

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD

REGULAR MEETING

June 22, 2007

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

ROLL CALL – QUORUM PRESENT

Members Present:

Mr. Bruce F. Malott, Chairman
Ms. Mary Lou Cameron, Vice-chair
Mr. H. Russell Goff
Mr. James B. Lewis
Dr. Pauline Turner

Members Excused:

Mr. Gary B. Bland, Secretary
Dr. Veronica Garcia

Legal Counsel Present:

Mr. Robert Shulman, Staff Attorney

Staff Present:

Mr. Frank C. Foy, Deputy Chief Investment Officer
Mr. Bob Jacksha, Chief Investment Officer
Ms. LeAnne Larrañaga-Ruffy, Investment Officer
Mr. José Martinez, IT Director
Ms. Deborah Martinez, Chief Financial Officer
Ms. Bernadette Montoya, Executive Admin. Assistant
Mr. Steve Moreno, Benefits Manager
Mr. Steve Neel, Portfolio Manager
Mr. Paul Swanson, Member Services
Mr. Greg Trujillo, IT Network Specialist

Others Present:

Ms. Jennifer Dunstan, Public Relations Director
Mr. Allan Martin, New England Pension Consultants
Ms. Judith Beatty, Recorder
[Also see sign-in sheet]

a. Approval of Agenda

The Agenda was reprioritized.

Ms. Cameron moved approval of the Agenda, as amended. Mr. Lewis seconded the motion, which passed by voice vote.

b. Approval of Minutes: April 18, 2007

Ms. Cameron asked the minutes to reflect that she had been unable to attend this meeting telephonically because of technical difficulties at the Albuquerque office.

Mr. Lewis moved approval of the Minutes of the April 18 meeting, as amended. Mr. Goff seconded the motion, which passed by voice vote.

c. Introduction of Guests

Guests were introduced.

CONSENT AGENDA — BOARD TRAVEL

a. Bruce Malott — to attend The Summit at the Festival Del Sole, Napa Valley CA, July 20-21, 2007

Mr. Malott asked the Board to authorize his attendance at a hedge fund summit in California on July 20-21. He said Messrs. Jacksha and Neel would also be present.

Ms. Cameron moved approval of the Consent Agenda – Board Travel. Mr. Lewis seconded the motion, which passed by voice vote.

[Note: later in the proceedings, Dr. Turner moved to authorize Mr. Lewis to attend this event. Ms. Cameron seconded the motion, which passed by voice vote.]

2006 AUDIT REPORT — Julia Petty, Deloitte & Touche LP

Ms. Petty stated that the 2006 Audit Report was coming to the Board much later than normally, primarily because the implementation of the new software system had caused a few backups.

Ms. Petty reviewed Statements of Plan Net Assets and noted that the organization continues to grow, as evidenced by the change in total investments from \$8 billion in 2005 to \$8.9 billion in 2006. She said total bottom line net assets increased from \$7.4 billion to \$8.2 billion.

In the course of her review, Ms. Petty said a \$170 million error related to a posting made on the trade date versus the settlement date was identified and adjusted during the audit. She stated that this was simply an oversight.

Ms. Petty reviewed Material Weaknesses found in the course of the audit and what Management had done, or was doing, to correct them.

In conclusion, Ms. Petty commented, "We feel that we had access to everyone that we needed to have access to. We had access to all the books and records. We got good cooperation from Management, as we have in the past."

Mr. Riggs said the ERB appreciated the work of Deloitte & Touche, because they add value to the organization. He added that, while the report is just being released now, staff has been working on the various shortcomings identified in the audit for quite some time and should have nearly all of these problems corrected within the next few days.

Dr. Turner expressed particular concern that no process was currently in place to monitor money manager contracts.

Mr. Jacksha responded that ERB staff is working with NEPC to see what kind of reporting could be provided to ensure that the investment managers are complying with the limits the ERB puts in their contracts.

Mr. Martin explained that some of the items in the individual investment manager contracts have nothing to do with risk exposure and therefore aren't necessarily relevant in this case. He said NEPC plans to review the contracts with staff and make sure that what the ERB does track, and which is crucial to monitoring the risk of the portfolio, is tracked and rigorously reported. He said most of this begins with the custodian, who knows what securities are being bought and sold on any particular day. He added that there are many things NEPC can do quarterly to give the ERB more information on this, but ultimately NEPC will help staff go back to the custodian and create a number of more timely reports. He said it will take one to three months to get this done.

