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

October 12-13, 2010
Room 307, State Capitol
Santa Fe

The fifth meeting of the Retirement Systems Solvency Task Force (RSSTF) was called to order by Representative Mimi Stewart, co-chair, on October 12, 2010 at 9:06 a.m.

Present
Rep. Mimi Stewart, Co-Chair
Mr. Tito Chavez, Co-Chair
Mr. Diego Arencon
Mr. Oscar Arevalo
Mr. Charles Bowyer
Mr. Bill Fulginiti
Mr. H. Russell Goff
Ms. Jan Goodwin
Sen. Phil A. Griego
Mr. David Heshley
Ms. Alexis Lotero
Mr. Andrew Padilla (October 12)
Mr. Wayne Propst (October 12)
Mr. Terry Slattery
Sen. John Arthur Smith
Rep. Thomas C. Taylor (October 13)
Mr. Jeff Varela
Rep. Luciano "Lucky" Varela

Absent
Sen. Pete Campos
Rep. John A. Heaton
Ms. Emily Kane
Ms. Michelle Lewis
Sen. Steven P. Neville
Mr. Ronald Sanchez
Ms. Christine Trujillo

(Attendance dates are noted for members not present for the entire meeting.)

Staff
Raúl E. Burciaga, Director, Legislative Council Service (LCS)
Tom Pollard, LCS
Doris Faust, LCS
Claudia Armijo, LCS
Michelle Aubell, Legislative Finance Committee (LFC)

Guests
The guest list is located in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

<u>Tuesday, October 12</u>

Educational Retirement Board (ERB) Solvency Proposals

Ms. Goodwin, executive director for the ERB, provided a summary of the current status of the Educational Retirement Fund, saying that as of June 30, 2010, the fund had $8.2 billion. She said the unfunded actuarial accrued liability was $5.2 billion, the funding ratio is 64.2% and the projected funding period is 67 years.

Ms. Goodwin reminded the members that certain aspects of the Educational Retirement Fund have significant effects on the fund, including:

1) the multiplier;

2) the age for unreduced benefits;

3) changes in an employee's final average salary;

4) increased contribution rates, achieved by lengthening the contribution period, converting to base pay only and eliminating sick, vacation and terminal pay; and

5) elimination or suspension of the cost-of-living adjustment (COLA).

She next discussed that the changes to certain aspects of the plan have little effect on the fund, including:

1) establishing COLA banks;

2) altering vesting periods;

3) anti-spiking provisions;

4) altering an employee's final average earnings period;

5) eliminating terminal pay from the pension earnings;

6) incentives; and

7) decreasing the interest crediting on member contributions.

Ms. Goodwin told the task force members that, if the ability to pay its benefits to members is the standard, the ERB is not insolvent because it can make those payments for many years. She added that the ERB board has set funding standard goals to include an actuarially required contribution rate of 22.95%, which is greater than the current annual contribution rate of 20.30%. Ms. Goodwin indicated that if this contribution rate is met, the funding ratio should reach 80% in 30 years.

Ms. Goodwin continued, saying the ERB would like to ensure long-term sustainability of the plan by meeting funding standards within a short time frame. The guiding principles that should be behind all changes are:

1) intergenerational equity relating to benefits and contributions for all employees, both current and new hires;

2) a commitment to the 2005 contribution rate changes; and

3) a plan that keeps New Mexico competitive in its ability to hire and retain the best employees for K-12 and higher education.

On the issue of comparing New Mexico's ERB plan to similar plans in other states, Ms. Goodwin opined that the plan is similar to most other states and noted that the ERB multiplier is not high when compared to others.

Ms. Goodwin explained that the ERB met with its actuaries earlier in October. At that meeting, the ERB determined it needed additional information prior to making final recommendations. Ms. Goodwin said that when the final recommendations are available, they will be provided to the task force. Some of the preliminary proposals made by the ERB include:

1) employers' contribution rate of 13.90%;

2) possible changes to employee contribution rates, ranging from 8.65% to 9.40%;

3) changing the future service multiplier for all employees, both current and new hires, ranging from 2.23% to 2.35%;

4) multiplier backfill provisions, depending on the status of the funding;

5) a possible minimum retirement age, ranging from 55 to 60 years; and

6) changing the number of years from which to calculate the final average salary, ranging from five to seven years.

