MINUTES
of the
FOURTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

October 16, 2018
State Capitol, Room 307
Santa Fe

The fourth meeting of the Investments and Pensions Oversight Committee was called to order by Representative Tomás E. Salazar, chair, on October 16, 2018 at 10:00 a.m. in Room 307 of the State Capitol.

Present	**Absent**
Rep. Tomás E. Salazar, Chair	Rep. Miguel P. Garcia
Sen. George K. Munoz, Vice Chair	Sen. Steven P. Neville
Sen. Jacob R. Candelaria	
Sen. Gay G. Kernan	
Sen. Carroll H. Leavell	
Rep. Jane E. Powdrell-Culbert	
Rep. William "Bill" R. Rehm	
Rep. Patricia Roybal Caballero	
Sen. John M. Sapien	
Rep. Larry R. Scott	
Sen. Elizabeth "Liz" Stefanics	
Rep. Jim R. Trujillo	

Advisory Members

Sen. Carlos R. Cisneros	Sen. William F. Burt
Rep. Roberto "Bobby" J. Gonzales	Sen. Mary Kay Papen
Sen. Stuart Ingle	Sen. William H. Payne
Rep. Bill McCamley	Sen. James P. White
Rep. Sheryl Williams Stapleton	

Guest Legislator
Sen. Mark Moores

Staff
Tessa Ryan, Staff Attorney, Legislative Council Service (LCS)
Kathleen Dexter, Researcher, LCS
Nancy Martinez, Staff, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file and posted on the legislature's website.

Tuesday, October 16

Education Trust Board (ETB) Update

Barbara Damron, Ph.D., secretary, Higher Education Department, and chair, ETB; Ted Miller, J.D., executive director, ETB; and Kay Ceserani, managing director, Pension Consulting Alliance, LLC (PCA), gave an update on college savings programs available through the ETB.

The ETB administers two 529 college savings programs: The Education Plan and Scholar's Edge, which account for 23 percent and 77 percent of ETB assets, respectively. As of June 30, 2018, combined assets in the program portfolios totaled approximately $2.5 billion; nearly $440 million of that total was held in New Mexico resident accounts, which had an average account balance of slightly more than $20,000. Between the two 529 programs, participants have a range of investment risk options, from conservative to aggressive. PCA regularly monitors and reviews all investments and produces a quarterly "watch list" of funds in the portfolios whose performance dips. Overall, most portfolios to date have produced returns that meet or exceed expectations and peer medians.

Many of the accounts in the ETB 529 programs are established by out-of-state residents. In addition to families setting up their own accounts, the National Junior Honor Society recently chose to participate in The Education Plan's annual grant program for middle school students, an affiliation that has resulted in 1,417 new accounts opened and more than $225,000 in contributions made in addition to the grant awards. The presenters noted that such out-of-state participation in the 529 programs serves to reduce costs for New Mexico participants.

As originally established, 529 accounts were designated for higher education expenses. Under changes to federal law that became effective in December 2017, 529 account funds now may also be used for private school tuition and expenses in kindergarten through grade 12 (K-12) and may be rolled into an account established under the federal Achieving a Better Life Experience, or ABLE, Act. Under both federal and New Mexico law, contributions to 529 accounts are tax deductible; however, the Taxation and Revenue Department issued an advisory letter to the ETB stating that the New Mexico tax deduction applies solely to contributions for "qualified higher education expenses" and that state deductions claimed on contributions for other purposes are subject to recapture.

Over the past few years, the ETB negotiated for a 41 percent reduction in program management fees, which are paid by program participants and came to just under $2 million in fiscal year (FY) 2018. Also in FY 2018, the ETB eliminated fees formerly charged on small accounts, eliminated the $25.00 minimum contribution requirement and reduced commissions. In the coming fiscal year, the ETB plans to pursue further fee reductions, increase its outreach efforts, enhance its website and make Scholar's Edge a more compelling choice for investment advisors. The presenters also noted that they would like to create a grant program similar to 529 grant programs available in other states; however, the statute that established New Mexico's 529 programs does not provide authority to establish a grant program.

