# New Mexico Educational Retirement Board

## Improving NMERB's Sustainability

**Revenue Stabilization & Tax Policy Committee**

**Representative Jim R. Trujillo, Chair**

**Senator Carlos R. Cisneros, Vice Chair**

December 17, 2018

Jan Goodwin, Executive Director

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Mary Lou Cameron, Board Chair

H. Russell Goff, Board Vice Chair

# 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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# Why is 100% funding desirable for ERB?

1. It’s good public policy!
2. Better able to withstand market downturns
3. Contribution rates can be lower
4. COLA reductions will end
5. GASB 68 reporting to employers will not be necessary
6. Improve state’s and participating employers’ credit rating

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# ERB Process

| | |
|---|---|
| Spring 2017 | After June 30, 2016 experience study, funding period was 84 years |
| Fall 2017 | Met with members to discuss improving sustainability |
| Spring 2018 | Survey of active and retired members |
| Spring/Summer 2018 | Two Board retreats on sustainability |
| Summer/Fall 2018 | Worked with Stakeholder Group |
| November 16, 2018 | Board approves proposal to be fully funded in 30 years |

# Increase contributions

**1.** Increase employer contribution by 1% for three years, reaching 16.9% in FY22

Each 1% increase costs $27 million

No increase in employee contributions

**2.** Return to Work Program

Change layout period to 6 months

If no layout can only work 0.25 FTE and retiree and employer will pay contributions

Expected contributions $4.1 million

# Increase contributions, continued

**3.** PERA retirees working for ERB employers will pay contributions

Expected contributions $2.2 million

PERA retirees who currently or in the future work for ERB employers will pay contributions

**4.** All short-term substitutes who work 0.25 FTE or more will be considered ERB members and they and their employers will pay contributions

Expected contributions $3 million

# Encourage longer careers

5. Tiered multiplier for new members

- First 10 years multiplier is 1.35%
- Second 10 years multiplier is 2.35%
- Third ten years multiplier is 3.35%
- Years after 30 multiplier is 2.4%

6. Minimum retirement age 58 for new members

Benefit is actuarially reduced if retire before age 58

# Perception of benefit manipulation

7. Anti-spiking provision from SB 86, 2013 regular session

- For employees with annual salary greater than $60,000, exclude increases greater than 30% from Final Average Salary calculation

# HB 628 2011 Special Appropriation

8. Special Appropriation

Impact of:

- Contribution swaps from 2010-2012: $51.3 million
- Delay in increased employer contributions: $197 million
- Total amount requested in Special Appropriation from AFSCME litigation settlement: $248.3 million

# NMERB Proposed Legislation

| | Element | Description | Details | Effective Date |
|---|---|---|---|---|
| 1 | Tiered Multiplier | Institute benefit multiplier for new hires on a tiered structure based on length of service to result in a 2.35% for a 30-year work history. | Years of service: .25 to 10 = 1.35%; 10.25 to 20 = 2.35%; 20.25 to 30 = 3.35%; 30 + = 2.4% | July 1, 2019 |
| 2 | Employer Contribution | Increase employer contribution by 1% per year for 3 years. | Make sure that the contribution increase is fully funded. The employer contribution increase attributable to ARP participants will remain in the DB plan. Employee contribution rates will remain unchanged. | July 1, 2019 |
| 3 | Anti-spiking | Language similar to SB 86 from 2013 session | Limit increased from 20 to 30% | July 1, 2019 |
| 4 | Return to Work | All NMERB retirees wanting to return to work for NMERB employers during retirement must first lay out six months, and they and their employers will pay contributions on income. There is no cap on earnings. | The Board's Return to Work Exception will be eliminated. Layout under RTW Program reduced from 12 months to six months. Retirees who work 0.25 FTE or less will not be subject to the 6-month layout. Retirees may still suspend retirement benefit and work to earn more service credit. | July 1, 2019 |

