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

July 7, 2016
Room 322, State Capitol
Santa Fe

The second meeting of the Investments and Pensions Oversight Committee (IPOC) was called to order by Senator George K. Munoz, chair, on July 7, 2016 at 9:15 a.m. in Room 322 of the State Capitol.

Present
Sen. George K. Munoz, Chair
Rep. Monica Youngblood, Vice Chair
Sen. Jacob R. Candelaria
Rep. Larry A. Larrañaga
Sen. Steven P. Neville
Rep. Jane E. Powdrell-Culbert
Rep. Jim R. Trujillo
Rep. Luciano "Lucky" Varela

Absent
Sen. Sue Wilson Beffort
Rep. Miguel P. Garcia
Sen. Carroll H. Leavell
Sen. Bill B. O'Neill
Rep. William "Bill" R. Rehm
Sen. William P. Soules

Advisory Members
Sen. Ted Barela
Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales
Sen. Stuart Ingle
Sen. John C. Ryan
Rep. Tomás E. Salazar
Rep. James E. Smith
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. William H. Payne
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton

Staff
Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Diego Jimenez, Research Assistant, LCS
Tessa Ryan, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

Handouts
Handouts and other written testimony are in the meeting file.

<u>Thursday, July 7</u>

Update from the Educational Retirement Board (ERB)

Jan Goodwin, executive director, ERB, introduced several members of the ERB staff who were in the audience. Ms. Goodwin and Bob Jacksha, chief investment officer (CIO), ERB, presented an update on the ERB, its membership and its investment performance as follows.

Active members, retirees, benefit payments and contributions. Over the period from fiscal year (FY) 2001 through FY 2015, the number of active members, who are personnel serving students in pre-kindergarten through twelfth grade and students in the higher education systems, remained fairly constant at around 61,000. Meanwhile, the number of retirees has steadily increased over that period. In each fiscal year since FY 2001, the amount in benefit payments has exceeded the sum of employee and employer contributions. That imbalance is characteristic of mature pension plans.

Historic and future retirements. The number of retirements in the last nine fiscal years is consistent with national trends, including the "silver tsunami". An apparent spike in retirements in FY 2013, as shown on page five of the presentation handout, actually reflects a change in methodology used by ERB actuaries. Those actuaries, who consider factors such as employer type and employee tier, project that retirements will gradually decrease between FY 2016 and FY 2025. A map on page eight of the handout shows the distribution by county of the more than $775 million in benefits paid to retirees in 2015. Those payments directly and indirectly benefit the state's economy.

Investment performance and assets through March 2016. For the year ending March 31, 2016, investments yielded a return of almost $45 million, or .4%, net of investment management fees. That number falls short of the 7.75% actuarial target. When measured for periods going back fewer than 30 years, almost all returns have fallen short of the target. Nevertheless, actual returns have exceeded the policy index targets in all periods measured, and the 30-year return average of 9.2%, gross of fees, has ranked the ERB first among its peers. Charts on pages 16 and 17 of the handout show, for the periods of one, three, five and 10 years before March 31, 2016, the ERB's total-fund's and other portfolios' performance, gross of fees, as measured by risk taken and return yield.

On March 31, 2016, ERB-managed assets equaled $11.1 billion. Overall, total assets have increased over the eight-year period before then.

May 2016 investment update. In April, investments yielded a 1.2% rate of return. For May, the figure was .3%. At the end of May, assets equaled $11.3 billion, and the fiscal-year-to-date return was 1.5%. The ERB expects that the measures for June will be comparable.

Key consultants and service providers. Some of the ERB's consultants and service providers, who perform a variety of actuarial, legal, financial, information technology and other services, and who are selected through competitive processes, have had long professional relationships with the ERB.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Proportion of active members to retirees; fund solvency. Several members expressed concerns that: 1) over time, the number of active members has remained relatively constant, while the number of retirees has increased; 2) often, in a given year, more money has been paid out of the fund than drawn into it; and 3) because of these trends, the fund's corpus will erode. In response, Ms. Goodwin: 1) pointed out the difference between the ERB and a "pay-as-you-go" retirement program like social security: the ERB has a trust fund of over $11 billion, while others do not; 2) noted that, in some years, investment returns have filled the gap between payments and contributions; 3) said that actuaries who study the fund are cognizant of the matter; and 4) noted that the state's economy is relatively stagnant, which explains why there are not more schools and teachers to drive up the number of active members. Mr. Jacksha remarked that the ERB, to meet its obligations, was designed to rely on active members' contributions in the program's early stages and, after that, to rely increasingly on investment income.

