slides on BoardEffect, the platform the Board would be using to manage documents during meetings, with the use of an iPad.

4. CONSENT AGENDA

a. Board Travel

There were no requests.

[Chairwoman Cameron joined the proceedings by telephone. Vice Chair Goff continued to preside over the meeting.]

5. INVESTMENT REPORTS: BOB JACKSHA, CHIEF INVESTMENT OFFICER

a. Investment Policy Revision

Mr. Jacksha stated, after discussion about the need for a policy statement about management fees, the Investment Committee has recommended approval of the following addition to the Investment Policy:

7. NMERB recognizes that management fees are an important consideration, but NMERB also recognizes that fees are secondary in importance to return and risk goals. Fees are a component of the net return of an investment, but a potentially small savings in fees can easily be outweighed by the performance of different managers or different asset classes. Fees are highest in alternative asset classes. Research has shown that the dispersion of returns between managers is highest in these alternatives. Thus, a relatively small savings in fees can easily be offset by a large differential in return caused by manager or asset class choices. Minimizing fees must be secondary to striking the proper return/risk profile for the investment portfolio and secondary to manager quality and capability. Nonetheless, Staff will seek to

negotiate fees that are standard market rates or lower for managers in the asset class in question. While some fee savings may be achieved, this policy recognizes that reducing fees is not always possible, depending upon the supply/demand dynamics for a specific asset class and specific managers. Staff may recommend an investment that carries higher than standard fees, but must present sound rationale in support of the recommendation. NMERB will present the Board with an annual fiscal year report detailing management fees, expenses and incentive.

Dr. Woodfin moved that the Board approve the recommended changes to the Investment Policy. Mr. Magid seconded the motion, which passed unanimously by voice vote.

b. December Quarterly Performance Report

[Presenter: NEPC consultant Dan LeBeau.]

Mr. LeBeau said nearly two months have gone by since the December figures were published in what has been a very volatile market. Through yesterday, the S&P 500 was down 4.5 percent YTD, giving back almost all of the gains experienced in Q4. He said 10 year Treasuries were at 1.7 percent yesterday, down from about 2.25 percent at the beginning of the year. He said those figures could dip even lower, depending on how the market reacts in the coming months.

Mr. LeBeau presented the December Quarterly Performance Report.

Mr. LeBeau noted that, for the one-year period, the two best performing asset classes were international small cap stocks (up 9 percent) and real estate (14 percent). Other than that, it was very difficult to find areas to produce significantly positive results that would move the NMERB toward meeting its investment objectives.

Mr. LeBeau stated that, for the year ending 12/31/15, the fund experienced a net investment gain of \$167.1 million, which includes a net investment gain of \$275.5 million during the fourth calendar quarter. Assets decreased from \$11.3 billion 12 months ago to \$11.1 billion on 12/31/15, with \$320 million in net distributions during the year. The fund returned 1.5 percent, outperforming the policy index by 1.7 percent and ranking in the 21st percentile of its peers.

Mr. Jacksha added that, even though the NMERB was positive for the whole year at 1.5 percent, payouts are around 2.5 to 3 percent.

Mr. Magid pointed out that the standard deviation is very low in the NMERB portfolio, and people don't realize how significant that number is. He commented that the NMERB takes minimal risk relative to some of its peers who are 60 or 70 percent in equities with a standard deviation of 15 to 20.

Mr. LeBeau agreed. He said realized volatility in the markets has been flat over the past several years with an upward trending equity market, and it is unusual to see that kind of growth in assets under those conditions. He said the expected volatility for many of the NMERB's peers is in the 11 to 13 percent range; so to Mr. Magid's point, the NMERB is getting bond-like volatility while having exposure to a much more diversified set of asset classes.

Ms. Goodwin commented that this was very important information that would be helpful for plan members and legislators to understand. She said she would like to see a communications plan developed around this that could be included in a newsletter to the members as well as on the NMERB website.

Mr. Jacksha stated that it is very unlikely that the fund will return 7.75 percent this fiscal year, which would be the second year in a row for that.

