



INVESTED IN TOMORROW.

Audit & Budget Committee Meeting

via Zoom

Tuesday, May 11, 2021
9:00am

Committee Members

Diana Rosales Ortiz, Chair
Lawrence Davis, Vice Chair
David Roybal

Loretta Naranjo Lopez
John Melia

AGENDA

- 1. Call to Order**
- 2. Roll Call**
- 3. Approval of Agenda**
- 4. New Business**

- | | | |
|--------------------------------------------------------------------|---------------|----------------------------------------|
| A. Review of Office of State Auditor Recommendations | Informational | Anna Williams, CPA
ASD Director/CFO |
| B. Review of Office of the Attorney General Recommendations | Informational | |
| B. Overview of Governance Audit Recommendations/Findings | Informational | |

- 5. Adjournment**
-

Any person with a disability who is in need of a reader, amplifier, qualified sign language interpreter, or any other form of auxiliary aid or service to attend or participate in the hearing or meeting, please contact Trish Winter at 795-0712 or patriciab.winter@state.nm.us at least one week prior to the meeting, or as soon as possible. Public documents, including the agenda and minutes, can be provided in various accessible formats. Please contact Ms. Winter if a summary or other type of accessible format is needed.

INVESTED IN TOMORROW.

MEMORANDUM

DATE: May 11, 2021

TO: Audit & Budget Committee

THROUGH: Greg Trujillo, Interim Executive Director

FROM: Anna Williams, CPA, CFO/Administrative Services Director

SUBJECT: Recommendations

Attorney General's recommendations

- PERA should, "take immediate steps to resolve the conflict of interest between applicable statutes, rules, and policies."
- Proper delegation to the Executive Director should be prescribed by rule rather than policy. "Therefore, PERA must properly resolve these conflicts through the rulemaking process, in order to lawfully solicit input from both the public and all Board members."
- "The PERA board shall review the 2014 increase of the Executive Director for either ratification or rescission in a public meeting pursuant to the Open Meeting Act." - This has already been done.

OSA recommendations

- OSA notes, "due to inconsistencies within the structure of applicable statutes, administrative code rules, and Board policies and procedures, the Board should take immediate action to provide clear alignment between Board policies and procedures and applicable legal authority."
- "OSA recommends that PERA's Board clarify either the Administrative Code or their current Board Policies and procedures to clearly define what the duties and responsibilities of the Executive Director."
- "PERA's statute does not contain a definition of chief administrative officer. Without a definition, one is left to interpret what duties and responsibilities the CAO is tasked with." As such, OSA observation is, "PERA's administrative code does not contain a definition of 'Proper delegation' and whether this equates to written/documented delegation or if verbal delegation is allowable."
- "OSA recommends that PERA's Board clarify either the Administrative Code or their current Board Policies and Procedures to clearly define what the process is for pay increases for the Executive Director and whether full board approval will be required in future letters to the DFA Cabinet Secretary."

REDW Internal Audit Recommendation

- Listed in the Governance and Investment Policy Statement Compliance Internal Audit under Observations, Recommendations and Management Responses.





State of New Mexico Office of the State Auditor

May 7, 2019

Via E-mail

Dr. Jacquelin Kohlasch, PhD
jkohlasch@nmpera.org

Mr. John Melia
jmelia@nmpera.org

Ms. Claudia Armijo
carmijo@nmpera.org

Mr. Stephen J. Neel
sneel@nmpera.org

Mr. David J. Roybal
droybal@nmpera.org

Ms. Patricia French
pfrench@nmpera.org

Mr. Lawrence L. Davis
ldavis@nmpera.org

Mr. Daniel Mayfield
dmayfield@nmpera.org

Ms. Loretta Naranjo-Lopez
lnaranjolopez@nmpera.org

Hon. Maggie Toulouse Oliver
secretary.state@state.nm.us

Hon. Tim Eichenberg
Tim.Eichenberg@state.nm.us

Mr. James Maxon
jmaxon@nmpera.org

Re: PERA Raises, FY20 Operating Budget, and Fiduciary Duties

Dear PERA Board of Trustees,

The Office of the State Auditor (OSA) received complaints containing allegations of fraud and misconduct, including with regard to pay increases of PERA executive staff and its Executive Director. Based on the information received and evaluated at this time related to allegations of improper pay raises, the OSA did not review supporting information that would have substantiated the allegations. However, what was identified is actual conflict between the applicable statutes, administrative code rules, and policies and procedures of the PERA Board of Trustees ("Board"). The Board should take immediate steps to resolve the conflict between applicable law, administrative rules, and Board policies and procedures to prevent these issues from recurring.

While the OSA's oversight role is not a position where it is proper to comment on the optics of the matter and the propriety of whether the raises were appropriate, the timing and nature of the dispute as it relates to public trust and confidence is problematic. The Board should implement a system for review of salaries and pass an appropriate budget that serves its membership and satisfies its

Office of the State Auditor

PERA Board of Trustees

May 7, 2019

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fiduciary duties. Notwithstanding, based upon a full examination of the applicable governing statutes, administrative code rules, and Board policies and procedures in reference to the complaints, the OSA's review of available evidence suggests that the Executive Director acted reasonably and within his authority in meeting with and obtaining Board approval for the proposed raises. However, the Board has the authority to appoint the Executive Director and set salary; as such, the Board, acting as a whole can determine what salary it deems appropriate for those positions. NMSA 1978, § 10-11-131(B) and (C). The Board's policies and procedures, at Section VII(D), state the Executive Director "has the authority to employ all NMPERA employees." Finally, the Administrative Code states "[t]he executive director shall be the chief administrative officer of the board and of the association. He or she shall attest to official actions of the board when required and shall serve at the pleasure of the board." 2.80.1800.8(A) NMAC. The OSA further notes due to inconsistencies within the structure of applicable statutes, administrative code rules, and Board policies and procedures, the Board should take immediate action to provide clear alignment between Board policies and procedures and applicable legal authority. The Board has the authority to rescind pay raises it deems inappropriate or no longer supports. Further, there should be a process applied, which provides a vehicle to approve pay increases under its purview. I have attached the OSA's conclusion to its review of the complaints at issue for reference.

Additionally, I received Board Chair Dr. Kohlasch's letter dated April 29, 2019, and want to stress the importance of the Board acting as a whole to satisfy its duties. I am extremely concerned with the Board's failure to uphold its fiduciary responsibilities. Dr. Kohlasch reported in the communication the Board's failure to approve and submit PERA's Operating Budget for FY 2020 by the statutory deadline of May 1, 2019. As of last fiscal year, 2018, the PERA Fund's fiduciary net position was over \$16 billion with a funded ratio of 71.6% (New Mexico PERA Comprehensive Annual Financial Report 2018). This failure to act to submit the budget by the statutory due date was reckless or negligent, or both, and coupled with the Board's lack of focus on its fiduciary responsibilities puts our retirees and future generations of retirees at risk. The Board's behavior is unacceptable and harms the fund's membership.

Because the fiduciary relationship between the Board and its members is one of trust and confidence, I am particularly concerned about the consequences of the Board's inaction and the result it may have on the fund in light of its potential breach of duties. New Mexico's constitution (Art. XX, Sec. 22) provides that all funds, assets, proceeds, income, contributions, gifts and payments from any source whatsoever paid into or held by a public employees retirement system or an educational retirement system created by the laws of New Mexico shall be held by each respective system in a trust fund to be administered and invested by each respective system for *the sole and exclusive benefit* of the members, retirees and other beneficiaries of that system. It also provides that the retirement board of the public employees retirement system and the board of the educational retirement system shall be the trustees for their respective systems and have the *sole and exclusive fiduciary duty and responsibility* for administration and investment of the trust fund held by their respective systems. Fiduciary duties are the highest level of duties, and require the

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persons acting in a fiduciary capacity to act solely on behalf of the members and other beneficiaries on matters within the scope of the fiduciary relationship. The Board members are strictly accountable for this stewardship and are required to demonstrate the requisite care, loyalty, and impartiality. The same Section of the State Constitution also provides that plan members who meet the minimum service requirements of an applicable retirement plan acquire a vested property right with due process protections under the New Mexico and United States Constitutions. The Board's conduct could be deemed to be in violation of its fiduciary duties to the members.

Further, under NMSA 1978, Section 10-11-130, the retirement board "is the trustee of the association and the funds created by the state retirement system acts and has all the powers necessary or convenient to carry out and effectuate the purposes and provisions of the state retirement system acts, including, in addition to any specific powers provided for in the Public Employees Retirement Act but without limiting the generality of the forgoing, the power to ... make and execute contracts; ... [and] make and adopt such reasonable rules as may be necessary or convenient to carry out they duties of the retirement board and activities of the association" It is essential that the Board promptly act to rectify the potential breach of its duties.

