



NEW MEXICO LEGISLATURE

**INVESTMENTS AND
PENSIONS OVERSIGHT
COMMITTEE**

2015 INTERIM FINAL REPORT

LEGISLATIVE COUNCIL SERVICE
411 STATE CAPITOL
SANTA FE, NEW MEXICO 87501
(505) 986-4600
WWW.NMLEGIS.GOV

TABLE OF CONTENTS

INTERIM SUMMARY

WORK PLAN AND MEETING SCHEDULE

AGENDAS AND MINUTES

ENDORSED LEGISLATION

INTERIM SUMMARY

Investments and Pensions Oversight Committee 2015 Interim Summary

The Investments and Pensions Oversight Committee held five meetings in 2015. The committee discussed and studied a variety of issues, ranging from the solvency of the state's pension funds, to the effects of Governmental Accounting Standards Board (GASB) statements on the reporting of liabilities by certain state entities and local governments, to the status of investments of the state pension funds and other funds, such as the Severance Tax Permanent Fund and the Land Grant Permanent Fund.

The committee heard testimony from officials from the Public Employees Retirement Association (PERA) and the Educational Retirement Board (ERB) regarding the manner in which those agencies are implementing GASB Statement 67 and assisting employers with the implementation of GASB Statement 68. The PERA and ERB presented reports detailing their net pension liabilities for fiscal year 2014. In addition, officials from local governments provided testimony regarding their plans for implementation of GASB Statement 68. The Office of the State Auditor provided information regarding its role in the implementation of the GASB statements, while the Department of Finance and Administration discussed possible effects on the state's statement of net position.

Officials from the Retiree Health Care Authority (RHCA) provided information on the impacts expected from the implementation of GASB Statements 74 and 75, which include new standards for reporting of post-employment benefits other than those offered through pension plans. As the result of adoption of the new standards, net liabilities will be reported similar to the manner in which they are reported by the appropriate entities under GASB Statements 67 and 68. RHCA officials also provided the committee with an overview of the RHCA's five-year strategic plan.

The state's investment agencies, including the PERA, ERB and State Investment Council (SIC), provided the committee with presentations on their respective investment strategies, asset allocations and investment-related fee reporting. They also provided reports on the economic impact in the state of the investments and activities of those agencies. Officials from those agencies also discussed how they developed a joint methodology to report fees and asset allocations. Those agencies additionally presented reports providing information on fund balances and investment returns. SIC officials provided the committee with an update on the SIC's management of the Severance Tax Permanent Fund.

Officials from the Higher Education Department and the Education Trust Board (ETB) provided a report on the ETB's administration of New Mexico's 529 college savings plan. They also discussed recent initiatives to market the plan and for investment of trust assets.

At its last meeting of 2015, the committee engaged in a discussion with representatives from the State Treasurer's Office, ERB, SIC and PERA regarding the possible effects of merging functions among those agencies. In addition, the committee heard proposals for the endorsement of three pieces of proposed legislation, and each one was endorsed by the committee.

WORK PLAN AND MEETING SCHEDULE

**2015 APPROVED
WORK PLAN AND MEETING SCHEDULE
for the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

The Investments and Pensions Oversight Committee (IPOC) was created by the New Mexico Legislative Council on April 27, 2015. Committee members are as follows:

Members

Sen. George K. Munoz, Chair	Sen. Steven P. Neville
Rep. Monica Youngblood, Vice Chair	Sen. Bill B. O'Neill
Sen. Sue Wilson Beffort	Rep. Jane E. Powdrell-Culbert
Sen. Jacob R. Candelaria	Rep. William "Bill" R. Rehm
Rep. Miguel P. Garcia	Sen. William P. Soules
Rep. Larry A. Larrañaga	Rep. Jim R. Trujillo
Sen. Carroll H. Leavell	Rep. Luciano "Lucky" Varela

Advisory Members

Sen. Ted Barela	Sen. William H. Payne
Sen. Carlos R. Cisneros	Sen. John C. Ryan
Rep. Roberto "Bobby" J. Gonzales	Rep. Tomás E. Salazar
Sen. Stuart Ingle	Sen. Michael S. Sanchez
Rep. Patricia A. Lundstrom	Rep. James E. Smith
Sen. Mary Kay Papen	Rep. Sheryl Williams Stapleton

Work Plan

During the 2015 interim, the IPOC will:

- (1) receive from the Public Employees Retirement Association (PERA), the Educational Retirement Board (ERB) and the Retiree Health Care Authority (RHCA) reports on each agency's maintenance of sustainability and solvency, as demonstrated by:
 - ▶ actuarial valuation reports, including details of unfunded liabilities, other actuarial metrics and experience studies;
 - ▶ funding policies; and
 - ▶ plans for addressing any impediments to sustainability and solvency;

- (2) receive from the State Investment Council (SIC), the PERA, the ERB, the RHCA and the Education Trust Board (ETB) reports on each agency's maintenance of transparency, as demonstrated by:
 - ▶ policies and controls, including:
 - asset allocation policies and implementation of such policies;
 - investment committee policies;
 - financial reports, investment performance reports and, if applicable, actuarial reports; and
 - investment manager and consultant selection processes and required disclosures;

- ▶ investment management and consulting expenses, including base performance and incentive fees and costs, whether expensed or capitalized, on-budget or off-budget; custodial fees; investment transaction fees; commissions; and any other investment-related expenses; and
- ▶ audited financial statements and board and committee meeting minutes posted on each agency's web site;

(3) receive from the SIC, the PERA, the ERB, the RHCA and the ETB reports on each agency's value, as demonstrated by:

- ▶ economic impact; and
- ▶ comparison to peers;

(4) receive from the SIC, the PERA, the ERB, the RHCA and the ETB reports on each agency's strategic goals, as demonstrated by:

- ▶ plans and actions; and
- ▶ troubleshooting any impediments to meeting goals;

(5) receive reports from the PERA, the ERB, the Department of Finance and Administration and the state auditor regarding the effects of Governmental Accounting Standards Board Statements 67 and 68 on governmental entities;

(6) receive reports from the SIC on its investment of the Severance Tax Permanent Fund in New Mexico private equity funds or New Mexico businesses whose investments or enterprises enhance the economic development of the state;

(7) receive reports from the PERA regarding the legislative retirements plans;

(8) receive reports regarding the disposition or progress of legal claims filed by or on behalf of the SIC, the PERA and the ERB regarding alleged breaches of contract, alleged breaches of fiduciary duty or similar claims allegedly committed by investment managers or consultants;

(9) receive testimony about the pros and cons of merging the SIC, the PERA, the ERB, the Office of the State Treasurer and the New Mexico Finance Authority into a single agency;

(10) receive reports on proposed legislation; and

(11) examine other issues related to the investment of public funds and the administration of pension benefits, as necessary.

**Investments and Pensions Oversight Committee
2015 Approved Meeting Schedule**

<u>Date</u>	<u>Location</u>
June 16	Santa Fe
July 21	Santa Fe
August 18	Santa Fe
September 15	Rio Rancho
November 5	Santa Fe

AGENDAS AND MINUTES

**TENTATIVE AGENDA
for the
FIRST MEETING IN 2015
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**June 16, 2015
Room 322, State Capitol
Santa Fe, New Mexico**

Tuesday, June 16

- 9:00 a.m. **Call to Order**
—Senator George K. Munoz, Chair
—Representative Monica Youngblood, Vice Chair
- 9:05 a.m. (1) **Public Employees Retirement Association (PERA): Overview of Governmental Accounting Standards Board Statement 67 and Statement 68**
—Natalie Cordova, Chief Financial Officer, PERA
—Jeff Bridgens, Moss Adams, LLP
- 10:00 a.m. (2) **State Investment Council (SIC): Overview of Current Investment Theories and Trends**
—Steven K. Moise, State Investment Officer, SIC
—Vince Smith, Deputy State Investment Officer, SIC
- 10:30 a.m. (3) **SIC: Investment Details for 2008-2014, Including:**
• Losses and Gains in Each Fund
• Fees and Costs for Investment Transaction Services and Investment Strategy and Manager Selection Services Provided to the SIC
—Steven K. Moise, State Investment Officer, SIC
—Vince Smith, Deputy State Investment Officer, SIC
- 12:00 noon (4) **2015 Interim Work Plan and Meeting Schedule**
—Lisa Sullivan, Staff Attorney, Legislative Council Service
- 12:30 p.m. **Adjourn**

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

**June 16, 2015
Room 322, State Capitol
Santa Fe, New Mexico**

The first meeting of the Investments and Pensions Oversight Committee for the 2015 interim was called to order by Senator George K. Munoz, chair, on Tuesday, June 16, 2015, at 9:15 a.m. in Room 322 of the State Capitol in Santa Fe.

Present

Sen. George K. Munoz, Chair
Rep. Monica Youngblood, Vice Chair
Sen. Jacob R. Candelaria
Rep. Miguel P. Garcia
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Rep. William "Bill" R. Rehm
Rep. Jim R. Trujillo
Rep. Luciano "Lucky" Varela

Absent

Sen. Sue Wilson Beffort
Rep. Larry A. Larrañaga
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Sen. William P. Soules

Advisory Members

Sen. Ted Barela
Rep. Roberto "Bobby" J. Gonzales
Sen. John C. Ryan
Rep. Tomás E. Salazar
Rep. James E. Smith
Rep. Sheryl Williams Stapleton

Sen. Carlos R. Cisneros
Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. William H. Payne
Sen. Michael S. Sanchez

Staff

Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Tuesday, June 16

Public Employees Retirement Association (PERA): Overview of Governmental Accounting Standards Board (GASB) Statements 67 and 68

Natalie Cordova, chief financial officer, PERA, and Jeff Bridgens, Moss Adams, LLP, provided the committee with an overview of the manner in which the PERA is implementing GASB Statements 67 and 68. Ms. Cordova explained that the GASB is the independent organization that establishes standards of accounting and financial reporting for state and local governments and is recognized by governments as their official source of generally accepted accounting principles. She commented that while standards established by the GASB do not have the force of law, compliance with the standards is critical to auditors who render opinions based upon the conformity of financial statements with generally accepted accounting principles. Ms. Cordova mentioned that failure to comply with the GASB's standards could result in modified audit opinions and affect bond ratings of government entities.

Ms. Cordova stated that changes issued by the GASB under its Statements 67 and 68 are intended to provide for improved consistency and transparency in employer reporting. Through those statements, the GASB requires governments to report their net pension liabilities on the face of their financial statements. She also stated that the inclusion of net pension liabilities is intended to permit users of financial statements to better assess the long-term benefit obligations and the long-term financial health of the government entity. In addition, Ms. Cordova stated that the disclosure is meant to provide information on whether the government entity is meeting its pension obligations.

Ms. Cordova described the differences between GASB Statements 67 and 68. She stated that GASB Statement 67 applies to entities that administer pension benefits, such as the PERA and the Educational Retirement Board (ERB). She explained that the PERA administers a cost-sharing multiple employer defined benefit plan, which covers state employees from each branch of government and local government employees. Ms. Cordova stated that GASB Statement 68 applies to government entities that provide pension benefits to their employees. Those government entities might include counties, municipalities, housing authorities and water and sanitation districts.

Ms. Cordova discussed some of the characteristics of pension plans, indicating that pension plans are considered as part of an employee's total compensation and that an employer incurs a pension obligation as a result of an employment exchange. She said that a principle underlying recent changes effected by the GASB is that the costs attributable to pension benefits should be recognized in the period the services are provided. Ms. Cordova noted that while the pension plan is primarily responsible for paying pension benefits to the extent sufficient assets are available, the employer is responsible for paying benefits not covered by the assets of the pension plan.

As a result of the changes effected by the GASB, net pension liabilities are now to be reported on employer balance sheets. Ms. Cordova explained that the net pension liability is effectively the total pension liability, less a pension plan's fiduciary net position, or market value of assets. To calculate the total pension liability, the total future pensions of current and former employees are calculated based on the terms of the pension plan and certain actuary assumptions, such as projected salaries and the periods during which the employees are expected to work and collect retirement benefits. The present values of the projected benefits are determined and then attributed to past and future earning periods. Ultimately, a pension plan's fiduciary net position is subtracted from the total pension liability to determine the net pension liability.

Ms. Cordova discussed the difference between the net pension liability of \$3.3 billion reported by the PERA and its unfunded actuarial accrued liability (UAAL) of \$4.3 billion as of June 30, 2014. She stated that the market value of assets or the fiduciary net position is greater than the value of assets used in the June 30, 2014 actuarial valuations. She also explained that the calculation of the fair market value of assets is often more volatile relative to the actuarial value of assets used to calculate the UAAL because of a four-year smoothing feature characteristic of the UAAL. She stated that the net pension liabilities of the PERA divisions and funds are less than their UAALs in the 2014 actuarial valuation, with the exception of the Magistrate Retirement Fund. That fund is the only fund projected to become insolvent using the GASB Statement 67 projection method. Thus, a lower blended discount rate will be applied, resulting in an increase to the net pension liability attributable to the Magistrate Retirement Fund under the new GASB standards.

Ms. Cordova explained that the PERA is responsible for implementing GASB Statement 67 and including the required information in the PERA's financial report for fiscal year 2014. She added that the PERA is also assisting various employers in the collection of data necessary for their implementation of GASB Statement 68. For fiscal year 2015, Ms. Cordova stated that the PERA is paying for the calculation of employer allocations and related audits for each entity participating in the PERA pension plan. She also described the process by which pension contribution data will be incorporated into a schedule of employer allocations. A schedule of employer allocations would include, for each employer, its share of net pension liability, deferred inflows and outflows, pension expense and a rate-sensitivity disclosure.

Ms. Cordova presented a report showing the components of the separate net pension liabilities of the PERA's members, according to the fund. The reported net pension liabilities included: \$3.3 billion for the PERA; \$41 million for the Judicial Retirement Fund; and \$21 million for the Magistrate Retirement Fund. A negative pension liability of \$21 million was reported for the Volunteer Firefighters Retirement Fund.

Mr. Bridgens discussed the significance of discount rate assumptions upon the PERA's net pension liability calculations. He said that the discount rate used to calculate net pension liabilities was 7.75 percent, but that net pension liability calculations are sensitive to changes in the discount rate. He presented a table that showed the changes in net pension liabilities relative

to one percent changes in discount rates. For instance, the PERA's calculated net pension liability is \$3.3 billion if a discount rate of 7.75 percent is used. However, if the discount rate is reduced by one percent to 6.75 percent, the net pension liability is increased to \$5.5 billion. On the other hand, if the discount rate is raised to 8.75 percent, the net pension liability is reduced to \$1.6 billion. Mr. Bridgens explained that GASB Statement 67 requires a note disclosure of the effect of such discount rate changes.

Mr. Bridgens additionally discussed the impact of GASB Statement 67 on the manner in which raw data inputs are collected and used in the calculation of liability projections. He explained that demographic data, such as pension member birth dates, gender, wage information and other data, are increasingly being audited because these data are critical in making total pension liability and UAAL calculations. Mr. Bridgens said that the PERA's external and internal auditors annually perform test work on such data.

Questions and comments from committee members followed. A committee member asked whether the standards established by the GASB were used by states with defined benefit plans and states with defined contribution plans. Mr. Bridgens explained that GASB Statement 67 applies to both defined contribution plans and defined benefit plans. In addition, a committee member asked if GASB standard compliance is required by New Mexico law. Susan Pittard, general counsel, PERA, referenced some requirements, such as the state audit rule, which have been modified to address changes made by the GASB.

A committee member asked about any actions that might be taken with respect to the projected insolvency of the Magistrate Retirement Fund. Ms. Cordova explained that a blended discount rate of about 5.96 percent will be applied to reflect the contributions to the fund and benefits to be paid. Wayne Propst, director, PERA, added that legislation passed in 2014 would assist with returning the Magistrate Retirement Fund to solvency. He noted that the effects of legislation upon that fund's solvency would be realized later than the effects of 2013 legislation aimed at assisting with the solvency of other retirement funds.

A committee member additionally inquired about the internal and external audits conducted with respect to demographic data used for net pension liability calculations. Mr. Bridgens noted that audits are often coordinated to avoid a duplication of effort with respect to the review of demographic information. Another question arose with respect to whether administrators of pension funds in other states are increasingly focusing on audits of demographic data. Mr. Bridgens indicated that other states are doing so.

A committee member inquired about the extent to which the PERA is meeting its annual funding requirements. Mr. Propst stated that the PERA is meeting its statutorily required contributions, and he explained that its existing UAAL is attributable to a market downturn during the recession, when the PERA funds lost half of their value. Mr. Propst added that legislation on pension reform from 2013 would assist the PERA in eventually paying off its UAAL in the long term. A committee member asked when the PERA estimates that the UAAL

would be eliminated. Mr. Propst responded that, with an assumed discount rate of 7.75 percent, it would take 20 years for the PERA to reach a level at which it is 100 percent funded.

Committee members and Ms. Cordova discussed how net pension liabilities for state-administered funds might be reflected in the comprehensive annual financial report. A committee member asked about the effect that UAALs might have on the bond ratings of government entities. Mr. Propst stated while there has not necessarily been a correlation with the reporting requirements stemming from GASB Statements 67 and 68, there is a chance that pension reform legislation in 2013 could be considered favorably by bond rating agencies.

