MINUTES
of the
FIFTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

November 28, 2012
State Capitol
Santa Fe, New Mexico

The fifth meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2012 interim was called to order by Senator George K. Munoz, chair, on Tuesday, November 28, 2012, at 9:15 a.m. at the State Capitol in Santa Fe, New Mexico.

Present
Sen. George K. Munoz, Chair
Sen. Timothy M. Keller
Rep. Larry A. Larrañaga
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Sen. Mary Kay Papen
Sen. John M. Sapien
Rep. Jim R. Trujillo
Rep. Luciano "Lucky" Varela

Absent
Rep. Henry Kiki Saavedra, Vice Chair
Rep. David L. Doyle
Rep. William "Bill" J. Gray

Advisory Members
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Rep. Rhonda S. King
Rep. Jane E. Powdrell-Culbert
Rep. Sheryl Williams Stapleton
Rep. Mimi Stewart
Rep. Shirley A. Tyler
Rep. Richard D. Vigil
Sen. Tim Eichenberg
Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Sen. William H. Payne
Rep. William "Bill" R. Rehm
Sen. John C. Ryan
Sen. Michael S. Sanchez

Staff
Tom Pollard, Legislative Council Service (LCS)
Doris Faust, LCS
Claudia Armijo, LCS

Guests
The guest list is located in the meeting file.

Handouts

Handouts and written testimony are in the meeting file and posted on the New Mexico Legislature web site.

<u>Tuesday, November 28</u>

Senator Munoz welcomed the committee members and guests. He reminded members that the meeting was being webcast and then asked them to introduce themselves, which they did. Members discussed a possible date for the next IPOC meeting. December 17 was the date selected and agreed upon by the members.

College Savings Plan and Recent Investment Performance and Pending Litigation

Robert Desiderio, vice chair, Education Trust Board (ETB) of New Mexico, Jeremy Thiessen, managing director, Pension Consulting Alliance, Inc. (PCA), and John Boyd, Freedman, Boyd, Hollander, Goldberg, Ives & Duncan, P.A., addressed the committee.

Mr. Thiessen began by providing background information about the PCA, saying it is an independent, full-service investment consulting firm providing a broad range of investment advice to a wide variety of institutional investors. Investment consulting is the PCA's only line of business. The PCA began consulting for the ETB in December 2011. Prior to that, the PCA did not provide consulting services to any 529 college savings programs run by Oppenheimer. Currently, the PCA now provides investment consulting services to eight 529 college savings plans, with total client assets of $27.7 billion.

The ETB uses the PCA's team of consultants to develop and influence the monitoring and guidelines process. Reports provided by the PCA to the ETB include monthly performance watch reports on underlying mutual funds, monthly investment risk metrics reports, quarterly investment monitoring reports, quarterly watch list review and updated memos and an assessment of Oppenheimer's annual program review.

The New Mexico college savings programs consist of two separate programs: the education plan, sold directly to participants; and the scholars savings plan, sold through investment advisors. Participants in each plan tend to select an age-based option.

Referring to the handout, Mr. Thiessen directed the members' attention to the charts and graphs illustrating the funds' performance as of September 30, 2012.

Mr. Desiderio explained that the education trust plan is known as the 529 plan in state and federal law. Money earned under the plan can be used for tuition, books, room and board and anything related to college.

Mr. Boyd led a discussion about the litigation related to the New Mexico 529 funds. He noted that a settlement with Oppenheimer of $67 million was recovered for account holders. The amount represents about 60% of the losses. The ETB hired three experts to determine the fairness of the settlement. However, the class action suit filed before the settlement was reached is still pending. He added that the class has been certified.

Members asked what entity was responsible for hiring Oppenheimer. The ETB made that hiring decision. There was a discussion about whether the account holders are satisfied with Oppenheimer. Members were told that the ETB is looking into management options.

The chair asked that Mr. Desiderio give Mr. Pollard copies of the board's operating expenses. It was noted that Oppenheimer's fees are higher than average.

There was a brief discussion about New Mexico's lottery scholarship program, during which members voiced concerns about its financial future. Some members asked if an additional revenue stream could be used. The members were told that the issue is being researched.

Proposed Legislation from the Treasurer's Office for Endorsement by the IPOC

Committee members were advised that copies of legislation proposed for endorsement could be found in the bound handout.