Ms. Goodwin closed her presentation by saying that the ERB board is considering a few more factors, including:

1) adjusting the multiplier in a manner to encourage early retirement, encourage retention or reduce benefits for new members;

2) implementing a mandatory retirement age of 50, 55, 60 or 65;

3) increasing the vesting period to seven, eight, nine or 10 years; and

4) implementing varying contribution rates tied to the COLA waiver.

Prior to making final changes, the ERB would like to get input from its members. Again, Ms. Goodwin noted that the actuaries are reviewing various proposals, and the ERB will meet on October 22 to make its final recommendations.

There was a discussion about the timing of the ERB's recommendations and the input to be solicited from the ERB membership. Task force members expressed concern that agreement by members and recommendations by the ERB may not be available in time for legislation to be introduced at the upcoming legislative session. Some members advised that the legislature may have to act, regardless of receiving timely recommendations from the ERB. Some members asked what the ERB is considering, and Ms. Goodwin noted that the actuaries will be providing an analysis of all proposed changes, and the ERB will be reviewing the analysis.

Retiree Health Care Authority (RHCA) Plans to Address Solvency

Mr. Propst, executive director for the RHCA, began his presentation by referring members to a copy of a letter dated September 27, 2010, addressed to the task force co-chairs. Mr. Propst noted that, as the result of legislation, a work group was formed to study retiree health care. In December 2007, the work group made recommendations, and the RHCA has since acted upon those recommendations. Some of the steps taken by the RHCA are:

1) increasing health insurance premiums in accordance with market trends;

2) adjusting premium subsidy percentages;

3) adding cost-sharing requirements; and

4) increasing contribution levels from the Tax Administration Suspense Fund (TASF), as well as from active employees and employers.

According to Mr. Propst, the latest projections indicate that the RHCA will be solvent until calendar year 2026. In spite of improvements, the RHCA is faced with deficit spending as early as FY 2017. Consequently, the RHCA is seeking an increase in the funding it receives from the TASF to $7 million annually. According to Mr. Propst, the increased funding would add three years of solvency to the Retiree Health Care Fund.

Mr. Propst advised the members that the RHCA has already eliminated three costly pre-Medicare plans, replacing them with two plans. The board increased premiums 8% effective on January 1, 2011. As a consequence, the projected solvency of the fund has been extended to 2026.

Mr. Propst told the members that the RHCA board has exercised control over the levels of benefits provided, but it does not control the employee and employer contribution rates. Although the legislature has made changes to the contribution rates, Mr. Propst estimates that the RHCA will once again seek an increase in contributions in about five years.

Next, Mr. Propst mentioned that the RHCA would seek legislation similar to that proposed during the last session to create an interagency benefits advisory council to purchase services jointly. There was a brief discussion about why the state entities jointly bid for services, such as prescription drugs, but do not jointly purchase. Some members said that the boards do not all agree or support the proposed joint administration but would support certain components of the proposed legislation. Some members expressed concern that the proposed legislation is too expansive when dealing with the four separate entities.

There was a discussion about the possible changes and the need to keep retirees informed in advance. Some task force members noted that they get calls from constituents who are concerned over potential changes in benefits or premiums.

When asked what the RHCA covers, Mr. Propst said it covers 300 entities, including all public and charter schools and all major cities and counties in the state. He added that the largest entities not covered are the University of New Mexico and New Mexico State University.

The RHCA receives its funding through the TASF, which is the fund to which tax revenues are deposited and from which all tax revenues flow before being appropriated by the legislature. Ms. Goodwin added that there are about 20 state entities that are recipients of the TASF.

There was next a general discussion about ideas the different boards have considered for reducing the overall costs of health care. Mr. Propst said that the RHCA board has talked about incentives for positive behavioral changes, such as higher premiums for smokers. It was noted that Albuquerque Public Schools (APS) has implemented a biometric screening requirement for all employees and their spouses. Those screenings can indicate risks such as high cholesterol. Mr. Propst noted that the RHCA board has already implemented health and wellness programs for persons under the age of 65. Persons who attend the programs receive free health screenings.

A number of task force members praised Mr. Propst for his dedication, leadership and diligent work on behalf of the RHCA.

