

Investments & Pensions Oversight Committee

Senator George K. Muñoz, Chair

Representative Patricia Roybal Caballero, Vice Chair

ERB Update

August 19, 2020

Jan Goodwin, Executive Director

Bob Jacksha, Chief Investment Officer

Steven Gluckstern, Board Chair

H. Russell Goff, Vice Chair

Sections:

- What's happened since last year
- How to improve sustainability
- On the horizon
- Investments

What's happened since last year?

HB 46

SB 111

Covid-19 response

Experience study

BBER analysis

Goal: 100% funding within 30 years

A series of transfers and distributions

- FY21: \$50 million plus 1% of salaries as of June 30, 2019 plus 1% of FY20 salary increases from General Fund
- FY22: 2% of FY21 salaries from GRT
- FY23: \$50 million plus 3% of FY22 salaries from GRT
- FY24 and thereafter until 100% funded

Did not pass

Repealed many parts of HB 360, ERB's 2019 full funding bill

- Eliminated contribution requirements that would have been effective July 1, 2020 for retirees (and their employers) for retirees working less than 0.25 FTE
- Eliminated contribution requirements for PERA retirees
- Eliminated contribution requirements that would have been effective July 1, 2020 for day-to-day substitute teachers (and their employers)
- Allows retirees to return to work after 90 days, earnings cap \$15,000
- Increased ERB's funding period by 2 years

In the meantime, the legislature focused on changes to increase PERA solvency...

Most employees have been working at home since mid-March

Investment staff fully functional

NMERB operational staff fully functional

All benefits continue to be paid without operation

Virtual Board and Investment Committee meetings

Offices at no more than 25% capacity

Offices shut to public until further notice

Despite closure, NMERB fully operational—communications with public enhanced through new website

In depth review of all assumptions supporting a valuation report

Based on ERB's June 30, 2019 valuation report

Changes in assumptions:

- Inflation decreased from 2.5% to 2.3%
- Earnings assumption decreased from 7.25% to 7%

Impacts:

- Future COLAs: will average 1.8%, rather than 1.9%. With 20% reduction, most retirees receive 1.44%
- Unfunded liability: increased from \$7.9 billion to \$8.3 billion
- Funded ratio: decreased from 62.9% to 61.6%
- Funding period: increased from 47 years to 70 years

Quantification of the disparity in retirement benefits among educational employees and state employees over time

Employees compared:

- Average ERB member/Average state employee
- Average classroom teacher, with 4-year degree/average state employee with same educational requirements
- Average classroom teacher, with Masters degree/average state employee with same educational requirements

Cohorts compared:

