Building Fiscal Sustainability for Pensions

New Mexico Investments and Pensions Oversight Committee
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Corryn Hall, Senior Manager
David Draine, Principal Officer
State Fiscal Policy Project, The Pew Charitable Trusts

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Pew's Work on Public Sector Pensions

- Beginning in 2007, research includes 50-state trends on public pensions and retiree health benefits covering funding, investments, governance, plan design and retirement security.
- Technical assistance for states and cities since 2011.
- Recent area of policy focus – effective practices of highly successful retirement systems.
- Evidence-based, data-driven approach.

Overview

- Pew's Model Systems Framework and New Mexico
- Cost-of-Living Adjustments
- Reserve Funds
- Layered Amortization
- Considerations for New Mexico

Model Systems Framework - New Mexico



Notes: *Regarding planning for uncertainty, PERA's practices meets Pew standards for pension risk reporting. ERB's current practices falls short.
Pew's metrics cover about 90% of public retirement assets nationally and were applied to all 50 states. They are not, however, inclusive of every system. For more information and methodology, please see here.

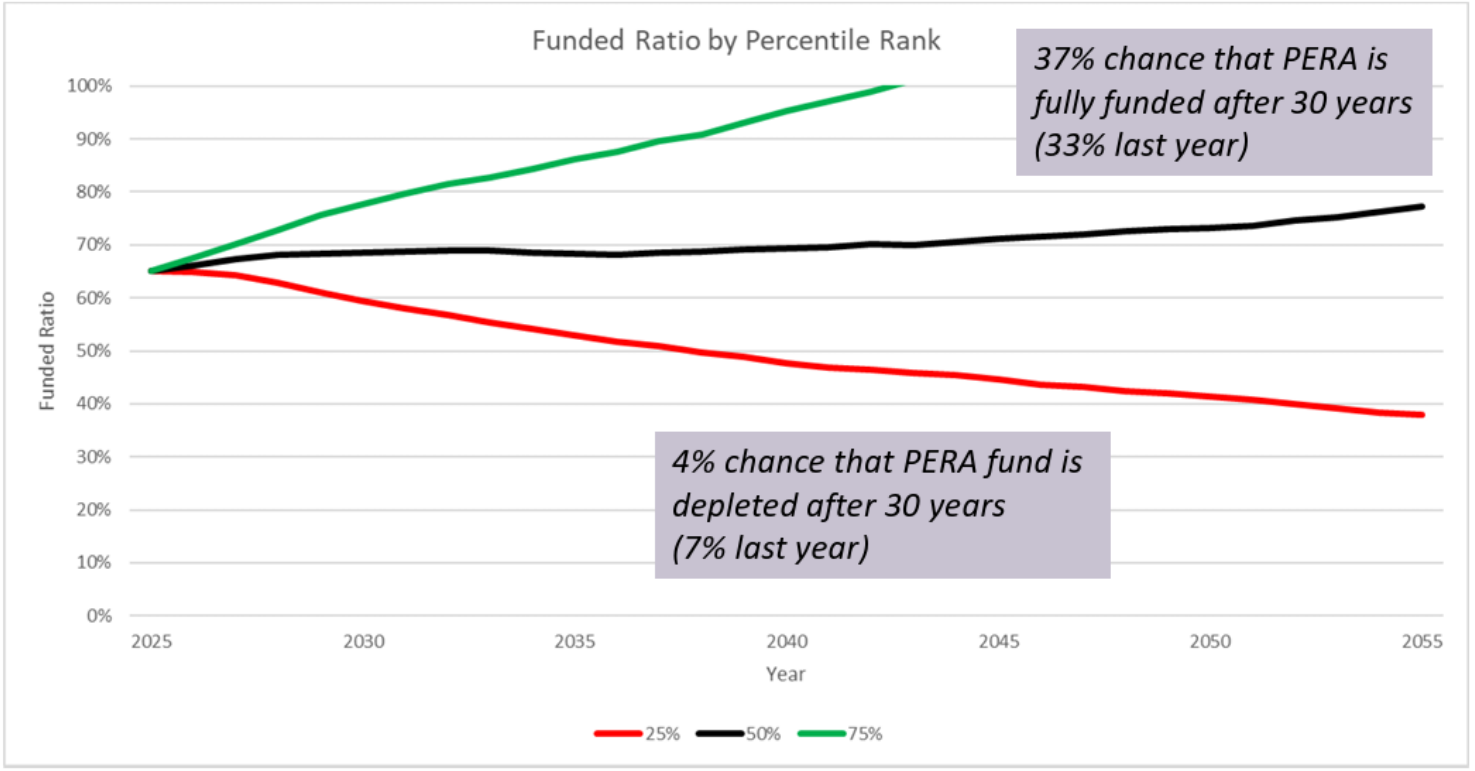
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Cost-of-Living Adjustments

Public Employees Retirement Association (PERA) Long-Term Projections

Prepared by GRS for Fiscal Year 2025.

Stochastic Projection with Varying Investment Returns and COLA

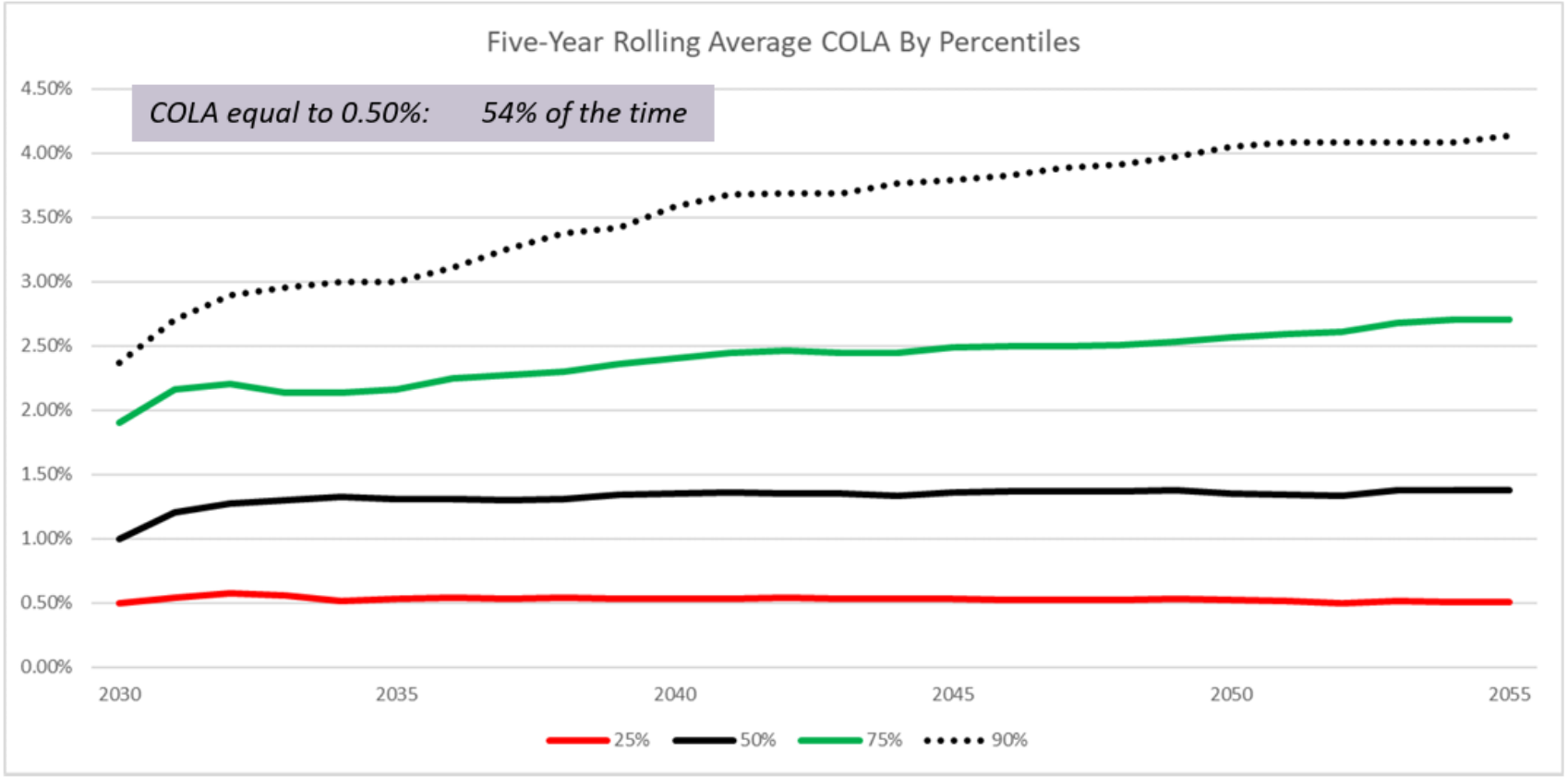


Source: GRS, PERA Long Term Projections (FY 2025).

