

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

**August 26, 2009**  
**State Capitol**  
**Santa Fe**

The third meeting of the Investments Oversight Committee (IOC) for the 2009 interim was called to order by Representative John A. Heaton, chair, on Wednesday, August 26, 2009, at 10:00 a.m. at the State Capitol in Santa Fe.

**Present**

Rep. John A. Heaton, Chair  
Sen. John Arthur Smith, Vice Chair  
Rep. Donald E. Bratton  
Sen. Timothy M. Keller  
Rep. Larry A. Larrañaga  
Sen. Carroll H. Leavell  
Sen. Steven P. Neville  
Sen. John M. Sapien  
Rep. Jim R. Trujillo  
Rep. Shirley A. Tyler  
Rep. Luciano "Lucky" Varela

**Absent**

Sen. Tim Eichenberg  
Rep. Henry Kiki Saavedra

**Advisory Members**

Sen. Carlos R. Cisneros  
Rep. Miguel P. Garcia  
Sen. Mary Kay Papen  
Rep. Sheryl Williams Stapleton

Rep. Andrew J. Barreras  
Rep. Roberto "Bobby" J. Gonzales  
Sen. Stuart Ingle  
Rep. Patricia A. Lundstrom  
Sen. William H. Payne  
Rep. Jane E. Powdrell-Culbert  
Sen. John C. Ryan  
Sen. Michael S. Sanchez  
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 located in the meeting file.

## **Public Employees Retirement Association (PERA) Updates on Investment Performance Through Second Quarter of 2009**

Terry Slattery, PERA's executive director, and Bob Gish, chief investment officer for the PERA, presented an update on the investment performance of the PERA through the second quarter of 2009. Referring to an investment performance analysis report prepared for the PERA, Mr. Gish pointed out that the second-quarter update ended on June 30, 2009. He followed by noting that as of July 31, 2009, the fund was up 9.5%, which is down 33% from the fund high point of \$13.3 billion and higher than the fund low point in March of \$7.6 billion.

Mr. Gish walked the members through the performance report and highlighted areas of interest, particularly the breakdown of performance by management. Members inquired as to when the PERA determines it is necessary to reallocate the funds. Mr. Gish said that generally, reallocation is triggered when the fund is at 5% from the target.

Members wanted to know if the PERA was underallocated because of losses in the market. Mr. Gish answered that the PERA was partially underallocated due to the firing of a fund manager, which resulted in \$360 million being moved to cash. He noted that some of that cash has since been reallocated.

The members inquired as to the fees paid for the management of the PERA's funds. Mr. Gish said that the PERA's fees are often near the lowest paid in comparison with similar funds. He added that right now, some of the active managers are having problems, but that managers are not hired due to a month's performance nor fired due to a month's performance. Mr. Gish noted that the PERA issues a request for proposals (RFP) for all traditional managers based on their long-term records. Performance ups and downs are expected, but over time, managers typically outperform their benchmarks. Of course, if the PERA is not satisfied with a manager, the manager is terminated.

It was mentioned that satisfaction with fees paid to managers, and rate of return, is a complex issue. The PERA used to pay flat fixed-rate fees, but has started moving to performance-based fees. The PERA board has been trying to assess the benefits of management fees and continues to consider whether managers are adding value above what would be achieved through indexed funds.

Committee members asked if the PERA was doing better, worse or about the same as its "peer group" with relation to the fees paid. Board Chair Cynthia Borrego noted that as early as the past week, she had contacted others to look at the PERA peer groups because the board was not happy with the last quarter's results. She added that the board depends heavily on its staff in an effort to get better returns. She noted that she was not speaking for the board, but she did not think the PERA had been performing better than other similar-sized funds. She said the board looks at long-term returns and how they will impact the future.

Reference was made to the 8% benchmark set for the PERA, and the committee asked if that 8% was a realistic percentage when considering the PERA funds' historic performance. There was concern voiced about the ability to maintain PERA members' benefits. Mr. Gish referenced the report and said that even when including the funds' underperformance, PERA is still positive. He added that over the past 15 years, with 8% being the target, the returns have often exceeded that 8% benchmark. According to Ms. Borrego, the board took action in June and supports the 8% at this time, but it will reconsider it next year.

The committee asked about member distributions. Mr. Gish said that annual distributions to retirees are approximately \$51 million per month, whereas the fund takes in approximately \$40 million per month, amounting to a \$125 million annual deficit. He added that the pension fund is 62 years old. When it was started, contribution rates were set up to pre-fund the system. As the fund matures, the liabilities catch up with the pre-funded assets, so now the liabilities are greater than the contributions. It is anticipated that the fund will not get back to a position of having a greater amount in contributions than distributions. The actuaries determine what it takes to fund the liabilities and to maintain a fund that will last in perpetuity.