Retirement trends. Ms. Goodwin indicated that members' average retirement age has risen, partly because of recent changes to the eligibility rules. She summarized those rules for each of the classification tiers. She also stated that, even though there are increasingly fewer payers in the system, the fund will remain solvent for the foreseeable future.

Economic effects of benefit payments. A member underscored the economic importance to counties of the benefit payments made to retirees residing in those counties and the loss of economic potential corresponding to payments made outside the state.

Report on the ERB's Efforts to Enhance Transparency and to Improve Governance Structures

Ms. Goodwin prefaced the presentation by stressing that government employees serve in positions of trust. That trust is especially important in the case of those who help manage a high-value pension system, like the ERB does, she said. Then she and Mr. Jacksha outlined, as follows, some practices of the ERB for publicizing agency-related information and for ensuring effective governance.

Transparency. On its website, the ERB publishes program participation information and a variety of current and historic information concerning the pension fund's status and investments; the agency's policies and operations; and board meetings and policies. In particular, within these categories are: 1) quarterly performance reports, which include both general information and detailed information on investments, such as allocations, managers and performance metrics, and which include placement agent disclosures; 2) investment policies focused on such topics as: the selection process for service providers; roles and responsibilities of key individuals and entities; management of the internal core bonds portfolio; and risk controls; and 3) annual actuarial and financial reports. In June, the board formalized these publication practices by adopting a transparency policy, copies of which were distributed to the committee.

The ERB has researched and resolved to adopt financial reporting best practices by similar public pension systems. Accordingly, the agency is striving to follow a set of recommendations issued recently by The Pew Charitable Trusts to improve transparency. Among other measures, the ERB will adopt comprehensive fee reporting standards and increase public disclosure of investment policies. Examples of the ERB's current financial reporting and disclosures are on pages 13 and 14 of the presentation handout. Sample sheets containing the types of information the ERB wishes to incorporate in its reporting are on pages 15 through 18 of the handout. Future statements of changes in fiduciary net position will, as in the example on page 15, include amounts of contributions by members and employers and include more detail about investment expenses. The ERB will also issue schedules to spotlight internal investment activity expenses for the portion of the fund managed by ERB staff, and it will issue schedules of administrative expenses and schedules of professional/consultant fees.

To further improve its transparency, the ERB participates as a member of the Institutional Limited Partners Association and has endorsed the organization's fee transparency initiative.

Governance. The ERB's trustees oversee and help carry out some of the agency's responsibilities. They are charged with hearing agency reports, reviewing certain agency policies, establishing certain agency practices and hiring certain agency staff. The board complies with the Open Meetings Act in holding regularly scheduled and as-needed meetings. Meanwhile, committees of the board are charged with overseeing investments, audits and the alternative retirement plan.

The ERB is learning about and considering for adoption other state pension fund programs' models of governance.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Board retreat; Arizona's pension-governance system. Mr. Jacksha explained that the choice to hear from the executive director of Arizona's public pension system at the board's retreat was influenced by his and a board member's having heard the executive director speak at a conference and by the board's desire to learn about Arizona's model.

Investment-related governance. Mr. Jacksha reported that the investment committee meets monthly for about three to four hours at a time and that the committee: hires the ERB's private equity managers; approves other types of investment services contracts; reviews investment reports and performance; and decides on policy changes.

Policy on investment risk. Mr. Jacksha indicated that: 1) the fund's portfolio is relatively conservative; 2) managers focus on how the portfolio's pieces interact; 3) managers evaluate asset allocation every two years and make changes accordingly; and 4) managers generally do not drastically change the portfolio. In response to a member's suggestion that a law be enacted to limit the degree of risk-taking managers engage in and ensure conservatism in investing, Mr. Jacksha said that managers are currently governed by the board, the prudent investor rule and standards for institutional investors. The member expressed a preference for conservative investments that yield slow but steady financial growth.

Status of litigation; possibility of legal action. Roderick Ventura, general counsel, ERB, who was in the audience, summarized the status of litigation affecting the ERB, and he characterized that activity as relatively quiet. He reported that, because the litigation involved agency settlements, the attorney general had moved to take over as the plaintiff in a *qui tam* suit filed under the Fraud Against Taxpayers Act (FATA) by an individual plaintiff, Frank Foy. Mr. Ventura added that: such settlements require court approval to take effect; other settlements, besides the one at issue, could materialize; and the ERB has pursued its own lawsuits in this context. Mr. Jacksha remarked that the placement agent disclosure policy was established in response to the alleged fraud and that the ERB monitors the disclosures made under it.

