

**MINUTES  
of the  
THIRD MEETING  
of the  
INVESTMENTS OVERSIGHT COMMITTEE**

**August 16, 2010  
State Capitol  
Santa Fe**

The third meeting of the Investments Oversight Committee for the 2010 interim was called to order by Representative John A. Heaton, chair, on Monday, August 16, 2010, at 9:10 a.m. at the State Capitol in Santa Fe.

**Present**

Rep. John A. Heaton, Chair  
Sen. George K. Munoz, Vice Chair  
Rep. Donald E. Bratton  
Sen. Timothy M. Keller  
Rep. Larry A. Larrañaga  
Sen. Carroll H. Leavell  
Sen. Steven P. Neville  
Rep. Henry Kiki Saavedra  
Sen. John M. Sapien  
Rep. Jim R. Trujillo  
Rep. Luciano "Lucky" Varela

**Absent**

Sen. Tim Eichenberg

**Advisory Members**

Sen. Carlos R. Cisneros  
Rep. Miguel P. Garcia  
Rep. Roberto "Bobby" J. Gonzales  
Rep. Patricia A. Lundstrom  
Sen. Mary Kay Papen  
Sen. William H. Payne  
Sen. John C. Ryan

Rep. Andrew J. Barreras  
Sen. Stuart Ingle  
Rep. Jane E. Powdrell-Culbert  
Sen. Michael S. Sanchez  
Sen. John Arthur Smith  
Rep. Sheryl Williams Stapleton  
Rep. Shirley A. Tyler  
Rep. Richard D. Vigil  
Sen. Peter Wirth

**Staff**

Tom Pollard, Legislative Council Service (LCS)  
Doris Faust, LCS  
Claudia Armijo, LCS

**Guests**

The guest list is in the meeting file.

## **Handouts**

Handouts and written testimony are in the meeting file.

## **Monday, August 16**

Representative Heaton welcomed the members of the committee and the guests. He advised the members that the meeting would be audiocast and asked that they keep sidebar conversations to a minimum. He requested that the members introduce themselves before speaking, and he asked that they turn their microphones on before and off after speaking.

Representative Heaton asked for a motion to approve the minutes from the June 14, 2010 and the July 2, 2010 meetings. A motion to approve the minutes was made and seconded, and the motion passed unanimously. After the approval of the minutes, Representative Heaton advised the members that Mr. Pollard had sent out some information regarding the state's investment-related lawsuits. He asked the members to please review that information.

## **New Mexico Attorney General Gary King**

Attorney General Gary King addressed the members. He said he appreciated the opportunity to speak with them regarding the state's investment litigation and investigations. He cautioned that some information the members might seek would not be amenable to public discussion, but he hoped to provide adequate information during the meeting.

Initially, Attorney General King talked about specific fiscal cuts made to the Attorney General's Office (AGO) budget. He also mentioned that the Government Accountability Unit of the AGO would soon have three full-time lawyers. That unit handles such issues as the Region III Housing Authority litigation, commonly referred to as the "Region III case". Four individuals are under indictment in the Region III scandal. The men are facing felony charges, including fraud and money laundering. The State Investment Council (SIC) has filed a separate civil case associated with the Region III criminal case. In the civil case, the SIC is suing two individuals, the former Region III Housing Authority director, Vincent "Smiley" Gallegos, and Region III's former bond counsel, Richard Strumor. The SIC lost \$5 million in 2006 when the Region III Housing Authority defaulted on bonds. The SIC accuses Mr. Strumor of having misrepresented the facts when he urged the SIC to participate in the bond proposal and when he negotiated the terms of those bonds.