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PERA Long-Term Projections Show Range of Future COLAs

Increases in investment returns and funded ratios will lead to higher COLAs.



Source: GRS, PERA Long Term Projections (FY 2025).

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Variable COLA Research – Overview

- Variable cost-of-living adjustments (COLAs) share risk (and benefits) among government sponsors and retirees, for the overall fiscal health of the retirement system.

- The design can take a several forms including a benefit based on funded levels, investment performance, or a hybrid approach.

- Partnering with an actuarial firm, The Terry Group, Pew sought to understand the effectiveness of different variable COLA approaches.
  - Analyzed policies in Rhode Island, Colorado, Montana, New Mexico and proposed policy in Alaska.

Variable COLA Research – Key Findings

- The analysis asked how much of the cost impact from a low-return scenario would be mitigated by the variable COLA policy.
- The 25th percentile scenario represents investment returns of about 5.4%. The 10th percentile scenario shows returns of about 4%.
- The increase in costs from low return scenarios is the sum of both the increase in employer contributions (when actuarial funding is being modeled) and the unfunded liabilities.
- Why do this? State policymakers need a framework for asking which potential policy changes will be effective at supporting well-funded pension systems with good benefits and predictable costs.

	Actuarial Funding			
	State		Teachers	
Risk Reduction	25th Percentile	10th Percentile	25th Percentile	10th Percentile
RI	-9.6%	-10.3%	-8.1%	-8.7%
AK	-4.2%	-4.5%	-3.8%	-4.0%
CO	0.9%	0.8%	0.8%	0.7%
MT	-4.7%	-5.2%	-3.5%	-3.3%
NM	**-19.1%**	**-18.6%**	-2.3%	-2.2%
	Fixed Contributions, Full Funding Target			
	State		Teachers	
Risk Reduction	25th Percentile	10th Percentile	25th Percentile	10th Percentile
RI	-10.3%	-10.1%	-8.9%	-8.7%
AK	-9.1%	-9.7%	-8.1%	-8.2%
CO	-2.4%	-3.2%	-2.4%	-3.3%
MT	-3.7%	-3.5%	-2.9%	-2.3%
NM	**-17.5%**	**-16.0%**	-0.6%	-0.2%

Source: Analysis of COLA policies by The Terry Group.

Variable COLA Research – New Mexico Findings

- New Mexico PERA's variable COLA policy was the most effective of the policies analyzed, mitigating between 16% and 20% of the risk from low investment scenarios..

- The PERA variable COLA is based on both investment returns and plan funding levels. Variable COLA formulas that incorporate returns in the COLA calculation are more responsive to investment fluctuations than relying on changes to the funded ratio.

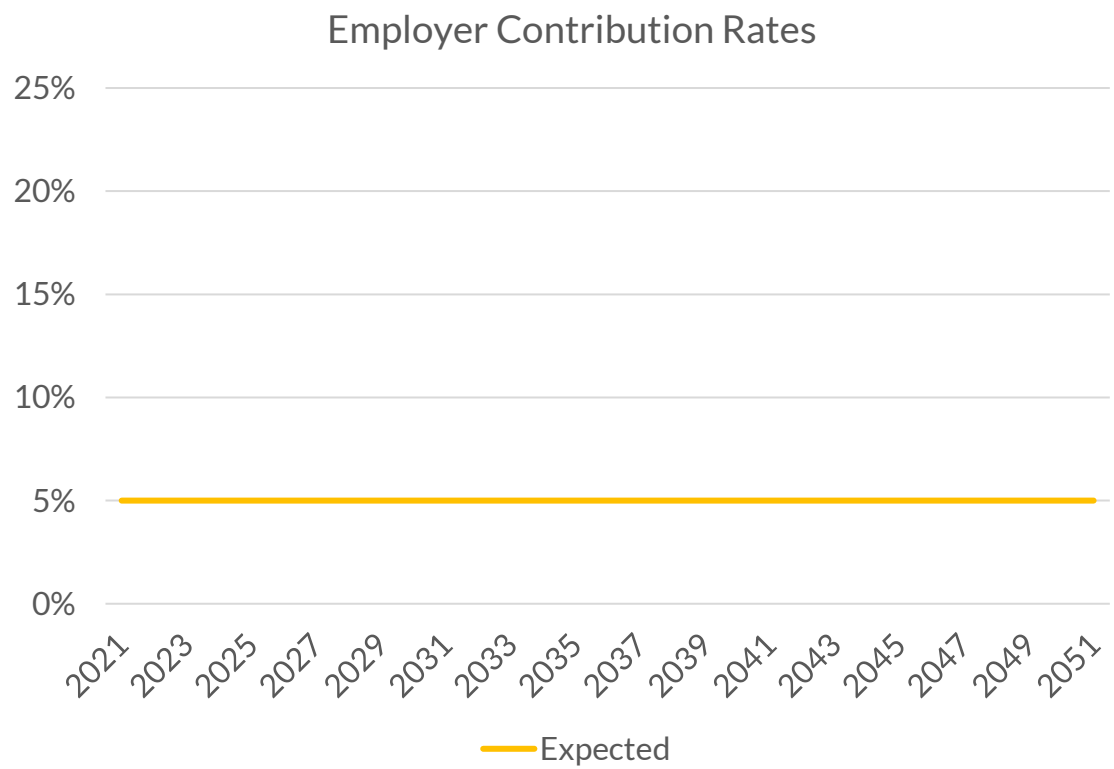
- The PERA COLA increases as funding improves—speeding up achieving actuarial full funding will improve the state's balance sheet as well as provide more inflation protection for retirees. Since both NM PERA and the Educational Retirement Board (ERB) are underfunded, the COLAs will be reduced in the near term even if investment returns meet their targets.