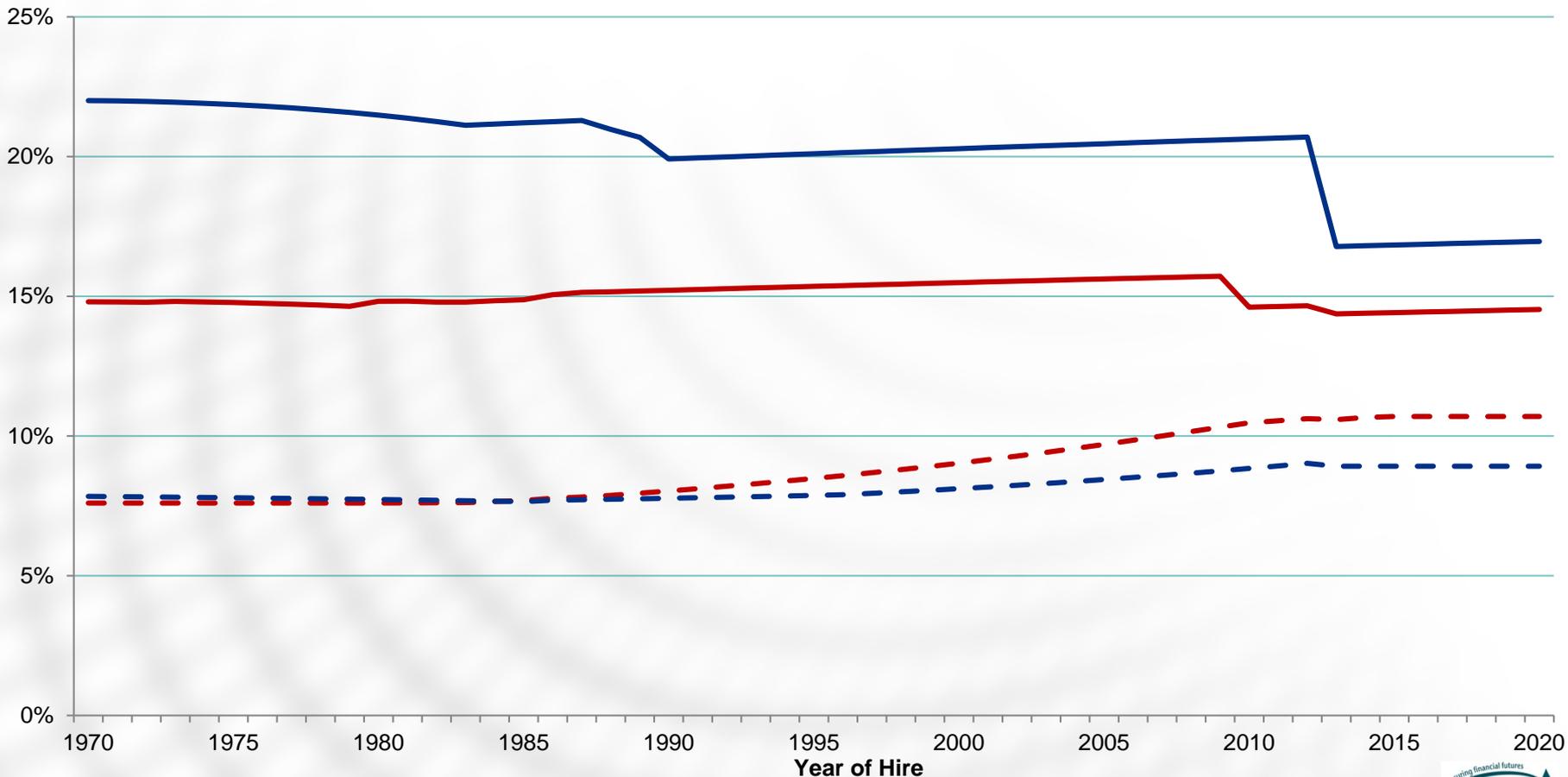
Start dates 1958, 1978, 1998 and 2018

- PERA has consistently paid higher retirement benefits relative to salaries. This is true for all four cohorts, although the variance is expected to narrow in the 2018 cohort.
- COLA payments account for much of the difference – PERA kicks in after 2 years (52 y/o, now 57 y/o) vs. ERB at 65 y/o (now 67 y/o);
 - The 1958 and 1978 cohorts received COLAs of 3% for much of their retirements, including during periods when inflation averaged 2%.
- PERA employer contribution rates have consistently been higher than ERB's since the early 1980's.
- The largest disparities occurred in the 1978 and 1998 cohorts when PERA increased its multiplier to 3% (compared to 2.35% for ERB) while maintaining a higher COLA and shorter waiting period to receive a COLA.
- Benefit differential for newest cohort (2018-2048) is much lower (8%)
 - PERA multiplier was reduced (3.0% to 2.5%)
 - Time collecting COLA and the higher multiplier still explain most of the variance for this cohort.

- Actuarially speaking: same position as before 2019 session
- We continue to be on the path to 100% funding, but the path is too long
- ERB does not have a solvency problem
- Have made many needed changes to benefits to ensure equity
- Have already increased member contribution rate to a high level
- Need to increase the employer contribution