Judicial Retirement Fund and Magistrate Retirement Fund Solvency Recommendations

Arthur W. Pepin, director of the Administrative Office of the Courts (AOC), and Mr. Arevalo, fiscal services director for the AOC, next addressed the task force.

Referring to a letter addressed to the RSSTF, Mr. Pepin explained that data relating to the judicial retirement funds, which include the Judicial Retirement Account (JRA) and the Magistrate Retirement Account (MRA), reveal serious issues challenging those funds. The judiciary proposes an incremental plan that begins by asking the legislature to address in the

2011 legislative session the most serious issue facing the retirement funds, which is the reliance on docket fees. He noted that other issues can be addressed in future sessions once the problem of docket fees has been resolved.

Mr. Pepin explained that in FY 2008, judges' contributions to the JRA and MRA were at 7.5% of salary, while the state paid from the general fund 11% to the MRA and 12% to the JRA, and docket fees contributed 17.92% of salary to the MRA and 19.39% of salary to the JRA. According to the Public Employees Retirement Association's (PERA's) analysis of June 30, 2008, the total funding required for full funding was 45.87% in the JRA and 40.25% in the MRA. Thus, in FY 2008, contributions from the docket fees and general fund totaled 28.9% in the MRA (11 + 17.92) and 31.39% in the JRA (12 + 19.39). After adding in the judges' 7.5%, the total funding as a percentage of salary in FY 2008 was 36.42% in the MRA and 38.89% in the JRA. The result was a funding shortfall in the MRA of 3.83% and in the JRA of 6.98%. However, the docket fees are static, so the percentage contributed by the docket fees varies from year to year depending on case filings, and the dollar amount decreases as a percentage of salaries any time there is a salary increase.

The PERA Actuarial Evaluation Report for FY 2009 shows that judges' contributions to the JRA and MRA were 9.0% of salary, while the state paid from the general fund 10.5% to the JRA and 9.5% to the MRA, and docket fees contributed 18.16% of salary to the JRA and 14.17% of salary to the MRA. Thus, the total actual funding in FY 2009 was 37.66% in the JRA (9.0 + 10.5 + 18.16) and 32.67% in the MRA (9.0 + 9.5 + 14.17). According to the PERA's analysis, the total funding required for full funding in FY 2009 was 53.49% in the JRA and 55.30% in the MRA. This means that contributions from the docket fees and general fund in FY 2009 resulted in a funding shortfall in the JRA of 15.83% and in the MRA of 22.63%.

As these figures show, the deficit in both funds varies from year to year, but there is a recurring deficit that threatens the solvency of the funds over time. As long as the funding stream for these retirement funds relies on docket fees, the contributions will not meet the funding requirement. The FY 2009 "funded ratio" is only 60.5% in the JRA and 66.3% in the MRA. In November 2010, figures for FY 2010 showing contributions from the docket fees and other data on the JRA and the MRA should be available from the PERA.

The PERA Actuarial Evaluation for FY 2009 reiterates, as have the annual reports for many years, that the most significant risk to the JRA and the MRA is the use of docket fees as a funding source. Instead, all contributions should be related to payroll. The PERA's June 30, 2009 executive summary of its annual report states: "Historically, there has been a poor correlation between docket fee revenue and judicial payroll" and the PERA recommends "that all employer contributions be related to payroll". The PERA recommends that serious action be taken to mitigate these funds' deficiencies within the next couple of years.

In order to address solvency issues, Mr. Pepin recommended moving docket fees from retirement funding to the general fund. He explained that severing the link between docket fees and these funds is paramount to the long-term health of the funds. For this reason, the judiciary supports legislation that would direct the docket fees to the general fund and eliminate any tie between the docket fees and the JRA or the MRA. This can be accomplished in FY 2012 at no cost to the general fund if the general fund pays as a percentage of salary the same percentage that was contributed by fees in FY 2010. The data substantiating this assertion will be available from the PERA in November 2010. Mr. Pepin offered an example, saying that for FY 2009, the combined contributions from the general fund and docket fees were 28.66% to the JRA (10.5% now paid by the employer plus the docket fee contribution of 18.16%) and 23.67% to the MRA (9.5% now paid by the employer plus the 14.17% docket fee contribution). Although this would leave in place the other factors about which the PERA has expressed concerns, it would solve the issue that is most important to address first. There are several reasons to make this action the priority for the 2011 legislative session, including:

