# NEW MEXICO

# PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

# BOARD MEETING

# November 30, 2017

This monthly meeting of the Public Employees Retirement Board was called to order by Dan Mayfield, Chair, at approximately 9:05 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.

## 1. Roll Call

Roll call preceded the Pledge of Allegiance and a quorum was established with the following members present:

**Members Present:**
Dan Mayfield, Chair - Retiree
Claudia Armijo - State
Tim Eichenberg - *Ex-officio*
Dan Esquibel - Municipal
Patricia French - Municipal
Jackie Kohlasch - State
James Maxon - County
John Melia - Municipal
Loretta Naranjo Lopez - Retiree
John Reynolds - State
Cathy Townes - State

**Member(s) Absent:**
Maggie Toulouse Oliver - *Ex-officio*

**Staff Members Present:**
Wayne Propst, Executive Director
Susan Pittard, Chief of Staff/General Counsel
Greg Trujillo, Deputy Director
Karen Risku, Deputy General Counsel
Dominic Garcia, CIO
Renada Peery-Galon, ASD Director
Anna Williams, CFO
Jude Pérez, Deputy CIO
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
Emily Lopez, Financial Specialist
Christine Ortega, Portfolio Manager
Anna Murphy, Compliance Officer
Mark Montoya, Investment Analyst

**Others Present:**
Jeremy Vaughan, New Mexico State Police
Anna Hanika-Ortiz, LFC
Paul Lium, Nationwide
Mike Krems, Torrey Cove
Jim Broder, AFSCME Retiree
Don Wencewicz, AFSCME
John Doran, AFSCME
Harvey Leiderman, Contract Board Fiduciary Counsel

Ms. Kohlasch was congratulated on receiving her Ph.D.

## 2. Approval of Agenda

Mr. Reynolds introduced the following motion:

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

Mr. Maxon seconded and the motion passed by unanimous voice vote. [Ms. French and Ms. Townes were not present for this action.]

## 3. Approval of Consent Agenda

[*Exhibit 1*: *Consent Agenda*]

Mr. Maxon introduced the following motion:

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

Ms. Reynolds seconded and the motion to approve the consent agenda passed without opposition. [Ms. French and Ms. Townes were not present for this action and arrived shortly thereafter.]

## 4. Current Business

### A. Acceptance of Board, Staff and Consultant Investment Roles and Responsibilities

Dominic Garcia, Chief Investment Officer, thanked Ms. Naranjo Lopez for calling his attention to an article in the *Albuquerque Journal* regarding how PERA's strategic asset allocation model is working. Stating "we are all on the same page." Further noted this is the conversation we should be having- how our model is working. Mr. Garcia outlined PERA's strategic goals. The first is to maintain an appropriate asset allocation that can meet actuarial hurdles, namely 7.25 percent now, moving to 7.75 percent. The second goal is the need to meet the ten-year annualized return policy benchmark. PERA must build its portfolio with those goals in mind.

Mr. Garcia used a graph to demonstrate the 7.75 percent long-term assumption curve vis-à-vis the policy portfolio, a reference portfolio and the active management curve, pointing out the goal is to flip those lines. The current economic and market forecasts project a 6.5 percent return with 10.8 percent risk. This leaves a strategic gap of 1.25 percent, to reach the Board's adopted 7.25% target now, moving to 7.75%, which is the big challenge. He noted that the new investing environment has low returns as compared to the time before 2008 when "assets did all the work" and a simple portfolio would have met the portfolio's goals. A new, more robust model is required for the low-return environment.

Mr. Garcia discussed three potential ways to close the strategic gap. First, he discussed the simple Vanguard/Bogle approach, which at the same level of risk of the current portfolio actually increases the gap and is a step back. Another approach would be to "go all in" and take more risk with 70 percent equity, whereas the portfolio is now at 43 percent. The third path, is the enhanced model with better risk balance and efficiency and embracing well calculated active management. This strategy diversifies risk, can bridge the gap, but it is complex to execute and communicate.

Mr. Garcia advocated building a bridge from the current 6.5 percent to 7.75 percent. A more disciplined approach with greater accountability could help provide the needed bridge.

Acting differently, Mr. Garcia explained, means demanding more from staff, behaving more like a business, and working as a well-oiled machine. Everything starts at the top and flows down. Following industry best practices, the Board's role would be strategic and staff's role implementation.

Mr. Garcia highlighted three clear goals: working together and making sure everyone is going in the same strategic direction; building a better framework for staff and consultants; and monitor results to ensure accountability. The suggested changes imply new responsibilities. The Board sets policy, risk and return goals. The Investment Committee must vet and do oversight on a risk budget, establish clear benchmarks and measure the value added, as well as responsibility for adopting an annual work plan and overseeing consultants.