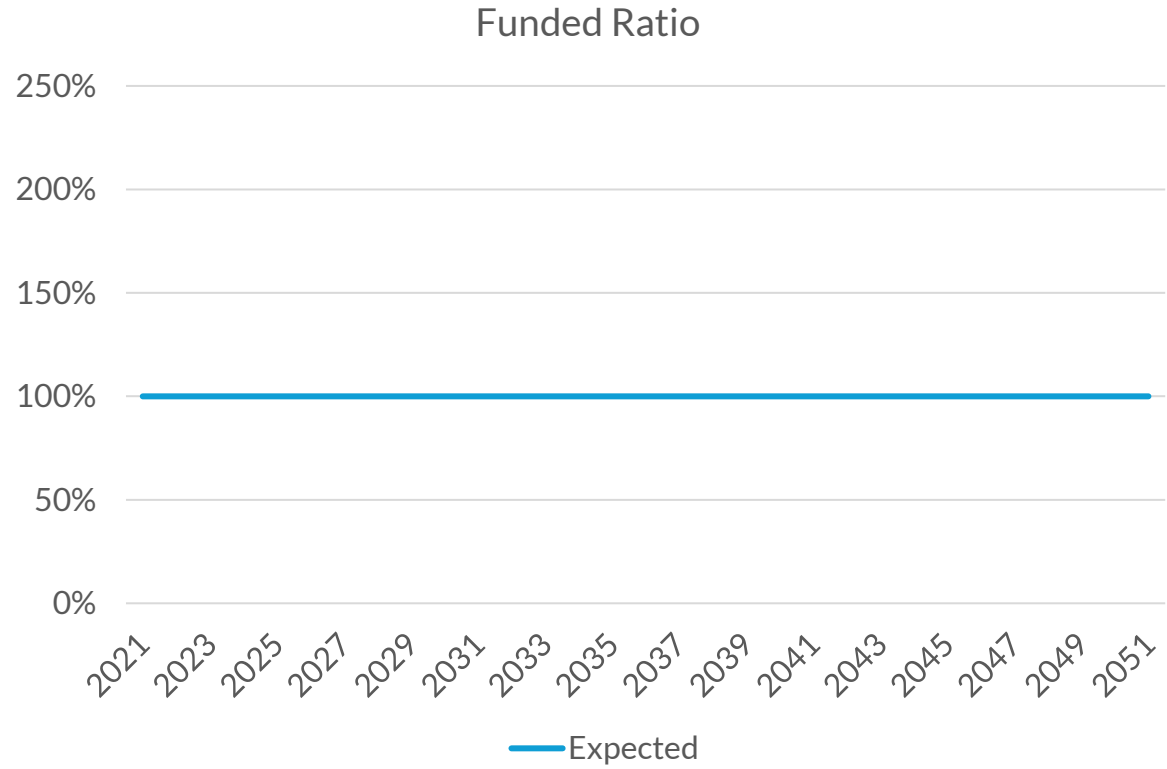
- A perpetually low COLA is not one that is effective at mitigating risk, and a variable COLA can also be an effective tool at sustainably sharing gains.

Reserve Funds

Current Practice Can Handle the Expected

If everything meets expectations, typical plan funding will allow for stable employer costs.

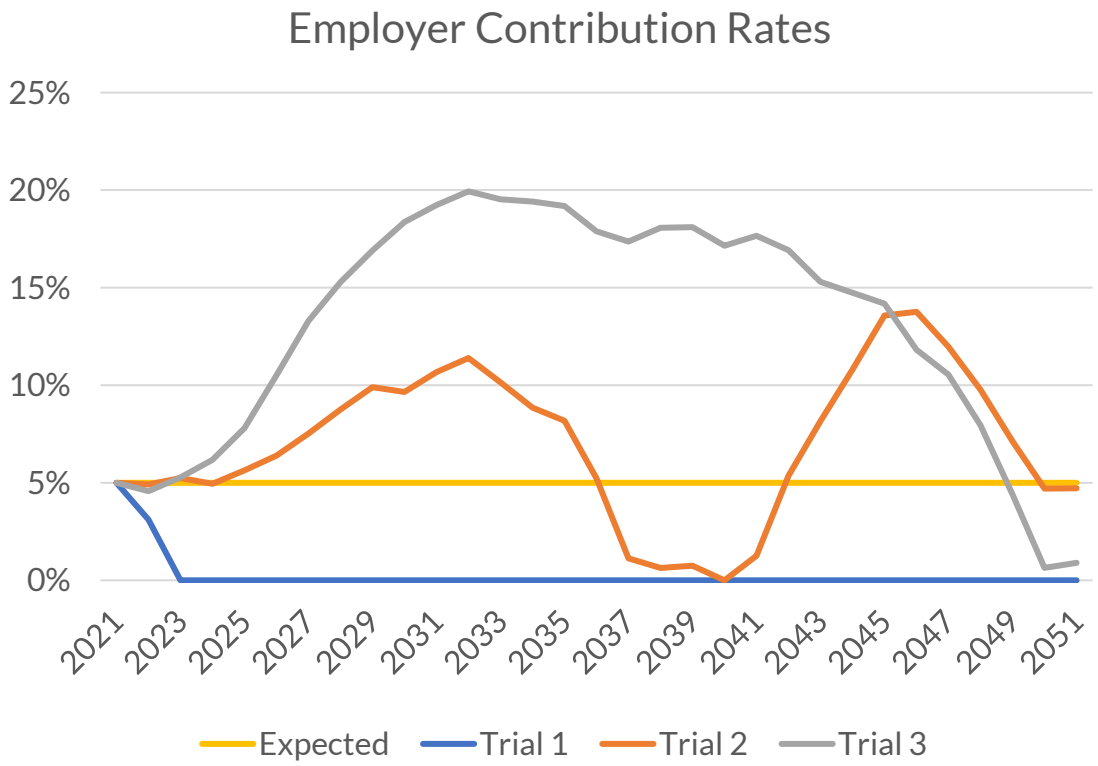


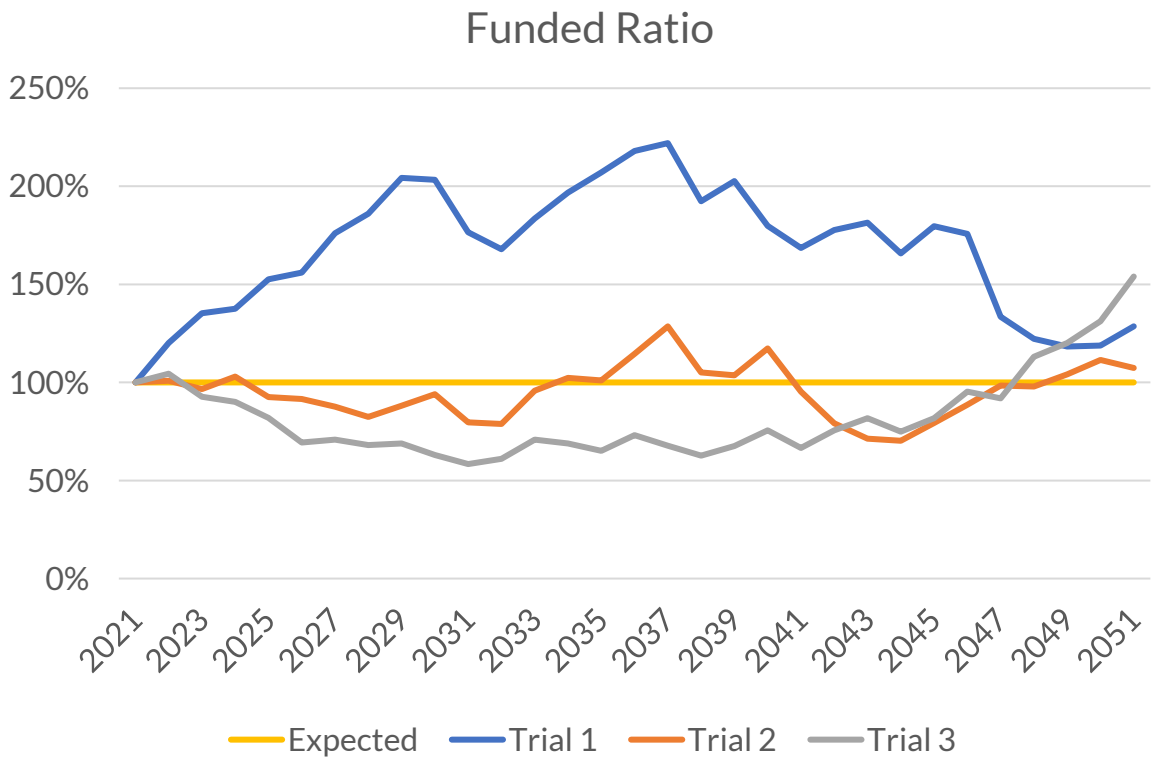


Note: Analysis based on a hypothetical pension plan with an actuarial funding policy.

But Not the Unexpected

Standard actuarial funding practices can lead to unpredictable costs given the volatility of public pension plan investments.



