

**MINUTES  
of the  
SECOND MEETING  
of the  
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**July 29, 2019  
State Capitol, Room 309  
Santa Fe**

The second meeting of the Investments and Pensions Oversight Committee for the 2019 interim was called to order by Senator George K. Munoz, chair, on Monday, July 29, 2019, at 9:06 a.m. in Room 309 of the State Capitol in Santa Fe.

**Present**

Sen. George K. Munoz, Chair  
Rep. Patricia Roybal Caballero, Vice Chair  
Sen. Jacob R. Candelaria  
Rep. Natalie Figueroa  
Rep. Miguel P. Garcia  
Rep. Tomás E. Salazar  
Sen. John M. Sapien  
Sen. Elizabeth "Liz" Stefanics

**Absent**

Sen. Gregg Fulfer  
Sen. Gay G. Kernan  
Sen. Steven P. Neville  
Rep. William "Bill" R. Rehm

**Advisory Members**

Rep. Phelps Anderson  
Sen. Carlos R. Cisneros  
Rep. Roberto "Bobby" J. Gonzales  
Sen. Mary Kay Papen  
Rep. Sheryl Williams Stapleton  
Sen. James P. White

Sen. William F. Burt  
Sen. Stuart Ingle  
Sen. William H. Payne

**Staff**

Anthony Montoya, Staff Attorney, Legislative Council Service (LCS)  
Rebecca Griego, Records Officer, LCS  
Carrie McGovern, Researcher, LCS

**Guests**

The guest list is in the meeting file.

**Handouts**

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

**Monday, July 29**

**Overview of Actuarial Processes**

Wayne Propst, executive director, Public Employees Retirement Association (PERA); John Garrett, A.S.A., F.C.A., M.A.A.A., principal and consulting actuary, Cavanaugh Macdonald Consulting, LLC; and Jonathan Craven, A.S.A., F.C.A., M.A.A.A., E.A., consulting actuary, Cavanaugh Macdonald Consulting, LLC, provided the committee with an overview of actuarial processes. Mr. Propst began by noting that Cavanaugh Macdonald Consulting, LLC, has provided actuarial services for the PERA for 10 years. Mr. Garrett continued the presentation with a review of commonly used actuarial funding definitions, including "present value of benefits" (the value of benefits to be paid to all active and retired members), "actuarial accrued liability" (the value of benefits expected to be paid to participants based on past service), "normal cost" (the present value of active members' benefits allocated to the upcoming year of service), "actuarial cost method" (used to allocate the present value of benefits between past and future service), "actuarial value of assets" (the value of pension plan investments and other property), "funded ratio" (the ratio of the actuarial value of assets to the actuarial accrued liability), "funding period" (the number of years to reach 100% funding) and "unfunded actuarial accrued liability" (UAAL) (the difference between the actuarial accrued liability and the actuarial value of assets). Mr. Craven discussed the three levels of actuarial analysis: "actuarial evaluation"; "actuarial open-group deterministic projection"; and "actuarial open-group stochastic projection", also known as "asset liability model", which he stated is the best decision-making tool for actuaries as it gives the probability of attaining certain goals.

Mr. Craven provided the following PERA actuarial valuation results as of June 30, 2018: a present value of benefits at \$24.1 billion, actuarial accrued liability of \$21.3 billion, present value of future normal costs at \$2.8 billion, actuarial value of assets at \$15.3 billion, UAAL of \$6.1 billion and a funded ratio of 71.6%. He described how the PERA went from being 100% funded in 2002 to 71.6% funded in 2018, primarily because of the Great Recession, which caused the PERA to lose one-third of its assets, or \$5.7 billion.