Attorney General King explained that there are two ways the AGO can pursue cases of fraud on behalf of the state: civilly or criminally. Civil cases involve allegations of fraud, breach of contract and similar claims. Criminal cases involve charging defendants in criminal court, and sometimes restitution can be sought. He noted that lawyers from the Government Accountability Unit have worked diligently with the U.S. Attorney's Office in the fraud case involving the Bernalillo County Metropolitan Courthouse. In that case, former Senator Manny Aragon was ordered to pay restitution in the amount of \$700 million. Attorney General King said that his office works to get restitution paid to the state. Regarding the Aragon case, he said he did not believe that the restitution had been paid, but he was aware of discussions concerning

how it could be paid. Regarding the Region III case, Attorney General King said that the case had been moving slowly and had been held up for a variety of reasons. He noted that the AGO had asked the legislature to clarify in statute whether the attorney general has the authority to bring charges in corruption cases involving state officials. In the Region III case and in the secretary of state case, the AGO has declarations from the state that the attorney general has the authority to bring those charges. However, the Constitution of New Mexico has broad language indicating that the attorney general has authority to bring such charges when it is deemed to be "in the best interest of the state". Again, Attorney General King stated that clarification in statute by the legislature indicating the attorney general has the authority to file suit would be extremely helpful.

Attorney General King told the members that the case involving the secretary of state, known as the "Help America Vote Act fraud case", has had conflict of interest issues due to the fact that the AGO is charged with representing the secretary of state. The case was originally scheduled to go to trial in October 2010, but since the defendant's previous attorney could no longer provide representation, the judge reset the trial for January 2011.

A case that will not involve any money being paid back to the State of New Mexico is the case against Public Regulation Commissioner Jerome Block, Jr., who is charged with misusing public funds and violating the Election Code. The action was brought pursuant to New Mexico's Voter Action Act, and it is a case of first impression in the district court. In that case, an issue arose concerning how the action could be brought forward. The judge ruled that, according to New Mexico law, a case can be pursued by only one means. The AGO appealed that ruling to the New Mexico Court of Appeals, and the case is currently on hold.

Attorney General King advised committee members that there are currently six investigators in the Government Accountability Unit. The unit employs forensic accountants and ex-U.S. Secret Service personnel. He said the AGO receives a lot of tips, information and leads from the public, from legislators and from others. All the investigators in the unit are busy with active investigations in six or eight cases; Attorney General King noted that it would be inappropriate for him to comment on those cases.

Attorney General King stressed that it is critical that a prosecutor like the attorney general not talk about cases prior to trial. Speaking publicly about a case can taint the jury pool and cause a variety of issues concerning the prosecution of the case. Additionally, Attorney General King said that as a prosecutor he is bound only to bring charges when there is evidence beyond a reasonable doubt that a crime has been committed. When handling fraud and corruption cases, the facts can be quite complicated. Often, the would-be defendant is politically connected and will go to great lengths to hide wrongdoing.

Attorney General King mentioned that the AGO's Medicaid Fraud Unit has nurses and medical investigators. Those personnel may be looking at 60,000 separate transactions. They must review each transaction, highlight transactions that raise concerns and then follow up with a thorough investigation of the specific suspicious transactions. He stressed that these are

extremely complicated cases.

Attorney General King mentioned the Martin Act out of the State of New York. He said that the act provides the New York attorney general with a number of tools not available to the attorney general of New Mexico. Pursuant to the Martin Act, the New York attorney general does not have to prove intent in court. Additionally, the New York attorney general has broad subpoena powers and can subpoena financial records, which are often very helpful as evidence. Attorney General King said that the tools provided by New York's Martin Act are helpful not only in prosecutions, but in investigations as well. He opined that any similar legislation enacted in New Mexico would need to be balanced and to be drafted so as to avoid the opportunity for misuse.

Attorney General King explained to the committee that in cases of civil prosecution, the AGO has two or three major tools. Pursuant to New Mexico's Fraud Against Taxpayers Act (FATA), the AGO shares civil authority with other state agencies. Currently, the AGO has a few open cases pursuant to that act. He added that the AGO can bring cases pursuant to other state statutes and also pursuant to federal law. He noted that the AGO can bring actions on behalf of the SIC, the Educational Retirement Board (ERB) and the Public Employees Retirement Association (PERA). Those state agencies are the three main clients of the AGO. The AGO can join or lead a multistate action on behalf of its clients. When filing a case pursuant to the FATA, the action can be brought by whistleblowers or other individuals. The act provides for the relator to present its case to the AGO. Then, the attorney general determines whether to intervene or bring the case. Each case is presented under seal, with no public documents, and is reviewed before the attorney general determines how to move forward. The act is broad and authorizes New Mexico's attorney general to bring cases outside of New Mexico, including multistate actions. Currently, New Mexico is involved in a case involving faulty equipment which was sold to government agencies in all 50 states. The case was originally filed in California, then claims were added and the court brought in the FATA because some of the equipment was sold in New Mexico. If it is determined that the damages for New Mexico in that case are large enough, it may be worthwhile for New Mexico to remove itself from the multistate action to pursue its own case. Attorney General King advised that once the seal on the case has been lifted, he will be free to speak about it.

