

March 25, 2014

MEMORANDUM TO THE TRUSTEES

FROM THE PRESIDENT and CHIEF EXECUTIVE OFFICER

**SUBJECT: Selection of Investment Manager for the Authority's
Other Post-Employment Benefits Trust Fund**

SUMMARY

The Trustees are requested to approve the award of a multiyear investment management service contract to replace an expiring agreement for professional investment management services in connection with the Authority's Other Post-Employment Benefits Trust Fund to New Amsterdam Partners, LLC.

BACKGROUND

Section 2879 of the Public Authorities Law and the Authority's Guidelines for Procurement Contracts require the Trustees' approval for procurement contracts involving services to be rendered for a period in excess of one year. Moreover, the Authority's Expenditure Authorization Procedures require the Trustees' approval for the award of personal services contracts in excess of \$1 million if low bidder, or \$500,000 if sole-source or non-low bidder. The terms of the contracts considered herein are for more than one year and therefore, the Trustees' approval is required.

Certain Governmental Accounting Standards Board ("GASB") standards¹ issued in 2004 require governmental employers to account for other post-employment benefit ("OPEB") liabilities on an "accrual" basis (i.e., as the benefits are earned during the working career of the employee) rather than on a "pay-as-you-go" basis, where costs are recorded as the benefits are paid during the employee's retirement years. OPEBs may include medical, prescription drug, dental, vision, life and other long-term care benefits for retirees and eligible beneficiaries. Similar GASB standards for pensions have existed since 1994. The Authority began reporting its OPEB obligations in this manner in 2002.

The GASB rules do not mandate funding of the accrued OPEB obligations, only a recognition of the accrued OPEB liability on the employer's financial statements. If left unfunded, however, the amount of the unfunded liability could significantly impact the employer's overall financial condition and its credit rating with an attendant impact on the cost of debt financing.

¹ These standards include Statement No. 43 – Financial Reporting for Post-employment Benefit Plans Other Than Pension Plans and Statement No.45 – Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions.

After an assessment by Staff, it was determined that the establishment of a separately managed trust fund would be fiscally prudent. Authority staff, with the support of its financial advisor, PFM Advisors (“PFM”) then evaluated various portfolio strategies designed to meet the investment objectives of the Authority. Reviews of different strategies were conducted based on projected assets class returns, correlations and risk tolerances to determine the optimal allocations. The portfolio design considered to be most aligned with the Authority’s overall return objectives and risk tolerances was a diversified approach employing domestic and international equity assets, fixed income assets as well as real estate investment trust asset classes to further enhance diversification.

At their July 31, 2007 meeting, the Trustees (1) approved the creation of the Power Authority of the State of New York Other Post-Employment Benefits Trust (the “Trust”); (2) adopted the Trust Investment Policy Statement; (3) appointed a Trustee Custodian and (4) approved an initial \$225 million funding plan. Subsequently, in October 2011, the Trustees approved an on-going annual funding plan for the OPEB Trust and certain amendments to the Investment Policy Statement clarifying diversification and credit quality standards.

As of December 31, 2013, the market value of assets held in the OPEB Trust Fund totaled \$422 million, of which \$289 million were invested in equities, \$112 million were invested in fixed income securities, and \$21 million were invested in real estate investment trust securities. When compared to the actuarial accrued liability of \$573 million (as of December 31, 2013), this represents a funding level of 74%.

DISCUSSION

On November 6, 2013, the Authority solicited proposals for professional domestic equity small-capitalization investment management services by notice to a number of firms providing such services and advertisement in the *New York State Contract Reporter* in order to determine qualified domestic equity small-capitalization portfolio managers for the OPEB Trust Fund. On or before December 12, 2013, the Authority received a total of 72 proposals.

Authority staff, with the support of PFM, evaluated each proposal taking into consideration quantitative and qualitative factors. From a quantitative standpoint, staff evaluated historical performance, various risk metrics and the schedule of fees. From a qualitative standpoint, firms were evaluated based on team duration and experience, investment style and research capabilities. In evaluating the proposals, 54 different factors are considered to provide a comprehensive overview of a firm’s organizational background, team depth and stability, investment process, fees, and past performances, with weightings of 15%, 20%, 30%, 15% and 20% respectively. Combined, a firm’s team depth and stability, investment process consistency, and past performance make up 70% of the total scoring weight, as replication of past performance is largely contingent on a stable, experienced team implementing a consistent investment process over time. After conducting extensive reviews and analysis of each proposal, a total weighted score combining the quantitative and qualitative factors assessed by PFM was calculated, and examined by the Authority staff for conducting their own independent analysis. The Authority, with the recommendation of PFM, invited five firms on site to give oral presentations. Based on the above factors and oral presentations, New Amsterdam Partners, LLC, a New York State

Woman Owned Business, was identified to be best qualified to manage the domestic equity small-capitalization portion of the OPEB assets for up to \$25 million. The rationale for this selection was based on the firm's concentrated portfolio construction approach supported by a thoughtful combination of quantitative and fundamental models, consistency in its investment philosophy, stability of its core investment team, and a very strong past performance.

The recommended firm will be awarded five-year contract, subject, however, to early termination at any time by the Authority on 60 days' notice.

FISCAL INFORMATION

The fees for the recommended investment manager, which will be paid from OPEB Trust assets, are expected to average approximately 43 basis points per annum (a basis point is equal to 1/100th of 1%, or 0.01%). The fees should equal about \$107,500 for the first year, growing in conjunction with the Fund's growth. Over the course of the recommended five-year term of the investment manage contracts, fees are estimated to total about \$600,000 assuming a normal growth rate in the Fund's Assets.

RECOMMENDATION

The Deputy Treasurer recommends the Trustees' approval of the award of multiyear service contracts to New Amsterdam Partners, LLC.

For the reasons stated, I recommend the approval of the above-requested action by adoption of the resolution below.

Gil C. Quiniones
President and Chief Executive Officer

RESOLUTION

RESOLVED, That pursuant to the Guidelines for Procurement Contracts adopted by the Authority, the award of the multiyear investment management service contract to New Amsterdam Partners, LLC for professional investment management services in connection with the Authority's Other Post-Employment Benefits Trust Fund, as recommended in the foregoing memorandum of the President and Chief Executive Officer, is hereby approved and the execution of such contracts by the Executive Vice President and Chief Financial Officer or the Treasurer, subject to the approval of the form thereof by the Executive Vice President and General Counsel, on behalf of the Authority is approved; and be it further

RESOLVED, That the Chairman, the Vice Chair, the President and Chief Executive Officer, the Chief Operating Officer, the Executive Vice President and Chief Financial Officer and all other officers of the Authority are, and each of them hereby is, authorized on behalf of the Authority to do any and all things and take any and all actions and execute and deliver any and all agreements, certificates and other documents to effectuate the foregoing resolution, subject to the approval of the form thereof by the Executive Vice President and General Counsel.