I understand a Special Board meeting has been scheduled for Tuesday, May 7, 2019, and I am hopeful the Board will take all necessary steps during this meeting to become compliant with its obligations under applicable authority and duties owed to its members. If you have any questions, do not hesitate to contact me at (505) 476-3800.

Thank you.

Sincerely,

A handwritten signature in blue ink, appearing to read "B. Colón", with a stylized flourish at the end.

Brian S. Colón, Esq.
New Mexico State Auditor

cc: PERA Solvency Task Force, Diego Arencon (diego.arencon@state.nm.us)
New Mexico Office of the Attorney General, Hector Balderas (hbalderas@nmag.gov)
New Mexico Legislative Finance Committee, David Abbey, Director (david.abbey@nmlegis.gov)
New Mexico Department of Finance & Administration, Olivia Padilla-Jackson, Cabinet Secretary (olivia.jackson-padilla@state.nm.us)
CliftonLarsonAllen LLP, Matthew Bone (Matthew.Bone@claconnect.com)

RESOLUTION NO. 20-15

RESOLUTION REGARDING DELEGATION OF AUTHORITY TO THE EXECUTIVE DIRECTOR

BE IT RESOLVED that pursuant to the authority granted the Board under applicable law, including, but not limited to, the New Mexico Constitution, Art. XX, Sec.22, NMSA 1978, Sections 10-11-130, 10-11-131, 10-11-132, and 10-11-133, and the Board Policies and Procedures, the Board hereby delegates authority to the Executive Director as more fully set forth in this Resolution. This Resolution shall be deemed effective as of the date adopted and shall remain in full force and effect, unless otherwise amended, restated or superseded.

1. General Delegation

The day-to-day administration of the Public Employees Retirement Association (PERA or Association) is hereby delegated to the Executive Director, who shall be the chief administrative officer for the Board and the association. The Executive Director shall operate the association in compliance with all applicable federal and state laws, and in accordance with rules and policies adopted by the Board. The Executive Director shall consult with the Board on all matters pertaining to the association, act as liaison between the Board, members and retirees, employers, employer and member organizations, state agencies, the Executive and the Legislature. The Executive Director shall bring to the attention of the Board all matters which have a material impact on the association or the retirement systems.

2. Specific Duties and Authority

A. Fiduciary Duties. As a fiduciary to PERA's members, retirees and beneficiaries, the Executive Director has the duty to utilize their power loyally, equitably and with prudence in managing the association and the PERA Fund for the exclusive benefit of PERA's members, retirees and beneficiaries, including incurring reasonable expenditures of administering the system, according to the terms of the PERA Act, the New Mexico Constitution and federal and state statutes. The Executive Director shall not cause or allow any act, decision, activity or circumstance that is imprudent, in violation of commonly accepted business and professional ethics, or a breach of fiduciary, contractual or regulatory responsibility. The Executive Director shall be expected to have a working knowledge of public pension plan administration and to be in compliance with all applicable state and federal laws, regulations and the Board Policies and Procedures.



B. In administering the association, the Executive Director has the duty and is granted the authority to:

1. Present staff recommendations to the Board with respect to policies, rules and regulations for the purpose of carrying out the provisions of the laws applicable to the retirement systems administered by the association;
2. Submit to the Board reports, resolutions and procedures, and make recommendations for legislative action on changes in the retirement systems and deferred compensation program administered by the association;
3. Be the principal legislative liaison and appear before legislative committees and address employers, employer and employee groups or other interested groups and provide information regarding the provisions of the retirement systems, operations of the association and the retirement plans it administers, and positions taken by the Board on proposed legislation and other related issues; provided, however, that the Executive Director shall not attribute any position to the Board without its prior approval;
4. Determine and calculate the amount of pensions under the retirement systems statutory scheme and make timely payment of monthly pensions, refunds to members, retirees, beneficiaries, and former members of the retirement systems, in accordance with applicable federal and state laws;
5. Collect all overpayments of benefits and adjust pension benefits paid in accordance with NMSA 1978, Section 10-11-4.2 and Board policy;
6. Negotiate, enter into, amend and terminate operational contracts for goods and services provided by external vendors and service providers, subject to the limitations on authority set forth in the New Mexico Procurement Code;
7. Negotiate, enter into and terminate contracts for investment-related services provided by external vendors and service providers, subject to the limitations on authority set for the in the PERA Investment-Related Procurement Policy;
8. Submit to the Board for its timely approval an annual operating budget that is appropriate to the fulfillment of PERA's mission, and timely submit the Board-approved budget to the Legislature for inclusion in the State's annual budget in accordance with the Board's constitutional authority. The Executive Director is responsible for administering PERA's operations within authorized budget resources;
9. Prepare the Comprehensive Annual Financial Report, which covers the operations of the system for the preceding fiscal year including investment and actuarial results, and thereafter send copies of the report to oversight agencies and any other persons/entities as appropriate;

10. Maintain membership and participate in the proceedings of nationally recognized organizations in the fields of public retirement administration, investments, and other disciplines as appropriate for the purpose of keeping abreast with the latest developments applicable to public pension plan administration and to further the interests of PERA;
 11. In consultation with the Board Chair, act as the primary spokesperson for the system to the public, the media and the Legislature, subject to the provisions of Paragraph 3, above;
 12. Identify, articulate, prioritize and schedule matters the Board will regularly address, including, in consultation with the Board and Committee Chairs, setting meeting agendas as well as preparing a summary of issues to be discussed, a staff or committee recommendation (if applicable), and a proposed motion or motions for the Board to consider;
 13. Conduct Board elections utilizing an independent external vendor or by other means approved by the Board in accordance with 2.80.200 NMAC;
- C. The Executive Director is granted the authority to act finally with respect to the following matters:
1. Planning, organizing and directing the operational and strategic work of the association as deemed necessary to fulfill the functions thereof;
 2. Negotiating, entering into, amending and terminating operational contracts of a non-investment nature as may be necessary for the administration of the association.
 3. Negotiating, entering into, amending and terminating contracts for investment management, advice, consulting, and legal counsel and authorizing expenditures for such investment services to be paid out of budgeted funds, all subject to the terms of the Investment-Related Procurement Policy t;
 4. Execute, on the recommendation of the Chief Investment Officer, all documents or authorize the issuance of instructions, necessary to purchase, sell, convey, assign, incur debt, encumber assets or otherwise manage investments and assets of the system including, but not limited to, those involving real estate, equities, fixed income, limited partnerships, fund-of-one and commingled accounts investments, and special situations, in compliance with the Investment Policy Statement and guidelines adopted by the Board and Investment Committee, including authorized investment delegation levels. A copy of this Delegation of Authority and the most current list of discretion levels delegated to the Chief Investment Officer and investment staff shall be maintained in the Investment Policy Statement;
 5. Vote, vote by proxy and otherwise act in accordance with Board policy and applicable procedure on all matters relating to the corporations, limited

partnerships, limited liability companies and other entities through which the system holds title to investments, including but not limited to matters of corporate governance;

6. Establishing and directing the maintenance of an effective system of internal controls and records and accounts following generally recognized accounting principles;
7. Directing the preparation of accurate statistical records to serve as a basis for actuarial audits, valuations, and computations in sufficient detail to permit the valuation and establishment of demographic experience factors;
8. Hiring, evaluating, disciplining, promoting, dismissing and compensating such employees as may be necessary to carry out the provisions of the law applicable to the retirement systems and defining the duties thereof, *provided*, that employee compensation shall be reflected in the proposed annual budgets submitted to the Board and shall be subject to approval by the Board as part of the budgetary process.
9. The Executive Director has the authority to employ all PERA employees, subject to applicable law, and shall disclose the credentials of newly hired individuals for the positions of Deputy Director, Chief Investment Officer and General Counsel. The Executive Director shall develop and execute performance plans for all employees under their supervision. Such performance plans shall be consistent with the Executive Director's performance plan. Exempt employees shall be evaluated by the Executive Director in relation to their performance plan at least annually.
10. Initiating, prosecuting, and defending appeals, writs and other litigation in the courts and administrative forums on behalf of the association as necessary to comply with and enforce applicable law and to carry out the decisions and policies of the Board. Board approval will be obtained before taking such action where required by Board policy or otherwise appropriate under the circumstances;
11. Accept service of summons and any other legal service of process for and on behalf of the Board and the association;
12. Initiate, prosecute and defend subrogation actions, appeals, and other related litigation matters, such as cross complaints, and to file liens, intervene in court proceeding, join parties to actions, consolidate actions, compromise claims, contract with outside counsel, and take other such action as necessary to recover amounts owed to the association;
13. Make programmatic decisions regarding the system's defined contribution program, including but not limited to selecting investment options available to plan

participants, subject to the limitations of the SmartSave Deferred Compensation Investment Policy Statement. Any authority the Executive Director has to enter into contracts shall be subject to the limitations imposed above.