Mr. Ventura acknowledged the possibility of a legal remedy, besides that established in the FATA, that a member could pursue against the ERB for an alleged breach of fiduciary duty.

Fund management. Mr. Jacksha said that the ERB actively manages most of the fund's portfolio; it does not actively manage international stocks.

Investments and economic development. Mr. Jacksha said that the ERB is limited in its ability to make investments to enhance the state's economy because it must comply with the prudent investor rule, which requires that it make investments in the best interest of the fund's beneficiaries; nonetheless, managers do look for in-state investments that could enhance the state's economy. In contrast, he said, the State Investment Council (SIC) operates an economic-development-focused investment program. A member praised investments that help the state's economy, such as the expansion of a natural gas pipeline to Mexico.

Funded ratio; fund solvency. Ms. Goodwin reported: that, as of June 30, 2015, the ERB funded ratio was 63.7%, up from 63.1% on that day in 2014; that more recent figures on the funded ratio will be available in the fall; and that, ideally, a public pension plan is funded at 100%, but such an ideal is rarely attained. Responding to a member's statement that a mark of a healthy plan is an 80% or higher funded ratio, Ms. Goodwin pointed out that the direction a plan is headed in, not just its funded ratio, also matters. The member reiterated the concern about the fund's solvency and suggested that further program changes might be in order. Ms. Goodwin said that after the results of an actuarial study become available, the ERB will, if appropriate, recommend that the board adopt program changes.

Ms. Goodwin also expressed her view that despite anticipated volatility in investment performance, the fund will become increasingly solvent thanks to pension reform legislated in 2013, and she said that actuaries take into account the effects of increasing life expectancy of ERB retirees on fund solvency.

The "Brexit" event. Mr. Jacksha commented that: Brexit, Britain's intended exit from the European Union, caused some market upset, which then subsided; some of the ERB's foreign investments took a hit as a result; about 15% of the portfolio consists of foreign investments; and the long-term effects of the ongoing event are hard to predict.

Transparency policy; reporting. Ms. Goodwin noted that the ERB has been implementing most of its transparency policy for over eight years. She said that the ERB addresses potential conflicts of interest through gift-reporting and annual financial disclosure requirements. Mr. Ventura and Mr. Jacksha added that managers' fiduciary duties and the board's governance policy also help guard against conflicts of interest.

Mr. Jacksha indicated that ERB quarterly investment reports are available on the ERB website and are provided to the Legislative Finance Committee (LFC) and that the IPOC receives the substance of monthly reports disseminated to the LFC and the board, which meets monthly, through the ERB's periodic presentations to the IPOC. Ms. Goodwin indicated that the ERB will begin producing statements of financial position with its statement ending June 30, 2016. Mr. Jacksha explained that the approximately three-month lag in investment reporting is due to the fact that the ERB cannot complete its financial statements until after it receives its private assets reports, which are made quarterly.

Approval of Minutes

On a motion made and seconded, the minutes from the May meeting were adopted without objection.

Report on the Deferred Compensation Plan Administered by the Public Employees Retirement Association (PERA)

Wayne Propst, executive director of the PERA, apologized for his absence at the previous meeting and introduced Jon Grabel, CIO, PERA, and Karyn Lujan, PERA Smart Save plan manager, PERA, who presented as follows on the PERA-administered deferred compensation plan.

Smart Save plan overview and administration. The PERA views the Smart Save plan as one of the three legs of a retirement-savings stool. The Smart Save plan, participation in which is optional and which is supplemental to the state's pension plan, follows a different structure from the pension plan in that it: 1) is participant-directed; 2) is defined-contribution; and 3) poses no risk of liability to the plan sponsor, the PERA. The PERA recently re-branded the plan to help clarify that it is a PERA-sponsored, not nationwide, program.

The PERA employs on-staff and contract personnel to administer the program. A program director and an administrative assistant are based in Santa Fe, and three regional representatives serve in the northern, central and southern regions of the state. The PERA also uses a third-party administrator, Nationwide Retirement Solutions, to perform recordkeeping services and an investment consultant to report fund metrics, which it does quarterly.

