MINUTES
of the
THIRD MEETING
of the
STATE PERMANENT FUND TASK FORCE

August 3-4, 2005
NMSU Regents Board Room
Las Cruces

The third meeting of the State Permanent Fund Task Force for the 2005 interim was called to order by Representative John A. Heaton, chair, on Wednesday, August 3, 2005, at 10:10 a.m. at the New Mexico State University (NMSU) Regents Board Room in Las Cruces.

Present	**Absent**
Rep. John A. Heaton, Chair	Gary Bland, SIC
Sen. John Arthur Smith, Vice Chair	Sen. Pete Campos
Frank Foy, Education Retirement Board (ERB)	Sen. Joseph J. Carraro
Robert Gish, Public Employees Retirement Association (PERA)	Rep. Justine Fox-Young
Robert Jacksha, State Investment Council (SIC)	Sen. Phil A. Griego
Sen. Carroll H. Leavell	Rep. Larry A. Larranaga
Rep. Henry Kiki Saavedra	
Scott Stovall, State Board of Finance	
Rep. Luciano "Lucky" Varela	
Advisory Members	
Rep. Donald E. Bratton	Sen. Carlos R. Cisneros
Rep. Joe M Stell	Sen. Joseph A. Fidel
	Rep. Miguel P. Garcia
	Sen. Stuart Ingle
	Rep. Kathy A. McCoy
	Sen. Leonard Lee Rawson
	Sen. H. Diane Snyder

Staff
David Abbey, Legislative Finance Committee (LFC)
Greg Geisler, LFC
Cleo Griffith, Legislative Council Service (LCS)
Larry Matlock, LCS
Doug Williams, LCS

Guests
The guest list is in the meeting file.

Wednesday, August 3

NMSU President Michael Martin offered opening remarks and welcomed the task force.

Representative Heaton asked what universities are doing to meet the need for engineering and science graduates because foreign students cannot get visas; the president said that recruitment efforts would be intensified and programs designed to better prepare graduates for the workforce.

History of Severance Tax Collections and Current Forecast

Mr. Williams made a presentation concerning the history of severance tax bonds and the current status of the Severance Tax Permanent Fund (see attachments). Representative Varela requested the statutory citation for the sweep ($85 million).

Senator Smith requested that union and other association representatives attend the September meeting with respect to retirement funds.

Hypothetical Impact of Additional Deposits to the Permanent Fund

Mr. Jacksha made a presentation outlining the potential impact on the Severance Tax Permanent Fund with annual revenue deposits greater than those currently forecast. The following table is an example of the impact at various revenue levels.

Calendar Year Ending 12/31	Difference in Market Value with Added Annual Contribution of:		
	$10 Million	$20 Million	$50 Million
2006	10,000,000	20,000,000	50,000,000
2007	20,773,000	41,546,000	103,865,000
2008	32,284,753	64,569,506	161,423,764
2009	44,491,098	88,982,196	222,455,490
2010	57,337,517	114,675,034	286,687,586
2011	70,758,748	141,517,496	353,793,740
2012	84,725,467	169,450,935	423,627,337
2013	99,251,315	198,502,630	496,256,575
2014	114,352,963	228,705,925	571,764,813
2015	130,049,852	260,099,704	650,249,259
2016	146,363,787	292,727,575	731,818,936
2017	163,318,374	326,636,747	816,591,868
2018	180,938,506	361,877,012	904,692,529
2019	199,250,172	398,500,345	996,250,862
2020	218,280,449	436,560,898	1,091,402,245

Mr. Jacksha presented the procurement policy adopted by the SIC board of directors. He noted that several changes were made in response to comments from the task force and the SIC board. Mr. Foy and Mr. Gish indicated that they would be seeking approval of their procurement policies at their next respective board meetings. The chair requested the ERB and PERA to return to the task force to explain any differences from SIC procurement policies.

When asked about the compensation typically awarded fund managers, Mr. Foy said they are paid a flat fee of 25 basis points times the value of assets under management. In this way, fund managers are rewarded when assets under management grow and are penalized if they do not.

Review of General Consultant Quarterly Reports

Ruthann Moomy, senior vice president with Callan Associates, made a presentation of the quarterly report prepared by Callan Associates for PERA. She noted that one measure of risk is volatility, as measured by standard deviation. Callan measures "manager effect" and "asset allocation effect" when reporting performance vs. benchmark.

Mr. Gish spoke about the use of the Callan report in terms of underperforming investment managers and the use of "watch lists".

