NEW MEXICO EDUCATIONAL RETIREMENT BOARD

ACTION SUMMARY

RETREAT: DAY ONE

September 23, 2016

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MINUTES OF THE

NEW MEXICO EDUCATIONAL RETIREMENT BOARD RETREAT

DAY TWO

September 23, 2016

1. CALL TO ORDER: QUORUM PRESENT

Day One of the New Mexico Educational Retirement Board Retreat was called to order on this date at 8:30 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
Mr. H. Russell Goff, Vice Chairman
Mr. Hipolito J. Aguilar, Secretary
Dr. Donald W. Duszynski
The Hon. Tim Eichenberg, State Treasurer
Mr. Larry Magid

Members Excused:
None

Staff Present:
Ms. Jan Goodwin, Executive Director
Mr. Rick Scroggins, Deputy Director
Mr. Bob Jacksha, CIO
Mr. Roderick Ventura, General Counsel
Ms. Susanne Roubidoux, Deputy General Counsel
Ms. Dianne Rossbach, CFO
Ms. Lealia Nelson, Outreach Coordinator
Ms. Monica Lujan, Member Services Director

Others Present:
Mr. Reese Fullerton, GenQuest, Inc., Facilitator
Mr. Allan Martin, NEPC
Ms. Judith Beatty, Recorder
[See sign-in sheet.]

b. Approval of Retreat Agenda

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

c. Introduction of Guests

Chairwoman Cameron welcomed staff and guests.

2. STRATEGIC PLANNING: REESE FULLERTON

Mr. Fullerton introduced himself to the board, stating that he has been a facilitator in New Mexico and around the nation and world for about 25 years.

Mr. Goff commented that Ms. Goodwin and staff have done a tremendous job in terms of transparency, but he wanted to know how the NMERB could become even more transparent. He said issues are becoming increasingly complex.

Ms. Goodwin said she had given a presentation to the board in March about making the financial statements more transparent, and the State Treasurer now wants to do a bill to have all the other state investing agencies have the same level of disclosure the NMERB will have in its own financial statements.

Ms. Goodwin said the problem is how much information should the NMERB put out that is informative and helpful to constituents rather than raising unnecessary fear and concern. The NMERB has tried to find a balance on that. For example, NMERB has published an article in the newsletter explaining that, while the 7.75 percent target has not been reached recently, the NMERB is a long-term investor and there will be bumps in the road and drastic changes are unnecessary when there are market downturns. She said she feels the members are getting that message, based on phone calls that the NMERB receives. She said she feels transparency can continue to be achieved with a lot of information on the website and in the newsletter, as well as through providing a lot of information to the legislative committees.

Ms. Goodwin said perhaps the NMERB could have a webinar to answer member questions, as well as do mailings. She commented that she was willing to take whatever steps were necessary to reach the membership. She noted that the NMERB has just hired a contractor to work on op-ed pieces.

Ms. Goodwin said the COLA this year is very low, and that is causing a lot of worry among the constituency. She said the reality is that it is tied to the change in CPI, which is what it should be; however, the members are looking at their Retiree Health Care premiums going up and their medical and prescription co-pays going up as well, and they are feeling the pinch with the lower COLA.

Mr. Aguilar commented that there is a difference between “transparency” and “message.” While the NMERB is very transparent, it also has to be able to deliver the message in a cogent and understandable way that gets people’s attention.

Dr. Duszynski said many retirees aren't on the Internet because they don't want to be on the Internet or don't have service that allows for it. He said one way to get to these people is to be more visible and proactive and address the important questions before they're asked.

Ms. Goodwin noted that NMERB does at least one board meeting in a different part of the state every year. She said visibility is difficult.

Dr. Duszynski suggested having at least one open session every year, where people can come in and ask questions.

Responding to suggestions from the board, Ms. Goodwin said she would continue to reach out to the *Albuquerque Journal* in an effort to get the message across in a positive way.

Board members discussed possible changes to the 2014-16 Strategic Plan. Mr. Fullerton complimented the board on this plan, which offered good guidance and was very practical.

Mr. Scroggins said staff regularly refers to and incorporates the 2014-16 Strategic Plan goals set by the board.

LEGAL BASIS FOR DELEGATION OF INVESTMENT FUNCTIONS

a. Uniform Prudent Investor Act
b. Uniform Management of Public Employee Retirement Systems Act (UMPERSA)
c. New Mexico Law

[Presenters: Rod Ventura; Ian Lanoff, Groom Law Group (on phone); Paul Matson, Arizona Retirement System (on phone).]