ERB Members Pay More for Less

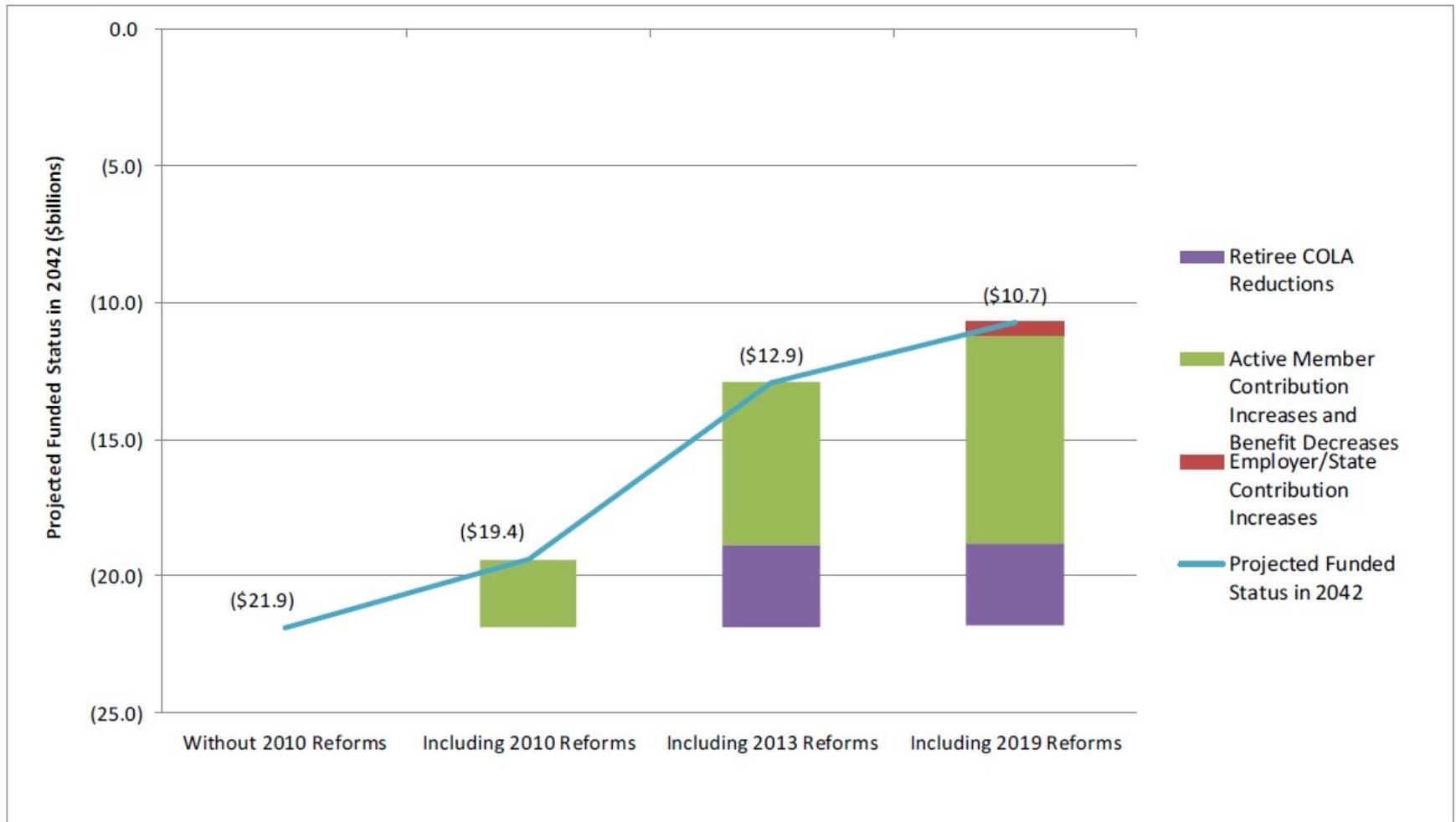
Present Value of Benefits and Contributions (% of Lifetime Pay)



--- ERB Contributions — ERB Benefits --- PERA Contributions — PERA Benefits



Who has paid for changes?



First, a bit of context...

2020 solvency improvement changes enacted for state employees participating in PERA

PERA	ERB			
Reduce COLA delay from 7 years (enacted in 2013) to 2 years; 13th check- GF	COLA begins at age 65 (since 1984) or 67 (members starting after 2013)			
Increase member contribution from 8.92% to 10.92% over 4 years	Member contribution has been 10.7% since 2015			
Increase employer contribution from 17.24% to 19.24% over 4 years	Employer contribution rate is 14.15%			

If state continues to be unwilling to increase the employer contribution rate may need to cut benefits for employees:

- Cut benefits for active and new members- reduce multiplier by 0.35% for all future work and cap COLA at 0.5% to be 100% funded in less than 30 years

Pension obligation bonds- notional amount \$1 billion

Increase employer contribution rate

- To ensure 100% funding within set time period will need to have automatic trigger to increase employer contribution/reduce benefit if investment performance is not realized or actuarial assumptions change

Return to Work (RTW) statute sunsets December 31, 2021

Reality- RTW is not beneficial, on average, unless retiree works more than 11 years full-time before ceasing work

Working with our actuary to create a calculator so members can see this for themselves