A committee member asked which investment agencies are affected by GASB Statement 67. Mr. Propst explained that it applies to the PERA and the ERB. He added that the GASB recently issued statements that will affect the Retiree Health Care Authority and will change how it reports its funding status.

A committee member asked about a settlement reached between the PERA and Wells Fargo stemming from a lawsuit for breach of contract and breach of fiduciary duty filed by the PERA in 2010 against Wachovia Bank. Wells Fargo subsequently acquired Wachovia Bank. Mr. Propst stated that the parties reached a settlement resulting in a recovery of \$50 million for the PERA. Ms. Pittard stated that the settlement amounts are currently in transition. A committee member asked whether the PERA would incur attorney fees. Ms. Pittard indicated that attorney fees would be paid to outside counsel.

A committee member suggested that the committee consider review of the balances in the Legislative Retirement Fund and asked the PERA staff about the status of the fund. Mr. Propst stated that the fund currently holds a balance of \$7.5 million, and its funded ratio is 129.3 percent. He stated that it is anticipated that the fund balance will continue to grow as it continues to receive member contributions and statutory distributions.

State Investment Council (SIC): Overview of Current Investment Theories and Trends and Investment Details for 2008-2014

Vince Smith, deputy state investment officer, SIC, provided an overview of a number of economic factors affecting the SIC's investments of public funds. In particular, he noted that inflation is expected to stay within the average range, between two and five percent, within the next seven to 10 years. Gross domestic product growth is expected to range between 3.5 and six percent, but a rate of about five percent is generally characteristic of overall corporate strength. He noted that during the last 10 years, the growth rate for global stocks was at about six percent, but that rate is expected to approximate 6.5 percent within the next seven to 10 years. He also noted that the growth rate for stocks and bonds, within a basic "60 to 40" allocation model, is expected to approximate 5.5 percent.

Overall, Mr. Smith noted that the SIC is anticipating lower-than-average investment returns for the next seven to 10 years. He explained that expected rate of return is composed of a

risk-free rate of return and a risk premium. The risk-free rate has dropped to two percent from five percent, thus reducing the expected rate of return for all asset classes. Mr. Smith presented the committee with a chart showing the historical risk-free rates and risk premia from 1998 through 2014. He stated that for the SIC to achieve its long-term target return of 7.5 percent over the next seven to 10 years, a risk premium of 5.25 percent would need to be achieved and would present challenges. He pointed out that while public funds earned a median of almost 8.75 percent annually over the last 20 years, market conditions have changed. He pointed out that the Shiller price-to-earnings ratio, a measure of stock market valuation, has risen from about 10 in 1985 to about 27 in 2015. He also pointed out that bond yields have decreased from 10 percent in 1985 to four percent in 2015.

Mr. Smith described the SIC's strategy in light of the current market and economy. He stated that the SIC's strategy will focus on reducing a dependence on equity risk premiums; incorporating more real return assets; increasing income-producing assets relative to capital gain assets; increasing international exposure; and reducing publicly traded assets, while increasing private assets.

Mr. Smith explained how the SIC diversifies investments to serve the needs of each fund and client. He clarified that the staff members of the SIC do not act as investment advisors. He presented a chart showing the current percentages invested by the SIC in different types of assets. While 23 percent of the SIC's investments constitute fixed-income investments, another 27 percent is invested in private market investments and 50 percent is invested in public equity.

Mr. Smith talked about the SIC's investment in publicly traded investments, including stocks and bonds. He said that those investments are externally managed and internally monitored. He added that the SIC increased its allocation toward passive investments in 2014. Management fees are paid quarterly, but the SIC does not pay performance incentive fees. Instead, manager payments are based on the size of the funds managed. He noted that a management fee maximum of 25 basis points has been eliminated in an effort to recruit high-quality managers. Mr. Smith also stated that the SIC has structured its portfolio of active managers to provide protection during down-cycle markets. The SIC has reduced reliance on equity markets and has shifted toward income-producing assets.

Next, Mr. Smith provided an overview of the management of the SIC's private equity investments outside of New Mexico. There are 110 private equity funds invested by 78 managers. He indicated that the investment managers for those private equity funds receive a portion of profits as part of their fee structures. The SIC's target asset allocation for private equity fund investments constitutes 12 percent of its portfolio. In addition, there are 19 private equity funds invested in New Mexico companies by 13 managers. Those funds are invested in passive investments, primarily focused on venture capital and technology transfer. The SIC's target asset allocation for those investments is five percent of the market value of the Severance Tax Permanent Fund, but an asset allocation of up to nine percent is permitted by statute.

Mr. Smith indicated that the SIC has shifted its real estate investments to real estate funds in primary markets. He stated that the SIC is working toward achieving an investment allocation target for this category of 10 percent within the next couple of years. Mr. Smith additionally discussed other strategies used by the SIC, including those using absolute return techniques and those that focus on credit and structured debt.

Mr. Smith and Steven K. Moise, state investment officer, SIC, indicated that the SIC's primary investment consultant is RVK, which provides the SIC with monthly and quarterly investment reporting; manager research and performance monitoring; and portfolio construction and strategic planning. They also provided a list of investment consultants used for specific investment strategies. They indicated that those investment consultants provide quarterly performance reporting to the SIC, in addition to manager recommendations and ongoing fund monitoring.

Mr. Moise and Mr. Smith presented a detailed report showing balances and returns of the Land Grant Permanent Fund and Severance Tax Permanent Fund since 1989. While the SIC has established an investment return target of 7.5 percent, Mr. Moise and Mr. Smith indicated that the SIC will assess later this year whether that target is still appropriate.

Mr. Smith presented a table, produced by the Legislative Finance Committee, showing the performance rankings with respect to the funds invested by the SIC, the PERA and the ERB. Brent Shipp, chief financial officer, SIC, presented statements of net position and the contributions and distributions relative to the funds invested by the SIC since fiscal year 2008. The SIC staff also presented an analysis of investment management and other fees paid by the SIC since fiscal year 2008. In addition, the staff presented a comparison of fees relative to the ERB and the PERA.

Mr. Smith stated that investments by the SIC are managed entirely by external managers and that the SIC does not pay broker fees. With respect to placement agents, Mr. Smith said the SIC has never paid placement fees. The SIC's lawsuits against placement agents and funds has resulted in recoveries of about \$32 million. Mr. Smith also provided a brief description of the transparency and disclosure policy enacted by the SIC in 2010, which requires disclosure of campaign contributions by investment funds and the ban of placement agents by investment officers.

Mr. Moise stated that the SIC will study and approve an investment plan for the next year, and he noted that the SIC manages about \$20.8 billion in public funds. Distributions to the Land Grant Permanent Fund and Severance Tax Permanent Fund for fiscal year 2016 are expected to reach \$849.3 million. He reiterated that the staff and members of the SIC are fiduciaries of those funds. Harold Lavender, member, SIC, spoke briefly about the SIC's development of investments.

Comments and questions by the committee members followed. A committee member asked how payments of private equity investment managers compare to payments of investors of publicly traded investments. Mr. Moise stated that for publicly traded investments, investment management fees are proportional to the size of the assets invested. For private equity investors, the management fees increase as profits rise.

Committee members discussed whether additional investments could be made to promote New Mexico business growth. Mr. Moise indicated that the SIC requested Sun Mountain Capital, its New Mexico private equity consultant, to conduct a pacing study focused upon how much money the SIC could prudently invest in New Mexico businesses. The study resulted in a target allocation for New Mexico private equity investments of five percent. In response to a question as to whether that percentage might change, Mr. Moise indicated that the SIC has tasked Sun Mountain Capital with a study of what could be done to improve investment in New Mexico businesses. Committee members also discussed the effects of efforts within recent years to diversify Land Grant Permanent Fund investments and to increase inflows to the Severance Tax Permanent Fund.

A committee member asked why the SIC's expenditures for contractual services have increased over the past few years. Mr. Shipp indicated that the SIC's assets are growing, accounting for the increase in fees. He noted that fees had increased from 19 basis points in fiscal year 2008 to 26 basis points in fiscal year 2014.

2015 Interim Work Plan and Meeting Schedule

Ms. Sullivan presented the committee's proposed work plan and meeting schedule for the 2015 interim. Ms. Sullivan noted a change to the proposed work plan, which would require reports on the effect of GASB Statements 67 and 68 on government entities. The committee adopted the revised, proposed work plan, with other additions, including items to permit the committee to study the Legislative Retirement Fund and the investment of the Severance Tax Permanent Fund in private equity funds or New Mexico businesses.

Adjournment

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

Revised: July 20, 2015

**TENTATIVE AGENDA
for the
SECOND MEETING IN 2015
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**July 21, 2015
Room 307, State Capitol
Santa Fe, New Mexico**

Tuesday, July 21

- 8:30 a.m. **Call to Order**
—Senator George K. Munoz, Chair
—Representative Monica Youngblood, Vice Chair
- 8:35 a.m. (1) **Update on the Deferred Compensation Plan Administered by the Public Employees Retirement Association (PERA)**
—Wayne Propst, Executive Director, PERA
—John Grabel, Chief Investment Officer, PERA
- 9:15 a.m. (2) **Analysis of Investment Management Fees Authorized by the PERA**
—John Grabel, Chief Investment Officer, PERA
- 10:10 a.m. (3) **Approval of Minutes**
- 10:15 a.m. (4) **Analysis of Investment Management Fees Authorized by the Educational Retirement Board (ERB)**
—Bob Jacksha, Chief Investment Officer, ERB
- 11:10 a.m. (5) **Report on ERB Experience Studies**
—Jan Goodwin, Executive Director, ERB
—Rick Scroggins, Deputy Director, ERB
- 12:05 p.m. **Lunch on Your Own**
- 1:15 p.m. (6) **Update on the State Investment Council's (SIC's) Management of the Severance Tax Permanent Fund**
—Steve Moise, State Investment Officer
—Charles Wollmann, Director of Communications and Legislative Affairs,
SIC

- 2:00 p.m. (7) **Report on the SIC's Investment of the Severance Tax Permanent Fund in New Mexico Private Equity Funds and New Mexico Businesses**
—Steve Moise, State Investment Officer
—Charles Wollmann, Director of Communications and Legislative Affairs,
SIC
—Lee Rand, Managing Partner, Sun Mountain Capital
- 3:00 p.m. (8) **Update on the Balances in and the Uses of the Permanent Funds and Other Funds Managed by the SIC**
—Steve Moise, State Investment Officer
—Charles Wollmann, Director of Communications and Legislative Affairs,
SIC
- 4:00 p.m. **Adjourn**

**MINUTES
of the
SECOND MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**July 21, 2015
Room 307, State Capitol
Santa Fe, New Mexico**

The second meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2015 interim was called to order by Representative Monica Youngblood, vice chair, on Tuesday, July 21, 2015, at 8:45 a.m. in Room 307 of the State Capitol in Santa Fe.

Present

Sen. George K. Munoz, Chair
Rep. Monica Youngblood, Vice Chair
Sen. Sue Wilson Beffort
Rep. Miguel P. Garcia
Rep. Larry A. Larrañaga
Sen. Bill B. O'Neill
Rep. William "Bill" R. Rehm
Rep. Jim R. Trujillo
Rep. Luciano "Lucky" Varela

Absent

Sen. Jacob R. Candelaria
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Rep. Jane E. Powdrell-Culbert
Sen. William P. Soules

Advisory Members

Sen. Ted Barela
Sen. Stuart Ingle
Sen. John C. Ryan

Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. William H. Payne
Rep. Tomás E. Salazar
Sen. Michael S. Sanchez
Rep. James E. Smith
Rep. Sheryl Williams Stapleton

Staff

Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Tuesday, July 21

Update on the Deferred Compensation Plan Administered by the Public Employees Retirement Association (PERA)

Wayne Propst, executive director, and John Grabel, chief investment officer, PERA, presented to the committee an update of the PERA tax-deferred compensation plan. Mr. Propst described a deferred compensation retirement savings plan as one of the three legs of a sturdy pension stool; the other two legs being a defined benefit plan and social security. The PERA pension plan for public employees in New Mexico is one of the best defined-benefit plans in the nation, and the optional deferred compensation plan is a great choice for employees. The PERA administers member contributions to the plan using the same fiduciary standard that governs the regular pension plans, instead of the commonly used "suitability standard", which only requires that investments be suitable for the member, rather than always be in the member's best interests.

Members currently have 19 investment strategy options, ranging from passive to active member involvement. Mr. Propst said that the PERA tries to get members to think more about asset allocation and less about branding. Generally, the most beneficial long-term strategy for members to choose is a life cycle portfolio, in which a member's funds are invested into a custom asset allocation proportion according to the member's age and expected year of using the funds. Members who want a more active role in investing their funds have many allocation options available. Members pay a low annual administrative fee of \$52.00, except for those members who are just starting the plan, for whom the fee is waived. Investment management fees are also low, due to the fact that members are paying an institutional rate rather than a typical retail rate if their money were to be invested in a branded fund. Management fees for the last fiscal year were 42 basis points, lower than the national median expense rate.

The PERA has more than 18,000 public employees enrolled in the deferred compensation plan, with 219 employers participating. More than \$500 million has been invested by the PERA on behalf of the participants. The PERA is attempting to increase the number of employers participating and the number of members investing in the next few years. A new enrollment form has been created, making it much easier to sign up for the plan, and the name of the program will be changed to make it more identifiable as a state-run retirement plan.

Questions and comments from committee members included the following.

- Are school employees allowed to join the deferred compensation plan, even though they are covered by the Educational Retirement Act? Mr. Grabel said that all school districts are eligible to participate in the plan, but the only school district that has opted into the plan is the Albuquerque Public School District.

- Why are members charged two different fees? Mr. Grabel said that the \$52.00 administrative fee is used to cover the expenses of administering the plan, including recordkeeping, preparation of statements, payroll deductions, customer support and outreach. As more members join the deferred compensation plan, that fee will be reduced. Investment fees are kept by mutual fund companies that make the actual investments and are charged at institutional rates.
- Can tax-exempt nonprofit organizations join the plan? Susan Pittard, chief legal counsel, PERA, said that those organizations are allowed under federal law to participate in such programs, but New Mexico's Deferred Compensation Act currently only allows for governmental entities to join the state plan.
- Does the deferred compensation plan have the same performance as the regular PERA pension plan? Mr. Grabel said that most members choose investment options that typically underperform optimal allocations by one to two percent. People tend to choose too many equity plans, rather than a real asset allocation across classes.
- Are there annual limits on how much can be invested and tax deferred? Mr. Grabel said that the Internal Revenue Service annually publishes contribution limitations. With a few exceptions, this year's limit is \$18,000.
- How often can a member change asset allocation strategies? Mr. Grabel said that a member can change asset options at any time; however, it may take a few weeks for the changes to be implemented. Mr. Propst said that there are three pillars of investing: time in market, contributions and asset allocation. The PERA, however, does not give specific investment advice to its members.
- Do any investments made by the PERA have any relationship with Donald Trump? Mr. Grabel said that he was not aware of any direct involvement.
- Are return-to-work employees eligible to make contributions to the plan? Mr. Propst said that he believed that they are eligible but he would check and report back to the committee.

Approval of Minutes

The minutes from the June 16, 2015 meeting of the committee were approved without changes.

Analysis of Investment Management Fees Authorized by the PERA

Mr. Grabel provided the committee with a discussion of how the PERA oversees fees charged by its investors. In July 2014, the PERA board directed staff to perform a comprehensive review of the value of its money manager relationships. There are currently no industry-wide standard methodologies to assess fees. Discrepancies in how fees are reported include that incentive fees are often ignored; some performance measures are reported as gross of fees and some are reported as net of fees; fee analyses are often not adjusted according to asset type; and fees are often reported without any context of risk-adjusted performance. PERA staff developed its own methodology to study its fees that included performance benchmarks, peer comparison, risk measures and fees paid for each manager of its funds.

In fiscal year 2014, the PERA fund returned 17 percent and gained in value by more than \$2.1 billion. It paid \$70.8 million in management fees, or fees that are paid based on the value of the asset, and \$48.4 million in performance fees, which are based on profit-sharing. The PERA hired CEM, a third-party benchmarking service, to compare the management fees paid by the PERA to other similar funds. CEM found that the benchmark, or expected, basis fee level for a fund the size of the PERA's would be 70 basis points. In actuality, the PERA paid only 59 basis points, representing a savings of approximately \$15 million. CEM ranked the PERA fund among the best category of funds: positive value-added and low cost. The study ranked most asset categories held by the PERA as efficient, including U.S. equity, foreign equity, fixed income, real estate and real asset.

The CEM study was subsequently used by the PERA to fine-tune the management in several asset categories. For example, in the domestic equity category, the PERA eliminated three managers and positioned the portfolio to achieve a higher Sharpe ratio (a measurement of earnings versus risk). In the portable alpha sector of the absolute return asset category, the PERA made significant changes to the portfolio, including reducing investment managers from 19 to one manager, achieving better liquidity and reducing management fees by \$5 million.

