MINUTES
of the
FIRST MEETING IN 2009
of the
INVESTMENTS OVERSIGHT COMMITTEE

June 8, 2009
Room 322, State Capitol
Santa Fe

The first meeting of the Investments Oversight Committee (IOC) for 2009 was called to order by Representative John A. Heaton, chair, at 10:10 a.m. on Monday, June 8, 2009, in Room 322 of the State Capitol in Santa Fe.

Present
Rep. John A. Heaton, Chair
Rep. Donald E. Bratton
Sen. Tim Eichenberg
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. John Arthur Smith, Vice Chair

Advisory Members
Rep. Andrew J. Barreras
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Rep. Jane E. Powdrell-Culbert
Sen. John C. Ryan
Rep. Sheryl Williams Stapleton
Rep. Shirley A. Tyler
Rep. Richard D. Vigil

Sen. William H. Payne
Sen. Michael S. Sanchez
Sen. Peter Wirth

Staff
Tom Pollard, Legislative Council Service (LCS)
Doris Faust, LCS

Guests
The guest list is in the original meeting file.

Handouts
Handouts from the meeting are in the original meeting file.

<u>Monday, June 8</u>

Interim Legislative Committee Protocols

John Yaeger, assistant director, LCS, advised the committee of the interim committee protocols, including those relating to the establishment of a quorum. He said that a quorum consists of 50 percent plus one of the voting members assigned to the committee. Once a quorum is established, it is presumed to exist until the question of whether a quorum exists is raised by a voting member or a roll call vote is taken. He said the New Mexico Legislative Council authorizes the speaker of the house and the president pro tempore to adjust the membership of the committees. Members may resign at any time. Mr. Yaeger addressed issues related to the sound system in the committee rooms, saying that the sound system adjusts automatically and is easily disrupted by background noise. If a committee member is having trouble hearing, he suggested checking for excessive background noise (e.g., side conversations, paper rustling, typing, etc.). Mr. Yaeger discussed the interim committee calendar and said that meeting conflicts were avoided as best as possible during the calendar creation. He added that any changes to the calendar must be approved by the legislative council. Finally, Mr. Yaeger addressed per diem and mileage forms and conference attendance, and he noted that complaints have arisen over the use of cell phones during committee meetings and that it is up to the committee chairs to address those concerns. Mr. Yaeger discussed the blocking provision, which states that no action shall be taken if a majority of the members from one house vote against a measure.

Review of State Investment-Related Legislation from the 2009 Session, Including a Status Report on the Implementation of the Retirement Systems Solvency Task Force

Ms. Faust, a staff attorney for the LCS, provided a brief report on the key bills relating to investments from the 2009 legislative session. Ms. Faust noted that the committee had not endorsed any bills for the last session and that there were only three bills relating to committee work that were signed into law and one that passed both houses but was vetoed.

Two separate handouts of summaries of bills were provided to the committee. A report on bills related to pensions and solvency was distributed for informational purposes but was not discussed.

The legislative council complied with the mandate set in House Bill 573 by appointing members to the Retirement Systems Solvency Task Force (RSSTF), including the chair and vice chair of the IOC. The task force will be studying pension fund solvency and will be reporting to the IOC. Rather than duplicate the work of the task force on pension solvency, the IOC intends to focus on investment issues.

Ms. Faust reported that House Bill 454, which enacts in New Mexico the Uniform Prudent Management of Institutional Funds Act, repeals existing law dealing with the same topic. The new act was adopted by the National Conference of Commissioners on State Laws in 2006 and has been adopted in 29 other states.

House Bill 454 may be applicable to some state investments, based on the definitions in the bill. The term "charitable purpose" is defined to include the promotion of a governmental purpose, and the term "institution" is defined to include a governmental instrumentality. So arguably, all state investments would need to comply with this act. Only two state funds are excluded from being covered: the Severance Tax Permanent Fund and the Permanent School Fund. The new law provides more guidance to fund managers.

House Bill 876 prohibits the state investment officer, the State Investment Council (SIC), the retirement board of the Public Employees Retirement Association (PERA) and the Educational Retirement Board (ERB) from making any investment, other than investments in publicly traded securities, unless the recipient of the investment discloses the identity of any third-party marketer who assists the recipient in obtaining the investment. The amount of the fee, commission or retainer paid to the marketer must also be disclosed. A violation of the act, which requires a knowing withholding of information, constitutes a fourth degree felony and can result in a fine of up to $20,000.

Senate Bill 406 was vetoed by the governor. This bill would have changed the makeup of the SIC, providing for more input from the legislature and less from the governor.

House Judiciary Committee Substitute for House Education Committee Substitute for House Bill 573 created the RSSTF. The details of this bill were addressed by Wayne Propst, executive director, Retiree Health Care Authority (RHCA).

