MINUTES
of the
FIRST MEETING
of the
INVESTMENTS OVERSIGHT COMMITTEE

June 14, 2010
State Capitol
Santa Fe

The first meeting of the Investments Oversight Committee for the 2010 interim was called to order by Representative John A. Heaton, chair, on Monday, June 14, 2010, at 9:10 a.m. at the State Capitol in Santa Fe.

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

Advisory Members

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

Handouts
Handouts and written testimony are in the meeting file.

Monday, June 14

Welcome

Representative Heaton welcomed the members and guests and gave a brief recap of what transpired at the last committee meeting in the 2009 interim. After a brief discussion on the topic of the legal fees for investment agency board members and staff, the chair asked the LCS staff to provide information about the statutory obligation regarding the requirements for the legal fees to be paid for Educational Retirement Board (ERB) and the Public Employees Retirement Association (PERA) employees.

Recent Investment Performance: State Investment Council (SIC)

Steve Moise, the interim state investment officer (SIO) for the SIC, addressed the committee. Mr. Moise provided a brief background outlining his previous professional experience, including years as a commercial transactions lawyer in Denver and Albuquerque. He added that after a brief retirement, he had been involved in the reorganization of the University of Colorado, serving on the university's foundation. Mr. Moise has most recently served on the State Board of Finance at the request of the governor. He resigned that post to take his position as interim SIO as of April 1, 2010. Mr. Moise expressed a long-running interest in state investment policy and noted that he looks forward to serving the state in his new position.

Mr. Moise advised the members that there have been critical changes at the SIC. He indicated that its mission is to ensure inter-generational equity in the management of the state's permanent funds. He said that recent changes to the SIC's governing statutes have been helpful, citing that the makeup of the council is much more balanced and its decision-making role is strengthened. Mr. Moise noted that the SIC has some recommendations for additional statutory changes for the upcoming legislative session; in particular, the SIC is interested in amending the 15 percent limitation placed on it for international investments.

Mr. Moise next told the members that the SIC has new committees that have been appointed and are now under the responsibility of the council, not the SIO. He added that the State Personnel Office has performed a review of the SIC office. Additionally, he noted that the SIC has adopted a new asset allocation model, formed an investment committee at the council level chaired by Doug Brown and has formed other working committees at the council level as well.

Lastly, Mr. Moise explained that the SIC currently has a request for proposals (RFP) out for bid and is seeking a search firm to locate a deputy for investments. He noted that the SIC is evaluating its current managers and consultants and has RFPs out for new managers and new asset classes. He anticipates that RFPs will be issued for new consultants as well.

The chair began a discussion by noting that the state depends heavily on the yields from the funds and that the 10-year numbers from the funds are not promising. Kay Chippeaux, senior portfolio manager for the SIC, told the members that one of the things that has contributed to the SIC funds' underperformance has been the statutory limitation on international investments at 15 percent. She added that another reason has been the poor performance of the U.S. large-cap stocks. There was a general discussion regarding the funds' performance and whether better results can be expected. Mr. Moise added that it is hoped that the statutory changes could help with the ability of the SIC to get better performance from the funds.

Some of the members inquired about internal restructuring and changes within the SIC and how those changes might transpire. Mr. Moise relayed that the SIC is extremely focused on the execution of those changes. He said it is making needed changes without taking on unnecessary risk.

Ms. Chippeaux and Mr. Moise explained that the SIC is now, and will be in the future, faced with some new start-up investment costs because new investments are being acquired. They explained that adjustments must be made for the timing of investing at the height of the market. Mr. Moise also told the members that in the past, the SIC had a 25 basis point limit it would pay outside fund managers. He said the council has determined it to be in the state's interest to remove that restriction and pay reasonable fees associated with getting the best possible fund managers. Some members questioned whether there was a need for a cap on the basis points. Mr. Moise responded that there is no cap at this time. However, he emphasized that industry standards will apply.

Members of the committee requested a list of fund managers and how much they are being paid as well as information regarding what industry standards for payment are. Ms. Chippeaux advised the committee that the standards vary depending on the asset class.

Ms. Chippeaux reviewed the asset allocation information contained in the performance report handed out to the members. She went over the breakdown of the fund and reviewed fund performance versus benchmarks, including projections 10 years out. Some members questioned the validity of select benchmarks used for certain funds. Additionally, some members questioned whether getting returns that are no better than those the state could get from investing in corporate bonds can justify the need for asset managers and the SIC in general. Mr. Moise assured the members that the SIC is looking at the state's investment strategies from all angles, including asset management, positive versus active management, internal versus external management, indexing and every other means available to determine the best use of the money and the best way to ensure growth.