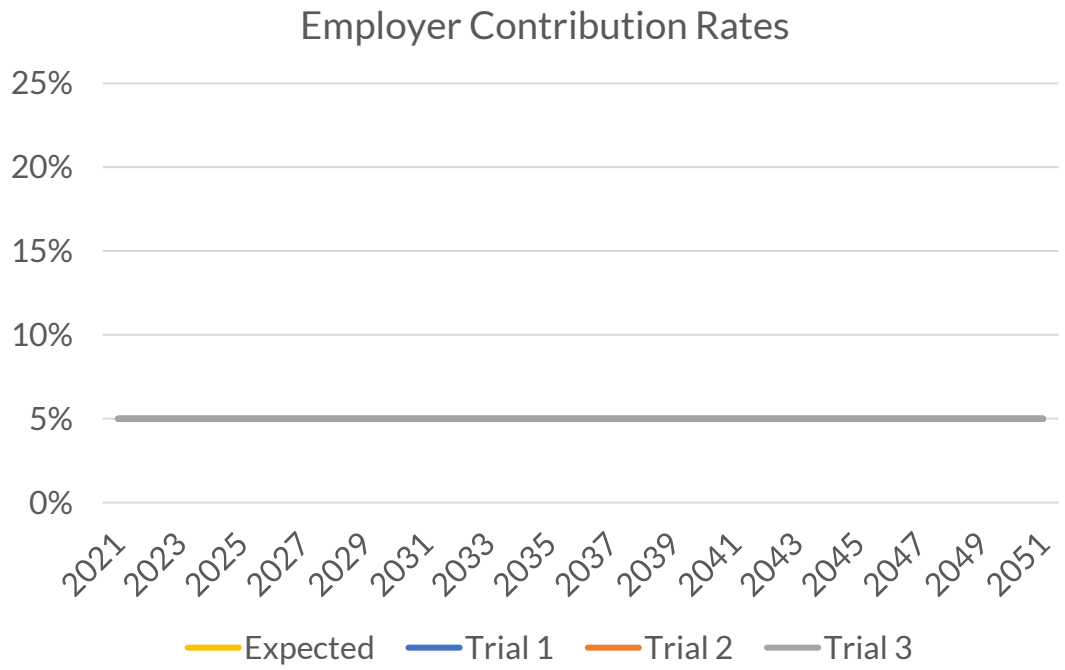


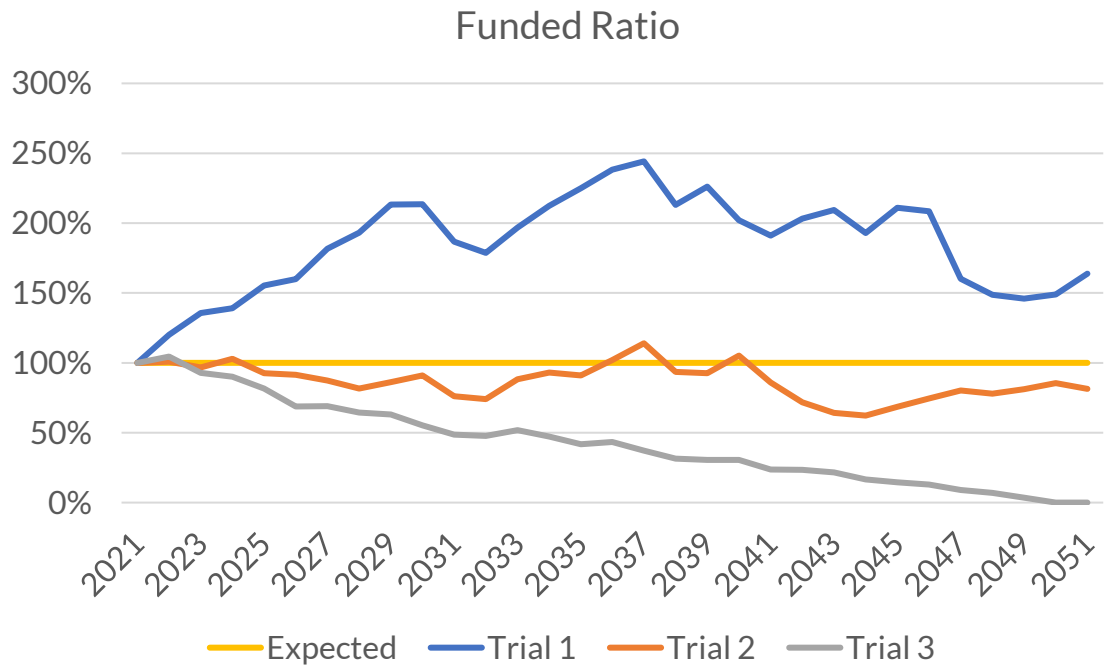
Note: Analysis based on a hypothetical pension plan with an actuarial funding policy.

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Fixed Funding Policies Risk Insolvency

Without a plan to manage low returns, investment risk and volatility can lead to the depletion of plan assets.





Note: Analysis based on a hypothetical pension plan with an actuarial funding policy.

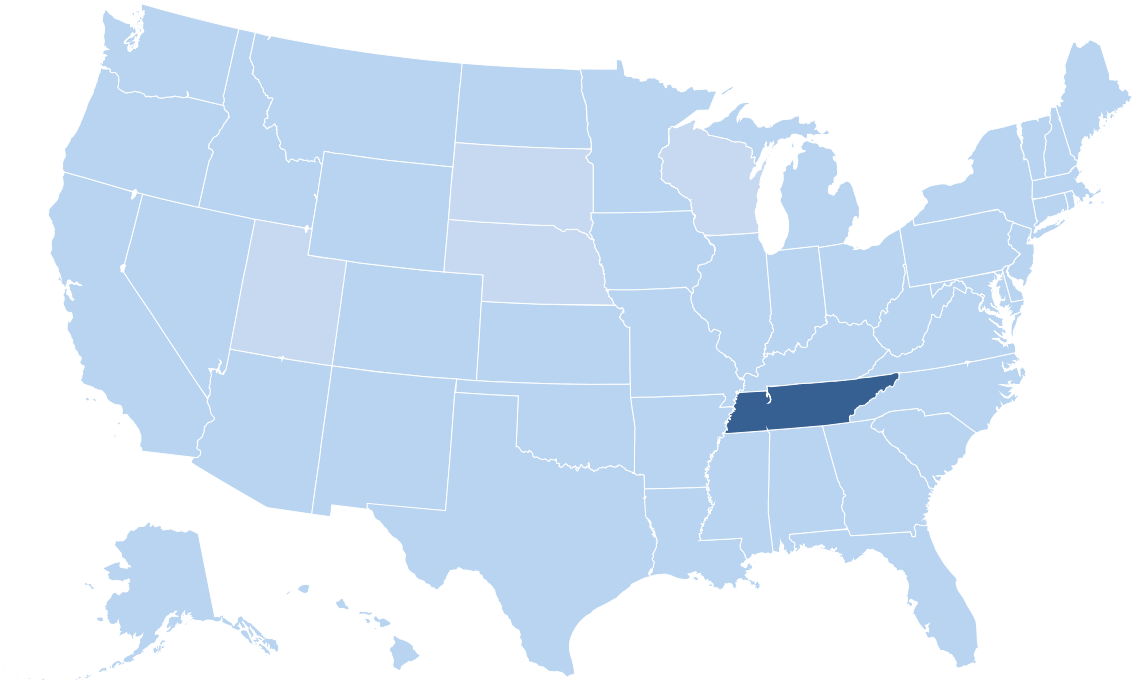
National Picture

What trends are we are seeing in the country?

- Since 2020, at least 22 states have made supplemental contributions to help pay down retirement system liabilities, with many states making multiple payments over the period.
- In many cases, these supplemental contributions reflect states taking advantage of budget surpluses or excess rainy-day funds to help pay down pension debt.
- A handful of states have policies in place that regularly allocate excess funds to pay down retirement debt through reserve funds.

Tennessee's Pension Reserve Fund – (100% funded)

The state's hybrid plan ensures predictable costs through the combination of a reserve fund, variable benefits, and by providing a portion of benefits via a Defined Contribution (DC) account.



How the TN reserve fund works:

- Every participating employer will contribute 4% of payroll for the hybrid Defined Benefit (DB).
- If the normal cost is projected to be below that—the excess goes to the reserve.
- If the actuarial contribution for the hybrid exceeds 4%, the reserve is used to pay for the difference.
- If the reserve is depleted, the variable benefit provisions apply.