Mr. Propst introduced the RHCA board members who were present and thanked the legislature for passing House Bill 573 and House Bill 351. He reviewed the market values and changes in net asset value posted by the fund, noting that the last six months have been a roller coaster. The market value of the fund, effective April 30, 2009, was $136,752,722.24, whereas in February 2009 the fund value was $122,897,300.45.

Turning to the subject of 2009 legislation, Mr. Propst informed the committee that House Bill 351 will have an important and positive effect on the solvency of the fund by increasing employer and employee contributions. House Bill 573 also improves fund solvency. Under the new law, members must purchase service credit from the RHCA if they purchase service credit from the PERA or the ERB, and it requires return-to-work employees and their employers to contribute to the RHCA.

Despite these two bills, there is still a lot of work to do with regard to fund solvency. By 2018, fund expenses will exceed fund revenue. Mr. Propst warned of the need to be cognizant of the state's unfunded liability and to ensure that fund benefits are available to all current and future retirees.

The RHCA staff will be making comprehensive recommendations to the board at its next meeting, on July 7-8, 2009. Issues to be addressed will include premium increases, plan design changes, select plans and carriers for Medicare members and a review of other finance elements. The authority will continue to look at age and service requirements.

On questioning by the committee, Mr. Propst discussed: the difference between the terms "unfunded liability" and "solvency"; reinvestment assumptions; and whether the fund can expect an 8% return on investments.

The committee expressed concern about the fund's underperformance against its benchmarks and the plan affecting the borrowing capacity of the state, and it discussed the ability and need for the authority to change co-pay and deductible rates, even in the absence of legislation on that point.

Representative Heaton noted that health care is the second-largest problem in the United States, that it consumes 16.5% of the gross domestic product and that this needs to be addressed if the United States is to remain competitive in the world market.

Update on Investment Performance and Recent Issues Involving Third-Party Placement Agents

Daniel White, economist, Legislative Finance Committee (LFC), provided a handout regarding FY09 third-quarter investment performance highlights. Mr. White reported that all state investment agencies improved on their second-quarter performance relative to benchmarks. The SIC-managed Land Grant Permanent Funds and Severance Tax Permanent Fund were the most impressive performers, beating their overall policy benchmarks by an outstanding 620 and 650 basis points, respectively. The funds' performance was good enough to rank them both in the top 8% of U.S. endowment funds.

Both the PERA and the ERB investments underperformed quarterly policy benchmarks, marking the sixth consecutive quarter that the PERA investments have underperformed quarterly policy benchmarks. The PERA funds continue to be ranked in the bottom 3% of all U.S. public funds for one-year and five-year returns.

The ERB fund improved significantly from the previous quarter, missing its quarterly benchmark by only 40 basis points. This performance improved the fund's quarterly peer ranking from the ninety-seventh percentile to the forty-fifth percentile relative to other U.S. public funds. However, the fund's one-year and five-year returns remain substantially below their respective benchmarks.

The primary reason for the SIC-managed permanent funds' outperformance of benchmarks was the domestic equity hedging program. The strategy utilizes derivatives products to mitigate risk associated with volatile market conditions and allowed the two funds to outperform the S&P 500 by an impressive 1,140 basis points.

Michelle Aubel, senior fiscal analyst, LFC, discussed third-party marketing issues and reported on the current status of charges and investigations into third-party marketing payments in New Mexico. Ms. Aubel described the new SIC rules relating to third-party marketers, noting that the LFC will also be monitoring this issue and that diligent oversight by the LFC and the IOC is important to safeguard state funds.

Investment Performance Update: Public Employees Retirement Association

Robert Gish, investment director, PERA, and Terry Slattery, executive director, PERA, reported that they are pleased with the PERA's current numbers. The presenters reviewed detailed handouts on the PERA's investment performance, noting that the fund value was approximately $8.7 billion as of April 30, 2009. Mr. Gish stated that the PERA has passed its low point and should remain that way if the markets hold up. As of May 2009, the fund is down 22% for the fiscal year. The PERA has experienced six quarters of underperformance, but as the credit crisis continues to resolve, the fund will perform better.

The presenters discussed allocation targets, reporting that the PERA has not changed its targets, but has changed the allocations. The PERA is slightly overallocated to U.S. equities and very overallocated to international equities.

On questioning by the committee, Mr. Gish discussed:

- alternative investments and how they are broken out in the report;
- the structure of the PERA and who helps with investment decisions;
- the PERA consultants, and who monitors all of the PERA's investments;
- how consultants, including Cliffwater, LLC, consultants, are compensated;
- the valuation of private equity investments;
- the PERA's request for proposals process;
- the PERA's performance in relation to its peers and what policy changes the PERA has made in response to being in the bottom 3% of funds;
- termination of fund managers who are underperforming;
- the PERA's option to take a defensive stance and to preserve funds by getting out of the market and the 13 triggers that would make the PERA take such a defensive policy;
- expertise on the PERA board, and whether the breakdown in the market was foreseeable; and
- accepted best practices of large funds.