Members wanted to know if in the long term, the PERA would be looking for more contributions from members to ensure solvency. Mr. Slattery pointed out that the PERA looks out 30 to 50 years in the future when analyzing the fund and constantly reviews information. He is confident that the PERA will meet its liabilities for at least 40 to 50 years. He further noted that, based on the PERA's asset allocations, it is believed the PERA will make investment returns over time and that an increase in contribution levels is not necessary now. He stressed that the PERA is by no means insolvent, and through working with the PERA's consultants, everything necessary will be done to preserve the fund.

Representative Heaton noted that two things had emerged from the discussion. He asked the PERA staff to get back to the committee with information regarding the PERA's fee policy and the reasoning behind it. Also, he noted that in the report presented to the committee, the PERA funds are performing in the bottom quartile. Consequently, he asked that the PERA staff return to the committee and explain the PERA's policy with regard to meeting benchmarks in an understandable way, with emphasis on how the PERA funds can improve performance relative to that of its peers. Next, Representative Heaton asked the PERA staff to report back concerning the 8% growth target. He wants to know specifically if it is the right number in light of current markets. Mr. Slattery noted that the issue is currently being reviewed.

Next, the discussion moved to the topic of defined contribution plans and defined benefit plans. Mr. Slattery said that the two types of plans have been reviewed. He noted that there are issues with putting new employees into defined benefit plans because the result is an elimination of the base of employee contributions. Mr. Slattery noted that such a change would cause an unfunded liability, and the resulting deficit would have to be made up. He said that about 1,500 members retire each year, and a small number terminate their benefits.

Committee members asked if there had been an external review of the PERA by an agency other than the Legislative Finance Committee (LFC). Mr. Slattery was unsure, but noted

that, in its review, the LFC uses information supplied by PERA. It was mentioned that an external review might be appropriate.

### **PERA Overview of Governance Structure, Policies and Processes Under Which PERA Operates**

Mr. Slattery started by explaining that, in 2001, the board adopted a mission statement and values statement intended to govern everything the board does. The presentation continued with an overview of the PERA's employment structure, the board's fiduciary responsibilities, its administration of the PERA governing statute and the adoption of policies and rules. Mr. Slattery invited committee members to visit the PERA offices.

Mr. Slattery mentioned that the PERA board receives an extraordinary amount of information, and members travel to conferences for educational purposes. Board members are encouraged to take one or two educational sessions each year. He also noted that almost half of the board members have received certification from the International Foundation of Employee Benefit Plans. He added that the board has standing committees that meet monthly, and the board complies with the Open Meetings Act.

There was further information presented regarding the statutory authority for the investment of the PERA funds, including the requirement that the board invest the funds in accordance with the Uniform Prudent Investor Act.

There were questions regarding the ability of outside influences to gain access to the PERA's investment system and how abuses in the alternative assets are prevented. Susan Pittard, general counsel for the PERA, told the committee that consultants sign a statement saying there has been no solicitation of them from a third-party marketer. She added that the consultant certifies to the PERA that no one has pressured the consultant, and that due diligence is reviewed by her and the legal staff. After further questions, Ms. Pittard explained that with regard to traditional investments, the PERA has an internal policy and issues RFPs for consultants. On the alternative investment side, the staff performs legal due diligence after an investment has been approved by the board.

### **Educational Retirement Board (ERB); Update on Investment Performance Through Second Quarter of 2009**

Bob Jacksha, chief investment officer for the ERB, referred to the handout given to committee members, saying that it was half the size of the quarterly report and that if members wish to review a copy of the quarterly report, copies would be provided.

Mr. Jacksha discussed the ERB's investment performance noting that almost all of the major markets are negative. He added that all of the equities were in the negative, and he told the committee that the ERB's fund performance for the past 12 months was down about \$1.5 billion in net cash flow, not just benefits. He said that for the fiscal year, the ERB was down 17.3%, putting it at the fifty-seventh percentile, slightly below the median. According to Mr. Jacksha, the large funds are down 20% to 25%, while the smaller funds did better with a high point around \$9.3 billion to \$9.5 billion. He said that today, the funds are at \$7.6 billion.

Mr. Jacksha said that as the markets have rallied, the ERB's equity percentage has gone up. He noted that the ERB fired a manager on August 15, but that the ERB is now going to index that money and probably get as good or better returns. Compared to the median public fund in amounts of equities, the ERB fund is intentionally below the median. He said, "We made an effort to have a lower equity commitment. We were doing that in 2008 when the market turned down on us.". He added that with regard to total fund performance, the ERB is in the top 7% of funds. In comparing the ERB's policy to the median, the ERB would have been about average if it had invested just in indexes. He reported, however, that in some cases, the ERB's management did not perform well, leading to low performance and higher risk

The ERB's fixed income managers underperformed in the last quarter. Mr. Jacksha said, "We talked to them and understood why, and we thought it would turn around.". According to Mr. Jacksha, the managers were involved in less safe treasury assets and owned more corporate bonds and mortgages. He said that the ERB fired a couple of managers, including one international manager. He noted that there are costs associated with transferring funds to a new manager and said, "We have been long-term oriented and we have tried to be more opportunistic, especially in this market where certain areas are mispriced. PIMCO is doing well on pretty safe income investments.".

