

**MINUTES  
of the  
FOURTH MEETING  
of the  
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**October 7, 2019  
State Capitol, Room 307  
Santa Fe**

The fourth meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2019 interim was called to order by Senator George K. Munoz, chair, on Monday, October 7, 2019, at 9:17 a.m. in Room 307 of the State Capitol in Santa Fe.

**Present**

Sen. George K. Munoz, Chair  
Rep. Patricia Roybal Caballero, Vice Chair  
Sen. Jacob R. Candelaria  
Rep. Natalie Figueroa  
Sen. Gregg Fulfer  
Rep. Miguel P. Garcia  
Sen. Gay G. Kernan  
Sen. Steven P. Neville  
Rep. William "Bill" R. Rehm  
Rep. Tomás E. Salazar  
Sen. John M. Sapien  
Sen. Elizabeth "Liz" Stefanics

**Absent**

**Advisory Members**

Rep. Phelps Anderson  
Rep. Roberto "Bobby" J. Gonzales  
Sen. Stuart Ingle  
Rep. Sheryl Williams Stapleton

Sen. William F. Burt  
Sen. Mary Kay Papen  
Sen. William H. Payne  
Sen. James P. White

**Guest Legislators**

Rep. Alonzo Baldonado  
Sen. John Arthur Smith

**Staff**

Anthony Montoya, Staff Attorney, Legislative Council Service (LCS)  
Rebecca Griego, Records Officer, LCS  
Carrie McGovern, Researcher, LCS

**Guests**

The guest list is in the meeting file.

## **Handouts**

Handouts and other written testimony are in the meeting file and posted on the legislature's website.

## **Monday, October 7**

### **Welcome and Introductions**

Senator Munoz asked committee members to introduce themselves. A moment of silence was observed for Senator Carlos R. Cisneros, a committee member who recently passed away.

### **Pension Plan Governance**

Hank Kim, executive director and counsel, National Conference on Public Employee Retirement Systems (NCPERS), Brad Kelly, partner, Global Governance Advisors (GGA), and Peter Landers, partner, GGA, provided the committee with a presentation on pension plan governance. Mr. Kim began by noting that the NCPERS is the country's largest trade association for state and local pension plans and that both the Public Employees Retirement Association (PERA) and Educational Retirement Board (ERB) are members of the NCPERS. In 2016, the NCPERS partnered with GGA to provide pension stakeholders with an accreditation program on pension plan governance. Mr. Kim said that while most public pension plans are well-governed, diversity on pension boards is an asset.

Mr. Kelly said that pension sustainability is a widespread concern. According to Moody's, based on 2017 fiscal returns, pension liabilities for all 50 states total \$1.6 trillion, or 147% of total state revenue, with Illinois having the worst pension liability at \$250.1 billion, or 601% of state revenue. New Mexico has \$12.5 billion in unfunded pension liabilities. Mr. Kelly referenced a 2007 pension fund governance study that concluded that poor plan governance can cost pensions 1% to 2% on return annually, which can be significant over a period of years. The study also enumerated the following key elements of pension board functioning: financial oversight; board composition and skills; board evaluations; clarity in board and management roles; and high-performance culture with competitive compensation. Mr. Kelly then described a 2019 study on North American public pension board composition and returns, which found that pensions can gain 24 basis points in their 10-year investment returns by adhering to five optimal governance elements: having one fiduciary board for both investment and administrative oversight; having a board size of between six and 10 members; having a board with at least one ex-officio member and only 20% to 70% active and/or retired members; having at least two board members with financial or actuarial experience; and having an average of eight to 10 years of tenure on a board.

Mr. Kelly next reviewed the basic fiduciary duties of pension board members, which include loyalty to the fund with no self-dealing; prudence in holding everyone accountable and asking good probing questions; and impartiality to all constituencies and groups in the pension. He provided two examples of policy board governance models: the Carver model, which places

its focus on the ends of an organization's purpose, and the Cortex model, which focuses on the value that the organization brings to the community.

