New Mexico Educational Retirement Board

Sustainability, Solvency and Fund Liquidity Plans for Market Downturn

Investments and Pensions Oversight Committee

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July 29, 2019

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What is the difference between Solvency and Sustainability?

Solvency

- Ability to pay obligations as they become due
- ERB is solvent and can pay benefits for all time horizons and is on the path to 100% funding

What is the difference between Solvency and Sustainability?

Sustainability

- Standard- Contributions + Investment income= Benefits + Expenses

- Actuary- can pay all of the promised benefits without any future modifications to contributions or benefits

- Proposed definition- ability to pay benefits and reach 100% funding within a reasonable length of time

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How ERB Board Has Been Proactive about Sustainability

- Prior legislation- 2005, 2009, 2013 and 2019
- This year:
  - Worked with legislature and governor to pass/enact HB 360
  - Soliciting input from stakeholders to develop legislative package for 2020

HB 360 Components

1. Tiered Multipliers
2. Increase of Employer Contributions (.25% increase only)
3. Anti-spiking (Applies to annual salary after July 1, 2019)
4. Revise Return-to-Work provisions (contributions for those working less than .25 FTE applies after July 1, 2020)
5. Require PERA retirees who work for ERB employers to pay contributions (police officers currently working for LAUs are grandfathered in)
6. Reduce pension benefits for those who retire before age 58
7. Substitute teachers who work more than .25 FTE will pay contributions (not effective until July 1, 2020)
8. Threshold for higher employee contributions raised from $20,000 to $24,000.

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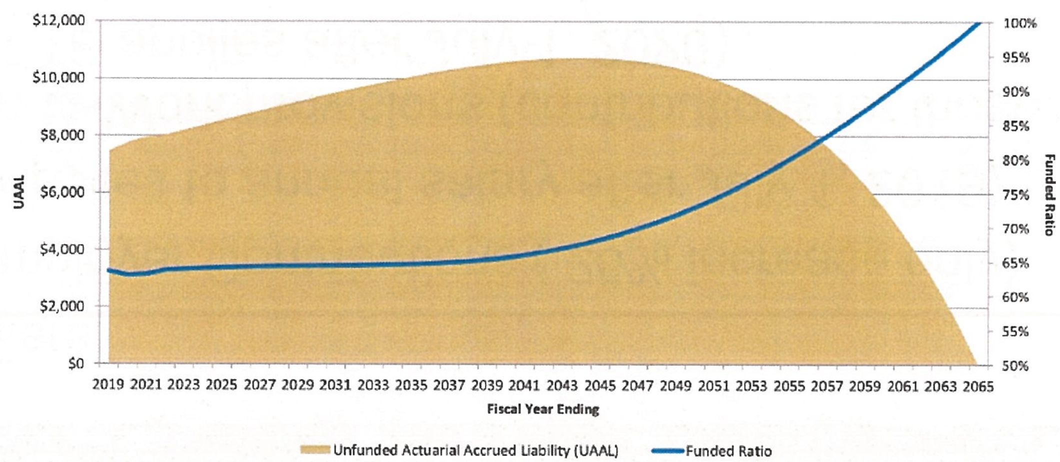
Impact of HB 360 Legislation

- No immediate change to unfunded liability
- Will cause UAAL to grow more slowly in the future
- Funding period at 46 years, based on June 30, 2018 valuation

ERB Funded Status – HB360

Projected UAAL and funded ratio for ERB reflecting the provisions of HB360 enacted in 2019.



Source: Gabriel Roeder Smith

What is the difference between Solvency and Sustainability?

Characteristics of sustainable pension plans (*National Institute on Retirement Security- Lessons from Well-Funded Public Pensions*)	**How is ERB doing?**
Pay Annual Required Contribution and maintain stable contribution level over time	
Employees share in the cost of the plan	✔
Actuarially value benefit improvements and ensure funding source	✔
Cost of living adjustments are responsible and if automatic, capped at a modest level	✔

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What is the difference between Solvency and Sustainability?

Characteristics of sustainable pension plans (*National Institute on Retirement Security- Lessons from Well-Funded Public Pensions*)	How is ERB doing?
Anti-spiking measures to ensure actuarial integrity and transparency	✓
Economic actuarial assumptions can be expected to be achieved over the long term	✓

Conclusion:

ERB is solvent.