Policies Directing Excess Revenues to Pay Down Pension Debt – (less than 100% funded)

California

- Under Proposition 2 (2021), minimum general fund revenues and excess capital gains payments must be split between payments to the state's rainy-day fund and mandatory transfers to pay pension contributions and retiree healthcare. These mandatory debt repayments are required through 2030.

- The state has made over $3 billion in supplemental contributions to the California Public Employees' Retirement System (CalPERS) under this policy since 2020 and expects to pay an additional $3 billion through FY28. The most recent budget noted that CalPERS contributions are $1.6 billion lower than in the previous year as a result.

Policies Directing Excess Revenues to Pay Down Pension Debt – (less than 100% funded) (cont.)

Indiana

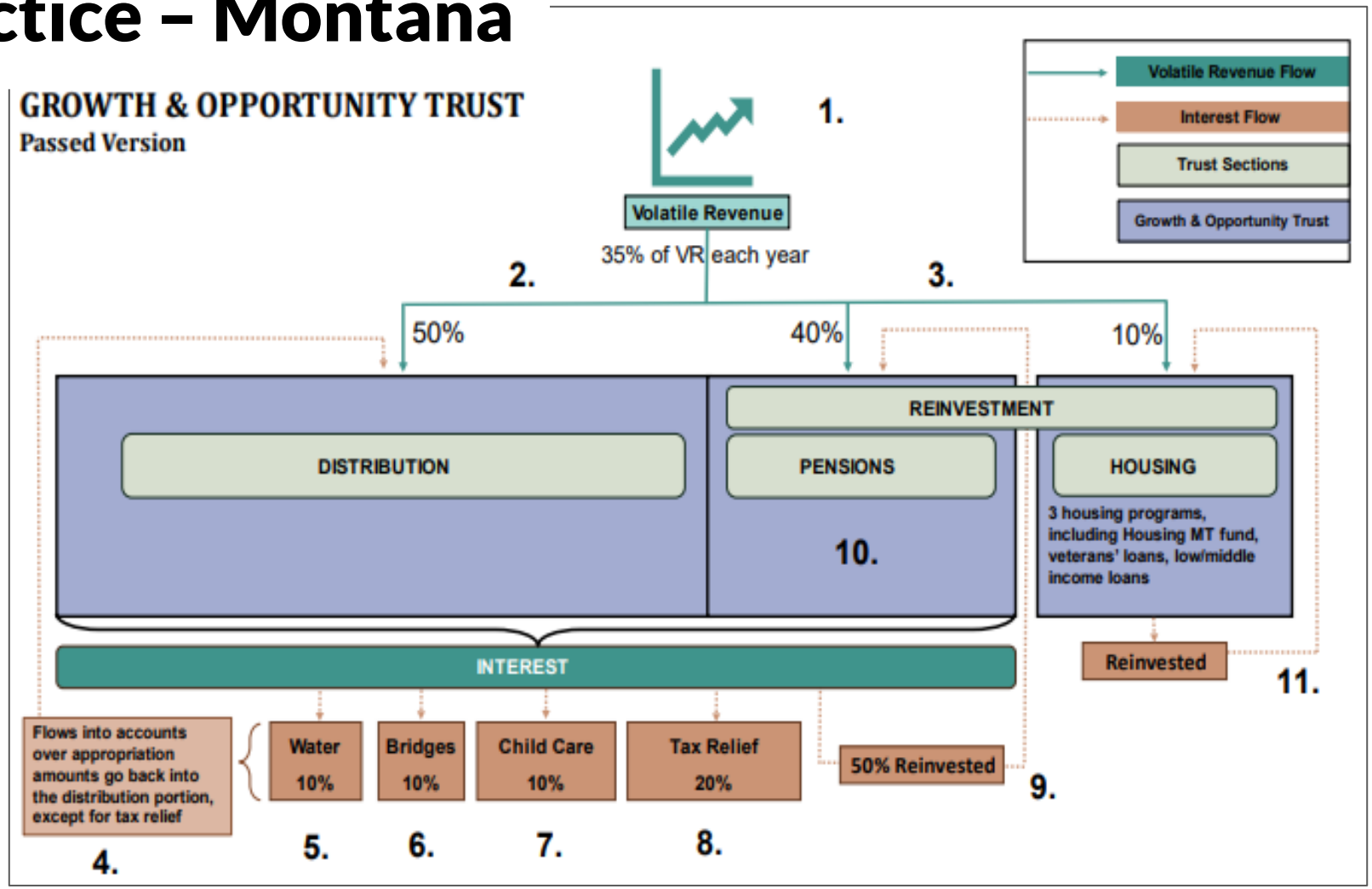
- State law requires any excess reserves to be allocated evenly to taxpayer refunds and payments to the state's pension stabilization fund (though the exact allocations sometimes shifted from year to year).
- Under the policy, the state has made an additional $3.7 billion in supplemental contributions to the Teachers' Retirement pre-1996 Fund. The state now expects the formerly pay-as-you-go plan to be fully funded in 2028, freeing up the existing contributions for other spending goals.

Massachusetts

- Under state law, excess capital reserves are allocated between the state's rainy-day fund (90%), Retiree Benefits Trust Fund (5%), and Pension Liability Fund (5%).
- The state has contributed about $130 million in supplemental contributions since 2020 under this policy and is expected to contribute another $6.9 million in the FY25 budget.

Reserve Funds in Practice – Montana

- **Montana Growth and Opportunity Trust (GO Trust)** enacted in 2025 via HB 924.
- 35% of "volatile revenue" is transferred to the GO Trust for use toward various purposes, including pensions.
    - Transfers of funds are initiated to the pension systems if investment performance falls below the target rate for two consecutive years.
    - A portion of the interest earned on the trust fund is "reinvested" towards pensions.



Source: Legislative Fiscal Division, Summary of HB 924 (2025)

Reserve Funds in Practice - Connecticut

Volatility Transfers – (49.9% Funded)

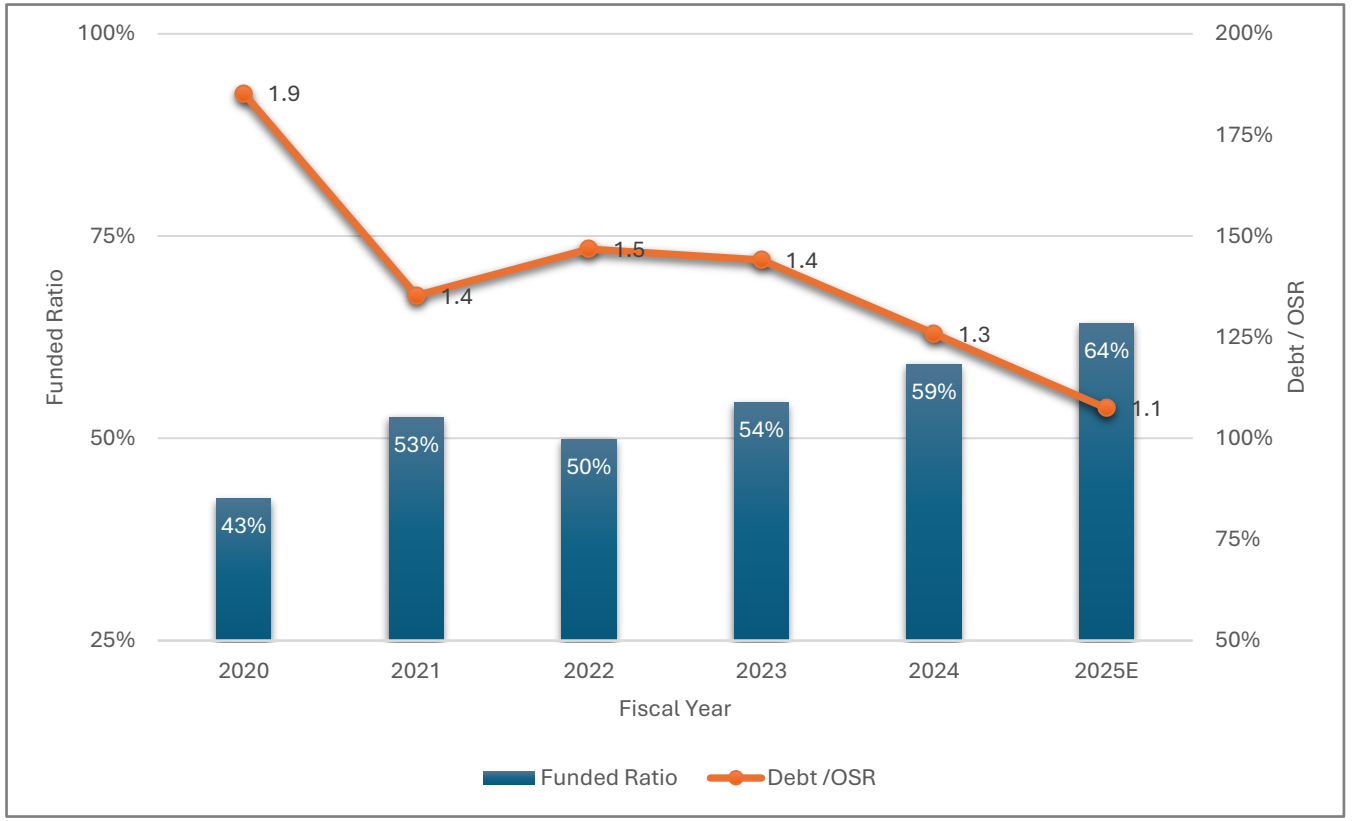
In 2017, Connecticut passed legislation implementing budget controls for fiscal year 2018-2019 to capture excess revenues from volatile income tax components (such as capital gains) for deposit in the state's budget reserve fund (BRF) —the state's rainy-day fund— and to repay pension debt.

