RETIREMENT SYSTEMS SOLVENCY TASK FORCE

NMERB STATUS REPORT AS OF JUNE 30, 2010

MONDAY, AUGUST 9, 2010

Jan Goodwin, Executive Director

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NEW MEXICO EDUCATIONAL RETIREMENT BOARD

ERB'S RETIREMENT PLAN

Defined Benefit Plans

Defined Benefit (DB) Plans are designed to provide employees with a predictable monthly benefit in retirement. This amount is typically a function of the number of years and employee devotes to the job and the worker's pay – usually at the end of their career. ***ERB provides a defined benefit plan.***

Defined Contribution Plans

Defined Contribution (DC) Plans offer no implicit guarantee of retirement income. Rather, employers (and usually employees) contribute to the plan over the course of a worker's career.

Defined Contribution Plan Characteristics

- DB plans pool the longevity risks of large numbers of individuals. They need only accumulate to enough funds to provide benefits for the average life expectancy of the group.
- DB plans do not age, unlike the individuals in them, they are able to take advantage of the enhanced investment returns that come from a balanced portfolio over long periods of time. This means DB plans can ride out bear markets and take advantage of buying opportunities that they present without having to worry about converting all of their money into cash for benefits in the near future.
- DB plans achieve greater investment returns as compared with DC plans based on individual accounts. Superior returns can be attributed partly to lower fees that stem from economies of scale.
- DB plans, which are professionally managed, achieve greater investment returns as compared with DC plans made up of individual accounts.

Defined Contribution Plan Characteristics

- Individuals in DC plans will need to set aside much more money to last for the "maximum" life expectancy if they want to avoid the risk of running out of money in retirement. Since the maximum life expectancy can be substantially greater than the average life expectancy, a DC plan will have to set aside more money than a DB plan to achieve the same level of monthly retirement income.
- Individuals in DC plans must gradually shift to a more conservative asset allocation as they age in order to protect against financial market shocks later in life.
- DC plans can be more flexible. They allow workers the opportunity to save for retirement in a manner that reflects their individual situations.
- Many workers fail to contribute sufficient amounts to the plans, and individuals' lack of expertise in investment decisions can create unbalanced portfolios.

Retirement Eligibility

- **Rule of 25** – Member has earned and allowed service credit totaling 25 or more years
- **Rule of 75** – Member age and earned service credit add to the sum of 75 or more - A reduction of a member's benefit is applicable only when the member is under 60 years of age and has less than 25 years of earned service credit
- **Rule of 65** – Member age is 65 with at least 5 years of earned service credit

Retirement Eligibility for New Employees after July 1, 2010

- **Rule of 30** – Member has earned and allowed service credit totaling 30 or more years
- **Rule of 80** – Member age and earned service credits add to the sum of 80 or more - A reduction of a member's benefit is applicable only when the member is under 65 years of age and has less than 30 years of earned service credit
- **Rule of 67** – Member age is 67 with at least 5 years of earned service credit

Retirement Benefit Calculation

FAS x service credit x .0235 = Annual benefit

The Final Average Salary is the greater of:

- The member's average annual earnings in the last twenty calendar quarters immediately preceding retirement; or
- The member's average annual earnings in any twenty consecutive calendar quarters in which there are earnings.

Cost of Living Adjustment (COLA)

- The first COLA to a retiree's benefit will be made on July 1 of the year in which the retired member reaches age 65, or on July 1 of the year following the member's retirement date, whichever is later.
- The COLA is tied to the Consumer Price Index (CPI). If the change in CPI is less than 2%, the COLA will be the same percent as the change in CPI; if the change is greater than 2% the COLA will be one half of the change in CPI but not less than 2% and no greater than 4%.
- In 2009, the first time in 54 years, the CPI declined. The COLA statute required a negative adjustment which would have resulted in an annual average decrease of $69 in the pension benefit.
- HB239 passed in the 2010 legislative session amends the COLA statute to prohibit a decrease in the retirement benefits of retired members over age 65 if there is a decrease in CPI.

Benefit Options

- **Option A –** If the member elects Option A there is no reduction to the monthly benefit other than any "Rule of 75" deductions or any community property or child support reductions. There will be no continuing benefit to a beneficiary or estate upon the retiree's death, except the balance, if any, of contributions. Those contributions are usually exhausted in 2 to 3 years. Approximately 63% of ERB retirees select Option A.