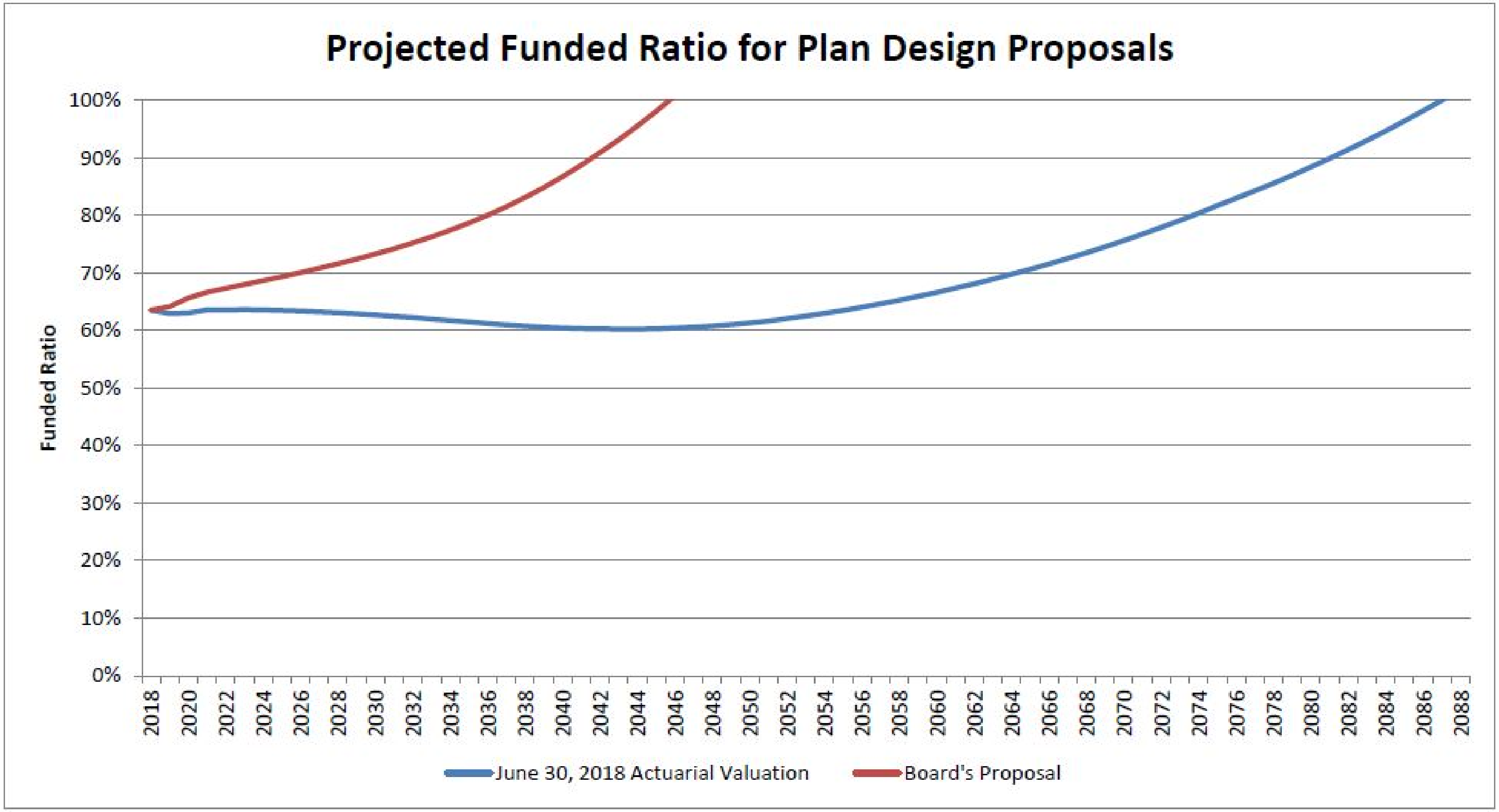
# NMERB Proposed Legislation - continued

| | Element | Description | Details | Effective Date |
|---|---|---|---|---|
| 5 | PERA Retirees | All PERA retirees who work for a NMERB employer will pay contributions, as will their employers. | NMERB will support PERA legislation to accomplish the same thing with NMERB retirees that go to work for a PERA employer. | July 1, 2019 |
| | | | | |
| 6 | Minimum Retirement Age of 58 | New employees hired on or after July 1, 2019 will have a minimum retirement age of 58. | This will be a "soft" minimum retirement age, meaning that their benefit will be actuarially reduced if they qualify and retire before they reach the age of 58. | July 1, 2019 |
| | | | | |
| 7 | Substitute Teachers | Substitute teachers treated as all other employees, and if working more than .25 FTE they would be members and pay contributions as would their employer. | Remove substitute teachers as excluded category under 2.82.2.11.C NMAC. | July 1, 2019 |
| | | | | |
| 8 | Restitution to Fund | Payment to NMERB of employer contributions and lost earnings. | Working with stakeholders to seek resolution of the negative impact of the contribution swaps and delays of employer contribution increases from 2009-2011 to the fund. | July 1, 2019 |