How the volatility transfers work:

- When the BRF reaches its statutory cap, these excess reserves are allocated by the state's comptroller for deposit into the state employees' and teachers' retirement funds to pay down unfunded liabilities.
- The state's pension stress tests show that without these payments, annual contributions would average approximately $300 million more each year, on average—representing long-term savings of more than $8 billion.
- To date, this policy has directed $12 billion to the BRF or to reduce pension debt, including $3 billion in 2022 at the peak of the COVID-19 pandemic era revenue wave.

Connecticut's Unfunded Pension Liabilities Have Fallen Sharply Over the Past 5 Years

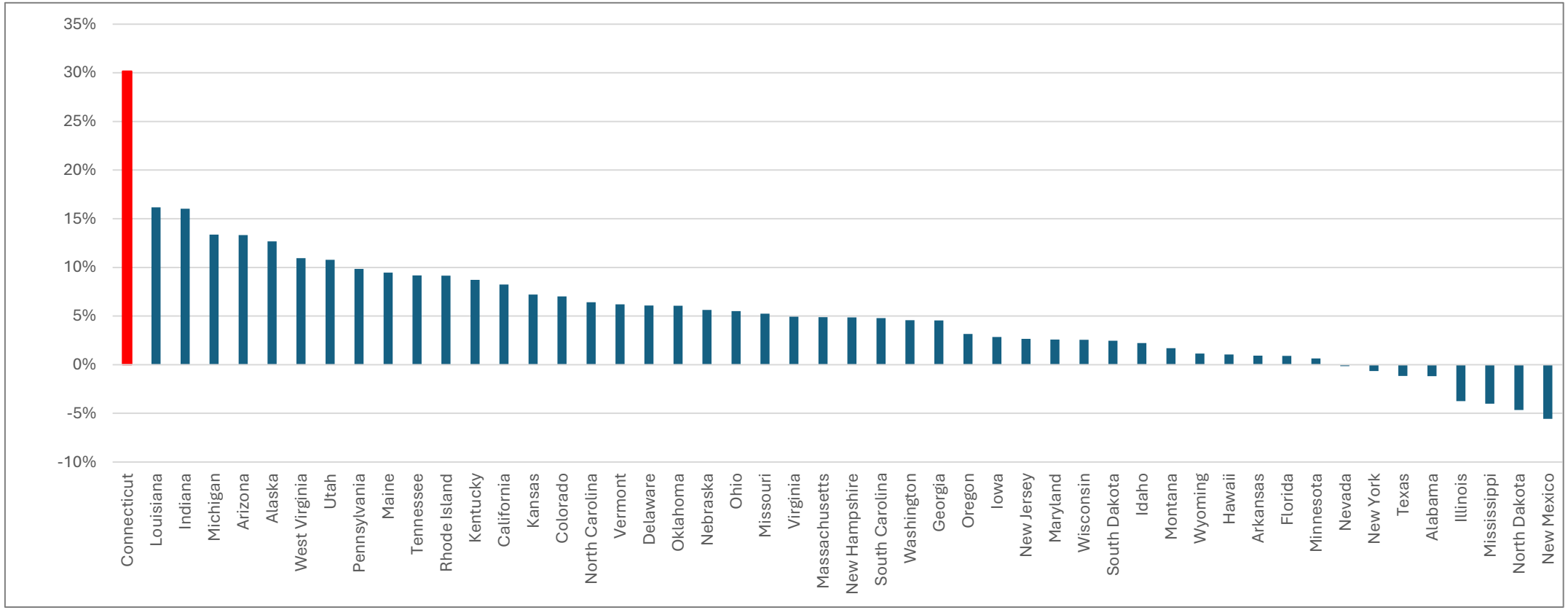
Combined state and teacher funded ratio and pension debt as a share of own source revenue, 2020 to 2025.



Source: Annual comprehensive financial reports, actuarial reports and valuations, or other public documents, or as provided by plan officials.

Connecticut Made Nation's Highest Pension Contributions as a Share of Payroll

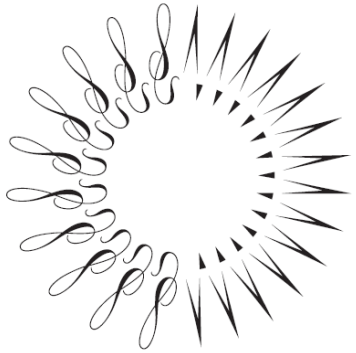
Net amortization as a share of payroll from 2021 – 2024.



Source: Annual comprehensive financial reports, actuarial reports and valuations, or other public documents, or as provided by plan officials.

Layered Amortization

Why is Actuarial Funding Important for Pension Plans?



"From the beginning, Pew's research has emphasized the importance of adequately funding pension promises…the lack of consistent, adequate funding will make any pension policy unsustainable."
The Pew Charitable Trusts

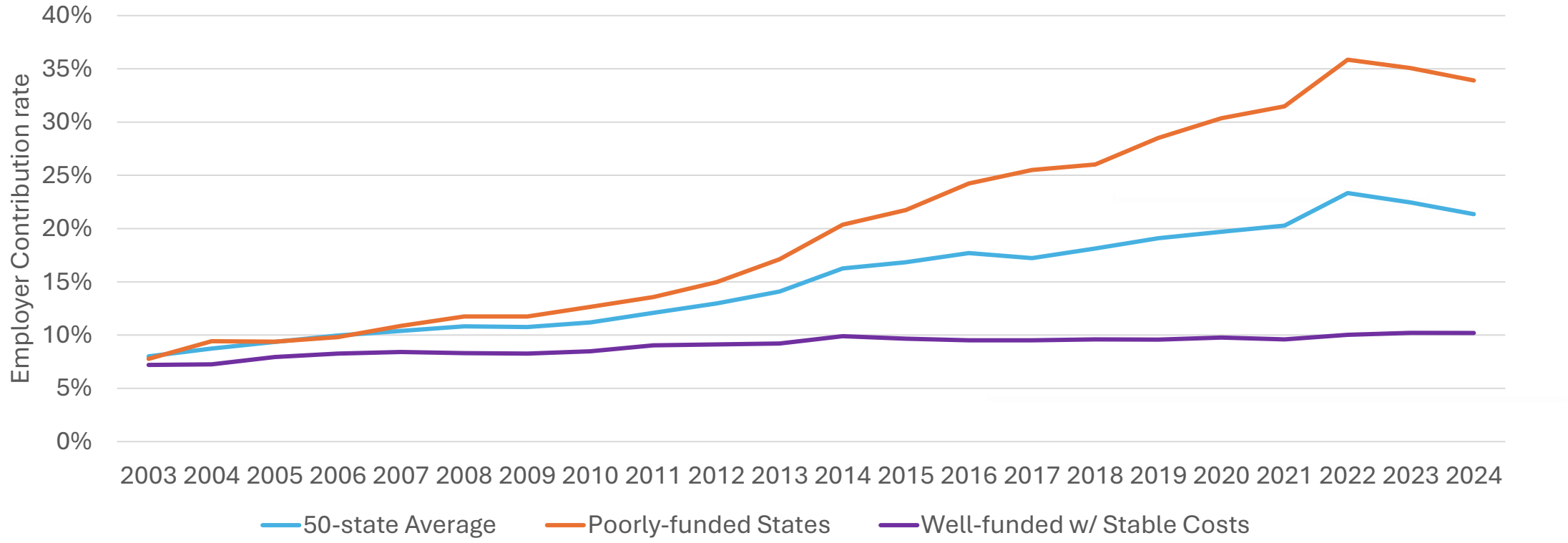
"The GFOA recommends that the full amount of the actuarially determined contribution be paid to the plan each year." *The Government Finance Officers Association*