1) the "paramount" threat to the health of the funds would be eliminated;

2) addressing this paramount threat has no cost to the general fund in FY 2012;

3) this action will accomplish objective ll (4) of the New Mexico Judiciary Long-Range Strategic Plan 2008-2013: "legislation that will ensure actuarial soundness of the judicial and magistrate retirement plans, specifically eliminating dependency on docket fees as a source of funding of each plan"; and

4) once the reliance on the fluctuating docket fees is eliminated, the PERA can assess the actuarial status of the funds from a much more certain perspective and will be able to identify what level of total contributions, as a percentage of salary, will make the funds sound. The legislature can then determine appropriate contributions from either the employee or employer, or both, to ensure the funds are sound.

Mr. Pepin opined that for all of the reasons indicated, the most important "first step" that the legislature can take toward addressing the critical issues threatening judicial retirement funds would be to amend the applicable statutes to sever the tie between docket fees and the retirement funds. Once that is accomplished, other funding issues can be addressed.

Members voiced concerns over the proposed changes and the inability to fully understand what the costs associated with those changes would be. Because the amount of docket fees received in any fiscal year is not a fixed amount, there is no way to project accurately how much money would go into the general fund. Members generally thought that more information is required prior to passing the proposed legislation. However, members also generally agreed that the current system of funding the judicial retirement accounts with the funds from docket fees is not workable and puts the retirement funds' solvency in jeopardy.

Report on Audits of Actuarial Valuations of the PERA and the ERB, the Experience Studies and the PERA Ideal Plan

David Slishinsky, principal and consulting actuary for Buck Consultants, and Michelle DeLange, director and retirement actuary for Buck Consultants, addressed the members regarding the review and evaluations of the PERA and the ERB.

Mr. Slishinsky started by explaining the overall purpose of conducting the review, which was to present the task force members with another actuary's opinion regarding the actuarial soundness of the PERA and the ERB. Additionally, the review offers analysis of whether the original actuarial calculations are accurate and meet the standards of practice and offers ideas of ways to improve and exercise the fiduciary obligation of completing an independent review of the plans every four to five years. He noted that the scope of the review includes:

1) reviewing the work of the PERA and the ERB actuaries, Gabriel Roeder Smith & Company (GRS). The pensions systems reviewed include the magistrate, judicial and volunteer firefighters;

2) reviewing membership data;

3) reviewing sample member calculations;

4) reviewing sample benefit calculations;

5) reviewing recent experience analysis;

6) reviewing actuarial valuation results;

7) assessing completeness and validity of membership;

8) opinions regarding reasonableness of actuarial assumptions, methods and procedures;

9) determining whether valuation procedures are technically sound;

10) determining whether generally accepted actuarial standards are being followed;

11) reviewing actuaries' reports; and

12) reviewing experience analysis reports.

Mr. Slishinsky advised the members regarding the principal findings of the actuarial review. He said the consultants noted that there are a large number of records that, although reported by the PERA, are not included in GRS's valuation. He said that missing or incomplete data are not uncommon when reviewing data from large systems. In addition, he considers the missing or unreasonable data rates moderate for most of the PERA plans and moderate for the ERB plan. He went on to recommend that the PERA and the ERB include the following data in further valuations:

1) dates of hire and termination;

2) termination reason codes, including status as vested or non-vested, and reduced or unreduced retirement;

3) a separate field showing the amount of the benefit for the joint and survivor options; and

4) remaining contribution balances for the calculation of modified cash refund benefits.

Next, Mr. Slishinsky spoke regarding the asset smoothing analysis for the PERA plan. He noted that the PERA uses a four-year smoothing period. He said that according to the National Association of State Retirement Administrators (NASRA) Public Fund Survey, 57% of plans use a five-year smoothing period, while 17% of plans use a four-year smoothing period. He said that the PERA may want to consider using a five-year smoothing period, noting that more than 40% of the PERA's recent investment losses are not yet recognized in the actuary valuation of assets because of the smoothing period used.

