

THE INVESTMENT COMMITTEE
OF THE
MARYLAND STATE RETIREMENT AND PENSION SYSTEM

MINUTES OF OPEN MEETING

November 17, 2016

The Investment Committee convened on Thursday, November 17, 2016 at 9:03 a.m. in the 16th Floor Board Room of the State Retirement Agency, SunTrust Building, 120 E. Baltimore Street, Baltimore, MD.

Committee Members
Attending:

Michael K. Barry
David Brinkley
Eric Brotman
James A. Bush, Jr.
James “Chip” DiPaula
Peter Franchot
Kenneth Haines
David Hamilton
James Harkins

Sheila Hill
Linda A. Herman, Co-Chair
F. Patrick Hughes, Chairman
Larry E. Jennings, Jr.
Charles W. Johnson
Nancy K. Kopp
Theresa Lochte
Stefan Strein

Committee Members
Not Attending:

Richard Norman

Also Attending:

Victor Adekoya
Phillip Anthony, MLIS
Frank E. Benham (Meketa)
Nathan Bowen, DBM
Colleen Bower
Kathy Brady, OAG
Susanne Brogan
Robert Burd, Deputy CIO
Elizabeth Burton
Antionette Butcher
Rachel Cohen, OAG
Sandra Cohen (UniteHere!)
Melody Countess
Brian Dana (Meketa)
Eric Farls
David Ferguson
Christy Fields (PCA)
Anne Gawthrop
David Glickman (PCA)
Michael Golden
Dimitri Grechenko
Will Green (Loop Capital)
Monica Hausner (Brown Adv.)
Roxie Herbekian (UniteHere!)

Marilyn Julius (UniteHere!)
Faina Kashtelyan
Gregory Kasten
Larry Katsafanas
Dean Kenderdine
John Kenney
Colleen Kraw (Alex Brown)
Michelle Lowery
Michael McCord
Stephen Muturi
Eileen O’Grady (UniteHere!)
Andrew Palmer, CIO
Stephen Reilly
David Rongione, Chief Internal
Auditor, Internal Auditing Div.
Michael Rubenstein, MLIS
Bill Seymour (SB’s Company)
Jody Shaw, OAG
Frederick “Beau” Smith
Paula Smith (Citizen)
Jared A. Synnestvedt (Wellington
Mgmt.)
Toni Voglino
Pat Wild

Mr. Hughes, Chairman, called the Investment Committee meeting to order at 9:07 a.m.

Item 1: UNITE HERE

Treasurer Kopp left board room recusing herself from the discussion / presentation by UNITE HERE.

UNITE HERE requested an opportunity to make a presentation to the Investment Committee regarding a report prepared by UNITE HERE with respect to Oaktree Capital Management.

Ms. O’Grady, Ms. Cohen, and Ms. Julius (UNITE HERE) presented the Oaktree Capital Management report dated October 2016. Ms. Paula Smith also presented her personal story.

Investment Division staff reports that the System is not a participant in any of the Oaktree Capital Management funds referenced in UNITE HERE’s report. Thus, the System has no direct exposure to the investments at issue.

The UNITE HERE Group gave their presentation and left at 9:17 a.m.

Item 2: Minutes

Treasurer Kopp returned to the Board Room at 9:18 a.m.

On a motion made by Ms. Hill and seconded by Mr. Bush, the Investment Committee unanimously approved the September 20, 2016 open meeting minutes.

Item 3: PCA Report

Christy Fields and David Glickman of Pension Consulting Alliance, LLC gave an update on the System’s real estate program.

Christy Fields noted that the System’s real estate program has performed quite well. The program has a diversified mix of managers and no concentration issues. The real estate portfolio currently consists of 21 different investment managers and 37 separate investment vehicles.

Mr. Jennings asked for follow up information showing the median, top quartile and bottom quartile performance for the funds that make up the ODCE real estate index. (NCREIF Open End Diversified Core Equity)

Mr. Hughes feels that there needs to be a more in-depth real estate discussion since it’s a big part of the portfolio.

