MINUTES
of the
FOURTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

October 13, 2014
Room 307, State Capitol
Santa Fe

The fourth meeting of the Investments and Pensions Oversight Committee for the 2014 interim was called to order by Representative Jim R. Trujillo, chair, on Monday, October 13, 2014, at 10:09 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Rep. Jim R. Trujillo, Chair
Sen. Jacob R. Candelaria
Rep. Larry A. Larrañaga
Sen. Carroll H. Leavell
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Rep. Luciano "Lucky" Varela

Absent
Sen. George K. Munoz, Vice Chair
Sen. Sue Wilson Beffort
Sen. Steven P. Neville
Rep. William "Bill" R. Rehm
Rep. Henry Kiki Saavedra
Sen. William P. Soules

Advisory Members
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Rep. Miguel P. Garcia
Rep. William "Bill" J. Gray
Sen. Stuart Ingle
Rep. Emily Kane
Sen. Timothy M. Keller
Rep. Tim D. Lewis
Sen. William H. Payne
Sen. John C. Ryan
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton

Staff
Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Ric Gaudet, Researcher, LCS
Celia Ludi, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Monday, October 13

Public Employees Retirement Association (PERA) Status Reports and Updates

Wayne Propst, executive director, PERA, and Jonathan Grabel, chief investment officer, PERA, gave an update to the committee on the activities and investment returns of the PERA. The PERA fund balance on June 30, 2014 reached an all-time high of $14.56 billion, and the deferred compensation account had $485 million. The fund returned 17 percent during fiscal year 2014, which amounted to $2.1 billion earned. The PERA fund has a volatility rating of 9.6 percent, below the national median of 10 percent, according to CEM Benchmarking.

Mr. Grabel said that the PERA board recently established a committee to review the structure of all asset categories and is trying to optimize fees in those categories. The committee is expected to issue a report to the board soon. Asset allocation is the driving force behind investment returns, and the PERA periodically reviews its allocation targets. New asset allocation targets include reducing total equity from 60 percent to 53 percent, but with an increase in private equity; increasing fixed income assets from 26 percent to 31 percent; increasing real assets and real estate from six percent to 12 percent; and decreasing hedge fund investments from eight percent to four percent. The decision to reduce hedge fund exposure was made a few months before the announcement that the California public employees retirement system (CalPERS) would eliminate all investment in hedge funds, given financial market prognostications. Mr. Grabel said that the PERA fund, with $14 billion in assets, has much more flexibility than the $300 billion CalPERS fund, and hedge funds continue to play an important role in asset allocation for the PERA fund.

Questions and comments from committee members included the following.

- How did the PERA arrive at the new asset allocation targets? Mr. Grabel said that the targets are based on an iterative modeling exercise in which thousands of scenarios were compared in order to arrive at the most desirable return-versus-volatility scenario. He said that the PERA performs such an asset allocation study at least every three years. The strategy is also predicated on the liquidity needs of the PERA in order to pay for its ongoing retiree pensions. Seventy-six percent of the PERA fund is in somewhat liquid assets, which can be converted to cash in just a few weeks if necessary.

- The municipal firefighters retirement plan is still in poor actuarial shape, and reforms need to be made to that plan. Mr. Propst said that a new actuarial study of all of the plans managed by the PERA will be available in November. He predicted that all of the plans, with the possible exception of the municipal firefighters plan, would show significant increases in their funded ratios.

● The recent pension reforms probably created a retirement spike, especially with employees who wanted to avoid a reduction in the cost-of-living allowance. Mr. Propst said that most members retire when they become eligible to retire, regardless of pension reforms. However, the increase in the maximum retirement benefit from 80 percent to 90 percent of final average salary for most plans should mean that more public employees will work longer before retiring. He cautioned the committee against recommending any new retirement perks for public employees until the recent funded ratio gains are more established.

● Carter Bundy, state political and legislative director of the American Federation of State, County and Municipal Employees (AFSCME), was asked to comment on recent newspaper articles that speculated that political deals with some legislators may have already been made to reverse some of the recent pension reforms. Mr. Bundy said that he has heard that some groups are trying to reverse some of the pension reforms, especially the "double-dipping" restrictions, and want to enact new recruitment and retention perks for certain classes of public employees. The AFSCME does not favor such reversals of pension reforms, and it issued a joint press release with its usual adversary in politics, the Rio Grande Foundation, to oppose such efforts.

Approval of Minutes

The minutes from the September 9, 2014 meeting of the committee were adopted without changes.

