BOARD OF TRUSTEES
- OF THE -
FIREFIGHTERS' PENSION AND RELIEF FUND
FOR THE CITY OF NEW ORLEANS
2401 Westbend Parkway Suite 3001
New Orleans, La 70114
504-366-8102
504-366-8103 fax

March 2, 2022

Mr. Edward Michael
Inspector General
525 St. Charles Avenue
New Orleans, Louisiana 70130

Re: Firefighters' Pension Governance & Investment Policies Evaluation

Dear Mr. Michael:

Thank you for the opportunity to review the draft report on the evaluation of the New Orleans Firefighters' Pension and Relief Fund's governance and investment policies. We have completed the Management Response Form and will utilize this letter as our supplemental written response. Our comments outlined below provide an opportunity to share additional facts not evident in your report.

Introduction

The most senior tenured Board member of the current Board took office in August 2014. No current Board member or the Fund's consultant is responsible for the underperformance cited in your report. This Board did not make an investment until 2018. The underperformance from 2011 thru 2018 results from a number of factors, a major factor being liquidity. The City's failure to pay the entire Actuarially Required Contribution (ARC) for the years 2009 through 2015 caused the illiquidity, as illustrated in the following chart.

Year	City's Contribution (Per audited reports)	Required Contribution (Per actuarial reports)
2009	$10,187,077	$24,532,819
2010	10,635,430	29,428,359
2011	11,398,565	32,212,794
2012	9,000,000	34,386,640
2013	9,000,000	36,182,434
2014	17,329,381	31,992,610
2015	29,635,220	35,880,883

Because the City failed to pay the ARC, (approximately $130 million), the fund was forced to liquidate all of its stocks and bonds, as well as certain non-liquid assets to make member benefit payments. The investment opportunity lost during the stock market run over the period 2009-2018 makes the nonpayment of the ARC overly costly, resulting in the significant underfunding we presently witness. This underfunding was compounded when the Fund took the extra cooperative step during negotiations with the City, as noted in your report, to agree that "the City's obligations under the ARC judgment were considered fulfilled as long as it continued to pay the ARC for the New System." This meant the City would not be forced to pay past due ARC amounts immediately. Thus, in 2016, the Fund was left over weighted in non-liquid alternative investments (the legacy assets), which compounded the ability to produce positive returns.

Compliance with Agreements and Policies

The Fund has adopted the use of the closed, level-dollar, 30-year amortization for liabilities effective calendar year 2022. While we consider the open amortization method to be the preferable method, we have implemented the change.

We have also complied with the CEA's requirement to conduct an actuarial audit every three to five years. The Fund marks 2017 as the initial year following the CEA agreement. RFP's for actuarial service and consultant services have been issued in late 2021 and will be finalized in 2022, within the five year period as prescribed by the CEA.

We also submit that we have met our requirements with respect to semi-annual reports to the City Council. We disagree that our reports are not public. The annual reports are made public in a separate meeting with the council and the City's (our) auditors. Our budget hearings provide the second opportunity to meet the Council publically. Board members and staff attend both public hearings and are available as needed.

Management of the Fund and Board will meet with the Administration to update the CEA during 2022.

Performance Monitoring and Investment Decision Making

Finding 2:

We disagree with the finding that the Fund did not develop, document, and use meaningful criteria for evaluating the performance of its investment portfolio. The heart of this finding is the Fund's lack of benchmarks on its legacy portfolio. The legacy portfolio, which consists mainly of alternative assets deemed worthless or non-marketable, was not assigned benchmarks, as none exists for worthless, non-marketable securities. The majority of these assets have been fully reserved on the Fund's audited financial statements. Every other investment in the Fund's portfolio is benchmarked and complies with the investment policy.

To clear up this matter the Fund's investment policy will be updated to delineate the goals of benchmarking the active portfolio, while distinguishing the legacy assets that are held but marked for sale or liquidation.

Finding 3:

The goal of the pension fund investment portfolio is to meet the long term assumed rate of return identified for the retirement system. Due to the ongoing evolution of investment markets, a System's investment portfolio will evolve over time and will therefore include varying levels of fixed income, equity, and potentially alternative investments. The pension board is charged with working with the investment consultant to evaluate opportunities in the investment landscape and to then create the most efficient portfolio with the goal of meeting its long term assumed rate of return. In periods of high interest rates, such as the early 1980s, this goal was accomplished through a portfolio heavy in fixed income securities, resulting in a portfolio with a very low level of expected volatility. As interest rates have declined, pension plans have allocated more funds to equities and alternatives, resulting in portfolios with higher expected levels of return. The statement of a defined risk tolerance would indicate a targeted level of "risk", in this case we would assume the OIG means return volatility. If a portfolio is locked into a set volatility metric and cannot evolve, it lessens the portfolio's ability to generate long term performance. We feel the practice of periodically reviewing the portfolio's asset allocation and comparing the trade off in expected return and expected risk due to the inclusion of various asset classes is the prudent way for trustees to manage overall portfolio risk. This practice has been in place and will continue. One thing to point out however, is that due to the size and impact of the legacy, underperforming private assets, the current board was unable to make new portfolio investments between 2013 and 2018, therefore annual reviews of asset allocation and risk tolerance would have been fruitless with no free cash flow to make investments that could alter risk and return. The Fund will review its asset allocation and resulting expected return and risk in the second quarter of 2022 as part of the periodic review process. We have attached our December 31, 2021 performance review packet to support this position.

Alternative investments are not inherently bad and have a place in the asset allocation of the System moving forward, just as they are used successfully in Systems across Louisiana and across the country. In having been invested in alternatives, the trustees have sought to learn from the portfolio's successes and struggles. In response, the Fund has included several updates in its investment policy (IPS) to address the potential negative impact of "risky assets" impacting portfolio returns. The IPS calls for a minimum balance of $2.5 million to make sure liquidity needs are met in the System. This is designed to help avoid forced selling of liquid assets that have occurred in the past due to a mixture of funding and performance issues within the plan. The System has also taken steps to make sure that the types of underperforming assets that impacted the plan – direct company loans and direct real estate investments – cannot be included moving forward by adding language in the IPS under prohibited investments.

Finding 4

Management of the Fund will develop and document clear performance criteria for its investment consultant.

In closing, on behalf of the Board and staff, we appreciated the opportunity to work with the staff assigned this review. We commend their professionalism and effort. The final product is a welcome upgrade from prior OIG audits and reviews, which failed to discuss audit findings, hold exit conferences or allow a review of reports before being released to the public. Your team exhibited the feeling that all of us have the same goal, to put our heads together and make things better.

If you should have any questions or need any additional information, please do not hesitate to contact me.

Best regards,

Paul C. Mitchell, Jr.
Director