- **OPTION B –** If the member elects Option B, the monthly benefit is reduced to provide for a 100% survivor's benefit. The reduced benefit is payable during the life of the member with the provision that, upon the retiree's death, the same benefit is paid to the beneficiary for his or her lifetime. The named beneficiary may not be changed after the effective date of retirement since the amount of the option is calculated by using both the age of the member and the beneficiary. If the beneficiary predeceases the member, the member's benefit will be adjusted by returning it to the "Option A Benefit" amount. The IRS prohibits selection of Option B for a non-spouse beneficiary more than ten years younger than the member. Approximately 25% of ERB retirees select Option B.

- **OPTION C –** If the member elects Option C, the monthly benefit is reduced to provide for a 50% survivor's benefit. The benefit is payable during the life of the member with the provision that, upon the retiree's death, one half of the member's benefit is paid to the beneficiary for his or her lifetime. Here again, the named beneficiary may not be changed after the effective date of retirement. If the beneficiary predeceases the member, the member's benefit is adjusted by returning it to the "Option A Benefit" amount. Approximately 12% of ERB retirees select Option C.

ERB Defined Contribution Plan

An Alternative Retirement Plan (ARP) is available to some higher education faculty and professionals who were initially employed after July 1, 1991. Approximately 1,700 members of higher education institutions participate in this plan.

Legislation passed in 2009 allows a member to switch from the ARP plan into the regular ERB plan after seven years of employment. Before this legislative change the ARP election was irrevocable.

Mature Fund Status

• ERB is a "mature fund" – this means that each year the plan pays out more in benefits than the contributions it takes in. As a result the difference between the amount of contributions and retiree payroll must be paid by the ERB fund.

Contribution Rate History

Fiscal Year	Member	Employer
FY05 and Earlier	7.600%	8.65%
FY06	7.675%	9.40%
FY07	7.750%	10.15%
FY08	7.825%	10.90%
FY09	7.900%	11.65%
FY10*	9.400%	10.90%
FY11*	9.400%	11.65%
FY12	7.900%	13.15%
FY13	7.900%	13.90%

** For members whose annual salary is greater than $20,000. Members with annual salary of $20,000 or less, employers will contribute 12.40% in FY10 and 13.15% in FY11.*

Retiree Payroll Compared to Employee/Employer Contributions

Fiscal Year	Total Contributions	Retiree Payroll	Difference
2000	$ 295.9	$ 312.4	$ (16.5)
2001	$ 315.2	$ 339.2	$ (24.0)
2002	$ 328.6	$ 363.9	$ (35.3)
2003	$ 337.9	$ 397.8	$ (59.9)
2004	$ 355.6	$ 425.2	$ (69.6)
2005	$ 371.0	$ 459.2	$ (88.2)
2006	$ 408.5	$ 504.0	$ (95.5)
2007	$ 449.6	$ 547.8	$ (98.2)
2008	$ 496.2	$ 586.0	$ (89.8)
2009	$ 538.8	$ 626.6	$ (87.8)
2010	$ 560.9	$ 659.3	$ (98.4)
Total	**$ 4,458.2**	**$ 5,221.4**	**$ (763.2)**

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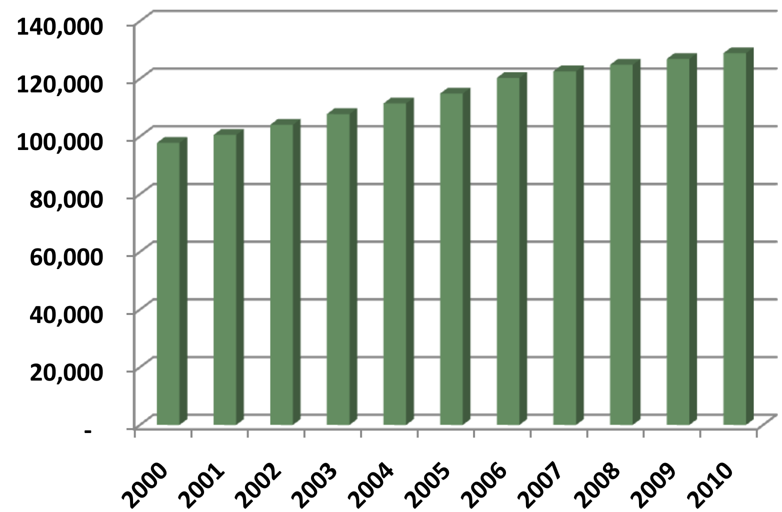
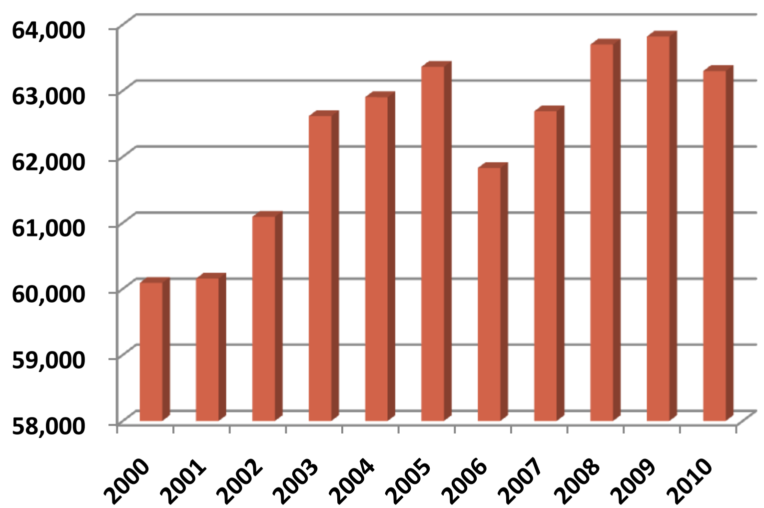
Membership Facts