14. It is the responsibility of the Executive Director, or their designee, to act as the liaison for communication and information flow between the Board and PERA staff.
- D. The Executive Director shall perform such other duties as may be required for the administration of the retirement systems, other provisions of law governing the retirement systems, and for the transaction of its business.
 - E. The Executive Director may delegate any and all of the powers and authority delegated herein as appropriate, consistent with applicable law and Board policies. The Executive Director must act prudently with respect to delegation of duties and any such delegation must be in writing. The Executive Director must regularly evaluate performance under such delegation to assure competent performance.
 - F. The Executive Director shall be formally evaluated by the Board at least annually, following the close of the fiscal year. The Board shall follow the process set out in the Executive Director Evaluation Form attached as an appendix to the Board's Policies and Procedures. Performance criteria shall primarily include objectives for outcomes that are under the Executive Director's control, but may also include outcomes for which the Executive Director may reasonably be expected to exercise influence. Performance criteria requiring additional resources shall be enforced only in the event that such incremental resources have been authorized and funded in PERA's annual budget. The performance plan which the Board adopts and monitors each year for the Executive Director shall include training and professional development. The Board shall approve training for the Executive Director in the same manner as for Board Members.
 - G. The Executive Director does not have delegated authority to establish their own compensation or benefits. That authority is reserved explicitly to the Board, acting as a whole. The annual compensation for the Executive Director shall be set by Board action, upon majority vote taken during open session at a regular Board meeting following the annual performance evaluation, subject to the Board's authority to modify such compensation at any time upon appropriate notice. The compensation of the Executive Director shall be included in the budget submitted to the Board for adoption for the fiscal year in which the compensation is to be paid, and is subject to final approval of that budget.

RESOLUTION NO. 20-0X

RESOLUTION REGARDING DELEGATION OF AUTHORITY TO THE EXECUTIVE DIRECTOR

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BE IT RESOLVED that pursuant to the authority granted the Board under applicable law, including, but not limited to, the New Mexico Constitution, Art. XX, Sec. 22, NMSA 1978, Sections 10-11-130, 10-11-131, 10-11-132, and 10-11-133, and the Board Policies and Procedures, the Board hereby delegates authority to the Executive Director as more fully set forth in this Resolution. This Resolution shall be deemed effective as of the date adopted and shall remain in full force and effect, unless otherwise amended, restated or superseded.

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1. General Delegation

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2. Specific Duties and Authority

A. **Fiduciary Duties.** As a fiduciary to PERA's members, retirees and beneficiaries, the Executive Director has the duty to utilize their power loyally, equitably and with prudence in managing the association and the PERA Fund for the exclusive benefit of PERA's members, retirees and beneficiaries, including incurring reasonable expenditures of administering the system, according to the terms of the PERA Act, the New Mexico Constitution and federal and state statutes. The Executive Director shall not cause or allow any act, decision, activity or circumstance that is imprudent, in violation of commonly accepted business and professional ethics, or a breach of fiduciary, contractual or regulatory responsibility. The Executive Director shall be expected to have a working knowledge of public pension plan administration and to be in compliance with all applicable state and federal laws, regulations and the Board Policies and Procedures.

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B. In administering the association, the Executive Director has the duty and is granted the authority to:

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1. Present staff recommendations to the Board with respect to policies, rules and regulations for the purpose of carrying out the provisions of

the laws applicable to the retirement systems administered by the association;

2. Submit to the Board reports, resolutions and procedures, and make recommendations for legislative action on changes in the retirement systems and deferred compensation program administered by the association;

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3. Be the principal legislative liaison and appear before legislative committees and address employers, employer and employee groups or other interested groups and provide information regarding the provisions of the retirement systems, operations of the association, and the retirement plans it administers, and positions taken by the Board on proposed legislation and other related issues; provided, however, that the Executive Director shall not attribute any position to the Board without its prior approval;

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4. Determine and calculate the amount of pensions under the retirement systems statutory scheme and make timely payment of monthly pensions, refunds to members, retirees, beneficiaries, and former members of the retirement systems, in accordance with applicable federal and state laws;

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5. Collect all overpayments of benefits and adjust pension benefits paid in accordance with NMSA 1978, Section 10-11-4.2 and Board policy;

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6. Negotiate, enter into, amend and terminate operational contracts for goods and services provided by external vendors and service providers, subject to the limitations on authority set forth in the New Mexico Procurement Code;

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7. Negotiate, enter into and terminate contracts for investment-related services provided by external vendors and service providers, subject to the limitations on authority set for the in the PERA Investment-Related Procurement Policy;

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8. Submit to the Board for its timely approval an annual operating budget that is appropriate to the fulfillment of PERA's mission, and timely submit the Board-approved budget to the Legislature for inclusion in the State's annual budget in accordance with the Board's constitutional authority. The Executive Director is responsible for administering PERA's operations within authorized budget resources;

9. Prepare the Comprehensive Annual Financial Report, which covers the operations of the system for the preceding fiscal year including investment and actuarial results, and thereafter send copies of the report to oversight agencies and any other persons/entities as appropriate;
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10. Maintain membership and participate in the proceedings of nationally recognized organizations in the fields of public retirement administration, investments, and other disciplines as appropriate for the purpose of keeping abreast with the latest developments applicable to public pension plan administration and to further the interests of PERA;
11. In consultation with the Board Chair, act as the primary spokesperson for the system to the public, the media and the Legislature, subject to the provisions of Paragraph 3, above;
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12. Identify, articulate, prioritize and schedule matters the Board will regularly address, including in consultation with the Board and Committee Chairs, setting meeting agendas as well as preparing a summary of issues to be discussed, a staff or committee recommendation (if applicable), and a proposed motion or motions for the Board to consider;
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13. Conduct Board elections utilizing an independent external vendor or by other means approved by the Board in accordance with 2.80.200 NMAC;
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- C. The Executive Director is granted the authority to act finally with respect to the following matters:
1. Planning, organizing and directing the operational and strategic work of the association as deemed necessary to fulfill the functions thereof;
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2. Negotiating, entering into, amending and terminating operational contracts of a non-investment nature as may be necessary for the administration of the association;
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3. Negotiating, entering into, amending and terminating contracts for investment management, advice, consulting, and legal counsel and authorizing expenditures for such investment services to be paid out of budgeted funds, all subject to the terms of the Investment-Related Procurement Policy ‡;
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4. Execute, on the recommendation of the Chief Investment Officer, all documents or authorize the issuance of instructions, necessary to
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purchase, sell, convey, assign, incur debt, encumber assets or otherwise manage investments and assets of the system including, but not limited to, those involving real estate, equities, fixed income, limited partnerships, fund-of-one and commingled accounts investments, and special situations, in compliance with the Investment Policy Statement and guidelines adopted by the Board and Investment Committee, including authorized investment delegation levels. A copy of this Delegation of Authority and the most current list of discretion levels delegated to the Chief Investment Officer and investment staff shall be maintained in the Investment Policy Statement;

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5. Vote, vote by proxy and otherwise act in accordance with Board policy and applicable procedure on all matters relating to the corporations, limited partnerships, limited liability companies and other entities through which the system holds title to investments, including but not limited to matters of corporate governance;
6. Establishing and directing the maintenance of an effective system of internal controls and records and accounts following generally recognized accounting principles;
7. Directing the preparation of accurate statistical records to serve as a basis for actuarial audits, valuations, and computations in sufficient detail to permit the valuation and establishment of demographic experience factors;
8. Hiring, evaluating, disciplining, promoting, dismissing and compensating such employees as may be necessary to carry out the provisions of the law applicable to the retirement systems and defining the duties thereof, *provided*, that employee compensation shall be reflected in the proposed annual budgets submitted to the Board and shall be subject to approval by the Board as part of the budgetary process.
9. The Executive Director has the authority to employ all PERA employees, subject to applicable law, and shall disclose the credentials of newly hired individuals for the positions of Deputy Director, Chief Investment Officer and General Counsel. The Executive Director shall develop and execute performance plans for all employees under their supervision. Such performance plans shall be consistent with the Executive Director's performance plan. Exempt employees shall be evaluated by the Executive Director in relation to their performance plan at least annually.
10. Initiating, prosecuting, and defending appeals, writs and other litigation in the courts and administrative forums on behalf of the association as necessary to comply with and enforce applicable law and to carry out the

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decisions and policies of the Board. Board approval will be obtained before taking such action where required by Board policy or otherwise appropriate under the circumstances;

11. Accept service of summons and any other legal service of process for and on behalf of the Board and the association;
 12. Initiate, prosecute and defend subrogation actions, appeals, and other related litigation matters, such as cross complaints, and to file liens, intervene in court proceeding, join parties to actions, consolidate actions, compromise claims, contract with outside counsel, and take other such action as necessary to recover amounts owed to the association;
 13. Make programmatic decisions regarding the system's defined contribution program, including but not limited to selecting investment options available to plan participants, subject to the limitations of the SmartSave Deferred Compensation Investment Policy Statement. Any authority the Executive Director has to enter into contracts shall be subject to the limitations imposed above.
 14. It is the responsibility of the Executive Director, or their designee, to act as the liaison for communication and information flow between the Board and PERA staff.
- D. The Executive Director shall perform such other duties as may be required for the administration of the retirement systems, other provisions of law governing the retirement systems, and for the transaction of its business.
- E. The Executive Director may delegate any and all of the powers and authority delegated herein as appropriate, consistent with applicable law and Board policies. The Executive Director must act prudently with respect to delegation of duties and any such delegation must be in writing. The Executive Director must regularly evaluate performance under such delegation to assure competent performance.
- F. The Executive Director shall be formally evaluated by the Board at least annually, following the close of the fiscal year. The Board shall follow the process set out in the Executive Director Evaluation Form attached as an appendix to the Board's Policies and Procedures. Performance criteria shall primarily include objectives for outcomes that are under the Executive Director's control, but may also include outcomes for which the Executive Director may reasonably be expected to exercise influence. Performance criteria requiring additional resources shall be enforced only in the event that such incremental resources have been authorized and funded in PERA's annual budget. The performance plan which the Board adopts and monitors each year for the Executive Director shall include training and

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professional development. The Board shall approve training for the Executive Director in the same manner as for Board Members.