Construction of new ERB headquarters building

- Total budget: \$8.6 million
- Approved in 2020 session
- Southside of Santa Fe
- 24,500 square feet

Divestment issue:

- Board policy December 2019
- Private prisons
- August 14, 2020 Board meeting

Update on ERB Investment Actions

- In August 2019, the Board approved changes to the Investment Policy that will allow the use of derivatives (futures, options, etc.) and leverage at the portfolio level.
- We are currently conducting a manager search.
- Changes also included a few small adjustments to allocation targets.
- At the April 2020 Board meeting, the Board voted to reduce our return target from 7.25% to 7%.
- At the August meeting, the Board approved policy changes that allow staff to select managers and consultants. Previously, the Investment Committee of the Board had final approval authority.

Fiscal Year 2020 Environment: Volatility Anyone?

- Initially, markets reacted violently to the economic shutdowns caused by the COVID-19 pandemic.
- For example, the S&P 500 stock index plunged almost 34% from the high on February 19th to a low on March 23rd.
- By the end of June, most of that loss had been recovered.
- The reason for the recovery?
- MASSIVE Federal stimulus.

Federal Government Stimulus Takes Hold

- Congress issued \$ trillions in fiscal stimulus.
- The Fed also injected massive liquidity into investment markets, including purchasing a variety of public securities.
- Public markets reacted spectacularly. From March 23rd, the S&P 500 posted a gain of about 39%. Today, we are flirting with new highs.
- Private assets recovered at a slower pace. Less direct benefit from Fed actions than public securities.
- Reporting of private asset values lags, often by a calendar quarter or more.

