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Retirement Association
of New Mexico

INVESTED IN TOMORROW.

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Questions received in connection with Total Fund Overlay RFP No. NM INV-001-FY19 (Answers are in bold)

Questions Related to Objectives of Solicitation (Part I, E) and Scope of Work (Part II, A)

1. On page 3, Part II, Section A, in the 3rd paragraph of the Description of Services Sought, the RFP asks "PERA is seeking proposals for optimization of our structure decisions and portfolio drift, or systematic sources of risk relative to the benchmark target allocations, not to exceed some portion of the 65 bps tracking error budget." We are seeking clarification of whether the service provider is being asked to take discretion and implement their own views on the best way to deploy a 65bps tracking error budget by making the "structure decisions", or is the service provider being asked to design a program to implement the views and structure decisions made by PERA?

   Said differently, if our firm does not have views on when to be overweight or underweight the different asset classes, is that sufficient so long as our firm is willing to provide feedback or analysis on both PERA's views and efficient and effective ways to implement PERA's decisions? Or is PERA seeking a greater scope of services than that?

2. Would this be a discretionary mandate or an advisory mandate? Are the discretionary parameters available for overlay candidates to review now?

3. Is the described overlay service currently being managed in-house or by other external managers? How will the size of the overlay services be determined?

4. Do you intend to allocate a slice of the portfolio to managers who will have full discretion, using the Strategic Asset Allocation as a Benchmark?

5. Is there a desired degree of active or passive and/or proprietary implementation in public markets?

6. Is this mandate a fully funded mandate or a partially funded overlay mandate?

7. What would be the implementation strategy for the mandate: purely overlay portfolio with notional exposures equal to the total AuM of the Plan (~15bn) or a fully funded separately managed account? If the former, what is the significance of the SAA provided?

8. The RFP references funding with cash. Given the derivatives usage is there an expectation that additional capital may be available to be called to meet margin requirements if needed? Or should the expectation be the mandate will be fully funded with the initial cash allocation?

9. Is the tracking error target for the proposed mandate 65bps? If so, given that the 65 bps tracking error budget is applied to the entire plan, what percentage of the AUM of the plan would be allocated to the overlay program?

10. When referencing the 150 bps of tracking error for the total fund overlay, is the intent to engage with an overlay manager who would equitize all or part of efficient asset exposure (i.e. US Equity) using a total return swap and then using the freed up cash to run an overlay with a TE of 150 bps at the total fund level to produce returns that are not correlated to the respective asset being equitized (i.e. portable alpha)? (Part II Scope of Work, A. Description of Services Sought, Page 2, paragraphs 2, 3,)

11. The RFP also allows for an additional 65 bps to account for portfolio drift - can you more precisely define the specific services you are requesting and how the additional 65 bps of TE would be calculated and monitored in practice or in terms of implementation? (Part II Scope of Work, A. Description of Services Sought, Page 2, paragraphs 2 & 3)
12. Is there an expectation for the overlay manager to work with staff and/or primary consultant on the overall plan's strategic asset allocation?
13. Does Wilshire or PERA have capital market assumptions data that can be shared, so any analysis we provide can be consistent with those assumptions?
14. When services are referenced, are NM PERA interested in engaging with a manager for GTAA/TAA advice in addition to the overlay services being managed? (reference to "long-term strategic advisor" in Part II Scope of Work, A. Description of Services Sought, Page 4, paragraph 1)
15. There is a reference around providing customized services to support PERA in eventually transitioning to a partially or wholly internally implemented overlay program. Can you expand on the service expectations for this and what type of support and partnership you envision to receive from managers?
16. Is NM PERA envisioning a single firm or multiple firms running an overlay on the total plan?
17. Where are the assets expected to be custodied, and is the implementation and execution of the portfolio retained by PERA or delegated to the manager?
18. Would proposals that utilize a separate account to manage portfolio drift relative to the strategic asset allocation while also utilizing a commingled vehicle for tactical and active views be considered?
19. Part II, A
    a. Can you confirm that the risk budget for the overlay services is 65bps (rather than the 150bps at the plan-level which we assume includes other active management returns or plan decisions)?
    b. Based on that assumption, what is the time horizon for measuring tracking error?
    c. Is PERA's view of TAA long-only relative to their policy (e.g., tilting equity versus fixed income), or will PERA also consider long-short constructions (e.g., relative value within an asset class)?