ERB has been proactive about its sustainability, but ERB's sustainability can still be improved upon.

ERB Liquidity Requirements

- ERB must regularly fund investment capital calls, administrative expenses and pension benefit payments.
- On average, investment capital calls are roughly equal to distributions.
- Expenses for FY18 were approximately $9.9 million.
- Benefit payments in excess of contributions comprise the largest source of negative cash flow.
- For FY18, benefits were $1.1 billion and contributions were $676 million, for a net outflow of $431 million. For FY19, that figure is estimated to total $465-470 million.

Meeting Liquidity Requirements

- Our top priority is to meet required payments, WITHOUT FAIL. The reason for the existence of the fund is to pay monthly retirement benefits when they are due.
- To meet required payments, ERB regularly sells liquid assets.
- On an ongoing basis, we evaluate our current cash balance, estimated receipts, out going payments and execute trades accordingly.
- The estimation process is very reliable for 30-90 days into the future.

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March 31, 2019 Investment Portfolio

	Current Mkt Value	Current Allocation	Policy Target[1]
Equity	**$4,162,824,441**	**32.0%**	**33.0%**
U.S. Equity	**$2,331,966,167**	**17.9%**	**19.0%**
U.S. Large Cap Equity	*$1,989,526,284*	*15.3%*	*16.0%*
U.S. Small/Mid Cap Equity	*$342,439,883*	*2.6%*	*3.0%*
Non-U.S. Equity	**$1,830,858,274**	**14.1%**	**14.0%**
Non-U.S. Developed Mkts	*$612,723,499*	*4.7%*	*5.0%*
Non-U.S. Emerging Mkts	*$1,218,134,775*	*9.4%*	*9.0%*
Fixed Income	**$3,451,803,655**	**26.5%**	**26.0%**
Core Fixed Income	*$868,997,873*	*6.7%*	*6.0%*
Opportunistic Credit	*$2,360,594,208*	*18.1%*	*18.0%*
Emerging Mkts Debt	*$222,211,575*	*1.7%*	*2.0%*
Alternatives	**$5,309,800,081**	**40.8%**	**40.0%**
Absolute Return	**$400,836**	**0.0%**	**0.0%**
Diversifying Assets	**$1,546,795,211**	**11.9%**	**12.0%**
Global Asset Allocation	*$586,641,213*	*4.5%*	*4.0%*
Risk Parity	*$695,120,020*	*5.3%*	*3.0%*
Other Diversifying Assets	*$265,033,977*	*2.0%*	*5.0%*
Real Estate	**$869,094,559**	**6.7%**	**7.0%**
REITs	*$284,159,594*	*2.2%*	*3.0%*
Private Real Estate	*$584,934,966*	*4.5%*	*4.0%*
Private Equity	**$1,904,430,050**	**14.6%**	**13.0%**
Inflation-Linked Assets	**$989,079,424**	**7.6%**	**8.0%**
Cash	**$95,705,999**	**0.7%**	**1.0%**
Total	**$13,020,197,300**	**100.0%**	**100.0%**

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Liquid Assets

The current investment portfolio totals $13 billion in market value. Of that amount 55%, or $7.1 billion, is readily available within 1-30 days notice to meet operational needs.

This include all Cash, Core Bonds, Public Equities, REITs, Global Tactical Asset Allocation, Risk Parity assets and a portion of Opportunistic Credit assets.

