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

June 7, 2018
State Capitol, Room 307
Santa Fe

The first meeting of the Investments and Pensions Oversight Committee was called to order by Representative Tomás E. Salazar, chair, on June 7, 2018 at 10:00 a.m. in Room 307 of the State Capitol.

Present	**Absent**
Rep. Tomás E. Salazar, Chair	Sen. George K. Munoz, Vice Chair
Sen. Jacob R. Candelaria	Rep. Miguel P. Garcia
Rep. Larry A. Larrañaga	Sen. Gay G. Kernan
Sen. Steven P. Neville	Sen. Carroll H. Leavell
Rep. Jane E. Powdrell-Culbert	Rep. William "Bill" R. Rehm
Sen. John M. Sapien	Rep. Patricia Roybal Caballero
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. William H. Payne
Sen. Stuart Ingle	
Rep. Bill McCamley	
Sen. Mary Kay Papen	
Rep. Sheryl Williams Stapleton	
Sen. James P. White	

Guest Legislators
Rep. Tim D. Lewis
Sen. Nancy Rodriguez
Rep. Linda M. Trujillo

Staff
Tessa Ryan, Staff Attorney, Legislative Council Service (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.

Thursday, June 7

Update from the State Investment Council (SIC)

Steven K. Moise, state investment officer, SIC, and Vince Smith, deputy state investment officer, SIC, gave an update on the public funds under SIC management.

The SIC currently manages $23.85 billion in assets held in the Land Grant Permanent Fund, Severance Tax Permanent Fund, Tobacco Settlement Permanent Fund and Water Trust Fund, as well as in funds of state agencies, local governments and higher education institutions. Of these, only the Water Trust Fund decreased in value over the past year. Fund growth is attributed to a combination of inflows, which include both money deposited to a fund and investment earnings. One significant driver of inflows to the permanent funds has been oil production in the Permian Basin and the dramatic rise in production over the last decade from hydraulic fracturing. Mr. Moise presented a growth comparison of the Land Grant Permanent Fund and the Severance Tax Permanent Fund and noted that the latter has grown at a much slower rate due to its low level of annual inflows.

Combined distributions from the permanent funds in fiscal year (FY) 2019 are projected to be more than $968 million and account for approximately 15 percent of the state's annual budget. The largest share — $637 million — is allocated to public schools, with the balance allocated to special schools, public buildings, correctional facilities, hospitals, reservoirs and higher education institutions.

Investment returns in the past year for the Land Grant Permanent Fund and the Severance Tax Permanent Fund have been 11 percent and 10 percent, respectively, exceeding the long-term return targets for those funds. Investments are split among public equity (46.4 percent), private market (28.3 percent) and fixed income (24.3 percent) investments. The SIC is shifting the portfolio toward private market investments to offset current slow growth in corporate stocks and bonds, a condition that is projected to continue over the next several years. The portfolio shift is also geared toward weathering the next recession; Mr. Smith noted that the economy and the market seem to be entering a "late cycle" phase, which suggests a recession may soon follow.

The presenters suggested that the committee consider the following in its interim work: 1) New Mexico investments and whether they are prudent; 2) the structure of the investment portfolio; 3) the SIC's oversight of the work done by SIC staff; 4) management fees; and 5) possible legislation.

In response to a question, Charles Wollmann, director of communications and legislative affairs, SIC, who spoke from the audience, explained that a 2003 constitutional amendment increased the distributions from the Land Grant Permanent Fund and that, had it been invested rather than spent, the $750 million in additional distributions made over 12 years might be worth $1.5 billion today.

The chair requested that, in the interest of time, in lieu of questions, members make information requests of the presenters for them to respond to at future meetings. Members requested information on the following from the SIC presenters:

- a breakdown of returns on economic-based investments, i.e., investments in New Mexico;
- dollar-cost averaging for the Severance Tax Permanent Fund if it had better inflows;
- the effect of inflation and possible federal interest rate changes on the funds managed by the SIC;
- legislation necessary to use the income generated by the strong oil production in southeast New Mexico to create jobs in other industries; and
- restoring funds taken from the Tobacco Settlement Permanent Fund for solvency.

Mr. Moise noted in closing that approximately $20 million will be deposited into the state's "rainy day" fund.

Update from the Public Employees Retirement Association (PERA)

Wayne Propst, executive director, PERA, and Dominic Garcia, chief investment officer, PERA, gave an update on the PERA pension system and funds.

The PERA serves nearly 49,000 active and 38,000 retired public employee members, with pension benefits payments paid from the PERA fund exceeding $1.1 billion in FY 2017. The fund currently totals approximately $15.5 billion, and its performance measured at the one-year, five-year, 10-year and 20-year marks ranges from 4.98 percent (10-year return) to 8.34 percent (one-year return). The PERA also administers a 457(b) deferred compensation plan, which includes more than 21,000 participants and has a fund balance of more than $600 million.

The PERA pension system is 75 percent funded. Mr. Garcia noted that in order to reach 100 percent fundedness by the year 2043, the PERA's investment portfolio would need a 10.9 percent return rate over the next 10 years; by his calculation, the probability of that happening is very low. Three main factors have contributed to the system's underfundedness: 1) increases in member benefits that were enacted in the mid-1990s, when investment returns were high; 2) a market downturn in the early 2000s due to the "dot.com bust"; and 3) the Great Recession.