Answer

PERA is seeking discretionary investment management services for a total fund overlay program, which will be the first mandate of its kind. Part II, Section A states that Qualified Offerors will display demonstrated skill in "tactical views on relative merits across asset classes/strategies." Capital market assumptions will not be provided. Proposals for advisory services alone will be insufficient. Proposals related to the management of underlying collateral assets will not be considered. Offerors are not expected to consult on the overall plan's strategic asset allocation ("SAA").

PERA will consider proposals with long-short constructions, provided that they align with the stated objective to optimize systematic sources of risk relative to benchmark target allocations, are within the parameters of PERA's active risk budget and SAA tolerance ranges, and are constructed through a risk-based lens, inclusive of gross and net position levels and the evaluation criteria described in Part II, Section A, p. 3.

The program is intended to run as a partially funded overlay mandate rather than a fully funded strategy. The mandate will be collateralized with cash, and funding will be set at the levels that PERA, at its sole discretion, sees fit. The services are expected to encompass the total fund.

The service provider(s) will have discretion over the strategy, however PERA retains the right to establish appropriate parameters, inclusive of, but not limited to, the active risk budget and SAA tolerance ranges. The mandate will not exceed some portion of the 65 bps annualized tracking error budget for structure decisions at the total fund level. The time horizon for measuring tracking error will be established at PERA's discretion, for example, on a rolling one year basis.

The service provider(s) may also assist in transitioning PERA to a partially or wholly internally implemented overlay program at a future date. This would be inclusive of, but not limited to, advisory services and analytical support related to the implementation of the overlay program.

Given the need for full transparency, the assets are expected to be custodied with PERA's custodial bank. Fund products will not be considered.

As stated in Part II, Section A, PERA reserves the right to make single or multiple source awards, and will disclose implementation decision further in the RFI process.

Questions Related to the Mandate Opportunity Set

20. Is NM PERA open to a multi-part program to modulate the asset allocation that is not a single over lay? For example, would NM PERA consider an equity option overlay strategy to modulate equity exposure based on market conditions either standalone or coupled with other TAA strategies and alternative risk premia (e.g., momentum, volatility etc)?
21. Is there a list of permitted asset classes, strategies and instruments available for overlay candidates to review?
22. What is the investment opportunity set? Is anything from the Strategic Asset Allocation in Part I, D, excluded, including Private Equity, Illiquid Real Estate and Illiquid Real Assets
23. How granular do you expect the investment manager to be when addressing drift away from the strategic asset allocation? Is it at the Asset Class level – ie Global Equity vs. Risk Reduction & Mitigation vs. Credit Oriented vs. etc level, or within the broad categories of the asset class – ie addressing developed vs emerging equity and US vs Non-US fixed income etc? Or at the individual country equity or fixed income exposure level?
24. Will drift away from targeted illiquid exposure be part of the scope and proxied with liquid sources?
25. We have a question about the following guideline, "Structure decision, which are relevant to this proposal, are budgeted as 65 bps of tracking error at the total fund level". Structure decisions is being defined as "benchmark target allocations". The SAA has 27.9% in "illiquid" exposures (including Private Equity) and an additional 10% to Multi-Risk Allocation which has a "blended custom" benchmark. Our experience has been that providing overlays for illiquid assets, uninvestable or custom blended benchmarks can produce significant amounts of tracking error. Would you please provide clarification about this guideline? Are all asset classes subject to the 65 bps of tracking error for structure decisions? If so, can we have some understanding of the intuition that resulted in the 65 bps target?
26. Can you please further define what the RFP refers to as 'structure decisions' and typical source and time horizon associated with such decisions? (Part II Scope of Work, A. Description of Services Sought, Page 2)