# Expected effect of bill

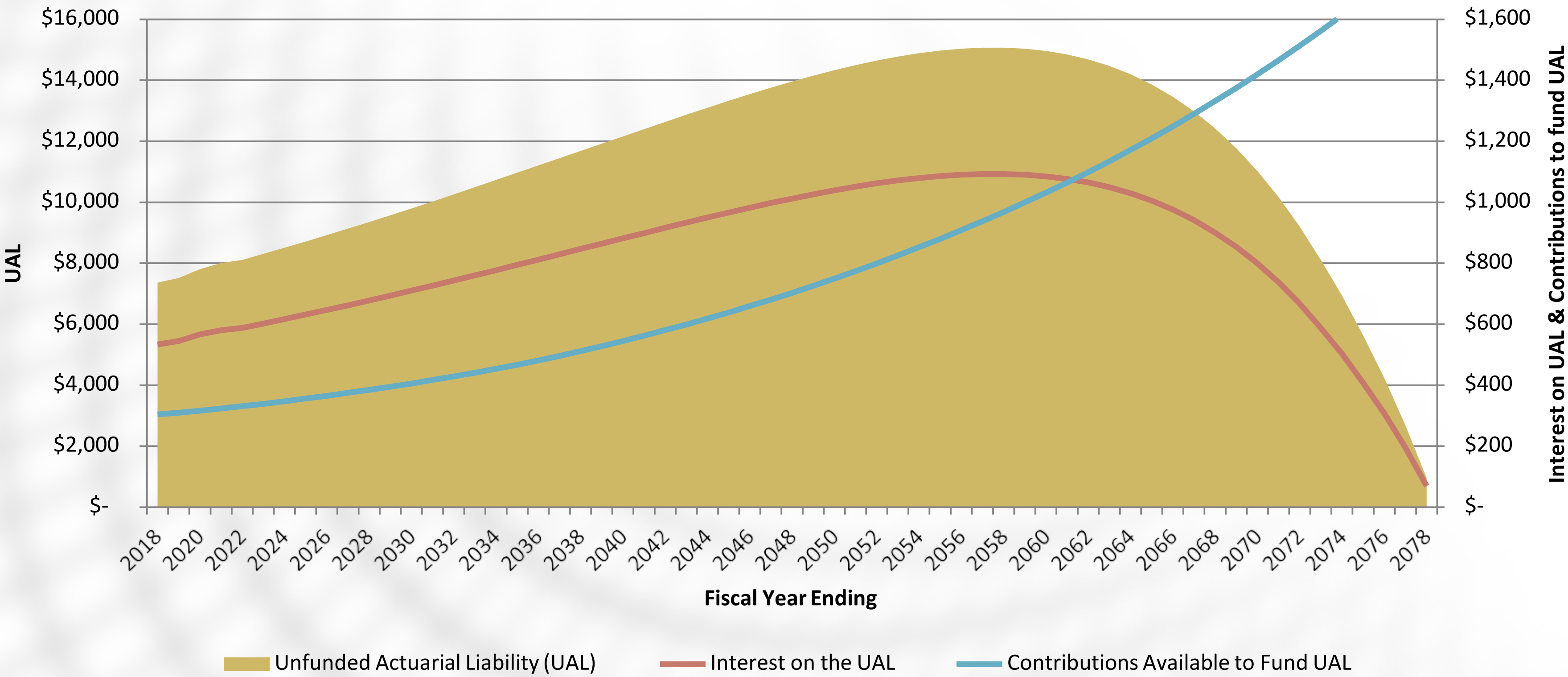
- Fully funded within 30 years
- Negative amortization for 15 years

# Projected Funded Ratio for Plan Design Proposals



# Negative Amortization

Total projected contributions until UAAL eliminated: $110.4 billion
Contributions directed to the interest on the UAAL: $49.8 billion

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# Cost of Delay

- Expected FY2018 contributions of $298 million allocated to eliminating UAAL
  - Total expected contributions for FY2018 are $668 million
  - However, first $370 million is allocated to normal cost
- UAAL at June 30, 2017 was $7.4 billion
  - At 7.25% per year, interest on UAAL for FY2018 is $533 million
- Excess of interest over UAAL contributions results in negative amortization
- Contributions expected to exceed interest on UAAL in approximately 40 years
  - Contributions increase as payroll increases