Investment Performance Update: State Treasurer

James B. Lewis, state treasurer, and Scott Newman, interim chief investment officer, provided an overview of the state treasury, including the history of the State Treasurer's Office, the treasurer's duties, the organizational structure of the State Treasurer's Office and the treasurer's oversight functions. The State Treasurer's Office manages the day-to-day operating money of the state and does not contract with an outside investment advisor.

Mr. Lewis reported on the general fund investment portfolio, which had a market value of $1.63 billion as of May 31, 2009. This compares to a $2.3 billion value at the same point last year and a $2.54 billion value at the same point two years ago. The market value of the portfolio decreased by $9 million from April 30, 2009 to May 30, 2009.

The general fund outperformed its benchmark with an earned yield of 2.12%. However, May earnings were $2.53 million, representing a 49.98% decrease from April earnings. Fiscal year earnings totaled $72.42 million.

As of May 31, 2009, the local government investment pool portfolio market value was $964 million, compared to a market value of $1.7 billion at the same time last year and $972 million two years ago.

As of May 31, 2009, the tax exempt bond proceeds investment pool portfolio market value was $738.5 million, compared to a market value of $524.9 million at the same time last year and $547.6 million two years ago.

As of May 31, 2009, the taxable bond proceeds investment pool portfolio market value was $791.4 million, compared to a market value of $648.2 million at the same time last year and $687.7 million two years ago.

Investment Performance Update: State Investment Council

Adam Levine, senior deputy, SIC, and Charles Wollmann, public information officer, SIC, presented the committee with a handout detailing the status of SIC funds, noting that there is a lot of red ink on the fund summary page. Domestic equity benchmarks and international equity benchmarks are generally down, domestic fixed income benchmarks are up and alternative benchmarks are mixed.

Over the past 12 months, the combined funds experienced a net investment loss of $3.6 billion, which includes a net investment loss of $124.5 million in the first quarter. Contributions totaled $574.2 million for the year, while distributions totaled $746.8 million. For the quarter, total assets increased from $11.4 billion at the beginning of the quarter to $11.8 billion at the quarter's end, with $72.5 million in net distributions.

Over the past five years, the Land Grant Permanent Funds returned 0.7% per annum, outperforming its policy index by 1.8% and ranking in the thirty-fourth percentile of the independent consultant cooperative's endowments and foundations universe. Over the same period, the Severance Tax Permanent Fund returned 0.0% per annum, trailing its policy index by 0.6% and ranking in the forty-sixth percentile.

For the one-year period ending March 31, 2009, the Land Grant Permanent Funds returned -23.8%, outperforming its policy index by 4.4% and ranking in the thirty-fifth percentile of endowment and foundations funds, while the Severance Tax Permanent Fund returned -25.7%, outperforming its policy by 2.2%, ranking in the fifty-second percentile.

For the quarter, the Land Grant Permanent Funds returned -1.0%, outperforming its policy index by 6.2% and ranking in the seventh percentile of endowment and foundations funds, while the Severance Tax Permanent Fund returned -1.1%, outperforming its policy by 6.5% and ranking in the eighth percentile.

Mr. Levine next discussed the SIC's new transparency and disclosure policy and provided committee members with copies of the policy. After reviewing many other disclosure policies, the SIC has concluded that this new policy is the most expansive and comprehensive it has found.

Investment Performance Update: Educational Retirement Board

Jan Goodwin, executive director, ERB, and Bob Jacksha, chief investment officer, ERB, reviewed their handouts detailing the performance of the ERB fund and also welcomed input from the committee on the format of the ERB handouts.

The presenters reported that all but three of the ERB fund managers have turned their underperformance around in the last three months. Fund balances were $6.2 billion at the end of March 2009, $6.6 billion at the end of April and $7.0 billion at the end of May.

The ERB's next actuarial study will begin on June 30, 2009, with a report anticipated in November.

The committee raised the issue of subpoenas served on the ERB. Ms. Goodwin stated that the ERB was comfortable with its responses to those subpoenas, which was to deny the request. Senator Ryan noted that the committee may require a further discussion of this issue in the future and that the committee might want to have the subpoenaed information disclosed to the committee. Ms. Goodwin expressed a concern with interfering with an ongoing federal investigation and noted that disclosing such information might hamper the ERB's future efforts to obtain full disclosure from consultants regarding third-party marketing fees paid by those consultants.

The committee discussed third-party marketer fees and how to improve policies to control payments to third-party marketers, concluding that there is a lot of room for improvement in these policies.

Adoption of Interim Work Plan

Mr. Pollard, a legislative fiscal analyst for the LCS, reviewed the details of the proposed interim work plan, which was adopted by the committee without objection.

There being no further business, the committee adjourned at 5:25 p.m.