27. Could PERA further define "systematic sources of risk relative to the benchmark target allocations"? (Part II Scope of Work, A. Description of Services Sought, Page 2, paragraph 3)

28. Could NM PERA further define the multi-risk allocation – is this a new allocation / benchmark to capture this new mandate or is an existing allocation? (Part I: Introduction and General Information, Part D: Overview of PERA Investment Activities, Page 2, table)

29. Can you further explain and contrast how PERA views Strategic Asset Allocation, SAA ranges (pg. 2 D), and benchmark target allocations? (Part II Scope of Work, Part A. Description of Services Sought, Page 3, paragraph 2 and Part I: Introduction and General Information, Part D: Overview of PERA Investment Activities, Page 2, table)

30. Is there a preference or concerns on the allowable implementation vehicles (derivatives only, physical securities, funds, ETFs,)?

31. Will there be any derivatives usage limits?

    a. Whose ISDA will the overlay manager use, NM PERA or their own?

    b. Are over-the-counter derivatives permitted?

32. Could you provide clarification on the universe of instruments permitted for the overlay mandate? The Investment Policy Statement has potentially conflicting sections.

    a. Section VI. A under Risk Reduction and Mitigation sub-bullet Cash Overlay (pg 8) references the cash overlay being permitted to trade futures, options, swap agreements, and forward agreements

    b. Section VI. B under Derivatives (pg 9) references the cash overlay program being permitted to trade only exchange-traded derivative instruments and exchange-traded funds

       Given that swap and forwards are generally OTC traded, would they be allowable instruments?

Answer

PERA is seeking proposals for overlay services that optimize systematic risk exposures relative to benchmark target allocations ("structure decisions" and portfolio drift), in real time. Structure decisions are the equivalent of policy implementation decisions that deviate from the SAA beta allocations (i.e. U.S. small cap vs. global equity), and the time horizon for these decisions is expected to be medium to long term.

The program is intended to run as a partially funded overlay mandate rather than a fully funded strategy. The mandate will be collateralized with cash, and funding will be set at the levels that PERA, at its sole discretion, sees fit. The services are expected to encompass the total fund.

PERA's Strategic Asset Allocation ("SAA"), given Part I, Section D, outlines the asset classes, sub-asset classes, policy benchmarks, target weights, and rebalancing ranges that are relevant to this mandate. Policy benchmarks for illiquid investments are public indexes. The multi-risk allocation policy benchmark, to be established at a future date, will consider the impact of tracking error relative to the SAA. Offerors should propose a customized solution that utilizes the managers' expertise in relevant markets and instruments, within the parameters of PERA's active risk budget and SAA tolerance ranges.

PERA will evaluate proposals on their relative merits, including the alignment of the proposed strategy with PERA's active risk budget and PERA's stated need for customization and transparency (Part II, Section A). While there is no list of permitted asset classes *per se*, implicit and explicit costs, liquidity, and other risks associated with particular instrument types, will be

considered in the evaluation of proposed strategies. PERA retains the right to exclude asset classes and instruments at its sole discretion. Details pertaining to the requirements of particular instrument types, such as OTC derivatives, will be evaluated on a case by case basis.

Specific reference to the Cash Overlay program will be revised in the IPS to reflect a Total Fund Overlay. However, current language in the IPS regarding the use of derivatives is not intended to be limiting to any specific investment types.

Questions Related to Measurement and Attribution

33. How is NM PERA planning to measure tracking error?

    Tracking error will be measured relative to the SAA, provided in Part I, Section D. The SAA will be amended at PERA's sole discretion. PERA retains the right to establish the appropriate time horizon for measuring tracking error, for example, on a rolling one year basis.

    a. How will you attribute tracking error contribution from drift or long only managers versus overlay manager?

    PERA retains the right to establish multiple accounts for the purpose of attribution.

    b. Do you envision giving the overlay manager "X" amount of capital with limits, e.g., volatility and leverage limit?