Some committee members inquired as to the types of indictments that may be pursued by the AGO, specifically the case filed by the former chief investment officer for the ERB, Frank Foy. Mr. Foy filed suit alleging undue pressure and pay-to-play tactics by the Richardson administration and others involving investments with the Chicago-based firm, Vanderbilt Capital (Vanderbilt). Vanderbilt contributed to the governor's presidential campaign. In response to questions regarding his plans involving the case, Attorney General King declined to affirm or deny any intention to file criminal charges. He stressed that it would be improper and imprudent for him to comment. He told the members that there are ongoing investigations that could be compromised by anything he might say in a public setting. Attorney General King added that he has had conversations with certain legislators who said they would prefer civil suits versus criminal cases in many political corruption cases because of the opportunity to recover some of

the financial losses associated with the cases. He said he respectfully disagrees with that opinion. He added that pursuing the criminal charges in political corruption cases is imperative. Additionally, he cautioned that political pressure to move cases along at a certain pace is unacceptable in all circumstances. He said the best way to handle political corruption cases is to let the "bad actors" know that once the AGO gets its teeth into a case, it will not let go, regardless of political pressures.

Attorney General King told committee members that he is working closely with State Investment Offices Steven Moise. He said they have developed a plan that would allow the SIC to pursue civil cases aggressively, giving the AGO the time and ability to pursue criminal charges. He noted that the case involving Vanderbilt is one touted in the press as involving criminal activity. However, he cautioned that such a determination will ultimately depend on the quality of the evidence.

There was a discussion regarding the FATA and whether it is helpful as enacted or needs amending so it can better serve the needs of the AGO. Attorney General King said that his office is pursuing all avenues provided in the act. He said that the AGO is issuing requests for proposals (RFPs) to hire outside counsel to handle cases directly. He added that he also recently created a FATA position and hired an attorney for it. He reiterated that the AGO has worked to give the SIC the authority to issue RFPs to hire counsel to pursue civil cases. Lastly, he noted that the AGO has demonstrated to the courts that it has built a "Chinese wall" within the office for handling complicated and overlapping cases.

There was a discussion regarding the state's obligation to provide legal counsel to state employees accused of malfeasance. Attorney General King said that perhaps the legislature would want to review the law because currently, if a state official acting in an official capacity is accused of malfeasance, the state's Risk Management Division of the General Services Department is required to represent that official. He also said that under federal law, a relator in a law suit must have actual knowledge of wrongdoing. New Mexico does not have a similar requirement, and he opined that perhaps it should.

A discussion ensued regarding payday lending practices and abuses in New Mexico. Committee members asked whether the AGO has pursued any cases involving payday loan companies. Attorney General King said that his office recently filed suits against a company charging 1,000 percent interest and one charging 700 percent interest. Both suits were filed pursuant to the Unfair Practices Act. He advised committee members that in both cases, the defendants are arguing that because New Mexico statutes do not provide for a cap on interest rates, the AGO does not have the authority to file the suits.

There was a lengthy discussion regarding legislators' perceived inability to be informed and updated regarding cases the AGO is investigating. Several committee members asked if there is a way for the attorney general to let the legislature know about certain types of cases that are being considered. Attorney General King responded by saying that any such notifications would jeopardize the cases involved. When asked if the attorney general would support a

legislative initiative to provide a statutory initiative like New York's Martin Act, Attorney General King said his office would support it. However, he cautioned that the legislature might want to ask the LCS to review the provisions carefully with constitutionality in mind.

Committee members requested detailed information regarding financial recoveries achieved by the AGO. Attorney General King said he would see that the members got the information. He was also asked to research the issue of the state providing legal counsel for employees accused of wrongdoing and to come up with a statutory fix for the situation. Lastly, the chair asked Attorney General King to provide guidance and recommendations to the committee regarding any legislative initiatives that would be helpful, including but not limited to the Martin Act issues and provisions of the FATA.