Smart Save contributions withdrawal options, fees and activity. The payoff to a Smart Save participant depends on the amount, timing and duration of contributions and on the participant's investment choices.

A participant may withdraw money from the participant's plan upon retirement, upon separation from employment or while employed. Federal and state taxes on those withdrawals are generally withheld, but there is no federal penalty for early withdrawal. If employed, a participant may make withdrawals if the participant is 70 and one-half years or older, if the withdrawals are in the form of a loan or if the balance is $5,000 or less and the participant has not contributed to the plan in the two prior years.

Each quarter, the PERA board reviews the plan's fees. Every participant pays the automatically deducted, annual fee of $52.00, which is waived until either two quarters in the program pass or the account balance reaches $1,000. In addition, a net expense ratio of .41% (as of the March 2016 quarter) applies to each account. The chart on page seven of the handout illustrates the cost advantage of paying institutional rate fees over retail rate fees.

Participants' target-date investment options consist of four investment classes, each with a selection of portfolios that range from conservative to aggressive. Participants also may select from a discrete list of other investment funds. The target-date investment options are illustrated in a chart on page eight of the handout. Target-date funds are designed to perform optimally within a time period determined by a participant's age and projected retirement year; they automatically update each year to make the portfolio more conservative.

Nationwide Retirement Solutions reported that, for the quarter ending in March, the program had $494 million in assets and had 19,053 participants collectively employed by 289 public entities. PERA administrators are mindful of the gap between the average plan balance of $22,800 and the median balance of $6,632. They are working to enroll more younger participants.

Plan accomplishments and initiatives. The number of enrollments increased substantially in response to the introduction of the program's "EZ Enrollment Form", which allows participants to enroll in a plan and choose a target-date fund-based portfolio. Program administrators have also improved the program by simplifying program distributional materials and by conducting seminars throughout the state.

To achieve its goals of enrolling more young participants, increasing employer participation and improving the program, the PERA plans to: 1) broaden its investment education initiatives; 2) explore social media and other technology-related opportunities; 3) continue its traditional methods of outreach; and 4) evaluate its administrative fees.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Plan eligibility. Ms. Lujan indicated that all PERA-covered employees, including state and local government employees, are eligible to participate in Smart Save; she added that a small number of schools — mostly colleges — have adopted resolutions allowing participation by their employees. Mr. Grabel said that he would follow up with information on when the program was first made available to all PERA-covered employees.

Plan advertising and financial advice. Ms. Lujan indicated that, in addition to the PERA's participation in new employee orientations and its other initiatives to educate younger, prospective participants, Nationwide Retirement Solutions helps the PERA in those efforts. Ms. Lujan also said that Nationwide Retirement Solutions representatives may provide personalized financial advice.

Tax consequences of deposits, loans and withdrawals. Ms. Lujan explained that: 1) money paid into the plan is tax-deferred; 2) interest payments a participant makes on a loan are deposited into the participant's account; 3) if money from a loan is not repaid, the Internal Revenue Service treats the amount borrowed as income for income tax purposes; 4) the standard percentage tax withholding applies to withdrawals, but is subject to participant adjustment; 5) the standard rules for withdrawals that apply to other types of retirement savings accounts apply to Smart Save withdrawals; and 6) Nationwide Retirement Solutions tracks and advises participants of their required minimum-distribution deadlines and makes distributions in accordance with those requirements.

Report on the PERA's Efforts to Enhance Transparency and to Improve Governance Structures

Mr. Propst acknowledged Secretary of State Brad Winter, who has formerly served on the PERA board, in the audience.

Mr. Propst stressed that the PERA is committed to good governance and transparency and strives to improve in those areas. He said that the agency has taken steps in the last few years toward that improvement, and he underscored the great responsibility the PERA is charged with in overseeing the approximately $14 billion in assets belonging to its members. Mr. Propst and Mr. Grabel described the PERA's governance and transparency as follows.

Governance and transparency: key components. The PERA's efforts to protect its members' interests and the fund fall into three categories: 1) governance structure; 2) implementation and accountability; and 3) financial objectives.