Mr. Jacksha summarized by saying, "In sum, we are not satisfied with the negative \$17 million. We are near the median of other public funds. We are seeing some results of new strategies in place and hope to continue.".

There was discussion concerning the 8% benchmark, and it was asked if the ERB ever met that benchmark. Mr. Jacksha said that in 2006, the 10-year average was at or near 8% and that 1997, 1998 and 1999 were very good years. He added that moving forward and picking up a -20% return for one year has a big effect on the average, which is always influenced by the endpoint.

Mr. Jacksha was asked who would be the one authorizing a deviation if there is a deviation from the ERB's policy. He explained that part of the deviation occurs as part of the market and that there was a decision not to rebalance. He said that there are ranges allowed within the ERB's policy and that if the deviations remain within the range, personnel do not have to go before the board for approval. The ranges allow for market fluctuations. However, outside of the ranges, staff have to go to the board.

Mr. Jacksha reported that the ERB's revenue from contributions last year was \$580 million but that income from investments varies based upon returns. He added that the ERB has a fund it can get cash from in a few days because sometimes the ERB requires more liquidity.

The members next advised Mr. Jacksha that they had information that the ERB had received a subpoena and that the members of the committee would like the ERB to provide to the committee the information that was requested within that subpoena, along with the ERB's responses. Noting that the ERB had received more than one subpoena, Mr. Jacksha said he would defer to his general counsel. The discussion turned as to whether the ERB could, in fact,

provide such information to the committee, since it was the subject of a current grand jury. Representative Heaton requested that the committee be informed relating to the documents referenced in the subpoena.

Representative Heaton also asked the ERB to provide the same information regarding the justification of the 8% benchmark as was requested of the PERA. He added that the committee also wants information regarding how the ERB pays consultants, which was also requested as a written response.

### **State Investment Council (SIC) Update on Investment Performance Through Second Quarter of 2009 and Overview of Governance Structure, Policies and Processes Under Which SIC Operates**

Gary Bland, state investment officer, and Adam Levine, senior deputy state investment officer, started by telling the committee that in light of the detailed interest in the SIC's governance aspects, he and Mr. Levine would first address the SIC's performance and then discuss the governance aspects, addressing any questions members may have in accordance to the letter sent by the committee to the SIC, which is a reference the IOC's letter dated August 19, 2009 urging the SIC to "...cooperate fully, timely and openly in all investigations into and examinations of the SIC's operation, so as to remove any doubt as to the strength, honesty and openness of the SIC's organization and finances."

Mr. Bland told the members that the SIC had a disappointing quarter for a number of reasons and that it is important to remember that this is not a retirement fund and that the distributions are based on a five-year annual rate of return (distributions from the severance tax and the land grant funds). He noted that it is a percentage that changes substantially, paying the state a higher premium for stability on the downside. He said that the SIC had a very slight decline last year.

Mr. Bland explained that the funds come from the Land Grant Permanent Funds, severance taxes and oversight of the tobacco settlement funds and Water Trust Fund, as well as the agencies that participate in some four fund pools.

Mr. Bland briefly explained the industry process whereby short-sellers borrow securities, then take the securities and find someone who wants to borrow them, getting 10% to 12% of the market value. Then, the short-seller invests that cash in secure and safe assets. Mr. Bland said that the SIC had invested in popular assets like mortgage-backed securities that "went into the tank", and as a consequence, the SIC is carrying paper losses on those investments. He further explained that in the SIC's accounting entry, it wrote what it thought the SIC can recoup on a conservative basis, as some may end up being worth only \$.15 on the dollar. He clarified that these securities have not yet been sold.

When asked by the committee if the SIC lent securities, got 102% in cash, put the cash in historically safe investments (which were probably toxic) and lost the cash as a result, Mr. Bland replied, "Yes". He further noted, "We are still in a very defensive mode. We are still holding 10% cash in our equity folder.... Our exposure is starting to get back to the positive territory."

Regarding the severance tax and land grant funds, Mr. Bland and Mr. Levine reported that the SIC is maintaining a conservative posture until it sees what the markets are going to bring.

