MINUTES
of the
SECOND MEETING
of the
RETIREMENT SYSTEMS SOLVENCY TASK FORCE

July 12, 2010
Room 307, State Capitol
Santa Fe

The second meeting of the Retirement Systems Solvency Task Force was called to order by Representative Mimi Stewart, co-chair, on July 12, 2010 at 10:10 a.m.

Present
Rep. Mimi Stewart, Co-Chair
Mr. Oscar Arevalo
Mr. Charles Bowyer
Mr. Bill Fulginiti
Ms. Jan Goodwin
Rep. John A. Heaton
Mr. David Heshley
Ms. Emily Kane
Mr. Andrew Padilla
Mr. Wayne Propst
Mr. Terry Slattery
Sen. John Arthur Smith
Mr. Jeff Varela
Rep. Luciano "Lucky" Varela

Absent
Mr. Tito Chavez, Co-Chair
Mr. Diego Arencon
Sen. Pete Campos
Sen. Phil A. Griego
Ms. Michelle Lewis
Ms. Alexis Lotero
Mr. Bruce Malott
Sen. Steven P. Neville
Mr. Ronald Sanchez
Ms. Christine Trujillo

Staff
Raúl E. Burciaga, Director, Legislative Council Service (LCS)
Tom Pollard, LCS
Doris Faust, LCS
Claudia Armijo, LCS

Guests
The guest list is located in the meeting file.

<u>**Monday, July 12**</u>

Representative Stewart advised the task force that because a number of members had not yet arrived, the task force would be acting as a subcommittee. She additionally told them that, at the direction of the New Mexico Legislative Council, as many interim committee meetings as possible would be webcast. She further noted that today's meeting was being audio webcast, but not video webcast. Consequently, Representative Stewart asked the members to identify themselves prior to speaking and to turn their microphones on and off before and after speaking. Lastly, she clarified that the webcasts are not archived; rather, they are broadcast live.

Public Employees Retirement Association (PERA) Review and Comparison of the Current 30-Year Plan and PERA's Proposed Model Plan; Fiscal Analysis and Summary of Benefits

Mr. Slattery, executive director for the PERA, directed the members' attention to the multiple handouts provided by the PERA for the meeting discussion. He began by describing several aspects of the benefit adequacy study report issued in the spring of 2010. He noted that the study was the result of the provisions in House Bill 573, which, among other things, created the task force. Mr. Slattery told the members that the purpose of the study was to compile data and information to enable the PERA board to recommend benefit changes for future state employees hired on or after July 1, 2010. Any proposed changes would not go into effect until July 1, 2011 and would not affect current members. He noted that this would allow the task force time to consider and make recommendations.

The study was completed by Gabriel Roeder Smith & Co. (GRS) Consultants and Actuaries and involved comparing peer benefit plans to New Mexico's PERA plan in an effort to determine what might constitute an "ideal plan" for the PERA. Mr. Slattery pointed the members to page 1 of the study report, which provided a background for comparing the PERA to five other designated state retirement plans. Those five plans include Hawaii, Iowa, New Hampshire, Utah and Wyoming. When asked by the members why those particular plans were selected, Mr. Slattery replied that several possible plans were presented to the PERA board and, based on commonality of criteria, the board selected the five indicated plans and asked GRS to conduct the study accordingly.

GRS provided estimates of costs, including system costs and replacement ratios, as well as net pay. Those factors and others were then analyzed to determine what the benefit payout plus social security payments would be for a member. This analysis was done to determine a reasonable replacement plan relative to the amount of net pay a member had been taking home during the member's career. The actuary determined the normal cost for each of the various state employee divisions: state police, general, municipal general and municipal fire. Next, the actuary developed the estimated normal costs going forward related to each of those plans. In the PERA's ideal plan, many of the costs would be less than those under the current PERA plan. Mr. Slattery noted that the PERA did not initiate making changes to the plan due to concerns over the PERA fund's solvency. Rather, the changes were made due to input from legislative committees indicating that the current member benefit plan is too "rich".