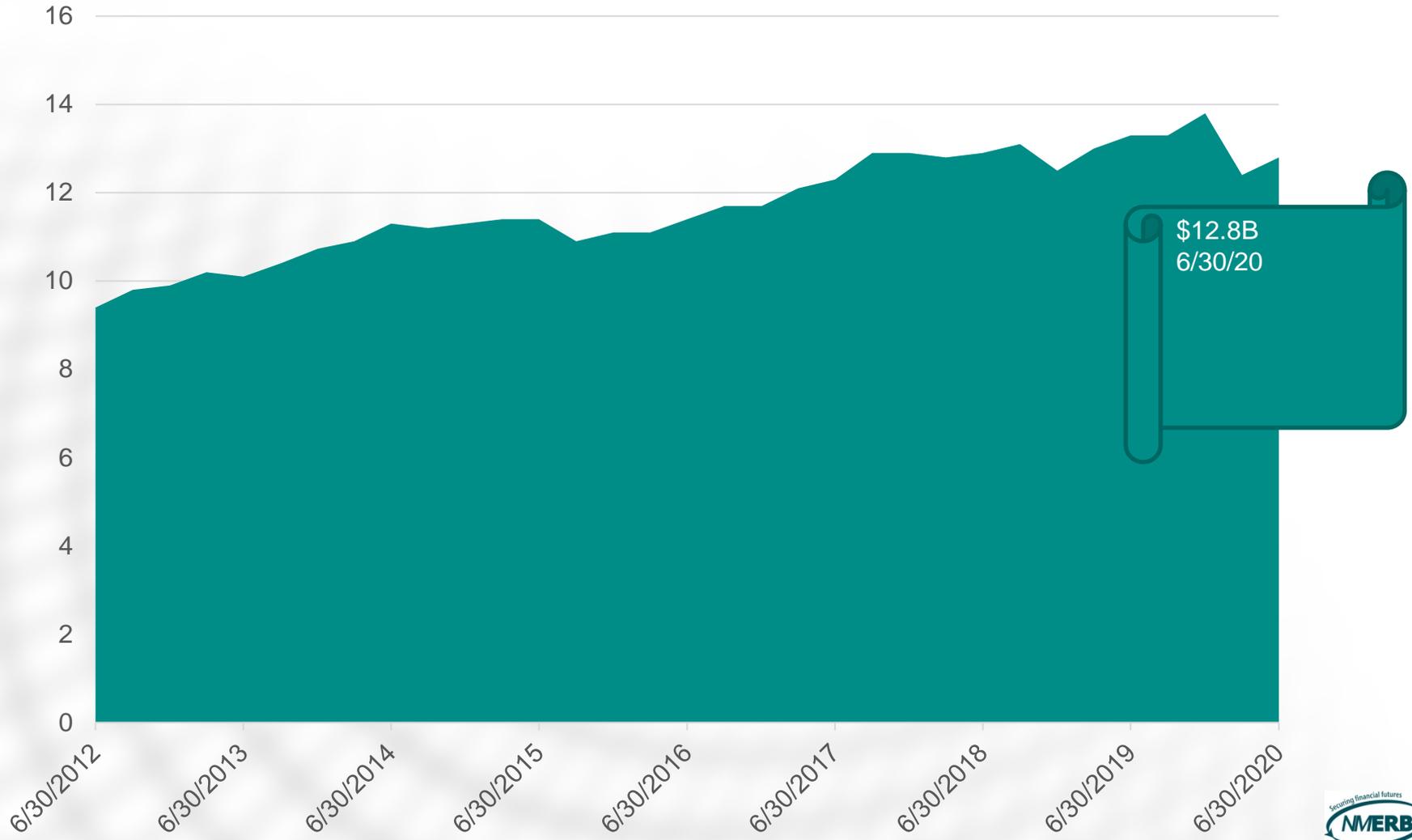
Outlook – Uncertain

- Dependent on the path of the pandemic and the impact on the economy and markets.
- Is more Federal stimulus forthcoming?
- If so, what will it look like?
- Impact of the 2020 elections?
- Our strategic outlook remains the same. Diversification is likely to provide benefits over time.
- Private assets are likely to provide better outcomes in the long run compared to public securities.

- Opportunistic Credit: 18% of total assets
- Private Equity: 16%
- Real Assets: 9%
- Private Real Estate: 4%
- Other Diversifying Assets: 4%
- Total Private Assets: 41%

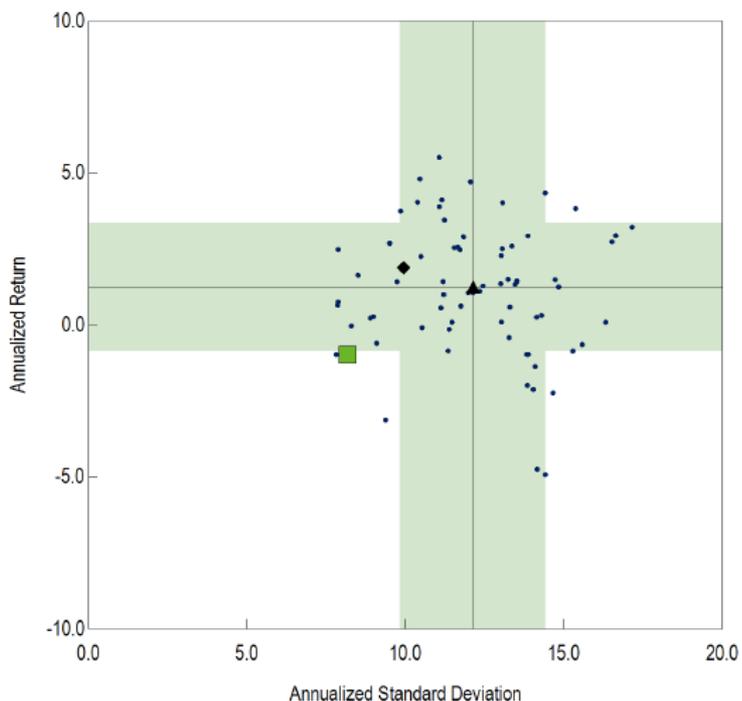
You may view the full quarterly investment report on our website: <https://www.nmerb.org/wp-content/uploads/2020/08/Q2-NMERB-IPA-Final.pdf>