Members asked if the SIC had written down some of these assets 100%. Mr. Levine answered that some of the assets have no determinable value and have been written down to about \$.15 on the dollar. He noted that a lot of the assets were Lehman Brothers and some of those securities will be tied up in litigation for years. Both Mr. Bland and Mr. Levine noted that these investments were considered low-risk at the time of the investment, but these assets got caught in the credit crunch. Mr. Bland mentioned that the SIC expects to get some recovery back from Countrywide.

There was some discussion about the accounting mode used by the SIC, and Mr. Levine explained to the committee that the SIC uses fair value accounting to price assets, whereas many others use cost accounting. Using cost accounting would keep the value at the cost's basis. Mr. Bland added that he does not think it is fair for clients, so a fair market value is used. Mr. Bland added that the choice was an internal decision.

When asked how the PERA compares to the SIC assets situation, Mr. Jacksha told the members that the agency's unrealized loss is about \$12 million, with a chance at some unknown recovery amount.

The discussion returned to the topic of the subpoenas issued by the United States attorney in Albuquerque and received by both the ERB and the SIC. The SIC's legal counsel, Bryan Otero, addressed the issue, saying that the SIC is working with the issuing agency in an effort to trim down the information being sought. He noted that the number of documents was voluminous. He added that the SIC has been responsive and timely. The SIC has isolated nearly 80 million documents that fit the request. Consequently, providing all of those documents to the committee would be difficult considering the breadth of the request. He added that since the grand jury operates in secrecy, there could be a conflict in supplying the committee with the same specific documents supplied as a result of the subpoenas.

Representative Heaton advised the SIC and ERB representatives, along with their legal counsels, that, although the legislature does not want to interfere with an investigation, by the nature of its representation of the citizens of the state, the members need to know and understand what is happening. He added that legislators must understand the implications of the situation, as it may affect future policy decisions, particularly regarding prudent investing. The issue remained unresolved, with all parties determining that the legal issues need to be researched.

Mr. Levine led a discussion resulting from a question posed by Senator Keller at a previous committee meeting regarding private equities. Greg Kulka, director of private investments for the SIC, told the committee that he did not anticipate seeing significant write-downs relating to private equities. He said that the SIC had hired a third-party company to look at the companies in this portfolio.

A discussion ensued regarding the checks and balances in place, and members noted that the legislature needs to scrutinize these investments, especially with respect to transparency and disclosure. The discussion also touched upon the legislature's need to know about the companies in which the state is investing and if these companies are creating employment opportunities in the state.

Next, Mr. Levine spoke in regards to the governance structure of the SIC, highlighting some of the key policies and procedures as they relate to the Uniform Prudent Investor Act. Mr. Otero stated, "We are fiduciaries to the funds. We act a lot like a registered investment advisor. We are trying to ensure we have good compliance policies.". He added that the SIC is looking at the transparency and disclosure policy and is looking at contracting with a software provider to help with transparency. He told the members that they could report back on the implementation of the compliance program. Some of the committee members were concerned that they should be going before the board with some of these issues, specifically the hiring of consultants.

### **Committee Business**

Ms. Faust reported that she spoke to legal counsel for both the ERB and SIC regarding the letters sent to those agencies by the committee. As a result of the conversations, Ms. Faust and the agencies' lawyers will be working together to understand the scope of the document requests made in the subpoenas and will monitor where the agencies are in complying with the discovery process.

Ms. Faust next addressed the committee inquiry into the State of New York's Martin Act. She led a discussion summarizing the act and comparing it to New Mexico's pertinent related statutes. The Martin Act became law in 1921 and was amended in 1926. It remained a law unused by the State of New York until former New York Attorney General Elliott Spitzer rediscovered it around 2002. The Martin Act gives very broad powers to the state attorney general. Consequently, Mr. Spitzer started using the act to go up against securities brokers and even global warming.

Ms. Faust pointed out that the New Mexico securities act gives most of those powers to the director of the Securities Division of the Regulation and Licensing Department. In New York, the attorney general can launch an investigation without initially determining whether it will be a civil or criminal matter. Thus, the defendant does not know if the defendant has a right to counsel. Ms. Faust pointed out that New Mexico law is very similar and that the Martin Act has simply been broadly interpreted by the state's courts.

Securities Division director Bruce Kohl spoke regarding the New Mexico securities act and his familiarity with the Martin Act. He noted that the Martin Act is similar to New Mexico's securities act, with a major difference being that New York does not register or license securities as is done in New Mexico. The state enacted a new securities act in 2010 based on the Uniform Securities Act. The new act designates the Securities Division as enforcement officers, and it can employ officers for investigation. Mr. Kohl stated that he believes New Mexico has a very strong securities act. He noted that many of the New York cases were brought against large

security firms headquartered in that state. He said that he would be happy to address further issues for the committee. Representative Heaton asked Mr. Kohl to provide the committee with a written form of the pros and cons of the New York statute compared to the New Mexico statute that will go into effect in January.

The committee adjourned at 5:48 p.m.