In conclusion, Mr. Grabel said that the PERA has a positive fee investment structure. He cautioned, however, that fees comprise a very small portion of overall investment outcome and that asset allocation accounts for 90 percent of investment returns. Seeking low fees should not be the sole basis of an investment decision.

Questions and comments from committee members included the following.

- Has there been a study comparing the investment outcomes of the PERA, State Investment Council (SIC) and Educational Retirement Board (ERB)? The legislature needs to be informed of how each agency is performing, compared to each other and to the rest of the country. Mr. Propst said that the Legislative Finance Committee (LFC) produces quarterly investment reports for the three agencies. Each agency has different financial obligations and goals, so making broad investment comparisons is not always useful.
- The investment management study set in motion a method for the PERA to continually improve investment performance vis-à-vis fees. This is an excellent idea.
- Can the PERA study the exposure the PERA fund has to various global risks? Mr. Grabel said that the PERA produces a monthly basis valuation study plus an annual benchmark review to ensure that its investments are performing adequately. In addition, all assets can be reviewed on a daily basis to measure risk, liquidity and other factors. The PERA can now also do much more scenario testing. For example, it was able to test its exposure in Greece during its recent economic turmoil in order to measure the PERA's risk in that market.

- PERA staff was asked to provide the committee with much more detail about every investment manager, including amounts under contract, fee rates and actual investments made.
- The CEM study did not study performance fees and, as a result, only a partial picture of the fees paid by the PERA was provided. Mr. Grabel said that CEM is currently developing a methodology to study performance fees, and the PERA will contract with that company to study its performance fees.
- Does the PERA pay any third-party marketing fees? Mr. Grabel said that the PERA does not pay such fees. Some of its investment managers may pay placement fees, which fees are disclosed quarterly.
- The PERA is paying tens of millions of dollars annually in investment management fees. Some states are using in-house investment managers, rather than outside contractors, with similar results. Mr. Grabel said that in many cases, the economies of scale and information-gathering edge associated with using a large investment firm outweigh any management fee savings by using in-house staff to manage investments.

Analysis of Investment Management Fees Authorized by the ERB

Bob Jacksha, chief investment officer, ERB, discussed with the committee investment management fees paid by the ERB. Mr. Jacksha began by discussing a presentation at the June IPOC meeting at which the fees paid by the ERB appeared to be much higher than the SIC's fee structure. The main reason the ERB fees appeared higher is because the ERB fees included performance fees, whereas the SIC data only included management fees. Another difference in the data is that the method to calculate basis points used different kinds of asset totals. The ERB data used net asset value to determine fees, but the SIC data also included unfunded commitments, resulting in lower apparent fees. When the fee structure of the two entities is compared using similar data, the ERB's fee structure is much more comparable to the SIC's.

For fiscal year 2014, the ERB paid 96 basis points for alternative investments and 25 basis points for traditional investments, for a weighted average of 66 basis points for the entire portfolio. This fee structure is very similar to the SIC's December 2013 reported fee structure of 61 basis points, rather than the misleading figure of 80 basis points previously reported.

Mr. Jacksha said that the ERB hired a consulting firm to study management fees paid. The results of the study showed that the ERB is getting a good return for the fees it pays. The ERB seeks to minimize fees, but not at the expense of performance. Asset allocation is the primary factor in the level of fees as well as overall portfolio performance. The net return of an investment is more important than the amount of fees actually paid, as is the amount of risk exposure a portfolio has.

Questions and comments from committee members included the following.

- Does the ERB prohibit third-party placement fees? Mr. Jacksha said that the ERB allows its investment managers to pay third-party marketers if they wish to, but each such contract and fee paid must be disclosed.
- Mr. Jacksha was asked to explain the recent New Mexico Supreme Court ruling in one of the "pay-to-play" lawsuits. Mr. Jacksha said that the ERB has a pending lawsuit against Aldus, in which placement agent fees were not disclosed to the ERB. The recent Supreme Court ruling pertains to what is known as the "Foy" lawsuit, in which the ERB is not a direct litigant. The ERB does stand to benefit from the case if the state prevails. In that case, the court ruled that the case may proceed, and the defendants may be liable for restitution.
- Does the ERB pay fees on portfolio investments that have not yet been made? Mr. Jacksha said that in the private equity market, it takes some time for appropriate investments to be made. The fees that the ERB pays are based on the money committed, rather than on the money invested. Of the \$2.3 billion committed toward private equity, \$943 million is still unspent.
- Did the ERB perform a fee study similar to the extensive study commissioned by the PERA? Mr. Jacksha said that the ERB did a fee study that was somewhat similar to that of the PERA, but the study did not include individual investment managers. That analysis is continually done by the ERB, however.

Report on ERB Experience Studies

Jan Goodwin, executive director, ERB, gave a report to the committee about the 2008-2014 experience study performed for the ERB by the actuarial firm Gabriel Roeder Smith & Company. The study is periodically performed in order to answer several questions about each actuarial assumption in the ERB pension plan, including: "What was the plan's actual experience?"; "How does that compare with current assumptions?"; and "Is a change in an assumption warranted?". There are many types of assumptions that are built into a pension plan's net pension liability, including mortality rates, retirement and termination patterns, investment return rates, the inflation rate, salary expectations and general economic assumptions. Keeping assumptions up to date will keep the actuarially determined contribution rate (the theoretical amount needed in contributions to make the pension plan 100 percent solvent) more stable and will more accurately reflect the actual funded ratio of the plan.

Results of the study of several assumptions include:

- Inflation. The 3.00 percent inflation rate is expected to continue unchanged.
- Investment Return. The 4.75 percent net real return and the 7.75 percent nominal return assumption are expected to continue unchanged.
- Annual Cost-of-Living Allowance (COLA). The 2.0 percent COLA (less the statutory reductions until the pension plan is fully funded) is expected to continue unchanged.
- Wage Inflation. The 4.25 percent annual wage inflation should be reduced to an expected 3.75 percent.

- Payroll Growth. The 3.5 percent annual payroll growth is expected to continue unchanged.
- Mortality. Current mortality rates are factored using static tables; emerging best practices recommend that there is an expectation of improvement in mortality rates each generation. The new expectation is that annual mortality rates will be decreased by four percent per year for males and one percent per year for females, using the most recent static tables.

The net result of the changes in assumptions had a small impact on the ERB's funded ratio, reducing it from 63.1 percent to 62.0 percent funded and increasing by six years the expected 100 percent funded date to 2046.

Questions and comments from committee members included the following.

- Has the ERB had the same actuary for the past 20 years? Ms. Goodwin said that the ERB puts out a request for proposals for an actuary every four years. The same firm has won the bid for the past 20 years.
- How was the investment rate of return determined? Ms. Goodwin said that the ERB asked eight separate consultants to review the current discount rate of 7.75 percent. The results of those consultants confirmed that the current rate is appropriate.
- ERB staff was asked to present to the committee a comparison of employer and employee contribution rates and investment return rates for states similar to New Mexico.
- There needs to be some sort of automatic procedure to ensure actuarial soundness of the state's pension funds, in case another economic downturn occurs. Ms. Goodwin said that long-term trends are more important than brief economic snapshots. Prior to 2013, the ERB was expected to eventually run out of money; today, it is expected to be fully funded by 2046.
- The biggest mistake the state ever made regarding pension plans was to allow for 25 years of service to qualify for retirement. In the 1990s, when those changes were made, the legislature was promised double-digit investment return rates for the long-term. That prediction abruptly fell short of expectations after the stock market crash of 2001.

Update on the SIC's Management of the Severance Tax Permanent Fund (STPF)

Steve Moise, state investment officer, and Charles Wollmann, director of communications and legislative affairs, SIC, presented to the committee an update on the management of the STPF. Mr. Moise began by posing the question of whether using the STPF to fund the mandates of the *Zuni* lawsuit settlement for school construction was the best use of that revenue stream. Contributions to the fund have dropped so much, and the fund has hardly grown in the past 15 years, that the fund is no longer achieving intergenerational equity for New Mexicans. The current value of the fund, as of May 31, 2015, was \$4.776 billion, which matches the previous highest level from 2007. In 2007, 85 percent of the STPF was invested in "risk"

assets, and when the economic downturn came in 2008, the fund's value plummeted to \$3.1 billion. The fund's asset allocation was restructured, and the fund has achieved a five-year return average of 10.1 percent. The problem, however, is with contributions to the fund, which have been inconsistent and often very small. For example, in fiscal year 2015, the state collected \$486 million in severance taxes, but contributions to the STPF were only \$97.18. Distributions from the fund are set at 4.7 percent of the five-year rolling average of the fund and are expected to top \$200 million in fiscal year 2017. Strong investment returns are not enough to guarantee the growth of the fund, since distributions from the fund are not offset by contributions to the fund in a meaningful manner.

In 2015, the legislature enacted legislation to incrementally increase the contributions to the STPF from the Severance Tax Bonding Fund from a theoretical five percent of the annual bonding capacity (after setting aside money for future bond payments) to a more reliable 13.8 percent of bonding capacity. This increase in contributions to the STPF will allow the fund's growth over the long term, rather than the previous expected stagnation of the fund's growth. This potential growth can be appreciated by comparing the growth of the Land Grant Permanent Fund (LGPF) since 2000 with that of the STPF. Both funds performed somewhat similarly in terms of investment return, but the LGPF has also seen significant contributions each year. In fiscal year 2000, the STPF was valued at \$4.2 billion, and the LGPF was valued at \$7.9 billion. In fiscal year 2015, the LGPF was valued at nearly double its 2000 value, but the STPF has barely grown and is valued today at \$4.8 billion.

Another factor limiting growth of the STPF is a law requiring that part of the fund be invested in differential rate investments intended to stimulate the New Mexico economy. These economically targeted investments (ETIs) are mostly permissive, except for the requirement that one percent of the fund be invested in the Small Business Development Corporation for loans to small businesses. The impact of ETIs on the STPF, according to the LFC, is a one percent opportunity cost, or \$40 million annually, versus investing in market rate investments.

Questions and comments from committee members included the following.

- The loss of uranium mining in New Mexico also had a big impact on the STPF's growth. The legislature has recognized the importance of infrastructure needs by using severance taxes to fund capital projects. There are other more pressing issues than the growth of the STPF.
- Is the SIC prepared for another stock market correction? Vince Smith, deputy state investment officer, SIC, said that there is currently very little cushion between equity and bond rates. The SIC has increased investment in income-producing assets and will be better positioned against a correction in a few years.
- Capital outlay projects generate jobs and improve the economy, not to mention the infrastructure improvements that improve the quality of life in the state.

- SIC staff was requested to work with staff of the ERB and PERA to develop a consistent methodology of reporting management fees and other data to the legislature.

Report on the SIC's Investment of the STPF in New Mexico Private Equity Funds and New Mexico Businesses

Lee Rand, managing partner, Sun Mountain Capital, gave a report to the committee about the New Mexico Private Equity Investment Program (NMPEIP). The program was established in 1993 to make investments in venture capital firms that in turn make investments in New Mexico businesses. From 1993 to 2003, the program was managed as a differential rate program, with the emphasis on economic stimulus and job creation. Since 2004, the program has been managed with financial returns as the primary focus, with economic development benefits as a secondary consideration. Since 2004, financial returns have improved dramatically. The first 10 years returned -18.2 percent, compared to the past 11 years returning 22.9 percent.

In fiscal year 2014, the STPF received distributions of over \$20 million from 11 different venture capital funds from profitable companies. That year also saw two notable exits of Lumidigm and WellKeeper, as well as two successful initial public offerings. The program also works closely with partners to foster small technology company creation and growth. Funding commitments totaling \$50 million were made through the program. The SIC approved an investment pacing strategy to keep five percent of the STPF invested in the NMPEIP. Sun Mountain Capital provides to the SIC annually a pacing update estimating the amount of money that can be responsibly invested in New Mexico businesses.

At the end of calendar year 2014, the program had a total of \$297 million invested, with a corresponding \$2.2 billion invested in those companies by external funds. Seventy companies have been invested in, with 37 companies still active. Eleven of those companies exited the program at a gain, and 22 exited at a loss.

Questions and comments from committee members included the following.

- There is still a significant lack of accessible capital for small businesses. Mr. Rand agreed, and he said that the NMPEIP is focused on growth-stage businesses. Many investment professionals in the state have been talking about the need for capital at various stages of business development. Early capitalization is usually a high-risk investment.
- Local business incubators are always needing more money to be able to get small businesses to the next level. Mr. Rand said that investors need to be able to get a return on an investment. The NMPEIP may need to look beyond the high-technology sector for investment opportunities.
- SIC staff was requested to provide better job-creation statistics for jobs generated by the NMPEIP. Mr. Wollmann said that the SIC is working with the Workforce Solutions Department to get better data on job creation.

Adjournment

There being no further business, the committee adjourned at 3:16 p.m.

Revised: August 14, 2015

**TENTATIVE AGENDA
for the
THIRD MEETING IN 2015
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**August 18, 2015
Room 322, State Capitol
Santa Fe, New Mexico**

Tuesday, August 18

- 9:00 a.m. **Call to Order**
—Senator George K. Munoz, Chair
—Representative Monica Youngblood, Vice Chair
- 9:05 a.m. (1) **Changes to Pension Accounting Precipitated by Governmental Accounting Standards Board (GASB) Statements 67 and 68**
—Jan Goodwin, Executive Director, Educational Retirement Board
—Natalie Cordova, Chief Financial Officer, Public Employees Retirement Association
—John Garret, Principal, Cavanaugh Macdonald Consulting, LLC
—Jeff Bridgens, Senior Manager, Moss Adams, LLP
- 10:25 a.m. (2) **Approval of Minutes**
- 10:30 a.m. (3) **GASB Implementation at the Employer Level: Local Impact**
—Dan Olsen, Director of Financial Services, City of Rio Rancho
—Leandro Cordova, Finance Director, Taos County
- 11:30 a.m. (4) **GASB: State Auditor's Role**
—Sanjay Bhakta, Deputy State Auditor, Office of the State Auditor
- 12:15 p.m. **Lunch Break**
- 1:30 p.m. (5) **GASB Implementation at the Employer Level: State Impact**
—Tom Clifford, Secretary, Department of Finance and Administration
(Invited)
- 2:00 p.m. (6) **Implementation of GASB 43 and 45 and Preparing for GASB 74 and 75**
—Mark Tyndall, Executive Director, New Mexico Retiree Health Care Authority (NMRHCA)

2:30 p.m. (7) [NMRHCA Five-Year Strategic Plan](#)
—Mark Tyndall, Executive Director, NMRHCA

3:15 p.m. **Adjourn**

**MINUTES
of the
THIRD MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**August 18, 2015
Room 322, State Capitol
Santa Fe, New Mexico**

The third meeting of the Investments and Pensions Oversight Committee was called to order by Senator George K. Munoz, chair, on August 18, 2015 at 9:20 a.m. in Room 322 of the State Capitol in Santa Fe.

Present

Sen. George K. Munoz, Chair
Sen. Sue Wilson Beffort
Rep. Miguel P. Garcia
Rep. Larry A. Larrañaga
Rep. William "Bill" R. Rehm
Sen. William P. Soules
Rep. Jim R. Trujillo
Rep. Luciano "Lucky" Varela

Absent

Rep. Monica Youngblood, Vice Chair
Sen. Jacob R. Candelaria
Sen. Bill B. O'Neill
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Rep. Jane E. Powdrell-Culbert

Advisory Members

Sen. Ted Barela
Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales
Rep. Tomás E. Salazar

Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. William H. Payne
Sen. John C. Ryan
Sen. Michael S. Sanchez
Rep. James E. Smith
Rep. Sheryl Williams Stapleton

Staff

Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS

Guests

The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Tuesday, August 18

Changes to Pension Accounting Precipitated by Governmental Accounting Standards Board (GASB) Statements 67 and 68

Public Employees Retirement Association (PERA). Wayne Propst, executive director, PERA, introduced PERA staff present at the meeting. Mr. Propst indicated that as a result of GASB Statement 67, local governments will be required to report significant net pension liabilities on their financial statements as part of the PERA's cost-sharing plan. Mr. Propst stated that the PERA has a net pension liability of \$3.3 billion after the implementation of pension reform initiatives.

Natalie Cordova, chief financial officer, PERA, discussed changes required through implementation of GASB Statements 67 and 68. She indicated that the statements are intended to promote increased comparability and transparency with respect to the long-term benefit obligations of governmental entities. Ms. Cordova explained that GASB Statement 67 applies to plans that administer pension benefits, such as the PERA and the Educational Retirement Board (ERB). In contrast, GASB Statement 68 applies to governments that provide pension benefits to their employees and includes various local government entities. Ms. Cordova explained that the GASB's reforms will require net pension liabilities to be included on employer balance sheets. The net pension liability is calculated by subtracting a pension plan's fiduciary net position, or the market value of assets, from its actuarially accrued liability. Ms. Cordova stated that deferred inflows and outflows would be recorded as a result of the GASB changes.

Jim Lanzarotta, certified public accountant, Moss Adams, provided the committee with an overview of how pension liabilities were previously recorded for employers, including the state and local governments. He explained that previously, the accounting for total contributions was based on a statutory requirement. So long as the employers paid their annual payments, no liability was recorded on their respective financial statements. Mr. Lanzarotta explained that GASB reforms require recognition of an unfunded liability for a pension plan if its investment balance is lower than its total pension liability. Employers are now required to report their respective shares of the unfunded liability on their financial statements.