The members requested a list of the advisors and consultants and the fees they are charging the SIC as well as their respective performance histories. Additionally, the members asked for an outline of the new SIC structure and information relating to how the SIC is now in compliance with SB 18. Mr. Moise said that he and the SIC staff would be happy to supply the information, and he added that they would also provide an update of the recommendations they had presented to the State Board of Finance.

There was a discussion about job creation and venture capital interests in New Mexico as well as dialogue concerning the film industry's impact on the local economies. It was noted that the chart used by the Government Restructuring Task Force (GRTF) might be beneficial for use by the committee.

Recent Investment Performance: PERA

Terry Slattery, executive director for the PERA, and Joelle Mevi, the PERA's chief investment officer, presented to the committee the PERA funds' performance. Mr. Slattery told the members that in the last quarter of 2009, the PERA saw an increase of retirements driving monthly payment totals up to $55 million. He added that as of July 1, 2010, JP Morgan Chase will serve as New Mexico's custody bank.

Mr. Slattery noted that the PERA has invested in three new hedge funds since the beginning of 2010. He added that the PERA is feeling the impact of the downturn in the global economy and that the fund had a negative 5.5 percent return for May 2010. He noted that small caps outperformed large caps. He advised the members that at the end of May 2010, the PERA was close to meeting all of its target allocations and decreased its exposure to equities.

While referring to the PERA handout outlining the fund allocations, members asked Mr. Slattery if, in future presentations, the fees could be listed next to each fund. Much of the general discussion was driven by the topic of fund solvency. The members questioned Mr. Slattery about the long-term solvency of the fund. He replied that the PERA pays out about $600 million a year to retirees while taking in about $500 million a year. Consequently, there is a negative $100 million each year. Ms. Mevi discussed the PERA's intentions to reduce international investments and increase domestic investments. She explained the due diligence necessary prior to the board's approval for asset investments.

When asked how the PERA funds compare with similar funds throughout the country, Ms. Mevi replied that the PERA has been in the ninth percentile over the last year, ranking quite well compared to similar funds. She advised the members that 100 percent of the PERA's assets are externally managed and that most of the PERA's 2009 fees paid to fund managers were based on performance, noting that many of the asset managers have exceeded their required basis points. Members asked to see fund management fees as a percentage of fund totals in future presentations.

Recent Investment Performance: ERB

Bob Jacksha, chief investment officer for the ERB, started by telling the members about the ERB's investment results for the past 12 months. He noted that the fund experienced a gross investment gain of $2.5 billion, which includes a gross investment gain of $310.9 million during the first quarter. Additionally, the fund's total assets increased from $8.3 billion at the beginning of the quarter to $8.6 billion on March 31, 2010, with $35.7 million in net distributions.

Mr. Jacksha continued by telling the members that over the past five years, the fund returned 5.3 percent per annum, outperforming its policy index by 0.7 percent, ranking in the eleventh percentile of public funds greater than $1 billion.

Mr. Jacksha told the committee that for the year ending March 31, 2010, the fund returned 40.4 percent, outperforming its policy index by 8.0 percent and ranking in the ninth percentile of public funds greater than $1 billion. He added that for the current quarter, the fund posted a 3.7 percent return, outperforming its policy index of 0.6 percent and ranking in the twenty-eighth percentile of public funds greater than $1 billion. He noted that all of the fund's asset classes were within their respective policy ranges as of March 31, 2010.

There was continuing discussion about the eight percent fund growth target used by the ERB and whether it is a realistic amount and how it is reviewed and determined for validity. Jan Goodwin, ERB executive director, told the members that the eight percent is reviewed on a regular basis and has been determined to be the best number for its specific purposes. It will be reviewed again. It is not set in stone, but it continues to withstand much scrutiny when evaluated for its usefulness. It was noted that the Legislative Finance Committee (LFC) has focused on the eight percent and reported on the implications of changing that number. Members may find the LFC information helpful. Ms. Goodwin urged the members not to make any changes to contribution rates for employees at this time. She noted that new employees will be entering the system with higher contribution rates, and she said that any additional changes to the contribution rates should require a deliberative process, not quick actions.