June 30, 2020 Assets



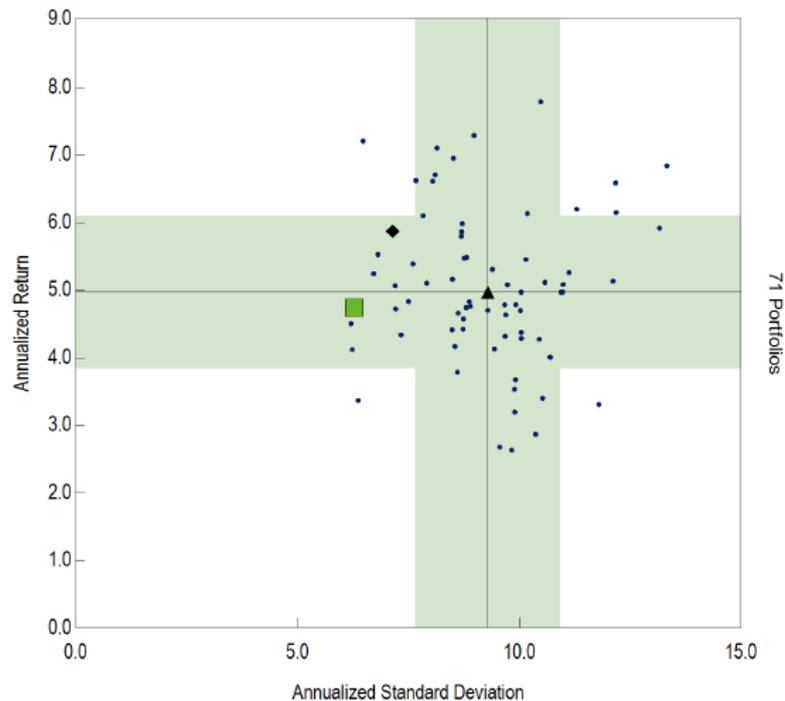
TOTAL FUND RISK/RETURN

1 Year Ending June 30, 2020



- Total Fund
- ◆ Policy Index
- ▲ Universe Median
- 68% Confidence Interval
- InvMetrics Public DB > \$1B Net

3 Years Ending June 30, 2020

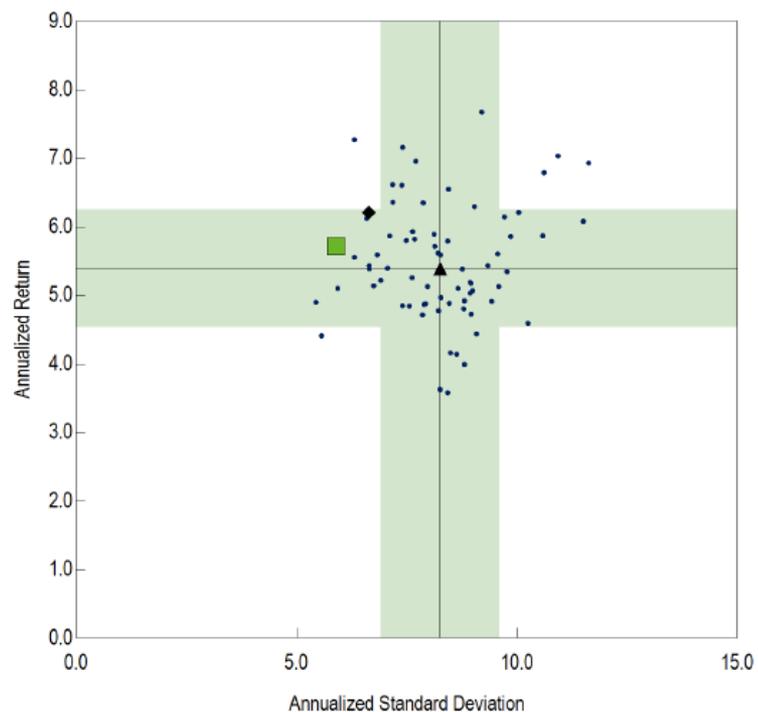


- Total Fund
- ◆ Policy Index
- ▲ Universe Median
- 68% Confidence Interval
- InvMetrics Public DB > \$1B Net