Review of LFC Quarterly Report

Mr. Geisler made a presentation concerning the LFC quarterly report on ERB, PERA, and SIC investment performance.

The chair asked about having one common benchmark for all of the investment agencies. Mr. Geisler noted that the LFC currently reports such a benchmark made up of 60 percent stock plus 40 percent bonds as if they are not actively managed, but simply indexed.

The chair asked the fund managers what deficiencies exist in the LFC report. Mr. Gish indicated that the LFC report is the best available snapshot. Mr. Foy agreed.

The chair indicated that the investment aspect of reporting seems adequate; what is needed is a new report that presents the retirement contributions and benefits impact on the health of the retirement funds.

Representative Varela commented that he does not think the legislature has done enough with respect to actuarial analysis.

<u>Thursday, August 4</u>

Senator Smith called the task force to order at 9:15 a.m.

Review of Current Quarterly Reports Submitted to the LFC and the Department of Finance and Administration

Mr. Foy reviewed the monthly report prepared by the ERB, noting individual fund manager performance and identifying those managers that are currently on the "watch list".

Mr. Stovall asked about asset allocation. Mr. Foy indicated that the board establishes the asset allocation policy.

Senator Smith asked about the composition of the board. Mr. Foy identified the seven members; they consist of public members and gubernatorial appointees.

Mr. Foy said that ERB is preparing a report on defined benefit (DB) and defined contribution (DC) retirement plans pursuant to a memorial passed during the 2005 session. The task force indicated that it wants a presentation on DB vs. DC plans. Also, Senators Smith and Leavell said that similar presentations should be made to the Revenue Stabilization and Tax Policy Committee and the Legislative Education Study Committee (LESC).

Mr. Jacksha reviewed the monthly SIC "flash report". The chair asked about benchmarks, how they are developed and who approves them. The chair would like to see a universal policy with respect to creating benchmarks and reporting performance.

Dominick Garcia reviewed the monthly report prepared by PERA. The report covers overall market performance for the month, PERA investment performance, asset allocations and individual asset class performance.

Mr. Gish reviewed the quarterly report prepared for the LFC and DFA. The report includes detailed performance by asset class and fund manager for quarterly and annual periods up to 15 years, asset allocations by dollar amount and management, consultant, custodial and brokerage fees.

Representative Varela indicated that the duties of the state treasurer and state auditor should be better defined since they are ex-officio members of the retirement boards. Generally, Representative Varela would like to examine the composition of the boards.

Representative Varela asked about the potential impact on the markets of terrorist events. Mr. Foy and Mr. Jacksha said that the London bombings had little, if any, impact on the markets. Mr. Gish said that it would appear that the markets have already discounted for the threat of terrorism.

In response to a question from Mr. Geisler regarding the role of general consultants, Mr. Gish and Mr. Foy indicated that they rely upon their consultants for independent third party performance evaluation, searches for individual fund managers and advice on asset allocation.

Discussion of September Agenda

The theme for the next meeting will be the status of the retirement funds. The task force indicated that the following should be invited to the meeting:

- the secretary of public education;
- the secretary of higher education;
- the director of the LESC;
- the chairs of the House and Senate Education committees; and
- the director of the Retiree Health Care Authority.

Representative Varela would like to review the "return to work" bill.

Representative Bratton would like a discussion of the impact of three-tier teacher licensing on the retirement fund at the next meeting.

Other Business

The task force recommended that the legislature receive quarterly reports describing the investment performance of the retirement funds using benchmarks that ensure the actuarial soundness of the funds.

The task force adjourned at 11:00 a.m.

Chapter/Date	Use of Revenues for Bonds	Types of Bonds	Purpose of Bonds
Ch. 5, 1961	50% of prior year revenues	Severance tax bonds	Projects specifically authorized by the legislature
State Board of Finance policy, 1993	50% of prior year revenues	Short-term severance tax bonds (commonly known as "sponge" bonds)	Maximize use of revenues for bond by "sponging up" revenues not needed for long-term debt payments, up to statutory maximum
Ch. 6, 1999 special session	62.5% of prior year revenues for severance tax bonds and supplemental severance tax bonds with severance tax bonds limited to 50% of prior year revenues	Supplemental severance tax bonds created; these are any bonds over and above those issued as severance tax bonds (commonly called senior bonds)	Authorized $125 million of supplemental severance tax bonds (estimated capacity for next 5 years); $100 million were for public school capital outlay projects through the Public School Capital Outlay Council and $25 million were for higher education projects
Ch. 95, 2000	75% of prior year revenues for severance tax bonds and supplemental tax bonds, of which 62.5% can be used for long-term bonds. Severance tax bonds limited to 50% of prior year revenues	Created short-term supplemental severance tax bonds (commonly known as "sponge" bonds)	Authorized an additional $75 million of supplemental severance tax bonds (estimated additional capacity for next 5 years) for public school capital outlay projects through the Public School Capital Outlay Council
Ch. 11, 2000 special session	Raised total to 87.5% of prior year revenues of which 62.5% could be used for long-term bonds. Severance tax bonds limited to 50% of prior year revenues	Additional short-term supplemental severance tax bonds	Authorized an additional $400 million of supplemental severance tax bonds (estimated additional capacity for next 10 years) for public school capital outlay projects through the Public School Capital Outlay Council