NASRA

"Disciplined funding of public employee retirement systems is critical to minimize costs, maximize investment returns, and ensure the long-term viability of the trust."
The National Association of State Retirement Administrators

Achieving High Funding and Stable Costs

Effective funding policies, risk-management tools, and plan designs can lead to stable contribution rates, high funded ratios, and strong benefit provisions.



Note: Well-funded states with stable costs are Idaho, Nebraska, South Dakota, Tennessee, and Wisconsin.
Poorly funded states are the 10 with the lowest funded ratio in 2024.
Source: State annual financial reports, pension plan financial reports, and plan actuarial valuations

Layered Amortization

- Pension amortization approach that establishes new closed funding periods, or layers, for gains and losses in individual years in order to pay down future liabilities as they are incurred.
  - Achieves the advantages for closed amortization while maintaining the strength of an open approach.

- Layered amortization is cited as best practice by the Conference of Consulting Actuaries (CCA) and Government Finance Officers Association (GFOA).

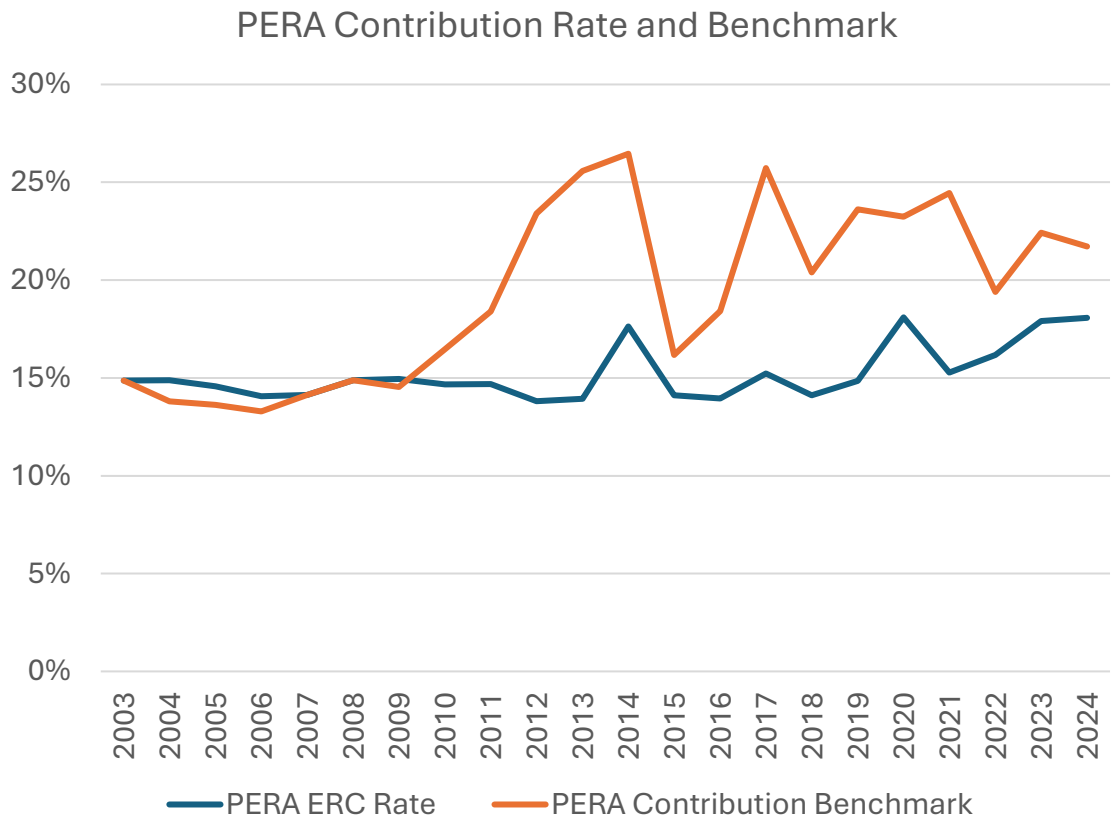
- Growing number of states are implementing layered amortization.
  - Minnesota (2025)
  - Maryland (2023)
  - Connecticut (2019)

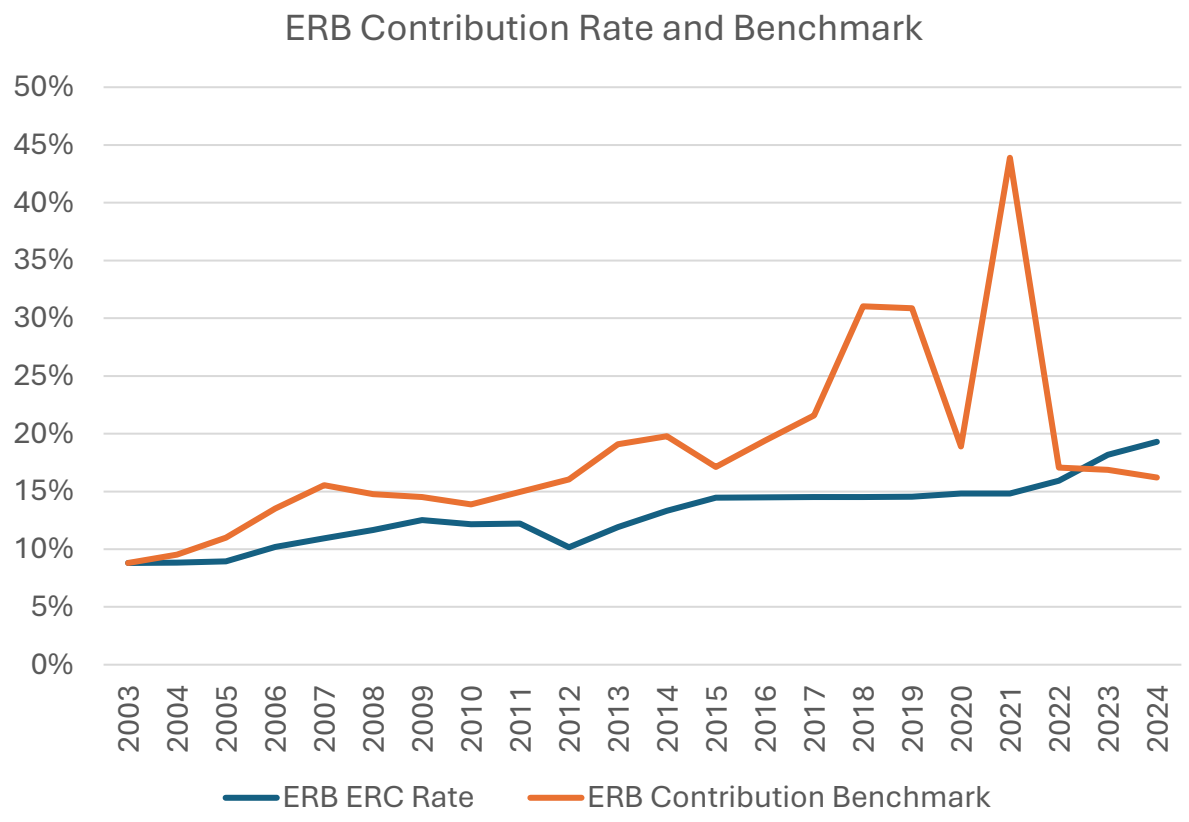
What is Layered Amortization Trying to Solve?