Responding to Mr. Aguilar, Mr. Jacksha said the fund has to generate 3 percent to break even with cash flow. He added that the NMERB had been ahead of plan during some good years, and so now it is seeing the other side. The assumption is that it will average out in the long run. Total fund return for the life of the fund is 9.1 percent, and 7 percent for the past 5 years.

c. NEPC Revised Capital Market Assumptions

Mr. LeBeau discussed highlights from the NEPC 2016 Public Fund Workshop, held on January 11-12. On an annual basis, NEPC develops 5-7 year and 30-year capital market assumptions using expected return, expected volatility and a correlation matrix across 40+ asset classes that NEPC models within its asset allocation material.

Mr. LeBeau stated that the NMERB is one of the few clients NEPC has that is expecting a higher return going forward than it had last year. NEPC's expectation for the NMERB portfolio over the next 5-7 years is 7.6 percent, which is up about 20 basis points relative to last year, and the 30-year number is expected to be just under 8.5 percent, which is slightly higher than the 8.3 percent expected last year. The 30-year numbers are typically provided to the actuaries, and those numbers certainly support the plan's 7.75 percent discount rate.

Mr. LeBeau said NEPC doesn't feel that any significant changes are needed to the asset allocation going forward. The portfolio is very well positioned in terms of protecting in a volatile market going forward, and also to capitalize on some depressed valuations in the credit and equity markets.

Mr. Jacksha said staff has discussed the idea of exploring a small amount of leverage at the portfolio level to see what the outcome might be. Staff plans to take this idea to the Investment Committee for discussion and bring a recommendation to the Board at approximately the midyear point.

Mr. Magid suggested tweaking opportunistic credit, since it has added positive returns to the portfolio.

d. Investment Committee Report

Mr. Jacksha reviewed action taken at yesterday's Investment Committee meeting:

- Approved a \$50 million commitment to Tenex Capital Partners II, a private equity fund.
- Approved a \$40 million commitment to Ares Corporate Opportunity Fund, which is a combination of buyout and distressed, depending on the opportunity.
- Approved a \$40 million commitment to Lone Star Real Estate V.
- Approved a contract extension on the Halderman Farms Agriculture contract to February 2018.

- Reviewed the 4th quarter commission report and approved the 4th quarter proxy report.
- I Squared, one of the NMERB's infrastructure funds, is investing in a San Juan gathering system, which is in New Mexico. The NMERB is also looking at this as a co-investment.
- Mark Canavan was contacted by the White House about a new initiative they are undertaking to forge a public/private partnership in the area of water. They are looking at ways of attracting more private capital.

Mr. Aguilar noted the dramatic increase in earthquakes in Oklahoma, possibly as a result of hydraulic fracturing, and asked if the NMERB could be subject to risk if production slows down and stops.

Mr. Jacksha responded that there is risk with any of these pipeline projects if there is no product flowing through the pipeline, but it is the job of the advisor to do the due diligence and determine whether a particular investment makes sense.

e. Other Investment Reports

Mr. Jacksha said the committee scheduled the next meeting for 9 AM on March 24, which would precede the Board Retreat at 1:00 PM.

[Break.]

6. FINANCIAL REPORTS: DIANNE ROSSBACH, CHIEF FINANCIAL OFFICER

- a. Fiscal Year 2016 2nd Quarter Budget Status Report
- b. Midyear Financial Statements

Ms. Rossbach presented these reports.

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

Ms. Lujan presented the December-January report, reflecting that 303 retirees were processed for benefits during that period.

Ms. Lujan stated that staff is working on additional statistics, and future reports will include age, gender and benefit information.

Dr. Woodfin moved for approval. Mr. Aguilar seconded the motion, which passed unanimously by voice vote.

8. DISABILITY ACTIONS: RICK SCROGGINS, DEPUTY DIRECTOR

Mr. Scroggins reported that the NMERB contract with MMRO, the disability evaluation service provider, is now in effect. He reviewed a recommendation report prepared by MMRO. In this case, the Executive Director approved MMRO's recommendation, and the individual began receiving payments the following month. He said the MMRO reports are confidential, but staff will circulate a modified version of these reports (with names and other information redacted) to the Board for ratification at the regular meetings. He said the Board could choose not to ratify an approval, in which case the action would be reversed and the payments would be terminated.