Mr. Ventura stated that, prior to 1992, trust investment law forbade a trustee to delegate investment and management functions. That all changed through the years in the sixties; and under the Uniform Prudent Investor Act, they decided a trustee can delegate as long as they take certain safeguards when they do that. They include reasonable care, skill and caution when selecting an agent; establishing scope and terms of delegation; and periodically reviewing the agent's actions to monitor the agent's performance and compliance with terms of delegation. An agent is someone who is assigned to do the duties that the trustee has for a particular responsibility. This can be a person, group, company, agency or something along those lines.

Mr. Ventura said the second law that gives the board authority is the Uniform Management of Public Employee Retiree Systems Act, or UMPERSA. This is important because, under the Uniform Prudent Investor Act, which applies to all trustees regarding investments, UMPERSA was specifically designed for public retirement systems. Private retirement systems are dictated by ERISA, and so their duties are all the same under federal law.

Mr. Ventura said the problem (cited in the Rick Funston and Randy Miller article, "The Risk-Intelligent Public Pension Trustee) is that all the state pension systems do things in different ways because they are dictated by different state laws. The idea of UMPERSA was to take a uniform law and give everybody a uniform way of managing the various public retirement systems. Under this suggested law, they adopted the same standard in the Uniform Prudent Investor Act, which allowed delegation of authority for investments and management to somebody who is responsible provided certain safeguards were taken.

Mr. Ventura said UMPERSA is not mandatory because it was not adopted by New Mexico; however, the Uniform Law Commission structured it so it could apply to all public retirement systems and adopted the Uniform Prudent Investment Act standard.

Mr. Ventura said the heart of the matter is New Mexico law, which adopted the Uniform Prudent Investor Act. It states, “A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances.” Section 22-11-13, part of the Educational Retirement Act, states, “The board is authorized to invest or reinvest the fund in accordance with the Uniform Prudent Investor Act.” This is the statutory authorization for the board to delegate authority for investing.

Ms. Goodwin stated that the board packet contains presentations by highly regarded fiduciary consultants, as well as academic articles and articles for a more general readership. She said all of the materials stress the importance of good governance and how it can enhance and improve investment performance. She commented that it is important for boards to delegate many duties so that they can concentrate their efforts on their core responsibilities, which are setting policy and providing oversight. If a board does move to greater delegation of investment duties, the board should have a robust monitoring process to be sure its policies are being followed. This is addressed in the materials she has provided to the board.

Mr. Matson said certain decisions made by the board are always prudent. In Arizona’s case, that is: 1) external auditor recommended by staff and hired and fired by the board; 2) external actuary; and 3) one external investment consultant. They do not allocate more board time to oversight, but instead make sure that they have direct links to an independent outside organization that can only be hired and fired by the board.

Mr. Martin asked Mr. Matson discuss the investment functions that the Arizona board has retained.

Mr. Matson responded that the Arizona State Retirement System (ASRS) board approves the budget; and while best practice says that the board should have final approval, Arizona has a very hands-on legislature and the budget does go to the legislature for final approval. The board also approves the strategic plan, board committees, hiring and firing of external auditor, general consultant, actuary, and executive director. On the investment side, the board approves the investment policy and the asset allocation.

Responding to Mr. Magid, Mr. Matson said Arizona has three committees: Investment Committee; Operations & Audit Committee; and External Affairs Committee. Each has three to four people on it, the board has nine people, and the Investment Committee receives reports approximately every second month. These come from staff and the external investment consultant. No investment that is made is seen by the Investment Committee before it is made (seen but not voted on).

Mr. Jacksha asked if he understood correctly, then, that the Investment Committee and external consultant are there to verify that the right process and the policies that have been set or approved by the board have been followed. Mr. Matson responded yes.

Mr. Matson stated that everything is documented in a governance handbook, which is reviewed by the board every three years. Initially, the review was done annually or at the discretion of the director.

Mr. Lanoff said he represents some of the largest state funds in the country, and all of his clients delegate a great deal of investment decision authority to staff. This has been ongoing for many years. For instance, CalSTRS has been delegating to staff for over 20 years. The legal backup for a board to do this is that, when it makes decisions as fiduciaries, it is compared to other prudent trustees of comparable skills and experience (Prudent Expert Rule). Almost every large state fund that he is aware of already does this, and those are the funds against which the NMERB would be compared if it were to decide to delegate to staff. It provides a legal basis for it to make that decision.

