



PERA

Efforts to Enhance Transparency and Improve Governance Structures

Investments and Pensions Oversight Committee

Representative Tomás E. Salazar, Chair

Senator George K. Muñoz, Vice-Chair

November 13, 2017

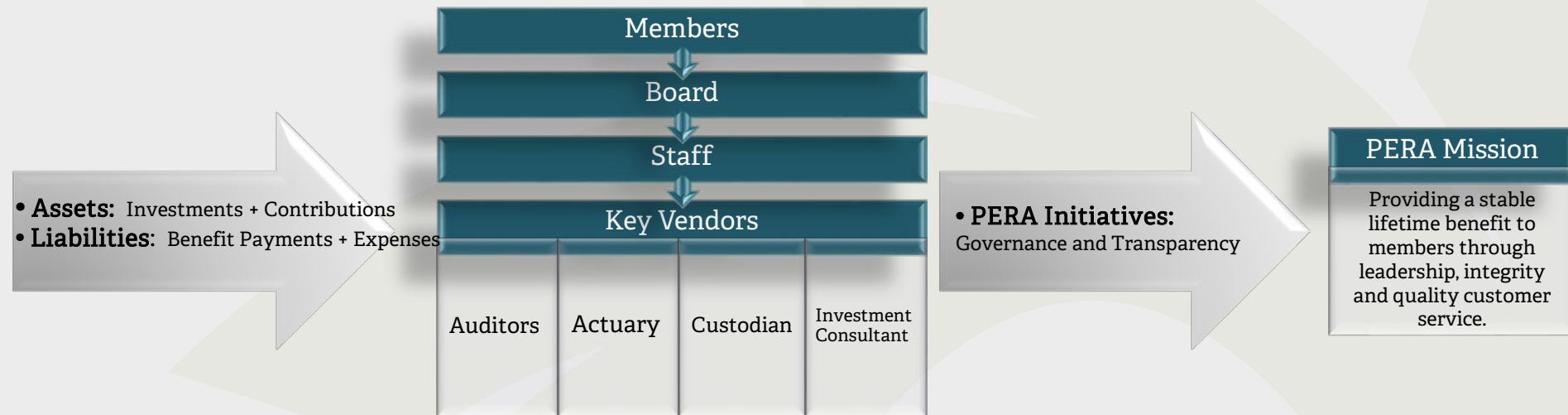
Dan Mayfield, Chair

Wayne Propst, Executive Director

Dominic Garcia, Chief Investment Officer

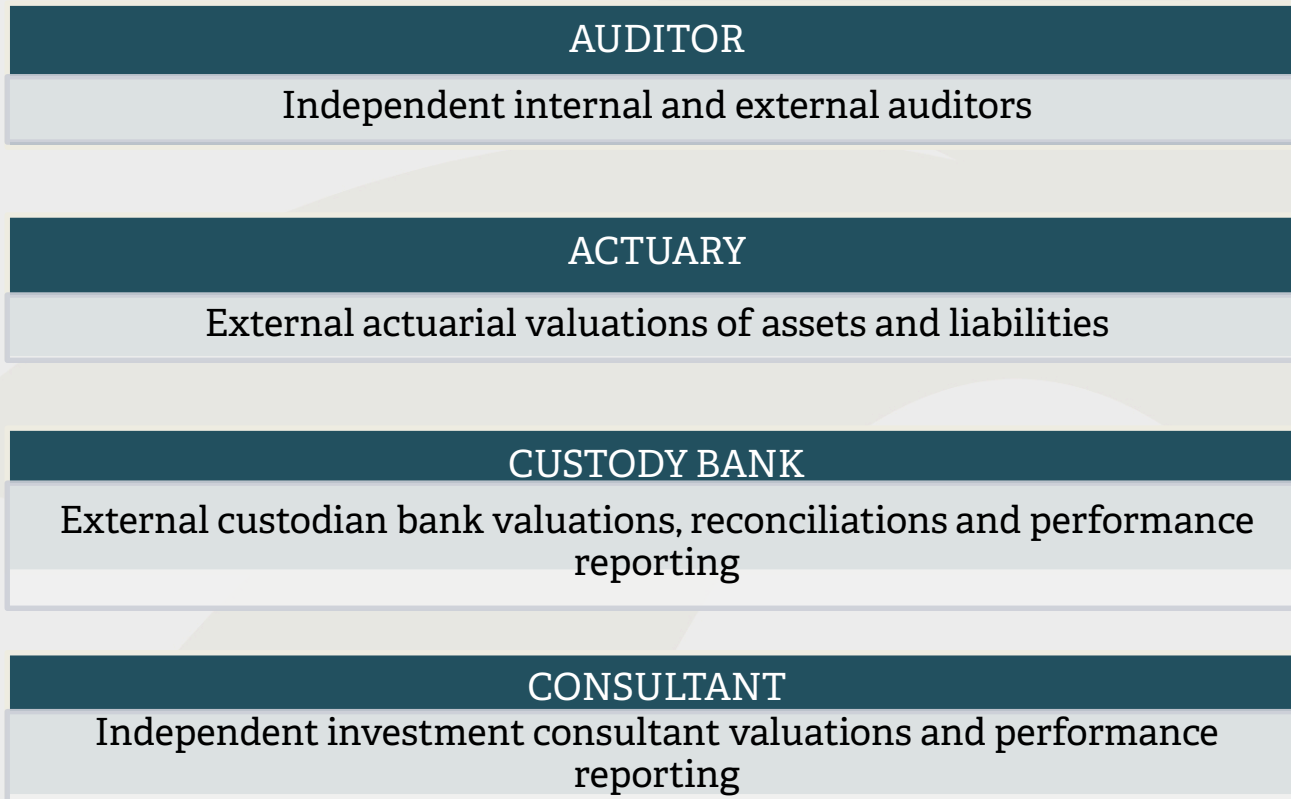
Anna Williams, Chief Financial Officer

Governance and Transparency: Organizational Framework



Governance Structures: Multiple Levels of Review

Multiple layers of independent oversight and review provide external verification of assets, liabilities and internal controls



Governance Structures: Open Meetings

- All PERA Board and Committee meetings comply with the Open Meetings Act
- Since 2013, Board and Committee meetings have been audio streamed in real time
- Beginning this month, meetings will also be video streamed in real time
- Meeting minutes and recording are posted online
- All governance rules are clearly defined and available online

September 2017

- Annual Board Meeting ([Minutes](#)) ([Audio](#))

August 2017

- Board Meeting ([Minutes](#)) ([Audio](#))
- Investment Committee ([Minutes](#)) ([Audio](#))
- Audit & Budget ([Minutes](#)) ([Audio](#))
- Rules & Administration ([Audio](#))
- Smart Save Committee ([Audio](#))



LIVE STREAMING

Live Streaming of PERA
Meetings

Governance Structures: Transparency Through Audits

- Continual review and evaluation of operations through quality control processes, rigorous documentation and independent internal and external audits

INTERNAL AUDIT FOCUS	
Census Data & Employer Payroll Information	Completed
Custodial Bank Transfer Process	Completed
Benefit Payments & Member Refunds	Completed
Investment Policy Statement Compliance	Completed
Governance, Fiduciary Responsibility and Training	Completed
Years of Service & Wage Eligibility	Completed
Accounts Payable & 1099 Reporting	Completed
Recurring Census & Benefit Payment Testing	Completed

FY 2015 & 2016 FINANCIAL AUDIT REPORT
Unmodified opinion issued with no findings

Comprehensive Annual Financial Report

- PERA has received 15 consecutive annually awarded “Certificate of Achievement for Excellence in Financial Reporting” by the GFOA for PERA’s annual CAFR.
- Beginning in FY17, PERA will also prepare a Popular Annual Financial Report (PARF) to supplement the CARF.