Responding to Mr. Aguilar, Mr. Bulman stated that, based on Rule 6, the Board authorizes the Executive Director to put someone on payroll before it ratifies that action. Mr. Aguilar noted the language in rule stating, "all such approvals must be ratified." Mr. Bulman responded that the language was written in 1999. He agreed that the language was somewhat awkward; but at that time, the Board had truly delegated that authority to the Executive Director.

Chairwoman Cameron suggested that the Board review the "must ratify" provision in Rule 6 at the March Board Retreat.

Dr. Woodfin moved to ratify the report. Mr. Magid seconded the motion, which passed unanimously by voice vote.

9. NMERB INFORMATION TECHNOLOGY UPDATE: LAWRENCE ESQUIBEL

Mr. Esquibel presented a status report.

Mr. Esquibel stated that the Information Technology staff consists of six members. Four members are involved in the upgrade of the Vitech application from IRIS Classic to IRIS V3 browser. He said the IT team has a combined 60.8 years of service to the NMERB.

Mr. Esquibel stated that 80 percent of the 1,539 items in the latest security assessment are new to the environment from the ever-changing threat landscape over the past year. This is not specific to the NMERB but to the IT world at large, and speaks to the need to continue to perform these audits and increase their frequency to twice a year. He said the current year's contract was for \$18,625. He commented that these are all good first steps, but there is still much to do to address all of the items in the last three security assessments. He added, "No matter how much we do, how vigilant we attempt to be, it takes only one misstep by an employee to succumb to any of the social engineering attacks by clicking on a link in a poisoned email or website or opening an infected file." He said the hardware being used and training of users helps raise the bar to keep hackers out, and the NMERB has done a good job of training users over the last 18 months.

**10. PROPOSED IRS RULES REGARDING NORMAL RETIREMENT AGE:
CHRIS BULMAN, GENERAL COUNSEL**

Mr. Bulman said the IRS has issued proposed regulations on the definition of "normal retirement age" for qualified governmental retirement plans, which it has been looking at since 2007. The new regulations in large part adopt many of the approaches that commenters in the public plan community have called for, most notably allowing normal retirement age to be based on years of service at any age.

Mr. Bulman said the new regulations would apply to new employees beginning January 1, 2017, and for the NMERB, this would apply only to Tier 3.

Mr. Bulman said the IRS definition of “normal retirement age” is “the earliest age at which a participant has the right to retire and receive benefits based upon the amount of the participant’s service on the date of retirement at the full rate set forth in the plan.” As a general safe harbor, the IRS states that this should not happen before the age of 62, but other IRS safe harbors appear to support Tier’s 3’s eligibility requirements.

Mr. Bulman stated that the NMERB will not have to make any tweaks to the plan in the next legislative session in order to fall within the IRS guidelines, but he will contact the Groom Law Group to confirm that.

11. UPDATE ON PROPOSED ERB RULE CHANGES: CHRIS BULMAN, GENERAL COUNSEL

Mr. Bulman stated that the public comment period for the proposed rule changes to the New Mexico Administrative Code is from February 12 to March 31, 2016, a 45-day period. The full text of the proposed changes is available on the NMERB’s website, and the notice of the comment period was published in the New Mexico Register. He stated that the NMERB also emailed the rule change notice to 800 payroll and HR staff, as well as to about 8,000 plan members. He said any changes would go into effect on July 1, 2016.

Mr. Bulman highlighted two rule changes proposed since the last presentation of this item to the Board.

-- Deleting Section 2.82.1.11.C, relating to substitute teachers. If this section is deleted, substitutes would be treated the same as all other classes of school employees whose FTE status is used to determine ERB membership. The current wording is ambiguous and raises a concern that it is being inconsistently applied among LAUs.