- Employer Payroll has increased 61.65% from 2000 – 2010 ($1,795.7 in 2000)to $2,902.7 in 2010.
- Retiree Payroll has increased 111.2% from 2000 – 2010 ($312.2 in 2000 to $659.3 in 2010).
- Active members have increased 5.34% from 2000 – 2010 (60,090 in 2000 to 63,297 in 2010).
- Retired members have increased 59.30% from 2000 – 2010 (21,186 in 2000 to 33,749 in 2010.
- In 2000 there were 3 active members working for each retired member. In 2010 there are 2 active members working for each retired member.

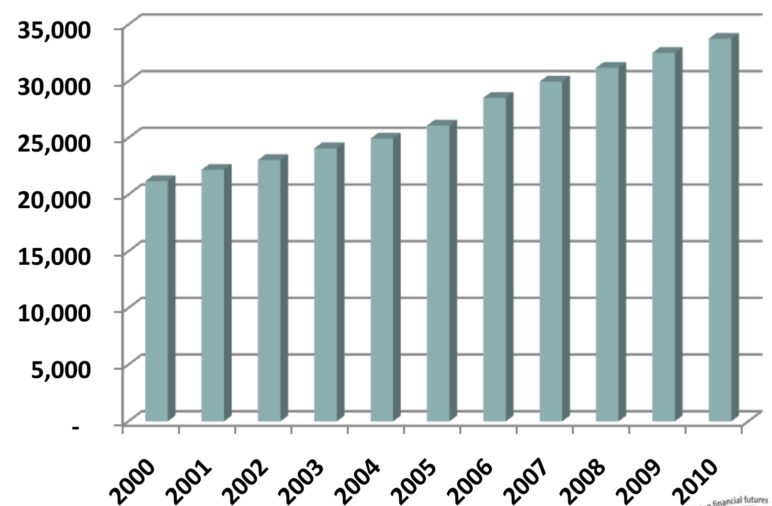