Mr. Lanzarotta discussed the process that led to the GASB's implementation of GASB Statements 67 and 68. He said that the GASB began deliberating on pension accounting changes in 2006 and that final pension standards were issued in August 2012. From August 2012 to April 2014, the American Institute of Certified Public Accountants (AICPA) deliberated on audit guidance for the pension standards, yet all issues were not identified. Mr. Lanzarotta indicated that in July, issues were discovered with respect to the inclusion of beginning net pension liabilities in employer pension schedules. In addition, Mr. Lanzarotta indicated that the PERA discovered an issue with respect to the classification of employee contributions "picked up" by employers. Mr. Lanzarotta explained that GASB Statement 67 classifies these contributions as a pension expense, but final guidance is awaited from the GASB on this matter.

Mr. Lanzarotta compared the PERA's net pension liability, calculated pursuant to GASB Statement 67, with the PERA's unfunded actuarial accrued liability (UAAL). He said that for fiscal year (FY) 2014, the net pension liability for the PERA multi-employer cost-sharing fund was \$3.3 billion, while the UAAL was \$4.3 billion as of June 30, 2014. Mr. Lanzarotta stated that the differences in those two calculations exist because the UAAL calculation uses a four-year smoothing factor, while the calculation of the net pension liability is based on the market value of assets, which is more volatile.

Mr. Lanzarotta and Ms. Cordova presented a draft schedule of employer allocations, which is intended to permit the PERA's employer participants to obtain information on their respective shares of net pension liability for their financial statements.

Committee members asked about how employee contribution "pick-ups" by employers might vary among various employers. Mr. Propst noted that the contribution amounts are different for each employee because their salaries vary. A committee member inquired whether the GASB has developed any guidelines with respect to employer contribution levels. Mr. Lanzarotta stated that the GASB does not have such guidelines in place because it functions strictly to set accounting standards, separate from any particular funding policy.

Committee members asked about the effects of employee contribution pick-ups. Ms. Cordova noted those pick-ups approximated \$74 million for all PERA participating employers. She said that GASB Statement 67 requires pension plans to distinguish the employee contribution pick-ups as either a salary expense or a benefit expense. If employers recorded the pick-ups as a salary expense, they were not considered as a component of a pension expense. If the pick-ups were recorded as benefit expenses, they were considered as a component of a pension expense. Ms. Cordova said that the only pick-ups included in the draft schedule of employer allocations prepared by the PERA are those that were recorded as benefit expenses. A committee member discussed the possible benefits of employee pick-ups in attracting quality employees to local governments.

In response to a question from a committee member, Mr. Lanzarotta clarified that GASB Statement 67 is a standard that applies to a pension plan, while GASB Statement 68 applies to all participating governments within a cost-sharing plan. He stated that employers are reliant on pension plans to obtain information necessary to comply with GASB Statement 68.

A committee member commented that a number of governmental entities have put a significant amount of work toward comportsing with the new GASB standards. Another committee member expressed concern about the new standards' potential impacts upon local government autonomy. Some committee members questioned whether the addition of new accounting methodologies would yield significant benefits.

Mr. Propst indicated that in addition to reporting net pension liabilities using the new GASB standards, the PERA will continue to report the UAAL. He explained that the UAAL

might sometimes provide better information with respect to a pension's financial position because of its inclusion of a four-year smoothing factor. Mr. Propst and Ms. Cordova noted that the new GASB standards are intended to increase transparency, which will be useful to individual employers in formulating a trend analysis on their shares of net pension liability. Mr. Propst stated that the additional analysis would be helpful to the Public Employees Retirement Board. Mr. Lanzarotta noted that even with the new GASB standards, the PERA's reports show that it is more than 80 percent funded, which reflects a healthy position compared to other pension plans nationwide. He predicted that if the PERA remains funded at that level, local governments will fare well in bond markets. In response to a question from a committee member, Mr. Lanzarotta estimated that the funded status of the PERA lies within the top quartile of similar plans nationwide.

A committee member asked whether the new net pension liability calculations would have any effect on pension budgetary issues. John Garrett, principal, Cavanaugh Macdonald Consulting, LLC, said that net pension expenses will not have a relationship to budget expenses. He explained that net pension expenses would be determined as a proxy of change in net pension liabilities. He said that net pension expenses will be volatile, and some plans might record negative pension expenses. However, net pension expenses would not be included in budgets.

Committee members asked about the information obtained from local governments and used in the PERA's draft schedule of employer allocations and whether there are any safeguards to ensure the accuracy of the information. Mr. Lanzarotta said that the information in the schedule would be subject to audit. He also indicated that materiality would be a factor to be considered in the audit.

A question was raised about efforts to train employees of local governments with respect to the new GASB standards. Ms. Cordova indicated that the PERA has made presentations to the New Mexico Association of Counties and the New Mexico Municipal League. A committee member commented that there might be some opportunity to work with universities to train students with respect to the demands of governmental entities within New Mexico specific to the new accounting standards.

A committee member inquired whether net pension liability calculations take into account predictions of the number of employees that will be hired in the long term. Mr. Lanzarotta clarified that a calculation of net pension liability only takes into account active employees paying into a pension, inactive employees who have separated from service but have earned service credit and retirees receiving pension benefits. It does not take into account employees that might be hired in the long term. A committee member raised the question of whether the use of vacancy savings might provide a possible alternative toward improving pension solvency.

ERB. Jan Goodwin, executive director, ERB, noted that the ERB was one of the first pension plans in the country to adopt the standards in GASB Statement 67. She stated that

GASB Statement 67 includes standards on accounting disclosures for pension plans, while GASB Statement 68 includes standards on accounting disclosures for employers participating in pension plans.

Ms. Goodwin discussed the possible effects of GASB Statement 68 on issuers. She said that the balance sheets of all of the ERB's 230 participating employers will be affected. She indicated that while the financial statements of the employers will look different, cash flows, which are considered by credit rating agencies, will be unchanged. She said that Standard and Poor's has indicated that it expects that the new reporting methods would not have any significant effects on credit ratings. She stated that rating agencies seem to be primarily concerned with the ability of borrowers to make principal and interest payments when due.

Ms. Goodwin discussed the new requirements contained in GASB Statement 68. New information to be reported includes:

- a description of the plan and benefits provided;
- significant assumptions used in the measurement of net pension liability;
- amounts of the net pension liability and deferred inflows and outflows of resources related to pensions;
- an analysis of the net pension liability's sensitivity to changes in the discount rate; and
- descriptions of changes in the assumptions used in measuring the net pension liability.

Ms. Goodwin said that GASB Statement 68 does not create a new liability or change the amounts employers will be required to contribute to a pension plan. Ms. Goodwin stated that the GASB's goals, with respect to the new standards, are to provide increased transparency and comparability among pension plan employers.

Ms. Goodwin presented a schedule of collective pension amounts for FY 2014. On the schedule, the net pension liability with an assumed discount rate of 7.75 percent approximates \$5.7 billion. With a discount rate of 8.75 percent, the net pension liability would approximate \$4.0 billion and with a discount rate of 6.75 percent, the net pension liability would approximate \$7.7 billion.

Ms. Goodwin presented a draft schedule of employer allocations and pension amounts for FY 2014, containing the relative shares of net pension liability for the ERB's participating employers. The schedule also contains a net pension liability sensitivity analysis for each employer.

A committee member asked if all charter schools are included on the ERB's schedule of employer allocations and pension amounts. Ms. Goodwin indicated that only information for state-chartered charter schools is included on the schedule. A committee member asked how the net pension liabilities of other school districts might be affected if a charter school included on the schedule closed. Ms. Goodwin indicated that the net pension liability would be spread out

among all of the entities included on the schedule. She added that employees from closed charter schools might become employed at other charter schools or school districts included on the report, and the liabilities with respect to their pensions would be reported as part of the liabilities of their new employers. However, she noted that the net pension liabilities would not have an effect on the cash flows of charter schools or school districts.

A committee member asked whether the new GASB standards are mandated by state law. An ERB staff member indicated that the standards are not statutorily required in New Mexico. However, agreements between bondholders and issuers might require use of the GASB standards.

In response to a question about cost-of-living-adjustment decreases, Ms. Goodwin stated that those decreases are expected to cease once the ERB's pensions are at a level of 100 percent funding. She stated that the ERB's experience study predicts that the level could be reached by 2046.

A committee member asked whether New Mexico has used contribution holidays. Ms. Goodwin indicated that while she was not aware of any such contribution holidays in New Mexico, there was a contribution swap, coupled with delayed contribution increases in 2005. In response to a question about the ERB's education efforts with respect to the new GASB standards, Ms. Goodwin indicated that the ERB has been working with affected employers and school board associations.

Approval of Minutes

On a motion made and seconded, the minutes from the July meeting were adopted without objection.

GASB Implementation at the Employer Level: State Impact

Dan Olsen, director of financial services, City of Rio Rancho, talked about the city's employer contribution rates. He said that the City of Rio Rancho has 723 active employees and pays 75 percent of employee pension contributions as a result of union contract provisions. Employer contributions, including employer contributions on behalf of employees, represent approximately 11 percent of the city's general fund budget and approximately seven percent of the city's overall operating budget.

Mr. Olsen discussed how the city has prepared for implementation of GASB Statement 68. He stated that the city's financial staff has downloaded the GASB tool kit, attended various training seminars and is preparing templates and narratives for financial statements.

Mr. Olsen presented a snapshot of the city's FY 2014 statement of net position. Its unrestricted net position with respect to governmental activities approximates \$17.2 million. Mr. Olsen stated it is not yet known whether the city's unrestricted net position will absorb its net

pension liability. However, he clarified that the net pension liability would not affect the city's budget or fund balances.

Mr. Olsen indicated that in August 2014, Moody's affirmed a rating of Aa2 for the city's general obligation bonds but calculated an "elevated pension liability" of \$266 million, which is five times greater than the liability estimated by the PERA. He also noted that Moody's commented that "future reforms resulting in increased employer contributions for the plan could pressure the city's operations and place negative pressure on the rating".

Mr. Olsen identified factors that are beyond the city's control with respect to its pension liability. He indicated that benefit levels, contribution rates, assumptions behind liability calculations and asset investments are such factors. Yet, he stated the city is still responsible for reporting its proportionate share of the PERA's unfunded liability.

Mr. Olsen additionally identified factors that are within the city's control, such as the hiring of new employees. Ultimately, he said that information reported by the city is most meaningful when taken into context with the PERA's financial reports.

Leandro Cordova, chief financial officer, Taos County, indicated that the county participates in various PERA plans, including Municipal Plan 4, Municipal Police Plan 5 and Municipal Detention Officer Plan 1. He also described employer and employee contribution rates with respect to each plan. He said that for FY 2015, Taos County reported a total of \$995,661.53 in employer contributions, which represents the statutory requirement. He added that as a result of the passage of recent pension reform legislation, employee contributions increased by 1.5 percent. Additionally, in September 2013, the Taos County Commission adopted a resolution to pick up one percent of employee pension contributions. He stated that when an employer elects to pick up a portion of the employee's contribution rate to the PERA, the reporting of the contributions does not change. Mr. Cordova reported that in FY 2015, Taos County contributed \$74,133.06 on behalf of its employees as a result of the one percent buydown. Mr. Cordova said that Taos County staff members are continuing to become educated on the requirements of GASB Statement 68 and are reviewing the effects of the one percent buydown on the county's budget.

Mr. Cordova discussed the possible effects of the implementation of GASB Statement 68 on the county's bond ratings. He stated that the county does not anticipate that implementation of GASB Statement 68 will affect the county's bond ratings. He further stated that the county's participation in the bond market is very limited because of its relatively small size. Mr. Cordova said that the county may use other financing alternatives, such as those available through the New Mexico Finance Authority (NMFA). In response to a question from a committee member, Mr. Cordova indicated that the NMFA might offer bond ratings that are more favorable than those of some small local government entities.

Committee members talked about the potential for unintended consequences with respect to changes in factors affecting pension plans. They also asked about the extent to which employers could control changes to contributions toward employee pensions. Mr. Cordova clarified that Taos County's contribution toward one percent of employee contributions was a decision adopted through an ordinance adopted by the Taos County Commission. Other similar buydowns might be implemented as the result of union contract provisions. Mr. Cordova stated that some buy-down provisions adopted by ordinance are irreversible.

A committee member inquired about how Moody's assesses pension liabilities when issuing its bond ratings for local governments. Mr. Olsen explained that Moody's uses an internal calculation, which includes an analysis of the state's pension report, which is ultimately incorporated into an analysis of the position of a local government entity. In response to another question, Mr. Olsen indicated that Moody's considers a local government entity's share of pension liability as similar to a debt service liability. He said that implementation of GASB Statement 68 might provide more transparent financial statements and favorably affect Moody's analysis of the financial position of some local governments.

GASB: State Auditor's Role

Sanjay Bhakta, deputy state auditor, talked about the role of the Office of the State Auditor (OSA) in the implementation of GASB Statements 67 and 68. He said that in 2013, a task force comprising staff from the OSA, the PERA, the ERB and the Department of Finance and Administration (DFA) was formed to discuss how states would implement the new standards. The AICPA recommended that pension plan administrators, such as the PERA and the ERB, produce a report with amounts of the relative portion of pension liability for each participating employer. The AICPA further recommended that the report be subject to audit. Mr. Bhakta indicated that those recommendations were incorporated into the OSA's 2014 audit rule. In addition, the same rule requires that the reports be considered as public records and made available to pension plan participant employers.

Mr. Bhakta discussed provisions contained in the 2015 audit rule. He indicated that the 2015 audit rule clarifies the measurement date for obligations by requiring the PERA and the ERB to provide each of the participant employers with their allocated pension liability information as of June 30, 2014. The rule also provides interpretation guidance on disclosure requirements for state agencies, component appropriation funds of the general fund and the statewide Comprehensive Annual Financial Report (CAFR).

Mr. Bhakta indicated that some issues have been identified with respect to implementation of GASB Statement 68, including a recommendation that pension plans prepare an additional schedule of employer allocations and a schedule of pension amounts as of the plan's prior year end. He indicated that the PERA and the ERB are in the process of adding columns for beginning pension liabilities. Mr. Bhakta also stated that the OSA is engaged in ongoing discussions with the state controller regarding note disclosures affecting state agencies, the general fund and the statewide CAFR.

A committee member asked Mr. Bhakta about the OSA's role in reviewing compliance with GASB Statement 68. Mr. Bhakta indicated that the OSA has reviewed the templates used by the PERA and the ERB and that those templates are in compliance with GASB standards. He indicated that while the OSA does not have the data underlying the amounts contained in reports from the pension plans, those amounts have been audited and the OSA will rely on those audits.

In response to a question from a committee member about the relationship between the provisions of GASB Statement 68 and the state audit rule, Mr. Bhakta clarified that the state audit rule is not intended to provide requirements beyond those contained in GASB Statement 68. He indicated that the rule is meant to provide guidance with respect to standards that might be ambiguous. A committee member expressed concern about how the perception of the stability of small-entity employers might be negatively affected as the result of new reporting requirements.

GASB Implementation at the Employer Level: State Impact

Ron Spilman, state controller, DFA, summarized a few concepts concerning GASB Statements 67 and 68. He stated that GASB Statement 67 affects the reporting of pension plans, while GASB Statement 68 affects the reporting of the pension expense and liability of employers. In addition, he stated that GASB Statement 68 affects reporting for employers participating in defined benefit plans, which include single-employer and multiple-employer cost-sharing plans. He stated that GASB Statement 68 requires recognition of employers' obligations to employees in the period those obligations are earned. GASB Statement 68 incorporates a concept that although pensions are deferred compensation, they represent a present obligation. An employer is primarily responsible for paying benefits to the extent the plan does not have sufficient assets.

Mr. Spilman outlined differences between prior standards under GASB Statement 67 and current standards under GASB Statement 68. Previously, a pension expense was required to be recognized based on funding, but now pension expenses are reported when earned. This change represents a separation between accounting recognition and funding policy. In addition, Mr. Spilman indicated that the new standard places pension liabilities on an equal footing with other liabilities.

Mr. Spilman stated that financial statements of some proprietary and fiduciary funds would be affected by the changes related to GASB Statement 68, in addition to the statewide CAFR. The CAFR will reflect an increase in total long-term liabilities due to unfunded pension liabilities. Overall, Mr. Spilman said that the CAFR would reflect a weaker, but positive, total net position.

The DFA estimates that as the result of GASB Statement 68 requirements, net pension liabilities for FY 2015 will approximate \$3.3 billion for the PERA and \$5.7 billion for the ERB. The FY 2015 pension expense for the PERA is estimated at \$300 million, while the pension expense for the ERB is expected to approximate \$400 million. The net pension liability that will

be allocated among employers in both pension plans is \$3.6 billion, with \$1.8 billion in net pension liabilities for each plan.

