

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

**December 17, 2012
Room 322, State Capitol
Santa Fe**

The sixth meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2012 interim was called to order by Senator George K. Munoz, chair, on Monday, December 17, 2012, at 9:20 a.m. at the State Capitol in Santa Fe, New Mexico.

Present

Sen. George K. Munoz, Chair
Rep. Larry A. Larrañaga
Sen. Steven P. Neville
Sen. Mary Kay Papen
Rep. Luciano "Lucky" Varela

Absent

Rep. Henry Kiki Saavedra, Vice Chair
Rep. David L. Doyle
Rep. William "Bill" J. Gray
Sen. Timothy M. Keller
Sen. Carroll H. Leavell
Sen. John M. Sapien
Rep. Jim R. Trujillo

Advisory Members

Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Rhonda S. King
Sen. William H. Payne
Rep. Jane E. Powdrell-Culbert
Rep. Richard D. Vigil

Rep. Donald E. Bratton
Sen. Tim Eichenberg
Rep. Roberto "Bobby" J. Gonzales
Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Rep. William "Bill" R. Rehm
Sen. John C. Ryan
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton
Rep. Mimi Stewart
Rep. Shirley A. Tyler

Staff

Tom Pollard, Legislative Council Service (LCS)
Doris Faust, LCS
Claudia Armijo, LCS

Guests

The guest list is located in the meeting file.

Handouts

Handouts and written testimony are in the meeting file and posted on the New Mexico Legislature web site.

Monday, December 17

D Senator Munoz welcomed the committee members and guests. He reminded members that the meeting was being webcast and asked them to introduce themselves, which they did. There was not a quorum, so the committee acted as a subcommittee. However, shortly into the meeting, and due to the time-sensitive agenda items before the IPOC, Senator Cisneros and Senator Payne were authorized by Senate President Pro Tempore Timothy Z. Jennings to act as voting members.

Legislation Proposed by the State Investment Council (SIC) for IPOC Endorsement

R Steve Moise, state investment officer, SIC, addressed the committee regarding the SIC's proposed legislation. He began by thanking committee members for the conversations they had engaged in concerning possible changes to the SIC. He said he appreciated members' feedback on the bills proposed by the SIC that would increase its budget and personnel autonomy. He added that the SIC is committed to ensuring proper oversight along with flexibility, and he stressed that the SIC must be in a position to pay government market rates for its employees.

A Mr. Moise reminded the members that the SIC seeks flexibility in hiring and paying its investment managers. The costs associated with fund management vary depending on the investment asset classes. The SIC also seeks flexibility on personnel issues. It needs to hire the best qualified candidates, and in a competitive industry such as investments, that requires paying a competitive wage. Working under the constraints of the state personnel system makes meeting market wage demands difficult.

I Mr. Moise reminded the members that the SIC delegates the day-to-day operational duties to the state investment officer, and as such, he is working closely with the SIC on all of the legislative proposals.

T There was a discussion related to the makeup of the SIC staff. Members noted that it has both classified and exempt positions. Mr. Moise said the SIC is seeking flexibility to make any full-time employee classified or exempt as deemed necessary to recruit the best employees. He said the SIC has found qualified investment managers, but it simply cannot offer those candidates enough compensation.

T Mr. Moise said that the SIC is already seeking a significant budget increase from its fiscal year (FY) 2013 budget of \$34 million to an FY 2014 budget request of about \$60 million.

There was a discussion comparing the SIC to another instrumentality of the state that is not a state agency, the New Mexico Mortgage Finance Authority (MFA). Mr. Moise noted that the SIC is looking at the MFA and its operation as a possible model for the SIC.

Discussion regarding the SIC's proposed legislation related to the IPOC's endorsements was postponed until later in the meeting.