James B. Lewis, state treasurer, and Mark Valdez, deputy state treasurer, presented to the committee regarding proposed legislation. Treasurer Lewis said that he is in the process of reviewing the proposed initiatives with stakeholders. He said his office would like to propose legislation that, among other things, would provide "clean-up" language, removing the treasurer references where the references are deemed inappropriate.

Mr. Valdez added that the Office of the State Treasurer is proposing the language contained in *Discussion Draft .190369.2SA*, a copy of which was handed out to each committee member. The legislation would clarify authorized investments of the state treasurer, change the name of the *Participating Government Investment Fund* to the *Local Government Investment Pool* (LGIP) and increase the percentage of general funds and bond proceeds that can be invested in the LGIP. Mr. Valdez noted that, currently, municipalities and counties have greater autonomy related to investing in municipal bonds than the state treasurer.

Discussion Draft .190369.2SA was endorsed, without objection, by the committee. Either Senator Munoz or Senator Keller will carry the bill.

New Mexico Retiree Health Care Authority (RHCA) Proposed Legislation for IPOC Endorsement

Mark Tyndall, executive director for the RHCA, presented the proposed legislation by the RHCA. Mr. Tyndall reminded the members that the RHCA was created in 1990 and provides medical coverage to over 50,000 retired public employees and educators. About 300 employers with more than 133,000 employees participate. The RHCA has increased its positive fund balance over the past five years. However, increasing medical costs, and career contributions that do not match benefits, present fundamental challenges requiring additional action. Page 5 of the RHCA handout illustrates the proposed contribution increases for both employees and employers.

Mr. Tyndall explained the impact of the proposed contribution increases, saying that an employee making an annual salary of $40,000 will have increased contributions of $3.85 per biweekly pay period, or about $100 annually over a three-year period. He added that there will be no general fund impact until fiscal year (FY) 2017, at which time employer contributions will increase 0.5% annually for three years. The general fund impact each year will be approximately $9.9 million, with a total impact of $29.6 million once fully implemented.

With discussion, and opposition by two committee members, the committee voted to endorse the RHCA legislation.

Educational Retirement Board (ERB) Proposed Pension Solvency Legislation

Jan Goodwin, executive director for the ERB, and Bob Jacksha, chief investment officer for the ERB, spoke with the members about the Educational Retirement Fund performance.

Mr. Jacksha began with a review of the investment portfolio and its performance. He directed the members' attention to the ERB handout dated November 28, 2012. He noted that the value of the fund's assets reached an all-time high of $9.8 billion on September 30, 2012; the previous high was $9.6 billion as of September 30, 2007. Investment earnings for the 12 months ending on September 30, 2012 were $1.4 billion. The fund is ranked, for that same period, in the top 25% of its peer universe. For most time periods evaluated, the fund exceeded the investment target rate of return of 7.75%. Despite the excellent investment performance, changes to the plan need to be implemented to bring the plan into long-term solvency.

Ms. Goodwin began by acknowledging the board members present at the meeting, including Chair Mary Lou Cameron and Vice Chair Russell Goff. Next, Ms. Goodwin referred committee members to the ERB handout dated November 28, 2012. She noted that the plan covered under the Educational Retirement Act currently has 61,673 active members, 35,457 retirees and beneficiaries and 33,011 inactive members.

Next, Ms. Goodwin reminded the committee members that the ERB statute currently provides three ways for its members to retire. Members can retire:

1) at age 65 with five years of service credit;

2) at any age, if the sum of the member's age and earned service credit equals at least 75 (rule of 75); or

3) at any age, with 25 years of earned service credit.

Ms. Goodwin reminded the committee that the stakeholders in the Educational Retirement Act plan met on several occasions and throughout the state. As a consequence of those meetings, on July 17, 2012, a consensus on changes was reached. The stakeholders presented their proposal for plan changes to the ERB at its August 2012 meeting. The group of participants included individuals from 15 groups representing ERB plan stakeholders. The proposal would increase all active members' employee contribution rates to 10.7% in a phased-in process reaching the increased rate in FY 2015. Additionally, the proposal would create a new tier of employees hired on and after July 1, 2013. The retirement age and service requirements and benefits for members in the new tier would include a minimum retirement age of 55 years. Retirement eligibility would occur:

1) at age 67 years with five years of earned service credit;

2) at any age if the sum of the member's age and years of earned service credit equals at least 80 (rule of 80); or

3) at any age with 30 or more years of earned service credit.