Mr. Landers said that high-performing boards have the following key characteristics: clarity around role and focus; an effective chair of the board; a balanced board team with varied experience; and a culture of trust and respect among board members. In contrast, barriers to high-performing board include: no strategic plan; a temptation to micromanage; an ineffective nominating and/or governance committee; too small board size; a lack of functioning committee structure; overrepresentation of senior executives; no plan for board rotation or member development; a failure to remove unproductive members; and no plan for orientation of new and old members.

Mr. Landers next turned the focus to board evaluations as a way for boards to assess themselves and increase their skill levels. Governance effectiveness assessments can identify board deficiencies; revisit and determine required board skills and expertise; and strategically evolve and improve board capabilities. A general rule for conducting evaluations is to have a "deep" evaluation every three years, in which a third party holds one-on-one interviews to identify areas that can be improved upon, and to conduct a "shallow" evaluation annually to track progress and identify emerging problems. According to Mr. Landers, good assessments should provide clarity on meeting expectations and requirements, board performance and ideas for improvement. In addition, skills matrix assessments help to identify gaps in board members' knowledge, experience and capabilities, which can highlight where improvements are required and how targeted education and strategic recruitment may help. Strategies to improve board trustees' skills include maintaining membership; attending conferences or seminars; bringing in outside experts; having alternate meeting locations; providing additional materials for trustees; and providing supplemental materials for committee members. Mr. Landers also emphasized that planned succession of board members is a best practice.

In closing, Mr. Kelly said that good governance of public pensions is hindered by slowness to assess their recent governance practices; review their foundational documents and guiding policies; introduce performance plans that incentivize the right behaviors; and adopt technological innovations.

Questions and comments from committee members addressed the following:

- assessments can help to identify problems and short- and long-term solutions;
- human capital as an asset to be developed is important, and the education and training models used are out of date; innovative strategies to address this include encouraging trustees to share best practices;
- regarding training, a variety of media for education works best, such as webinars and education sessions;
- while the presenters did not look specifically at the PERA and ERB boards, they suggested that, in order to effectuate change, a questionnaire followed by interviews

- with individual members conducted by a third party is useful to identify concerns and aspirations and establish trust. There is a standard list of questions that are typically asked. The cost of this depends on how many interviews are conducted, with most other costs on a fixed-fee basis. This third-party analysis may be beneficial for both the IPOC and the pension boards;
- this presentation applies to other governmental entities as well, such as boards of regents;
  - a member expressed concern that no members of the PERA or ERB were in the audience for this presentation and said that their boards should have this seminar presented to them;
  - changes in pension boards usually stem from crisis. Public pensions need to be purely independent entities;
  - states cannot declare bankruptcy, but municipalities can;
  - the statistic that showed high-performing boards attaining better investment returns was determined based on statistical analysis by highly respected economists in two studies;
  - in New Mexico, honesty needs to be built in to pension board performance;
  - an improvement of 24 basis points during a 10-year period on a \$15 billion pension translates to \$37.5 million per year;
  - the PERA previously invited legislators to its board's actuarial presentations, which was very beneficial, and this practice should be reinstated to unite the board, PERA staff and legislators;
  - third-party evaluations are overseen by a governance committee and its chair;
  - pension boards need to be open to constructive criticism;
  - in order to keep educational seminars from becoming junkets, a culture needs to be established where education is taken seriously and prioritized, and for-profit conference organizations should be avoided;
  - even though statutes can limit public pension plans and board composition, pension boards can still identify ways to improve skill sets and fill vacant positions and work within existing legislation to make incremental improvements; and
  - the last PERA board meeting illustrated the turmoil and lack of trust within the PERA. No elected PERA board member lives outside of Bernalillo County, which skews representation. The pension boards need to take the opportunity to let the legislature help them.

### **Minutes Approval**

On a motion made, seconded and approved, committee members approved the minutes of the July 29 and September 5 meetings.