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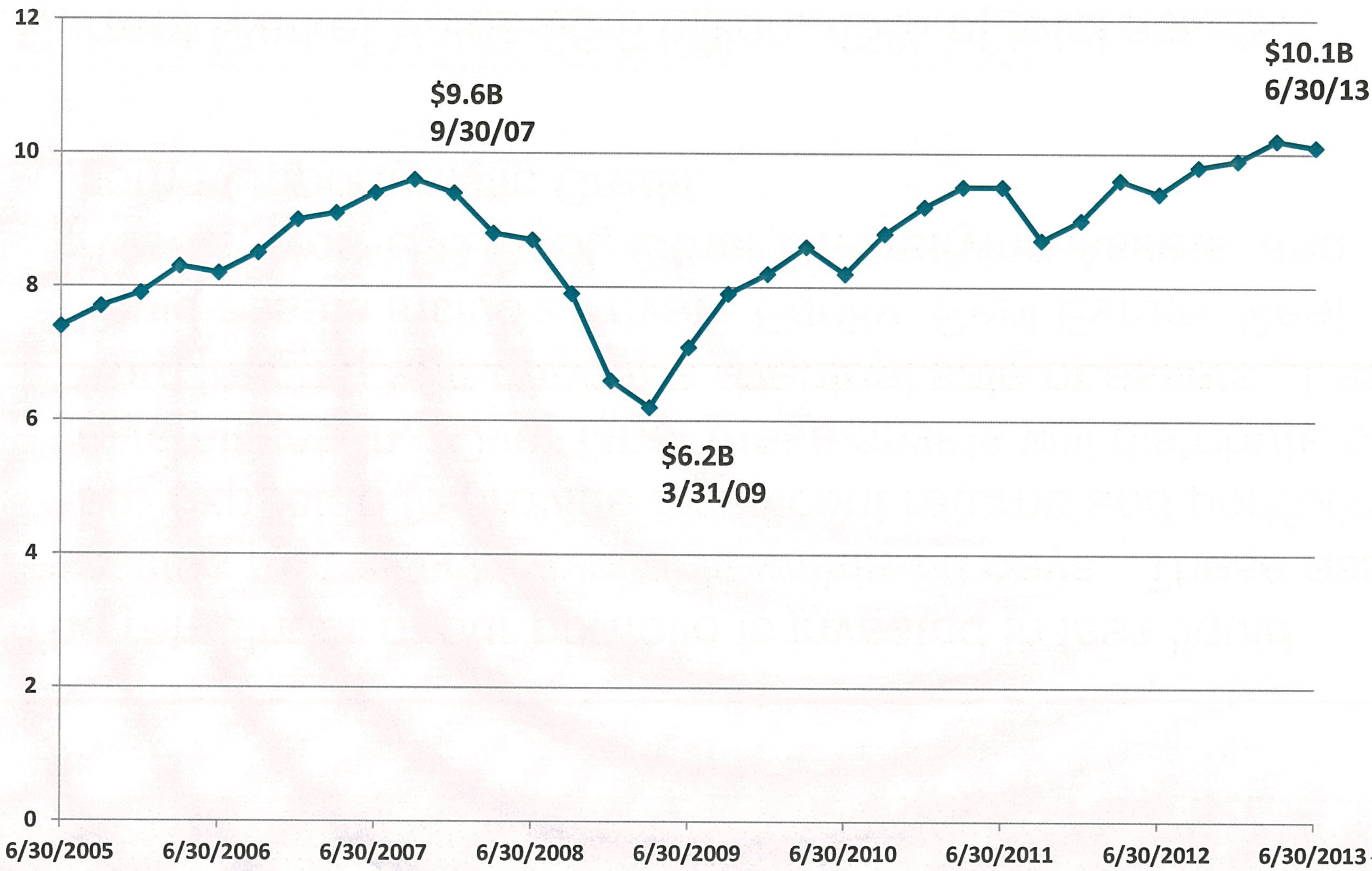
Less Liquid Assets

The remainder of our portfolio is invested in less liquid assets that are not available within 30 days. These assets are expected to provide significant returns and portfolio diversification. Over time, these assets will distribute cash from income and upon the eventual sale of assets. Less liquid assets include Private Equity, Real Estate, Real Assets, Non-U.S Debt, Other Diversifying Assets, and some Opportunistic Credit.

Current Market Value $5.9 billion, 45% of total assets.

What Does a Market Decline Look Like?