- G. The Executive Director does not have delegated authority to establish their own compensation or benefits. That authority is reserved explicitly to the Board, acting as a whole. The annual compensation for the Executive Director shall be set by Board action, upon majority vote taken during open session at a regular Board meeting following the annual performance evaluation, subject to the Board's authority to modify such compensation at any time upon appropriate notice. The compensation of the Executive Director shall be included in the budget submitted to the Board for adoption for the fiscal year in which the compensation is to be paid, and is subject to final approval of that budget.

STATE OF NEW MEXICO
OFFICE OF THE ATTORNEY GENERAL



HECTOR H. BALDERAS
ATTORNEY GENERAL

September 26, 2019

Via Hand Delivery

Dr. Jacquelin Kohlasch, PhD
Mr. Stephen J. Neel
Ms. Patricia French
Mr. Daniel Mayfield
Hon. Maggie Toulouse Oliver
Mr. James Maxon

Ms. Claudia Armijo
Mr. David J. Roybal
Mr. Lawrence L. Davis
Ms. Loretta Naranjo-Lopez
Hon. Tim Eichenberg

Dear Honorable Board Members:

The Office of the Attorney General has completed its investigation of complaints received regarding personnel actions taken by Public Employees Retirement Association of New Mexico's (PERA) Executive Director Wayne Propst. The Office of the Attorney General conducted a multi-disciplinary review of this matter through staff attorneys, investigators and certified fraud examiner accountants. We completed a forensic analysis of compensation practices at PERA and have thoroughly researched the legal authority to modify compensation for the Executive Director and other PERA staff. Our findings are fully detailed within this investigative report.

Duties and Authority of the Executive Director

New Mexico law states "[t]he retirement board shall appoint an executive director who shall be the chief administrative officer for the retirement board and the association." NMSA 1978, Section 10-11-131(B) (1997). The Public Employees Retirement Act Board (PERA Board) "shall employ professional, technical, clerical and other services as required for the operation of the association. The compensation for employed services shall be fixed by the retirement board." NMSA 1978, § 10-11-131(C) (1997). Section 10-11-130(A)(10)(2011) grants the PERA Board the authority to make and adopt such reasonable rules as may be necessary or convenient to carry out the duties of the retirement board and activities of the association. Pursuant to this statutory authority, the Board promulgated NMAC 2.80.1800, stating that the Executive Director shall be the chief administrative officer of the PERA Board, shall attest to official actions of the Board when required and shall serve at the pleasure of the board. The Rule further states that the Executive Director is authorized to perform any acts required of the board pursuant to a proper delegation of authority by the Board.

Records indicate that on April 26, 2012, Mr. Propst was introduced to the PERA Board as the new Executive Director. During this meeting, the PERA Board also unanimously resolved to approve an amendment to the PERA Board's policy manual regarding the Executive Director's duties and authority. Most significant to this analysis is Section 7(D) which states as follows:

The Executive Director has the authority to employ all NMPERA employees, except that the Board requires that the credentials of proposed exempt employees for the positions of Deputy Director of Operations, Deputy Director of Member Services, Chief Investment Officer and General Counsel be formally presented to and endorsed by a majority of the Board prior to any offer of employment for candidates for such positions.

It is also important to note that as a state employee, the Executive Director is subject to the provisions of the Personnel Act, NMSA 1978, Sections 10-9-1 to -25 (1961 as amended through 2009). The purpose of the Personnel Act is to establish for New Mexico a system of personnel administration based solely on qualification and ability, which will provide greater economy and efficiency in the management of state affairs. Section 10-9-2. Thus, all personnel actions must comply with the Personnel Act, regardless of conveyed authority.

Section 10-9-22 of the Personnel Act provides that it shall be a misdemeanor to:

- A. make any false statement, certificate, mark or rating with regard to any test, certification or appointment made under the Personnel Act; or
- B. directly or indirectly give, pay, offer, solicit or accept any money or other valuable consideration or secure or furnish any special or secret information for the purpose of affecting the rights or prospects of any person with respect to employment in the service.

The Executive Director is also subject to the Standards of Conduct within the PERA Policy Manual which states in relevant part. "Board Members and the Executive Director shall conduct themselves with integrity and dignity; exercising care, prudence and diligence required of public pension fund fiduciaries."

PERA Staff Reclassification and Promotional Increases

PERA must submit for approval all classified staff in-grade hires with an hourly rate over 114.6% comparison ratio, promotional increase over 15%, reclassifications and In-Pay Band Adjustments to State Personnel Office (SPO) through their administrative process. SPO has the final determination on staff increases, promotions and reclassifications, which can be rejected if determined to be unjustified.

With regard to exempt staff, PERA submits all exempt staff increases to the Department of Finance and Administration (DFA) through their administrative process. DFA has the final determination on exempt staff increases, which also can be rejected if determined to be unjustified. It is our understanding that the Executive Director's current practice is to notify the current Board leadership of any proposed compensation adjustments for exempt staff prior to submitting to DFA.

Exhibit A (attached) details salary increases for PERA Staff from FY 2015 through 2018. As indicated on Exhibit A, during the period from 2013 to 2019, numerous documents obtained through this investigation reveal a pattern of reclassification and promotional increases for several PERA staff members. Additionally, five employees were converted from a classified position to a Governor Exempt Position, thus increasing the pay range and resulting salary for each employee. Two employees received a salary increase in each of the four years analyzed and twenty (20) employees received an increase greater than 20%.

Records indicate that the explanation for such increases was consistently that the PERA employee is “valuable to PERA and exemplifies the type of talent that PERA is trying to attract and retain.” Extensive documentation was also provided to indicate compensation changes were made to place staff in alignment with their counterparts at the State Investment Council and the Educational Retirement Board. This data was retrieved from Personnel Position Action Request Forms (PARFs) submitted by Director Propst. Each compensation action was reviewed by the requisite state agency and approved pursuant to their regulations. Thus, each PARF reviewed was approved by the Department of Finance or State Personnel Office in compliance with the Personnel Act and enacted pursuant to the delegated authority.

Executive Director’s Salary Increase

As previously noted, the PERA Board is statutorily tasked with setting the compensation for employed services, unless otherwise delegated. See Section 10-11-131(C), NMAC 2.80.1800. Exhibit B (attached) details the compensation actions for Mr. Propst. The Executive Director was initially hired at 25.9% above the mid-point at a salary of \$142,459. Mr. Propst received a legislative cost of living salary increase of 1.26% in 2013. The Executive Director received two increases in 2014. The first increase was legislative 3% and the second was a promotion 10% increase, resulting in a salary of \$163,029.86. In 2018, Mr. Propst received a legislative salary increase of 2.75% for a resulting salary of \$166,290.45. Most recently, in 2019, Mr. Propst received a 4% promotional increase for a current salary of \$172,942.08.

The New Mexico Constitution provides that appropriation of public monies shall be made by the legislature and every law making an appropriation shall distinctly specify the sum appropriated and the object to which it is to be applied. N.M. Const. Art. IV, § 30. Where the Constitution creates or prescribes the salary, such provision is an appropriation, and dispenses with the necessity for legislative appropriation for such office. *State ex rel. Fornoff v. Sargent*, 1913, 18 N.M. 272, 136 P. 602. Therefore, a legislative appropriation would carry the weight of law and not require additional approval on behalf of the PERA Board.

In 2013, Chapter 227, Section 8 authorized DFA to distribute funding to provide salary increases to employees in budgeted positions. A 1.26% salary increase is attributed to a legislative cost of living increase for all state employees, systematically entered by DFA. While the PERA Board did not have the ability to approve this increase, the Executive Director also had no ability to influence or initiate this increase.