Governance structure. PERA members elect a board, which sets standards for good governance and transparency and which, in turn, directs staff to implement those policy initiatives fairly. Staff, in turn, direct key vendors who help with that implementation and who must make a commitment to the PERA's mission. Several layers of review — in the form of internal and external audits, external actuarial valuations of assets and liabilities, external custodian bank reporting and independent investment consultant reporting — help ensure that every cent under the agency's control is accounted for. The agency plans to act on recent internal audit recommendations for improvement. Meanwhile, it is encouraged by having: consistently received awards for excellence in financial reporting; reached full compliance with Governmental Accounting Standards Board Statements 67 and 68; responded quickly to requests for its public records; promoted a culture of accountability and ethics; and amended its vendors' contracts to include gift disclosure requirements.

To apprise the public of the PERA's activities, all meetings are conducted in accordance with transparency-focused laws and are streamed online. Further, meeting materials and governance rules are made available on the agency's recently improved website.

Implementation and accountability. The PERA is implementing the results of a strategic planning process it began in July 2014, which involved all PERA staff. The process included a nonscientific survey of PERA members, a follow-up of which is planned for FY 2017. The process brought about a new mission statement, new core values and new organizational priorities. Those priorities are: 1) improving advocacy and outreach for members; 2) providing clear, transparent information about the status of the fund; and 3) improving outreach to employers and members. To implement its goals, staff are conducting retirement seminars throughout the state; holding monthly seminars in Santa Fe and Albuquerque; offering employers training in accounting; participating in relevant conferences; meeting with employers on request; and providing online monthly investments updates. The PERA is considering reporting on its website the salaries of its exempt employees and the amounts of the contracts it enters into.

Financial objectives. As part of its focus on solvency, the PERA began in December to review its portfolio and, with input from consultants, concluded that it had too much of the assets it manages invested in private equity. It decided to expand its equity market exposure. In an effort to increase returns and decrease risk, the PERA also established as objectives: reducing to four the number of its asset categories, which, together, can weather different economic cycles; establishing new allocation targets; focusing on risk-adjusted returns; right-sizing its rate-of-return expectations; considering a reduction of its actuarial return assumptions; and implementing a comprehensive risk system to improve control of the portfolio. Elsewhere, the PERA comprehensively reviewed its investment policies and procedures and adopted an update of its investment policy statement. It has also reduced its investment manager fees by over $10 million from the prior year and decreased its custody banking and consultant services fees.

PERA fund update. FY 2016 was a challenging period for investors; the global bond market performed poorly and Brexit led to high market volatility. In May, at which time the PERA was managing \$13.94 billion in assets, the total cumulative amount in benefits paid from the fund since June 2006 was \$7.65 billion.

Conclusion. Mr. Propst closed the presentation by stressing that the PERA's progress and achievements should be considered as the result of the agency's having accepted its heavy responsibility and having striven to meet the high standards the agency must hold itself to, rather than as a cause for self-commendation. He added that he believes the agency should maintain the highest standards possible, accept and recover from its failures and constantly strive to improve.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Discount rate. In response to a member's point that changes to the PERA discount rate, now set at 7.75%, can drastically alter figures reflecting the fund's net pension liability, Mr. Propst said that, although staff consider the rate too high and that it cannot be known what the optimal rate is, the board decides the rate. He added that other states are beginning to lower their rates. The member remarked that it would be better to set a more realistic, lower rate, even given that doing so would raise the fund's reported net pension liability. Also in response to a member's question, Mr. Propst indicated that the PERA's investment managers do not use as their goal in making investments that rate of return. Mr. Grabel added that, for different categories of asset allocation, there are different benchmarks and guidelines that money managers are charged with meeting. Further, he said, the changes made to the fund's portfolio, which now features lower-risk investments, will likely result in higher returns.

Effects of the state's economy on the fund. Mr. Propst and Mr. Grabel described an anemic state economy as having both positive and negative effects on the fund. A poor economy correlates to a lack of growth in payroll, which helps the fund, but also to low return from investments in the oil and gas industry, which hurts the fund.

SIC Performance Update

Steve Moise, state investment officer, SIC, and Vince Smith, deputy state investment officer, SIC, reported as follows on the recent performance of assets under SIC management. Mr. Smith noted that Brent Shipp, chief financial officer, SIC, Evan Land, general counsel, SIC, and Charles Wollmann, director of communications and legislative affairs, SIC, were in the audience.

Recent and future changes in funds' value. There was significant, concern-raising volatility during the year's first two quarters, largely due to Brexit. Net cash flows during that period neared negative \$150 million. At the end of the period, the value of assets, \$20.19 billion, approximated the value of assets at the beginning of the year. Meanwhile, overall returns for the period from June 1, 2015 through May 31, 2016 were negative.