Mr. Spilman provided an overview of the impacts of GASB Statement 68 on the state's statement of net position in the FY 2015 CAFR. First, the combined net position liability and deferred pension inflow of \$4.3 billion could increase reported liabilities by a fraction of two-thirds. In addition, the unrestricted net position, which had been positive at \$1.6 billion, is expected to fall to a deficit position of \$2.7 billion. Meanwhile, the total net position is expected to remain positive due to large levels of restricted funds and capital assets. The state's statement of activities is expected still to reflect a positive change in net position, but could be \$2 billion lower than expected prior to the implementation of GASB Statement 68.

In summary, Mr. Spilman stated that impacts on financial statements are anticipated because of the changes required by GASB Statement 68. Bond rating agencies expect weaker reported financial ratios due to increased total liabilities, weaker net positions and higher reported pension expenses. Financial statements and funds using an economic measurement focus are expected to be affected. Moreover, Mr. Spilman stated that liabilities associated with the public school system would be reported on school district balance sheets. Liabilities of state charter schools will be reflected on state balance sheets, while the liabilities of district charter schools will accrue to the appropriate school districts.

Mr. Spilman stated that new accounting standards will affect the Retiree Health Care Authority (RHCA), for which only 10 percent of the actuarial accrued liability is funded as of FY 2014. He said that the GASB has revised requirements for accounting associated with other post-employment benefits, and those revisions will affect the RHCA.

Committee members asked whether compliance with the requirements of GASB Statement 68 would have any effect on state bond ratings. Tom Clifford, secretary of finance and administration, stated that since all states are implementing the requirements, New Mexico's bond ratings are not expected to be affected. Moreover, Secretary Clifford stated that net pension liabilities comprise only one aspect of the state's finances. He said that when New Mexico borrows money, it is through the issuance of severance tax and general obligation bonds. He said there are strong protections around those bonding programs because of factors such as the strength of New Mexico's permanent funds. Thus, the state can still obtain strong bond ratings despite reported net pension liabilities.

A committee member asked about the manner in which Moody's provides credit ratings for various entities relative to other rating agencies. Secretary Clifford indicated that Moody's uses methods that more conservatively account for existing liabilities.

Committee members discussed the impact of different variables on pension plans, including discount rates. A committee member asked whether bond rating agencies consider factors such as the value of a state's assets. Secretary Clifford indicated that while bond rating

agencies might consider the value of some assets, other assets are not readily accessible. For instance, there are some state permanent funds that could not be used to pay state liabilities without adoption of a constitutional amendment. Secretary Clifford reiterated that a net pension liability is not a liability that affects a state's cash flow position or that must be paid off at once.

In response to questions regarding how rating agencies might view state liabilities associated with the Rail Runner and Spaceport America, Secretary Clifford indicated that to the extent financing for those projects was secured by severance tax bonds, rating agencies probably would not view those outstanding liabilities unfavorably. When asked about balloon payments with respect to the Rail Runner, Secretary Clifford indicated that some refinancing might be necessary. He indicated that to the extent assets are financed by general obligation bonds, there are probably minimal issues because debt service payments are secured by property taxes, which are adjusted to meet payment obligations.

In response to a question about whether additional pension reform might be necessary to improve the state's unrestricted net position, Secretary Clifford said that additional reforms could address that issue. He said that the state's personnel system has a high pension load relative to its payroll. Committee members discussed the possible benefits of adjusting pension policies to mitigate solvency issues and also discussed how strong pension plans attract employees to governments.

Implementation of GASB Statements 43 and 45 and Preparing for GASB Statements 74 and 75

Mark Tyndall, executive director, RHCA, provided a summary of the requirements of the New Mexico Retiree Health Care Act. He said the act became effective in July 1990 but did not contain provisions for an appropriation and contained a pre-funding period of six months. The RHCA began paying full benefits for over 16,000 members in January 1991, with statutory limitations on premium increases until 2008. The act provided the RHCA board of directors with the broad authority to set plan parameters, but contribution levels are set by the state legislature.

Mr. Tyndall indicated that financial planners, such as Fidelity and Nationwide, estimate that a couple retiring at the age of 65 can expect to incur \$240,000 of medical expenses during retirement. He said that the RHCA uses actuaries to project revenues and expenses to determine the life of the trust fund it manages. The RHCA uses a calculation similar to that used by Social Security and Medicare trustees. Pursuant to new GASB standards, the RHCA will be required to calculate future liabilities in a manner similar to the calculation required of pension plans.

Mr. Tyndall stated that the RHCA has 300 participating public employers, with 50 percent of the employers including public schools, 25 percent including employers within state government and 25 percent including municipalities, counties and universities. He stated that as of August 1, 2015, the RHCA provides coverage to 58,349 retirees. The RHCA's top sources of income include employee and employer contributions and retiree premiums. Employee and

employer contributions for FY 2016 are estimated to approximate \$109.4 million, while retiree premiums are estimated to approximate \$135.6 million.

Mr. Tyndall described current accounting standards affecting the RHCA, including GASB Statements 43 and 45. GASB Statement 43 requires accounting and reporting standards similar to pension plans for entities such as the RHCA. GASB Statement 45 applies to individual employer groups. Mr. Tyndall presented a table showing the RHCA's UAAL as a percentage of covered payroll for FY 2006 through FY 2014, with the assumption of a five percent discount rate. At the end of FY 2006, the RHCA's actuarial value of assets approximated \$154.4 million, which increased to about \$377 million by the end of FY 2014. He pointed out that the RHCA's current actuarial value of assets is about \$429 million. At the end of FY 2006, the actuarial accrued liability of the RHCA exceeded its actuarial value of assets by about \$4.1 million. By FY 2014, that difference dropped by about \$700 million. Mr. Tyndall stated that as long as the trust fund managed by the RHCA continues to grow at a rate faster than liabilities are accruing, the program will continue to remain viable.

Mr. Tyndall indicated that new standards will be adopted when GASB Statements 74 and 75 become effective. GASB Statement 74, which will become effective in FY 2017, replaces the requirements of GASB Statement 43 and includes new standards for financial reporting of post-employment benefits other than those offered through pension plans. GASB Statement 75 will apply to individual employers and supersedes the requirements of GASB Statement 45. GASB Statement 75 will become effective in FY 2018. As a result of adoption of the new standards, net liabilities will be reported as part of an employer's balance sheet, similar to the manner in which they are reported by the appropriate entities under GASB Statements 67 and 68. Discount rates will be based on AAA municipal bond yields. Mr. Tyndall indicated this would likely reduce the discount rate assumed by the RHCA to a rate below five percent. He also indicated that the new standards will result in increased reported liabilities and increased actuarial costs. Mr. Tyndall indicated that the RHCA plans to adopt the standards in GASB Statement 74 in FY 2016.

Committee members asked whether Mr. Tyndall had any estimates of changes in liability amounts that would be reported by RHCA due to adoption of GASB Statement 74. Mr. Tyndall indicated that while those estimates are not yet available, he predicted that the sensitivity analysis reporting required by GASB Statement 74 would improve disclosure to members and provide increased information about health care costs.

RHCA Five-Year Strategic Plan

Mr. Tyndall provided the committee members with an overview of the RHCA's five-year strategic plan, which was approved by the RHCA's board of directors in October 2012.

The first element of the plan includes a phase-out of family coverage subsidies for retirees with multiple dependent children. The subsidy in 2016 was reduced from 25 percent to 12.5 percent.

Another element of the plan includes increasing cost-sharing on prescription drug coverage. In 2013, the RHCA introduced co-insurance on all mail order prescriptions. The plan also provides for increased cost-sharing of pre-Medicare plans. In 2013, a \$15.00 co-payment differential was imposed with respect to specialty office visits.

The RHCA's plan also includes a graduated minimum age requirement, so that after January 1, 2020, new retirees must reach a minimum age of 55 to receive subsidies. In addition, the plan requires increased years of service to receive a maximum subsidy from 20 to 25 years for new retirees after January 1, 2020. Pre-Medicare retiree subsidies will also be reduced in 2016 from 65 percent to 64 percent of the total premium. Pre-Medicare spousal subsidies will also be reduced in 2016 from 38 percent to 36 percent.

The RHCA also plans to implement enhanced wellness programs and, in 2016, will implement a financially incentivized wellness program with an emphasis on smoking cessation.

The RHCA plans to increase employee and employer contribution levels. During the last session, legislation was introduced to provide for a 1.25 percent contribution increase, but it did not pass. Mr. Tyndall also mentioned the RHCA's plans to convert \$6,000 basic life insurance policies, which are paid by the RHCA, to supplemental retiree-paid life insurance policies over the course of four years, beginning in 2018.

Mr. Tyndall provided the committee with an outlook of the RHCA's solvency, which is projected through 2035. The trust fund managed by the RHCA was valued at \$432 million as of July 2015. Since 2010, \$158.3 million has been added to the trust fund. The RHCA has an unfunded liability of \$3.4 billion. Mr. Tyndall also provided the committee with a chart showing cumulative increases in health insurance premiums, workers' contributions to premiums, inflation and workers' earnings from 1999 through 2013.

Mr. Tyndall indicated that during the 2016 session, the RHCA could seek legislation to increase employee contributions by three-eighths of one percent over a three-year period, beginning in FY 2018. In addition, it could seek legislation that increases employer contributions by three-fourths of one percent over a three-year period beginning in FY 2018.

Committee members commended the RHCA for the progress it has achieved. Committee members also talked about possible changes in contribution levels to improve the RHCA's solvency position.

Adjournment

There being no further business before the committee, it adjourned at 3:36 p.m.

Revised: September 14, 2015

**TENTATIVE AGENDA
for the
FOURTH MEETING IN 2015
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**September 15, 2015
Central New Mexico Community College Workforce Training Center
5600 Eagle Rock Avenue NE
Albuquerque**

Tuesday, September 15

- 9:00 a.m. **Call to Order**
—Senator George K. Munoz, Chair
—Representative Monica Youngblood, Vice Chair
- 9:05 a.m. (1) **Joint Presentation by the Public Employees Retirement Association (PERA), the Educational Retirement Board (ERB) and the State Investment Council (SIC) on Investment Strategies, Asset Allocation and Investment-Related Fee Reporting**
—Jon Gabel, Chief Investment Officer, PERA
—Bob Jacksha, Chief Financial Officer, ERB
—Vince Smith, Deputy State Investment Officer, SIC
- 10:30 a.m. (2) **June 30, 2015 Investment Reports by the PERA, the ERB and the SIC**
—Jon Gabel, Chief Investment Officer, PERA
—Bob Jacksha, Chief Financial Officer, ERB
—Vince Smith, Deputy State Investment Officer, SIC
- 11:45 a.m. **Approval of Minutes**
- 11:50 a.m. (3) **Report on Economic Impact of the PERA, the ERB and the SIC (Working Lunch)**
—Wayne Propst, Executive Director, PERA
—Jan Goodwin, Executive Director, ERB
—Steven K. Moise, State Investment Officer, SIC
- 1:00 p.m. (4) **Local Impact of Governmental Accounting Standards Board Statement 68**
—Santiago Chavez, Finance Director, New Mexico Association of Counties
—Edwin S. Zendel, Risk Services Director, New Mexico Municipal League

2:30 p.m. (5) [Potential Legislation — Municipal Post-Employment Benefit Trust](#)
—Thomas J. Horan, Esq.
—Lou Hoffman, Director, Finance and Administrative Services Department,
City of Albuquerque

3:30 p.m. **Adjourn**

**MINUTES
of the
FOURTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**September 15, 2015
Central New Mexico Community College Workforce Training Center
Albuquerque, New Mexico**

The fourth meeting of the Investments and Pensions Oversight Committee for the 2015 interim was called to order by Representative Monica Youngblood, vice chair, on Tuesday, September 15, 2015, at 9:14 a.m. at the Central New Mexico Community College Workforce Training Center in Albuquerque, New Mexico.

Present

Sen. George K. Munoz, Chair
Rep. Monica Youngblood, Vice Chair
Sen. Sue Wilson Beffort
Rep. Miguel P. Garcia
Rep. Larry A. Larrañaga
Sen. Bill B. O'Neill
Rep. William "Bill" R. Rehm
Rep. Jim R. Trujillo
Rep. Luciano "Lucky" Varela

Advisory Members

Sen. Ted Barela
Sen. Stuart Ingle
Sen. John C. Ryan

Absent

Sen. Jacob R. Candelaria
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Rep. Jane E. Powdrell-Culbert
Sen. William P. Soules

Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. William H. Payne
Rep. Tomás E. Salazar
Sen. Michael S. Sanchez
Rep. James E. Smith
Rep. Sheryl Williams Stapleton

Staff

Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS

Guests

The guest list is in the meeting file.

Handouts

Copies of all handouts are in the meeting file.

Tuesday, September 15

Joint Presentation by the Public Employees Retirement Association (PERA), the Educational Retirement Board (ERB) and the State Investment Council (SIC)

Jon Grabel, chief investment officer, PERA, Bob Jacksha, chief financial officer, ERB, and Vince Smith, deputy state investment officer, SIC, gave a presentation to the committee on investment strategies, asset allocation and investment-related fee reporting. The three agencies met three times during the summer to develop a joint methodology of reporting fees and asset allocation in order for the committee and public to better understand the costs incurred by the state's investment agencies. The unique mission of each agency drives its strategic asset allocation, which, in turn, impacts its risk/return profile and cost structure. Merely comparing the cost structure incurred by the respective agencies does not result in an accurate comparison. Each agency has a different strategic asset allocation with varying amounts invested in public equities, fixed income, absolute return, global asset allocation, private equity, real estate, inflation-linked assets and cash. This asset allocation means that each agency also has a different cost structure. Asset allocation is the primary driver of returns, and fee savings have only a marginal benefit.

The PERA reported having a total of 42 basis points (bps) (equivalent to .01%) in management fees for fiscal year (FY) 2015; the ERB reported 73 bps; and the SIC reported 57 bps. This disparity in total bps cost can be partially explained by looking at the asset allocation of each agency. The ERB has more assets invested in "high-fee" categories than the other agencies. For example, the ERB reported \$18.3 million in management fees for the private equity sector, or 98 bps, while the PERA reported \$7.6 million in management fees for that same category, or 67 bps. However, the ERB reported only 56 bps for the real estate category, while the PERA reported paying 118 bps.

The agencies also reported how they manage risk in their investments. The PERA mitigates risk at the asset allocation level by better diversification of asset categories; the prudent use of risk-seeking and risk-reducing assets; a methodical approach to rebalancing of investments; and the positioning of the portfolio for multiple economic and market scenarios. The PERA also has mitigated risk by reducing the number of investment managers to reduce asset overlap and strategy drift; tightening investment management guidelines; approaching portfolio construction with an overall view rather than viewing each mandate separately; and improving asset return expectations while lowering fees. The other agencies reported using similar strategies to those of the PERA. The SIC also separates risk into two types: market risk and specific risk (or systemic and non-systemic risk). Market risk is necessary to earn an investment return, and very little can be done to mitigate it, except by not investing. Specific risk is associated with the risk of a particular asset class. The SIC reduces the risk exposure to specific risk by having broad asset diversification. For example, the Land Grant Permanent Fund

(LGPF) investments were restructured over the past few years to reduce the over-reliance on U.S. public equity markets and increase the income-producing power of the portfolio relative to its exposure in the equity market.

Questions and comments from committee members included the following.

- The SIC, with a net asset value (NAV) of \$20 billion, paid \$170 million in management and profit-sharing fees. The PERA, with a NAV of \$14.7 billion, paid \$90 million in total fees. The ERB, with a NAV of \$11.4 billion, paid \$130 million in total fees. Why is there such a large discrepancy in the amount of fees paid? Mr. Jacksha said that fees are largely driven by an agency's strategic asset allocation. Mr. Smith said that the size of a fund also drives the amount of actual fees paid. Mr. Grabel said that private equity investment fees are much higher than public equity investment fees. However, in the past fiscal year, private equity returned a 17% profit, while public equity only earned 6%.
- How can agency staff be certain that they are getting the highest-performing investment managers? Mr. Jacksha said that ERB staff does much research before choosing investment managers, but there is no guarantee that the managers will perform in the top tier of managers.
- Why does the amount of management fees increase as the NAV increases? Mr. Jacksha said that public equity managers usually charge a flat fee based on the size of assets, measured in bps.
- Do investment managers manage multiple investment categories for an agency? Mr. Grabel said that all investment decisions begin with the strategic asset allocation, followed by mandates for each asset category. The PERA then looks for the best manager in each asset category, using fairly complex data analysis to rank managers.
- Is there a difference in the asset allocation of endowment funds and pension funds? Mr. Smith said that the SIC is able to have less liquidity than pension funds and therefore take on more risk. The SIC distributions are based on asset valuations, while pension distributions are based on benefit requirements. Mr. Grabel said that the PERA fund has 20% in liquid assets, because the PERA cannot ever miss a benefit payment.
- Each agency has different asset allocation targets, which appear to be somewhat random. Mr. Smith said that each agency board has slightly different asset investment preferences but that, overall, the asset allocation goals are similar. Mr. Grabel agreed and said that there are more similarities than differences in the asset allocations of each agency. Each agency has a very diverse portfolio.