GFOA’s award program encourages entities to go beyond the minimum requirements of generally accepted accounting principles to prepare comprehensive annual financial reports that evidence “*the spirit of transparency and full disclosure*”

Comprehensive Annual Financial Reports

▼ Select Year

- CAFR 2016
- CAFR 2015
- CAFR 2014
- CAFR 2013
- CAFR 2012
- CAFR 2011
- CAFR 2010
- CAFR 2009
- CAFR 2008

Governance Structures: Additional Efforts

- Provision of effective mechanisms for stakeholders to request and obtain information
- PERA responded to 63 IPRA requests during the Fiscal Year to date
- Promoting a culture of accountability and ethical behavior through training, performance evaluation and policy review
- In FY16, amended all contracts to require that vendors document compliance with gift reporting requirements and disclose all gifts
- Addressed a number of governance finding from a FY15 internal governance audit including improved reporting of compliance with the Gift Act.

Governance into Value Creation



- Sustainability of Funding Status
- Culture of Success
- Long-term View

- Solid Pension Design
- Good Governance
- Robust Business Model
- Portfolio Mgmt. Best Practices
- Attract and Retain Talent

Measures of Success:

- Funding Surplus/Shortfall
- Value Add vs. Benchmarks
- Value Add vs. Reference Portfolio
- Risk Adjusted Returns
- Balance through Economic Regimes
- Peer comparison

* Adapted from Peter Drucker "Model", research from Keith Ambachtsheer, and Clark and Irwin, (2008) "Best-practice pension fund governance", *Journal of Asset Management*, vol 9, 1, 2-21

Financial Objectives: Accomplishments

Ensuring the ability to pay promised benefits by maintaining an adequate funding status is the primary measure of success for PERA

- Right-sizing expectations: reduction of actuarial return assumption
- PERA instituted a fee study & reduced its pro forma investment manager fees by over \$10M
- All returns are presented and disclosed net of fees and expenses
- Annual disclosure to Board and Legislature of all money manager expenses, including profit sharing
- PERA completed a comprehensive review of investment policies and procedures including revision and audit of Investment Policy Statement
- PERA transitioned custody banking services, decreasing expenses by 30+% with an increase in service level
- Revised contracts of money managers and key vendors to require proactive disclosure

Financial Objectives: Advancing the Model

PERA is committed to managing costs to align with maximizing value and efficiency for its members

- Policy Portfolio (Beta)
 - Passive, low cost approach
- Active Portfolio (Alpha)
 - Align with value added creation
 - Reduce fixed cost (management fee) & emphasize variable cost (performance fee)
 - Pay-for-performance
 - Co-invest, JV, Direct investing

Integrating portfolio management best practices to better manage risk and cost to enhance member value

- Separating Alpha (Skill) from Beta (market returns)
- Institute comprehensive risk management analytics and processes across public and private markets
- Seek risk and economic balance

Financial Objectives: Advancing the Model

- Governance is the primary tool to align interests of PERA and managers of its capital
- Further codify roles and focus
- Align compensation with value creation

	Decision Mode	Area of Focus
Board & Investment Committee	Strategic	Strategic Direction Asset Allocation Risk Budgeting Benchmarking Evaluation & Accountability
Staff	Strategic & Implementation	Asset Allocation implementation Active risk management (strategy selection, diligence, monitoring) Setting annual work plan Education



PERA

**New Mexico Public Employees Retirement Association's
GASB 67 and Net Pension Liability**

Anna Williams, Chief Financial Officer

GASB 67 & 68

GASB 67

- GASB approved *Statement No. 67, Financial Reporting for Pension Plans*
- Applies to plans that administer pension benefits, such as the Public Employees Retirement Association (PERA) of New Mexico
- Stmt No. 67 expands footnote disclosures and Required Supplementary Information Schedules for PERA.

GASB 68

- GASB also approved *Statement No. 68, Accounting and Financial Reporting for Pension Plans*
- Applies to governments that provide pension benefits to their employees
 - *Examples: The State, Counties, Municipalities, Housing Authorities, Water and Sanitation Districts*
- Smt No. 68 has a significant and material impact on the FS for most employers.
- Smt No. 68 also requires additional disclosures on elements of pension expense and deferred inflows/outflows of resources.

