MEKETA

Wyoming Legislature
Legislative Service Office

October 30, 2024

Benchmarks and Performance Compensation Operational and Financial Review/Audit- STO

Executive Summary

→ Overall, we find that the performance reporting calculations and practices utilized for quarterly reporting, and the incentive compensation program are accurate, and methodologies fall within industry standards.

→ We provide opinions and recommendations in several areas, primarily regarding benchmarking and incentive compensation at the overall structural level.

→ We received all documents requested from RVK, all requested custodial data, all performance details requested through PARis, full access to the STO Staff as needed, and did not note any deficiencies in the sharing of data.

→ Based on our assessment, we do not find any demonstrated likelihood of ability to manipulate outcomes in the reporting of performance data- with the third party consultant responsible for reporting of performance, as well as recommending benchmarks; we feel this risk is reduced to the lowest possible level. From the Staff perspective, we do not find any evidence that calls into question the presentation of any data.

Benchmarking Review Takeaways

→ There is no single "right" benchmark for any asset class, nor is there an industry agreed upon standard for the number of asset classes and benchmarks used in reporting. Understanding the process utilized to select the appropriate benchmarks, and assessing whether this was consistently applied, is of utmost importance to the integrity of the process.

- To that end, we find that the benchmarks utilized in both reporting, and the incentive compensation process, are all within the bounds of reasonability. We do have several areas where we believe RVK, Staff, the IFC and/or the SLIB Board could have more conversation. In those areas, we highlight our professional opinions.

→ Post-time period in review, the private equity benchmark was changed to a more standard Cambridge Index. Meketa supports this change.

→ Private Infrastructure utilizes a less common benchmark (10 Year US Treasury Yield +350 bps). While this is not common, we do believe it is reasonable and aligns with the goal of selecting a benchmark with less price volatility than a core bond index, and also less inflation volatility than CPI + 350 (which is more common in the industry).

→ For Real Estate, we believe a non-core real estate benchmark could be added to the non-core segment of the portfolio, to better align with the underlying investments.

→ We found that a collaborative approach to benchmark selection was utilized, with Consultant, Staff, SLIB board and the IFC having the opportunity to review any asset class level changes, and are satisfied that any differing opinions were voiced by various parties, and considered when presenting final recommendations.

Private Credit Benchmark

Current Benchmark: Bloomberg US Intermediate Aggregate plus an expected annualized illiquidity premium of 400 basis points

→ Pros:

- Simple in concept and implementation.
- Some form of public market benchmark is increasingly utilized by institutional funds.
- Private Debt program no longer immature.

→ Cons:

- Spread needs to be determined over public markets benchmark.
- Possibility of wide tracking error over short term.
- Not investable.

→ Suitability: Private Credit is difficult to benchmark, but using a public market benchmark plus an illiquidity premium is a common and reasonable approach to benchmark and institutional private credit allocation.

→ **Alternative Recommendation**: As private markets benchmarks providers, such as Cambridge, develop robust data sets, there may be opportunities to select a benchmark that better represents the opportunity set.

Core Real Estate Benchmark

Current Benchmark: NCREIF – Open-End Diversified Core Equity Index

→ Pros:

- NCREIF (National Council of Real Estate Investment Fiduciaries) ODCE (Open-End Diversified Core Equity) benchmark is widely recognized and used. Incorporates a variety of core, private real estate funds to attempt to benchmark income and capital appreciation trends in a variety of property types.
- NCREIF has stringent and transparent rules of inclusion to be part of the composite index, such as: property type, diversification, leverage limits, and US–focused direct investments.

→ Cons:

- Essentially a peer benchmark, not an investable index.
- Will not match monthly composition of STO portfolio.
- Complexity of calculation.

→ Suitability: The NCREIF ODCE index is widely used and perfectly suitable for a portfolio of Core Private Real Estate.

Non-Core Real Estate Benchmark

Current Benchmark: NCREIF – Open-End Diversified Core Equity Index

→ Pros:

- NCREIF (National Council of Real Estate Investment Fiduciaries) ODCE (Open-End Diversified Core Equity) benchmark is widely recognized and used.
- Incorporates a variety of core, private real estate funds to attempt to benchmark income and capital appreciation trends in a variety of property types.
- NCREIF has stringent and transparent rules of inclusion to be part of the composite index.

→ Cons:

- Essentially a peer benchmark, not an investable index.
- Typically, core property types are established properties, nearly fully leased, with stable income/rents. The nomenclature “Non-Core” typically applies to “Value-Added” and “Opportunistic” real estate where there is some element of development or renovation included.
- “Value-Added” and “Opportunistic” funds typically come with higher risk and return expectations versus Core property types.

→ Suitability: The NCREIF ODCE index is not as widely used for a portfolio of Non-Core Private Real Estate. The risk embedded in value-added and opportunistic funds is typically higher than in property types and funds labeled as “Core”. **Recommendation:** Consider adding a value-add component to benchmarking for the non-core portion of real estate portfolio.

Infrastructure Benchmark

Current Benchmark: 10 Year US treasury Yield + an expected annualized premium of 350 basis points

→ Pros:

- Simple, transparent calculation.
- Infrastructure is an asset class typically used for income, diversification and as an inflation hedge. When inflation increases, treasury yields often do as well. Theoretically, they should move in the same direction.
- Yield on 10-Year treasuries are widely available, and the 10-Year Treasury is easily investable.
- More stable path of resulting returns as compared to a benchmark like bond returns plus a premium.

→ Cons:

- Underlying assets in in the portfolio and benchmarks are not the same.
- 10-Year Treasury Yield will almost always be positive, where as any investment that accepts risk as a way to achieve a return over the risk-free rate, may have negative returns.
- When yields are high, this could be a difficult benchmark to outperform.
- Not widely used as an infrastructure benchmark.

→ Suitability: The most common method to benchmark an infrastructure allocation in institutional portfolios is to use CPI plus an illiquidity premium given infrastructure's role in a diversified portfolio.

→ There are also infrastructure benchmarks available from providers such as Cambridge (private markets peer composite) or MSCI, FTSE, DJ Brookfield (public markets, where an illiquidity premium is typically added) that could be utilized.

Opportunistic Benchmark

Current Benchmark: Total Fund performance excluding opportunistic returns and non-permanent funds, or another benchmark as deemed appropriate by the IFC and approved by the Board.

→ Pros:

- Typically, an Opportunistic allocation is an asset class without a specific target, and can allow for tactical investments that don't neatly fit into another asset class as specified by the investment policy statement.
- The goal of a tactical investment should be to outperform the total fund, and in this case, using the total fund return as a benchmark is reasonable.

→ Cons:

- Comparing yourself to benchmark totally subject to market movement that may not be relevant to any opportunistic investment.
- Underlying assets will not be the same as a diversified institutional portfolio.
- Complexity of Calculation.
- Market returns are cyclical and it would be unreasonable to assume any investment can outperform the total fund in all environments.

→ Suitability: The total fund's return is appropriate to use for an opportunistic allocation.

→ **Alternative Recommendation**: Using the Total Fund Policy Benchmark would create a simpler methodology.