CIO Corner

Fall/Winter 2016

SCOTT SIMON, CHIEF INVESTMENT OFFICER, FIRE & POLICE PENSION ASSOCIATION OF COLORADO (FPPA), DISCUSSES THE CHALLENGES OF A LOW-RETURN ENVIRONMENT, THE ROLE OF ILLIQUID ALTERNATIVES AND THE REWARDS OF PUBLIC FUND STEWARDSHIP.

Q: What skills does someone need to be an effective leader and CIO of a public pension plan?

SIMON: First, you have to be a good listener. Good ideas can come from anywhere, and you've got to be curious. You need to recognize that you can't be the expert in everything and that you need a lot of help, a lot of players all running in the right direction, to make a good organization. You can't have a culture where it's your way or the highway. You need to delegate to your staff the ability to do the right things for the portfolio.

Q: What is the organization's structure?

SIMON: We used to be a very outsourced model of a pension fund. Most, if not all, of the investment decisions were delegated to outsourced entities. Over the last few years, we've made an effort to build staff and internal capabilities to manage those processes internally. We've grown from a staff of two or three and we're now up to a staff of 11. Along with me, there are eight investment professionals.

Q: How do you think about asset allocation as a driver of returns—and specifically, illiquid alternatives? Earlier this year, the fund raised its illiquid alternatives target three percentage points to 23%, close to your 25% long-term target. In this category, you include real assets, private equity, private credit and real estate.

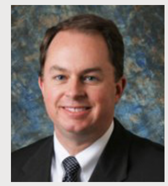
SIMON: We're big fans of illiquid alternatives, which have been a long-term driver of performance for us. In assessing how much illiquidity risk we can take, we really ramped up our analytics about a year ago. We're fully funded and we can continue down this path of taking more [illiquid] exposure. But that doesn't happen overnight. We try to give our team a lot of flexibility so we can allocate to where we see the best opportunities.

Q: Where do you see opportunities in the illiquid space?

SIMON: We continue to be big fans of private equity—in smaller funds and more niche strategies rather than allocating to large buyouts. Private credit is definitely an area of attention. Real assets have been a struggle of late, given the energy exposure there.

Continued

PROFILE



Scott Simon, Chief Investment Officer, Fire & Police Pension Association of Colorado (FPPA)

- **Born:**
  1970, Denver, Colorado
- **Education:**
  B.S., M.S., University of Colorado;
  J.D., University of Denver
- **Personal highlights:**
  Married 16 years, two boys (15 and 13)
- **First job:**
  Denver Employees Retirement Plan (financial analyst)
- **Hobbies:**
  Golf, volunteering on boards (Littleton Hockey, Young Americans, Colorado Trust)
- **Favorite movies:**
  Armageddon, Silence of the Lambs
- **Favorite books:**
  Outliers; First, Break All the Rules

Q: You group hedge funds among your liquid assets. What's your perspective on the role and purpose of hedge funds in your portfolio?

SIMON: We've gotten some challenges from our constituency groups questioning the role of hedge funds. But if you explain their role in the context of diversification, uncorrelated returns and risk reduction, hedge funds appear in a much brighter light. We have three different allocations: managed futures, dedicated long-short equity and absolute return.

Q: How have your targeted allocations changed in recent years?

SIMON: From their peak in 2007, public equity is down from 60% to 36% and fixed income from 25% to 15%. The absolute return target of 10% has been pretty consistent since its inception in 2011.

Q: You became CIO in 2007—a challenging juncture to take the reins. Tell us about that period, both for you and the fund.

SIMON: In the middle of 2007, you were starting to get indications of what was yet to come. As mentioned, we had a lot of public equity risk in the portfolio. Another problem was portable alpha, which ended up being leveraged hedge fund exposure. And then in our core fixed income strategies, we were surprised by how much credit exposure they had. It was a challenging time. We were fully funded and in a good cash flow position, so we were in a much better position to weather the storm.

Q: Lessons learned?

SIMON: It led us to a more thoughtful asset allocation and much more thoughtful governance structure in how we manage and make decisions. For example, in our process of choosing managers, we had long, drawn-out RFP processes, beauty contests where managers were presented to the board, which would decide on the manager. Now we conduct our own analyses internally. Staff now has the ability to execute on our best recommendations. The board has migrated to a much better governance structure of overseeing rather than being in an operational, executional mode.

Q: Public plans are facing serious problems, including underfunding and budget shortfalls that are pressuring state contributions. How do you think public plans can best meet this challenge?

SIMON: They're trying to create the longer-term plans to address the problem, but it's going to take, obviously, multiple years to do it. They're finally focusing on contributions and benefits as well as asset allocation. You can't just hit your current employees or your future employees—you've got to tackle retirees as well. Everyone has to sacrifice a little to make the plan a little bit better.

Q: What are you most concerned about in terms of managing pension assets over the next three to five years?

SIMON: Not a shocker, but the low-returning environment is the biggest one. That low interest rate is your building block for expectations for all your other classes, so it's managing your expectations to a lower-returning environment. I think I worry a lot about a big market drawdown. I think we could survive that better than others, given our funded status. But it would put so much more pressure on the defined benefit model. There's a lot of concern about risk management and technology—being able to monitor and manage risks within the portfolio and across the fund. We're using our asset managers to help assess these risks.

Q: You devote quite a bit of your personal time and energy to working with nonprofits and philanthropies. Tell us a little about how that informs your work as the CIO, and vice versa.

SIMON: The volunteer work is very gratifying. These nonprofits really appreciate the expertise you can offer. Conversely, sitting in on meetings with entities that have different perspectives on their goals just gives you a different perspective on managing your own entities and portfolios.

Q: Finally, what gives you the greatest satisfaction as CIO?

SIMON: I interact with some extremely bright and creative people in this industry. You get to tap their brains and hear what they think about being in the markets and how to best achieve returns. I think I'm also fortunate to have a constituency group of participants who are firefighters and policemen—not that we interact with them on a daily basis, but occasionally we do. To provide them with a good and safe retirement is very rewarding.

CIO Corner_10_2016