Total Membership: 2000 - 2010



Active Membership: 2000 - 2010



Retired Membership: 2000 - 2010



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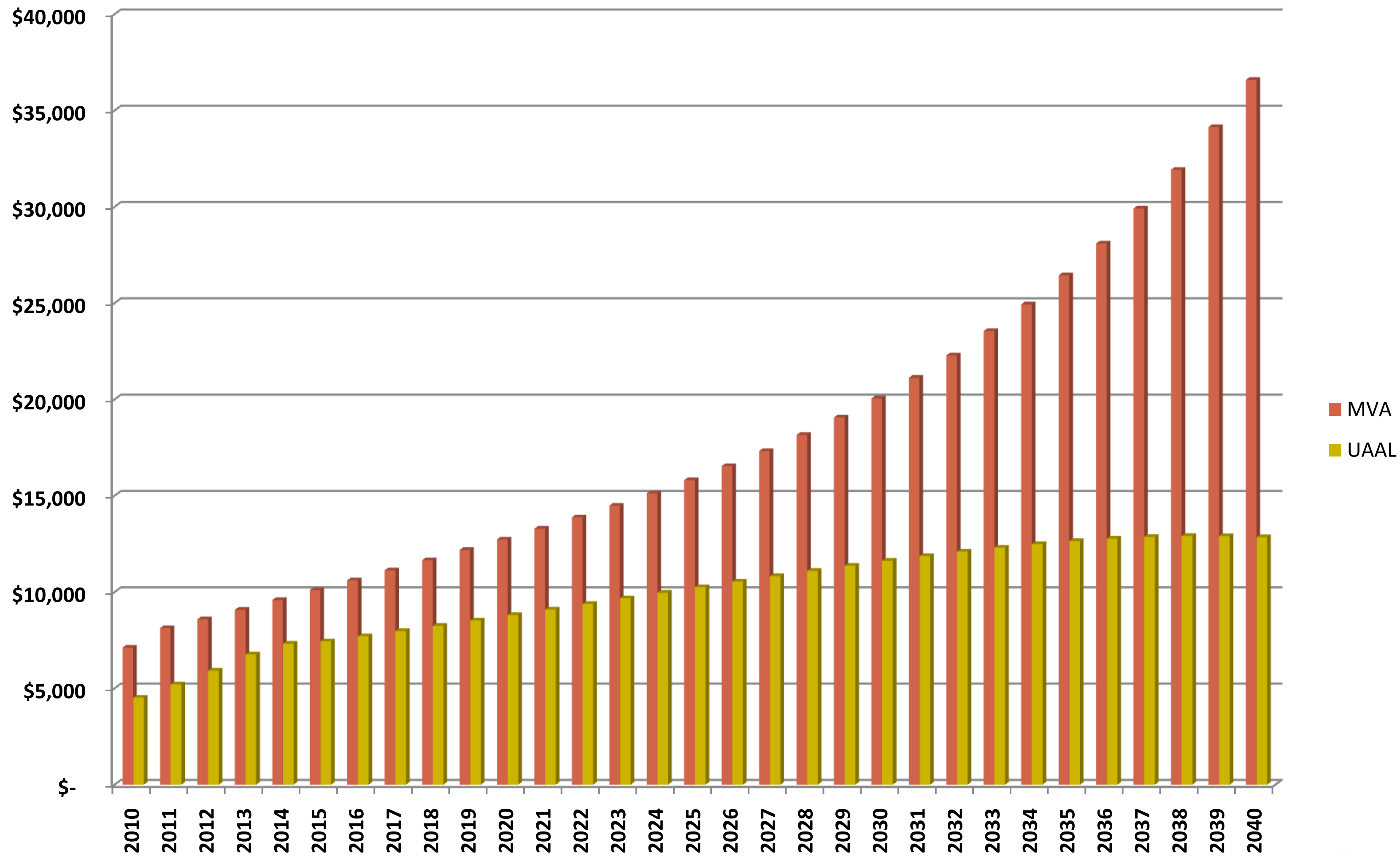
Actuarial Market Value of Assets (MVA) vs. Unfunded Actuarial Accrued Liability (UAAL)



**** Dollar amounts are in millions***

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

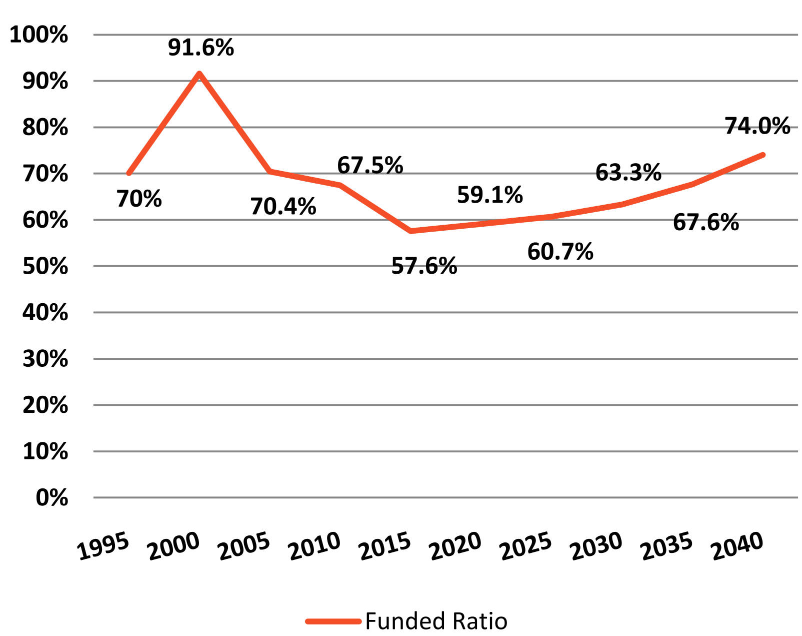
Governmental Accounting Standards Board

GASB 25 – This statement establishes financial reporting standards for defined benefit pension plans.