    The program is intended to run as a partially funded overlay mandate rather than a fully funded strategy. The services are expected to encompass the total fund. The mandate will be collateralized with cash, and funding will be set at the levels that PERA, at its sole discretion, sees fit.

    PERA retains the right to establish appropriate parameters, inclusive of, but not limited to, the active risk budget and SAA tolerance ranges. The mandate will not exceed some portion of the 65 bps annualized tracking error budget for structure decisions at the total fund level. Part II, Section A provides additional risk-based criteria on which strategies will be evaluated.

34. How would the success of the program be evaluated; e.g., benchmark?

35. Is there any indication of what would be the benchmark for the overlay mandate? It appears that this may not yet be known, but any sense of the benchmark components would be helpful. Or is this an absolute return mandate with no underlying or cash benchmark?

    As stated in Part I, Section A, the proposed program benchmark will be determined upon final contract award, and PERA retains sole discretion to select and reselect the benchmark that is appropriate for the proposed services.

Questions Related to Part II, Section B ("List of Minimum Qualifications"),

36. What are the track record requirements for the proposal?

    As stated in Part II, Section B ("List of Minimum Qualifications"), as of the date of the Offeror's proposal submission, the Offeror must have at least one separately managed portfolio in the proposed or similar services with at least 2 years of reporting history.

Questions Related to Appendix C

37. We are requesting additional clarification on Section B2, Page 13, Question 5. For example, is this question referring to other liquid multi-asset strategies offered by the overlay provider or other strategies currently in or slated to be in PERA's portfolio?

    Section B2, Page 13, Question 5 of Appendix C refers to the broader universe of liquid multi-asset strategies.

38. Throughout the document there are questions related to fund specific investments (Section A-8). What is the expectation to get this information from managers offering customized separate accounts and not Fund investments?

    Questions contained in Appendix C ("Overlay Management Questionnaire") that do not apply to the proposed strategy should be populated with "N/A".

39. While this is a general question, we reference Part B - Investment Philosophy, section B2, paragraph 2:

    Will the Trust consider an approach to its Total Fund Overlay which achieves the asset allocation benchmark and rebalancing objective through a passive synthetic overlay and with an active approach to underlying collateral assets?

    As stated in Part I, Section E, PERA is seeking discretionary investment management services for a total fund overlay program. Proposals related to the management of underlying collateral assets will not be considered.

40. Appendix C

    a. Regarding questions **A3.2-4**, we view the RFP as seeking policy overlay services with delegated TAA embedded in the mandate. While many of the questions references a fund, can you confirm that we have the discretion to address both the derivative overlay aspects as a custom/SMA, as well as our Multi-Asset TAA in a fund offering?

       Given the need for full transparency and customization, a fund product will not be considered. Questions that are not applicable should be marked "N/A".

    b. Regarding **A5.4-8**, this would necessarily be an SMA, so fund terms would not apply. Would you prefer we respond to address liquidity for a policy overlay?

       Yes.

    c. Regarding **A8 table**, while we can provide information for our FCM and broker platforms, most of this information would come from PERA because of the SMA nature. Should we still address the relevant service providers?

       Yes.

Questions Related to Appendix F

41. Appendix F

    a. For medium- and longer-term asset allocation views, will PERA expect that we advise on tilts that are best expressed through physical allocations (e.g., over/under-weighting liquid real estate or liquid real assets), or is the preference that all views be expressed synthetically?

The program is intended to run as a partially funded overlay mandate rather than a fully funded strategy. Offerors are not expected to consult on the overall plan's strategic asset allocation ("SAA").

b. What are the differences in implementation between Hedged Equity and Global Low Volatility Equity (given the same benchmark)? Are there different information ratio targets?

For the purposes of the total fund overlay, the relevant benchmark for both allocations is MSCI ACWI Minimum Volatility ($net).

c. What are the objectives and constraints of the Multi-Risk Allocation, and what is its custom blended benchmark?

Multi-Risk Allocation is inclusive of risk parity and risk balanced strategies. The allocation is currently unfunded and the custom blended benchmark has not yet been defined.