Wisconsin has the only fully funded pension system in the country. Mr. Garcia cited it and similar systems in Canada as examples of defined benefits plans that thrive, as plans can if they are managed with a long-term vision of sustainability and incorporate best practices at all levels. The PERA is in the process of adopting such strategies. For instance, the PERA board elected in December 2017 to end its involvement in selecting money managers and delegated that authority to Mr. Garcia, his staff and PERA consultants. The PERA is also completing an economic and demographic study that shows a need to adjust mortality rate assumptions and investment return projections, the latter currently set at 7.25 percent, with a reset to 7.75 percent after eight years. Actuaries recommend that the projection remain at 7.25 percent.

Members requested information on the following from the PERA presenters:

- the possibility of changing the deferred compensation program to a mutual fund arrangement handled by the SIC;
- the effect of inflation and possible federal interest rate changes on the funds managed by the PERA;
- an analysis of the effect of a one percent vacancy rate in state government on PERA fundedness;
- shifting away from a defined benefit plan to a defined contribution plan for new employees; and
- the percentage of income a retiree would get under a defined benefit plan versus under a 401(k) defined contribution plan.

Update from the Educational Retirement Board (ERB)

Jan Goodwin, executive director, ERB, and Bob Jacksha, chief investment officer, ERB, reported on the ERB pension system, its assets and possible changes to improve its sustainability.

The ERB serves nearly 60,000 active members, down from more than 63,000 in 2009. Retired members total more than 47,000, a number that is increasing. The ERB paid more than $1 billion in pension benefits to its retired members in FY 2017, 80 percent of which went to residents of New Mexico, with an average annual benefit of just over $22,000.

ERB assets totaled nearly $13 billion as of March 31, 2018. Approximately one-half of the investment portfolio is in "unconventional" investments, which yield better returns than are found in public securities and will provide some protection against inflation. Except for the 10-year investment return rate, which was affected by the global market downturn in 2008, returns over the last decade have essentially met or exceeded the ERB's target return rate of 7.25 percent.

Current estimates show that the ERB needs 61 years to become 100 percent funded. To determine what changes can be made to the retirement system to improve its fundedness, ERB staff conducted member interviews statewide and distributed a member survey to gauge member support, held a board meeting in April specifically to address sustainability and met with legislators to assess their support.

At a July meeting with stakeholders, the ERB will develop a legislative proposal to improve the retirement system's sustainability and, later in the interim, present the proposal to the committee for possible endorsement. A bill that was presented by the ERB in 2017 and received the committee's endorsement would have allowed state agencies to discuss certain cybersecurity matters in executive sessions rather than in open meetings and would have exempted certain cybersecurity-related documents from the Inspection of Public Records Act. The bill was not successful in the 2018 legislative session, and Ms. Goodwin reported that the ERB will push the measure again in the 2019 session.

In response to a question, Ms. Goodwin explained "reciprocity retirement", which covers members who have service credit under both the ERB and the PERA.

Members requested information on the following from the ERB presenters:

- the effect of inflation and possible federal interest rate changes on the funds managed by the ERB;
- an analysis of the effect of a one percent vacancy rate in state government on ERB fundedness;
- the percentage of public education employees who are near retirement age; and
- vacancies in the public education and higher education systems that account for the drop in active membership since 2009.

Update from the Retiree Health Care Authority (RHCA)

David Archuleta, executive director, RHCA, gave an update on the RHCA and the health care coverage it provides to the state's retired public employees.

The RHCA operating budget for FY 2019 is $338.5 million, one percent of which is used for program overhead costs. Active membership at the end of FY 2017 was more than 97,000, with one-half of the members coming from public education, one-fourth from state agencies and one-fourth from local governments and certain higher education institutions. Retired members and eligible family members at that same time totaled more than 62,000.

Premiums for plans offered through the RHCA increased in 2018, with increases ranging from six percent to 27 percent.

The RHCA's 2017 solvency study projected that the authority will begin deficit spending in 2020, when expenditures are projected to exceed revenues by more than $9 million. The study also projected the RHCA solvency period at 18 years, though possible changes in the federal Medicare program would affect that projection. The RHCA currently has a net unfunded liability of more than $4.5 billion, with a plan fiduciary net position of 11.26 percent.

The RHCA is on track to submit required employer allocation reports to the state auditor by mid-June. The authority will hold its annual board meeting in Taos in July, at which the board will elect new officers, review plan data and review plan changes for 2019. Also in the next several months, the RHCA will announce its selection of a pharmacy benefits manager and host open enrollment and switch enrollment periods.

In response to questions, Mr. Archuleta:

- clarified the RHCA policy of enrolling Medicare-eligible members by default in the Medicare Advantage plan if they do not state an enrollment preference; and
- explained that because Medicare Advantage plans are heavily subsidized by the federal government, they cost less for members and the RHCA and added that the subsidies for this plan may change.

A member requested information on the following from Mr. Archuleta:

- the effect of inflation and possible federal interest rate changes on the funds managed by the RHCA.

Proposed Work Plan and Meeting Schedule

Ms. Ryan presented a proposed work plan and meeting schedule for the committee's work during the 2018 interim. In discussion, members requested that the committee also address the following:

- possible amendments to statute to direct a certain portion of rent and royalty payments to the state's rainy day fund; and
- a review of other states' experiences moving from defined benefit pension plans to defined contribution plans.

The committee adopted the proposed work plan and meeting schedule without objection.

Adjournment

There being no further business before the committee, the committee adjourned at 12:30 p.m.