Risk and Return: 5 and 10 Years

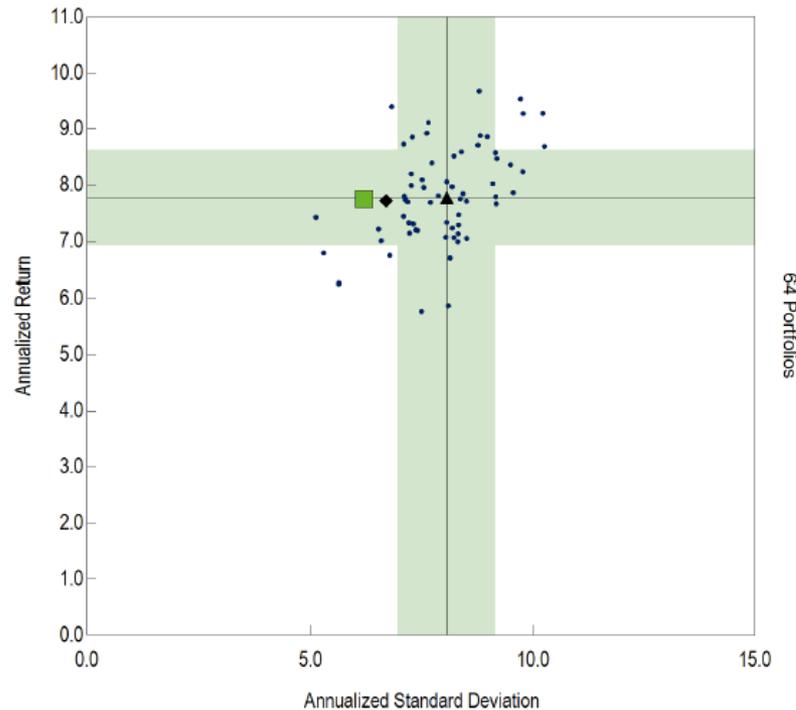
TOTAL FUND RISK/RETURN

5 Years Ending June 30, 2020



- Total Fund
- ◆ Policy Index
- ▲ Universe Median
- 68% Confidence Interval
- InvMetrics Public DB > \$1B Net