Additionally, members in the new tier can expect a cost-of-living adjustment of typically 2% annually once they reach the age of 67 years.

Ms. Goodwin further explained that the stakeholders' proposal is projected to reduce the ERB's unfunded liability, and according to those projections, the fund would be 75% funded by the year 2030, and would reach 100% funded status in the year 2043. Ms. Goodwin noted the various charts and graphs provided in the ERB handout, which illustrate the upward trend in the funding ratio anticipated if the stakeholders' proposal is enacted after the upcoming 2013 legislative session.

Some members asked if the proposed increase in member contributions would be applied to members making less than $20,000 a year and urged Ms. Goodwin to ask the board to consider exempting those members from the increased contributions. It was noted that, under the stakeholders' proposal, employer contribution rates would be 13.9%, the statutory rate. Ms. Goodwin said that she did speak to the board about the carve-out for those employees making less than $20,000 a year. She noted that the board will meet again on December 7, 2012 and will consider any changes to the plan at that time.

The committee members thanked Ms. Goodwin for her presentation and for the hard work of the board. The ERB *Discussion Draft 190404.4SA* was endorsed without objection.

Report on the Investment Policies and Performance of the State Investment Council (SIC) Private Equity Program and the Small Business Investment Corporation (SBIC)

Joseph Badal, chair of the SBIC, Russ Cummins, executive director and investment advisor for the SBIC, and Steve Moise, state investment officer for the SIC, spoke to the members about the SBIC programs.

Mr. Badal reminded the members that the SBIC was formed in 2001 pursuant to the Small Business Investment Act. It was originally founded by an allocation of 1% of the Severance Tax Permanent Fund. The purpose of the SBIC is to make investments to create job opportunities and support new or expanding businesses in New Mexico. It is required to make investments in connection with its cooperative agreement partners. The SBIC has two investments programs:

1) the equity program, with $17.4 million outstanding or committed; and

2) the loan program, with $12.2 million outstanding or committed.

Currently, there is $5.7 million of uncommitted money.

The SBIC's total original Severance Tax Permanent Fund allocation in 2007 was $47 million, and the current assets of the SBIC are $35.2 million as of October 31, 2012. The reduction in assets stems primarily from realized and unrealized losses in the equity program limited partnerships and equity management fund fees.

Mr. Badal continued, saying that the board believes that the equity program may have been an ill-conceived idea, at least in part because it has a high concentration of high-risk investments. He noted that most of the equity investments have been made in the Albuquerque area because it is not typical for such investments to present themselves in the rural areas of the state. Equity investments are often associated with high-technology ventures, not the typical mom-and-pop enterprise.

He continued by saying that investing only in New Mexico companies limits diversification. Equity investments are typically long-term in nature, with a slow turnover of funds for reinvestment purposes.

With regard to the SBIC's lending program, Mr. Badal said that since its inception, and through its lending partners, the SBIC has provided funding for more than 2,400 loans to New Mexico small businesses, supporting more than 5,800 jobs. Additionally, he noted that loans have been made in 31 of New Mexico's 33 counties. Committed capital has been loaned and recycled, providing leverage of the SBIC capital. Interest income has been greater than lending losses, resulting in a net gain for the SBIC's lending program. The SBIC is currently amending loan agreement terms to strengthen its lending practices and to reduce the risk of losses.
As a result of more stringent banking regulations, there has been a contraction of bank lending resulting in a funding gap for small businesses in New Mexico; however, the SBIC's lending program is helping to fill that gap.

Mr. Badal advised members that there have been recent changes to the SBIC, including a new board that was appointed by the governor in 2011, and a new executive director and investment advisor selected in 2012. According to Mr. Badal, the new board is both active and engaged. In November 2011, the board held a strategic planning meeting. Then, in August 2012, the SBIC held a meeting in Hobbs on the topic of *Accessing Capital in New Mexico*. Board members have attended community events and meetings with current and potential lending partners and have conducted detailed operational reviews of their lending partners.

Looking forward, the SBIC board plans to expand its lending program and de-emphasize its equity program.

There was a long discussion regarding the equity program. Members asked why the SBIC board did not view it as well-conceived. Mr. Badal reiterated his assessment that the program is not well-suited for businesses in rural or smaller population areas. He repeated that equity ventures usually lend themselves to the high-technology industry or larger businesses and those types of enterprises are typically located in the larger metropolitan areas, such as Albuquerque.