Some members commented that the term "rich", when referring to New Mexico's PERA plan, is a poor choice of words and is inaccurate. It was noted that in comparison to the other states used in the study, New Mexico has an 80% cap, which the other states do not have. Additionally, New Mexico employee contribution levels are higher than the employee contribution levels in the other states. Mr. Slattery concurred, noting that on page 13 of the report, it is evident that members get what they pay for, and he pointed out that New Mexico's employee contributions are higher than most of the other 49 states.

Mr. Slattery noted that the report was quite lengthy, as it was a culmination of a nine-month study. He asked for direction by the co-chair regarding which sections he should specifically address. Representative Stewart asked him to highlight various sections of the report that are particularly pertinent. Mr. Slattery continued by highlighting some of the significant differences between New Mexico's plan and the plans of the five other comparison states. He noted that Hawaii has an age limit of 55 and Iowa has an age limit of 65, both regardless of the member's term of service. He added that there is no real pattern or consistency in the various plans and they have all been in place for a long time, just like New Mexico's PERA plan.

Next, Representative Stewart asked Mr. Slattery to address the issue of the cost-of-living adjustment (COLA) paid to retirees pursuant to the PERA plan. Mr. Slattery indicated that the subject was covered on page 12 of the report. He noted that New Mexico has a flat 3% COLA, and he explained that once a member is retired for two full calendar years, the 3% COLA is compounded annually. He noted, however, that if the member is 65 years of age or is on disability, the two-year waiting requirement is reduced to one year. Hawaii allows COLA increases of 2.5% each year. However, the increase is based on the member's original benefit, so it is not compounded. Mr. Slattery said that Iowa uses a dividend reserve account. COLA dividends are paid only if the funds in the account grow as an investment. If this happens, Iowa declares a COLA dividend. In New Hampshire, the amount of the COLA increase is provided annually by the legislature out of a special reserve fund. In Utah, any increases for members' COLAs are given annually and are based on the consumer price index (CPI), with a maximum amount of 4% of a member's original benefit. Mr. Slattery noted that Wyoming's COLA is almost identical to that of New Mexico. He pointed out that most of the other 49 states do not have a compounding COLA factor like that of New Mexico.

Mr. Slattery next spoke regarding the specifics of the PERA's proposed ideal plan, comparing it to the legislative General Member Plan, Tier 2 Retirement Plan (General Plan). The General Plan provides that the employee contribution rate is 8.92% versus the PERA ideal plan, which would impose an employee contribution rate of 7.0%. Under the General Plan, the employer contribution is 15.09% versus 14.0% in the PERA ideal plan. According to Mr. Slattery, another significant difference in the two plans is that the General Plan uses a pension factor of 3%, whereas the ideal plan uses a pension factor of 2.5%. Also, the PERA ideal plan would include Department of Public Safety peace officers, including special investigators, motor transportation officers and juvenile corrections officers, while the General Plan excludes those members. Under the PERA's ideal plan, retirement eligibility would include age 55, with the sum of age and member's service credit equal to 85 (the Rule of 85); age 60 with 25 years of service credit; or age 65 with five years of service credit. The General Plan applies the Rule of 80, meaning that the sum of a member's age and years of service credit equals at least 80. Additionally included is any age and 30 or more years of service credit or age 67 or older with five or more years of service credit. Regarding pension calculations, the PERA's ideal plan would provide for 90% of final average salary after 36 years of service credit. The General Plan provides for 80% of the final average salary after 30 years of service credit. Again, the plans differ in their pension factor as noted above. In the ideal plan, the COLA would be determined based on the age of the member at retirement and on 75% of the change in the CPI with a 0%

decrease and a 3% maximum increase. The General Plan calls for a 3% increase after two full calendar years of retirement or one calendar year if the member retires at age 65 or older. In either plan, the final average salary is the average of the highest 36 consecutive months of a member's salary. Mr. Slattery noted that this amount may or may not be the last 36 months of a member's employment.