Nonetheless, on March 26, 2014, former PERA Board Chair Patricia French wrote a letter to DFA Secretary Thomas Clifford requesting a salary increase for Mr. Propst. The request was approved by DFA, resulting in a 10% increase.

It further appears that after this increase, the entire PERA board subsequently met in executive session and conducted the annual evaluations of the Executive Director, acknowledging his current salary. This includes the additional 4% salary increase for the Executive Director and other exempt staff on May 30, 2019.

Laws 2018, Chapter 73, Section 8 authorized DFA to distribute funding to provide salary increases to employees in budgeted positions who have completed their probationary period. In relevant

part, Section 8(A)(3) sets forth a compensation adjustment for a number of entities, including executive exempt employees with an average salary increase of two percent. Mr. Probst received 2.75% increase as part of this legislative initiative. Again, due to the legislative initiative, PERA Board was not able to opine on the legislative pay increase effective in 2018.

Mr. Propst has acknowledged that he did not seek full PERA Board approval for the 2014 compensation adjustment, but instead discussed this matter with only Board Chair French. Although the increase was approved by DFA through their administrative process, there is no record that the Chair was ever delegated the sole authority to set the compensation of the Executive Director. Thus, despite the fact that the PERA Board subsequently approved an additional increase in 2019, the entire PERA Board shall review Mr. Propst's 2014 increase for either ratification or rescission in a public meeting pursuant to the Open Meetings Act.

Conclusion

Upon final review, the Office of the Attorney General found no supporting information to substantiate any allegations of fraud or misconduct. However, we strongly advise PERA to take immediate steps to resolve the conflict of interest between applicable statutes, rules and policies. It is a fundamental rule in administrative law that a public body has only such power as is conferred on it by law. These powers include those expressly granted by statute and those fairly implied therefrom. Therefore, promulgation of rules, and not policies or directives is essential because "...once lawfully adopted, the regulations ... [have] the force of law and ... are binding upon the parties." *Brininstool v. New Mexico State Bd. of Ed.*, 81 N.M. 319, 322, 466 P.2d 885 (Ct. App. 1970). Thus, no matter how well intentioned, public bodies must comply with the law to properly promulgate rules in order to prevent any conflict or confusion with policies.

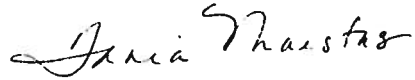
The various references cited do not adequately define the duties, nor the delegated authority endowed upon the Executive Director. Thus, while NMAC 2.80.1800 authorized Mr. Propst to perform certain board acts, including staff compensation, PERA Policy Section 7(D) was the mechanism used to delegate the compensation authority by the board. Moving forward, proper delegation should be prescribed by rule, rather than policy. Therefore, PERA must properly resolve these conflicts through the rulemaking process, in order to lawfully solicit input from both the public and all Board members.

In conclusion, we find no violation of criminal law regarding the salary increases of PERA staff, nor the Executive Director. Additionally, there is no evidence that these compensation actions were taken in violation of the rules or policies promulgated by the PERA Board. All actions were documented through Personnel Act procedures and approved by the requisite oversight entities.

However, as previously stated, the entire PERA Board shall review the 2014 increase of the Executive Director for either ratification or rescission in a public meeting pursuant to the Open Meetings Act. While the PERA Board has the authority to rescind pay raises it deems inappropriate or no longer supports, such action should only be done at the direction of in-house general counsel, properly advising of the legal consequences. Additionally, a transparent, open process should be enacted wherein the PERA Board has the ability to review compensation actions, regardless of delegated authority. Especially because PERA does not receive General Fund appropriations from the State of New Mexico and it is self-funded through investment income, a heightened sense of

integrity shall be employed when adjusting PERA staff salaries, since the increases and their resulting retirement benefits directly impact the PERA fund and its sustainability. We therefore consider this matter closed and will take no further enforcement action.

Sincerely,

A handwritten signature in cursive script, reading "Tania Maestas".

TANIA MAESTAS
Chief Deputy Attorney General

cc: Harvey L. Leiderman
Fiduciary Counsel to the PERA Board of Trustees



Public Employees Retirement Association of New Mexico
Internal Audit
Governance and IPS Compliance

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Public Employees Retirement Association of New Mexico Governance and IPS Compliance Report

INTRODUCTION

We performed the internal audit services described below solely to assist the Public Employees Retirement Association of New Mexico (PERA) in evaluating the process and internal controls related to governance, fiduciary responsibility and training as well as compliance with the Investment Policy Statement. Our services were conducted in accordance with the Consulting Standards issued by the American Institute of Certified Public Accountants and the terms of our Professional Services Contract agreement for internal audit services. Since our procedures were applied to samples of reports and processes, it is possible that significant issues related to the areas tested may not have been identified.

PURPOSE AND OBJECTIVES

Our internal audit focused on evaluating overall governance at PERA to determine compliance with fiduciary requirements, laws and regulations, and best practices. We evaluated whether Board training was in compliance with the New Mexico Administrative Code and the process in place for identifying and addressing code of conduct violations, including fraud, waste and abuse. We tested PERA Board Members and employees to ensure conflict of interests were reported timely. Our internal audit also focused on evaluating PERA's processes and controls surrounding the approval of investment policy changes and compliance with asset allocation benchmarks. Considering the magnitude of the Governance area for PERA, it was not possible to test all areas within governance. Our procedures instead focused on the areas and subsequent outcomes that could provide the most impact on improving the PERA Governance structure and related controls.

SCOPE AND PROCEDURES PERFORMED

In order to gain an understanding of the processes and operations, we interviewed and/or conducted inquiries via questionnaires for the following Board Members and PERA personnel:

- John Melia, Municipal Member Board Chair
- David Roybal, State Member Vice-Chair
- Steve Neel, State Member

- Paula Fisher, State Member
- Claudia Armijo, State Member
- Patty French, Municipal Member
- Lawrence Davis, Municipal Member
- Shirley Ragin, County Member
- Loretta Naranjo-Lopez, Retiree Member
- Dan Mayfield, Retiree Member
- Tim Eichenberg, Ex-Officio Member, New Mexico State Treasurer
- Greg Trujillo, Deputy Director
- Dominic Garcia, Chief Investment Officer
- Anna Williams, Chief Financial Officer
- Susan Pittard, General Counsel/Chief of Staff

In order to gain an understanding of the processes, we read relevant portions of:

- New Mexico State Statutes Annotated 1978
- NM Administrative Code (Public Employee Retirement Act)
- PERA Board Policies and Procedures revised December 2019
- PERA Investment Committee Charter revised October 2010
- Investment Policy Statement revised December 2019
- Board of Trustees and Committee meeting minutes for 2019 and 2020 (where available)
- Letter from NM State Auditor, Brian Colón to PERA Board of Trustees dated May 2019
- Chartered Financial Analyst (CFA) Institute's Elements Of An Investment Policy Statement For Institutional Investors
- Fi360 Prudent Practices for Investment Advisors

We performed the following testwork:

Board Policies and Procedures: We obtained the December 2019 Board Policies and Procedures and tested to determine if they were reviewed and approved in accordance with policy requirements of a biennial review.

Board Education and Training: We gained an understanding of the process used to select trainings for Board Members as well as the process for approval of external travel requests to determine whether the selection process allows for Board Members to receive relevant training. We then obtained a listing of all Board Members as of March 2020 and tested to determine:

- Board Members certified compliance with statutory requirements of Section 10-11-133(F) NMSA 1978 on the signed affidavit on or before December 31, 2019, in accordance with 2.80.200.21 NMAC;

- Board Members attended at least 8 hours of training in pension fund investing, fiduciary obligations or ethics during the calendar year for both calendar year 2019 and 2018 to ensure compliance with Section 10-11-133 (F) NMSA 1978;
- Board Members did not attend more than 2 relevant externally provided conferences or seminars each fiscal year.

Additionally, we obtained a listing of new Board Members with terms beginning in calendar year 2019 and 2020 and tested to determine that new Board member orientation was completed within two months of the start of their term.

Lastly, we analyzed Board member travel and registration costs associated with externally provided trainings for FY 2019 and 2020 to determine if trainings attended and relevant costs were in line with PERA budget and Board policies and procedures.

Survey of Board Members and Executive Management: Utilizing a questionnaire, we requested responses from PERA Board Members and executive staff to assist in identifying potential areas for improvement within the PERA governance structure in the following areas:

- Board Vision;
- Conflict of Interest, Fraud, Waste and Abuse Identification and Resolution;
- Agency Communication;
- Roles and Responsibilities;
- Decision Making;
- Board Meeting Length and Frequency; and,
- Board Training.

We then reviewed Board meeting and Investment Committee meeting audio for the period starting January 2019 to April 2020 to identify specific instances that supported or provided additional context for areas identified within the Board and Executive Management questionnaire.