Staff's responsibility is to implement active management, selecting managers, monitoring and overseeing consultants, and recommending the annual work plan. Additionally, the role of the consultants should be clear.

Mr. Garcia stated that the recommended changes are made in consultation with fiduciary counsel and industry best practices.

Mr. Esquibel asked if the implication was that they have not been working as a team and have been undisciplined. Mr. Garcia said no, but staff is looking to improve execution and efficiencies.

In response to a question from Mr. Esquibel, Tom Toth of Wilshire said they are currently analyzing on a benchmark-relative basis. Mr. Garcia highlighted the need for a stronger framework for managing different types of risk. Mr. Garcia added that this strategy should help bring a bigger bang for the active management buck.

Mr. Esquibel asked about functions and steps. Mr. Garcia said it starts with goals and expectations. Then the parameters of risk have to be determined. Targets and risk budgets would be set in February, then results analyzed quarterly vis-à-vis the goal. Much depends on whether the investment vehicle is public or private. Capital is drawn as opportunities arise. Staff does the due diligence, a recommendation made at the staff level and all investment activity is reported to the Investment Committee. The difference from the previous process is that the final investment-level approval is done by the CIO.

Mr. Melia quoted from the aforementioned newspaper article, which advocates not trying to beat the market with hedge funds, etc. and instead reduce costs, as a step back. According to former PERA CIO Grabel, the fees were already low and 60 percent of the fund was passive. Mr. Melia agreed that passive management would not attain the goal, but too much risk was unacceptable if it were to lead to lowering discount rate and reducing benefits. He mentioned the Nevada plan in comparison with other plans' exposure to alternative investments. Nevada's exposure is now 10 percent. In speaking with the Board Chair of NM ERB, ERB's success was attributable to a great CIO who was given appropriate authority to manage investments as an expert while the ERB Board focuses on its role.

Ms. Kohlasch asked if Board members would no longer participate in RFPs, and how would that affect the Board's fiduciary responsibilities.

Fiduciary Counsel Leiderman said fiduciary responsibilities can't be viewed in a vacuum. There is no requirement for Board members to visit potential managers, for instance, as long as the vetting process is exhaustive and there is future monitoring. Due to unforgiving market complexities there is little margin for error requiring a high level of expertise and accountability. A Board meeting a few hours a month is not enough to have a meaningful impact on manager due diligence and manager selection.

Mr. Leiderman said risk budgeting as an aspect of asset allocation will be a new and significant responsibility for the Board.

In response to Ms. Kohlasch question regarding the old investment policy, Mr. Garcia said, "Nothing goes away; this is an addition."

General Counsel Susan Pittard explained that the action item on today's agenda is a fundamental change in how the Investment Committee operates. It will be a two-step process. Mr. Garcia stated that if the Board agrees, the changes will be written into the Investment Policy Statement (IPS). Ms. Pittard said the Board would vote on the new IPS and governance policy which will be reviewed by Mr. Leiderman. The Board can always make changes.

Ms. French asked if these changes were following the Wisconsin model. Mr. Garcia said it follows best practices. Ms. French asked if staff was to have more responsibility, would they be compensated accordingly?

Mr. Garcia said the compensation structure is currently mandated by the State and wouldn't change. However, some classified positions could be changed to exempt, which allows greater compensation flexibility.

Pointing out that the current goals in asset allocation have yet to be met, Ms. French asked how he would be more aggressive in achieving that. Mr. Garcia said staff will immediately work to create a plan through asset allocation and active management.

Ms. Kohlasch opined that such a big contemplated change needed more time for consideration. Mr. Garcia said this is about how we will choose to work going forward.

Ms. Townes said she'd like to see clear segregation of duties and more focused expertise, along with the Board liability being minimized. She noted that Ohio has suspended COLA payments, and with a sound strategic plan in New Mexico that can be avoided.

Mr. Melia indicated that meeting once a month slows the process down and acts against timely implementation. Change is needed if PERA wants to improve its standing in the peer rankings.

Mr. Esquibel agreed that change was necessary but said this is a lot to digest in a short time. He said he would like to understand the full scope of the proposed change.

Ms. Naranjo Lopez asked how the process began, how fiduciary counsel was involved in its formulation, and why it was deemed best. Mr. Garcia stated the process began before he was hired and was spoken of at the August workshop. Mr. Leiderman has worked collaboratively with staff. Ms. Naranjo asked to hear the positives of the status quo. She felt they were moving too fast for such a big change.