### **Wafra Inc.: The Evolution of Pension Management**

Richard Safranek, senior managing director, Wafra Inc., Martin Lujan, vice president, Wafra Inc., James Saliba, vice president, Wafra Inc., and Stephen Burt, senior associate, Wafra Inc., gave a panel presentation on a study conducted by Wafra regarding best practices in pension

management and how to restructure to adapt to today's challenges. A panelist described Wafra as an investment firm wholly owned by the pension fund of the government of Kuwait that has clients throughout the world.

The first segment of the presentation focused on the fiscal state of public defined benefit (DB) pensions, in which deficits are a national challenge, with roughly \$4 trillion in deficits in the aggregate for state and local DB pension plans in the United States. This deficit reflects what will be needed in the future to pay beneficiaries as well as what is needed today. Because DB plans are sensitive to demographic and economic changes, benefits may accrue faster and longer than anticipated and asset growth may not keep pace. As a result, many DB plans are reliant on reserve funds to augment asset growth, which funds are a result of investment strategy. The panel used the challenges faced by the Ontario, Canada, Teachers' Pension Plan (OTPP) as an example of what many plans are experiencing: longer retirements; low interest rates; low investment risk tolerance, in that there is a smaller proportion of contributing members to make up any potential investment losses; and less cash to invest for the future. Mr. Saliba stated that because investment earnings account for a majority of revenue for a typical pension fund, the actuarial rate of return has a major effect on a plan's funding level, and setting this rate too high or too low causes problems. He stated that many pensions target a 7.24% rate of return, a rate that cannot be met by traditional asset classes alone. While pensions used to be reliant on fixed income, they now largely depend on equity and alternative investments. This new dependency has resulted in increased external management fees due to complex asset classes.

To address the need to improve investment performance and reduce external management fees, Mr. Saliba stated that many pension plans are turning to insourcing, defined by the presenters as managing investment performance portfolios with in-house investment teams. He stated that fee savings are most prevalent in alternative (private equity and real estate) investments. As an example, Wisconsin's pension investment board saved \$63 million in external fees in 2015 through insourcing and has gradually increased the proportion of insourced assets to 59% of total assets. Also, the OTPP, which pioneered the insourcing approach, has 80% of its assets managed with in-house resources in a global, alternatives-centric portfolio. Since 1990, it has had 78% of its funding come from investment income and a 9.7% annualized net rate of return, and it has insourced at a fraction of the cost of external management fees. According to the presenters, insourcing is challenging to implement, and the decisions on what assets to insource should balance potential cost savings and ease of implementation. For example, private equity and credit have the greatest cost savings potential but are the most difficult for which to implement insourcing. There are several insourcing models, including secondaries, co-investing, joint venture/club investing and direct investing, that can be leveraged to manage private assets. Insourcing can take many shapes and flavors, but there must be structures in place to make it work.

Next, the presenters focused on key enablers for successful management of insourcing, which include proper governance, setting competitive compensation and developing core infrastructure, including hiring additional back office personnel. Regarding governance, the key

stakeholders are legislative bodies, the responsibility of which is oversight; boards of directors, which are tasked with providing supervision and guidance; and investment teams, which execute investment strategy. Mr. Burt stated that these stakeholders need to determine which entity will allocate assets; set expected rates of return, expected contribution rates, budgets and compensation; select investment managers; and allocate assets for external versus internal management. He stated that in order to set competitive compensation, a pension plan's board of directors and investment team must have a shared strategy regarding fund performance. General principles of pay design include securing long-term stability, discouraging short-term risk-taking, maintaining oversight by the board of directors and aligning the investment team with fund goals. He then explained that compensation involves more than just a base salary and annual bonus; it needs to focus on long-term performance. Insourcing also involves hiring additional personnel based on the types of assets and volume of assets managed and investment complexity. In a survey of 26 leading pension funds, it was shown that they hired 1.7 to 2.5 back office full-time-equivalents (FTEs) for every one investment FTE. According to the presenters, risk management and audit functions are key to the success of insourced investment teams, but these functions are often overlooked. In closing, it was asserted that the meaningful challenges faced by United States pensions can be helped through insourcing, but this help is dependent on getting the right talent, structures and compensation in place.

