MINUTES
of the
FOURTH MEETING
of the
INVESTMENTS OVERSIGHT COMMITTEE

October 9, 2009
Room 307, State Capitol
Santa Fe

The fourth meeting of the Investments Oversight Committee for the 2009 interim was called to order by Representative John A. Heaton, chair, on October 9, 2009 at 9:15 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Rep. John A. Heaton, Chair
Rep. Donald E. Bratton
Sen. Timothy M. Keller
Rep. Larry A. Larranaga
Rep. Henry Kiki Saavedra
Sen. John M. Sapien
Rep. Jim R. Trujillo
Rep. Luciano "Lucky" Varela

Absent
Sen. John Arthur Smith, Vice Chair
Sen. Tim Eichenberg
Sen. Carroll H. Leavell
Sen. Steven P. Neville

Advisory Members
Rep. Andrew J. Barreras
Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales
Sen. Mary Kay Papen
Rep. Jane E. Powdrell-Culbert
Sen. John C. Ryan
Rep. Sheryl Williams Stapleton
Rep. Shirley A. Tyler
Rep. Richard D. Vigil

Rep. Miguel P. Garcia
Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Sen. William H. Payne
Sen. Michael S. Sanchez
Sen. Peter Wirth

Staff
Tom Pollard, Legislative Council Service (LCS)
Doris Faust, LCS

Guests

The guest list is in the original meeting file.

Handouts

Handouts from the meeting are in the original meeting file.

<u>Friday, October 9</u>

New Mexico Educational Retirement Board (ERB) — Recent Investment Performance and Potential Impact of 2010 General Fund Solvency Proposals on the ERB

Leadership of the ERB was brought to the committee on the heels of a report in the *Albuquerque Journal* that detailed how a former top consultant to the ERB admitted recommending making certain investments, although he knew the investments were not necessarily in the best interests of the state. Saul Meyer, a founding partner of Aldus Equity Partners (AEP), was quoted in the article admitting that he recommended certain investments because they would benefit some politically well-connected persons. Mr. Meyer pled guilty, and the firm was fired. Nonetheless, problems remain.

Representative Heaton questioned whether the committee should write the attorney general to note that no one returned calls requesting a report on the attorney general's involvement in the investigation and oversight of the ERB. The committee needs to know what tools it has available to resolve and, potentially, to prosecute these problems.

Jan Goodwin, executive director of the ERB, noted that the United States attorney is already involved and that the ERB is fully cooperating with the investigation and has turned over all materials requested. Discussion turned to the *Foy* lawsuit on behalf of taxpayers against the state for losses from the same series of investments and alleged payoffs. Ms. Goodwin noted that the ERB is not named in the suit, although the suit does name two ERB members. Ms. Goodwin and ERB chief investment officer Bob Jacksha were questioned about the adequacy of the ERB's errors and omissions coverage and were told that the Risk Management Division of the General Services Department can cover ERB members. The board members are also receiving additional training on ethics issues. Ms. Goodwin noted that the ERB is very active in providing regular training to board members.

In other discussion, the chair reminded the committee that the committee has already sent letters asking for documents released in response to subpoenas in the federal lawsuit, but the documents are not available at this time. Ms. Goodwin agreed to give the committee the documents when they are available and remarked that she could "fill this room with documents" if the committee wanted.

Senator Ryan questioned whether the ERB itself was the problem with the investments, but Ms. Goodwin answered that the board's general counsel conducted internal reviews and concluded that there is no internal problem, although no official report has been prepared on the issue. The senator emphasized that the committee needs to get to the root of the problems, at least in part because the committee has the duty to oversee the functions of the ERB. He asked whether the AEP federal litigation has prodded any changes in policy at the ERB, and Mr. Jacksha answered that the ERB is becoming more involved with information on investments and consultants. The chair noted that the committee has heard before about the ERB policies.

Mr. Pollard told the committee that the New Mexico Legislative Council has instituted a review of all investment policies and hired a company to report on December 15 on the practices for all state investment entities.

Mr. Jacksha explained that he started his internal review with a check on private equity investments, noting the number of funds that have done very well, although the ultimate outcome will not be known for a number of years. He explained how equity investments work and answered questions from committee members on the status of equity funds and fees.

Committee members also asked about the ERB lawsuit against Austin Capital and were provided an update on this issue.

The committee went on to discuss the results of the ERB discussions with actuaries about a one- to two-year delay in implementation of the 2005 bill regarding the ERB funding and the impact of that delay. Ms. Goodwin noted that the delay in funding meant a loss of approximately $18 million to the ERB and also reported that the ERB is not so concerned about the delay in funding itself, but is very concerned about the precedent the delay creates.

Representative Varela asked whether the state can recoup the $18 million lost to the general fund now, in the middle of the year. He was answered that the state is now a quarter of the way into the fiscal year, so it already has lost $5 million. David Abbey, director of the Legislative Finance Committee (LFC), agreed that the ERB should roll back 1% and get the money back prospectively. January 1 would be halfway through the fiscal year, so $10 million could be available. The big legal question is whether the ERB can get money back retroactively. To recoup the full $18 million in six to eight months would require a decrease in the employer contribution, in addition to the last year's decrease. The governor has not added the $18 million into the solvency package.