On questioning, the presenters and committee members addressed the following topics.

Equipment. Equipment used in any post-secondary educational program is a qualified expense in a 529 program.

ETB overhead and contracts. The ETB has enhanced its contractual services to reduce costs. Under its contract to monitor investments, PCA monitors more than 70 portfolios and 50 mutual funds. A member expressed concern that having such a large number of funds within the 529 programs increases the cost of monitoring and reviewing. Secretary Damron stated that she is not willing to serve as ETB president without a strong investment monitoring program.

529 accounts. New Mexico 529 account holders tend to establish their accounts when a child is four to six years old, which is earlier than the national average. Establishing an account early dampens the investment risk over time.

Accounts in The Education Plan are split equally between New Mexico resident accounts and out-of-state accounts. Approximately 80 percent of the accounts in Scholar's Edge, which is managed by brokers, are out-of-state accounts.

Grant program. Unlike legislative lottery scholarships, which are paid to the higher education institution a recipient attends, a 529 program grant would go to the student.

Investment choices. Many 529 account holders invest in the most aggressive, highest-risk track when making their own choices.

Tax deduction. If the state chooses to expand the tax deduction for 529 accounts to include contributions for K-12 education expenses or transfers to ABLE accounts, it would not be bound to include both purposes; it could include one without the other.

Secretary Damron agreed to:

(1) analyze federal law concerning individual development accounts to ascertain whether funds from such accounts can be transferred to 529 accounts and will also review state law for any changes necessary to facilitate these transfers; and
(2) look into reviving the 529 program television ads.

Representative Powdrell-Culbert stated that she would like to sponsor legislation to authorize a 529 grant program.

State Land Office (SLO) Update

Aubrey Dunn, commissioner of public lands, and Sandra D. Lopez, assistant commissioner for administrative services, SLO, reported on revenue generated by state trust lands in the past year and on extractive industry impacts to those lands.

The SLO manages two funds that receive revenue from industries operating on state land:

- the State Lands Maintenance Fund, which received $161.5 million in FY 2018 from renewable resources such as leases, rights of way and interest; and
- the Land Grant Permanent Fund, which received $690.4 million in FY 2018 from nonrenewable resources such as land sale proceeds and oil, gas and mineral extraction.

Revenue to the State Lands Maintenance Fund in FY 2018 was more than double the revenue seen in FY 2016, mostly due to oil and gas lease bonuses, and oil production on state trust lands topped seven million barrels per month by July 2018. Leases for grazing and renewable energy production, such as wind and solar, also generate income for the fund; however, Commissioner Dunn noted that wind energy, if fully developed across all state trust lands, would likely generate only 3.5 percent of the revenue currently generated by oil and gas industry activities.

Of the $828 million distributed from the State Lands Maintenance Fund and the Land Grant Permanent Fund in FY 2018, nearly $700 million went to public schools, with the balance distributed to state institutions and agencies designated as beneficiaries in the Constitution of New Mexico.

The Ogallala Aquifer, which lies beneath a large portion of southeastern New Mexico, is dropping by approximately one foot per year as water is used by oil and gas companies for hydraulic fracturing, or "fracking". In addition to reducing the water supply, fracking results in large quantities of "produced water" — water that has been used to extract oil and gas and that requires safe disposal. Some oil and gas companies have begun cleaning and reusing produced water. Commissioner Dunn urged the committee to consider creating a water reuse tax incentive as a way to encourage this practice and protect the region's water supply.

Commissioner Dunn cited several examples of the oil and gas industry being "out of control": illegal dumping, trespass, abandoned wells, spills, oil theft and lack of remediation on abandoned sites and wells. He noted that the Oil Conservation Division of the Energy, Minerals and Natural Resources Department is seriously understaffed and unable to adequately regulate the oil and gas industry, especially with the boom in drilling activities in the past few years.