- The ERB has 49% of its assets in high-fee categories, while the PERA has 17% and the SIC has 30%. Why does the ERB have such a large percentage of those assets? Mr. Jacksha said that the fixed-income category includes opportunistic credit, which has seen very good returns. Mr. Smith said that diversification is the only option for pension funds with a low funded ratio.
- What is the importance of a strategic asset allocation versus fee savings in the long term? Mr. Grabel said that the asset allocation is much more important than fees. Mr. Grabel emphasized that fees need to be viewed in the context of returns, volatility and access to liquidity. Ninety to 95 percent of a fund's returns can be attributed to its asset allocation versus the individual stocks chosen. Mr. Smith said that fees are not a driver of asset allocation or risk management. Mr. Jacksha said that the ERB negotiates fee savings when appropriate, but sometimes good investment managers attract plenty of demand for the quality of services and products they provide. Mr. Jacksha also agreed with Mr. Grabel that asset allocations drive the fee profile and the risk profile.
- Some investment agencies in Canada are using in-house investment managers, with great returns. New Mexico's investment agencies should consider doing the same. Mr. Jacksha said that the ERB is unable to hire high-quality managers at the going salary range that they require. The ERB is open to hiring an in-house manager, but only if that decision is good for the ERB fund. The ERB does manage some of its fixed-income assets in-house, because the staff has the right skills to manage those assets. Mr. Grabel said that having internal investment managers at the PERA would be a big mistake, because in-house managers would not have the information edge, access to huge pools of money or human capital needed to make optimal investments. Successful managers in big investment companies have all of the tools and information needed. The PERA does not have any in-house investment managers. Mr. Smith said that the SIC does not have any in-house investment managers but does have 11 staff members to oversee all of its contract managers.

June 30, 2015 Investment Reports by the PERA, the ERB and the SIC

Mr. Grabel, Mr. Jacksha and Mr. Smith each presented an investment report for the previous fiscal year for his agency. Mr. Grabel began with the investment returns of the PERA. The PERA fund balance was \$14.5 billion on June 30, 2015, with an investment return of 1.87% for the fiscal year. FY 2015 was a difficult year for capital investment, compared to the nearly 17% gains from FY 2014. The PERA paid \$989 million in pension benefits in FY 2015. The fund has grown steadily since the 2008-2009 downturn, from a low of \$8 billion to today's figure, nearly double that amount. The PERA has made significant progress in implementing its new strategic asset allocation, with 77% of investments being at the new asset target level. Alternative investments, such as private equity, take longer to re-invest, but those categories should reach their target levels within a couple of years.

Mr. Jacksha reported the ERB's investment returns for FY 2015. The ERB fund was valued at approximately \$11.4 billion on June 30, 2015. The ERB earned \$449 million, a return of 3.9% for the fiscal year. The best asset category earners were private real estate, with a 19.2% return, and private equity, with a 17.1% return. Those top-earning categories are also the high-fee classes. Emerging market assets performed the worst this past fiscal year, losing more than 5% in value. The fund did better than a peer policy index of 2.9%, but far short of the expected 7.75% rate of return. However, the aggregated three-year and five-year rates of return have exceeded that benchmark, as well as the 30-year rate of return.

Mr. Smith reported the SIC's investment returns for FY 2015. The LGPF and the Severance Tax Permanent Fund (STPF) totaled \$20.6 billion on June 30, 2015, with an investment return of 2.31% for the fiscal year. Mr. Smith presented a detailed report of the performance of each asset category, along with each manager. The best-performing asset categories were real estate, returning 13%, and domestic equity, returning 6.3%. Poor-performing categories included international equity, losing 4.3%, and absolute return, gaining only .2%. Mr. Smith said that the SIC will soon review its expected rate of return of 7.5% to see if it is still realistic for the long term. He said that if the Federal Reserve System raises interest rates, it will be much easier for the SIC to achieve a 7.5% rate of return.

Questions and comments from committee members included the following.

- Each investment agency will probably need to reduce its expected rate of return, because 7.5% and 7.75% are no longer achievable. Mr. Smith said that the SIC is currently conducting a study of its rate of return. Models predict that there is less than a 50% chance that the SIC will be able to earn 7.5% in the next 10 years. If interest rates increase, the chance of achieving the rate of return improves somewhat, he said. Mr. Jacksha said that the ERB decided to keep its 7.75% target for the next three years. However, he said, it will be difficult for the fund to earn at that rate for a few years. Mr. Grabel said that the net rate of return, or the nominal rate less inflation, is the most important figure to take into account. The PERA periodically reviews its expected rate of return.

Approval of Minutes

The minutes of the August 18, 2015 meeting of the committee were approved without changes. The minutes of the July 21, 2015 meeting of the committee were approved a second time, in order to include the previous inadvertent omission of the approval of the June 16, 2015 minutes of the committee in the July minutes.

Report on the Economic Impact of the PERA, the ERB and the SIC

Wayne Propst, executive director, PERA, Jan Goodwin, executive director, ERB, and Steven K. Moise, state investment officer, SIC, discussed with the committee the economic impact in the state of the investments and activities of those agencies. Ms. Goodwin began by reporting to the committee that the ERB distributed \$901 million to retirees in FY 2015. The

average annual retirement benefit in FY 2014 was \$21,480 for the ERB's 42,000 retirees, which replaced approximately 59% of those retirees' pre-retirement income. The ERB also employs 67 full-time-equivalent employees, with an annual payroll of \$4.9 million. Those employees live and spend their salaries primarily in Santa Fe and Bernalillo counties. The ERB estimates that there is \$4.48 in economic activity in New Mexico for each \$1.00 of employer contributions paid. Ms. Goodwin estimated that in 2012, ERB retirees created \$1.2 billion in economic output, with more than 9,000 jobs created by that output.

Mr. Moise next discussed the economic impact of the SIC in New Mexico. The LGPF distributed \$596 million in FY 2015 and is expected to distribute nearly \$700 million by FY 2018. The STPF distributed \$183 million in FY 2015 and is expected to distribute more than \$200 million in FY 2018. These distributions play a significant role in state and local government budgets. That money is spent as employee payroll and other services, resulting in a significant boon to the economy. The SIC also invests the smaller Tobacco Settlement Permanent Fund and the Water Trust Fund, as well as managing investments for many local governments. The SIC provides high-quality and low-cost asset management for these clients. Finally, the SIC manages economically targeted investments of the STPF. The New Mexico private equity program has invested \$390 million in 70 New Mexico companies. These investments have resulted in more than \$150 million in increased New Mexico payroll. In addition, the SIC estimates that for every \$1.00 invested by the SIC, an additional \$6.20 is invested by other investors. Finally, Mr. Moise said that the SIC invests in the Small Business Investment Corporation, which in turn has made more than 3,000 loans and \$32 million in equity investments since 2001.

Mr. Propst discussed the economic impact of the PERA in New Mexico. The PERA currently serves more than 49,000 active members and pays retirement benefits to nearly 37,000 retirees. Most of those retirees live in New Mexico and spend their pensions in the state. FY 2015 benefits totaled \$1 billion, which includes pension benefits and refunded member contributions. The average annual pension for a retired member in FY 2014 was almost \$30,000, with an average age of retirement of 55 years. The PERA estimated that pension benefits had a total of \$1.36 billion in economic output in the state, with more than 10,000 jobs created.

Questions and comments from committee members included the following.

- What effect do state agency and school district vacancy rates have on the pension funds? Ms. Goodwin said that there has been no net increase in educational employment for several years. If there are more employees contributing, with a corresponding increase in employer contributions, the ERB will reach a funded ratio of 100% sooner. Mr. Propst said that the PERA has a similar situation to that of the ERB.

- Why does the SIC oppose a distribution from the LGPF for early childhood education services? Mr. Moise said that SIC is acting as the fiduciary for the fund. The SIC does not oppose those programs but needs to protect the corpus of the fund.
- Why do so many retirees leave the state? The interim legislative Jobs Council is trying to attract more retirees to move to New Mexico in order to spur job creation. Mr. Propst said that he would be happy to include that question on the PERA's next survey of retirees.
- The SIC should have a more holistic approach to differential-rate investments, looking at more than just rate of return. The amount of capital investment made in the state, in addition to job creation, needs to be part of the calculations.
- Staff of the ERB and the PERA were asked to provide a comparison of retiree benefits by county versus county gross domestic product.

Local Impact of Governmental Accounting Standards Board (GASB) Statement 68

Santiago Chavez, finance director, New Mexico Association of Counties, and Edwin S. Zendel, risk services director, New Mexico Municipal League, discussed with the committee the possible impact on local governments of GASB Statement 68. The local impact of the new standard is still unknown, because it is unclear how the apportioned pension liabilities required to be reported by each local government will appear on its financial statement. The added liability will affect the overall net position, but enterprise programs may actually be required to report a negative net position. This may negatively affect the ability for these programs to borrow money at affordable rates, which could result in increases in utility rates for customers. In addition, existing bond covenants that require a certain equity coverage may now be violated by the addition of pension liabilities to their net position, which could also lead to increases in utility rates if the bondholders demand reissuance of the notes at a higher interest rate. There is also a possibility that bond ratings agencies will downgrade local governments or their enterprise functions. There has been no guidance from the GASB on how local governments should allocate their share of pension liability between enterprise and general fund accounts.

Questions and comments from committee members included the following.

- Very small local governments cannot afford to have any more risk in their enterprise funds. Mr. Chavez said that some small municipalities and districts may see their bond ratings downgraded because of the new reporting requirements. Natalie Cordova, chief financial officer, PERA, said that the reporting requirements should not affect any business operations of a local government, other than its accounting.

Potential Legislation — Municipal Post-Employment Benefit Trust

Lou Hoffman, director, Finance and Administrative Services Department, City of Albuquerque, gave a presentation to the committee about the possible endorsement of legislation

allowing certain municipalities to establish post-employment benefit trusts. In the 2015 regular legislative session, House Bill 577 was introduced. House Bill 577 would have allowed Albuquerque to establish these trusts, which would have the effect of reducing the city's unfunded accrued pension liability by nearly \$14 million. The bill originally was written to only allow the state's largest municipality to set up a trust, but Mr. Hoffman said that other municipalities have expressed interest in the idea. Mr. Hoffman said that the upcoming 30-day legislative session may not have the ability to address this issue, so the proposal may need to wait until the 2017 legislative session.

The committee directed Mr. Hoffman to work with LCS staff to draft the legislation to allow other municipalities to establish a trust.

Adjournment

There being no further business, the committee adjourned at 2:18 p.m.

Revised: November 4, 2015

**TENTATIVE AGENDA
for the
FIFTH MEETING IN 2015
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**November 5, 2015
Room 307, State Capitol
Santa Fe, New Mexico**

Thursday, November 5

- 9:00 a.m. **Call to Order**
—Senator George K. Munoz, Chair
—Representative Monica Youngblood, Vice Chair
- 9:05 a.m. (1) **Report from the Education Trust Board (ETB)**
—Barbara Damron, Secretary, Higher Education Department
—Theodore Miller, Executive Director, ETB
—Kay Ceserani, Principal, Pension Consulting Alliance, LLC
- 9:50 a.m. (2) **State Investment Council (SIC): Potential Legislation**
—Charles Wollmann, Director of Communications and Legislative Affairs,
SIC
- 10:10 a.m. (3) **Educational Retirement Board (ERB): Actuarial Valuations Report
and How the ERB Is Using the Valuations**
—Jan Goodwin, Executive Director, ERB
- 11:05 a.m. (4) **Public Employees Retirement Association (PERA): Report on the
Latest Actuarial Valuations and How the PERA Is Using the Valuations**
—Wayne Propst, Executive Director, PERA
- 12:00 noon **Lunch**
- 1:15 p.m. (5) **PERA: Report on Legislative Retirement Plans**
—Wayne Propst, Executive Director, PERA

Approval of September 15, 2015 Minutes

- 2:00 p.m. (6) [Discussion of Possible Economies of Scale from Merging Functions](#)
—Tim Eichenberg, State Treasurer
—Steven K. Moise, State Investment Officer
—Vince Smith, Deputy State Investment Officer
—Jan Goodwin, Executive Director, ERB
—Bob Jacksha, Chief Investment Officer, ERB
—Wayne Propst, Executive Director, PERA
—Jon Gabel, Chief Investment Officer, PERA
- 3:30 p.m. (7) [Request for Endorsement of Potential Legislation](#)
—Charles Wollmann, Director of Communications and Legislative Affairs,
SIC
—Lou Hoffman, Director, Department of Finance and Administrative
Services, City of Albuquerque
- 4:00 p.m. (8) [Evolution of Sustainable Investing](#)
—Bruno Bertocci, Senior Portfolio Manager, UBS Asset
Management
—Deidre Guice Minor, Client Advisor, UBS Asset Management

Adjourn

**MINUTES
of the
FIFTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**November 5, 2015
Room 307, State Capitol
Santa Fe, New Mexico**

The fifth meeting of the Investments and Pensions Oversight Committee was called to order by Representative Monica Youngblood, vice chair, on Thursday, November 5, 2015, at 9:07 a.m. in Room 307 of the State Capitol in Santa Fe.

Present

Sen. George K. Munoz, Chair
Rep. Monica Youngblood, Vice Chair
Rep. Larry A. Larrañaga
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Sen. William P. Soules
Rep. Jim R. Trujillo
Rep. Luciano "Lucky" Varela

Absent

Sen. Sue Wilson Beffort
Sen. Jacob R. Candelaria
Rep. Miguel P. Garcia
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Rep. William "Bill" R. Rehm

Advisory Members

Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales
Rep. Tomás E. Salazar
Rep. Sheryl Williams Stapleton

Sen. Ted Barela
Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. William H. Payne
Sen. John C. Ryan
Sen. Michael S. Sanchez
Rep. James E. Smith

Staff

Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Ric Gaudet, LCS
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS

Minutes Approval

Because the committee will not meet again this year, the minutes for this meeting have not been officially approved by the committee.

Guests

The guest list is in the meeting file.

Handouts

Copies of all handouts are in the meeting file.

Thursday, November 5**Report from the Education Trust Board (ETB)**

Barbara Damron, Ph.D., secretary, Higher Education Department (HED), presented a report on the ETB's administration of a 529 college savings plan for the state. Secretary Damron explained that a 529 plan is an education savings plan operated by a state or educational institution, and it is designed to assist families in saving funds for future post-secondary education costs. She noted that a child whose family achieves at least a few hundred dollars in savings for a post-secondary education is 2.5 times more likely to graduate from college than a family that has not saved any money for that child. Earnings and withdrawals from a 529 plan are free from federal and state income taxes if used to pay for qualified educational expenses.

The ETB, which is administratively attached to the HED, is responsible for the implementation, administration and marketing of the state's 529 plans. Secretary Damron said that state money is not invested in the 529 plans. By law, the ETB is required to fund its efforts entirely from program fees.

Theodore Miller, executive director, ETB, explained that Oppenheimer Funds serves as the program manager for the New Mexico 529 college savings program and is responsible for: program administration, customer service and recordkeeping; investment management; and marketing and distribution. Mr. Miller explained that the ETB receives recommendations from Oppenheimer Funds, and as the fiduciary for the state's 529 college savings plans, continuously monitors the funds in the plans.

Kay Ceserani, principal, Pension Consulting Alliance, LLC (PCA), provided an overview of the services provided by PCA to the ETB. PCA is an investment consulting firm that began providing investment consulting services to the ETB in December 2011. According to Ms. Ceserani, PCA provides investment consulting services to seven state-managed 529 plans totaling \$45.8 billion in client assets. Ms. Ceserani also clarified that PCA does not manage assets, but only provides consulting services. She indicated that PCA currently has \$1.1 trillion of client assets under advisement.

Mr. Miller discussed how 529 plans vary among states. He indicated that some states have options to sign up for 529 plans online, while some states offer tax benefits for investment in 529 plans. Mr. Miller said that the ETB is marketing the tax benefits offered in New Mexico to possible investors from other states. Mr. Miller also talked about developments in the ability

to offer multiple age-based investment tracks for college savings plans, rather than just one track. Mr. Miller also noted that the ETB continues to return a portion of management fees to members.

Next, Mr. Miller provided an overview of recent initiatives to market the state's 529 college savings program. He indicated that the ETB is currently researching establishment of an initial and matching grant program to encourage formation of 529 plan accounts by New Mexico residents. Mr. Miller stated that such a program might be able to improve college completion rates.

Mr. Miller presented a chart showing the total 529 plan trust assets and the percentages of assets owned by New Mexico residents versus the percentages of assets owned by out-of-state investors. At the end of fiscal year (FY) 2015, out-of-state assets approximated \$2 billion, while in-state assets approximated \$362.6 million.

Ms. Ceserani discussed how New Mexico's college savings programs were ranked in a recent comparison of state college savings programs. She said that, according to the comparison, the state's Scholar's Edge program is the sixth-best-performing adviser-sold plan in the nation, while the Education Plan ranks as the eleventh-best-performing direct-sold plan in the nation.

Ms. Ceserani presented data on the Sharpe ratios of the Scholar's Edge program and the Education Plan. A Sharpe ratio is used to characterize how well the return of a portfolio compensates for the risk taken. A higher Sharpe ratio reflects a better performance relative to risk. Ms. Ceserani indicated that Sharpe ratios indicate that the Education Plan performed more favorably than the Scholar's Edge program, but both had favorable returns.