Ch. 338, 2001	No change	No change	Made a permanent authorization for all supplemental severance tax bonds to be used for public school capital outlay projects and funding for the Public School Capital Improvements Act (SB 9)
Ch. 238, 2003	"Sweep" of year-end revenues (one-time authorization for additional bonds "notwithstanding" the statutory limitations)	Additional short-term supplemental severance tax bonds	Up to $40 million for public school deficiency correction projects
Ch. 429, 2003	"Sweep" of year-end revenues (one-time authorization for additional bonds "notwithstanding" the statutory limitations)	Additional short-term supplemental severance tax bonds	Up to $5 million for improvements at the Palace of the Governors and up to $4 million for purchase of a helicopter for the Department of Public Safety
Ch. 125, 2004	Raised total to 95% of prior year revenues of which 62.5% could be used for long-term bonds. Severance tax bonds limited to 50% of prior year revenues	Additional short-term supplemental severance tax bonds	No change - would be used for public school capital outlay projects and funding for the Public School Capital Improvements Act (SB 9)
Ch. 125, 2004	"Sweep" of year-end revenues (one-time authorization for additional bonds "notwithstanding" the statutory limitations)	Additional short-term supplemental severance tax bonds	Up to $57 million for continuation projects partially funded by the Public School Capital Outlay Council in Sept. 2003 and for deficiency correction projects
Ch. 126, 2004	"Sweep" of year-end revenues (one-time authorization for additional bonds "notwithstanding" the statutory limitations)	Additional short-term severance tax bonds and supplemental severance tax bonds	Up to $10 million for statewide human resources, accounting and management project and up to $10 million for public school deficiency correction projects
Ch. 347, 2005	"Sweep" of year-end revenues (one-time authorization for additional bonds "notwithstanding" the statutory limitations)	Additional short-term supplemental severance tax bonds	Up to $62 million for correcting serious roof deficiences and for a roof repair and replacement initiative of public school facilites

Severance Tax Permanent Fund

(Dollars in Millons)

Fiscal Years Ending June 30	Beginning Market Value	New Contributions	Total Return	Less Beneficiary Distributions	Ending Market Value	Net Severance Tax Revenue	% Revenue Deposited to STPF
1991	$1,544.9	$101.7	$149.4	$127.8	$1,668.2	$150.1	67.8%
1992	1,668.2	72.6	241.4	133.9	1,848.3	137.1	53.0%
1993	1,848.3	85.0	219.3	135.5	2,017.1	156.1	54.4%
1994	2,017.1	73.0	13.9	133.9	1,970.1	161.2	45.3%
1995	1,970.1	54.8	289.0	131.3	2,182.6	148.6	36.9%
1996	2,182.6	73.2	248.4	132.1	2,372.1	144.1	50.8%
1997	2,372.1	125.5	358.3	133.6	2,722.3	195.9	64.0%
1998	2,722.3	84.6	634.0	136.3	3,304.6	187.3	45.2%
1999	3,304.6	53.2	511.0	139.0	3,729.8	147.8	36.0%
2000	3,729.8	90.3	494.3	141.8	4,172.6	196.8	45.9%
2001	4,172.6	172.3	-337.9	144.7	3,862.3	356.3	48.4%
2002	3,862.3	32.1	-332.2	159.2	3,403.0	246.0	13.0%
2003	3,403.0	1.0	90.4	171.0	3,323.4	257.2	0.4%
2004	3,323.4	16.3	456.0	172.4	3,623.3	318.9	5.1%
2005 (unaudited)	3,623.3	?	?	?	?	394.0	?
Totals		**$1,035.6**	**$3,035.3**	**$1,992.5**			

Fiscal Year 2005 Consensus Forecast at Start of 2005 Session 362.8

Sources: State Investment Council, State Board of Finance, Taxation and Revenue Department

Analysis by: LCS