NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

BOARD MEETING

April 27, 2017

This meeting of the Public Employees Retirement Board was called to order by Dan Mayfield, Chair, at approximately 10:10 a.m. on the above-cited date at the PERA Building, 33 Plaza la Prensa, Senator Fabian Chavez, Jr. Board Room, Santa Fe, New Mexico.

2. Roll Call

Roll call established a quorum with the following members present:

Members Present:
Dan Mayfield, Chair – Retiree
Claudia Armijo - State
Dan Esquibel - Municipal
Patricia French – Municipal
Jackie Kohlasch - State
John Melia - Municipal
Loretta Naranjo Lopez – Retiree
John Reynolds – State
Maggie Toulouse Oliver - *Ex-officio*
Cathy Townes - State

Member(s) Absent:
Tim Eichenberg - *Ex-officio*
James Maxon – County [excused]

Staff Members Present:
Wayne Propst, Executive Director
Susan Pittard, Chief of Staff/General Counsel
Greg Trujillo, Deputy Director
Jude Pérez, Interim CIO
Karen Risku, Deputy General Counsel
Renada Peery-Galon, ASD Director
Misty Braswell, Assistant General Counsel
Dana David, Assistant General Counsel
Joaquin Lujan, Director of Rates and Credit
Trish Winter, Executive Assistant
LeAnne Larrañaga-Ruffy, Director of Equity
Karyn Lujan, Deferred Compensation Plan Manager
Kristin Varela, Portfolio Manager of Real Returns
Christine Ortega, Portfolio Manager
Mark Montoya, Investments Division
Anna Murphy, Compliance Officer
Isaac Olaoye, Financial Analyst

Others Present:
John Garrett, Cavanaugh Macdonald Consulting

Jonathan Craven, Cavanaugh Macdonald Consulting
Thomas Toth, Wilshire
Mike Krems, TorreyCove
Jeffrey Goldberger, TorreyCove
James Walsh, Albourne
Andrew Hayward, Albourne
Lisa Needle, Albourne
Anne Hanika-Ortiz, LFC

3. **Approval of Agenda**

Ms. Toulouse-Oliver introduced the following motion:

"RESOLVED, that the PERA Board approve the agenda."

Mr. Reynolds seconded and the motion passed by unanimous voice vote.

4. **Approval of Consent Agenda**
[*Exhibit 1*: *Consent Agenda*]

Ms. French requested that Investment items 1.a. (*Recommendation to commit up to €100 million to CVC Capital Partners VII, LP*) and 1.b. (*Recommendation to commit up to $75 million to Altaris Health Partners IV, LP and Altaris Constellation Partners IV, LP*) be removed from the consent agenda.

Explaining her vote against the commitment to CVC, Ms. Naranjo Lopez first complimented TorreyCove for their report and continued to state that she was not satisfied with CVC's handling of a lawsuit initiated by a woman working at the firm. The firm's current organizational chart does not reveal any change in their policies. Further, she felt the manager should be present.

Ms. Toulouse Oliver recommended that any dialogue regarding the investment items be heard during that discussion and she introduced the following motion:

"RESOLVED, that the PERA Board approve the consent agenda less the two investment items listed above."

Mr. Reynolds seconded and the motion passed without opposition.

Consent Agenda

1. **Investments: Alternative asset recommendations for approval, to be funded according to the cash plan and subject to legal review by the General Counsel:**
   a. **Recommendation to commit up to €100 million to CVC Capital Partners VII, LP**

Explaining why she asked to have the two investment items removed from the consent agenda, Ms. French said the Board members took an oath to protect the fund and the membership. She identified protection of PERA's investments as the Board's most important goal and said including investment commitment actions as a consent agenda item was not adequate. She was not expressing a disagreement with the investment recommendation rather the manner in which they are presented to the Board. The action regarding investments should be within the Board's official minutes, she stated.

Ms. Naranjo Lopez said she voted against the investment because a female employee at CVC initiated a lawsuit alleging she was not treated equally. CVC's organizational chart is all men and she wanted the manager present. "The Board is liable regarding its actions," she stated.

Mr. Reynolds said he appreciated Ms. Naranjo Lopez bringing up the equality issue at CVC. He too commended TorreyCove for their transparency regarding the issue.

Mr. Reynolds said he disagreed that managers needed to be present and that including the items on the consent agenda was appropriate. He pointed out that €100 million investment is less than 1 percent of PERA's $14.9 billion fund. He said he supports Investment Chair Melia's approach regarding managers.

Ms. French said what percentage the investment is to the fund did not matter because the Board's value statement addresses inclusiveness, "It is our responsibility as a Board to make those decisions." She said her issue is that the Board was not included in the decision to not have managers present.

Ms. Naranjo Lopez said a Board member could be liable in civil actions for gross negligence or willful misconduct or actions not taken in good faith.