Mr. Slishinsky advised that the ERB currently uses a five-year smoothing period but recommends adopting a 20% corridor, which would increase the unfunded liability by $830 million. He added that more than 30% of the ERB's recent investment losses are not yet recognized in the current actuary valuation of assets.

Mr. Slishinsky noted that the consultants reviewed the actuarial cost methods of both plans. They recommended that, for the ERB plan, GRS use the conventional Individual Entry Age Normal Method, which is the same method used by the PERA.

After completing the remaining areas of review of the PERA and the ERB plans, Mr. Slishinsky and Ms. DeLange concluded that:

1) the demographic assumptions are generally reasonable and reflect system experience, with some instances recommending further review;

2) Buck Consultants recommends that both the PERA and the ERB review economic assumptions as a consequence of the recent economic crisis, the extent of economic recovery and lower inflation and investment returns expectations;

3) the asset valuation method is appropriate for the ERB, properly applied and reasonable;

4) Buck Consultants recommends a change to the actuarial asset value (AVA) method for the PERA so that it converges to market asset value (MVA) sooner. Also, the PERA could consider removing the corridor for judicial and magistrate plans if the AVA method is adopted;

5) for the plans without a corridor, actuarial value of assets is between 32% and 43% more than the MVA; the plans should be aware of the difference between the MVA and the AVA and the short-term impact on the funded status, funding periods and actuarial contribution rates of the plans;

6) Buck Consultants recommends that GRS use the conventional Entry Age Normal Method for the ERB; and

7) Buck Consultants' review of the PERA plan is not complete, and the consultants are waiting for the test case information.

Mr. Slishinsky next addressed the issue of defining solvency. He advised that there are different approaches that can be used to get a quantitative view of solvency. One approach is to meet a 30-year amortization objective in accordance with the Governmental Accounting Standards Board (GASB) standards. He added that if the 30-year employer contribution rates are always made, the fund will always have enough money to pay the benefits.

Another approach is to project the market value balances using expected contributions, investment return and benefit payments. Using this method, the system is "insolvent" if assets are fully depleted during the projection period.

Mr. Slishinsky next directed the members' attention to the handout that contains graphs illustrating the PERA and the ERB projections of market values and a projection of the ratio of market value of assets to benefit payments. In both cases, the projected assets are not growing as fast as the benefit payments.

There was a discussion about the recommendations and who would receive them in their final form. Ms. DeLange said that the recommendations would be given to the PERA and the ERB for use by the actuaries, and she added that copies could be supplied to the task force as well. Some members asked why the consultants had recommended a longer asset smoothing period. Mr. Slishinsky explained that a longer period moves the funds' asset valuation further from the market valuation of assets.

When discussion continued, Mr. Slishinsky opined that the single most important decision the respective pension plan boards can make is to determine their risk tolerance. All of their investment decisions, and other plan-related decisions, will flow from the level of tolerable risk.

After additional questions and discussion, with no further business, the meeting recessed at 3:40 p.m.

<u>Wednesday, October 13</u>

The meeting was reconvened by Representative Stewart at 9:15 a.m. She reminded the members that the meeting was being audio webcast.

Referring to a handout that looks similar to a dollar bill, Mr. Slattery, executive director for the PERA, explained its significance. He said it illustrates the PERA's funding for every $1.00. He said $.69 of every $1.00 in the fund is from investments, $.19 represents employer contributions and $.12 represents employee contributions.

Gerri Madrid-Davis, executive director for the National Public Pension Coalition (NPPC), addressed the task force. She thanked the members for the opportunity to speak. She clarified before speaking that her remarks represent her personal viewpoint and are not a sanctioned viewpoint of the NPPC.

Ms. Madrid-Davis gave a brief overview of the work of the NPPC and mentioned some of its working partners, including the AFL-CIO and the National Education Association. She told the members that the NPPC supports the continuation of defined benefit plans. She opined that defined benefit plans are the foundation of a secure retirement. She noted that, in its defense of defined benefit plans, the NPPC:

1) tracks state and local plan design changes;

2) supports strategic assessments and state coalitions;

3) develops and disseminates messaging; and

4) synthesizes and distributes research to inform state and local policy discussions.