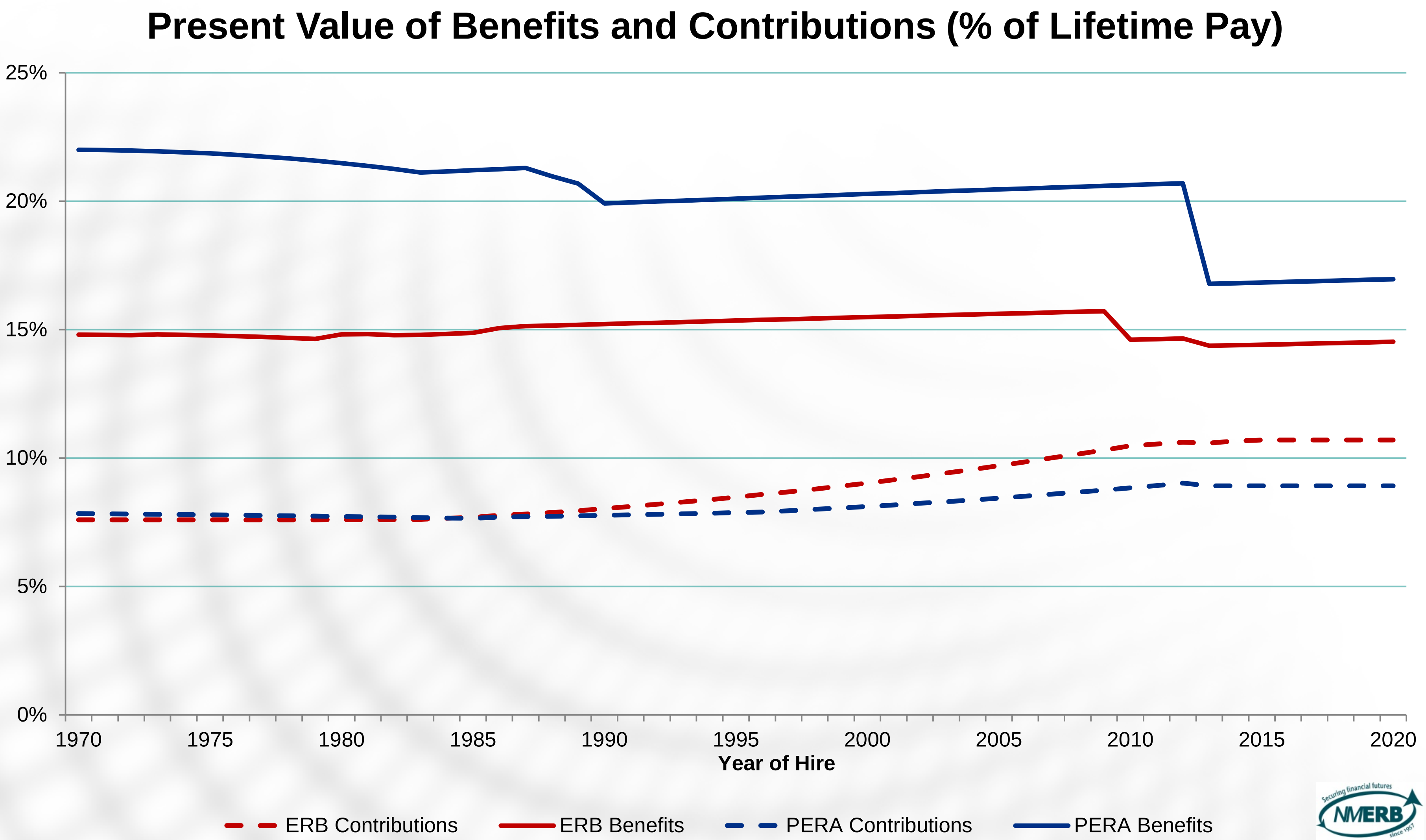
# Need a Dedicated Revenue Source to Sustain Education in New Mexico

Possible solutions:

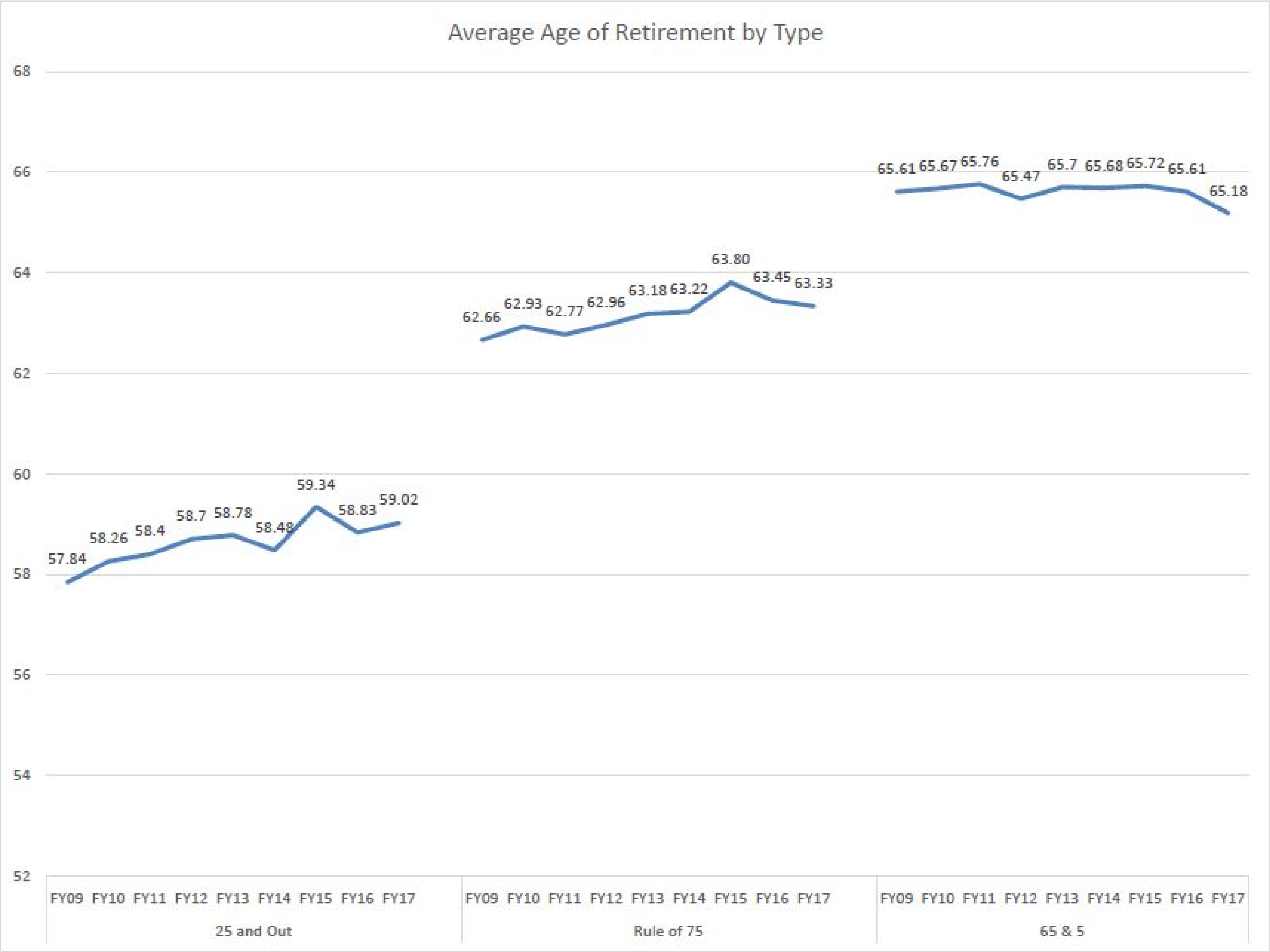
- Short Term
  - Collect delinquent taxes

- Long Term
  - Property taxes
  - Overhaul tax system
  - Pension obligation bonds