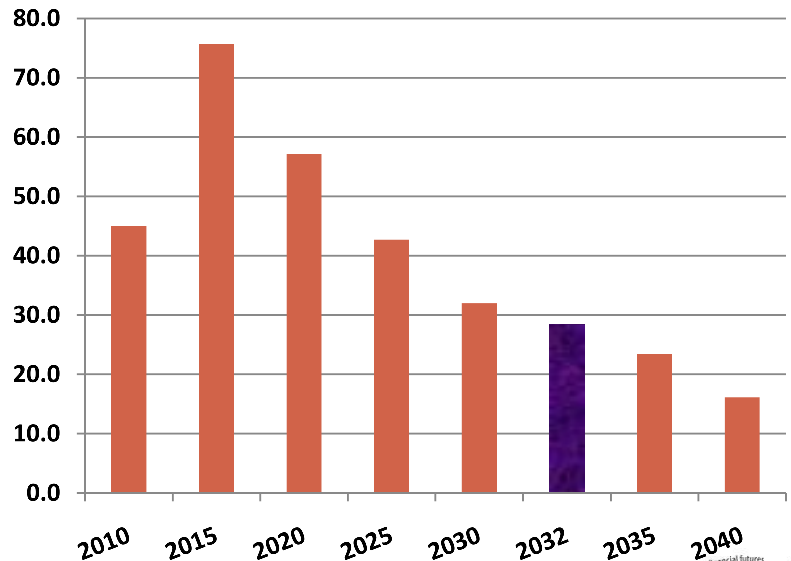
• The funding period, also known as the amortization period should not exceed the maximum 30-year period. ERB's current funding period is 45.0 years. ERB's funding period will be in compliance with GASB standards in 2032 when it reaches 28.4 years.

• The funded ratio (the ratio of the actuarial value of assets to the actuarial accrued liability) stands at 67.5% in 2010. Five years ago the ratio stood at 75.4% and ten years ago the ratio was 85.9%. The ratio reached an all time high in 2001 at 91.9% however began to decrease in as the negative investment experience in the 2001 – 2003 fiscal years was phased into the actuarial value of assets.

Funded Ratio: 1995 - 2040



Funding Period: 2010 - 2040



INVESTMENT PERFORMANCE

Summary of Investment Results

• ***For the fiscal year ending June 30, 2010, the Fund returned 18.6%, outperforming its policy index by 5.9%, ranking in the top 2nd percentile of public funds > $1 billion.***

•Over the last 12 months, the Fund experienced a gross investment gain of $1.3 billion, which includes a gross investment loss of $333.0 million during the second quarter. Total assets decreased from $8.6 billion at the beginning of the quarter to $8.2 billion on June 30, 2010, with $38.9 million in net distributions.

• Over the past five years, the Fund returned 4.0% per annum, outperforming its policy index by 0.8%, ranking in the top 10th percentile of the Independent Consultant Cooperative's Public Funds > $1 Billion Universe.

• For the quarter, the Fund posted a -3.9% return, outperforming its policy index by 0.6%, ranking in the top 32nd percentile of public funds > $1 billion.

• All asset classes were within policy ranges on June 30, 2010

Fund Allocation

	Market Value	Percent of Total Assets	Interim Policy Target[1]	Difference	Long Term Policy Target	Difference	Range[2]
TOTAL FUND	**$8,206,682,401**	**100.0%**					
TOTAL EQUITY	***$3,586,974,650***	***43.7%***	***45.0%***	***(1.3%)***	***45.0%***	***(1.3%)***	
U.S. EQUITY	**$2,140,961,124**	**26.1%**	**25.0%**	**1.1%**	**25.0%**	**1.1%**	**10-40%**
U.S. Large Cap Equity	*$1,793,695,152*	*21.9%*	*23.0%*	(1.1%)	*23.0%*	(1.1%)	
U.S. Small Cap Equity	*$347,265,972*	*4.2%*	*2.0%*	2.2%	*2.0%*	2.2%	
NON-U.S. EQUITY	**$1,446,013,526**	**17.6%**	**20.0%**	**(2.4%)**	**20.0%**	**(2.4%)**	**10-35%**
Non-U.S. Developed Markets	*$485,415,913*	*5.9%*	*10.0%*	(4.1%)	*10.0%*	(4.1%)	
Non-U.S. Emerging Markets	*$960,597,613*	*11.7%*	*10.0%*	1.7%	*10.0%*	1.7%	
FIXED INCOME	**$2,887,076,157**	**35.2%**	**33.0%**	**2.2%**	**20.0%**	**15.2%**	**5-40%**
Core Bonds	*$2,299,538,917*	*28.0%*	*28.0%*	0.0%	*15.0%*	13.0%	
Credit Strategies	*$587,537,240*	*7.2%*	*5.0%*	2.2%	*5.0%*	2.2%	
ABSOLUTE RETURN	**$499,102,188**	**6.1%**	**10.0%**	**(3.9%)**	**10.0%**	**(3.9%)**	**2-20%**
PRIVATE EQUITY	**$274,500,992**	**3.3%**	**2.0%**	**1.3%**	**10.0%**	**(6.7%)**	**2-20%**
REAL ESTATE	**$85,978,205**	**1.0%**	**2.0%**	**(1.0%)**	**5.0%**	**(4.0%)**	**0-10%**
REITs	**$311,499,555**	**3.8%**	**3.0%**	**0.8%**	**0.0%**	**3.8%**	
REAL ASSETS	**$61,354,056**	**0.7%**	**0.0%**	**0.7%**	**5.0%**	**(4.3%)**	**0-10%**
GLOBAL ASSET ALLOCATION	**$439,581,088**	**5.4%**	**5.0%**	**0.4%**	**5.0%**	**0.4%**	**0-10%**
CASH	**$60,615,508**	**0.7%**	0.0%	0.7%	0.0%	0.7%	0-10%