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September 30, 2007 Assets

	Market Value	Percent of Total Assets	Long Term Target
TOTAL FUND	**$9,585,955,061**	**100.0%**	
TOTAL EQUITY	**$5,700,591,272**	59.5%	58.0%
U.S. EQUITY COMPOSITE	**$3,722,812,822**	**38.8%**	**40.0%**
U.S. Large Cap Equity	*$3,261,015,568*	*34.0%*	*35.0%*
U.S. Small Cap Equity	*$461,797,254*	*4.8%*	*5.0%*
NON-U.S. EQUITY COMPOSITE	**$1,977,778,450**	**20.6%**	**18.0%**
Non-U.S. Developed Markets	*$1,652,390,210*	*17.2%*	*15.0%*
Non-U.S. Emerging Markets	*$325,388,240*	*3.4%*	*3.0%*
FIXED INCOME COMPOSITE	**$2,532,038,991**	**26.4%**	**27.0%**
Core Bonds	*$2,076,394,908*	*21.7%*	*22.0%*
High Yield Bonds	*$455,644,083*	*4.8%*	*5.0%*
ABSOLUTE RETURN	**$753,521,424**	**7.9%**	**5.0%**
PRIVATE EQUITY	**$81,316,865**	**0.8%**	**5.0%**
REAL ESTATE	**$492,474,115**	**5.1%**	**5.0%**
CASH	**$26,012,394**	0.3%	0.0%

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March 31, 2009 Assets

	Market Value	Percent of Total Assets	Current Policy Target[1]	Difference	Range[2]	Long Term Policy Target
TOTAL FUND	**$6,207,371,320**	**100.0%**				
TOTAL EQUITY	**$2,783,279,938**	44.8%	45.0%	(0.2%)		45.0%
U.S. EQUITY COMPOSITE	**$1,806,347,095**	**29.1%**	**25.0%**	**4.1%**	**10-40%**	**25.0%**
U.S. Large Cap Equity	*$1,552,381,204*	*25.0%*	*23.0%*	*2.0%*		*23.0%*
U.S. Small Cap Equity	*$253,965,891*	*4.1%*	*2.0%*	*2.1%*		*2.0%*
NON-U.S. EQUITY COMPOSITE	**$976,932,843**	**15.7%**	**20.0%**	**(4.3%)**	**10-35%**	**20.0%**
Non-U.S. Developed Markets	*$403,012,877*	*6.5%*	*10.0%*	*(3.5%)*		*10.0%*
Non-U.S. Emerging Markets	*$573,919,966*	*9.2%*	*10.0%*	*(0.8%)*		*10.0%*
FIXED INCOME COMPOSITE	**$2,335,798,903**	**37.6%**	**38.0%**	**(0.4%)**	**5-40%**	**20.0%**
Core Bonds	*$1,980,763,671*	*31.9%*	*33.0%*	*(1.1%)*		*15.0%*
Credit Strategies	*$355,035,232*	*5.7%*	*5.0%*	*0.7%*		*5.0%*
ABSOLUTE RETURN	**$532,511,023**	**8.6%**	**10.0%**	**(1.4%)**	**2-20%**	**10.0%**
PRIVATE EQUITY	**$155,512,927**	**2.5%**	**2.0%**	**0.5%**	**2-20%**	**10.0%**
REAL ESTATE	**$269,329,803**	**4.3%**	**5.0%**	**(0.7%)**	**0-10%**	**5.0%**
Private Real Estate	*$85,166,270*	*1.4%*				
REITs	*$184,163,533*	*3.0%*				
REAL ASSETS	**$39,250,128**	**0.6%**	**0.0%**	**0.6%**	**0-10%**	**5.0%**
GLOBAL ASSET ALLOCATION	**$0**	**0.0%**	**0.0%**	**0.0%**	**0-10%**	**5.0%**
CASH	**$91,688,598**	1.5%	0.0%	1.5%	0-10%	0.0%

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What Happens in a Market Decline?

For liquidity purposes, not much. But there would be other issues:

- A 20% decline in the value of liquid assets would still leave $5.6 billion in available market value. This amount would cover liquidity needs for 10+ years, even assuming zero market recovery in that time period.
- A 20% decline would be destabilizing to the fund, however. Since ERB must sell assets on a regular basis to meet our obligations, we would be forced to sell at low prices at a time we would rather buy, detracting from investment performance.
- Actuarial measures would also suffer.

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What Would Help ERB Fund Stability?

- An increase in employer contributions. A 1% increase in contributions adds $27 million per year, decreasing the cash outflow. The cost to the general fund is lower because of other funding sources.
- In the event of a severe economic downturn, the market value of ERB assets would fall and actuarial measures would suffer. It is also likely, interest rates would decline as well.
- These factors suggest pension obligation bond issuance could be a timely option. The additional infusion of assets would improve actuarial measures and the cost of the bond issue would be relatively low.