# Benefit Comparison :
# ERB and PERA State General Plan 3



# Retirement Age Trends

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# Summary: ERB Actuarials and Assumptions

| Fiscal Year | 6/30/14 Valuation | 6/30/14 Experience Study | 6/30/15 Valuation | 6/30/16 Valuation | 6/30/16 Experience Study | 6/30/2017 Valuation | 6/30/2018 Valuation |
|---|---|---|---|---|---|---|---|
| UAAL | **$6.3B** | **$6.6B** | **$6.5B** | **$6.6B** | **$7.4B** | **$7.4B** | **$7.5B** |
| Funded Ratio | **63.1%** | **62.0%** | **63.7%** | **64.2%** | **61.5%** | **62.9%** | **63.5%** |
| Funding Period | **26 years** | **32 years** | **37 years** | **46 years** | **84 years** | **61 years** | **70 years** |
| Inflation Assumption | **3.00%** | **3.00%** | **3.00%** | **3.00%** | **2.50%** | **2.50%** | **2.50%** |
| Investment Assumption | **7.75%** | **7.75%** | **7.75%** | **7.75%** | **7.25%** | **7.25%** | **7.25%** |
| Mortality Assumption | **Static Mortality** | **Generational Mortality** | **Generational Mortality** | **Generational Mortality** | **Generational Mortality** | **Generational Mortality** | **Generational Mortality** |
| Active Membership Growth Assumption | **0.50%** | **0%** | **0%** | **0%** | **0%** | **0%** | **0%** |
| Wage Growth Assumption | **4.25%** | **3.75%** | **3.75%** | **3.75%** | **3.25%** | **3.25%** | **3.25%** |
| Payroll Growth Assumption | **3.50%** | **3.50%** | **3.50%** | **3.50%** | **3.00%** | **3.00%** | **3.00%** |

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# September 30, 2018 Investment Returns

| Returns* | 1 Year | 3 Years | 5 Years | 10 Years | 30 Years |
|---|---|---|---|---|---|
| Portfolio | 7.5% | 9.6% | 7.9% | 7.9% | 8.7% |
| Policy Index | 8.0% | 9.8% | 7.5% | 7.2% | 7.8% |
| Value Add | -0.5% | -0.2% | 0.4% | 0.7% | 0.9% |
| Universe Ranking | 25 | 38 | 23 | 27 | 19 |

*All returns in this presentation are net of external manager fees.

# Why It's Important to Take Action Now

**Moody's credit rating agency downgraded New Mexico's general obligation bonds**

*New Mexico's GO Ratings Cut on Pension Liabilities by Moody's*

2018-06-18 15:14:20.789 GMT

By Polina Noskova

(Bloomberg) -- Moody's downgraded New Mexico general obligation bonds ratings to Aa2 from Aa1, with the outlook revised to stable from negative, primarily citing the state's large pension liabilities

- Action affects about $260m outstanding GO bonds
- New Mexico's pension liabilities include both its direct obligation to the Public Employees' Retirement System and an indirect obligation to the Educational Employees' Retirement System
- The need to assist districts in addressing their EERS pension liabilities represents a significant financial pressure for the state, Moody's writes:

  Pressure is compounded by spending challenges associated with large Medicaid caseload, revenue structure more concentrated and volatile that most similarly-rated states and economy that lagged the nation's.
- Stable outlook reflects positive recent economic trends, strong budget discipline following the decline in oil and gas related revenues in fiscal 2015 and 2016

**To contact the reporter or editor on this story:**

**Reporter**: Polina Noskova in New York at pnoskova@bloomberg.net **Editor**: Chakradhar Adusumilli at cadusumilli@bloomberg.net