As of June 30, 2010

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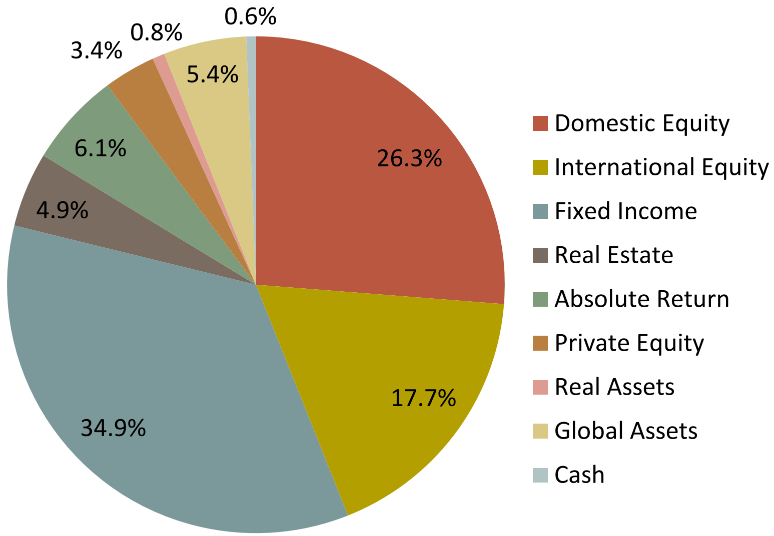
Total Fund Performance

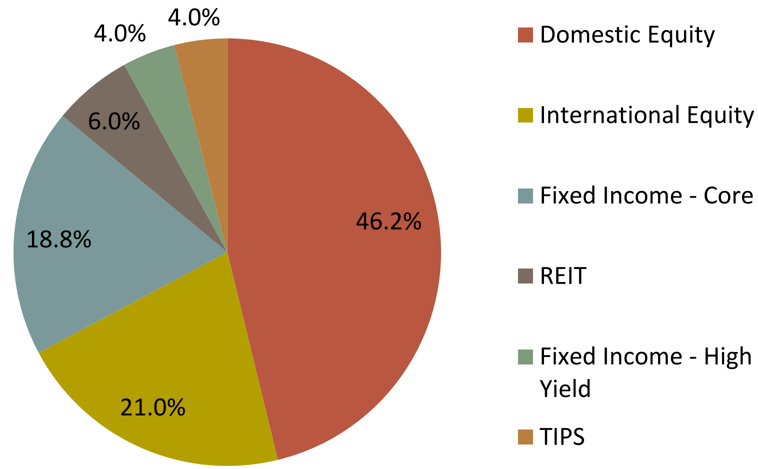
								Annualized Returns							
	Ending Market Value	Last 3 Months	Rank	Calendar YTD	Rank	Fiscal YTD	Rank	Three Years	Rank	Five Years	Rank	Ten Years	Rank	Fifteen Years	Rank
Total Fund	**$8,206,682,401**	**-3.9%**	**32**	**0.0%**	**12**	**18.6%**	**2**	**-2.8%**	**15**	**4.0%**	**10**	**2.6%**	**72**	**6.6%**	
Allocation Index		***-4.2%***	***35***	***-1.0%***	***40***	***14.2%***	***30***	***-2.2%***	***9***	***4.1%***	***9***	***3.4%***	***31***	***n/a***	
Policy Index		***-4.5%***	***45***	***-1.5%***	***59***	***12.7%***	***58***	***-3.5%***	***28***	***3.2%***	***32***	***3.0%***	***54***	***6.3%***	
60% S&P 500/40% BC Aggregate		*-5.6%*		*-1.8%*		*12.8%*		*-2.7%*		*2.0%*		*1.9%*		*6.6%*	
70% S&P 500/30% BC Aggregate		*-7.1%*		*-3.0%*		*13.3%*		*-4.5%*		*1.4%*		*1.1%*		*6.6%*	
ICC Public Funds > $1 Billion Median		-4.7%		-1.4%		13.4%		-4.4%		2.7%		3.1%		n/a	
ICC Public Funds Median		-5.0%		-1.5%		13.1%		-3.7%		2.7%		3.4%		n/a	

