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

October 27, 2011
State Capitol
Santa Fe

The fourth meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2011 interim was called to order by Senator George K. Munoz, chair, on Thursday, October 27, 2011, at 9:20 a.m. at the State Capitol in Santa Fe.

Present
Sen. George K. Munoz, Chair
Rep. Henry Kiki Saavedra, Vice Chair
Rep. David L. Doyle
Sen. Timothy M. Keller
Rep. Larry A. Larrañaga
Sen. Mary Kay Papen
Rep. Jim R. Trujillo
Rep. Luciano "Lucky" Varela

Absent
Rep. William "Bill" J. Gray
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Sen. John M. Sapien

Advisory Members
Rep. Donald E. Bratton
Sen. Carlos Cisneros
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Rep. Rhonda S. King
Rep. Patricia A. Lundstrom
Rep. Jane E. Powdrell-Culbert
Rep. William "Bill" R. Rehm
Rep. Sheryl Williams Stapleton
Rep. Mimi Stewart

Sen. Tim Eichenberg
Sen. Stuart Ingle
Sen. William H. Payne
Sen. John C. Ryan
Sen. Michael S. Sanchez
Rep. Shirley A. Tyler
Rep. Richard D. Vigil

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

Guest Legislator
Sen. John Arthur Smith

Guests

The guest list is located in the meeting file.

Handouts

Handouts and written testimony are in the meeting file and posted on the New Mexico Legislature web site.

<u>Thursday, October 27</u>

Senator Munoz welcomed committee members and guests. He reminded members that the meeting was being webcast and then asked them to introduce themselves, which they did. Senator Munoz asked Jan Goodwin, executive director of the Educational Retirement Board (ERB), to make a presentation to the committee.

Progress Report on Development of Retirement Benefits Plan Changes to Ensure ERB Pension Fund Solvency

Ms. Goodwin greeted the committee and explained that the ERB and staff are reviewing dozens of potential plan change scenarios provided by the ERB actuary, Gabriel Roeder Smith & Company (GRS). She explained that at its September 15, 2011 meeting, the ERB board set minimum guidelines for scenarios. The guidelines include the board's goal of the Educational Retirement Fund reaching an 80%, plus or minus 2%, funded ratio within 20 years and reaching a 100%, plus or minus 5%, funded ratio within 30 years. Ms. Goodwin clarified that the only scenarios provided by GRS and considered by the board must include terms that reach the funding ratios as approved by the board.

Next, Ms. Goodwin directed the members' attention to the handout provided by GRS containing several scenarios that meet the guidelines adopted by the board. Ms. Goodwin explained that, at its October meeting, and after adopting the funding ratio guidelines, the board narrowed its review of potential scenarios to six possibilities. Some of the scenarios under consideration would apply to all ERB members, including both retirees and non-retirees, and some scenarios would exclude retirees in the proposed changes. Ms. Goodwin noted that, according to GRS, when the adopted funded ratio goals are applied to the vast array of potential scenarios, only three scenarios that apply changes only to new hires and current nonvested ERB members meet the funding ratio requirements. Consequently, the board has focused its analysis of plans on changes that are not limited to new hires and nonvested members. Additionally, in an effort to minimize the impact of changes to the plan on members set to retire in the near future, the scenarios being considered contain grandfathering periods of either five or 10 years.

Ms. Goodwin told the committee that the ERB currently has 60,000 members, which include all of New Mexico's kindergarten through twelfth grade public school teachers and public education employees, all higher education employees, with a few exceptions, and some state agency employees. She said that the ERB is fully committed to providing a defined benefit plan for its members, noting that a defined contribution plan is a less cost-effective way to provide retirement benefits. She also noted that the management of a defined benefit plan and the expected returns are superior to those of a defined contribution plan.