Looking forward, poor performance in the oil and gas industry will temper inflows to the permanent funds. To illustrate, in May, the two major permanent funds' distributions exceeded inflows to those funds by $49.8 million. The void created by lower inflows would be filled, if at all, by revenue from investment earnings. It is expected that returns over the next seven to 10 years will fall below average; the SIC has anticipated this trend since at least 2013.

Asset allocation. SIC-managed assets fall into three broad investment categories: 1) fixed income (23.7% of assets on May 31); 2) private market investments (31.8% of assets on May 31); and 3) public equity (44.6% of assets on May 31). In 2010, the SIC set out to restructure its portfolio to correct an over-reliance on domestic private equity. Historically, heavy concentration of assets in that class has been typical of public pension fund portfolios. The SIC aims to move the proportion of Land Grant Permanent Fund investments in each of eight categories toward new long-term targets, which were established with the goal of reducing volatility and mitigating risk. The recent removal of the constitutional limit on the amount of allowable overseas investments has been important to the SIC's portfolio restructuring efforts.

Brexit. In response to a member's request for commentary on Brexit's effects on the global economy and the state's investments, Mr. Smith spoke as follows. Although the outcome of the vote is likely to restrain the Federal Reserve System from raising interest rates, the event's effects on the American economy were, and will probably remain, minor. That is, the event did not majorly disrupt the stock market in the United Kingdom (U.K.) or in Europe; the Brexit vote was only advisory; and, were the U.K. to resolve to the leave European Union, its departure would not be for several years. Furthermore, the SIC's exposure to international securities and private equity, at about 16% to 17% of all investments, is relatively conservative and, compared with other sovereign wealth funds, low.

Questions and Discussion

On questioning, the committee and presenters addressed the following topics.

Tobacco Settlement Permanent Fund. Responding to a member's concern about the prospect of lawmakers' sweeping money during a special session from the Tobacco Settlement Permanent Fund to the General Fund to resolve budget issues, Mr. Moise indicated that he had not received any inquiries related to such a prospect. A member questioned the prudence of applying money in the Tobacco Settlement Permanent Fund for the state's budget needs.

Land grant and severance tax permanent funds. Mr. Moise said that, even if inflows to the two major permanent funds sank to zero, there would still be distributions made from them because of the income from earnings on investments. But, he added, that scenario would cause the corpus and the amounts of distributions to shrink over time. Mr. Smith commented that economic forecasts show that, due to reduced inflows to the Severance Tax Permanent Fund, the chance of that fund maintaining its value over the next 50 years is only 25%. Mr. Smith offered to model the outcome of any situation for which a member provided a hypothetical distribution rate and other defined factors.

Report on the SIC's Efforts to Improve Governance Structures and Enhance Transparency

Governance. Several changes to the SIC's governance structures began in 2010. That year, lawmakers diluted the executive branch's influence over the council by allowing the legislature to appoint four of the council's members. The council then created new special committees to improve the council's system of checks and balances. Charters for each of those committees, which are composed of professionals in relevant fields, are available for review.

Transparency. The SIC believes it ranks high among sovereign wealth funds in the measure of transparency. Council and committee meetings are public, and council meetings are webcast and archived. The SIC's website includes council and committee agendas, minutes and other related materials, including the council's transparency and disclosure policy and manager statements. Those statements include disclosure of political contributions. Of note, the New Mexico Foundation for Open Government formally recognized Mr. Wollmann in 2012 for his work to promote transparency.

Mr. Shipp elaborated on the topic of management fees by referring to a table on page 13 of the presentation handout, showing those fees for 2015, including which of them are in the form of profit sharing. Mr. Shipp pointed out: that the SIC presents those figures to the PERA and the ERB for comparison; that the fees are incorporated into the SIC's budget; that there is growing emphasis nationally on disclosure in this context; that management fees paid by the SIC in 2015 totaled 57 basis points, or a little over .5% of all assets; and that administrative costs for that year were four basis points.

Questions and Discussion

On questioning, the committee and presenters addressed the following topic.

Management fees. A member remarked that the profit-sharing fees paid in the real estate asset class seemed high. Mr. Shipp explained that that class has a high number of deals, and, thus, fees. Mr. Smith cited another reason for the higher fees: the portfolio's maturity. He also said that the SIC consistently monitors the market and fees and uses techniques to lower them. Mr. Moise agreed to provide committee staff with additional details on the SIC's fee structure agreements with managers.