Asset Allocation and Fund Value as of June 30 of Each Year

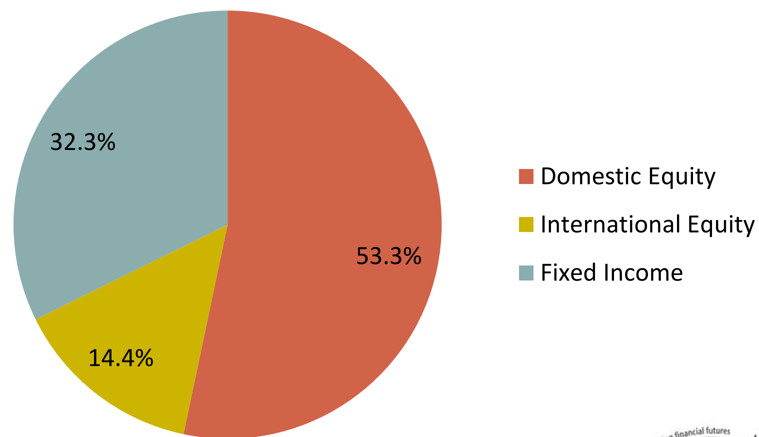
2010 Asset Allocation – Fund Value: $8.2 Billion



2005 Asset Allocation – Fund Value: $7.4 Billion

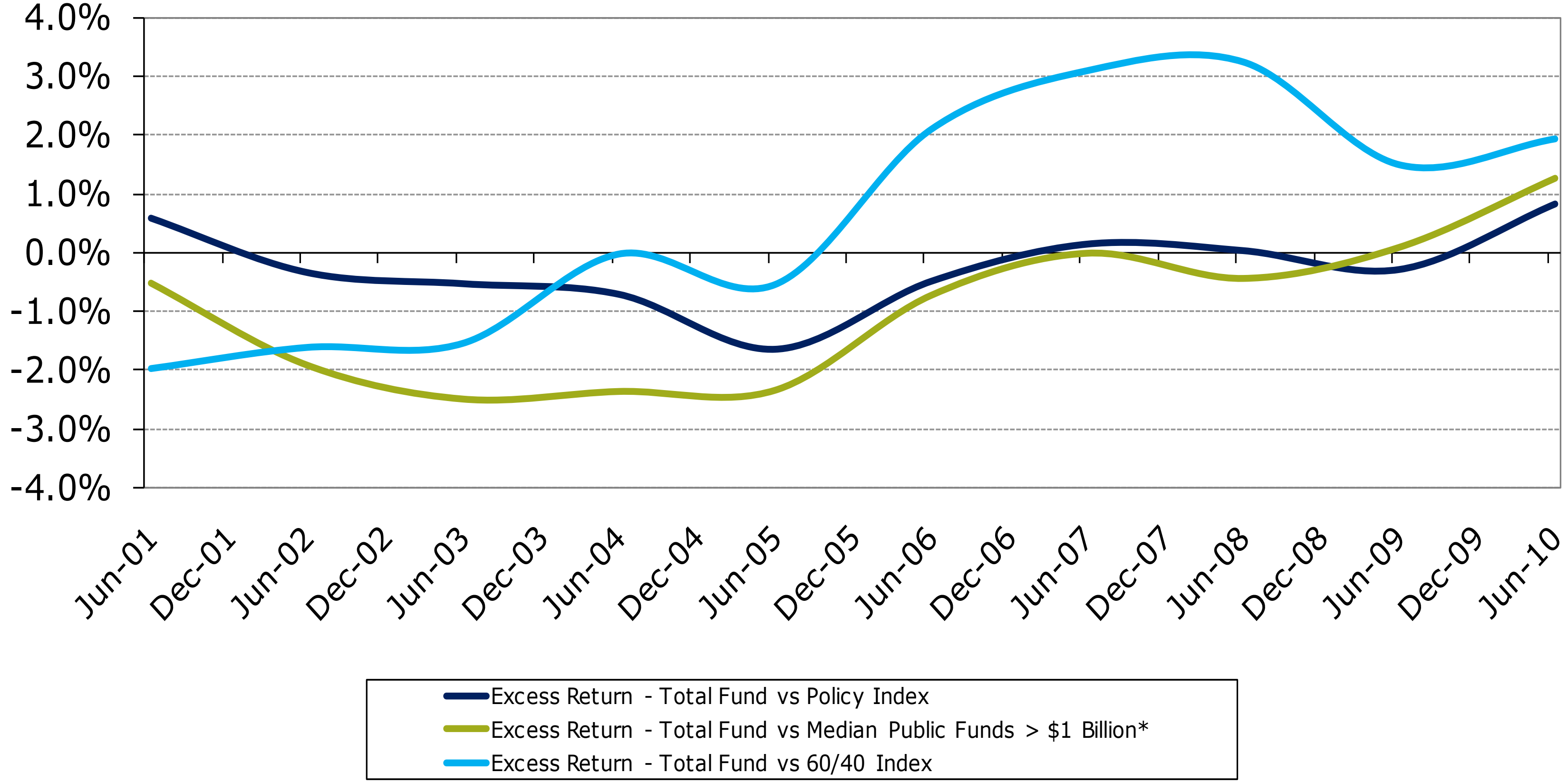


2000 Asset Allocation – Fund Value: $7.4 Billion



HB 389 – Permanent Fund Investment Limitations (Uniform Prudent Investor Act) passed in 2005 regular session allowed for further diversification of ERB's fund.

Rolling 5 Year Excess Returns



Policy Impact: *The policy index is calculated by multiplying the target asset class weights times the return of the respective passive benchmark (re-balanced monthly). The policy impact, which is the difference between the policy index and the median fund's performance, measures the effectiveness of Plan Structure.*

Allocation Impact: *The allocation index is calculated by multiplying the actual asset class weights times the return of the respective passive benchmark. When the policy index is subtracted from the allocation index, the result measures the impact of deviating from the target weights.*

Manager Impact: *The Composite is calculated by multiplying the actual asset class weights times the actual manager return. The allocation index is then subtracted from the Composite. The result, manager impact, measures the contribution of active management.*

Note: Returns are gross of fees.

PLAN DESIGN CHANGES

Pension Reform in Other Systems

- **Change the Minimum Retirement Age** – the minimum retirement age is the age an individual can retire and receive full benefits. In New York the minimum retirement age has been increased from 55 to 62 for new employees. ERB does not currently have a minimum retirement age.
- **Cap Pension Benefits –** Part of the Illinois pension reform capped the maximum pension amount at $106,800 (FICA Wage Limit) and the payout is based on their highest salary based on their highest salary during eight consecutive years of the last ten. ERB does not currently cap pension benefits and the payout is based on the final average salary over the highest twenty consecutive quarters.