Questions and comments from committee members addressed the following:

- the California Public Employees' Retirement System recently explored the possibility of insourcing its investments but ultimately decided it was not ready to do so. Texas has adopted a co-investment program, which is another insourcing approach;
- a member asked if infrastructure investments involve public-private partnerships, to which the presenters replied that this is one investment model used, especially in the United States. Other countries more often utilize fully privatizing infrastructure entities, such as airports. Infrastructure encompasses a range of tangible assets other than real estate;
- Wafra Inc. is private and 100% owned by the Kuwaiti pension fund, although most of Wafra is based in the United States and its investment exposure is dollar-based;
- if New Mexico wants to increase its pension funds' performance, it will have to increase the range of assets, especially alternative investments, in its portfolio, which requires having the right investment team in place; and
- the ERB already has some of its own investors and has saved about \$17 million per year.

#### **PERA 457(b) SmartSave Deferred Compensation Plan**

Dominic Garcia, chief investment officer, PERA, and Karyn Lujan, deferred compensation plan manager, PERA, provided the committee with an update on the PERA's 457(b) SmartSave Compensation Plan (SmartSave). SmartSave is a voluntary pre-tax defined contribution plan that is 100% participant-directed and -funded, with the PERA board acting as fiduciary. Also, the PERA board contracts with a third-party administrator to provide custody

bank, administrative and recordkeeping services, and this administrator meets quarterly with the board to review investment performance. As of June 30, 2019, SmartSave had \$644 million in total assets under management, with \$39 million in new assets in fiscal year (FY) 2019, and had 22,965 participants. According to Ms. Lujan, SmartSave is built on a four-tiered investment structure of target date funds, passive core options, active core options and additional diversification. Members can decide how actively they want to be involved with their accounts. Additionally, she stated that SmartSave features New Mexico life cycle portfolios, which are pre-designed investment portfolios with the appropriate asset allocation and diversification for a member's target year that is closest to either a member's year of retirement or attainment of a certain age. If members opt out of choosing their own investment options when they sign up for SmartSave, they are by default assigned to the life cycle option that is closest to the year they would reach the age of 65, but members can change their portfolio options at any time.

Next, Ms. Lujan reviewed the SmartSave enhancements for FY 2019, including the addition of a Roth feature into the plan that will allow after-tax contributions. Also, a major focus was conducting a request for proposals search for a third-party administrator, as the previous administrator was at the end of its eight-year contract term. At the end of April 2019, the PERA board awarded Voya Financial the new contract, effective October 1, 2019. While the PERA board will still maintain fiduciary control and current investment options will remain the same under the new contract, Voya will offer new services, including many new website capabilities that allow for much greater automation, a mobile application, advice and professional management for members, the Roth option and automated resources for employers.

Questions and comments from committee members addressed the following:

- the SmartSave program began in 1981;
- approximately one-third of the 60,000 eligible PERA members participate in SmartSave;
- the new contract with Voya will allow the PERA to better understand the demographics of SmartSave participants, which will hopefully improve plan participation in the future;
- Voya is a publicly traded company;
- the PERA board and staff are aware that fiduciary responsibility incorporates legal responsibility;
- employee contribution maximum limits are set by Internal Revenue Service rules at \$19,000 per calendar year, with increasing limits allowed based on age;
- members can make as many changes as desired to the SmartSave plan during a year, but some mutual funds may have trading restrictions; and
- the average balance for a participating member of SmartSave is \$25,000.

### **Adjournment**

There being no further business, the fourth meeting of the IPOC adjourned at 4:17 p.m.