Mr. Lanoff said that, if the board were to decide to delegate to staff, the required approach would be exactly the same approach if it would take if it were currently delegating to outside investment managers or to an investment consultant. Under New Mexico law, this means acting with reasonable care, skill and caution in selecting that agent (staff); establishing the scope and terms of the delegation; and exercising reasonable care in monitoring the performance of the agents to which the delegation has been made. He commented that there is no black and white answer in the law as to what appropriate and reasonable monitoring of staff requires. He likes to recommend to boards that they have some familiarity with what the staff is doing and what kinds of decisions the staff is making. The question then becomes whether staff's performance allows the board to continue to delegate that authority to staff, and what amount of information is required, and what degree of knowledge on the board's part is required. He said he likes to see information presented to the board or to the investment committee about what decisions have been made, and if a new category of investment has been approved by the board, he recommends that, for the first couple of investments, the board work very closely with staff and have staff make full scale presentations, bring in the managers to make presentations, etc., so the board would have some knowledge about the qualifications of staff to make these decisions and whether the board feels confident to have them continue.

Mr. Lanoff said some of his clients like quarterly reports, but CalSTRS, for instance, likes reports made at every meeting. Others do it less than that. He said sometimes reports are made orally, with the staff and consultant summarizing the investments made previously and how the investments are doing; other times, staff is asked to provide an analysis in writing after the fact, and to a sufficient degree that the board can decide on the adequacy of staff's experience and on the nature of the investments being made. He said there is no one definition of "best practice" or "prudence." He said he is satisfied if a reasonable amount of information is provided to the board, so that the board has adequate understanding of what staff is doing and the nature of the investments being made.

Mr. Lanoff said the issue of liability is not totally clear in the law. The laws that New Mexico statute incorporated (Uniform Prudent Investment Act) refers to agents, but doesn't specifically refer to staff. This is also true of UMPERSA. He said these acts were primarily based on ERISA, which applies to all of the private sector funds. In ERISA, delegation was permitted for all the funds covered by ERISA, but was limited to investments by outside managers and doesn't mention staff at all. He said the person has to be a registered independent investment advisor. Typically, it could be done, but typically staff is not going to be established as a registered independent investment advisor.

Mr. Lanoff said, "The issue here is, under these laws that I've referred to, and under New Mexico law and under ERISA, if you follow the steps, if the agent to whom you delegate has the requisite expertise, if the delegation is done properly so that you're not over-delegating, you're just delegating what is consistent with what other funds are doing – and that is primarily delegating authority to make picks, pick managers and pick funds, and finally the monitoring aspect of it – if you do all three of those things under New Mexico law, and under ERISA when you're hiring a manager, then you're free of any liability. And it's only the delegatee that has the essential liability. If someone is imprudent in making a decision that you've delegated, someone, including yourselves, has to have the ability to sue that party to recover any losses for the fund. As you can imagine, it becomes much more delicate and difficult when you're talking about the liability of the staff to which you're delegating authority. So how do you best protect the fund if the staff is imprudent? And that's a question that I don't really have the answer to and I don't see any answer in New Mexico law as to whether you could sue staff and recover from staff as individuals, so I guess my best analysis would be that, even if you follow these three steps, which are there to protect the fund and the board against liability, there's no absolute protection against liability if you delegate to the staff as there is when you delegate to an outside manager. Because that is explicitly spelled out in New Mexico law."

Mr. Magid asked Mr. Lanoff if, in his opinion, staff would just be an extension of the Investment Committee and not an agent. Mr. Lanoff responded that this would have to be determined, but if staff were deemed an agent, the question is how the board would protect against losses if staff were to act imprudently.

Mr. Matson said ASRS has never come across a situation like this; and practically speaking, any attempts to recover losses from a staff member by suing them would yield very little, since staff members typically would not have that kind of money.

Mr. Lanoff said all of his funds purchase fiduciary insurance, which covers the board and staff. If the NMERB does not have it, he would suggest the board consider it if they do decide to delegate to staff. This would protect the fund from any losses. Mr. Lanoff added that, in his 30 years of experience, he has yet to see a lawsuit against a board or staff under a fiduciary insurance policy or losses caused by investment decisions.

Mr. Martin commented that lawsuits are not specifically against investment losses; rather, they are around failure to follow policy. Mr. Lanoff concurred but pointed out that people can sue people for any reason.

Mr. Lanoff said that if the board follows the three steps, he should be able to defend the board successfully against any potential liability.

Mr. Lanoff stated that, even if the board delegates to an outside manager, someone could allege that the board didn't prudently monitor them, so there is a potential liability problem there, as well. He said that, to him, it is a great potential issue when delegating to staff.