Update by the SIC on Private Equity Investments in Businesses in the State and an Early Stage Seed Venture Funding Program

Mr. Wollmann prefaced the presentation by saying that the SIC's Private Equity Investment Program, in which the SIC has been allowed by law since 1993 to make investments that yield a rate of return lower than the market rate of return, is performing successfully. He gave as an example of the program's success a company that the SIC invested in that was recently acquired for $90 million. Mr. Moise and Mr. Smith presented as follows on the Private Equity Investment Program and the New Mexico Catalyst Fund administered by the SIC.

Private equity investment. From 1993 to 2003, the internal rate of return in the program, which was designed to energize the state's economy, was negative 18.2%. In 2004, the council changed its strategy and hired an outside expert, Sun Mountain Capital, to manage the program's funds. From then to now, the return rate has been 4.2%. Despite some losses in investments, performance is generally improving. The SIC gathers data quarterly on the program's economic impact; as of December 31, 2015, the program has had 6.3 times the amount of investment from external investment than from internal investment. In the last quarter of 2015, the program's economic impact in the state was almost $50 million. Lastly, the program has created in-state jobs whose average salary, at $41,799, exceeds the state average.

New Mexico Catalyst Fund. The newly launched, early- and seed-venture fund administered by the SIC, the New Mexico Catalyst Fund, consists of a combination of state, federal and private funding. The federal government gave permission for previously appropriated but unused money to be used for the fund. Through it, fund managers, who will share in the risk-taking, will join in investing in approximately 50 to 60 promising, early-stage, in-state businesses. Those investments will most likely begin in the year's third quarter.

Conclusion. Mr. Moise concluded the SIC's presentations by: articulating the SIC's desire to help create and retain highly successful businesses like Microsoft; noting that several handouts relating to topics covered are available for distribution; and remarking that the SIC is in the process of establishing a compliance office. He also stressed the importance of maintaining the health of the funds, which help offset the cost of state government, and keeping inflows to and outflows from the funds in balance. Lastly, he expressed thanks for lawmakers' appropriation of sufficient amounts to pay for the professional expertise and other resources necessary for effective fund management.

<u>Questions and Discussion</u>

On questioning, the committee and presenters addressed the following topics.

State's business climate. When asked for the SIC's views on whether the state has the resources needed to encourage business development, Mr. Wollmann replied that the state has improved in this area by having provided, through the SIC, a means for businesses across the state to secure investment capital. Mr. Moise added that the state seems to be more motivated to build a business-friendly mindset and environment and is encouraging entrepreneurial success more. The member encouraged the presenters to inform legislators if legislators can help increase awareness of the SIC's private equity investment efforts. Another member commented on the connection between a good business climate and attracting new and expanding businesses and the importance of helping governments finance investments that promise payoffs, like Roswell's airport project. A third member stressed the importance of venture capital in bringing about the jobs of the future.

Private equity investments. Mr. Wollmann reported that some of the program's investments have resulted in the creation of many companies, some of which are still active, some of which have created thousands of jobs, some of which have been sold at a profit and some of which have failed. Many relevant program figures, he said, are captured in quarterly reports. He added that the council is taking a methodical approach toward the program. A member spoke highly of the state's pursuit in this capacity to help companies, especially technology companies, get off the ground and provide opportunities for good jobs.

Prospect of a state bank. When asked about the possibility of creating a state bank, Mr. Moise said that related legislation has been introduced in the past; at that time, the SIC analyzed and, through the bill's fiscal impact report, commented on, the prospect. Mr. Wollmann added that North Dakota has such a venture investment bank. Doing that in New Mexico would be difficult for a number of reasons; however, the council has not taken a position on the matter. The member requested a copy of the SIC's analysis.

Litigation. Concerning recent SIC-sponsored litigation aimed at recovering money lost from investments that were entered into under improper circumstances, Mr. Smith reported that the Paul Hastings Law Firm of New York generated a report containing facts used in litigation initiated to recover the money. He said that the council has directed the firm to refrain from distributing the report as long as the litigation continues. A member asked whether that direction was recorded in the council's minutes, and Mr. Smith agreed to check. Mr. Wollmann added that over $32 million has been recovered; some of that will be used to pay lawyers' contingency fees. He also said that the SIC is pursuing further financial recovery.

Adjournment

There being no further business before the committee, the committee adjourned at 3:55 p.m.