Item 4: Meketa Reports

Mr. Benham gave an overview of hedge funds generally and discussed how hedge funds are being used in the System’s portfolio. Meketa’s report is for educational purposes and does not include a recommendation regarding the System’s hedge funds.

Mr. Benham discussed the System’s historical use of hedge funds. In 2009, the System increased its hedge fund exposure in an effort to reduce the risk of the portfolio. When Meketa Investment Group was hired in June 2014, the System had the ability to invest up to 20% of its assets in hedge funds. Meketa has advocated for, and the Board has begun, a gradual reduction in the hedge fund allocation. In 2015, the Board of Trustees began the reduction in the long-term hedge fund allocation, reducing the maximum allowable amount from 20% to 17%. This included reducing the target allocation to “absolute return” from 10% to 9). In 2016, the Board voted to lower the hedge fund threshold (to 16%) and absolute return target (to 8%). While Meketa believes that a continued reduction of hedge funds may make sense, they feel that a gradual approach is prudent. They believe the primary question for the Board and Investment Division staff to consider is what role hedge funds should play in the System’s portfolio.

In addition, Staff provided copies of educational materials provided to the Board by Albourne in 2012, a memo from HEK concerning the vision for the Absolute Return portfolio and a white paper from Meketa on Long Short Equity from a few years ago. These additional materials were distributed to provide historical context to the current discussion of hedge funds.

Brian Dana noted that Meketa has seven people in its office working on hedge funds. Mr. Franchot asked Meketa and Investment Division staff to keep Mr. Dana apprised of any discussions relating to hedge funds.

Item 5: Meketa Reports

Meketa Investment Group presented the Third Quarter 2016 performance update and current market overview to the Committee.

Mr. Benham reported the Market Value & Performance.

- At the end of the third quarter, the System was valued at \$46,284.8 million, an increase of \$819.5 million from the end of the second quarter 2016. The increase was the result of positive investment performance as there were net cash outflows of \$562 million.
- The System returned 3.0%, net of fees, during the third quarter of 2016, underperforming the Implementation Benchmark by 0.3%.
- Calendar year-to-date, the System has returned 6.7%, underperforming the Implementation Benchmark by 1.6%. The underperformance was mainly due to active management within credit.

Item 6: Report from CIO

Mr. Palmer reminded the Committee that at the Investment Committee meeting on September 20, 2016, the Board asked Staff to evaluate the performance of small firms versus large firms in U.S. small cap.

Mr. Palmer discussed the Small vs. Large Firm Results noted in the U.S. Small Cap memo included as part of the agenda packet. Mr. Palmer reported that Investment Division staff will continue to consider firms of all sizes for U.S. small cap mandates. While no large firms (in terms of assets under management) currently manage a dedicated U.S. small cap mandate, given Investment Division staff's recent focus on redesigning the Terra Maria program, the System does employ large firms that invest in U.S. small cap as part of a broader mandate (e.g., U.S. all cap, global, equity long/short).

Mr. Palmer introduced the two new staff members: Greg Kasten – Private Equity; and Michael McCord – Real Estate. He indicated that there were still two positions to be filled.

As a follow up to discussions at previous meetings, Trustee Herman requested that staff measure the exposure of fixed income holdings to the Carbon 200 companies.

Mr. Palmer noted that the Agency's Request for Information for In-State Private Equity and Venture Capital Investment Management Services, in response to Senate Bill 982, has been issued, responses have received and are being evaluated by Investment Division staff. Mr. Palmer also stated that the Operation Audit of Credit/Debt Strategy Investments is complete.

Item 7: ORP Update

Mr. Burd provided an update on the Optional Retirement Program.

Fidelity is one of the two authorized vendors to offer recordkeeping services in the Optional Retirement Program, the defined contribution program available to certain employees of public higher education institutions in the State. The initial seven-year term of Fidelity's contract expires on December 31, 2017.