Mr. Jacksha said that, right now, the board is covered by a policy, but staff is not, and the issue is that it will cost money for staff to defend itself if there is such a lawsuit. If this shift is made, that should be considered. Mr. Lanoff agreed. He added that he did not think there was an extra cost to covering staff; if there is, it isn't major. Mr. Jacksha clarified that the NMERB doesn't have fiduciary insurance, as it is very expensive. If board members are sued in carrying out their duties, their legal costs are covered by statute.

Ms. Goodwin thanked Mr. Matson and Mr. Lanoff for their comments and insights. [Mr. Matson and Mr. Lanoff signed off.]

[Break.]

DISCUSSION

Mr. Jacksha said he saw three options: 1) maintain status quo; 2) delegate authority to staff for investment manager decisions, consultant decisions (with exception of general consultant), and the board would retain all policy approval that it has now; and 3) limited discretion, with staff approving managers up to X dollars and certain asset classes. Mr. Jacksha said he wasn't advocating any of these, but added that he would not want a system that would create a lot more work for staff.

Mr. Aguilar said he was concerned about a number of things. He said the first is that the board has gone on record supporting the idea of moving investment staff to exempt status, which means they would serve at the will of the Director. In addition to that, investment staff and the Director currently hire the investment advisor (NEPC). He commented that the problems that arise in organizations in fiduciary matters are always a function of a lack of internal controls. He said he felt that delegating investment authority to staff that is not independent from the Director, and vice versa, would be problematic, and this would be compounded by the fact that the board would be advised about decisions after the fact. He said he realized this was a lot of work for the Investment Committee, but thought it was a very important function. He expressed concern that, without that, certain things could be influenced behind closed doors, and pointed out that it is very difficult to undo contracts, for example. He said staff does not have the fiduciary responsibility to the fund that the board members do.

Mr. Goff commented that his initial concern went back to what he had heard in the legislature a few years ago, where there were concerns expressed about the lack of experience on state boards.

Mr. Aguilar said he has absolute confidence in staff, and noted that the NMERB is outperforming its peers and other funds in New Mexico. He said he just liked the idea of the board hearing information "on the front end rather than the back end," which is provided by the board members who serve on the Investment Committee. He said the system wasn't broken.

Ms. Goodwin clarified that the investment advisor is hired by the board, not staff, through the RFP process.

Mr. Magid said perhaps the Investment Committee does not need to hear presentations from fund managers, since staff and the consultants cover that function very thoroughly through the vetting process. Mr. Jacksha noted that this would not require a policy change.

Mr. Eichenberg said he personally liked hearing presentations from the fund managers, consultant and staff. He commented that he agreed with Mr. Aguilar's comment that the system didn't need fixing because it wasn't broken.

Mr. Jacksha said he would discuss ideas for streamlining the review process with the Investment Committee. He said an existing manager might not need to make a second in-person appearance before the committee, for example.

3. EXECUTIVE SESSION: 11:30 a.m.

-- Limited Personnel Matters (session closed pursuant to NMSA 1978, Section 10-15-1(H)(2), compensation of Executive Director and Deputy Director

Chairwoman Cameron moved that the board go into executive session for the purpose of discussing limited personnel matters, as permitted by the Open Meetings Act, Section 10-15-1(H)(2). Mr. Aguilar seconded the motion, which passed on the following roll call vote:

For: Chairwoman Cameron; Vice Chair Goff; Secretary Aguilar; Dr. Duszynski, Mr. Eichenberg; Mr. Magid.

Against: None.

4. ACTION FROM EXECUTIVE SESSION: 1:00 p.m.

Chairwoman Cameron moved that the board come out of executive session. The only matters discussed in executive session were limited personnel matters, as permitted by the Open Meetings Act, Section 10-15-1(H)(2). Mr. Aguilar seconded the motion, which passed on the following roll call vote:

For: Chairwoman Cameron; Vice Chair Goff; Secretary Aguilar; Dr. Duszynski, Mr. Eichenberg; Mr. Magid.

Against: None.

Chairwoman Cameron moved that any action regarding the Executive Director's salary be delayed until the October meeting. Mr. Aguilar seconded the motion, which passed unanimously by voice vote.

5. NEXT REGULAR BOARD MEETING: FRIDAY, OCTOBER 21, 2016 – ALBUQUERQUE

6. ADJOURN

Its business completed, the Educational Retirement Board adjourned the meeting at 1:00 p.m.

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Mary Lou Cameron, Chairwoman

ATTEST:

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Hipolito J. Aguilar, Secretary