Legislators were still concerned that the ERB has less money to invest due to the funding delay and discussed ways to solve this problem without unfairly changing a negotiated settlement over employee versus employer contribution. Another problem created if teacher salaries are cut is that their pensions will be cut, since the pension is based on a teacher's highest five years of salary. Other committee comments included concerns about sending a poor message by spending one-time money for recurring needs.

New Mexico Retiree Health Care Authority (NMRHCA) — Recent Investment Performance and Potential Impact of 2010 General Fund Solvency Proposals on the NMRHCA

Wayne Propst, executive director of the NMRHCA, reviewed with committee members a handout to update them on "milestones", including the increase of both employer and employee contributions, extended solvency from 2014 to 2028, implementation of cost sharing in the Medicare supplement plan, consolidation of three non-Medicare plans into two plans and improved administration. The NMRHCA is fully staffed for the first time in four years. Mr. Propst projected savings from all the milestones mentioned — $5 million from collapsing three plans into two, $2.8 million from replacing a highly customized Medicare supplement plan with a standard Medigap plan, $500,000 from adding a new carrier and a Medicare Advantage Plan and $1.3 million from changing the prescription plan to decrease copays for generics and increase copays for brand drugs.

Mr. Propst emphasized the policy of the NMRHCA board not to deficit-spend and noted that the board expects a small surplus from fiscal year 2010.

The NMRHCA faces many budget challenges. Removal of an additional $3 million from the tax suspense fund for fiscal years 2010 and 2011would change the authority's projected $1 million surplus to a $2 million deficit. The NMRHCA would have to raise retiree premiums by 48.5% in order to avoid deficit spending in fiscal year 2011 or face a deficit of $31 million if it does not increase the employer and employee contribution as provided in House Bills 351 and 573. Otherwise, it is possible that the NMRHCA could lose two years of solvency for every year the increase is delayed.

Representative Varela asked about solvency and plans to recover $3 million this year. Mr. Propst replied that he is not aware of a mechanism to take back the entire $3 million, but that he would have staff contact the Taxation and Revenue Department on what the real numbers are. Other questions included discussion of oversight of the high-risk pool and the State Investment Council oversight of the authority's investments.

Minutes

Minutes of three committee meetings were unanimously approved upon a motion of Senator Cisneros with a second by Representative Powdrell-Culbert.

Update on Retirement Fund Investment Performance and Basic Determinants of Retirement Fund Stability

Dan White, LFC economist, told the committee that unfunded liabilities in the state's retirement funds have ballooned and increased contributions lie on the horizon. For the state retirement funds that reported actuarial data for 2008, the funded ratio was 77% in 2008, down from 88% for the same plans in 2007. Of all the state retirement systems across the country, 93% have a market value of assets less than pension liabilities — meaning they are underfunded at present.

Michelle Aubel, LFC analyst, told the committee the retirement funds may face declines in long-term solvency. Discussion included reasons for the lag between numbers included in the report and current numbers, the need for a long-term view of return on state retirement investments, alternative investments appropriate for the state's pension plans and whether an expectation of an 8% return on investment is realistic. Senator Sapien said he discussed the possibility of a complete liquidation of New Mexico pension plans as has been done by some private sector companies. Ms. Aubel responded that public pensions are different from private sector plans because the vested property rights of Public Employees Retirement Association (PERA) members are protected.

PERA Presentations: Long-Term Investment Returns and Implications for the Retirement Funds Solvency

Robert Gish, director of investments at the PERA, informed the committee that the PERA funds are outperforming other funds and that it may be premature to "yell fire" now. In previous years, the PERA underreported the funding status and so far, the last seven months have proven that it would be premature to make major changes. Although the PERA is not yet "out of the woods", it is appropriate to look at the long-term prospects for the fund and take action only if necessary.

Representative Varela asked for the PERA fund balances. At the end of September 2009, the balance was $10.7 billion. The PERA holds 0.68% of the fund in cash, or $69 million.

Jim Voytko, co-president of R.V. Kuhns and Associates, presented and discussed a handout on the strategic asset allocation and actuarial demands versus investment risk at the PERA. Mr. Voytko said he would like to convey that pension funding decisions are completely different from other legislative budgetary and fiscal discussions. His handout provided an analysis of asset allocation and a discussion of funding benefits with contributions and investment returns. The PERA's objective is to achieve an average annual return of 8%, and the board uses traditional and nontraditional asset classes and active and passive management.

Discussions for the remainder of the afternoon included: the structure of the PERA board and its training and expertise; discussion of active versus passive management of the funds; and the costs of management fees at the various funds.

Adjournment

There being no further business before the committee, the October meeting of the Investments Oversight Committee was adjourned at 4:10 p.m.