Mr. Malott stated that, while he would prefer to see no material weaknesses in the organization, the ERB does not have a big staff, and the implementation of the SHARE software program certainly didn't help the accounting team. He said bringing the internal auditor on board should help the situation.

Ms. Cameron requested that future ERB agendas include regular updates on audit issues.

INVESTMENT REPORTS — BOB JACKSHA

a. Investment Performance Report — Allan Martin, NEPC

Mr. Martin reviewed the First Quarter 2007 Investment Report, which was generated as of March 31. He noted that, since this report was generated, the S&P 500 is up an additional 7%, the Dow Jones is up an additional 9%, so the portfolio is very likely up another \$200-\$300 million.

Mr. Martin also stated that, over the last 12 months, the Fund grew by \$974 million from investment returns. He noted that, while the first quarter was up, it was a bumpy quarter — and as expected, even when the subprime mortgage market collapsed in February, the allocation to market neutral hedge funds did not drop and continued to generate solid returns above cash.

Mr. Martin added that total equity exposure was 58.3%, slightly above target by 0.3% and under the upper limit of 63%. He contrasted this to the previous quarter, when total equity exposure was 7.1% more than the current target.

Mr. Malott asked Mr. Martin if there was anything the ERB should be doing that it was not doing.

Mr. Martin responded that the ERB has substantially taken the steps to implement most of the core policy it adopted formally in February 2006; its absolute return positions are built, it has hired a real estate advisor and it has hired a private equity advisor, and they are doing what they need to do quickly. He said he and Mr. Jacksha have talked about re-looking at the asset allocation, now that the main strategic elements are in place, to see if there are additional things that might be done. He said reducing the exposure to high yield is one area they are considering.

In later discussion on indexing versus having to pay manager fees, Mr. Martin said that, while the last year has been unkind to active managers, that period has now passed, and he believes that active managers selectively will add value over the long term.

Mr. Martin noted that there has been discussion on the SIC about the idea of more indexing. He said NEPC would prefer to see people eliminate bad managers — which the ERB has been doing — and think about more reliable strategies like portable alpha (which it has done in hiring Mellon) in replacing those managers, rather than simply giving up and going to index funds. He said what happens in public funds is there tends to be a trend where a board sees certain data, decides to index everything, and then

over the next two or three years active managers do better, and then the boards decide to go back and give it all to active managers. He said this “in and out” costs money.

In the course of later discussion, Mr. Jacksha pointed out that the total hedge fund-of-fund portfolio is about 6.6% — better than staff anticipated — and annualized, the return is about 13%.

Mr. Martin reviewed a chart of the ERB Composite vs. Total Public Fund Universe. He commented, “The cluster of your results — your results being how you actually did, how your policy did, how your allocation did — shows very strong relative returns, very strong absolute returns that your Fund has enjoyed over this five-year period. So from an investment perspective, you’ve taken advantage of the recovery in the markets, you’ve reinvested part of that recovery to protect yourselves so if the markets aren’t as good a year or two from now, you’re not going to sink into the fourth quartile where you were in 2001 and 2002.”

b. Private Equity Investment Committee Update — Steve Neel

Mr. Neel reported that the Private Equity Investment Committee met and approved a \$20 million allocation to Goode Partners Consumer Fund I, a middle market buyout firm that focuses in retail, restaurants and direct marketing.

Mr. Neel also reported that, year to date, the ERB has committed approximately \$120 million to the program in seven partnerships, of which about \$8 million has been called.

Mr. Neel said there have been distributions from two funds (Levine Leichtman and Lexington Partners).

c. Small Cap Growth Manager RFP Update — Bob Jacksha

Mr. Jacksha reported that finalist interviews are scheduled on August 23 at the Investment Committee, and the Board is scheduled to vote on the final decision at its regular meeting on August 24. He said a contract should be in place by November 1.

Mr. Jacksha said the contract extension with Franklin is sufficient to cover this timeframe.