Mr. Slattery next discussed the PERA board's goals and objectives when developing the ideal plan. He noted that those goals and objectives are located on page 26 of the study. He pointed out that the specified goals and objectives were the driving force behind the study, adding that a different set of goals and objectives would yield a very different ideal plan.

There were some questions by task force members regarding the state's contributions. Mr. Slattery was asked if he had a chart that he could provide that would indicate those contributions. He replied that he does not have such a chart, but he has information regarding normal costs that would be the depiction of what it costs to fund each of the PERA plans. He reminded the members that normal costs are the ongoing costs of service. Representative Stewart asked Mr. Slattery if he could request his staff to provide the state's contribution information for the task force, and he agreed.

Next, there was a brief discussion regarding the scrutiny concerning disability benefits. Mr. Slattery assured the members that the PERA has a low incidence of disability claims. He added that the board did not think it was imperative to change the PERA's disability benefit.

Mr. Slattery directed the task force's attention to page 18 of the study. He noted that the changes enacted by House Bill 573 will not affect the PERA's funding for 10 years. He added that House Bill 573 did not affect public safety members, only general PERA members.

There was a discussion regarding the target of an 8% yield on PERA investments. Some members questioned whether 8% is a reasonable target goal. Mr. Slattery stated that, in his opinion, the 8% is achievable. He noted that the contribution rates in the PERA ideal plan would suffice, even if the PERA lowered its assumptions to 7%, adding that the PERA would not likely do such a thing. He said that even after decades, including downturns in investments, the PERA has still exceeded the 8% target. He said that an asset allocation was recently completed, with assumptions that the PERA can earn 7.66% without active management over the long term, and he feels confident that active management can bring the rate that the PERA can earn to one that is over and above what it needs. He strongly affirmed the PERA's belief that it can earn 8%, noting that there is a reduction in the PERA membership, which means more money will probably come out of the pension fund, but the PERA is accruing less in liabilities, so the liabilities are not growing. Additionally, employees are not getting salary increases. So, if payroll does not grow via salary increases, it amounts to a net gain. Some members still questioned the PERA's ability to achieve the 8% yield and noted that other states are questioning their target yields as well. Mr. Slattery stressed that the PERA's board, in developing an ideal benefit plan, was looking for a good benefit structure with reasonable costs. These goals were articulated to the actuaries when they came up with the ideal plan.

Some members asked if Mr. Slattery had information regarding court cases challenging existing COLAs. Mr. Slattery noted that some attorneys would be presenting to the task force later and perhaps could answer those questions in better detail. He added that some of the lawsuits in certain states, like Colorado and South Dakota, were situations where the COLAs had been altered with the retirement plans asserting the adjustment was necessary in order to maintain the retirement plans' solvency. The plans are being sued by retirees alleging that the COLA is a vested benefit that cannot be changed after the fact. It was noted by some task force members that the COLA costs are considered part of the normal costs for a plan and are factored into the employee's and the employer's contributions. This point was affirmed by Mr. Slattery. Some of the members asked for information regarding what percentage of the PERA's $600 million a year in benefit payouts is attributed to the 3% COLA factor. Although not sure of the exact amount, Mr. Slattery recognized that the amount could be substantial because New Mexico's COLA is compounded.

There was discussion regarding the fact that, in the past, the state has exchanged increased PERA benefits in lieu of increases in employee's salaries. Some members inquired as to whether the ideal plan could go into effect and be applied to existing PERA members. There was discussion about assuring members that any changes to benefits would be due to the financial situation faced by the PERA. Mr. Slattery noted that the most important aspect would be to assure current members and employees that any changes would only apply to new employees hired after July 1, 2010. Discussions about making the new changes retroactive were considered, but Mr. Slattery noted that such changes would likely cause an onslaught of lawsuits.

A number of members commended the PERA board for the work it had accomplished resulting in the ideal plan. Mr. Slattery thanked the members on behalf of the board and reiterated that the board was looking for the best possible and affordable plan. The meeting recessed for lunch.