Ms. Ceserani presented a chart comparing direct-plan maximum fees for various state-administered 529 plans across the country. She noted that such comparisons might be difficult to rely upon, since fee structures of the plans vary.

Questions from committee members followed. A committee member asked whether any of the 529 plans in New Mexico provide financial counseling services to participants. Secretary Damron said that the Education Plan does not provide for such services, but the Scholar's Edge program does provide for basic financial counseling services. The committee member also asked how money can be withdrawn by a fund participant for post-secondary education. Mr. Miller indicated that the funds in a student's account can be drawn down by that student at will for college expenses or expenses for graduate school. In response to a question from a committee member, Mr. Miller indicated that an account balance could be transferred by an account owner.

A committee member asked about possible strategies to attract additional investment into the state's 529 plans. Mr. Miller indicated that the ETB is working with consultants to increase investment. He also discussed other efforts to attract investors with grant programs and increased marketing efforts in schools. A committee member suggested exploration of contributions to 529 plans through mechanisms using optional contributions from state employee

paychecks or taxpayer rebates. Another committee member suggested studying how similar plans are marketed in other states.

In response to a question from a committee member, Mr. Miller indicated that no general fund appropriations are made to the state-administered 529 plans, and the plans are entirely supported by fees, which average about \$2.4 million annually. He said that portions of those fees are rebated to fund participants and that \$310,000 was rebated to New Mexico participants in New Mexico last year.

A committee member asked how fees were used by the ETB in previous years. Mr. Miller indicated that uses included administration, reserve maintenance, provision of scholarships and marketing. A committee member suggested that matching grants should be explored as an option to increase investment into the state's 529 plans.

Mr. Miller answered questions about the performance of Oppenheimer Funds as program manager for New Mexico's college savings programs. He indicated that the funds have exhibited above-average performance since 2008.

A committee member asked whether New Mexico's 529 plans provide different investment options to account owners. Mr. Miller indicated that different age-based programs are offered, in addition to a wide range of investment portfolios. A committee member requested a future report of the effects of 529 plans on student debt.

State Investment Council (SIC): Potential Legislation

Charles Wollmann, director of communications and legislative affairs, SIC, briefly summarized a bill draft proposed by the SIC to make changes to the SIC's private equity investment program. He stated that the bill draft would remove a requirement that private equity funds maintain an office located in New Mexico. He stated that the bill draft would be intended to attract regional funds to New Mexico. The committee deferred any action on endorsement of the bill until later that day.

Public Employees Retirement Association (PERA): Report on the Latest Actuarial Valuations and How the PERA Is Using the Valuations

Wayne Propst, executive director, PERA, provided the committee with an overview of the latest actuarial valuations for the retirement funds administered by the PERA. He presented a chart showing the valuations with respect to various PERA-administered plans. The state general plan reflected a funded ratio of 67.7 percent for FY 2015, which decreased slightly from the previous fiscal year. The overall ratio for the plans administered by the PERA for FY 2015 was 74.9 percent.

Mr. Propst indicated that modest decreases in funding levels were the result of lower-than-expected market returns and higher-than-expected salary increases in FY 2015. He said that a \$237 million actuarial loss to the fund was significantly attributable to salary increases. Mr.

Propst also noted that FY 2015 returns were 7.64 percent using a smoothed value, compared to an expected return of 7.75 percent. Mr. Propst indicated that an actuarial loss due to non-investment experience increased the unfunded actuarial accrued liability (UAAL) by \$286.5 million. The increase in the UAAL was \$410 million, and the funding ratio decreased from 75.8 percent to 74.9 percent. The UAAL is now expected to be fully amortized in 41 years. Mr. Propst indicated that, while the amortization expectation was 40 years last year, in previous years there was no set date at which the UAAL was expected to be amortized.

Mr. Propst indicated that the PERA funds are expected to be 100 percent funded by 2043. He indicated that a decline in the projected funded ratio in 30 years is the result of lower-than-expected returns for 2015. He indicated that projections are volatile and sensitive to market returns.

Mr. Propst presented a table showing average annual pensions, retirement ages and service credits earned with respect to various retirement plans administered by the PERA. Mr. Propst indicated that recent data show that average retirement ages are increasing. He said that if this trend continues, the funds will be impacted favorably. He also highlighted that reforms to the PERA statutes in the past few years also permit PERA participants to receive increased percentages of their average annual salaries upon retirement if they choose to work for longer periods before retirement. Mr. Propst indicated that there were fewer numbers of participants retiring in FY 2015 than in the previous two fiscal years. He indicated that the recent reforms might have contributed to longer periods of work for some PERA participants.

Mr. Propst and the committee members discussed provisions included in a memorial endorsed by the committee during the previous interim. The memorial proposed to request a moratorium on additional legislation to change retirement benefit provisions relevant to the PERA.

Committee members asked questions about the impact of pension reform provisions on police officers. Mr. Propst explained that some changes affect the periods of time that plan participants must work before receiving cost-of-living adjustments. He also noted that plan participants could earn up to 90 percent of their average salaries upon retirement if they work longer periods before retirement. He said that if this option is used, it might provide an offsetting effect with respect to the additional time required to achieve the first available cost-of-living adjustment. Mr. Propst stated that with an average age of 83, PERA retirees are sometimes receiving pensions for longer periods of time than they worked.

A committee member asked whether return-to-work provisions for police officers can be crafted in a manner that does not affect the long-term solvency of the PERA funds. Mr. Propst said that some reports indicate that rural police forces are close to being fully staffed, but the exception lies with police forces in certain large cities. He said that the Public Employees Retirement Board is concerned about legislation that could impact the PERA funds. He proposed exploration of options to address staffing issues without affecting the PERA funds. He

mentioned the use of bonus payments or other efforts to address retention issues as a possibility. Some committee members suggested that the PERA work with municipalities on a plan for pension reform that could allow return-to-work provisions, while providing for long-term solvency of the PERA funds. Other committee members suggested the exploration of strategies adopted in other states.

A committee member asked what policy issues drove the passage of legislation a few years ago to prevent double-dipping. Susan Pittard, general counsel, PERA, indicated that when return-to-work provisions were passed in 2003, retirements increased significantly. Ms. Pittard indicated that, at some point, there was an impetus to curtail that activity. She noted that of the 1,800 retirees who were able to return to work under the previous version of the law, 472 are still working as state employees.

A committee member suggested return-to-work legislation for some public employees for a limited period. Another committee member suggested that municipalities proposing return-to-work alternatives should propose bill drafts to the committee for review. Upon a motion made and seconded, the committee voted to request the New Mexico Legislative Council's approval for an additional meeting date in December to discuss legislative proposals pertaining to return-to-work options.

A committee member requested information on the UAALs for individual municipalities. In a subsequent presentation, Mr. Propst provided that information to the members.

Educational Retirement Board (ERB): Actuarial Valuations Report and How the ERB Is Using the Valuations

Jan Goodwin, executive director, ERB, explained that the latest report for the actuarial valuations for the ERB was prepared as of the end of FY 2015, using member data, financial data, benefit and contribution provisions, actuarial assumptions and methods. The valuations measure actuarial liabilities, help determine the adequacy of current statutory contributions and allow the ERB to track changes over time.

Ms. Goodwin summarized some key results from the report. She noted that the actuarial funded ratio increased from 63.1 percent to 63.7 percent. The UAAL also increased from \$6.3 billion to \$6.5 billion. In addition, the funding period increased from 42.1 years to 43.2 years.

Ms. Goodwin highlighted some recent events affecting the outcomes of the report. She said that the return on the market value of assets was 3.7 percent, while the return on the actuarial value of assets was 9.7 percent. Additionally, the total payroll of active members increased from about \$2.5 million to about \$2.6 million, with an annual increase of about 2.8 percent. Ms. Goodwin noted that increased payrolls lead to increased contributions and reduce the UAAL over time.

Ms. Goodwin provided data with respect to the members covered by the Educational Retirement Act. She indicated that during the past year, the average salary for active members increased from \$41,503 to \$42,793. She said that currently the average age of active members is 46.5, while the average years served by members is 9.7 years. The average annual benefit for a member is \$21,832. Ms. Goodwin indicated that there are 1.4 active members for each annuitant. She said this ratio is similar to that of other pension plans.

Ms. Goodwin indicated that the fair market value of the ERB's assets increased from about \$11.35 million to \$11.5 million. Total contributions to the Educational Retirement Fund were \$690 million, compared to \$634 million in the previous year. Total distributions totaled \$968 million. The fund had a negative cash flow of \$278 million at the end of the fiscal year. Ms. Goodwin indicated that such negative cash flows are typical of mature pension plans, where benefits are pre-funded.

Ms. Goodwin presented a chart showing the market and actuarial values of assets managed by the ERB. The actuarial return was 9.7 percent in FY 2015, compared to 12 percent in FY 2014. Ms. Goodwin pointed out that actuarial values have grown more steadily due to smoothing used in the calculation of actuarial values of assets.

Ms. Goodwin indicated that the UAAL of the Educational Retirement Fund is estimated to be fully funded in 43.2 years, assuming provision of a two percent cost-of-living adjustment each year.

Ms. Goodwin described the ERB's practices with respect to actuarial matters. She said that statutes require the ERB to provide a valuation report every two years, but the ERB provides an annual valuation report. She also said that while some have identified best practices to require an experience study every five years, the ERB produces an experience study every two years. She also said that consistent with best practices, the ERB conducts an actuarial audit every five years.

Based on its actuarial reports, Ms. Goodwin indicated that the ERB has reduced its long-term earnings assumption from eight percent to 7.75 percent. In addition, it has pursued long-term sustainability legislation and adopted new generational mortality assumptions.

Questions from committee members followed. A committee member asked about the negative cash flows reported for the Educational Retirement Fund at the end of the year. Ms. Goodwin indicated that it is typical for mature retirement plans and funds to pay benefits in excess of contributions received. She said that investment returns over time are crucial.

A committee member asked whether different estimates of funding ratios and funding periods have been calculated using a stress test with different market return assumptions. The committee member also asked how that information is communicated to members. Ms. Goodwin indicated that the ERB has tested different scenarios based on different market returns,

and the results of those different tests have been posted on the ERB's website. She indicated that the ERB conducts such stress tests annually. In response to a question from a committee member, Ms. Goodwin stated that the ERB believes that an assumed market rate of return of 7.75 percent is a realistic assumption.

A committee member requested information on the UAALs for individual school districts. In a subsequent presentation, Ms. Goodwin provided the requested information to the members. She indicated that the UAALs for individual school districts are posted on the ERB's website.

Approval of Minutes

The minutes of the September 15, 2015 meeting were approved without changes.

PERA: Report on Legislative Retirement Plans

Mr. Propst provided a brief overview of the current status of the legislative retirement plans administered by the PERA. He discussed basic requirements of the plans, including the requirement for members to elect membership within 180 days of first taking office. He also provided the members with the latest data on average annual pension amounts and retirement ages for legislators participating in the plan. The average annual pension paid from the Legislative Retirement Fund for a member is \$7,236 and the average age at retirement is 65.4. The funding ratio is 138.5 percent.

Mr. Propst noted that the Tax Administration Act requires an annual distribution of \$2.4 million to the Legislative Retirement Fund. He said that the distribution is in excess of the actuarially determined amount necessary to fund the normal cost associated with the plans.

Committee members and representatives from the PERA discussed the rules with respect to different legislative retirement plan options. In addition, a committee member asked whether there are some legislators who have opted not to participate in a legislative retirement plan. Mr. Propst indicated that there are a few legislators who have chosen not to participate.

A committee member asked whether there has been any discussion to redirect some of the distributions to the Legislative Retirement Fund to funds for other retirement plans. Mr. Propst indicated that a couple of years ago, legislation was introduced to provide a redirection of some of that money to provide funding for judicial and magistrate retirement plans, but the legislation was vetoed by the governor. Committee members further discussed issues pertaining to the funding status of the Legislative Retirement Fund and of retirement funds for judges.

Discussion of Possible Economies of Scale from Merging Functions

Representatives from the State Treasurer's Office (STO), SIC, ERB and PERA were part of a discussion on the possible merging of certain functions among their respective offices.

Tim Eichenberg, state treasurer, discussed the responsibilities of the STO. He stated that the STO is the investment manager for over \$4 billion in short-term assets. The STO is responsible for maximizing a return on the investment of those assets, while maintaining liquidity and safety. The STO manages the general fund, bond proceed investment pools, the Local Government Investment Pool and the Severance Tax Bonding Fund.

State Treasurer Eichenberg said that the STO is organizationally structured to support its core functions, including cash management, fund administration and investment. He indicated that relative to other offices, the STO has unique objectives and risk tolerances. The STO's objectives are focused on maintaining fund safety and liquidity. Thus, it only invests in high-quality short-term bond or cash investments. In addition, State Treasurer Eichenberg noted that its assets are internally managed.

State Treasurer Eichenberg listed some potential benefits and pitfalls of the possibility of the STO merging functions with other offices. He indicated that consolidation of investment knowledge could facilitate an exchange of ideas and that increasing internally managed assets could result in reduced fees. However, he noted that different offices have different investment objectives and those objectives could be impeded with consolidation.

Steven K. Moise, state investment officer, indicated that the SIC has not taken a position on the issue of consolidation. He noted that there are about 20 states that have, to one degree or another, consolidated investment functions among their investment agencies. Vince Smith, deputy state investment officer, noted that in his experience in other states, consolidation presents both advantages and disadvantages. He indicated that while other states have consolidated investment functions among investment agencies, cost savings is not necessarily an advantage of such consolidation. He indicated that alternatives to consolidation that might provide benefits include improved consistency in reporting methods and a focus on specialization.

Bob Jacksha, chief investment officer, ERB, said that the disadvantages of consolidation might outweigh any benefits. He suggested that an amendment to the Constitution of New Mexico might be required to allow consolidation. He explained that the constitution establishes the ERB and the PERA retirement funds as trust funds and designates the respective retirement boards as the sole trustees and fiduciaries of the funds. He also mentioned that the constitution gives similar authority to the state investment officer and the SIC. Meanwhile, the state treasurer is a constitutional officer.

Because of the separate functions of the investment agencies, Mr. Jacksha noted that the respective boards for which those agencies work have separate consultants, managers and staff. He said each agency chooses consultants, managers and staff in a manner that best carries out each agency's individual goals.

Mr. Jacksha indicated that if consolidation results in diminished performance of the investments of the respective investment agencies, any benefits from cost savings might be diminished. He also indicated that pooling of funds for investment purposes might not necessarily provide benefits for some funds, since sometimes the small size of some funds can be used to make investments not available for larger funds.

Mr. Jacksha additionally stated that from the ERB's perspective, investment return and risk are its most important investment considerations. Even if fees could be minimized through consolidation of functions with other investment agencies, the ERB's ability to diversify investments would be minimized and its risk would increase.

John Grabel, chief investment officer, PERA, presented the PERA's perspective on the issue of consolidation. He said that consolidation is not consistent with the PERA's mission and has the potential to increase costs for the PERA funds and its members.

Mr. Grabel noted that the PERA, ERB and SIC have different boards with distinct election and appointment criteria and that they manage separate funds. He said that the different boards have their own asset allocations and differing investment mandates. He said that when different boards have different missions, consolidation may lead to confusion in the achievement of distinct goals. He cited examples of inefficiencies arising in certain cities when investment functions had been consolidated among different investment agencies. Mr. Grabel also indicated that if investment functions were consolidated among New Mexico's investment agencies, inefficiencies could arise if various levels of reviews from staff of the different agencies become necessary.

Mr. Grabel indicated that separate investments by separate investing agencies may be desirable because every pension has a different liability structure. Fiduciaries of different plans might have different asset allocation goals. In addition, he stated that pensions and endowments have distinct liquidity requirements and investment mandates. Thus, Mr. Grabel said that in the process of consolidation, the different missions of the respective investment agencies might be implicated.

Mr. Grabel also suggested that consolidation might lead to other issues for smaller funds if they are consolidated for investment purposes with larger funds. He said that larger portfolios have fewer investment options than smaller portfolios. He also said that larger portfolios may be limited to large asset categories by virtue of their size. On the other hand, smaller portfolios may be able to access other investments. Mr. Grabel noted that a recent report by the Wilshire Trust Universe Comparison Service indicates that as the size of a fund increases, the median performance of the fund decreases over the long term.

Mr. Grabel indicated that consolidation might also result in increased expenses to the investment agencies. He said that states with more assets have a larger staff with greater compensation. He also indicated that cost savings on attorneys, accountants and consultants

cannot necessarily be achieved through consolidation, since separate legal entities would probably still be required to retain these professionals separately. In addition, Mr. Grabel said that larger asset pools do not necessarily yield lower cost structures. He said that costs are related to asset allocation, rather than to the sizes of the funds managed.