[Break.]

d. Quarterly Commission Report — Bob Jacksha

Mr. Jacksha stated that the two reports in the packet represent: 1) all of the trading by all of the managers in the fixed income area, and 2) all of the trading on equities. Mr. Jacksha said these reports show that the ERB's trading is fairly widely spread out, which is what the ERB would expect from its managers in trying to get the best price execution on trades. He added that the equity commission reflects trading at about 3 cents a share, which is a good commission rate.

Mr. Goff asked Mr. Jacksha to discuss a recent article in *The New Mexican* about some controversial funds that the ERB has.

Mr. Jacksha explained that the ERB has \$40 million in the Vanderbilt CDO Fund. He said the concern with CDOs in general has been their exposure to the subprime mortgage market, and there is some exposure in the Vanderbilt Fund, in that they asset-backed securities. He said he talks with Vanderbilt regularly about that exposure, and most recently reviewed their holdings, what has been downgraded and what has had negative rating actions. He added that, at this point, there is very little effect on Vanderbilt's holdings in terms of the downgrades, and there is no effect on the cash flow of those securities that is coming through to pay the ERB's dividends on this fund.

Mr. Jacksha also noted that this \$40 million fund represents most, if not all, of the ERB's subprime exposure. He said Vanderbilt has managed the fund well, and have chosen securities well, and it is not a major problem at this time. He said staff will obviously continue to monitor this fund.

Mr. Lewis commented that, although the SIC actually has substantially more invested in CDOs, SIC staff feels that the risk is minimal in terms of the subprime market. He pointed out that the prime market actually has more exposure than the subprime market.

e. Real Estate Update — Bob Jacksha

Mr. Jacksha reported that the ERB has hired ORG as its real estate consultant. He stated that, earlier this week, he, Steve Neel, Bruce Malott, Jonathan Berns and Steve Gruber met for a couple of hours to discuss the ERB's goals in terms of the cash flow, rate of return, and the J-curve effect.

Mr. Jacksha said they also talked about the general real estate market, i.e., different property types, different strategies, and geography in the U.S. versus international. He said ORG is now preparing a draft policy and implementation plan for review by staff, which ultimately will come to the Board for approval.

Dr. Turner asked how one mitigates the J-curve, and Mr. Jacksha responded that one way is to put some money in real estate debt, which generates an immediate coupon, and another way is to invest in a fully occupied office building, for example.

Mr. Malott said he sat in on the meeting with ORG because he has some concerns about real estate investing, but felt comfortable with the dialogue and the fact that ORG listened to staff's concerns and was very responsive.

RETIREE HEALTH CARE AUTHORITY REPORT — ROBERT SHULMAN

Mr. Shulman reported that there are a number of RFPs that are in the process of being issued, or have been issued, to determine the status of the Fund and its exact numbers. He said one of the RFPs is for an actuarial audit, since there have been several versions of why the actuarial health of the Fund has varied. He stated that an independent audit will be able to identify which figure is correct and possibly determine why they were so different.

Mr. Shulman said another RFP deals with a needs assessment for the IT system, which will have to be replaced, and a third RFP will look at the condition of the accounts receivables.

Mr. Shulman stated that the director, Marie Thames, is taking a temporary leave of absence for medical reasons, and the Retiree Health Care Authority Board has appointed deputy director Carla Marquez-Walton, as acting director.

Mr. Shulman stated that another area that is being worked on is coming up with a long term plan structure, which will involve premiums and different plans.

Mr. Lewis noted that the Investments and Pensions Oversight Committee is requesting that the acting director appear before them and present an overview report. He added that an independent group is also looking at structure issues because of the prospective impact on bonds.

AGE AND SERVICE RETIREMENTS

Dr. Turner moved for approval. Ms. Cameron seconded the motion.

Responding to questioning from Ms. Cameron, Mr. Moreno stated that, while last year there were 1,060 retirees, only 817 people have gone through the process to date. He said he thought the final figure might be around 900.

The motion passed by voice vote.

DISABILITY RETIREMENTS

a. New Applicants (Permanent & Continuing)

Ms. Cameron moved for approval. Mr. Lewis seconded the motion, which passed by voice vote.

b. Appeals

None.