GASB 67 and 68

- GASB statements 67 and 68 were intended to promote consistency and transparency of employer reporting.
- PERA's Actuary provides a GASB 67 supplemental report that is separate from the actuarial valuations used for funding decisions.
- GASB's decision to have the Net Pension Liability (NPL) reported on the face of a government's financial statements allows users of the financial statements to better assess:
 - ✓ *The long-term benefit obligations of a governmental entity;*
 - ✓ *The general long-term financial health of a governmental entity;*
 - ✓ *How well a governmental entity has supported and maintained the pension promises made to their employees.*

GASB 67 – Net Pension Liability Calculation

Net Pension Liability (NPL)

- To the extent that the cumulative long-term obligations to provide pension benefits of the participating governments in a cost-sharing plan (TPL) is *larger* than the value of the assets available in the pension plan's trust to pay pension benefits.

TPL	-	FNP	=	NPL
\$20 Billion	-	\$14 Billion	=	\$5.2 Billion
<i>PERA multi-employer cost sharing fund FY 2017</i>				

GASB 67 – Total Pension Liability Calculation

Net Pension Liability vs: Unfunded Actuarial Accrued Liability (UAAL)

- Market value of assets (Fiduciary Net Position) is different than the actuarial value of assets used in the actuarial valuations for funding purposes.
 - ✓ 4 year smoothing (UAAL) vs. Fair Market Value (GASB/NPL)
 - ✓ Fluctuations more volatile with GASB 67

Schedule of Net Pension Liability

Required GASB 67 RSI (NPL of Plan Membership)

- The components of the net pension liability of the plan's membership at June 30, 2017 by Fund:

Net Pension Liability by Fund				
	PERA Fund	Judicial Fund	Magistrate Fund	Volunteer FF Fund
Total Pension liability	\$ 20,068,143,304	\$ 176,290,693	\$ 65,627,669	\$ 48,502,745
Plan Net Position	14,798,917,909	89,616,194	32,225,122	66,400,768
Net Pension Liability	\$ 5,269,225,395	\$ 86,674,499	\$33,402,547	\$(17,898,023)
Ratio of plan net position of total pension liability	73.74%	50.83%	49.10%	136.90%

Actuarial assumptions—The total pension liability, net pension liability, and certain sensitivity information are based on an actuarial valuation performed as of June 30, 2016. The total pension liability was rolled-forward from the valuation date to the plan year ending June 30, 2017.

Schedule of Net Pension Liability

The components of the net pension liability of the plan's membership since implementation of GASB 67:

PERA	2014	2015	2016	2017
Total Pension Liability	\$ 17,744,186,898	\$ 18,516,054,874	\$ 19,986,038,742	\$ 20,068,143,304
Plan Net Position	14,424,792,739	14,255,528,543	13,826,658,367	14,798,917,909
Net Pension Liability	\$ 3,319,394,159	\$ 4,260,526,331	\$ 6,159,380,375	\$ 5,269,225,395
Ratio of plan net pension to total pension liability	81.29%	76.99%	69.18%	73.74%
Covered-employee payroll	\$ 2,102,265,325	\$ 2,248,254,276	\$ 2,326,254,276	\$ 2,193,888,677
Net Pension liability as a percentage -of covered employee	157.90%	189.50%	264.70%	240.18%

JUDICIAL	2014	2015	2016	2017
Total Pension Liability	\$ 132,451,573	\$ 137,037,970	\$ 191,555,049	\$ 176,290,693
Plan Net Position	91,141,300	88,988,252	84,932,021	89,616,194
Net Pension Liability	\$ 41,310,273	\$ 48,049,718	\$ 106,623,028	\$ 86,674,499
Ratio of plan net pension to total pension liability	68.81%	64.94%	44.34%	50.83%
Covered-employee payroll	\$ 13,163,305	\$ 15,084,263	\$ 15,612,212	\$ 15,492,927
Net Pension liability as a percentage of covered-employee	313.83%	318.54%	682.95%	559.45%

Schedule of Net Pension Liability

The components of the net pension liability of the plan's membership since implementation of GASB 67:

MAGISTRATE	2014		2015		2016		2017	
Total Pension Liability	\$	56,401,059	\$	63,536,415	\$	74,518,592	\$	65,627,669
Plan Net Position		35,184,910		33,187,494		31,038,048		32,225,122
Net Pension Liability	\$	21,216,149	\$	30,348,921	\$	43,480,544	\$	33,402,547
Ratio of plan net pension to total pension liability		62.38%		52.23%		41.65%		49.10%
Covered-employee payroll	\$	3,515,567	\$	5,065,798	\$	5,243,101	\$	5,633,125
Net Pension liability as a percentage of covered-employee		603.49%		599.09%		829.29%		592.97%

VOLUNTEER FIREFIGHTER	2014		2015		2016		2017	
Total Pension Liability	\$	40,881,090	\$	44,477,629	\$	48,935,662	\$	48,502,745
Plan Net Position		61,923,262		62,103,236		61,049,688		66,400,768
Net Pension Liability	\$	(21,042,172)	\$	(17,625,607)	\$	(12,114,026)	\$	(17,898,023)
Ratio of plan net pension to total pension liability		151.47%		139.63%		124.76%		136.90%
Covered-employee payroll	N/A		N/A		N/A		N/A	
Net Pension liability as a percentage of covered-employee	N/A		N/A		N/A		N/A	

Sensitivity of NPL

Required GASB 67 Note Disclosure (Sensitivity of NPL to discount rate):

- Discount rate for the PERA and Volunteer Firefighter Funds.* A select and ultimate rate of return assumption has been adopted funding purposes for the PERA and Volunteer Firefighter Funds. The rate is 7.25% for the first 9 years (select period) and 7.75% for all other years (ultimate). **The equivalent blended rate is 7.51%** and will be used as the discount rate used to measure the total pension liability. The projection of cash flows used to determine the discount rate assumed that future contributions will be made in accordance with statutory rates. On this basis, the pension plan's fiduciary net position together with the expected future contributions are sufficient to provide all projected future benefit payments of current plan members as determined in accordance with GASB Statement No. 67. Therefore, the 7.51% assumed long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability (NPL) to changes in the discount rate *PERA and Volunteer Firefighter Fund.*

PERA	1% Decrease 6.51%	Current Discount Rate 7.51%	1% Increase 8.51%
Net Pension Liability	7,714,032,339	5,269,225,395	3,242,456,288

VFF	1% Decrease 6.51%	Current Discount Rate 7.51%	1% Increase 8.51%
Net Pension Liability	(22,546,666)	(17,898,023)	(12,335,212)

Sensitivity of NPL

Required GASB 67 Note Disclosure (Sensitivity of NPL to discount rate):

- The discount rate used to measure the total pension liability for the Judicial fund is 5.77 percent. The discount rate used to measure the total pension liability for the Magistrate fund is 5.48 percent. The projection of cash flows used to determine the discount rate assumed that future contributions will be made in accordance with statutory rates. On this basis, the pension plan's (both Judicial and Magistrate) fiduciary net position together with the expected future contributions are not sufficient to provide all projected future benefit payments of current plan members as determined in accordance with GASB Statement No. 67. Therefore, for the Judicial fund, a 5.77% and for the Magistrate fund, a 5.48% assumed long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability. This rate is a blend of the 7.51% and the 20-year tax-exempt municipal bond rate of 3.56% as of the measurement date.

Sensitivity of the Net Pension Liability (NPL) to changes in the discount rate *Judicial and Magistrate Fund*

Judicial	1% Decrease 6.77%	Current Discount Rate 5.77%	1% Increase 4.77%
Net Pension Liability	70,470,984	86,674,499	105,794,082

Magistrate	1% Decrease 6.48%	Current Discount Rate 5.48%	1% Increase 4.48%
Net Pension Liability	27,152,372	33,402,547	40,859,138