### **SIC: Current and Proposed Litigation Efforts; Strategies to Recover SIC Funds Lost to Investment Fraud and Other Illegal Activities or Paid to Third-Party Marketers**

Mr. Moise and the SIC's general counsel, Bryan Otero, gave a presentation to the committee. Mr. Moise said he appreciates the attorney general working in collaboration with Mr. Moise and the SIC on important litigation matters.

Mr. Moise spoke about a trip that he and Mr. Otero took to New York City to oversee the transition from the Paul Hastings law firm to the Day Pitney law firm, which is handling legal claims for the SIC on a contingency fee basis. Mr. Moise said that he told the Pitney firm that the SIC is extremely interested not only in recovering funds for the State of New Mexico, but also in sending a message to investment firms that the state will pursue civil and/or criminal charges against wrongdoers.

Mr. Moise advised the committee that the SIC is in the process of hiring a new deputy for investments. He noted that the SIC has received resumés from a number of excellent candidates.

Mr. Otero directed the members' attention to a handout entitled "SIC Legal Issues Update", dated August 16, 2010. He spoke about cases in which the SIC was involved from 2006 through 2009, which ranged from class action civil claims to breach of contract, breach of fiduciary duty and agent placement fees. Mr. Otero said the SIC has recovered an excess of \$100 million as the result of those cases.

Mr. Otero directed the members' attention to ongoing SIC litigation, including claims involving securities law violations, fraud, misrepresentation and class action in which the SIC or the state of New Mexico is the lead plaintiff.

Mr. Otero noted that the AGO is assisting the SIC in its pursuit of the civil case against Region III. The claims in that case include unjust enrichment, securities law violations, violations of the New Mexico Uniform Securities Act and misrepresentation. Mr. Otero said that the SIC is represented by the Risk Management Division in the case initiated by Mr. Foy. Mr. Otero also noted that in a case involving Countrywide Financial, attorney fees have exceeded \$5 million. He noted that the state's losses in that case are significant and that the SIC is paying its

own legal fees. He added that the SIC expects to pay up to \$2.5 million at trial in that case, but the potential for recovery could be \$100 million, which represents the range of losses in the case. He noted that the ERB and the PERA are also plaintiffs in the lawsuit, but they experienced lower losses.

In the Austin Capital class action lawsuit — a case involving Bernie Madoff, who was convicted of securities fraud — the SIC is a member of the class. The AGO is representing the SIC.

Mr. Otero clarified for the members that the SIC had transferred its litigation involving placement agents, managers, Aldus Equity and others to the Day Pitney law firm. He said that this action was taken through the RFP process and that the SIC was assisted by the AGO in drafting the RFP.

Lastly, Mr. Otero explained that the SIC has been inundated with public information requests. A total of 28 such requests have been processed by the SIC since 2009. Many of those requests seek thousands, and some even millions, of pages of documents. He said that the SIC is cooperating with both the United States Department of Justice and the Securities Exchange Commission. The subject matter of all of the investigations involve placement fees.

### **ERB and PERA: Current and Proposed Litigation Efforts; Strategies to Recover SIC Funds Lost to Investment Fraud and Other Illegal Activities Paid to Third-Party Marketers**

There was a general discussion about the money the state lost as a result of bad investments and how many of those investment losses were the result of fraud. Chris Schatzman, general counsel for the ERB, noted that it can be difficult to determine when an investment is simply a bad investment, or whether fraud is part of the equation. A number of committee members expressed concern over not knowing the actual identities of the individuals behind a number of the bad investments. Mr. Schatzman said the pattern of investments suggests that some of the placement agents were intentionally misleading. Members voiced concerns about relationships not disclosed and whether the lack of disclosure is in material breach of fiduciary duty. When discussing the state's private equity funds, Mr. Schatzman pointed out that on many occasions, the third-party placement agent who placed the investment was not the same as the person disclosed. This fact suggests intentional concealment. Mr. Schatzman was asked about the statute of limitations applicable to the potential cases for recovery being considered by the ERB. He told the members that the statute of limitations varies with each claim. He cited the example of the Vanderbilt case, in which the investment was made in 2006 and was written off of the ERB balance sheet in 2007. The ERB did not learn about the potential issues until 2009. Consequently, there are different arguments that could be made regarding when the statute of limitations begins in that case. Mr. Schatzman stressed that these types of cases are very new to New Mexico. He also explained that the various cases are being brought pursuant to a variety of legal theories, primarily to avoid running into constitutional issues that could arise pursuant to the FATA.