Questions and comments from committee members addressed the following:

- June 30, 2019 UAAL predictions will be provided in October. It is expected that the UAAL will increase and the funded ratio will decrease, mainly resulting from underperforming assets and a shortage in statutory contributions;
- future hires are not accounted for in actuarial evaluations, which the panelists stated is one of the shortfalls inherent in the process. New hires do not have UAAL, but as they are all tier 2 employees, they have a slower accrual rate and lower normal costs. It was noted that if employees leave before vesting, it may actually provide some benefit to a pension plan, as the employer contribution rates are still included in the plan and are not refunded;
- the PERA's funded ratio has hovered around 70% for the past several years;

- if a member dies, benefits are passed on to a beneficiary, and there are several benefit options that a member can choose from at retirement. A beneficiary does not have to be a spouse or a relative but must be a living person;
- there is currently no proposed pension reform legislation available, but the governor's PERA Solvency Task Force has its final meeting in a week and will be making recommendations to the governor on possible legislation;
- a 1% increase in hires affects the funded ratio in 2043 by 1%;
- according to a Legislative Finance Committee analyst in the audience, there are 4,400 vacant positions in all three branches of state government. Staff turnover rates are very high, and the state has not been able to retain employees. The analyst stated that 37% of new hires leave within one year;
- when nonvested members leave state employment, they can opt to have their pension contributions refunded to them. The PERA spends about \$4 million to \$5 million per month on these refunds;
- the PERA has 84 full-time-equivalent (FTE) positions;
- since 1985, the rate of return has been 8.9%, but going forward, the assumption is that this rate will be 7.25%, which is also the median percentage of all plans in the nation and is a 20-year to 30-year projection; and
- a member inquired whether the 4% rate of return used by the Pew Charitable Trusts is a more accurate number for public pension plans, to which the presenters replied that the differing rates of return are the result of differing philosophies. The 4% rate is a risk-free rate, and the probability of achieving this rate is low. The presenter stated that there is a 50% chance of achieving the 7.25% rate.

### **PERA: Sustainability, Solvency and Fund Liquidity Plans for Market Downturn**

Mr. Propst, Mr. Garrett and Dominic Garcia, chief investment officer, PERA, presented to the committee on the PERA's plans for dealing with the next market downturn. Mr. Garrett began by stating that projections indicate that the PERA's funded ratio of 71.6% in 2018 is expected to rise to 74.4% in 2043. Since 2012, investment returns have fluctuated due to volatile markets. Mr. Garrett reviewed the UAAL by each division in the PERA, with state divisions accounting for 51.3%, municipal general at 26.6%, municipal police at 11.4% and municipal fire at 10.7%, and he noted that the state general and municipal police plans are below the funded ratio. Mr. Garrett next discussed net external cash flow, which consists of benefit payments plus expenses minus total contributions. He stated that while mature pension plans are expected to show negative external cash flows, excessive negative cash flows can slow growth in a plan's assets and slow improvement in the funded ratio. The PERA's net external cash flow is now at -4.25% and is expected to go to -5.5% in 2035. Mr. Garrett noted that when comparing trends in assets and liabilities, liabilities are growing very fast and are currently seeing an annual growth rate of 4.37% while assets have an annual growth rate of 4.01%. He said that the PERA's normal cost rates are high compared to other states. He also stated that cost-of-living adjustments (COLAs) typically comprise about 20% of liability and are part of negative cash flow.

Mr. Garcia described the PERA's long-term investment objectives. He pointed out that the PERA has met its actuarial discount rate assumption of 7.25%, met its long- and short-term benchmarks for annualized returns and remained cost-effective, saving an average of \$1.9 million annually in fees and costs. He outlined three major challenges that the PERA will face in the future: 1) meeting the goal of 7.25% in actuarial returns in a low-return environment; 2) maneuvering through a late-cycle economy with the possibility of a recession on the horizon; and 3) managing negative cash flow, as the amount paid out to beneficiaries is becoming unsustainable. According to Mr. Garcia, the last 10 years were exceptional in terms of the PERA's investment returns, conditions that are not expected to last.

Mr. Propst next presented a "stress test" analysis showing what could happen in the event of a financial recession. In closing, Mr. Garrett reminded committee members that extending the amortization period on UAAL means that more money will be paid out; for example, a 50-year amortization period on \$6.1 billion in UAAL would result in total payments of \$31.2 billion.