Commissioner Dunn cited several of the SLO's accomplishments in FY 2018, including: 1) reducing the turnaround time for right-of-way applications from 300 days to less than 50 days; 2) renegotiating game and fish easements; 3) opening an additional 50,000 acres of state lands to hunters; 4) finalizing a land exchange with the Pueblo of Cochiti; and 5) highlighting industrial water use and conservation as economic issues. He also noted that during his time as commissioner of public lands, the SLO has remediated 51,000 acres of state lands, removing more than 700 tons of trash illegally dumped on those lands.

On questioning, the presenters and committee members addressed the following topics.

Permits. The SLO issues right-of-way permits, and the Oil Conservation Division issues drilling permits. The SLO is required to conduct an environmental survey, archaeological review and endangered species review prior to issuing a right-of-way permit. Texas issues permits more quickly because it does not conduct these reviews. Right-of-way permits issued by the federal Bureau of Land Management (BLM) take more than a year to process. Right-of-way permits for New Mexico state trust lands cost less than the market rate for permits for private land.

Oil Conservation Division. Some appropriations to the Oil Conservation Division that were meant for capping abandoned wells have been used to cover staffing costs. Members and presenters spoke of the need to fully staff and fund the division and to make salaries competitive with those offered by the oil and gas industry.

Pipelines. Establishing a single major right of way for pipelines on state trust lands would be less effective than pushing the BLM to speed up its process for issuing right-of-way permits over federal lands.

It is more cost-effective for oil and gas companies to flare their wells than to build a pipeline to transport the gas for sale.

Water. The amount of produced water generated annually by fracking operations in the state is enough to fill Elephant Butte Reservoir. A tax incentive to clean and reuse this water would reduce the need for underground disposal.

Commissioner Dunn suggested that the state engineer and attorney general file a lawsuit against Texas over capture of water in the Ogallala Aquifer just over the state line for resale to New Mexico-based fracking operations.

Renewable energy. Members and presenters spoke of the need to increase lease rates for transmission lines and the possibility that counties and the state might charge override fees on these lines.

Reclamation bonds are required under leases for wind energy production. Bond amounts are based on the cost of tearing down a wind turbine and grinding its concrete pad.

Recommendations. Commissioner Dunn recommended the following changes:

- increase the bonding amount required for oil and gas activities;
- give the SLO increased control over siting of on-lease activities;
- increase the funding for and staffing of the Oil Conservation Division and the Department of Environment;
- improve funding for remediation efforts;
- oppose federal efforts to shut down wind farms near military flight patterns; and
- increase setback requirements for renewable energy facilities.

Senator Leavell stated that he will work with Commissioner Dunn on legislation to provide a water reuse tax incentive to oil and gas companies.

Minutes

On a motion duly made, seconded and unanimously adopted, the committee approved the minutes of its August 10, 2018 meeting.

Retirement Income Security Task Force

Tim Eichenberg, state treasurer, and chair, Retirement Income Security Task Force; Dr. Jeffrey Mitchell, director, Bureau of Business and Economic Research, University of New Mexico (UNM); and Senator Bill Tallman presented the final recommendations of the Retirement Income Security Task Force, which was formed in response to Senate Joint Memorial 12 (2017 regular session). The joint memorial directed the task force to study New Mexicans' ability to retire in a financially secure manner and to evaluate retirement savings options for those who have limited or no access to employment-based retirement savings arrangements.

The presenters opened with some principal findings that the task force used in its work.

- When New Mexico workers have access to employer-based retirement plans in the private sector, they are as likely as all U.S. workers to participate in those plans; however, only 34 percent of the state's private-sector workers have access to such plans, compared with 42 percent of private-sector workers nationwide.
- In the age group 50 years and older, 56 percent of employed New Mexicans have no retirement savings and only 27 percent have $10,000 or more in savings.
- By 2040, the number of New Mexicans who are over 60 years old is projected to increase to more than 600,000, two-thirds of whom will have less than $10,000 in retirement savings.
- Sixty-seven percent of New Mexico's private-sector workers have no savings for retirement at all.
- Thirty percent of New Mexico's social security recipients are living on social security benefits alone, which average $13,900 per year.