College Savings Plan Recent Investment Performance and Pending Legislation

Dr. Jose Z. Garcia, secretary of higher education and chair for the Education Trust Board (ETB), Kevin B. Dieters, executive director for the ETB, Jeremy Thiessen, managing director, Pension Consulting Alliance, Inc., and John Boyd, esq., of Freedman, Boyd, Hollander, Goldberg, Ives & Duncan, P.A., addressed the committee regarding the ETB's investment performance and potential legislation.

Dr. Garcia began by explaining that the ETB hired Mr. Dieters as the new executive director and added that the ETB is current on all of its required audits and that the board is fully integrated into the state accounting system.

Dr. Garcia described the five-year performance of both the Education Plan (TEP) and the Scholar's Edge Plan (SEP). He referred to page 2 of the ETB handout dated December 2012. The TEP 18+ five-year annualized performance trailed its median peer by 4.44% per year. The underperformance was due mainly to results of the Core Bond Fund in the years 2008 and 2009. The TEP 18+ 12-month performance ending September 30, 2009 trailed its median peer by 17.68%. The portfolio held a 50% allocation to the Core Bond Fund for part of that period.

The SEP 18+ five-year annualized performance trailed its median peer by 1.02% per year. The underperformance was also attributed to the results of the Core Bond Fund during the years 2008 and 2009. The SEP 18+ 12-month performance ending September 30, 2009 trailed its peers by 8.59%, and the portfolio held a 25% allocation to the Core Bond Fund for part of that time period. Both the TEP and the SEP have shown improved performance relative to their respective peer groups in the years 2011 and 2012.

Next, there was a discussion about the litigation related to the ETB. Mr. Boyd said that there are two lawsuits still pending. He noted that two lawsuits have been dismissed, but the class action suit remains. The class action suit is the *Ping Lu, et al.* case. The class action lawsuit was filed June 25, 2009 in New Mexico state court by the law firms of Rothstein, Donatelli, Hughes, Dahlstrom, Schoenberg & Bienvenu, LLP, and Keller Rohrback, LLP, seeking damages against the ETB for causing catastrophic losses to parents and grandparents who invested in the New Mexico 529 College Savings Plans.

The lawsuit alleges that parents were encouraged to invest in the plans to save for their children's college education and were required to choose investment portfolios based on the age of their children or the amount of risk they wished to assume. Parents investing in the "conservative" and "ultraconservative" portfolios were led to believe that their funds were invested in safe mutual funds that would protect their funds to pay college expenses. However, the ETB invested funds in the Oppenheimer Funds Core Bond Fund, which followed an ultra-risky strategy of investing in mortgage-backed securities and other toxic derivatives, using

borrowed funds, in effect turning the bond fund into a hedge fund. This fund suffered catastrophic losses in 2008, losing nearly 40% of its value, whereas comparable bond funds actually increased in value during 2008. As a consequence, parents who invested in what were marketed as the most conservative investments lost nearly half of their investments, just as their children were entering or about to enter college. The plaintiffs allege that the ETB violated the terms of the college savings agreements, causing over \$175 million in lost college savings.

Noting that the state is named as a defendant in the case, Mr. Boyd said that the attorneys representing the ETB are filing a motion for summary judgment in the case.

Members expressed serious concerns related to the college savings plans' performances and the management provided by the ETB, particularly with regard to the hiring of Oppenheimer. Some members asked if the board is considering canceling its contract with Oppenheimer. Dr. Garcia said that the contract does not end until 2015, and it would be far too costly to terminate it early. When asked how much money was lost by all of the plan participants, Mr. Boyd said the losses amounted to about \$113 million, and the recovery is about \$67 million, which he opined should be considered a good recovery, all things considered.

When asked about the costs associated with the litigation, Mr. Boyd said that there is no cost since the New Mexico Attorney General's Office (AGO) is handling it. Members were quick to point out that there is most definitely a cost to the state if the AGO expends resources on litigation.

The chair requested that the ETB provide the committee with reports related to the 17% losses and an explanation of why the plans trail their respective peer groups in earnings. Mr. Boyd said he would send the information to Mr. Pollard.