Questions and comments from committee members addressed the following:

- liquid assets can be used during a financial crisis to pay for benefits and investments; a committee member requested that, in the future, the PERA describe its strategy for how it is going to use liquid assets;
- the next global financial crisis will not be like any previous one, but bonds and cash are what is available during such an event;
- regarding how the PERA compares to its peers in rates of return, it is in the top quartile for the last one-year period ending in March and the top thirty-eighth percentile over the past 10 years;
- market volatility, not how money has been invested, is what has affected plan solvency;
- it cannot be assumed that a bull market will offset the growth in liabilities;
- the majority of states have COLAs built into their costs;
- after a member asked about the possibility of establishing a tier 3 component that would change the plan from defined benefit to defined contribution, Mr. Garrett replied that establishing a tier 3 component would not affect anything in the short term and would only have impacts in the very long term, and, of the three states that went from defined benefit to defined contribution, two went back to being defined benefit because it can be more efficient;
- 3% to 4% of the PERA's portfolio is allocated to infrastructure, which includes large public assets such as seaports and airports that are long-lived with strong cash flows; and
- diversification involves buying stocks outside of the United States, and emerging markets should be explored for diversification.

A motion was made and passed to request that the PERA provide this presentation to as many committees as possible this interim.

## **Educational Retirement Board (ERB): Sustainability, Solvency and Fund Liquidity Plans for Market Downturn**

Jan Goodwin, executive director, ERB, and Bob Jacksha, chief investment officer, ERB, reviewed how the ERB will maintain sustainability and solvency in the event of a financial crisis. Ms. Goodwin noted the difference between solvency and sustainability: solvency is the ability to pay obligations as they become due, while sustainability is the likelihood of the plan being able to stay as it is and maintain the ability to pay benefits and reach 100% funding within a reasonable length of time. She stated that legislation was passed in 2005, 2009, 2013 and 2019 that has helped the ERB to be proactive about sustainability and that the ERB is developing a legislative package for 2020. In addition, Ms. Goodwin stated that 2019 House Bill 360 (HB 360) improves sustainability, and while it does not have an immediate impact on UAAL, it will cause UAAL to grow more slowly. Ms. Goodwin referenced an article by the National Institute on Retirement Security that listed six characteristics of sustainable pension plans, noting that the ERB meets five of the six characteristics.

Mr. Jacksha continued with an overview of the ERB's liquidity. He said that the ERB must regularly fund investment capital calls, administrative expenses and pension benefit payments. Although investment capital calls do not cost the ERB much, as they are mostly offset by the distributions received from managers, administrative expenses in fiscal year (FY) 2018 were \$9.9 million, and benefit payments in excess of contributions comprise the largest source of negative cash flow. According to Mr. Jacksha, negative cash flow was \$431 million in FY 2018 and almost \$480 million in FY 2019 and is expected to grow. As the ERB's primary focus is to meet required payments, it must regularly sell liquid assets, defined as money readily available within one to 30 days, which comprise 55%, or \$7.1 billion, of the ERB's investment portfolio. Less liquid assets, which are not available within 30 days but do provide significant returns and portfolio diversification, are valued at \$5.9 billion, or 45% of total assets. After the Great Recession, the ERB diversified away from public equities by putting more money into private assets. He stated that if the market declines, the ERB would have the liquid assets needed for a number of years but that the fund could be destabilized and the ERB would have to sell assets at lower prices.

Questions and comments from committee members addressed the following:

- while the numbers are not yet finalized, the ERB's fund balance as of June 30, 2019 should be between \$13.1 billion and \$13.2 billion;
- if the ERB does not make any further changes, it is expected that its UAAL will have a period of time where it will grow until it starts to fall; once this happens, it will fall quickly;
- before HB 360 was enacted, it would have taken 70 years to be 100% funded; now it will take 46 years;
- the ERB's COLAs begin at age 65 or one year after retirement, whichever is later. In January of each year, the ERB's actuaries review the change in the Consumer Price

- Index from one year to the next to determine the COLA, which is then reduced by 10% to 20% depending on how long a member worked;
- the ERB's portfolio contains inflation-linked assets, which are infrastructure investments and natural resources investments that are adjusted for inflation;
  - HB 360 affects return-to-work retirees, many of whom are substitute teachers, by mandating that a member who retires and returns to work immediately has to work less than .25 FTE with no cap on their earnings or must wait one year before returning to work with no limitation on how much they work, which complies with Internal Revenue Service (IRS) regulations that an employee must have a bona fide termination to begin receiving benefits. Ms. Goodwin noted that it may be more prudent for members to retire for one year and suspend benefits, then come back to work, earn more service credit and then retire with higher benefits;
  - another change that HB 360 makes is that return-to-work retirees and their employers must now make nonrefundable contributions regardless of how much they work or earn;
  - as of June 30, 2018, the Educational Retirement Fund had a 63.5% funded ratio;
  - Ms. Goodwin requested that legislators contact her with any ERB-related constituent questions and said that she will be happy to assist them;
  - the ERB is working on a market downturn stress testing analysis similar to what the PERA presented earlier in the day and will share it with the committee when it is ready; it is also working with its stakeholder group on legislation to bring before the committee; and
  - the ERB's five-year to seven-year projection for investment returns is about 7.7%.