Update on Request for Proposals (RFP) for Consulting Actuarial Services

Representative Stewart reconvened the meeting at 1:30 p.m. Mr. Pollard reported to the members regarding the RFP that the LCS issued on July 2, 2010. Referring to the handout, he explained that the scope of work provides that an independent actuarial firm will conduct a review of all assumptions, valuations and methodology used by the PERA and the Educational Retirement Board (ERB) actuaries; to express an opinion regarding the reasonableness or accuracy of actuarial assumptions, actuarial cost methods, valuation results and statutory contribution rates; and to certify that the actuarial valuation report was performed by a qualified actuary, that the valuation was prepared in accordance with principles and practices prescribed by the Actuarial Standards Board and that the actuarial calculations were performed by qualified actuaries in accordance with accepted actuarial procedures. He further noted that the specific tasks required by the selected actuarial services firm are designated beginning on page 2 of the handout.

Mr. Pollard explained that the time line could be found on page 6 and that it is a quick time line with the RFP submission of proposals due on July 23, 2010. He said that the submissions received would be ranked by criteria that are outlined on page 9 and that the LCS staff would select the actuarial firm accordingly. The first report would be due on October 12, 2010. Some members asked if the RFP was drafted seeking auditors or actuaries. Mr. Pollard replied that the RFP would be responded to by actuarial companies, but the term used for the services requested is audit. The RFP specifies an independent actuarial audit and the evaluation of actuarial services related to the pension plans of the PERA and the ERB. There was a brief discussion about the differences between auditing and actuaries. Mr. Pollard said the focus of the RFP is for the selected firm to ultimately determine the consequences of each plan, such as the PERA ideal plan.

Legal Issues Related to Changing Pension Plans to Increase Solvency

Ms. Faust provided a brief overview of the legal issues related to any legislative changes to pension plans due to a desire to increase solvency. Ms. Faust began by noting that she does not practice in the area of pension plan law. However, she has performed research on the topic. She noted that there are other attorneys prepared to address the task force who practice in that area of law. She explained that they will provide their opinions as well.

Ms. Faust directed the members' attention to the PowerPoint handout. She said there are four potential groups of members that would be affected by any changes in the benefit plans. Those groups include: the not yet hired; the hired but not yet vested; the vested; and the retired employees. She advised that any analysis should include the application of potential changes for each of the four groups. She told the members that there are two sections of the New Mexico Constitution that come into play when analyzing potential legislative changes to pension benefits. She noted that the overriding applicable rule would ultimately be determined by answering the question of "What is constitutional?". The two constitutional sections that apply are the contract clause and the property rights clause.

Ms. Faust said that in some states the applicability of the contracts clause is clear, but not in New Mexico. She added that Article 2, Section 19 of the United States Constitution provides that no law impairing the obligation of contracts shall be enacted by a legislature. This raises the question of whether government employees in New Mexico have a contract right in their pension benefits. Such a contract would likely be an implied contract because for most state employees, there is likely no actual document memorializing a contractual agreement. However, the courts might find that the implied contract is unclear, and Ms. Faust noted that it would be determined on a case-by-case basis. Ms. Faust told the members that she had included a copy of La Voz, the PERA newsletter for the fall of 1994, in the members' meeting folders. She stated that the newsletter references the vote by PERA members who agreed overwhelmingly to approve a change in benefit coverage that would "improve the pension factor from 2.5% to 3% for both state general members and correctional officers". The newsletter goes on to explain that the improved pension plans would require an increase in contribution rates in order to keep the plans financially sound, and that the increased cost will be shared between the state and the members.