-- Amending Section 2.82.5.14 regarding disability-related COLAs. Section 22-11-31(G) of the Educational Retirement Act provides that a member who was certified by the board as disabled at the time of regular retirement is eligible for an early COLA. Under the proposal, if such a member later returns to gainful employment with an LAU in a position commensurate with the member’s background, education and experience, the member’s benefit would no longer be subject to the disability-related COLA. The member would remain eligible for future COLAs in the same manner as other ERB retirees.

Mr. Aguilar suggested that the upcoming Board retreat include discussion of possible statutory changes in anticipation of the 2017 legislative session.

12. DIRECTOR’S REPORT: JAN GOODWIN, EXECUTIVE DIRECTOR

a. Legislative Session Update

Ms. Goodwin stated that the NMERB was not able to get on the Governor's Call for legislation that the Board had approved to send to the Governor's Office. Senator Ingle, who carried the NMERB's sustainability legislation in 2013, has offered to sponsor a similar bill in the 2017 session if the NMERB wishes it.

b. Equipment Disposal

Ms. Goodwin requested approval of the Asset Disposal List, dated today.

Dr. Woodfin so moved. Mr. Magid seconded the motion, which passed unanimously by voice vote.

c. Disability Process

Ms. Goodwin reported that, in February 2015, the NMERB issued an RFP to select a disability review provider, and Managed Medical Review Organization (MMRO) was selected. Following contract negotiations and a two-month implementation process, MMRO began reviewing disability applications and supporting medical documentation in January 2016. MMRO is supplanting the work previously performed by the Medical Review Committee.

Ms. Goodwin stated that the transition should be seamless for new disability applicants, who will first contact NMERB to determine their eligibility after ten years of service, and receive an estimate of benefits. If the member indicates they wish to proceed with the disability process, NMERB will enter a new claim onto MMRO's web portal, which will send the member an application packet and deal directly with the member through the final recommendation.

Ms. Goodwin said NMERB expects this transition process will improve the disability process in the following ways: 1) improved documentation, as can be seen in the great level of detail in the recommendation report reviewed by the Board earlier in this meeting; 2) NMERB will no longer be responsible for handling medical records, except in the case of appeals, which is keeping a lot of HIPAA information out of the ERB offices; 3) all of the MMRO physicians will have current medical credentials and will meet continuing medical education requirements; 4) there will be more flexible response times, as MMRO's medical review committee meets weekly; and 5) in the event that a member is denied benefits and chooses to appeal, a physician or nurse will be available to appear telephonically during an administrative hearing to defend MMRO's recommendation, which improves due process for the members. In the past, MRC doctors objected to being called as witnesses.

d. Interest Overpayment

Ms. Goodwin noted that, of the original \$1.69 million that was overpaid, the NMERB has collected approximately \$1.3 million and is still actively working on the remaining \$226,000 that is currently due. Formal and informal payment plans are being worked on with 33 individuals, which total \$160,000, of which \$124,000 has yet to be paid. She said NMERB also regularly reviews the list of people who owe money to see if they have earned any service credit. These individuals are notified that they can either pay the amount owed or the NMERB will remove their service credit.

e. Other

Ms. Goodwin announced that Chris Bulman will be retiring at the end of May, and will be missed greatly.

Responding to a request from Chairwoman Cameron, Ms. Goodwin said staff would prepare a letter to the family of Dr. Pauline (Polly) Turner, former NMERB Board member who passed away this month, for the next meeting agenda.

Ms. Goodwin reported that GRS has notified the NMERB that the 2016 COLA for retirees will be either .09 or .08, depending upon length of service and pension amount.

13. EXECUTIVE SESSION—LIMITED PERSONNEL MATTER (SESSION CLOSED PURSUANT TO NMSA 1978, SECTION 10-15-1(H)(2))

None.

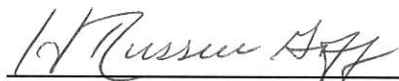
14. ACTION FROM EXECUTIVE SESSION

None.

15. NEXT MEETING: FRIDAY, APRIL 22, 2016 – ALBUQUERQUE

19. ADJOURN

Its business completed, the Educational Retirement Board adjourned the meeting at 11:45 a.m.



Russell Goff, Vice Chairman

ATTEST:



Hipolito J. Aguilar, Secretary