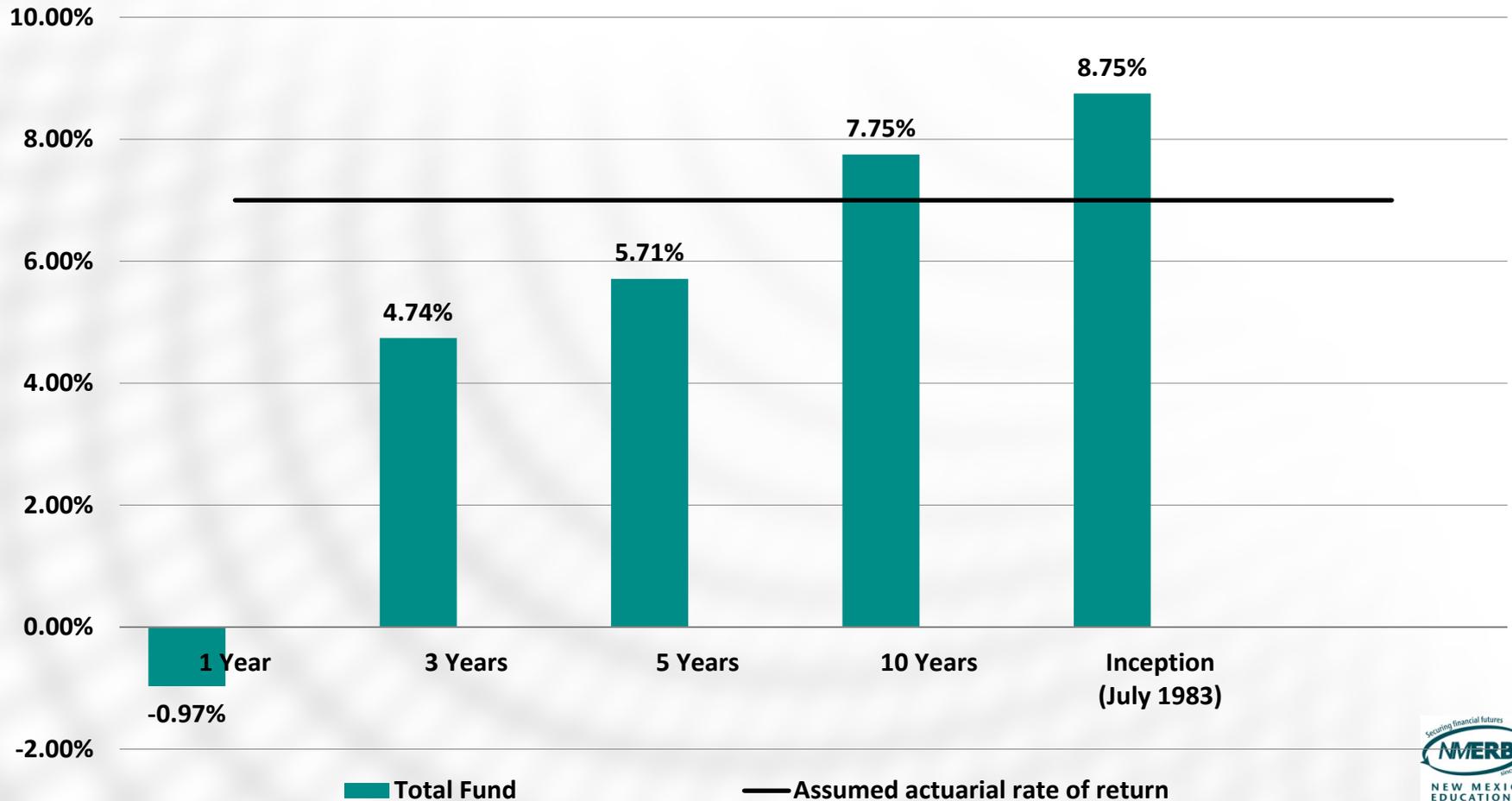
10 Years Ending June 30, 2020



- Total Fund
- ◆ Policy Index
- ▲ Universe Median
- 68% Confidence Interval
- InvMetrics Public DB > \$1B Net

Return vs. 7.25% Target

**NMERB Annualized Returns
As of June 30, 2020
Net of Fees**



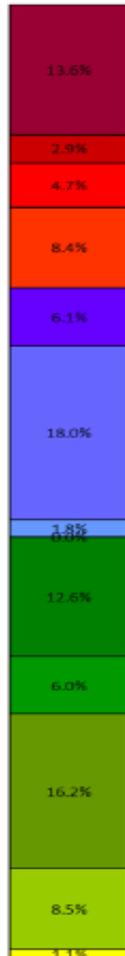
June 30, 2018 Investment Returns

<u>Returns*</u>	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>	<u>30 Years</u>
Portfolio	-0.97%	4.74%	5.71%	7.75%	8.16%
Policy Index	1.89%	5.87%	6.21%	7.72%	7.42%
Value Add	-2.86%	-1.13%	-0.5%	0.013%	0.74%
Universe Ranking	90	60	37	54	12

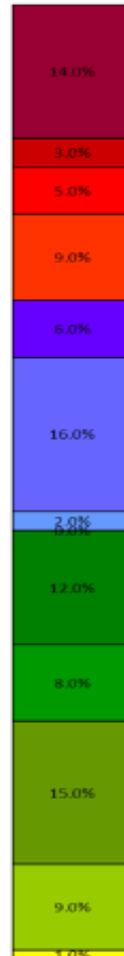
*All returns in this presentation are net of external manager fees.

Asset Allocation

Current Allocation



Policy Target



	Current Mkt Value	Current Allocation	Policy Target ¹
Equity	\$3,788,876,970	29.7%	31.0%
U.S. Equity	\$2,113,342,339	16.6%	17.0%
U.S. Large Cap Equity	\$1,739,309,493	13.6%	14.0%
U.S. Small/Mid Cap Equity	\$374,032,846	2.9%	3.0%
Non-U.S. Equity	\$1,675,534,632	13.1%	14.0%
Non-U.S. Developed Mkts	\$600,366,975	4.7%	5.0%
Non-U.S. Emerging Mkts	\$1,075,167,656	8.4%	9.0%
Fixed Income	\$3,309,112,267	25.9%	24.0%
Core Fixed Income	\$781,261,631	6.1%	6.0%
Opportunistic Credit	\$2,300,805,249	18.0%	16.0%
Emerging Mkts Debt	\$227,045,386	1.8%	2.0%
Alternatives	\$5,519,198,823	43.3%	44.0%
Absolute Return	\$338,345	0.0%	0.0%
Diversifying Assets	\$1,601,468,055	12.6%	12.0%
Global Asset Allocation	\$381,842,886	3.0%	2.0%
Risk Parity	\$738,284,208	5.8%	3.0%
Other Diversifying Assets	\$481,340,961	3.8%	7.0%
Real Estate	\$769,449,283	6.0%	8.0%
REITs	\$246,955,051	1.9%	2.0%
Private Real Estate	\$522,494,232	4.1%	6.0%
Private Equity	\$2,066,888,858	16.2%	15.0%
Inflation-Linked Assets	\$1,081,054,283	8.5%	9.0%
Cash	\$135,703,236	1.1%	1.0%
Total	\$12,752,949,305	100.0%	100.0%

¹Long-Term Policy Target approved by the Board in August 2019.

Note: Allocations shown here include cash held in separately managed portf. Totals may not add to 100% due to rounding. Total Plan includes Legacy As

Questions?

Jan Goodwin

Direct: 505.476.6118

Email: jan.goodwin@state.nm.us