Ms. Goodwin talked briefly about long-term asset allocation and the process involved with minimizing the risk. Mr. Jacksha notified the members that the ERB had made a strategic long-term decision to place more investments in emerging markets. He noted also that over the past three years, the ERB has had a plan in place to reduce its reliance on public equities so as also to reduce some of the volatility associated with those investments. Ms. Goodwin noted that there are benefits to a pension fund for investment purposes; specifically, because the fund operates in perpetuity, it provides a situation for investments that an individual could not prudently choose to invest in, like certain private equities and hedge funds. She also talked about the ERB's actuary and how all assumptions and aspects of the fund will be reviewed and looked at in detail for a long period of time. She noted that New Mexico's ERB fund is typical of a mature fund in that it has more people retiring from the system than entering it at this time.

There was a brief discussion about survivors' benefits and how they are determined and paid. Ms. Goodwin explained that many members have survivor beneficiaries, and there is a reduction in the survivor's benefits.

There were general questions about the ERB board's governance structure and how the board elects or selects a chair. Ms. Goodwin advised the members that the board elects its own chair, vice chair and secretary on an annual basis. Ms. Godwin noted that ERB staff could provide the committee with copies of the board's policies and procedures.

There was a discussion involving legal fees and indemnification. Ms. Goodwin noted that the ERB is self-insured. Mr. Moise said that the SIC has asked the Risk Management Division of the General Services Department to provide a written analysis of what legal protection it provides to state volunteers and employees. That analysis will then be reviewed to check for possible gaps in coverage. Members inquired as to whether buying insurance policies rather than self-insurance would be wise. Ms. Goodwin answered that it would require a statutory change.

Review of State Investment-Related Legislation, 2010 Session

Ms. Faust, staff attorney for the LCS, addressed the committee about legislative initiatives from the 2010 session. She indicated that there were three bills — two that passed and one that failed. The bill that failed was the initiative that would have put into statute provisions similar to the New York State's Martin Act. She highlighted the following.

Senate Finance Committee Substitute for Senate Rules Committee Substitute for Senate Bills 18, 218 and 238 (Laws 2010, Chapter 14):

- implements some of the "best practices" recommendations made by the EnnisKnupp firm;
- changes the makeup of the body by replacing the SIO and the three public members appointed by the governor with four public members appointed by the New Mexico Legislative Council and two public members appointed by the governor;
- requires that the six new members have at least 10 years of experience in investment or finance;
- transfers the investment decision-making power from the SIO to the SIC;
- authorizes the council to contract for its own custodial bank;
- clarifies that the SIO and the SIC are fiduciaries of all funds under management;
- requires the council to provide opportunity for public comment at any meeting;
- requires greater reporting to the legislature of fund performance and council policies; and
- prohibits a council member from contracting to do business with the council, investment office, Office of the State Treasurer, ERB, PERA, New Mexico Finance Authority or State Board of Finance for two calendar years before the member's appointment or two years after the member's term on the council.

House Bill 16 (Laws 2010, Chapter 19):

- provides retirees in the PERA a one-time irrevocable opportunity to deselect their original pension beneficiary and choose another payment option. Previously, a PERA retiree could only have payments changed pursuant to a divorce court order or if the beneficiary predeceased the retiree; and
- in order to avoid a negative fiscal impact on the retirement fund, the amount of the pension under the form of payment chosen will be recalculated to have the same actuarial present value as the current pension. In other words, if a retiree selects a younger beneficiary under this new law, the amount of the pension payment will be reduced to compensate for the longer expected lifetime of the new beneficiary.

Work Plan and Meeting Schedule

Mr. Pollard assisted the chair in the discussion concerning the committee's work plan and meeting schedule for the 2010 interim. A motion was made to approve the work plan with the addition of a work plan item asking the attorney general to come before the committee concerning the Fraud Against Taxpayers Act and potential litigation in an effort to recoup money for the state from the losses experienced through poor investments. It was noted that other states have pursued litigation against individuals and investment firms and perhaps New Mexico should be actively pursuing such litigation. The motion was seconded and passed by the committee.

GRTF Presentation

Raúl E. Burciaga, director of the LCS, addressed the committee and advised it of the mandate of the New Mexico Legislative Council that, as a cost-savings measure, all interim committee meetings are to be held in Santa Fe unless justified in writing as necessary to be held in another location. He added that meetings should be scheduled in a manner so as to reduce conflicts for voting members. Mr. Burciaga apprised the members of the work of the GRTF and asked the members, on behalf of the legislative council, to look closely at the agencies they oversee for ways to save money through efficiency and other cost-cutting measures. Lastly, Mr. Burciaga told the members that he is honored to serve them in his new position as director. He added that he and his staff at the LCS are happy to work with the legislative body.

Adjourn

The chair and members congratulated Mr. Burciaga on his new appointment as director of the LCS. With no other business, the meeting was adjourned at 1:15 p.m.