Lastly, members expressed disapproval of the ETB's practice of awarding scholarships with money received from college plan investors. The ETB charges an administrative fee to investors, and it uses a portion of that fee toward what is referred to as "bridge scholarships". Dr. Garcia explained that the bridge scholarship covers a student's first semester of college, a time period not covered under the New Mexico lottery scholarship. Members generally questioned the validity of using investors' money to fund other children's scholarships. The chair said he wants to speak about the issue with Dr. Garcia prior to the upcoming legislative session, and Dr. Garcia agreed.

Educational Retirement Board (ERB) Pension Solvency Legislation Proposed for IPOC Endorsement

Jan Goodwin, executive director for the ERB, presented the ERB's proposed legislation designed to improve the solvency of the Educational Retirement Fund. She began by reminding the members of the committee about the ERB's proposal. The proposal would increase all active members' employee contribution rates to 10.7% in a phased-in process reaching the increased rate in FY 2015. Additionally, the proposal would create a new tier of employees hired on and after July 1, 2013. The retirement age and service requirements and benefits for members in the

new tier would include a minimum retirement age of 55 years. Retirement eligibility would occur:

- a. at age 67 years with five years of earned service credit;
- b. at any age if the sum of the member's age and years of earned service credit equals at least 80 (Rule of 80); or
- c. at any age with 30 or more years of earned service credit.

Additionally, members in the new tier can expect a cost-of-living adjustment (COLA) of 2% annually once they reach the age of 67 years.

Ms. Goodwin further explained that the stakeholder proposal is projected to reduce the ERB's unfunded liability, and according to those projections, the fund would be 75% funded by the year 2030 and would reach 100% funded status in the year 2043. Ms. Goodwin noted the various charts and graphs provided in the ERB handout that illustrate the upward trend in the funding ratio anticipated if the stakeholder proposal is enacted after the upcoming 2013 legislative session. The chair asked Ms. Goodwin to ensure that the ERB would vote on the endorsed proposal with the change recommended by the IPOC, which will provide a carve-out of the employee contribution increase for members making \$20,000 or less annually. She agreed.

Prior to the next presentation, the IPOC, members voted, without objection, to approve the minutes from the IPOC October and November meetings.

Public Employees Retirement Association (PERA) Pension Solvency Legislation Proposed for IPOC Endorsement

Wayne Propst, executive director for the PERA, spoke to the members regarding the PERA board's proposal for legislation to ensure the solvency of the PERA funds. He referred to the handout dated December 17, 2012 and reviewed the proposed changes. He noted that, on the first page of the handout, there is information regarding the various PERA funds and their respective funded status. The Judicial Retirement Fund is the least funded, with a funded ratio of 51%, and the Volunteer Firefighter's Retirement Fund is the best funded at 167.9%.

Next, Mr. Propst relayed the most recent and updated financial status of the PERA, as well as information specifically related to the legislative retirement plans. That information is located in the handout "Legislative Retirement Overview".

There was a brief discussion regarding the PERA board proposal. Mr. Propst clarified that the PERA funds are valued as a singular fund, but for administrative purposes, the PERA is able to determine each fund's funded status.

Some members asked why the board did not look at changes to the judicial and magistrate retirement plans. Mr. Propst said the changes to the COLA were intended to affect both the judicial and magistrate members.

Administrative Office of the Courts (AOC) Solvency Legislation Proposed for IPOC Endorsement

Richard C. Bosson, justice of the New Mexico Supreme Court, and Arthur C. Pepin, director for the AOC, spoke to the members regarding legislation proposed by the AOC that would affect both the judicial retirement members and the magistrate retirement members. The proposal was originally presented to the IPOC at its November meeting.