The committee members asked to be apprised regarding the statute of limitations applicable to the ERB's ongoing litigation. Members asked the ERB staff to provide information regarding all of the companies being evaluated as potential defendants. Mr. Schatzman warned that as the ERB continues to investigate the issues, it will become aware of additional people or entities suspected of wrongdoing. He said identifying those people or entities prior to getting information from them could seriously jeopardize any of the cases the ERB might pursue.

Next, there was a general discussion about changing the makeup of the ERB and the PERA boards. It was suggested that requiring board members to possess more expertise pertinent to their duties as board members might be a positive move. Committee members suggested that a discussion of the subject should be added as an agenda item at the boards' meetings.

Jan Goodwin, executive director, ERB, told the committee that the ERB has retained the law firm of Freedman Boyd Hollander Goldberg Ives & Duncan, P.A. (Freedman Boyd), and Pomerantz Haudek Grossman & Gross LLP (Pomerantz Haudek) to represent the ERB in potential litigation against Aldus Equity; Saul Meyer, Aldus Equity's principal partner; and others to recover damages resulting from recommending certain investments to the ERB while Aldus Equity was the board's private equity investment advisor from late 2006 through May 2009. Additionally, placement agents who received fees related to those investments may also be named as defendants. Outside counsel is working closely with ERB staff to finalize the complaint. The potential lawsuit arises in part from Meyer's admission, in the course of his pleading guilty to an indictment secured by the New York attorney general, that on numerous occasions he recommended investments to New Mexico that were pushed on him by politically connected individuals in New Mexico. However, Mr. Meyer did not provide specifics in his allegations regarding those investment recommendations.

Ms. Goodwin said the ERB invested \$40 million in Vanderbilt, which held the equity strip portion of collateralized debt obligations (CDOs). A substantial portion of the investment pool was invested in CDOs that held securitized mortgages originated by other parties and sold to Vanderbilt. The equity strips received cash flows after payments were made on the rated securities created from those mortgages. The ERB wrote off its entire investment in 2007. In April 2009, the ERB learned for the first time that a placement agent fee had been paid to Mark Herrera in connection with this investment. The ERB has directed Freedman Boyd and Pomerantz Haudek to review this transaction and the events surrounding it, with the goal of bringing suit to recover damages. The review will include an analysis of the manner in which the underlying mortgages were originated and securitized and the role of the placement agent in the investment.

With regard to third-party placement agents and other private equity investments, Ms. Goodwin said that the ERB has directed its outside counsel to review transactions, excluding private equity investments, in which investment managers made payments to placement agents or in which the role of the placement agents and the fees paid were not accurately or fully disclosed to the ERB. The intent of the review is to determine whether the ERB was damaged

by the failure to make these disclosures and to recover damages when or where appropriate.

Ms. Goodwin said the ERB has agreed to serve as a class representative for public pension funds in a securities class action case against Boston Capital, a fund of hedge funds, and its affiliated and parent entities: KeyCorp, a regional bank headquartered in Ohio; Victory Capital Management; and Boston Capital Management GP Corp. Boston Capital invested in the Rye Select Broad Market Fund LP, which in turn invested with Bernie Madoff. Austin Capital has ceased business operations and is in the process of liquidating its hedge fund investments. Robbins Geller Rudman & Dowd LLP, a national securities litigation firm, is counsel for the class action.

Regarding litigation against Countrywide, Ms. Goodwin said the ERB joined with the SIC and the PERA, alleging misrepresentations and fraud in connection with Countrywide's issuance of certain mortgage-backed securities. The SIC is acting as the principal plaintiff in this litigation. The ERB held approximately 0.06 percent of the total securities at issue and incurred losses of less than \$250,000. Discovery is nearly completed in this case.