# History of ERB Contributions

| Fiscal Year | Wage category | Date Range | Member Rate | Employer Rate | Total | % of Total Contribution Employee Pays |
|---|---|---|---|---|---|---|
| 58-59 | | 7/1/1957 -6/30/1959 | 3.00% | 4.00% | 7.00% | 42.86% |
| 60-74 | | 7/1/1959 -6/30/1974 | 4.00% | 6.50% | 10.50% | 38.10% |
| 75-79 | | 7/1/1974 -6/30/1979 | 5.50% | 6.50% | 12.00% | 45.83% |
| 80-81 | | 7/1/1979 -6/30/1981 | 6.50% | 6.50% | 13.00% | 50.00% |
| 82-84 | | 7/1/1981 -6/30/1984 | 6.80% | 6.80% | 13.60% | 50.00% |
| 85-93 | | 7/1/1984 -6/30/1993 | 7.60% | 7.60% | 15.20% | 50.00% |
| 94-2005 | | 7/1/1993 -6/30/2005 | 7.60% | 8.65% | 16.25% | 46.77% |
| 2006 | | 7/1/2005 -6/30/2006 | 7.675% | 9.40% | 17.075% | 44.95% |
| 2007 | | 7/1/2006 -6/30/2007 | 7.75% | 10.15% | 17.90% | 43.30% |
| 2008 | | 7/1/2007 -6/30/2008 | 7.825% | 10.90% | 18.725% | 41.79% |
| 2009 | | 7/1/2008 -6/30/2009 | 7.90% | 11.65% | 19.55% | 40.41% |
| 2010 & 2011 | $20k or less | 7/1/2009 -6/30/2011 | 7.90% | 12.40% | 20.30% | 38.92% |
| 2010 & 2011 | Over $20K | 7/1/2009 -6/30/2011 | 9.40% | 10.90% | 20.30% | 46.31% |
| 2012 | $20k or less | 7/1/2011 - 6/30/2012 | 7.90% | 12.40% | 20.30% | 38.92% |
| 2012 | Over $20K | 7/1/2011 - 6/30/2012 | 11.15% | 9.15% | 20.30% | 54.93% |
| 2013 | $20k or less | 7/1/2012 - 6/30/2013 | 7.90% | 12.40% | 20.30% | 38.92% |
| 2013 | Over $20K | 7/1/2012 - 6/30/2013 | 9.40% | 10.90% | 20.30% | 46.31% |
| 2014 | $20k or less | 7/1/2013 - 6/30/2014 | 7.90% | 13.15% | 21.05% | 37.53% |
| 2014 | Over $20K | 7/1/2013 - 6/30/2014 | 10.10% | 13.90% | 24.00% | 42.08% |
| 2015 | $20k or less | 7/1/2014 - future | 7.90% | 13.90% | 21.80% | 36.24% |
| 2015 | Over $20K | 7/1/2014 - future | 10.70% | 13.90% | 24.60% | 43.50% |

# ERB Retirement Eligibility: Tier Structure

**Tier 1: ERB Membership Prior to July 1, 2010**

* “25 and Out” – Earned service credits + allowed service credits = 25 or more years. There is no minimum age required.
* “Rule of 75” – Your age + earned service credits = 75 or more. Under the Rule of 75, allowed service credits are used to calculate retirement benefit but do not count toward eligibility. There are permanent and significant reductions if you are under age 60, and even more if you are under age 55.
* “65 and 5” – If you are at least 65 years old and have at least five years of earned service credit, you are eligible for retirement.

**Tier 2: ERB Membership Beginning on or after July 1, 2010, but prior to July 1, 2013**

* “30 and Out” – Earned service credits + allowed service credits = 30 or more years. There is no minimum age required.
* “Rule of 80” – Your age + earned service credits = 80 or more. As with the Rule of 75, allowed service credits are used to calculate retirement benefit but do not count toward eligibility. There are permanent and significant reductions if you are under age 65, and even more if you are under age 60.
* “67 and 5” – If you are at least 67 years old and have at least five years of earned service credit, you are eligible for retirement.

**Tier 3: ERB Membership Beginning on or after July 1, 2013**

* Same retirement eligibilities as immediately above. If member receives pension benefit before age 55 with 30 and Out retirement eligibility, benefit will be actuarially reduced.
* Cost of Living Adjustment (COLA) begins at age 67 or on July 1 of the year following member’s effective retirement date, whichever is later.

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# ERB Retirement Eligibility – Benefit Structure

**ERB Benefit Structure**

* Final average salary (FAS) x service credit x .0235 = annual benefit
* Cost Of Living Adjustment (COLA) available on July 1 of the year in which you reach age 65 or on July 1 of the year following member's effective retirement date, whichever is later for Tier 1 and Tier 2 members. For Tier 3 members, COLA begins at age 67 or on July 1 of the year following member's effective retirement date, whichever is later. The amount depends on the annual change in the Consumer Price Index (CPI). The average COLA over time has been 2%. COLA was reduced as part of the 2013 sustainability bill until ERB is 100% funded.
* Five year vesting period
- No minimum retirement age (with exception of reductions in Rule of 75 and Rule of 80)

**Examples of retirement percentage rates:**

25 years x .0235 = 58.75% 30 years x .0235 = 70.5% 35 years x .0235 = 82.25%

# 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<br>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<br>Age 60 with 15 years' service<br>Age 65 with 10 years of service | SAME | Ad Hoc | 13.2 | 17.4 |
| 1971 | 35 years of service<br>30 years of service with actuarial reduction if younger than age 60<br>Age 60 with 15 years of service<br>Age 65 with 5 years of service | 1.50% | Ad Hoc | 13.8 | 18.6 |
| 1974 | 35 years of service<br>Rule of 75 with reduction if younger than age 60<br>Age 65 with 5 years of service | 1.5% for years before July 1, 1957<br>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<br>Rule of 75 with reduction if younger than age 60<br>Age 65 with 5 years of service | SAME | SAME | 14.6 | 19.1 |
| 1984 | 25 years of service<br>Rule of 75 with reduction if younger than age 60<br>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.