### **Minutes Approval**

On a motion made, seconded and passed, the committee approved the minutes of the June 5, 2019 meeting.

### **State Investment Council (SIC): Liquidity Plans for Market Downturn**

Robert "Vince" Smith, deputy state investment officer and chief investment officer, SIC, reviewed the SIC's liquidity plans for a market downturn. Mr. Smith noted that the SIC recognizes four different types of liquidity: asset (how easily or not an asset can be sold for cash), natural (cash income and inflows and distributions and fundings), normal (a combination of asset and natural liquidity available in normal market conditions) and crisis. Crisis liquidity occurs during a serious market downturn, which is a -35% or more decrease in the stock market. According to Mr. Smith, the economy has been in a late-cycle phase since the first quarter of 2018, and it is anticipated that the next recession will start in the second quarter of 2020. As the economic cycle moves into a recession, the SIC plans to address this by deploying liquidity into stocks/equity investments, looking for other opportunities in other asset classes and regularly assessing and reassessing liquidity needs versus liquidity position and equity exposure relative to long-term targets.

## **SIC: Economically Targeted Investments (ETIs)**

Charles Wollmann, director of communications, legislative and client affairs, SIC, provided an overview of ETIs, which are authorized by Section 7-27-5 NMSA 1978 and make up about 5% of the SIC's portfolio. ETIs, which are only allowed to be made from the Severance Tax Permanent Fund (STPF) and can only be directed to New Mexico-based enterprises, are meant to spur job and industry creation while also delivering financial returns. He stated that the three main ETIs over the years have been: 1) the New Mexico private equity investment program, which is valued at over \$400 million; 2) the Small Business Investment Corporation, whose allocation from the STPF increased to 2% due to 2019 Senate Bill 10 and is likely to receive \$55 million in new money in FY 2020; and 3) the New Mexico film loans program, from which no loans have been made since 2008. Mr. Wollmann explained that while investment returns for ETIs have lagged historically, recent performance has improved significantly for the private equity program.

Mr. Wollmann next described how the SIC plans to improve and expand ETIs. He mentioned the New Mexico Catalyst Fund, which provides early-stage funding for entrepreneurs and venture capitalists from state, federal and private sources. He stated that a statutory change in 2017 removed a barrier for venture capitalists, which resulted in more outside investments in the state. In the future, the SIC will work to coordinate with the Economic Development Department to identify targeted industries, such as aerospace, bioscience, cybersecurity and sustainable energy, and the SIC is looking to make investments in companies located on state trust land. Lastly, Mr. Wollmann said that many outside investors are looking at New Mexico, with recent large investment rounds in certain local businesses.

Questions and comments from committee members addressed the following:

- the SIC continues to evaluate and learn from past investment and has tried to hold people accountable, when possible, for mismanagement of assets; and
- a committee member stated that ETIs could lend themselves well to the hemp industry, which could benefit rural communities throughout New Mexico and draw youth back to the state and generate interest from youth still here, and that the SIC should explore how to steer venture capitalists in the direction of tribal and agricultural businesses to benefit rural areas of the state.

Committee members discussed how to address the need for further presentations this interim on the return-to-work issue, either through the formation of a subcommittee or an extra meeting day devoted to the topic. After debate, a motion was made to request the New Mexico Legislative Council to grant an extra meeting day specifically for return-to-work issues, which was seconded and passed. Members suggested consulting with constituents, school districts, PERA and ERB members and the Legislative Education Study Committee to obtain specific recommendations on how to develop legislation to deal with the return-to-work issue.

## **Adjournment**

There being no further business, the committee adjourned at 4:42 p.m.