Retiree Health Care Authority (RHCA) Status Reports and Updates

Mark Tyndall, executive director, RHCA, gave an update of the activities of the RHCA and discussed proposed legislation with the committee. The RHCA board approved several reforms for implementation in 2015, including increasing all pre-Medicare rates by eight percent and Medicare supplement rates by five percent; reducing the pre-Medicare spousal subsidy by two percent; instituting a minimum age of 55 for most retirees to receive subsidies from the RHCA; increasing the years of service required for most employees to receive the maximum subsidy from 20 to 25 years; and converting the current $6,000 basic life insurance plan to supplemental life insurance and beginning to phase that subsidy out.

The reforms instituted by the RHCA in the past seven years have resulted in an increase in the solvency of the Retiree Health Care Fund by an additional 12 years; a $267 million increase in the fund balance; and a $500 million reduction in unfunded liabilities. However, one major piece of the RHCA reform strategy remains to be implemented: enactment of legislation to increase the employee and employer contributions over a three-year period. This legislation would extend the Retiree Health Care Fund solvency period an additional seven years, to 2040, and would reach a funded ratio of 50 percent. The legislation would increase the employee contribution three-eighths percent over a three-year period and the employer contribution by three-fourths percent. The general fund impact would be an additional $5 million for each year the increase is phased in, for a long-term $15 million general fund impact.

Questions and comments from committee members included the following.

● Does the Martinez Administration support the RHCA proposed legislation? Mr. Tyndall said that he has discussed the proposal with administration officials but it has not yet received an endorsement.

● What real benefit does the RHCA provide, now that the provisions of the federal Patient Protection and Affordable Care Act (ACA) are in effect? Mr. Tyndall said that subsidized RHCA health plans provide more affordable coverage than comparable ACA-based plans. If the RHCA were to be dissolved, more than 20,000 pre-Medicare retirees currently covered by the RHCA would be dumped into the New Mexico Health Insurance Exchange. Besides it being difficult for the exchange to absorb that many insureds, the net result would be that everybody's insurance premiums would increase.

● Can legislators participate in the RHCA plans? Mr. Tyndall said that legislators are eligible, but they do not receive any subsidy in their coverage.

State Investment Council (SIC) Status Reports and Updates

Steven K. Moise, state investment officer, gave an update on the activities of the SIC and discussed proposed legislation with the committee. The SIC has two pieces of proposed legislation that it is seeking to be endorsed by the committee. The first proposal would modernize the enabling statutes for the SIC, including cleaning up dated or inconsistent language; clarifying experience requirements of the council and staff; adding disclosure requirements for prospective council members and staff; removing the Private Equity Investment Advisory Committee from statute; and adding indemnification language for the council, similar to what currently exists for the PERA board and Educational Retirement Board.

The second legislative proposal seeks to remedy the current imbalance of inflows to the Severance Tax Permanent Fund (STPF) by gradually decreasing the amount of severance tax bonds and supplemental severance tax bonds from 95 percent to 87 percent of each year's bonding capacity. The amount of unsold bonds would then be transferred to the STPF. Prior to the establishment of supplemental severance tax bonds issued for school construction as a result of a court decision requiring the state to uniformly provide for the capital outlay needs of school districts, the STPF typically received 50 percent of the bonding capacity each year. Currently, if there is no last-minute legislative "sweep" of the remainder and if the prior year's severance tax receipts are not lower than the current year's receipts, the STPF receives five percent of bonding capacity. The proposed legislation would gradually increase that percentage to 13 percent by uniformly reducing the bonding allotment for school, legislative, tribal, colonias and water infrastructure capital outlay projects. In addition, distributions to the STPF would be ensured each year by limiting total bonding capacity to the lesser of the newly established percentage of severance taxes collected the previous fiscal year and the estimate of the current year's tax revenue.

Evan Land, chief counsel, SIC, gave the committee an update on recovery litigation related to the "pay-to-play" scandal several years ago. Settlements to date with the SIC are approaching $30 million. SIC litigation against various placement agents, individuals and funds is ongoing and will enter a new phase in 2015. Mr. Land said that additional recoveries are likely and that some settlements will require court approval.

Questions and comments from committee members included the following.

● What consultants did the SIC employ in 2007 versus today? Vince Smith, deputy state investment officer, SIC, said that all consultants since 2009 have been replaced, with the exception of Sun Mountain Capital, the SIC's New Mexico private equity consultant. That company was not involved in any way in the misconduct. Mr. Land said that the SIC has a policy in place to never pay any third-party marketing fees or to allow such fees in any business arrangement into which it enters. Mr. Moise said that every consultant and manager that the SIC works with must sign a transparency, disclosure and prohibited practices agreement.

● Would the two former legislators now serving on the SIC still qualify to be members with the addition of language requiring "professional experience" in one of the listed areas of expertise? Mr. Moise said that Leonard Lee Rawson and Tim Jennings would still qualify to serve on the council.

● Staff was instructed to review the benefits versus drawbacks of codifying in statute some of the SIC enabling statute proposals.

Adjournment

There being no further business, the committee adjourned at 12:05 p.m.