Mr. Grabel discussed some operational challenges that could arise as a result of consolidation. He indicated that each investment agency has its own budget, so procedures for processing invoices and budget adjustment requests could be complicated. He also said that because each agency is required to maintain its own books and records, financial statement and audit challenges could arise from consolidation. He said that actuarial valuations could become more challenging to calculate. In addition, he stated that because investment agencies have different cash flow requirements, consolidation could lead to sub-optimized asset allocations.

Mr. Grabel talked about risks that could arise as a result of consolidation. He also indicated that friendly competition between the state's investment agencies is healthy and benefits the state. He said that consolidation might be time-consuming and expensive and that negative motivation for staff and performance at each investment agency could result.

Finally, Mr. Grabel said that there is no clear precedent for consolidation of investment funds totaling more than \$5 billion. He said that all states with sovereign wealth funds greater than \$5 billion have separate pension systems.

A committee member said that a thorough study should be conducted before any consolidation strategy is implemented. The member said that minimization of costs should not be the sole consideration, but the study should be aimed at permitting state government to run more efficiently and productively. Another committee member discussed possible benefits of consolidating staff between investment agencies.

Committee members discussed the benefits of studying the feasibility of consolidating New Mexico's investment agencies. Mr. Jacksha noted that strategies, such as uniform reporting, could be implemented without consolidating the investment agencies or the funds they invest.

Endorsement of Potential Legislation

Moratorium on Legislative Changes Affecting Funds Administered by the PERA

At the request of the committee, Mr. Propst briefly summarized the provisions of House Joint Memorial 2, which was endorsed by the committee during the 2014 interim and introduced during the 2015 session. Mr. Propst explained that the memorial requested the legislature to refrain from making changes that would affect the retirement benefits administered by the PERA.

Committee members discussed whether the memorial would implicate the legislature's ability to make changes affecting funds administered by the PERA. A committee member indicated that legislative changes might be necessary in the event of an economic downturn or in

other circumstances. Another committee member expressed concern that the memorial might suggest inflexibility if certain changes are necessary. Some committee members indicated that the memorial might serve as a statement of the legislature's desire to avoid making changes that could impact the solvency of the funds administered by the PERA.

Upon a motion made and seconded, the committee endorsed the memorial for the 2016 interim, with two members voting not to endorse the memorial.

Changes to the Definition of "New Mexico Private Equity Fund"

Mr. Wollmann presented a bill draft that would change the definition of "New Mexico private equity fund", which he described in a presentation earlier in the meeting. In response to a question from a committee member, Mr. Wollmann indicated that returns from private equity investments were at about 10.3 percent for three- and five-year investment periods, but long-term investment returns were at about .4 percent. Mr. Wollmann said that the bill proposed for endorsement would allow the SIC to use top investors from outside the state, but would guarantee that those investors would make some investments in New Mexico businesses. In response to another question, Mr. Wollmann clarified that the maximum investment in the New Mexico private equity funds would not be changed.

A committee member expressed concern that if the definition of "New Mexico private equity fund" is changed to eliminate a physical presence requirement, the state could lose tax revenues that could otherwise be collected from a fund with a manager residing in the state. Mr. Wollmann indicated that changing the definition would allow for better diversification and attract money from out-of-state businesses to New Mexico. Another committee member expressed support for the bill and also stated that the proposed legislation could maximize investment revenues for the state. In response to a question from another committee member, Mr. Wollmann indicated that the SIC is researching possibilities to maximize in-state job creation while maximizing investment returns. Upon a motion made and seconded, the members endorsed the bill without objection.

Municipal Post-Employment Life Insurance Benefits Trusts

Lou Hoffman, director, Department of Finance and Administrative Services, City of Albuquerque, presented a bill to permit a municipality to establish a post-employment life insurance benefits trust. Upon a motion made and seconded, the members endorsed the bill without objection.

Evolution of Sustainable Investing

Bruno Bertocci, senior portfolio manager, UBS Asset Management (UBS), provided the committee members with a description of investment strategies involving sustainable investment practices. He indicated that three basic approaches can be combined in a sustainable investment strategy. Those approaches include exclusion, integration and impact investing. Exclusion involves a strategy to avoid investing in certain stocks, while an integration approach focuses on investment in companies with certain characteristics to promote sustainability. UBS identifies

environmental, social and governance characteristics as possible sustainability factors. Mr. Bertocci said that sustainability factors create operating efficiencies, support value creation and create brand equity. He also indicated that highly sustainable companies tend to outperform other companies. Mr. Bertocci added that accounting standards for sustainable companies have evolved and strengthened, and the Sustainability Accounting Standards Board is developing material, non-financial, sustainability accounting standards.

Questions from committee members followed. A committee member asked whether UBS currently has any New Mexico governmental clients. Deidre Guice Minor, client advisor, UBS, indicated that UBS provides some work with respect to the SIC's real estate portfolio and manages the cash assets of the Santa Fe treasurer's office. Ms. Minor indicated that various entities in other states have expressed interest in UBS's sustainable investing practices.

A committee member commented that sustainable practices might need to reflect different values in different states. He indicated that since natural resources play a key role in New Mexico's economy, a sustainable investment strategy in New Mexico might require investment in companies that cultivate those resources. A committee member also inquired about investment in solar energy companies.

Adjournment

There being no further business before the committee, the committee adjourned at 4:25 p.m.

ENDORSED LEGISLATION

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

HOUSE BILL

52ND LEGISLATURE - STATE OF NEW MEXICO - SECOND SESSION, 2016

INTRODUCED BY

FOR THE INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

AN ACT

RELATING TO PUBLIC FINANCES; ALLOWING A MUNICIPALITY TO
ESTABLISH A MUNICIPAL POST-EMPLOYMENT LIFE INSURANCE BENEFITS
TRUST.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF NEW MEXICO:

SECTION 1. [NEW MATERIAL] MUNICIPAL POST-EMPLOYMENT LIFE
INSURANCE BENEFITS TRUST.--

A. A municipal post-employment life insurance
benefits trust may be established, maintained and used by a
municipal treasurer with the advice and consent of the
municipal board of finance.

B. The municipality's contributions to the
municipal post-employment life insurance benefits trust shall
be irrevocable, and the money in the trust shall be dedicated
exclusively to funding post-retirement life insurance benefits

underscoring material = new
~~[bracketed material] = delete~~

1 pursuant to the provisions of the trust established by the
2 municipal treasurer.

3 C. Money in a municipal post-employment life
4 insurance benefits trust shall be invested pursuant to the
5 Uniform Prudent Investor Act and the provisions of this
6 section. Earnings and income from investment of money in the
7 trust shall be credited to the trust.

8 D. The municipal treasurer shall serve as the
9 trustee and may use the services of a trust company to manage
10 the investment of money in the municipal post-employment life
11 insurance benefits trust.

12 E. As used in this section:

13 (1) "municipal post-employment life insurance
14 benefits trust" means an investment fund established,
15 maintained and used by a municipality exclusively for the
16 purposes permitted under Section 115 of the Internal Revenue
17 Code of 1986; and

18 (2) "trust company" means an individual or a
19 company, corporation, firm, partnership, state-chartered bank,
20 national bank or other legal entity that provides investment
21 services pursuant to the Trust Company Act and that agrees to
22 adhere to the provisions of the Uniform Prudent Investor Act.

underscored material = new
[bracketed material] = delete

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

SENATE BILL

52ND LEGISLATURE - STATE OF NEW MEXICO - SECOND SESSION, 2016

INTRODUCED BY

ENDORSED BY THE INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

AN ACT

RELATING TO PUBLIC FINANCES; CHANGING THE DEFINITION OF "NEW MEXICO PRIVATE EQUITY FUND".

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF NEW MEXICO:

SECTION 1. Section 7-27-5.15 NMSA 1978 (being Laws 1990, Chapter 126, Section 5, as amended) is amended to read:

"7-27-5.15. NEW MEXICO PRIVATE EQUITY FUNDS AND NEW MEXICO BUSINESS INVESTMENTS.--

A. No more than nine percent of the market value of the severance tax permanent fund may be invested in New Mexico private equity funds or New Mexico businesses under this section.

B. In making investments pursuant to Subsection A of this section, the council shall make investments in New Mexico private equity funds or New Mexico businesses whose

underscored material = new
[bracketed material] = delete

1 investments or enterprises enhance the economic development
2 objectives of the state.

3 C. The state investment officer shall make
4 investments pursuant to Subsection A of this section only upon
5 approval of the council and within guidelines and policies
6 established by the council.

7 D. As used in this section:

8 (1) "New Mexico business" means, in the case
9 of a corporation or limited liability company, a business with
10 its principal office and a majority of its full-time employees
11 located in New Mexico or, in the case of a limited partnership,
12 a business with its principal place of business and eighty
13 percent of its assets located in New Mexico; and

14 (2) "New Mexico private equity fund" means [~~a~~
15 ~~limited partnership, limited liability company or corporation~~
16 ~~organized and operating in the United States and maintaining an~~
17 ~~office staffed by a full-time investment officer in New Mexico]~~
18 an entity that makes, manages or sources potential investments
19 in New Mexico businesses and that:

20 (a) has as its primary business activity
21 the investment of funds in return for equity in or debt of
22 businesses for the purpose of providing capital for start-up,
23 expansion, product or market development, recapitalization or
24 similar business purposes;

25 (b) holds out the prospects for capital

underscored material = new
[bracketed material] = delete

1 appreciation from such investments;

2 (c) has at least one full-time manager
3 with at least three years of professional experience in
4 assessing the growth prospects of businesses or evaluating
5 business plans [~~and who has established permanent residency in~~
6 ~~the state~~];

7 (d) is committed to investing or helps
8 secure investing by others, in an amount at least equal to the
9 total investment made by the state investment officer in that
10 fund pursuant to this section, in businesses with a principal
11 place of business in [~~the state~~] New Mexico and that hold
12 promise for attracting additional capital from individual or
13 institutional investors nationwide for businesses in [~~the~~
14 ~~state~~] New Mexico; and

15 (e) accepts investments only from
16 accredited investors as that term is defined in Section 2 of
17 the federal Securities Act of 1933, as amended (15 USCA Section
18 77(b)), and rules and regulations promulgated pursuant to that
19 section, or federally recognized Indian tribes, nations and
20 pueblos with at least five million dollars (\$5,000,000) in
21 overall investment assets.

22 E. The state investment officer is authorized to
23 make investments in New Mexico businesses to create new job
24 opportunities and to support new, emerging or expanding
25 businesses in a manner consistent with the constitution of New

.202286.3SA

underscoring material = new
~~[bracketed material] = delete~~

1 Mexico if:

2 (1) the investments are made:

3 (a) in conjunction with cooperative
4 investment agreements with parties that have demonstrated
5 abilities and relationships in making investments in new,
6 emerging or expanding businesses;

7 (b) in a New Mexico aerospace business
8 that has received an award from the United States government or
9 one of its agencies or instrumentalities: 1) in an amount, not
10 less than one hundred million dollars (\$100,000,000), that is
11 equal to at least ten times the investment from the severance
12 tax permanent fund; and 2) for the purpose of stimulating
13 commercial enterprises; or

14 (c) in a New Mexico business that:
15 1) is established to perform technology transfer, research and
16 development, research commercialization, manufacturing,
17 training, marketing or public relations in any field of science
18 or technology, including but not limited to energy, security,
19 defense, aerospace, automotives, electronics,
20 telecommunications, computer and information science,
21 environmental science, biomedical science, life science,
22 physical science, materials science or nanoscience, using
23 research developed in whole or in part by a state institution
24 of higher education or a prime contractor designated as a
25 national laboratory by an act of congress that is operating a

.202286.3SA

underscored material = new
~~[bracketed material] = delete~~

1 facility in the state, or an affiliated entity; and 2) has an
2 agreement to operate the business on state lands;

3 (2) an investment in any one business does not
4 exceed ten percent of the amount available for investment
5 pursuant to this section; and

6 (3) the investments represent no more than
7 fifty-one percent of the total investment capital in a
8 business; provided, however, that nothing in this subsection
9 prohibits the ownership of more than fifty-one percent of the
10 total investment capital in a New Mexico business if the
11 additional ownership interest:

12 (a) is due to foreclosure or other
13 action by the state investment officer pursuant to agreements
14 with the business or other investors in that business;

15 (b) is necessary to protect the
16 investment; and

17 (c) does not require an additional
18 investment of the severance tax permanent fund.

19 F. The state investment officer shall make a
20 commitment to the small business investment corporation
21 pursuant to the Small Business Investment Act to invest one
22 percent of the market value of the severance tax permanent fund
23 to create new job opportunities by providing capital for land,
24 buildings or infrastructure for facilities to support new or
25 expanding businesses and to otherwise make investments to

.202286.3SA

underscored material = new
[bracketed material] = delete

1 create new job opportunities to support new or expanding
2 businesses in a manner consistent with the constitution of New
3 Mexico. On July 1 of each year, the state investment officer
4 shall determine whether the invested capital in the small
5 business investment corporation is less than one percent of the
6 market value of the severance tax permanent fund. If the
7 invested capital in the small business investment corporation
8 equals less than one percent of the market value of the
9 severance tax permanent fund, further commitments shall be made
10 until the invested capital is equal to one percent of the
11 market value of the fund.

12 G. The state investment officer shall report
13 semiannually on the [~~New Mexico private equity~~] investments
14 made pursuant to this section. Annually, a report shall be
15 submitted to the legislature prior to the beginning of each
16 regular legislative session and a second report no later than
17 October 1 each year to the legislative finance committee, the
18 revenue stabilization and tax policy committee and any other
19 appropriate interim committee. Each report shall provide the
20 amounts invested in each New Mexico private equity fund, as
21 well as information about the objectives of the funds, the
22 companies in which each private equity fund is invested and how
23 each private equity investment enhances the economic
24 development objectives of the state. Each report also shall
25 provide the amounts invested in each New Mexico business."

.202286.3SA

underscoring material = new
~~[bracketed material]~~ = delete

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

SENATE JOINT MEMORIAL

52ND LEGISLATURE - STATE OF NEW MEXICO - SECOND SESSION, 2016

INTRODUCED BY

FOR THE INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

A JOINT MEMORIAL

REQUESTING A MORATORIUM ON THE PROPOSAL AND CONSIDERATION OF
LEGISLATION AFFECTING RETIREMENT BENEFITS ADMINISTERED UNDER
THE PUBLIC EMPLOYEES RETIREMENT ACT AND REQUESTING THAT MEMBERS
BE URGED TO DEFER SUCH LEGISLATION.

WHEREAS, in 2013, the legislature reformed the Public
Employees Retirement Act; and

WHEREAS, many stakeholders agreed upon the necessity of
the enacted reform measures to improve the fiscal health of the
funds administered under the Public Employees Retirement Act in
order to continue provision of benefits that rank among the
best in the nation; and

WHEREAS, the enacted reform measures represent shared
sacrifices among retirees, active members and future members of
the public employees retirement system; and

underscoring material = new
~~[bracketed material] = delete~~

1 WHEREAS, the enacted reform measures, particularly the new
2 tier benefits and the provisions regarding the reemployment of
3 retired members, need to be in place for several years to
4 demonstrate actuarial gains; and

5 WHEREAS, although recent investment gains have improved
6 the funded ratio of the funds:

7 A. investment market volatility and economic
8 uncertainty continue to be a major concern;

9 B. the funded ratio has only begun to recover;

10 C. the implementation of newly mandated accounting
11 standards is likely to increase the volatility of the plan's
12 funded ratio and the net pension liability well into the
13 future; and

14 D. there remains a significant unfunded liability;
15 and

16 WHEREAS, the recently improved funded ratio could lead to
17 efforts to modify the enacted reform measures through proposals
18 that could alter the cost-of-living eligibility periods, age
19 and service retirement requirements, deferred retirement option
20 plans and other retirement options or benefits; and

21 WHEREAS, even slight modifications to the enacted reform
22 measures could adversely affect the legislature's goal of
23 reaching a funded ratio of at least one hundred percent by
24 2043, as projected by the actuaries; and

25 WHEREAS, the public employees retirement system should be

underscored material = new
~~[bracketed material] = delete~~

1 protected from premature calls for statutory changes that could
2 erode the funds or otherwise undermine the funding and fiscal
3 health objectives promoted by the legislature through its
4 passage of the enacted pension reform measures; and

5 WHEREAS, Article 20, Section 22 of the constitution of New
6 Mexico vests the retirement board of the public employees
7 retirement association, as trustees, with the sole fiduciary
8 duty and responsibility for the administration of the funds and
9 for holding all assets in trust for the sole and exclusive
10 benefit of its members, beneficiaries and retirees; and

11 WHEREAS, Article 20, Section 22 of the constitution of New
12 Mexico states that the legislature shall not enact any law that
13 increases public employee retirement benefits or that changes
14 the funding formula for a retirement plan unless adequate
15 funding is provided; and

16 WHEREAS, a five-year moratorium on benefit changes under
17 the Public Employees Retirement Act would allow sufficient
18 actuarial experience to be aggregated in order to properly
19 evaluate the enacted reform measures and their effects on the
20 long-term solvency of the funds; and

21 WHEREAS, a fiscally responsible and reasonable course of
22 action combining contributions, plan assets and future
23 investment earnings must continue to be employed, without
24 reversals or reconsideration of the enacted reform measures;
25 and

.202372.1