What is PERA's Role in GASB 68 - 2017

- Although it is not required, PERA is paying for the calculation of each participating entities' employer allocations and paying for the related audit.
 - ✓ Three years of audited "Schedule of Employer Allocations" available (June 30, 2014, June 30, 2015, June 30, 2016).
 - ✓ Anticipate June 30, 2017 Schedule being available early Spring 2018
 - ✓ The Schedule includes information to assist employer participants with the required GASB disclosures.
 - ✓ Provide a GASB 68 Journal Entry tool and GASB 68 user guide.
- **Allocation Process/Schedule of Employer Allocations:**
 - ✓ PERA compiled the data of contributions made and projected contributions for untimely remittances.
 - ✓ The data was given to PERA actuaries who computed the net pension liability and prepare schedule data.
 - ✓ PERA's independent auditor then audited the data.
 - ✓ The office of the State Auditor reviews and approves the release of the audited data.
 - ✓ The audited data is disseminated to all participating employers for implementation.

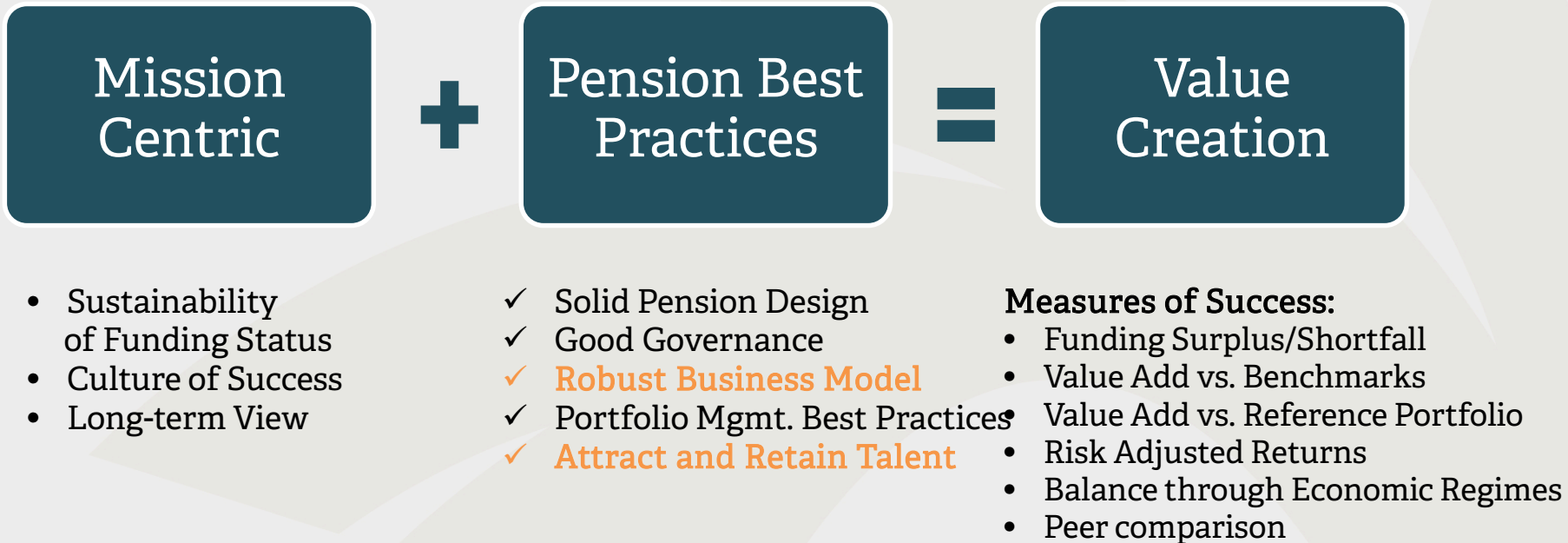


PERA

Wisconsin Business & Compensation Model Applied to New Mexico PERA

Dominic Garcia, Chief Investment Officer

Wisconsin Edge

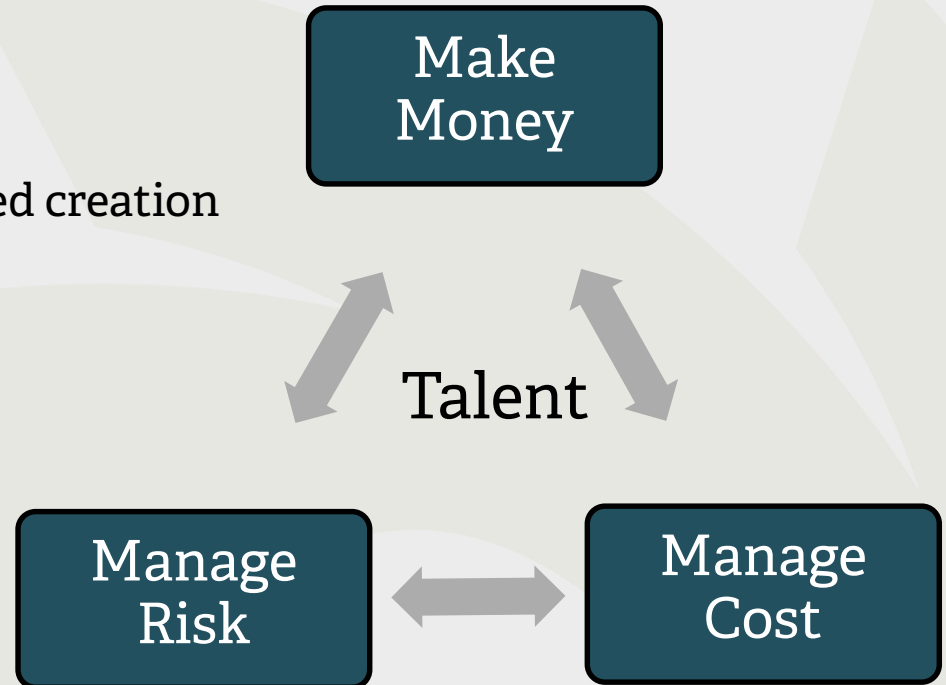


*Adapted from Peter Drucker “Model”, research from Keith Ambachtsheer, and Clark and Irwin, (2008) “Best-practice pension fund governance”,

Journal of Asset Management, vol 9, 1, 2-21

Business Model Objectives

- Manage like a business*
- Incentivize and produce value added creation
- Hold staff accountable
- More efficiently manage risk
- Manage & align cost
- Attract and retain talent