The contract may be renewed at the sole option of the Board of Trustees on a year-to-year basis for a period of three additional years. Mr. Burd noted that Investment Division staff is recommending not renewing Fidelity's contract, and to issue an RFP for ORP recordkeeping services in 2017. This recommendation is not a reflection of the level of satisfaction with Fidelity's performance, but rather to ensure competitive market pricing and services are offered to plan participants.

TIAA is the other approved vendor in the ORP and has been in place since the inception of the program in 1976. While TIAA's contract does not include a finite term, the Board of Trustees can terminate the agreement with sixty days' notice. Mr. Burd noted that Investment Division staff recommends that the Board of Trustees require TIAA to participate in the RFP process for continued participation as an ORP vendor. As with Investment Division staff's recommendation regarding Fidelity, this recommendation is not a reflection of the level of satisfaction with TIAA's performance, but to ensure competitive market pricing and services are offered to ORP participants.

During the May 6, 2016 Investment Committee meeting, the Committee authorized staff and the legal team to review the possibility of adding a brokerage account option to allow greater investment choice flexibility for ORP participants. The Office of the Attorney General has advised that the Board has the authority under SPP §30-202 to offer a brokerage account option. However, in light of the recommendation to conduct an RFP process in 2017 for both current vendors, staff believes it would make sense to defer implementation of brokerage services until the search process is complete, and incorporate brokerage capabilities as an evaluation item in the RFP.

Recommendations:

- Do not renew Fidelity's contract beyond 12/31/17
- Issue an RFP for ORP recordkeepers in 2017
- Require TIAA to participate in the RFP process
- Defer brokerage implementation until the RFP process is complete

ACTION

On a motion made by Ms. Herman and seconded by Mr. DiPaula, the Investment Committee unanimously approved Investment Division staff's recommendations.

Item 8: Investment Reports

The Committee received the following investment reports:

- State Street Performance Reports
- Private Markets Performance Reports
- Securities Lending Report
- Division's FY17 Travel Plan - Update
- Quarterly ORP Performance Report
- OPEB-PHBT Update
- New Hire Manager Report

On the Directors Desk:

- Broker Commission Reports

On a motion made by Mr. Bush and seconded by Ms. Herman, the Investment Committee voted without objection to meet in closed session at 12:10 p.m. for the purposes of:

(a) reviewing the closed session Investment Committee meeting minutes, pursuant to General Provisions Art., Section 3-103(a)(1)(i), the exercise of an administrative function;

(b) presenting by staff of a sample Manager Due Diligence report including the analysis of staff and Pavilion Alternatives Group, the System's private equity consultant pursuant to General Provisions Art., Section 3-305(b)(13), to comply with a specific statutory requirement that prevents public disclosure of trade secrets and confidential commercial or financial information; and

(c) discussing matters regarding the investment of public funds with staff, pursuant to General Provisions Art., Section 3-305(b)(5).

CLOSED SESSION

Committee Members
Attending:

David Brinkley
Eric Brotman
James A. Bush, Jr.
James "Chip" DiPaula
Peter Franchot
Kenneth Haines
David Hamilton
James Harkins

Sheila Hill
Linda A. Herman, Co-Chair
F. Patrick Hughes, Chairman
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Michael Golden
Dimitri Grechenko

Faina Kashtelyan
Gregory Kasten
Larry Katsafanas
Dean Kenderdine
John Kenney
Michelle Lowery
Michael McCord
Stephen Muturi
Andrew Palmer, CIO
Stephen Reilly
David Rongione, Chief Internal
Auditor, Internal Auditing Div.
Jody Shaw, OAG
Frederick "Beau" Smith
Toni Voglino
Pat Wild

Adjournment

There being no further business before the Investment Committee, on a motion made by Mr. Johnson and seconded by Mr. Bush, the meeting adjourned at 12:22 p.m.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Andrew Palmer".

Andrew C. Palmer
Chief Investment Officer