# 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<br>Hired after 7/1/2010: 30 years of service<br>Rule of 80 with reduction if younger than 65<br>Age 67 with 5 years of service | SAME | SAME | 19.6 | 22.4 |
| 2013 | Hired after 7/1/2013: 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<br>Until ERB is > 90% funded:<br>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.<br>ERB Funding >90% <100%<br>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.<br>ERB Funding=100%<br>COLA reductions cease. | 20.2 | 23.1 |

*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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# Gabriel Roeder Smith Sustainability Checklist

| Funding Policy | Answer | Rating |
|---|---|---|
| Do you have a legally required contribution amount based on accepted actuarial practices? | No | * |
| What is your current funded ratio? | 62.90% | * |
| Is your funded ratio higher than it was 10 years ago? | No, but largest source is decline from assumption changes | *** |
| Based on current practices and assumptions, is your funded ratio expected to be higher 10 years from now? | Yes | ***** |
| Based on current practices and assumptions, is your unfunded liability expected to be lower 10 years from now? | No, UAAL expected to grow until 2058 | * |
| What is the remaining amortization period for the current UAAL based on the current funding policy? | 61 Years | * |
| What is the sum of your amortization period and asset smoothing period? | 66 Years | ** |
| What is the amortization period for new experience losses, plan amendments, and assumption changes? | Same as funding period | ** |

# Gabriel Roeder Smith Sustainability Checklist (con't)

| Assumptions and Methods | Answer | Rating |
| --- | --- | --- |
| Does the Board regularly review actuarial assumptions? | 2 Years | ***** |
| What is the likelihood of meeting or exceeding the assumed rate over the next 20 years based on actuarial analysis? | 50% | *** |
| What is the annual percent change in active population last 10 years? | -4% | * |
| What is the assumed rate of payroll growth for amortization purposes? | 2.8% over 30 years according to open group projection | *** |
| **Plan Design** | **Answer** | **Rating** |
| Is the Plan open to new entrants? | Yes, including same contribution rate with lower benefits | ***** |
| Are there any benefits that are likely to be paid, but not reflected in the liabilities and contributions? Examples include ad hoc colas that occur regularly but are not advanced recognized, subsidized service purchases, or pay spiking patterns. | No | ***** |
| Are any of the liabilities contingent on future experience? Meaning future liabilities will be lower if actual experience fails to meet the assumptions? Examples include contingent post-retirement beneffit enhacements and cash balance interest credits based on actual market returns. | Yes, reduced COLA until funded ratio improves | ***** |

# Gabriel Roeder Smith Sustainability Checklist (con't)

| Risk Measures | Answer | Rating |
|---|---|---|
| What is your short – intermediate term negative cash flow as a % of assets? | -5.5% after about 10 years | *** |
| What is your longer term negative cash flow as a % of assets? | Trends down, better than -4% after 30 years | **** |
| What is your current active to retiree ratio? | 1.3 | ** |
| What is your longer term active to retiree ratio? | 0.9 | * |
| What is your current ratio of retiree liability to total liability? | 64.4% | *** |
| What is your longer term ratio of retiree liability to total liability? | 73% after 15 years, drifts back down below 67% in 30 years | *** |
| What is your current ratio of benefit payments to payroll? | 40% | *** |
| What is your longer term ratio of benefit payments to payroll? | Over 50% after 10 years, drifts back below 40% after 30 years | *** |
| What is your ratio of accrued liability to payroll? | 7.3 | ** |
| What is your longer term ratio of accrued liability to payroll? | Levels out at 6.0 after 20 years | ** |

# ERB Contact Information:

**Santa Fe**
701 Camino de Los Marquez
PO Box 26129
Santa Fe, New Mexico 87502
Phone: (505) 827-8030
Fax: (505) 827-1855

**Albuquerque**
6201 Uptown Blvd. NE, Suite 204
Albuquerque, NM 87110
Phone: (505) 888-1560
Fax: (505) 830-2976

Toll Free: 1-866-691-2345
Member Help Email: ERB-MemberHelp@state.nm.us
Website: www.nmerb.org