Ms. Goodwin stated that, in general, numerous securities class action lawsuits are brought against publicly traded companies by public pension funds, pursuant to federal securities law. Due to limited resources, the ERB generally is a lead plaintiff only when it has a substantial investment in a company and no other pension fund has brought the lawsuit. Also, as a consequence of limited resources, the ERB has not opted out of class action lawsuits brought by others in order to bring its own separate action. If a class action settlement is approved by a court, the ERB receives its share of the settlement fund when it is distributed. The ERB relies on the state's custodial bank and securities class action law firms under contract with the AGO to monitor litigation, and it relies on the custodial bank to file the ERB's claims.

Terry Slattery, executive director, PERA, discussed the PERA's recent organizational and investment-related changes. He said the investment division was reorganized in late 2009 to align the professional staff with the fund's assets allocation and corresponding workloads. He said the PERA contracts with two consultants: the general consultant, R.V. Kuhns, is responsible for total fund consulting, performance reporting, asset allocation, asset class structure studies and consulting specific to publicly traded investment classes; Cliffwater Consultants is the gatekeeper providing sourcing, due diligence, analysis, accounting and reconciliation for all alternative asset classes, hedge funds, private equity funds, real estate and real assets.

Mr. Slattery said that the PERA board recently approved an asset allocation change that increases alternative investments, fixed-income investments and international equities by decreasing the domestic equity allocation. He stated that this action was designed to lower the risk in the portfolio by reducing the most volatile asset classes and increasing asset classes with lower correlations to equities, such as fixed-income and alternative investments. Additionally, the board hopes the action will improve investment returns by increasing high-yielding alternative investments. Mr. Slattery explained that the recommendations for new actively

managed mandates, mandate consolidations or rebalancing within seven asset classes resulted from systematic asset class structure studies conducted by the general consultants in coordination with the PERA staff.

**PERA, SIC and ERB Panel Discussion: Potential for Increased Investment Earnings and/or Cost Savings from Refining or Restructuring the Agencies' Investment Functions**

There was a panel discussion regarding the possibility of consolidating the various state funds. Mr. Moise said the state has more than \$35 billion in institutional investment funds managed by four separate and segregated entities. Each entity has a different board, different clients and, in part, different governing statutes. Each entity operates independently. Mr. Moise pointed out that the funds all have different contribution sources and distribution requirements. Consequently, the investment strategies, practices and long-term goals at the ERB and the PERA often are different from those of the permanent funds managed by the SIC. Another notable difference is the legislature's authorization of certain differential rate and economically targeted investments in the Severance Tax Permanent Fund. Mr. Moise said that at the very core, the SIC, the PERA and the ERB have the same long-term mission: the growth of funds through superior returns, to be achieved through professional, prudent and ethical investment practices.

Mr. Moise urged the committee to consider carefully the consolidation of the investment funds. He also recommended an objective analysis of the issue. He said that even if the consolidation were not ultimately executed, the analysis could provide beneficial information to the state's investment agencies as they evolve and strive to improve their operations. Mr. Moise stressed that the analysis should be completed by a highly qualified objective outside agency, and not the legislature or a state agency.

Ms. Goodwin said there are pros and cons to consolidating all of the state investment funds. She provided a chart illustrating one possible way of consolidating the PERA, ERB and SIC boards to form a nine-member consolidated investment agency with three members from each of the originating boards. According to Ms. Goodwin, this could result in cost savings in management fees, systems expenses and salaries. She noted that any such savings are difficult to estimate. Ms. Goodwin further noted that since there would continue to be several strategies involved in the various investments, the potential savings related to staffing could be minimal.

Committee members said that looking closely at the issue is in the best long-term interest of the state. Some members noted that other states consolidate all of their funds for investing purposes and that consolidating the funds does not necessarily mean that all funds would be automatically consolidated into one. It was generally agreed that there may be some situations in which consolidation makes sense and others where it does not. Some members suggested that any restructuring of state funds should first include input and discussions from stakeholders. Members generally agreed that the committee should be prepared to make recommendations regarding the consolidation issues. Additionally, members returned to the topic of changing the composition of board members, specifically for the ERB and the PERA. They agreed to send comments, ideas and concerns to Mr. Pollard, who will compile and organize them for discussion at the October meeting. With no further business, the meeting was adjourned at 4:05

p.m.