Chair Mayfield reminded the Board members that they always have the opportunity to vote down an investment recommendation. It was his recollection that the managers present boilerplate information and sales brochure fluff when appearing before the Board. Staff and the consultants provide the Board with information necessary to make an informed decision.

Ms. French pointed out that PERA does not pay the managers to appear and the Board members took an oath to protect the fund. Not having the opportunity to speak to the managers hinders her ability to fulfill that oath.

Ms. Naranjo Lopez agreed and pointed out that the Board members receive education at the trainings/conferences they attend to help them make smart, informed decisions.

Mr. Melia said staff and the consultants spend a great deal of time conducting due diligence on these firms and any unanswered questions can easily be forwarded to the manager. He said he felt confident with his decision.

Mr. Esquibel opined that the concern appears to be whether Investments Committee

Chair Melia has over extended his authority in dictating what the Board can and cannot see. Commenting that the Board members represent many PERA members and if a Board member wants to see the manager then that should be afforded.

Speaking as a regulatory analyst, Ms. Townes said she was able to discern fluff and would appreciate the opportunity to speak directly to the investment manager.

Without discrediting the importance of the current discussion, Ms. Toulouse Oliver suggested that in order to make the PERA Board meetings more productive the Board should move on with the business as outlined on the agenda. She said the procedural and governance issues can be addressed under other business and that may facilitate a more structured and productive meeting.

Ms. Toulouse Oliver introduced the following motion:

"RESOLVED, that the PERA Board commit up to €100 million to CVC Capital Partners VII, LP according to the cash plan and subject to General Counsel review."

Mr. Reynolds seconded and the motion passed by majority [9-1] voice vote with Ms. Naranjo Lopez voting against.

b. Recommendation to commit up to $75 million to Altaris Health Partners IV, LP, and Altaris Constellation Partners IV, LP

Ms. Toulouse Oliver introduced the following motion:

"RESOLVED, that the PERA Board commit up to $75 million to Altaris Health Partners IV, LP, and Altaris Constellation Partners IV, LP."

Mr. Reynolds seconded and the motion passed by unanimous voice vote.

4. Current Business

A. Liabilities and Long Term Solvency Education Session: Part 1

Jonathan Craven, Cavanaugh Macdonald, reviewed basic actuarial principles and highlighted the funding equation C (contributions) + I (investment income) = B (benefit payments) +E (expenses. Which is inflow of employee contributions, employer contributions and investment income equals outflow, which is benefit payments and expenses. Actuaries have assumptions that when one joins a defined benefit plan that individual is going to exit by either quitting, dying, becoming disabled or retiring and a retiree is eventually going to exit by dying. Actuaries have assumptions as to how often each of those happens based on the population of retirees and actives through valuation programs. Currently, PERA is paying out just over $1 billion annually to retirees and he explained how a discount rate is used to determine what will be paid in the future. He reviewed actuarial funding definitions, purpose of valuations and what the valuations measure.

John Garrett, Cavanaugh Macdonald, confirmed that the actuaries periodically review the assumed rate of return and last summer the PERA Board reduced that assumption. He said the assumed rate of return can be revisited as often as the Board desires.

Currently PERA has a gap or an unfunded liability – the difference between the actuarial accrued liability and the actuarial value of assets – of $4.8 billion. The target in 2043 appears to be 77 percent, not much above where it is now, stated Mr. Craven. In 2007 the fund was 100 percent funded and the actuaries reviewed what occurred to make the plan's funding currently at 75 percent. On a market value basis the fund went from 101 percent funded to 59 percent in 2009. That was a tremendous loss.

Mr. Garrett pointed out that the assumption in 2008 was an earning's assumption of 8 percent and the following the drop, PERA was 32 percent down from where they needed to be. That loss was the basis for SB 27, stated Mr. Craven. Liabilities continue regardless of the market loss but the severity of the loss required the adjustments addressed within SB 27. Mr. Garrett said the funding status graph from 2002 through 2016 is basically the same for all the plans they work for.

Mr. Craven said they looked at the components of what happened between 2002 and 2016. The components were changes in benefits, changes in assumptions, assets and other gains and losses.

Mr. Garrett pointed out that modern pension funding is exposed to market volatility. He reviewed the impact of SB 27 on the normal cost and said there has been a modest decrease in the normal cost in the five divisions. The new tier will not change the course of the normal costs. The cash flow output projections are fairly stable. Based on the 6/2016 market value and without any inflow (investments and contributions) the current assets will last about 10 years. Including the contributions adds six years.

State General and Municipal Fire both have shortfalls because they lack the appropriate inflows to keep the funded status healthy compared to the benefit payouts. State General would require an additional 7.99 percent of salary and Municipal Fire 13.87 percent of salary to correct the shortfall.