In response to questions by task force members, Ms. Faust said that because the members agreed to increase their contribution rates based on action by the legislature, a court could determine that the legislature and the PERA members intended to make a contract. Ms. Faust noted that there are no definitive cases on point in New Mexico, and she said that the 2009 *Beggs v. City of Portales* case does not analyze the state benefits. The *Beggs* case was briefly discussed by members who asked about the outcome, and Chris Schatzman, general counsel for the ERB, said that the case is undecided and still pending. Again, Ms. Faust pointed out that only the courts can make the final determination of these types of cases, adding that the determination will be made on a fact-specific basis. Lastly, regarding contracts, Ms. Faust told the members that there are two ways that a contract can be created: one is expressed, which is the standard written or oral contract; and the other is implied by actions of the parties. If the courts in New Mexico were to find a contract regarding the PERA members' rights, it would likely be an implied contract.

Ms. Faust continued the discussion turning next to the property rights question. She noted that Article 20, Section 22 of the New Mexico Constitution provides, in part, that upon meeting minimum service requirements, a member of a plan shall acquire a vested property right with due process protections under the applicable provisions of the New Mexico and United States constitutions. Ms. Faust noted that no case law interprets this constitutional provision, which was adopted in 1998. But, by these terms, the legislature would have to comply with due process requirements prior to changing any pension benefits. Under earlier case law, the legislature might have to compensate employees for any diminution in the value of their pension benefits.

Ms. Faust concluded that altering pension benefits for existing employees would likely be subject to litigation. It is impossible to predict the outcome of such litigation, she added. It would be up to the courts to determine whether New Mexico PERA members have a contract right, a property right or no right at all in their pension benefits.

There was then a discussion regarding the theoretical possibility of the existence of a contract right in members' pensions. It was noted by some task force members that the legislature can add to the benefits, but it was questioned as to whether benefits could be subtracted. Mr. Schatzman opined that pursuant to the *Pierce* case and to the New Mexico Constitution, there is no contract right. In his opinion, the *Beggs* case provided a contracts analysis, but was distinguished due to the City of Portales adopting a manual and encouraging its employees to adopt the manual as well. He noted that the facts in that case distinguished it due to the city's inaction when joining the retirement health care plan, but not removing existing members from the original pension plan, and taking no action to do so until five years after the fact. He pointed out that those facts can influence how a court will ultimately decide. Mr. Schatzman said that, in his opinion, it would be a higher hurdle to change earned benefits.

Karen Risku, assistant general counsel for the PERA, noted that the discussion so far had been regarding general legal principles. She added that in court, a judge would look at specific facts. She advised the members that she was not speaking on behalf of the PERA or its board. She told the members that there is an association of national public employees retirement attorneys who have compiled an analysis of all the different cases and theories that courts have looked at when plan members initiate lawsuits. She remarked that Ms. Faust had successfully identified the legal theories that New Mexico's PERA would need to look at. She also spoke regarding the theory of promissory estoppel, explaining that it meant, "You promised me something, I relied on that promise, and now you are taking it away. Consequently, I have been harmed.". Under that theory, a court could say that the benefits are contractually enforceable. In general, Ms. Risku noted that there are a number of issues that come up when changes are made to pension plans. She said that it is not possible to say if changes will present a problem unless the exact proposed changes are analyzed. She further added that in her opinion, it is known that New Mexico members have a vested property right once vested under state and federal laws, and consequently, due process must be provided. She added that any legislative changes cannot be arbitrary or irrational. This means that if the legislature wants to make changes in the benefits, it must have a good reason. Without a legitimate state goal, a change cannot be made unless an equal or greater benefit is provided. General actuarial soundness is a legitimate state goal. However, a court will require that the state prove that no less drastic modifications could be implemented in lieu of the proposed changes. Courts have ruled that merely saving the state money is not a compelling legitimate reason.