Defined benefit plans, such as those in New Mexico's public employee retirement systems, are much less common now than defined contribution plans, such as 401(k) plans. Defined contributions offer an advantage for employers over defined benefit plans — limited and predictable cost. The major drawback to these plans affects employees. The plans provide a significantly lower percentage of what a retiree needs for expenses, and employees must put aside additional savings.

In 2017, AARP New Mexico conducted a survey of small business owners and employers regarding retirement plans. Seventy-five percent of the respondents said that they feel the state should be doing more to encourage people to save for retirement. Suggestions for state involvement that received strong bipartisan support from respondents included: 1) legislation to make it easier for small businesses to offer retirement plans; and 2) legislation to create a basic, privately managed, "ready-to-go" retirement option.

In considering possible retirement plan solutions for New Mexico, the task force centered its discussions on certain principles, notably that a plan should be accessible, automatic, self-sustaining and portable, with low fees for participants and low cost for employers, and that would provide a reliable retirement income. The task force studied what other states are doing and found four main structures:

- marketplace — the state vets private-sector retirement plan options and hosts an online portal to provide access to the plans, with voluntary employer participation;
- multiple-employer plan — the state authorizes multiple employers to establish a single 401(k) retirement plan;
- voluntary state individual retirement account (IRA) — participation is voluntary for both employers and employees; and
- automatic IRA — employees are automatically enrolled in an IRA plan but may opt out; employers are required to participate but have no fiduciary or contribution responsibility.

The task force's final recommendations are that:

- the state expand financial literacy programs;
- State Treasurer Eichenberg seek an attorney general advisory opinion on matters concerning IRA programs; and
- the state consider offering a hybrid retirement system for private-sector employees that combines a marketplace and a voluntary state IRA program, with the possible conversion of the voluntary IRA program to an auto-enroll IRA program.

On questioning, committee members and the presenters, who were joined by Gene Varela, state director, AARP New Mexico, addressed the following topics.

Financial literacy. The financial literacy initiatives included in the task force's final report are as yet unfunded. AARP New Mexico is willing to provide financial literacy programs.

Access and participation. Part-time employees have less access to retirement plans than full-time employees, and a large proportion of New Mexico workers are in this category.

Employee participation is lower in plans that allow employees to opt out. Employer participation can be costly; members spoke of the current state and federal employer tax deductions for contributions to retirement plans and noted that they are not a strong incentive for employers to participate. A member spoke in favor of creating a tax deduction for payments made by employers to match employee IRA contributions, so long as the private sector manages the accounts rather than the state playing a role.

Self-employed workers. The task force did not resolve the issue of how self-employed workers, which is the fastest-growing segment of the workforce, might participate in a state private-sector retirement plan.

Alternatives to Defined Benefit Pension Plans

Luke Martel, director, Employment, Labor and Retirement Program, National Conference of State Legislatures, reported on defined benefit plan reform efforts in other states.

In 2017, 148 pension-related bills were signed into law around the country, and so far in 2018, more than 700 bills have been introduced. Forty-eight states, including New Mexico, have revised their retirement plans in the past decade to address growing unfunded liabilities, which mostly have been caused by less-than-expected investment returns. Of those states, 10 replaced their defined benefit plans with other structures, including defined contribution plans, cash balance plans, hybrid plans and choice plans. Five more states will follow suit in 2019.

Defined contribution plans were originally offered to employees as a way for them to manage their own retirement savings and take advantage of what was, before the Great Recession of 2008, a rapidly rising stock market. After the recession, however, employers turned to these plans as a way to avoid unfunded liabilities and investment and mortality risk. A 2015 study conducted by the Colorado state auditor determined that defined contribution plans do not provide the same level of retirement income as defined benefit plans, in part because the latter plans have larger investment portfolios that are better suited to managing risk over time.