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History of ERB Retirement Benefits

YEAR	RETIREMENT ELIGIBILITY	MULTIPLIER	COLA	Life expectancy * at age 65	
				Males	Females
1962	30 years of service with actuarial reduction if younger than age 60 Age 60 with 15 years of service	1.5% first $4,000 of Final Average Salary (FAS) and 1% thereafter	Ad Hoc	13.2	17.4
1965	30 years of service with actuarial reduction if younger than age 60 Age 60 with 15 years' service Age 65 with 10 years of service	SAME	Ad Hoc	13.2	17.4
1971	35 years of service 30 years of service with actuarial reduction if younger than age 60 Age 60 with 15 years of service Age 65 with 5 years of service	1.50%	Ad Hoc	13.8	18.6
1974	35 years of service Rule of 75 with reduction if younger than age 60 Age 65 with 5 years of service	1.5% for years before July 1, 1957 2% for years after July 1, 1957	Ad Hoc	13.8	18.6
1979	SAME	SAME	Based on change in CPI, capped at 2%. Can decrease - but not below original retirement benefit. Begins after 4 years of retirement.	13.8	18.6
1981	30 years of service Rule of 75 with reduction if younger than age 60 Age 65 with 5 years of service	SAME	SAME	14.6	19.1
1984	25 years of service Rule of 75 with reduction if younger than age 60 Age 65 with 5 years of service	SAME	Based on change in CPI, capped at 4%. On average, 2%. Begins the later of age 65 or one year following retirement.	14.6	19.1

*From 1960 through 1999, the stated life expectancies are based on the life expectancies of Social Security at the time (https://www.ssa.gov/history/lifeexpect.html). Beginning in 2000, life expectancies are based on the actuarial valuation assumption for NMERB.

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History of ERB Retirement Benefits

YEAR	RETIREMENT ELIGIBILITY	MULTIPLIER	COLA	Life expectancy* at age 65	
				Males	Females
1987	SAME	2.15%	SAME	14.6	19.1
1991	SAME	2.35%	SAME	15.3	19.6
2010	SAME	SAME	Elimination of negative COLA	19.6	22.4
2010	Hired prior to 7/1/2010: SAME Hired after 7/1/2010: 30 years of service Rule of 80 with reduction if younger than 65 Age 67 with 5 years of service	SAME	SAME	19.6	22.4
2013	Hired after 6/30/2013: Actuarially reduced benefit if member retires with 30 years of service and is younger than age 55	SAME	Hired after 7/1/2013: COLA begins at later of age 67 or one year following retirement <u>Until ERB is > 90% funded:</u> Retirees with benefits at or below the median AND with 25 or more years' service have a 10% COLA reduction from statutory COLA formula. All other retirees have a 20% COLA reduction. <u>ERB Funding >90% <100%</u> Retirees with benefits at or below the median AND with 25 or more years' service have a 5% COLA reduction from statutory COLA formula. All other retirees have a 10% COLA reduction. <u>ERB Funding=100%</u> COLA reductions cease.	20.2	23.1

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History of Retirement Benefits

YEAR	RETIREMENT ELIGIBILITY	MULTIPLIER	COLA	Life expectancy* at age 65	
				Males	Females
2019	**Hired after 6/30/2019: Actuarially reduced benefit if member retires with 30 years of service and is younger than age 58**	**1.35% for .25 - 10 years** **2.35% for 10.25 - 20 years** **3.35% for 20.25 - 30 years** **2.4% for years in excess of 30**	Hired after 7/1/2013: COLA begins at later of age 67 or one year following retirement Until ERB is > 90% funded: Retirees with benefits at or below the median AND with 25 or more years' service have a 10% COLA reduction from statutory COLA formula. All other retirees have a 20% COLA reduction. ERB Funding >90% <100% Retirees with benefits at or below the median AND with 25 or more years' service have a 5% COLA reduction from statutory COLA formula. All other retirees have a 10% COLA reduction. ERB Funding=100% COLA reductions cease.	21.8	24.8

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