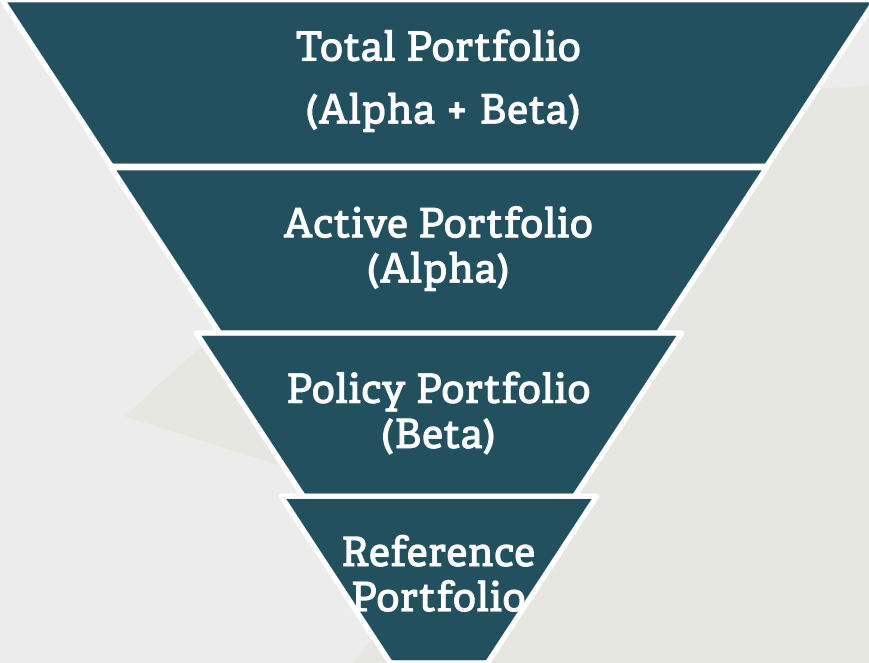


*NM PERA is \$1.1 billion dollar business with over 40,000 clients

Business Model Value Added Proposition

Example

Generate up to \$270m Value Add



Description	Expected Return	Expected Risk	Return/ Risk Ratio	1 Year Value Added
Total Portfolio Pro-Forma	7.5%	~11%	0.7	1.8% \$270m
Active Management	1.0%	2.0%	0.5	1.0% \$150m
Expanded opportunity set, including illiquid asset classes	6.5%	10.8%	0.6	0.8% \$120m
Simplest portfolio (58/42)	5.7%	10.6%	0.5	

Cost Approach

- Policy Portfolio (Beta)
 - Passive, low cost approach
- Active Portfolio (Alpha)
 - Align with value added
 - Reduce fixed cost (management fee) & emphasize variable cost (performance fee)
 - Pay-for-performance
 - Hurdle over benchmarks
 - 60% Alpha split
- Cost Savings via Internal Management

Cost Savings - Internal Management

Efficient External Investing

No Fund-of-Funds
Private Equity/Credit
Co-Invest
Real Asset JV or Direct
Asset Investment

Internal Security Selection

Physical Indexing
Derivative & Factor-
based Indexing
Internal Management

Total Savings

\$15-20m

Results:
Capture larger share of
gross value add from
external mgrs.

Market for Investment Talent is Broad & Competitive

- Market is not SIC and ERB, it is bigger. And it's not just in New Mexico. It's Texas, Arizona, Colorado, Utah...



Attract and Retain Talent

- Market competitive base pay
 - Target: 100% of competitive market median; minimum of 80% of median
 - Based on market competitive analysis via compensation consultant
- Pay-for-Performance Incentive
 - Compensation relative to value added over reference portfolio & benchmarks
 - Maximum incentive target = \$270m Value Added
 - ~1.5x Base Pay @ maximum incentive
 - Focused on long term 5 year+ performance
- Accountability
 - Make investment positions “At Will” and subject to measurable performance standards

Compensation Calculation: Illustrative Example

Scenario: PERA produces @ maximum hurdle 1.8% > Reference Portfolio for 5 Years or \$1.35 billion cumulative value added

Senior Portfolio Manager

- Base Pay: About \$200k
 - Based on market competitive median conducted by compensation consultant
- Pay-for-Performance Incentive
 - Total incentive award available: $\$200k \times 1.5 = \$300k$
 - Performance Calculation: 20% Discretionary + 80% vs. Reference Portfolio & Benchmarks
 - Time Period: 15% 1 Year Returns and 85% 5 Year Annualized Returns
- Total Maximum Compensation
 - Total Compensation = \$500k

New Mexico PERA Sample Model Results

- Produce **\$270m** in cost savings and value add to the system annually and **\$1.35 billion** over 5-year incentive evaluation period
- Total compensation (salary + incentive) estimated at \$7.5m
- System keeps 97% of the value add

	Median Salary Totals	Incentive Compensation Totals	Total Compensation
Executive Team Compensation	\$507k	\$431k	\$939k
Current Investment Staff Compensation	\$1.4m	\$2.2m	\$3.7m
New Investment Staff Compensation	\$1.1m	\$1.5m	\$2.9m
Totals	\$4m	\$4.2m	\$7.5m
Comp as % of Value Add	1.4%	1.5%	2.7%

= Better Alignment, greater Accountability and is cheaper than paying over \$20 million to NY-based money managers with no skin in the game



What is Needed to Execute?

Budget and Compensation

- Ability to establish own operating budget and create or eliminate staff positions
- Ability to set employee compensation through salary and pay-for-performance incentive compensation (Executive and Investment Staff)
- Increase in Staff FTE (6 to 8)

Governance

- Board governance to incorporate compensation oversight
- Compensation consultant

Infrastructure

- Analytic and risk tools enhancements
- Operations resources