In explaining the NPPC's support of defined benefit plans, Ms. Madrid-Davis noted attributes of the plans, including:

1) shared responsibility;

2) age-proof retirement income;

3) pooled investment and longevity risks;

4) protections against inflationary risks;

5) death and disability components are built in;

6) the plans are processionally managed with lower fees and better returns;

7) local and state economic supports;

8) the funds hedge against elderly poverty;

9) the funds aid in recruitment, retention and orderly retirement; and

10) the funds can be enhanced by supplemental plans, such as supplemental defined contribution plans.

Ms. Madrid-Davis told the members that attacks on defined benefit plans have escalated in recent years, particularly in light of their recent poor performance in the stock market. She noted that there has been a broader attack on government and public employees. She mentioned that there has been interest in some sort of federal oversight. She also noted the irony that Wall Street hands out huge million dollar bonuses after the bailout, yet there is a heightened focus on public pension plans whose recipients receive an average of between $20,000 and $30,000 a year.

In concluding her presentation, Ms. Madrid-Davis said that the alternatives to a well-designed defined benefits plan are inadequate. She cited:

1) growing retirement insecurity;

2) the nation's $6.6 trillion retirement income deficit;

3) that the use of defined contribution plans as primary retirement "plans" is a failure in its current form;

4) that governments are not corporations and must provide a safety net for the uninsured and under-insured; one-third of retirees rely solely on social security and 50% rely on social security payments for at least half of their income; and

5) that governments remain the laboratories of democracy; only one in five persons in private sector employment has access to a defined benefit plan.

Prior to her closing remarks, Ms. Madrid-Davis complimented the task force members on their work and foresight related to New Mexico's retirement plans. She advised them that they have time to make informed, responsible decisions, and she encouraged them to re-embrace the current system to maintain sustainability.

There was a discussion regarding the news articles all over the country pertaining to the solvency of state pension funds. Ms. Madrid-Davis said that the newspapers have sensationalized the issue and that the real problems have been the failures to fund the actuarial values in a timely fashion. She added that the majority of the news attention tends to focus on the states that are not doing well with regard to their pension plans and funding. She advised that states, municipalities and localities must understand that they cannot "get out" of their pension obligations.

Review and Discussion of Task Force Recommendations for Retirement Systems Solvency

Representative Stewart asked Ms. Faust, assistant director of drafting services for the LCS, to lead the members in a discussion regarding the various ideas task force members emailed to the LCS over the past few weeks. The ideas were organized by topic and compiled in a document by the LCS. A copy of the proposed ideas was handed out for the members' reference during the discussion. Among the proposed ideas were definitions of "solvency". Members discussed the proposed definitions. Some preferred definition #5, which included meeting obligations when they come due and reaching a funded ratio of 80% within the GASB suggested 30-year time frame.

Other proposed ideas included recommendations to the PERA and the ERB plans. The proposals ranged from no support for any changes to either plan to a qualified agreement with the proposed change already in development by both the PERA and the ERB boards.

Members discussed possible outcomes that might happen if changes to the plans are made. There was a discussion about pending litigation in other states and the prospect of similar litigation in New Mexico.

There was another discussion regarding the expertise and qualifications that should be required for board members of all plans. Members talked about the pros and cons of requiring certain expertise. Continued education requirements were also discussed as a positive requirement.

Some members discussed the value of incentives for longer retirement and other retention strategies. Members inquired as to whether the Investments Oversight Committee (IOC) could take up the retirement systems solvency issues because the task force is ending its work in the next couple of months. Mr. Burciaga, director for the LCS, said that the IOC is created annually by the New Mexico Legislative Council and as such, it would be up to the council to create the IOC again and assign it the oversight duties.

Representative Stewart asked the staff to draft bills for both the ERB and the PERA "ideal plans" for the task force members to review and discuss. Mr. Slishinsky suggested that the PERA and the ERB actuaries run the numbers on the ideal plans. He added that Buck Consultants could offer some input.

Representative Stewart also asked staff to draft a bill to increase employer funding for the ERB from the current 10.9% to 13.9% over six years, a bill to change the source of judicial and magistrate judge retirement funding from docket fees to the general fund and a bill to allow return to work for retirees for up to $15,000 before the double-dipping prohibition takes effect. Task force members agreed to those five bill requests.

With no further business, the meeting was adjourned at 12:10 p.m.