Board Meeting Attendance: We reviewed Board meeting attendance for the period starting January 2019 to April 2020 to determine if Board Members were in compliance with attendance requirements per Board policy.

Board Meeting Agendas and Minutes: For all Board meetings occurring from January 2019 to April 2020, we selected a sample of 6 and tested to determine:

- The agenda and related board materials were provided to Board Members at least 7 days prior to the scheduled meeting date in accordance with Board Policy.
- The Notice of Meeting was provided to the public at least 72 hours prior to the meeting and included a list of specific items of business to be discussed at the meeting and how the public may obtain a copy of the agenda in accordance with the Open Meetings Act.
- The Board Meeting agenda was posted to the PERA website 72 hours prior to the meeting.

In addition, we tested to determine if Board meeting minutes were documented and approved by the Board as well as made available on the PERA website upon approval.

Office of the State Auditor (OSA) Letter Recommendations: We obtained the letter from the OSA to the PERA Board dated May 2019 and analyzed the letter to determine if action steps had been taken to resolve concerns brought up in the letter.

Standards of Conduct for Board Members: We obtained an understanding of the process to identify and report on financial conflict of interests in accordance with Board policy section 3.00 Standards of Conduct. For all Board Members as of March 2020, we obtained the Financial Disclosure forms and tested to determine:

- Board Members completed their disclosure statement on or before January 31 for the year;
- The Financial Disclosure form was free from conflicts that would impair or threaten the individual's ability to act in the best interest of PERA and its Members.

We obtained the Gift Reporting forms for the same criteria above and tested to determine:

- Board Members completed and signed a Gift Reporting form for January 2019 through June 2019;
- Board Members completed and signed a Gift Reporting form for July 2019 through December 2019;
- Board Members did not report a single gift with a value over \$50;
- Total of gifts reported as received did not exceed \$150 for the year.

We then obtained an understanding of the process in place to identify and report Board nonfinancial conflicts of interest. Utilizing the Board questionnaire and review of Board meeting audio, we determined if conflict of interests appeared to exist and what action steps were taken to address them and determine if a conflict existed.

Finally, utilizing the Board questionnaire and review of Board meeting audio, we determined the process in place by the Board to monitor compliance with Board Member conduct related provisions of the Board policy including the requirement for the Board to speak in a unified voice when making decisions.

Code of Conduct for PERA Employees: We obtained an understanding of the process to identify and report on nonfinancial conflict of interests for PERA employees. We then obtained a listing of all PERA employees with start dates before April 2020 from PERA Human Resources. From the listing of 82 employees, we select a sample of 9 and tested to determine:

- PERA Employee Conflict of Interest form was signed and submitted timely;
- Governor Code of Conduct Acknowledgement form was signed and filed in the employee's personnel file;
- Employee attended the required Code of Conduct training provided by PERA Human Resources.

Additionally, we gained an understanding of the process in place to monitor conflicts of interest disclosed by PERA employees on the Employee Conflict of Interest form.

Assessment and Compliance with the IPS: We obtained the executed IPS dated July 26, 2018, and compared it to the Chartered Financial Analyst Institute’s and the Fi360 recommendations to ensure that all recommended areas were included.

IPS Policy Changes: We requested all policy changes and supporting documentation from the last IPS internal audit performed in 2015 to May 2020. For each major change identified in 2017 and 2018, we verified changes were properly presented and approved by the Board. In addition, we gained an understanding of the updated roles and responsibilities approved in the 2017 IPS and performed inquiries to determine if Board Members and staff were adhering to the updated roles and responsibilities for investment related activities.

Portfolio Composition: We obtained the investment holdings by asset class as of December 2019 and tested to determine if asset allocations adhered to the allowable IPS allocation ranges.

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

As a result of our testing, REDW identified the following observations which are prioritized based on the areas we believe can provide the most impact to PERA Governance. The observations have been split into two groupings with the first focusing on critical, high risk observations impacting Board productivity, transparency, and effectiveness and the second grouping focusing on reporting and administration.

Observations Relating to Board Productivity, Transparency, and Effectiveness

1) Communication and Decision Making

Effective communication and decision making between Board Members and PERA staff is integral to good governance and the management of the Agency and Fund. Several sections within the 2019 Board Policies and Procedures address required communication and planning expectations by the Board and staff and appear to not be consistently followed.

1. Board Policy section 2.11 states the Board is to “set the long-term strategic direction for PERA, focusing on the goals of PERA against which performance is measured and monitored.” In addition, Board Policy section 2.14 states the Board shall “delegate execution of the established Board policy and strategic objectives to the Executive Director and the Chief Investment Officer, and through them, re-delegation to PERA staff.” Through the questionnaire responses, we identified a trend where all Board Members and executive management who responded felt there was not a unified vision around the strategic direction at the Board level or, actions by the Board gave the appearance that a unified vision did not exist. The lack of unified visions amongst the Board appears to further escalate the inability of the Board to act as a cohesive group and speak with a unified voice when communicating and making decisions.
2. Board Policy section 1.40 states “The Board will act with integrity in meeting its fiduciary responsibilities to PERA’s Members and beneficiaries. The Board will make efficient, effective, prudent and visionary decisions in fulfilling its mission....The Board will engage in inclusive decision making processes, which support its expectations that the Board speaks with a unified voice.” Based on the board meeting audio, we observed many decisions made by a majority vote where despite the decisions made, Board Members continued to speak out

on the decisions in subsequent meetings thus violating Board policy 1.40 stating the Board will speak with a unified voice. In addition, this caused disruption at subsequent meetings and took away from the importance of current business.

3. Board Policy section 1.60 states “The Board is responsible for creating and maintaining an atmosphere that encourages frank and collegial discussions both at the Board and Committee levels and between the Board and PERA management.” In addition, Board Policy section 3.10 states “Board Members, the Executive Director and the PERA staff shall conduct themselves with integrity and dignity, exercising care, prudence, and diligence required of public pension fund fiduciaries. Board Members, the Executive Director and staff should also avoid conduct that gives the appearance of impropriety.” Based on review of board meeting audio, we observed several instances of Board Members having disagreements that resulted in accusations and negative commentary regarding other Board Members, staff, and consultant qualifications and competence which violates Board Policy 1.60 and 3.10 to act with integrity and dignity and an atmosphere of collegial discussion. In addition to REDW’s observations relating to Board conduct, the OSA also provided commentary regarding the necessity for the Board to act within its fiduciary responsibilities. In a letter dated May 2019 from the OSA regarding “PERA Raises, FY20 Operating Budget, and Fiduciary Duties,” the OSA commented “...Fiduciary duties are the highest level of duties, and require the persons acting in a fiduciary capacity to act solely on behalf of the members and other beneficiaries within the scope of the fiduciary relationship. The Board members are strictly accountable for this stewardship and are required to demonstrate the requisite care, loyalty, and impartiality....The Board’s conduct could be deemed to be in violation of its fiduciary duties to the members.”
4. Board Policy section 2.51 states “At all times, individual Board Members shall act in the best interest of PERA consistent with their fiduciary duty, ensuring the highest standard of duty to PERA’s members and beneficiaries, and in conformance to the Board’s policies.” In addition, NMSA 10-16-3 Ethical Principles of Public Service states “Public officers will use powers and resources to advance the public interest. Legislators and public officers and employees shall conduct themselves in a manner that justifies confidence placed in them by the people.” In two instances, quorum was lost when Board Members walked out of the meeting to avoid a vote being able to take place thus resulting in a delay of the critical business being handled which violates Board Policy section 2.51 and NMSA 10-16-3. In one instance, the Board was unable to approve the FY2020 budget by the statutory deadline which the OSA deemed “reckless or negligent, or both, and coupled with the Board’s lack of focus on its fiduciary responsibilities puts our retirees and future generations of retirees at risk. The Board’s behavior is unacceptable and harms the fund’s membership.”
5. Our inquiry determined there were multiple instances of complaints or concerns brought up both at the Board and/or management level that were not addressed. Further discussion revealed there is no process in place to formally address complaints or concerns through an internal process. As a result, in some situations, external legal representation was obtained and PERA incurred additional legal fees approximating \$50,000 that ultimately resulted in no additional resolution. While the legal fees were not material to the fund, they do not appear to have been utilized for purposes in line with fiduciary responsibility.

Potential Risk: High— The observations identified above highlight several potential risk areas which are summarized below:

1. The perception that the Board Members and PERA staff do not have shared strategic goals and objectives nor a unified approach when decisions are made reduce public trust and negatively impact the public's and the PERA member's trust in the organization. Without a common strategic vision between PERA staff and the Board, there is an elevated risk the organization may not meet its long-term goals and objectives.
2. Disagreements and negative commentary about others in public meetings escalates the risk that PERA may be unable to recruit and hire employees as well as recruit Board Members to replace those who opt to retire as people may be hesitant to join an agency with the appearance of a toxic environment.
3. The absence of an internal process to address complaints increases the risk that PERA may continue to incur legal fees which must be paid from the trust funds and ultimately impact PERA membership as those monies should be used to continue advancing the agency in a positive direction.
4. While the Board took action to remedy the misalignment of Board policy to state statute referenced in both the OSA and NM Attorney General letters, little was done to address the continued behavior that gives the perception that fiduciary responsibility is not being upheld thus escalating the risk that the PERA Board may continue to function in a dysfunctional environment.