Mr. Leiderman said he gave a presentation on investment policies and processes last summer and it was his understanding the Board wanted a list of items for Board consideration with a proposed timeframe of issues dealing with ethics, governance, etc. He outlined a work plan beginning with different approaches to investing as part of his first presentation. He said it wasn't a matter of presenting sides but rather outlining what's working and what's not. The focus should be on inefficient management – fiduciary triage.

He compared risk to the push-me pull-you character; some is sought and some is avoided. He reiterated the volatility of the market leaves little margin for error.

Ms. Naranjo Lopez noted her belief that the majority of plans follow their old method and she was offended that this was an action item at this time. She said this is not a business and they weren't trying to get rich. She speculated they were handing over their fiduciary responsibilities. She quoted passages from a Trustee handbook referring to periodic meetings with managers. She said it behooved them all to slow down in order to make a sound decision.

Mr. Melia asked Mr. Toth and Mr. Leiderman if they supported the recommended changes and both said "yes".

Mr. Melia introduced the following motion:

**"RESOLVED, that the PERA Board adopt the Board, staff and consultant investment roles and responsibilities"**

Ms. Armijo seconded.

Mr. Eichenberg asked how many employees would be moved to exempt status. Mr.

Garcia said he contemplated moving four.

ASD Director Peery-Galon said staffing changes would be done in phases with three done in the first year at a cost of $130,000. Director Propst said a case could be made that PERA lags SIC and ERB for investment staff salary ranges. Approval to bring PERA staff into parity with SIC ante ERB has to be sought from the Department of Finance and Administration, but doing so has been a priority for some time.

Mr. Esquibel indicated the members want a stable and healthy fund and reasonable benefits. Additionally, future employees want to be able to rely on the same benefits. He said he trusted staff's professionalism and with flexibility they can grow the fund.

Ms. French noted the problem is not staff classification but asset allocation.

Ms. Kohlasch said change is necessary to move forward. If this doesn't work it can be reconsidered.

Ms. Armijo asked about accountability, noting classified employees should be accountable as well. Mr. Garcia said with clear objectives and targets, if there is underperformance "we take that risk away."

The motion carried by 9-2 voice vote with Ms. French and Ms. Naranjo Lopez casting the nay votes.

**B. Executive Director's Report**

Mr. Propst referred to his report included in the packet and indicated a presentation will be made before the Revenue Stabilization and Tax Policy Committee on December 11th at 2:00.

**C. Trustee Reports on Board Education Travel**

**1. Cathy Townes – CAPPP II**

Ms. Townes stated the class on strategic planning was timely and educational. She noted plans can always be revisited through the use of triggers. She said the CAPPP training helped her to feel comfortable with her vote on the new roles and responsibilities.

**D. Executive Session**

**1. 2017 Audited Comprehensive Annual Financial Report (Under NMSA 12-6-5)**

Mr. Reynolds moved to meet in Executive Session to discuss the Smart Save 457b Audit Review under NMSA Section 10-15-1. Mr. Maxon seconded and the motion passed by unanimous roll call vote as follows:

| | |
|---|---|
| Dan Mayfield | Yes |
| Claudia Armijo | Yes |
| Patricia French | Not Present |
| Jackie Kohlasch | Yes |

| | |
|---|---|
| Dan Esquibel | Yes |
| John Melia | Yes |
| Loretta Naranjo Lopez | Yes |
| John Reynolds | Yes |
| James Maxon | Yes |
| Tim Eichenberg | Yes |
| Cathy Townes | Yes |
| Maggie Toulouse Oliver | Not Present |

[The Board met in executive session from 11:27 to 11:40.]

Mr. Esquibel moved to return to open session. His motion was seconded by Ms. Kohlasch and passed by roll call vote as follows:

| | |
|---|---|
| Dan Mayfield | Yes |
| Claudia Armijo | Yes |
| Patricia French | Not Present |
| Jackie Kohlasch | Yes |
| Dan Esquibel | Yes |
| John Melia | Yes |
| Loretta Naranjo Lopez | Yes |
| John Reynolds | Yes |
| James Maxon | Yes |
| Tim Eichenberg | Yes |
| Cathy Townes | Yes |
| Maggie Toulouse Oliver | Not Present |

Chair Mayfield stated that only the item as listed on the agenda was discussed in closed session.

## 5. **Other Business**

None was presented.

## 6. **Adjournment**

Having completed the agenda and upon motion by Ms. French and second by Ms. Naranjo Lopez, Chair Mayfield declared this meeting adjourned at 11:42 a.m.

Approved by:

Dan Mayfield
Chair, PERA Board

ATTEST:

Wayne Propst, Executive Director

Attached Exhibits:
*Exhibit 1*: *Consent Agenda*