Mr. Garrett said 50 years ago pension plans did not have 60 percent/70 percent equity allocations and today almost every plan in the country has over 50 percent allocation to equity and most have a standard deviation of expected returns of 11 percent to 13 percent. It should be expected when the investment return is as high as 18 percent and as low as negative 5 percent and PERA's returns since 2009 are within that range.

Referring to the volatility of rate of returns from investments, Mr. Garrett said with a 7.25 percent expected rate of return – which is below most of the plans in the country – if a pattern of return is reviewed and over a 10-year period of time earned 7.32 percent, he illustrated that it is not merely the size of the return but the order in which the returns are earned. Everything in the investment side will cause a fluctuation in the expected funded ratio in the evaluations on a closed group and projected out in future years.

Ms. Townes pointed out that those under the State plan are operating under a pay freeze and the potential of furloughs. Mr. Garrett said freezing pay means the expected benefit for those people is reduced causing a plan gain. However, typically the freeze is followed with a catch-up and the net effect long term is negligible. Payroll is the engine that contributions are driven from so it could be net negative to PERA.

Mr. Garrett discussed the ultimate trend in benefit growth that will occur in 30 to 40 years; it is typically considered to match payroll growth. With a sustainable plan that can handle a negative 4 percent cash flow, the assets will need to grow at the same pattern that the benefits are growing. If the assumption is a 2.2 percent payroll growth and assets are growing at 7.75 percent, then there is a maximum of 5.55 percent of cash flow that can be used for the current benefits.

Using a software program, the actuaries were able to demonstrate through a series of cash flow scenarios its effects on the fund ratio. It would take roughly 8 percent of payroll to get State General 100 percent funded in 30 years and for Municipal Fire it would be 13.7 percent of payroll. The model allowed for a review of investment return patterns over a 10-year period of time.

Typically in general employee plans the contribution is approximately 7 percent and police and fire put in 10 percent to 12 percent. He noted that PERA's plans provide far more benefits than a typical general employee and Municipal Fire plans.

Executive Director Propst pointed out that the State continues to pay its statutory contribution of 16.99 percent.

Mr. Garrett said the normal cost is a small part of the problem where $19 billion is for service already performed. He said a hybrid plan or a DC type plan may be something to look at although New Mexico has always had a fantastic defined benefit plan.

Mr. Garrett said public safety plans cost more because of disability benefits. Firefighter plans are more expensive than police plans because of the low turnover rate within firefighting. A higher percentage of firefighters get benefits paid after vesting than before and are typically the most expensive plans after judges' plans throughout the country.

Ms. French recalled the education piece that PERA produced in the form of a dollar bill that showed where the funds came from with 77 percent coming from investments.

C. Executive Director's Report

In addition to his report within the Board packet, Mr. Propst provided the following information:

- Staff will be undertaking a strategic planning exercise starting June 8th
- The CIO search closes tomorrow and there were approximately 50 applicants
- The Board retreat is scheduled to begin on Tuesday, June 27th at 1 p.m. He said the retreat agenda was being developed
- There were eight responders to the Board fiduciary counsel RFI. The responders will make presentations at the May Rules & Administration Committee for a recommendation to the full Board

5. <u>Other Business</u>

Ms. French returned to the issue of investment managers attending IC and the Board meetings. Addressing her comment to Chair Mayfield, Ms. French asked how he planned to address the four Board members who, to fulfill their oath and fiduciary responsibilities, want to talk to investment managers and reminded him there is no cost to PERA for their attendance.

Prefacing his response that this is an interesting topic, Chair Mayfield said PERA spends a great deal of money hiring consultants and exemplary staff to research and prepare investment recommendations. He suggested a compromise where the manager can be present via Skype or deferring approval subject to a presentation when necessary.

Interim CIO Pérez said staff was prepared to support whatever the Board desires in this matter. He expressed concern about the Board's liability if they were to base an investment decision on an investment manager's sales pitch.

Chair Mayfield said Board members have expressed concern in the past about the length of time the meetings take and while he supports the meetings taking as long as is necessary he is also sensitive to the time issue for working Board members. He said the issue merits further discussion.

Ms. French said for her to make the best decision she needs to have the opportunity to talk to the managers and she requested that the Chair make a yes or no decision.

Chair Mayfield said he was prepared to allow the investment managers to attend but mentioned that PERA is paying out over $1 million in fees to consultants and salaries for those people to serve as PERA's experts. He said there may be a way to improve on the current method and he was prepared to discuss this issue again perhaps at the retreat during the team building exercise.

6. <u>Adjournment</u>

Having completed the agenda, Vice Chair Maxon declared this meeting adjourned at 12:30 p.m.

Approved by:

Dan Mayfield
Chair, PERA Board

ATTEST:

Wayne Propst, Executive Director

Attached Exhibits:
Exhibit 1: Consent Agenda