Recommendations: In order to enhance communications between Board Members and staff as well as the Board itself, and ultimately support the goal of a unified vision, we recommend the following action steps:

1. The Board should work to develop a long-term strategic vision for the agency and all decisions should adhere to that vision. The Board should collaborate with management to come up with performance metrics to which success is measured against. Management should be responsible for the execution of the vision and action steps with the Board being the oversight function. Periodic monitoring by the Board should take place to ensure compliance with performance metrics established and any variances should be discussed with management so adjustments can be developed.
2. Once a majority vote is made, procedures should be put in place to ensure the Board accepts the vote and a unified approach is taken for all subsequent communications. A process should be implemented to address situations that arise where a Board Member does not comply. While it is not expected for all Board Members to agree unanimously on every decision, it is critical for all Board Members to acknowledge and accept the majority vote and ultimately support the Board in its decisions for PERA Membership.
3. All Board Members are required to sign that they acknowledge Board policies and procedures however, there does not appear to be any process in place to identify and resolve noncompliance. PERA should consider implementing an oversight committee to monitor compliance with Board policies and procedures. Repeated issues of noncompliance should be addressed and evaluated to determine appropriate action steps such as sanctioning of a Board member or removal. This process needs to be consistently followed and monitored.
4. In the event Board members purposefully walk out of a meeting to prevent business from moving forward, disciplinary action in accordance with Board Policy section 9.34 should occur.

5. PERA should consider implementing a formal complaint process for Board Members and management to utilize similar to the one developed for member/beneficiary complaints in Board Policy section 12.82. This would allow Board Members and management to express their concern in a formalized manner and provide a more open, collaborative form of communication regarding concerns or complaints. These complaints would be submitted to the Board Chair and must contain documentation to support the complaint prior to submission. The Board Chair will determine if the complaint will move forward to the full Board or designated committee based on information received. In the event a complaint is not properly addressed, procedures should be put in place for escalation to the OSA or other oversight agency.

Management Response: Management is available to assist the Board in developing a 5-year strategic plan and an annual work plan that verifies all requirements in Board Policies and Procedures have been met within prescribed deadlines. Management believes a standing Governance Committee could potentially be tasked with monitoring a Code of Conduct and review complaints. Management will assist the Board to develop a formal complaint process for Board Members at their request.

Board Response: The Board agrees with the need to establish a unified vision and development of processes to ensure good communication and consistent decision making. The Board will work to develop an oversight committee who will be tasked with reviewing current policies and procedures and proposing changes with a strong consideration towards enhancing the accountability, monitoring and disciplinary functions of the Board. The establishment of the committee and policy review will be completed by the end of FY 2021. In order to focus more on the short-term, a standing informational agenda item will be added to each board meeting for the rest of 2020 which will focus on the observations identified during this internal audit and any progress made as well as development of action items as necessary.

2) Nonfinancial Conflict of Interest Reporting

Board Policy section 3.60 states Board Members, the Executive Director and Executive Staff shall not engage in any outside employment or other activity that is not compatible with the full and proper discharge of their duties and responsibilities with the Board. In addition, Board Policy section 3.11 states “Board Members and the Executive Director shall make decisions consistent with their fiduciary duty....Board Members and the Executive Director shall disclose and refrain from participating in any discussion or decision concerning an investment, benefit, or other action in which the Board Member has an interest or conflict, including abstention from voting regarding the action.” Our testing determined several instances where a conflict of interest appeared to exist at the Board level; however, there did not appear to be a process in place to identify and discuss the conflict to ensure it did not impair fiduciary responsibilities.

In December 2019, the Board revised the Policies and Procedures to include section 3.33, which states, “Board Members shall disclose their employment, union affiliations, and any other organizational or association affiliations to the Executive Director annually, and the Executive Director shall make that information available to the Board at the next regular Board meeting after such information is collected. The Board can determine, in its discretion, whether a conflict of interest may exist for any particular Board Member by majority vote, and can discuss whether recusal from a decision would be recommended and/or necessary.” As of testing, the Board had yet to complete this process.

Potential Risk: High—The perception that Board Members are not being transparent in their reporting of potential conflicts of interest can negatively impact the public’s and PERA Membership’s trust in the Board. Additionally, if Board Members are engaging in external activities that interfere with the efficient operation of the Board, Board Members may not be fulfilling their fiduciary duties.

Recommendations: While the addition of Board policy section 3.33 provides a good initial oversight function to nonfinancial conflicts, we recommend PERA consider adding the following to the process:

1. Develop a nonfinancial conflict of interest form to assist Board Members in properly disclosing any employment, union affiliations, and any other organizational or association affiliations.
2. Put into practice requirements under Board Policy section 3.33, which requires Members to disclose their employment, union affiliations, and any other organizational or association affiliations to the Executive Director annually via the nonfinancial conflict of interest form. The Executive Director must make the information available at the next Board meeting.
3. In addition to monitoring conflicts of interest on an annual basis as required by Board Policy, the Board should establish a method of monitoring conflicts of interest that arise throughout the year to ensure they are addressed timely.
4. Provide Standards of Conduct training to Board Members on an annual basis and stress the importance that the annual acknowledgement of the Board Policy and Procedures includes acknowledgement of adherence to the Standard of Conduct.
5. Lastly, the Board should consider tasking the Rules and Administration Committee with enforcing the PERA Standard of Conduct during Board and committee meetings as well as during interactions with PERA Membership and the general public. The Committee would also be responsible for monitoring Board member compliance with the Standard of Conduct and reporting on exceptions on a periodic basis.

Management Response: Management agrees that the development of a nonfinancial conflict of interest form could assist Board Members to accurately disclose potential or perceived conflicts of interest. Management will work with the Board at their request to provide educational opportunities focused on disclosure of commercial, economic or employment relationships, as well as personal or employment affiliations, to identify any actual or perceived conflicts and will work with Board leadership and Board Fiduciary Counsel to develop an annual curriculum for such training. Once the Board adopts a process for monitoring, reviewing and reporting conflicts of interest, management will assist the Board to facilitate compliance as needed. Management believes a Governance Committee could provide appropriate oversight for monitoring conflicts of interest.

Board Response: The Board agrees enhancements can be made to the nonfinancial conflict of interest policy and will work with management to implement a process to disclose nonfinancial conflicts of interest to ensure a robust and transparent process is created. In addition, the Board will task the oversight committee developed in Observation 1 with ensuring compliance with Standards of Conduct policies for all board members. This will be completed by the end of FY 2021.

3) Annual Evaluation of the Board

Board Policy Section 2.00 Board's Role and Duties subsection 2.19 requires the Board to evaluate their performance annually at the retreat and take any steps necessary to improve Board operations. Our testing determined the Board has never conducted a self-evaluation.

Potential Risk: High—Self-evaluation plays a critical role in assessing the effectiveness of the Board. The absence of this activity enhances the risk that the Board is not considering possible areas of improvement.

Recommendations: PERA should implement a process to conduct a formalized self-evaluation annually to ensure compliance with Board policy section 2.00. This should be performed at the Board retreat and all Board Members should be required to participate to ensure all voices are heard. Consider identifying a facilitator for this process to help make this evaluation effective and helpful for PERA.

Board Response: The Board agrees an evaluation needs to take place and will conduct one by the end of FY 2021.

Observations Relating to Reporting and Administration

4) Meeting Agendas and Materials

Board Policy Section 2.84 states, "To the extent practicable, the agenda and related materials for Board and standing Committee regular meetings shall generally be distributed to the Board and/or Committee Members at least 7 calendar days in advance of the meeting." Board Members may continue to add agenda items up to 72 hours prior to the meeting and additional materials are added to the Board Portal as necessary. During our testwork, we determined:

- For three of 6 board meetings tested, the agenda was not uploaded to the Board Portal at least 7 calendar days prior to the board meeting. Variances ranged 4 to 6 days prior to the meeting.
- For five of 6 board meetings tested, the initial meeting materials were not posted at least 7 calendar days prior to the board meeting. Variances ranged from 3 to 6 days prior to the meeting.

In addition, during our review of board meeting audio, it was observed that there were several instances where approval of the agenda took a significant amount of time and discussion as there were agenda items that needed to be either removed or moved off the consent agenda.

Potential Risk: Moderate—If Board Members do not receive adequate time to review meeting materials and agendas, members might not have the necessary information to make decisions that align with PERA's mission.

