Public Employees
Retirement Association
of New Mexico

Procurement Code Would Hinder PERA's Investment Options

In 2005, the Legislature repealed PERA's legal list of permissible investment and adopted the Uniform Prudent Investor's Act (UPIA) for the state's investing agencies. Representative Luciano "Lucky" Varela introduced House Bill 387, which exempts from the procurement code contracts for investment advisory services, investment management services and investment-related services entered into by the ERB, PERA and SIC.

PERA's Investment Program will be Negatively Impacted by Procurement Code

Removing the procurement-code exemption would cause:

- ✓ significant restraints for procuring the types of investments allowable under the UPIA;
- ✓ decreased investment returns due to higher fees associated with the limited types of alternative assets procurable under code;
- ✓ the fund to incur additional expense related to staffing required for receiving, screening, analyzing and filing paper RFP documents related to PERA's 120+ mandates;
- ✓ the inability to utilize internet resources and retain electronic documents related to searches which are more efficient methods than requiring hard copy; and
- ✓ the fund to incur substantially more risk by restricting the types and quantity of alternative assets in the asset allocation model.

Public pension funds need the flexibility to make prudent investment decisions in a global, complex financial market. Modern pension fund asset allocation models utilize diversification and risk management to safely steer returns to a return target. With a return to the constraints of the procurement code, it is less likely that PERA will be as successful in the future with its investment returns as it has been over the past 10-year period.

Legislation is being considered for the 2011 session that would again place the state's investment agencies under the procurement code. PERA – along with the Educational Retirement Board and the State Investment Council – strongly disagree with this course of action. Here's why:

Procurement Code Limitations

Prior to being exempt from the procurement code, PERA was limited in the kinds of investments allowed within its portfolio: essentially, publicly-traded stocks and bonds. The UPIA provides PERA with the flexibility to significantly diversify its portfolio by investing in alternative assets. The addition of alternative assets to the portfolio acts to defuse the extreme volatility of returns experienced by stocks and bonds, while incurring only marginal additional risk. This diversity has helped PERA to capitalize on the recent market upswing and recover losses resulting from the market downturn of 2008-09: from a low of $7.6 billion in March 2009, the fund has reached $11.3 billion as of November 2010. Since its inception, the PERA's alternative asset program has returned $37 million, net of fees, to the fund. Procurement code constraints will negatively impact the PERA Board's current asset allocation and alternative investment portfolio practices, which has proven to enhance returns on the PERA portfolios.

It should be noted that PERA has not found it necessary to utilize either sole source or emergency procurement in order to secure investment-related services since adoption of the UPIA.

Safeguards Embedded within PERA's Procurement Policy

The PERA Board adopted an *Investment-Related Services Procurement Policy* with clear guidelines for contracting investment-related services and using internet-based search resources in Request for Proposals. The policy reduces the time periods for publishing notices and amendments, for awarding investment manager contracts and for transitioning portfolios. The process allows PERA to make decisions in a market-sensitive timeframe while ensuring transparency and best practices for choosing and monitoring investments. PERA acknowledges that transition costs associated with redirecting funds to a new investment manager can be a significant expense and should be reserved for those situations when an underperforming manager is terminated or when rebalancing is necessary in order to properly align asset allocation, but not simply for the purpose of complying with routine RFP protocol.

For procurement of alternative assets, a modified process is utilized. PERA contracts with an expert alternative asset consultant to source qualifying investments, analyze each, provide thorough due diligence, and conduct on-going monitoring of these asset types. PERA uses the expert consultant in this capacity because many alternative asset funds consider their investment strategies and underlying assets to be trade secrets and, therefore, require non-disclosure agreements before releasing information; as such, they will not release this information to a public entity that must comply with FOIA. Additionally, alternative assets, such as private equity partnerships, have limited periods of fundraising that don't conform to PERA's existing 4 to 6 month RFP timeline and commonly have 10 to 12 year durations, which do not fit within procurement code guidelines. The process for securing direct investment in alternative assets is detailed in PERA's *Investment Policy, Investment-Related Procurement Policy* and in a comprehensive alternative asset program procedure.

PERA Performance Measures Impacted

The procurement-code exemption helps PERA in meeting its performance measures. Specifically, PERA has the ability to issue requests for proposals and secure contracts in a more efficient timeframe. The facilitation of the procurement process allows for speedier deployment of funds intended to improve investment returns, diversify allocations and reduce risk in the portfolio. This contributes to PERA exceeding its internal benchmark.

Procurement Code Contradicts Pension Industry Standards

Under the procurement code, contracts for professional services are limited to a 4- year term. Issuing RFPs every 4 years is not considered a best practice in procuring investment management services for a long term pension fund; no term limit with a 30-day termination notice provision is more in line with industry standard.

The implications of routine 4 year RFPs for investment-related services are significant for PERA. Currently, PERA uses an 8-year term for its contracts awarded through the RFP process. This limits transition costs and provides the timeframe typically necessary for managers to handle a portfolio for a full market cycle of 5 – 7 years. Interrupting investment cycles for routine RFPs could result in premature mandate terminations, erratic investment performance, and lead to a short-term portfolio management focus instead of the long-term focus best suited for a pension fund. Additionally, certain of PERA's asset classes, specifically private equity and real estate investments, require long-term investment horizons (+/-10 years) for gains to be realized. In order for PERA to manage the fund for the long-term, as is statutorily intended, maintaining a long-term focus by employing long-term investment products and services is the optimal means.