Christopher Bulman, assistant general counsel for the PERA, next spoke to the members. He told the members that it is very difficult to discuss complex issues of constitutional rights and other legalities when talking in generalities. He referred to COLA legislation in South Dakota, Colorado and Minnesota. He said that the retirement boards in those states had already proposed COLA legislation. In all three states, the legislation is directly related to the solvency of the pension funds. He noted that in South Dakota, the fund is actually fairly well-funded and solvent and the state has proposed changes and adjustments to the formula linked to the cost of living. In his opinion, South Dakota's PERA has a fairly defensible position, particularly because, in that state, the members will get back to where they were after the fund is solvent. He added that Colorado is in bad shape and has suspended the COLA for fiscal year 2010. He said that the courts will not look kindly on the suspension unless Colorado can prove it is an absolute necessity. According to Mr. Bulman, Minnesota has numerous plans, and the teachers' plan is in the worst shape. The teachers have a two-year suspension of the COLA, which is a very drastic move, and the courts will likely uphold it only if the plan is clearly headed for insolvency. In summation, the key analysis point is the link to solvency. He added that New Mexico's legal team at the PERA is keeping abreast on these current cases and their outcomes.

With regard to the contract theory and its possible applicability in New Mexico, Mr. Bulman said that, in his opinion, the contract theory is not off the table. The state offered the 3% employee contribution increase in exchange for the improved benefits, and the members voted and accepted it. He noted that he had voted in favor of the 3% contribution increase. Mr. Schatzman then said that it is his personal belief that the court will not use the contract theory. However, it could still reach the same result based on a different legal theory.

The discussion continued focusing on the realm of possibilities if changes are made to PERA members' benefits, whether employees are non-vested or vested. Additional discussion regarding changing the COLA continued as well. It was noted that actuarial soundness is not defined in New Mexico law, and courts have handled the definition of actuarial soundness differently. Generally speaking, courts have held that a retirement program must be able to meet its "continual obligations".

Mary Frederick, deputy director for the PERA, next spoke to the task force. Ms. Frederick focused on giving the members a background and history of double dipping in New Mexico. She stated that prior to 2004, there was no such thing as double dipping for PERA employees. A PERA employee could retire and come back to work as long as the employee did not earn more than $15,000 annually. In 2004, the legislature passed the double dipping bill.

Ms. Frederick explained that Senate Bill 207 from 2010 allows retirees who were reemployed by PERA affiliates before July 1, 2010 to be grandfathered in and to continue double dipping, receiving both a pension and a salary. Effective July 1, 2010, newly reemployed retirees must begin paying the employee contribution portion of their salary. The PERA affiliate will continue to pay the employer contribution amount on behalf of the employee. Employee contributions made during reemployment are non-refundable and stay in the PERA funds. The only PERA retirees who are excluded from PERA membership as of July 1, 2010 are elected officials and legislative workers during the legislative sessions. Retirees who are reemployed by PERA affiliates before July 1, 2010 will be grandfathered in under the law in place when they are reemployed. Those reemployed retirees will continue to receive both a pension and a salary.

Ms. Frederick talked about implementing an earnings cap for PERA retirees returning to work for PERA affiliates as an alternative to the flat ban on double dipping. She noted that an earnings cap could be modest and in no way comparable to a second income. It could allow state and local governments to hire employees for seasonal or temporary positions from a pool of experienced employees. She added that allowing retirees to return to work with a $25,000 annual limitation would have no actuarial impact on the PERA fund. She added that no special interest group would be favored by limited options for retirees to return to work and assist state and local governments. The only restriction is the employee cannot earn more than $25,000 in a calendar year.

Ms. Frederick pointed to a handout she supplied to the members that outlines normal retirements, including the average age and average service for the New Mexico PERA. She thought the members would be interested in learning that the average retirement age under each of the plans is actually not very young. For example, in the state General Plan One, the average retirement age is 54 years and the average service credit for that group is 21 years.

Prior to adjournment, the members were directed to the National Association of State Retirement Administrators brief regarding public pension plan investment return assumptions. It was noted that the brief focuses on the issue of investment return assumptions used by public pension plans that have been the focus of increased attention recently. The brief explains the role those assumptions play in pension finance and how it is developed and compares the assumptions with public funds actual experience.

With no more task force business, Representative Stewart adjourned the meeting at 3:40 p.m.