Members asked for the SBIC to consider all options for the equity program, including seeking out smaller enterprises throughout the state.

Mr. Moise began his presentation to the committee by asking that each member read the Hewitt EnnisKnupp memo dated July 24, 2012 and included as a handout. He opined that the memo is a thoughtful piece of information, directly relating to the governance and fiduciary duties of the SIC.

Next, Mr. Moise advised that the SIC would be seeking five legislative initiatives. All five are contained in the handout to the IPOC from the SIC, dated November 28, 2012.

Discussion Draft .190286.5SA (SIC membership) — This bill would increase the experience and fiduciary standards required for appointment to the SIC. The bill would allow flexibility with the frequency of council meetings and notice of those meetings. Additionally, the bill would allow the SBIC to invest its Severance Tax Permanent Fund allocation in the SIC investment pool, rather than in short-term notes or certificates of deposit.

The members discussed the bill and also a similar bill proposed in an earlier session. After discussion, the members made a motion, which was seconded, to merge the current proposal with Senate Bill 53 from the 2012 session. The bill as merged was endorsed by the committee without opposition.

Discussion Draft .190287.2SA (prudent investor standard) — This bill would call for New Mexico voters to approve a constitutional amendment to increase the standard of care under which the land grant permanent funds must be managed, aligning its management with the provisions of the Uniform Prudent Investor Act (UPIA). According to the SIC, dated and arbitrary caps on certain investments would be removed, as they would conflict with the UPIA standard.

Members discussed the merits of the proposed legislation and voiced concerns regarding the voters' abilities to understand the logistics of such a constitutional change. In that regard, members noted that information about the proposed amendment would need to be readily available to voters.

Discussion Draft .190288.4SA (private equity) — This bill would repeal the Private Equity Investment Advisory Committee (PEIAC) as a statutorily established entity. It would also increase experience requirements of New Mexico private equity managers and would remove special dispensation for New Mexico aerospace investments. Additionally, the bill would reduce the acceptable investment exposure to 40% on any one entity and add mandatory reporting requirements to SBIC investments of the Severance Tax Permanent Fund.

Discussion Draft .190289.1SA (SIC budget responsibility) — This bill provides the SIC with flexibility in determining appropriate budget structure and direction needed to fulfill the council's required fiduciary obligations to manage and grow the $16 billion in permanent funds while also protecting them from unnecessary risk.

Members were generally not supportive of this SIC initiative. There were concerns about potential abuses, and although members feel confident in Mr. Moise and his work at the SIC, they realize that future state investment officers present a huge "unknown". The members generally maintained that the budget controls are in place for a good reason and help to ensure the public trust. The bill was not endorsed. However, Mr. Moise plans to work with legislators on developing a different concept for the IPOC's consideration at its December 17, 2012 meeting.

Discussion Draft .190290.1SA (SIC personal responsibility) — This bill would exempt SIC employees from restrictions in the Personnel Act. According to Mr. Moise, those restrictions prevent the council from properly hiring and compensating employees at a market rate. The SIC hires individuals that guide potentially hundreds of millions of dollars in public investments, and to get the best and brightest, the SIC needs to pay market-rate wages.

Members discussed the difficulties that all state agencies, not just the SIC, face related to the state personnel system. Some members questioned whether the answer is to work on that system, rather than simply removing agencies from its rules and procedures. Although members were generally sympathetic to the concerns and issues faced by the SIC, the bill was not endorsed. Mr. Moise agreed to bring a revised draft to the December 17 IPOC meeting.

Some members requested that Mr. Moise ask his staff to electronically send committee members a copy of the Hewitt EnnisKnupp report. Mr. Moise said he would be happy to get the report sent to them and mentioned it is also available on the SIC web site.

There was a discussion about the pending court cases and recoveries sought for the State of New Mexico by the SIC. Mr. Moise said that the SIC is confident in its decision to hire the Day Pitney law firm to handle litigation. He said that two defendants had been dismissed as the result of a New Mexico Supreme Court decision. Those defendants are Hank Morris and Alan Hevesi.

After a discussion related to the cost of the litigation, Mr. Moise reminded committee members that the litigation is being handled on a contingency basis. He noted that it is important to preserve the state's rights in the litigation.

Lastly, Mr. Moise said that the SIC would have bill drafts for the IPOC to consider at its November meeting.

With no further business, the committee adjourned at 4:00 p.m.