- **Increase contributions to the fund –** Montana is reviewing increases in employee and employer contributions. Currently employees pay 6.9% of their salaries while employers pay 7.17%. Over a six year period rates would increase to 12.9% for employees and 13.17% for employers. ERB is in the process of phasing in employee and employer contribution increases which will result in an increase of employee contributions from 7.60% in FY05 to 7.90% in FY09 and employer contributions will increase from 8.65% to 13.90% by FY13. It should be noted ever for FY10 & FY11 employees earning more than $20,000 are contributing 9.40% and the employer is contributing 10.90%.
- **Reduce Actuarial Assumed Rate of Return –** Utah reduced its investment assumption from 8% to 7.75% while Pennsylvania lowered its assumption from 8.5% to 8%. ERB's investment assumption rate is currently 8%. ERB's 2008 Actuarial Experience Study recommended no change in this rate and a new experience study will be performed this year.

Pension Reform in Other Systems

- **Update Benefit Formula –** New employees in Nevada will have their annual pension benefits calculated using a 2.5% multiplier, down from 2.67%. The multiplier for ERB is currently 2.35%.
- **Cost of Living Adjustment (COLA) –** Georgia passed a law that ends COLAs for new employees when they retire. The COLA for ERB is currently based on changes to the Consumer Price Index (CPI) and on average is 2%. This year no COLA was given since CPI was negative. ERB retirees are not eligible for a COLA until they reach age 65.
- **Shift to Defined Contribution (DC) Plans –** Alaska and Michigan have exchanged the defined benefit approach for defined contribution. Michigan did so in 1997 and Alaska in 2005. Recent losses in individual employees portfolios have prompted a number of bills in Alaska to repeal the decision. A recent study by the National Institute on Retirement Security has determined that the cost to deliver the same level of retirement income to a group of employees is 46% lower in a defined benefit plan than it is in a DC plan. The characteristics of the two plans are detailed on page 3 of this presentation.

What Should the ERB Benefit Look Like?

Staff is recommending the board look at the following:

- Target income replacement percent keeping in mind Social Security retirement benefits.
- Length of working career
- Equitable sharing of employee and employer contributions
- What portion of the benefit should be guaranteed (defined benefit or variable defined contribution)
- Should there be a minimum retirement age?

The ERB board will be addressing these issues at its September retreat in order to ensure sustainable retirement benefits for its members.