New Mexico has joined the majority of states in making certain changes to retirement systems since the Great Recession, including increased employee contribution levels, a move that was rare among states prior to the recession; increased age and service requirements for new members; and reductions in post-retirement benefit increases such as cost-of-living adjustments (COLAs).

On questioning, Mr. Martel noted that 70 percent of public workers in states with defined benefit plans are also covered by social security.

Mr. Martel agreed to provide:

(1) a brief prepared by the National Association of State Retirement Administrators on COLAs in retirement systems nationwide; and
(2) job-to-job comparison information between state and federal retirement systems.

Pension-Related Proposal Evaluation

Joe Newton, actuary, Gabriel, Roeder, Smith & Company, outlined general steps to be taken as New Mexico reforms its pension systems.

In addition to taking standard problem-solving steps, such as defining the issues and brainstorming solutions, Mr. Newton noted that the legislature must consider:

- human capital goals — what the stakeholders hope to accomplish, such as employee retention, employee attraction or retirement security;
- fringe risks — intergenerational equity, longevity protection and investment risk and reward;
- macro issues — funding policies, plan structures and the magnitude and schedule of change; and
- stress tests for the new plan — projections based on varied investment returns and contribution rates.

Mr. Newton cautioned that the legislature's pension reform efforts will create friction, and he urged the committee to address this by bringing all stakeholders to the discussions. He also urged the committee to work toward an unfunded actuarial accrued liability of no more than 20 percent and, in doing so, to stay in the "aggregate trust model" — plans that aggregate investments, such as defined benefit plans do — because this will produce the best investment results and benefit not only retirees but the state's economy.

On questioning, Mr. Newton noted that frequent small adjustments to a pension plan, such as adjustments to COLAs, can be very effective. He cited Wisconsin's pension plan, in which COLAs are not fixed but, rather, are based on investment returns averaged over five years.

Educational Retirement Board (ERB) Member Survey

Jan Goodwin, executive director, ERB, reported on the results of a survey conducted to assess ERB members' attitudes about possible retirement system revisions to improve sustainability.

After conducting several meetings around the state in late 2017 to educate ERB members on the retirement system's financial status and the need for reform, the ERB surveyed all members and employers on possible plan changes. Proposed changes that received the strongest support from respondents included:

- a phased-in three percent increase in the employer contribution rate;
- a five-year COLA suspension with a hold harmless provision for the longest-serving members at the lowest salaries;
- a tiered benefit multiplier; and
- ERB contributions on salary earned during retirement by both ERB retirees and employers and by Public Employees Retirement Association retirees working for ERB employers.

On questioning, committee members and Ms. Goodwin, who was joined by Rod Ventura, general counsel, ERB, addressed the following topics.

COLAs. The ERB has decided not to pursue a COLA suspension and, instead, is considering lowering the COLA.

Return to work. The return to work provision was originally enacted to address a teacher shortage, but it is primarily administrators who are taking advantage of this provision. Ms. Goodwin spoke in favor of allowing the return to work provision to sunset and, instead, increasing compensation for education employees.

Fundedness. The ERB is considering a package of reforms that will get the ERB fully funded within 24 years. The current projection for the ERB to be fully funded is 61 years.

Union litigation liability. As part of a tentative settlement that the ERB has reached in a suit brought by unions over member contribution swaps made in previous years, the ERB will make a request to the legislature for $248 million to cover its liabilities in this matter.

Public Comment

Dubra Karnes-Padilla, board member, UNM Retiree Association, read a statement from the association in opposition to changes to the ERB COLAs and proposing, instead, that a task force be convened to study ERB finances, practices, structure and term limits and to address the inequity between the state's public pension systems.

Adjournment

There being no further business, the committee adjourned at 5:55 p.m.