GOVERNANCE AND ORGANIZATIONAL STRUCTURE — BRUCE MALOTT

[Postponed to next meeting.]

EXECUTIVE DIRECTOR SEARCH — BRUCE MALOTT

[Postponed to next meeting.]

BOARD RETREAT — JEFF RIGGS

Mr. Riggs asked Board members if they felt a retreat would be useful this year; and if so, when might that be scheduled.

Following discussion, Board members agreed to hold the retreat on September 27-28 at Tamaya, which might also include the ERB Investment Committee meeting.

Mr. Malott said he would work with staff on an agenda.

Ms. Aibel noted that the PERA Board retreat in May included discussion on LDI (liability driven investing), a strategy utilized in European pension plans and which is now starting to get attention in the United States.

Mr. Jacksha suggested that the agenda include discussion on portable alpha and infrastructure.

DIRECTOR'S REPORT

a. ERB/PERA Statewide Impact Study

Mr. Riggs informed the Board that he and Mr. Swanson have begun discussions with BBER at UNM on the idea of developing, in conjunction with PERA, a statewide retirement plan impact study. He said CalSTERS and CalPERS recently did this jointly.

Mr. Riggs said the meeting with BBER was in response to comments by Board members last year when Texas Teachers had their own study done.

b. Report — Appraisal of Santa Fe Office

Mr. Riggs reported that the appraisal would be ready within a week.

Mr. Riggs said the electrical work and elevator work are well underway and the entire project should be completed in "mid fall."

c. Update — Customer Service Survey

Mr. Riggs stated that survey cards are being distributed to walk-ins with very favorable responses so far from that group. He said staff is also doing a phone survey and has met with Research & Polling.

Mr. Riggs stated that, once all of the survey information is in, staff will assess where the problem areas are and then work toward addressing them.

Dr. Turner said she would prefer that the survey be referred to as a "member service survey" because the members are not really customers. She said she thought the members should be consulted on whether they want to be called customers or members.

d. LESC Study on Merging ERB/PERA

Mr. Riggs distributed copies of a House Memorial directing the LESC to study the merging of ERB and PERA. He said the two funds can't be merged under a constitutional amendment, however.

Ms. Cameron commented that this issue comes up every year, and wondered if there were a way to put this to rest once and for all.

Ms. Aubel explained that part of the problem is that an actuarial study is required to determine the cost of merging the two funds and liabilities, and the study itself costs a lot of money, and no money has ever been appropriated for that.

Other matters

Mr. Riggs provided Board members with a list of upcoming educational conferences and asked Board members to contact him if they were interested in attending any of them.

Mr. Riggs announced that IT manager José Martinez will retire at the end of the year, so this will be his last meeting. He said the ERB advertised and went through the interviewing process, and Greg Trujillo was selected for the position.

TRUSTEE REPORT ON CONFERENCES — BRUCE MALOTT

Mr. Malott stated that he would provide a report at the August meeting.

NEXT MEETING — AUGUST 24, 2007 — ALBUQUERQUE

Dr. Turner said she would be unable to attend this meeting.

EXECUTIVE SESSION

a. Litigation — Personnel Matters

Ms. Cameron moved to go into Executive Session for the purpose stated on the agenda. Mr. Lewis seconded the motion, which passed on the following Roll Call vote:

For: Mr. Malott; Ms. Cameron; Mr. Goff; Mr. Lewis; Dr. Turner.

Against: None.

[The Board was in Executive Session from 11:25 until 11:30 a.m.]

Ms. Cameron moved to come out of Executive Session and to state that nothing was discussed in Executive Session except the item on the Agenda. Dr. Turner seconded the motion, which passed on the following Roll Call vote:

For: Mr. Malott; Ms. Cameron; Mr. Goff; Mr. Lewis; Dr. Turner.

Against: None.

ADMINISTRATIVE APPEAL — DANIEL SPARAGO

Ms. Cameron moved to deny the administrative appeal of Daniel Sparago. Dr. Turner seconded the motion, which passed by voice vote, with Mr. Goff recusing himself.

ADJOURN

Its business completed, the Educational Retirement Board adjourned the meeting at approximately 11:35 a.m.



Bruce Malott, Chairman

ATTEST:

Gary B. Bland, Secretary