Recommendations: PERA should implement a process to ensure Board member initial materials are uploaded at least 7 days prior to the meeting date to ensure Board Members have adequate time to review materials, develop questions and prepare discussion items, if necessary. PERA Board Members and staff should re-evaluate the decision making process to determine if improvements can be made to enhance communications prior to decisions being made. This would ensure Board Members have all necessary and relevant information to be able to make an informed decision regarding an issue. Alternatively, consider revising the information included

in the Board packet to better align with the timeline in place to allow adequate review of materials. Lastly, the Board Chair, with collaboration from management, should consider revising the agenda process.

Management Response: Management attempts to the extent practicable to post Board and Committee agendas and materials seven calendar days prior to all meetings. Management notes that the way the Board Portal works, even if all materials are posted seven calendar days in advance, any subsequent change to posted items, regardless of how minor, replaces the posting “footprint” date and will make it appear as if agendas and materials were posted outside of the seven day window. Management notes that all Board Effects users receive an email each time something is added to the Portal. Management will work on improving communication and efficiency of receiving materials and approval of agendas from Board and Committee Chairs.

Board Response: The board will review the process to compile agenda items and related materials to determine if improvements can be made in order to ensure adequate review of materials in advance of a Board meeting. We will complete this by end of FY 2021.

5) Annual Evaluation of the Executive Director

Board Policy section 2.13 states, “The Board shall evaluate the Executive Director at least annually.” and Board Policy section 10.31 states “The Executive Director shall be formally evaluated by the Board in closed session at least once a year, following the close of the fiscal year.” Our testing determined the evaluation did not occur for FY 2019.

Potential Risk: Moderate—Evaluation of Executive Director performance plays a critical role in assessing the current status of the agency. The absence of this activity enhances the risk that the Board is not considering possible opportunities for growth nor celebrating achievements for the Executive Director.

Recommendations: The Board should implement a process to ensure the Executive Director evaluation is performed annually and any action items developed during the evaluation should be regularly monitored. Consider conducting a 360 evaluation process that incorporates feedback from all levels of the organization.

Board Response: The Board agrees an evaluation needs to take place and will conduct one by the end of FY 2021.

6) Gift Reporting

Board Policy section 3.53 requires that at least semi-annually, Board Members, the Executive Director, and Executive Staff disclose anything of value received in their capacity as a PERA Board Member via the PERA Gift Reporting Form. The form is required to be completed even if no gifts were received. The reports shall be filed in the Executive Director’s Office with the Executive Director’s Executive Assistant immediately following the six-month period covered by the report. Board Members may file reports more frequently than semi-annually. Our testing determined:

- Two of 12 Board Members did not complete the January 2019 through June 2019 Gift Reporting Form until January 2020.

- One of 12 Board Members began their term in May 2019 however, a Gift Reporting Form was not completed for the January 2019 through June 2019 period.
- One of 12 Board Members tested ended their term in December 2019, however a Gift Reporting Form was not completed by the Board member for the six month period July 2019 through December 2019.

In addition, our testing determined there is no review in place by management or the Board to determine if any gifts received violated Board policy or state statute.

Potential Risk: Moderate—The perception that Board Members are not being transparent in their reporting of gifts received from vendors can negatively impact the public's and PERA member's trust in the Board. As with other compliance areas, failure to adhere to statutory requirements by the Board may impair the Board's ability to enforce other policies.

Recommendations: PERA should implement an independent review of Gift Reporting Forms for compliance purposes by designating an appropriate individual from management to review and sign off on the forms to ensure any potential issues are addressed. Additionally, this will aid in ensuring the statutory reporting requirements are met. In addition, Board Policy section 3.53 (B)(ii) states that reporting "shall be filed immediately following the six month period covered by the report." We recommend the Board policies be updated to better define the timing of when reports are to be filed so the deadline is clear.

Management Response: Management agrees that an independent review of gift reporting complies with best practices and attempts to assist Board Members to comply with reporting requirements. PERA contractually requires external professional service providers to report gifts to Board Members and staff. Management will begin reporting to the Board at a regular meeting on a bi-annual basis on the Board and staff compliance with gift reporting requirements. Management believes a Governance Committee could be best suited to receive gift reporting reports and perform oversight of this compliance function.

Board Response: The Board agrees with this observation and will add an informational agenda item to inform Board Members who have yet to submit their Gift Reporting Forms that they are due. This will take place beginning in FY 2021.

7) External Education Reporting

In accordance with Board Policy Section 7.110 Report on Travel, "Each Board member shall verbally report to the Board on any event requiring travel outside of New Mexico for which PERA has paid within sixty (60) days after travel has been completed. Such verbal report shall be made on the record at a regular Board meeting." Our review of Board meeting audio minutes determined:

- During the June 2019 meeting, five Board Members were on the agenda to report on education travel however, three were absent (excused) and did not give their report at the June meeting or the subsequent July meeting.

- During the December 2019 meeting, five Board Members were on the agenda to report on education travel however, three were absent (excused) and did not give their report at the December meeting or the subsequent January meeting. One member left the meeting due to disagreements and did not report on their travel at either the December or January meeting. The final member presented their travel in accordance with policy.

Potential Risk: Low—It is critical for Board Members to share the information received at various trainings to ensure all Board Members benefit from the information obtained and to determine if the conference is worthwhile for other Board Members to attend. The absence of this reporting increases the risk that Board Members are attending conferences that may not be enhancing the knowledge base for the PERA Board as a whole.

Recommendations: PERA should implement a process to ensure Board Members are reporting on out of state education travel within the 60 day requirement. Alternatively, since the Board meetings are typically full, PERA should consider implementing a questionnaire that Board Members can fill out prior to the meeting which can then be included into the board packet and reviewed by all board members for informational purposes only.

Management Response: Management suggests that when in person reports are not practical within existing deadlines, Board Members be allowed to provide a written report for the record. This alternative will require modification to current Board Policies and Procedures. Additionally, management will provide a quarterly report to the Board at a regular meeting on all Board travel and the costs associated with the travel.

Board Response: The Board agrees with this observation and will update the Board procedures to convert external education reporting to a written process which will be included in the Board packet. These changes will take place during FY 2021.

8) Education Affidavits

According to NMAC 2.80.200.21, each Board member shall annually certify his or her compliance with the statutory requirements of NMSA 1978, section 10-11-133(F) via an Education Affidavit on or before December 31st of each calendar year. Our testwork determined:

- Eight out of 12 Board Members did not certify compliance with statutory requirements of Section 10-11-133(F) NMSA 1978 via the Education Affidavit until after December 31, 2019. Variances ranged one to two months after year-end;
- Two out of 12 Board Members submitted but did not sign and date their Education Affidavit for calendar year 2019, violating PERA Rule 2.80.200.21B which requires Board member to certify education annually;
- One out of 12 Board Members did not submit their Education Affidavit for 2019.

Potential Risk: Low—If an adequate process is not in place to ensure Board Members certify mandatory education requirements by the deadline according to state statute, PERA may continue to be in noncompliance with statute requirements on education certification however, since they are completing the forms, just not submitted them timely, this reduces the risk to low.

Recommendations: PERA should implement a process to ensure all Education Affidavits are certified prior to the December 31 deadline. An internal review should be performed on each

form submitted to ensure Board Members are receiving the required amount of education to ensure compliance with training requirements.

Management Response: Management will provide monthly reminders during the 4th quarter of the calendar year to track Board Member compliance with statutory educational requirements. Management will report to the Board annually at a regular Board meeting on the status of completed education affidavits.

Board Response: The Board agrees with this observation and will add an informational agenda item to inform Board Members who have yet to submit their Education Affidavits that they are due. This will take place beginning in FY 2021.

PROCESS IMPROVEMENT RECOMMENDATIONS

9) Board Education Costs

During our testwork over Board education costs, we determined PERA is tracking board education costs on a fiscal year basis to align with the agency's budget process. However, externally provided trainings are tracked on a calendar year basis to conform with statutory requirements of certified compliance on or before December 31, 2019, in accordance with 2.80.200.21 NMAC. The Board should consider updating the policies and procedures to align with the NMAC code section of tracking education costs on a calendar basis.

In addition, Board Policy section 7.12 states, "if adequate funding is provided, a Board Member may attend one (1) and ideally two (2) relevant educational conferences or seminars every fiscal year." Our testing determined two instances where a Board Member attended three conferences during the fiscal year. We recommend the Board consider a per person budget that aligns with the requirements of Board Policy as opposed to an overall budget for the Board to ensure all Board Members have the opportunity to attend trainings if desired. Additionally, we recommend the Board consider presenting total travel costs per board member throughout the fiscal year to determine if Board members education travel requests are reasonable, compliant with Board Policy, and do not exceed budget.

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This report is intended for the information and use of the PERA management, the audit committee, Members of PERA's Board and others within the organization.

REDW LLC

Albuquerque, New Mexico
July 22, 2020