Justice Bosson began by mentioning an op-ed piece written by former Supreme Court Chief Justice Joseph F. Baca that appeared in the *Albuquerque Journal* on Sunday, December 16, 2012. Chief Justice Baca opined that earned PERA and ERB benefits are a property right under the Constitution of New Mexico, and as such, the constitution "...limits the permissible changes to benefits that may be made. In addition, the Fifth Amendment to the U.S. Constitution requires compensation for any property that is taken away.". Justice Bosson noted that he agrees with the opinion set forth by Chief Justice Baca.

There was a general discussion regarding Chief Justice Baca's op-ed piece. Some members disagreed with the opinion set forth by the former chief justice, and others agreed with it. Generally, members understood that until a court makes a determination, it is difficult to foresee the outcome of any litigation that may arise out of changes to the state's pension plans.

Mr. Pepin referred to the AOC handout with the heading "CURRENT STATUS OF JRA AND MRA". He reminded the members of the provisions proposed by the AOC, including a one-time appropriation of \$15 million to "jump-start" the solvency of the Judicial Retirement Fund and the Magistrate Retirement Fund. He also noted that the proposed changes would include contribution increases for employers. Employees would continue to contribute 9.0% of their annual salary, and employers would contribute 15% of each employee's annual salary. A distinguishing characteristic of the AOC proposal is the provision that would temporarily suspend the COLA for all judicial and magistrate members for two years. Then, beginning July 1, 2016, if the funds are funded at 70% or greater, a 2% compounding COLA could be implemented.

Retiree Health Care Authority (RHCA) Legislative Proposals

Mark Tyndall, executive director for the RHCA, addressed the members regarding legislation providing for increased employee and employer contributions to the Retiree Health Care Fund. Although Mr. Tyndall presented a different legislative proposal at the November IPOC meeting, he came forward at this meeting with a substitute proposal that would implement contribution increases earlier, beginning on July 1, 2013.

Mr. Tyndall explained that the legislative proposal is projected to have a general fund impact of about \$5 million annually. He added that the proposal is part of the RHCA's long-term sustainability plan and is necessary because active employees do not end up paying the total costs associated with the benefits they receive. He added that the board wants a system whereby the contributions match the benefits.

IPOC Voting and Endorsement of Proposed Legislation

After hearing the various presentations, the members discussed and voted on endorsement of proposed legislation. The IPOC voted on the following bills:

1) .190837.2SA — This bill is proposed by the PERA board and was voted on as merged with bill number .190838.1 and bill number .190744.2. The merged bill was endorsed and will be sponsored by Senator Munoz;

2) .190621.3SA — This bill is proposed by the AOC. The bill was endorsed and will be sponsored by Representative Trujillo;

3) .190544.1 — This is a bill related to court docket fees. The bill was endorsed and will be sponsored by Representative Stewart;

4) .190849.1 — This bill would permit double-dipping for chiefs of police and undersheriffs. This bill will be carried by Senator Cisneros;

5) .190850.1 — Double-dipping bill. This bill would permit retired state police members, municipal police and adult correctional officer members to return to work under the Public Employees Retirement Act. The bill was endorsed, but no sponsor was assigned;

6) .190682.1 — This bill would change the judicial retirement and magistrate retirement plans to align more closely to the PERA state general member coverage plan 3. This bill was endorsed, but no sponsor was assigned;

7) .190476.2 — This bill would provide that the PERA board would be responsible for determining, within limitations, employee contribution rates and the rate of the COLA. This bill was endorsed, but no sponsor was assigned;

8) .190546.1 — This bill would allow any retired member under the PERA to return to work without suspending the member's pension if the member returns to employment earning less than \$15,000 annually. This bill was not endorsed by the IPOC;

9) .190831.1 — This bill would eliminate the ETB and place the investing duties of the ETB with the SIC. This bill was endorsed, but a sponsor was not assigned; and

10) .190944.1 — This bill would increase both employee and employer contributions to the Retiree Health Care Fund beginning July 1, 2013. This bill was endorsed, but a sponsor was not assigned.

Adjournment

With no further business, the committee adjourned at 4:15 p.m.