- **Automatic adjustments**: Actuarial funding policies will adjust contribution rates to meet funding targets rather than require the legislature to respond to changes in investment performance, actuarial assumptions, or benefit provisions.
- **Certainty of paying down unfunded liabilities:** Unfunded liabilities created by investment losses or other causes will be paid down over a fixed period, creating certainty that the state will not have legacy funding gaps from many decades prior still on the books. Open or rolling amortization can end up never fully paying down pension debt or in some cases never even making progress.
- **Managing volatility:** A single fixed or closed amortization period can create unnecessary volatility if a downturn or market correction occurs at the end of the period. Having fixed layers for each year's gains or losses avoids that volatility.
- States can add additional tools to smooth out contribution volatility (for example, reserve funds or using gains to offset losses) to a layered amortization approach.

NM Employer Contribution Rate (ERC) Changes Over Time

Pension contributions have not kept pace with actuarial funding needs over time.



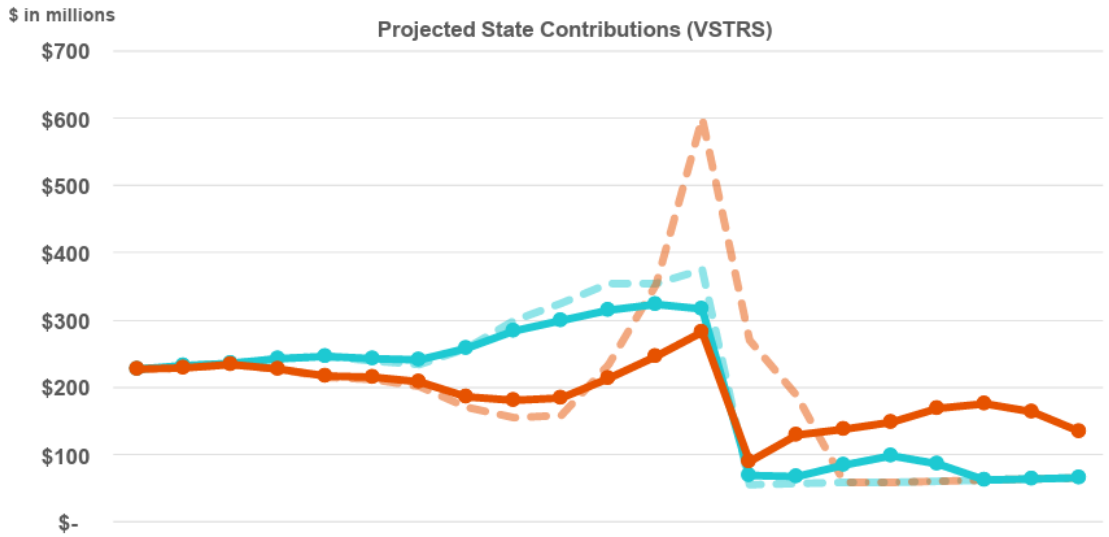


Note: Benchmark from 2003 through 2013 is the reported Actuarially Determined Employer Contribution.
For 2014 and subsequent years, it is the calculated net amortization benchmark.

A Fixed Funding Date Can Be Too Volatile

Analysis presented to the Vermont Pension and Benefit Funding Task Force shows how layered amortization can solve the volatility caused by a closed amortization policy.

Impact of Volatility – Alternative 2



	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046
2030-31 ↘	228	233	237	243	247	242	241	258	284	299	314	324	318	69	68	85	98	86	63	64	65
2032-36 ↘	228	229	234	227	217	215	209	185	180	185	214	246	282	90	130	138	148	169	175	163	135

↘ = "downturn"

Under Alternative 2, high projected contributions between 2034 and 2038 resulting from investment losses are funded by amortization layers that extend beyond 2038, potentially easing pressure on budgets.

Jump to Alt. 1 Segal 29

Source: Segal Presentation to the September 28th, 2026, meeting of the Vermont Pension and Benefit Funding Task Force

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Layered Amortization Is Responsive and Predictable

Each year's gains or losses have their own payment schedule.

Closed

CLOSED

STRENGTH
A set date by which the liability is paid off

WEAKNESS
Contributions can jump sharply near the end of the period

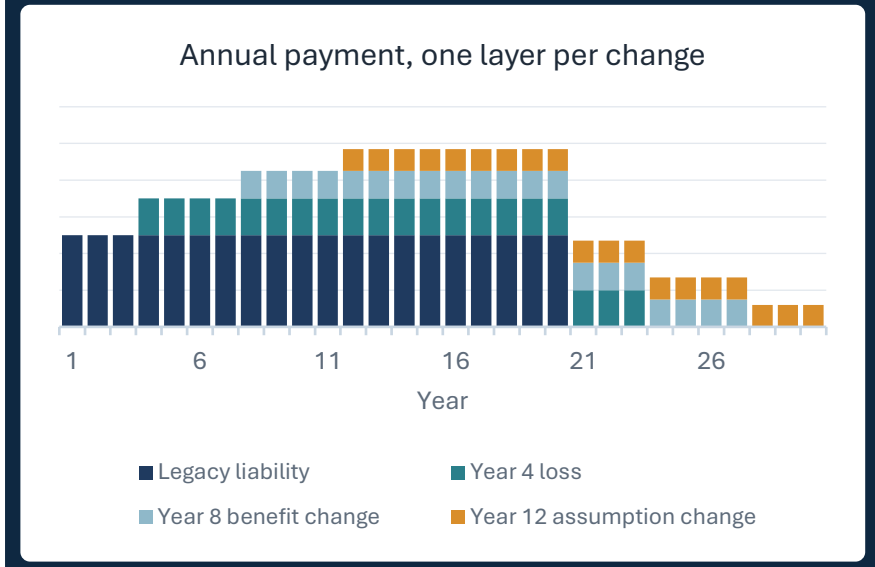
Open

ROLLING

STRENGTH
Stable, predictable contributions

WEAKNESS
Full funding keeps getting pushed back, shifting costs to future taxpayers

HYBRID



TAKEN FROM CLOSED
Every layer has a defined payoff date

TAKEN FROM OPEN
Contribution rates stay stable

PLUS
Helps avoid spikes near full funding and makes the cost of each benefit or assumption change easy to track

IN PRACTICE
Minnesota (2025): funding for legacy unfunded liabilities maintained, layered amortization applied to new gains/losses. **Maryland (2023):** adopted layering, targeting full funding by 2039.

Notes: Illustrative and simplified example. Assumes 20-year amortization of each layer. Amounts for comparison purposes.

Pew

Findings and Considerations for New Mexico

- PERA's adoption of long-term projections and risk analysis is a best practice. We recommend the same for ERB.
- Analysis of PERA's variable COLA policy is that it accomplishes the most in managing risk of the policies analyzed.
- States with volatile revenue can use one-time funds to pay down pension debt or build reserves.
- Actuarial funding policy is a long-term best practice and can be designed in a way to avoid contribution volatility.

Findings and Considerations for New Mexico (cont.)

- Current pensions funding policy has not been effective at paying down pension debt and getting to full funding.
  - Recommended best practice: Actuarial funding with layered amortization.
  - Secondary choice: Statutory funding with reserve option and layered amortization.

For more information:
https://www.pew.org/en/projects/state-fiscal-policy/state-pensions

Corryn Hall
Senior Manager
chall@pewtrusts.org

David Draine
Principal Officer
ddraine@pewtrusts.org

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