After describing some of the features of the different scenarios under consideration by the board, Ms. Goodwin explained that the board has been holding public meetings, referred to as the "Listening Tour", in areas throughout the state, and it intends to hold more such meetings. The meetings are designed to gather input from teachers and the public regarding the potential changes to the ERB plan. She also noted that the public, as well as ERB members, can go on the ERB web site and vote for their preference regarding a plan change. She also said that at its November 21, 2011 board meeting, the ERB would determine its final scenario selection and then present the selection to the IPOC at its December 2, 2011 meeting.

Members of the committee expressed serious concerns about members of the general public who are not also ERB members having access to vote on the ERB plan changes. Committee members acknowledged that public comment, although important and useful for the board in its daunting task of reviewing the plan, should somehow be distinguished from the ERB members' votes and that ERB members' input should be prioritized from that of the general public, particularly because the ERB members will be directly affected by any changes to the retirement plan.

Committee members inquired as to how the ERB compares to other states taking the new Governmental Accounting Standards Board (GASB) reporting standards into account for fund reporting purposes. Ms. Goodwin said that even before the anticipated GASB standards take effect, many states have been making changes to their plans, including increasing contribution rates, in an effort to reach a higher funding status. The ERB has increased its employees' contribution rates to 9.9%, which Ms. Goodwin indicated is one of the highest employee contribution rates in the country. It was noted by committee members that if the state had paid its 13.9% contribution rate as mandated by statute, the ERB would be in an entirely different position regarding funding status today. It was further noted that each one-half percent in employer contributions increases amounts to a cost of $14 million to the state's general fund. Members further noted that any increase to the employers' contributions is ultimately a bill on the state's taxpayers.

There was a brief discussion regarding the ERB's targeted investment rate of 7.75% , a rate that was recently adjusted downward from the longstanding 8% target investment rate. Members voiced concerns over the ERB's ability to meet the adjusted rate, particularly in today's economic climate. However, Ms. Goodwin noted that over the long term, which is the preferred method for analyzing the investment returns of a pension plan, the fund has exceeded a return rate of 7.75%. For example, for the 20-year period ending June 30, 2011, the ERB investment returns averaged 8.8%, and for the 25-year period prior to June 30, 2011, the return rate was 8.9%.

State Investment Council (SIC) Proposed Legislation

Steven K. Moise, state investment officer, SIC, addressed the committee. He began by thanking the members for the opportunity to speak and then introduced Charles Wollmann, director of communications, SIC, who Mr. Moise said would lead the discussion later regarding the possible legislative initiatives. Mr. Moise commented that the SIC would make final decisions regarding proposed legislation at its November 2011 meeting. He anticipates that some of the proposals sought by the SIC last year would be revisited.

Next, Mr. Moise talked about the SIC meeting that was held earlier in the week and was attended by several legislators, at which there was a discussion about the state's Severance Tax Permanent Fund (STPF). The discussion focused on the inflow of money into the fund. Two former legislators, Bob Grant and John Bigbee, gave presentations at the SIC meeting. Mr. Moise directed committee members' attention to a handout entitled *NMSIC's Presentation to Investments & Pensions Oversight Committee*, dated October 27, 2011. The handout contains the information presented by Mr. Grant and Mr. Bigbee. The two men contend that New Mexico's STPF is being compromised by a continual diversion of funds for "other purposes". They further contend that, as a consequence of actions by the legislature and the executive between 2002 and 2011, more than $1.33 billion that should have been deposited into the fund was diverted.

Included in the SIC handout is a memorandum to Rick May, secretary of finance and administration, from Stephanie Schardin Clarke, Department of Finance and Administration interim director. The memorandum from Ms. Clarke provides a history of the STPF along with policy considerations concerning severance tax bonding capacity. Also included in the SIC handout is a memorandum to Ms. Clarke from the Sutin, Thayer & Browne law firm. The memorandum provides additional historical information regarding the STPF and the Severance Tax Bonding Act, including an explanation of how the statutory provisions of the act are applied and used, and a section on the "Statutory Issuance Test", which is described as a test applied to the prior year's deposits into the Severance Tax Bonding Fund. The requirement is that senior long-term severance tax bonds may be issued as long as the debt service on all outstanding and new senior bonds in any future year equals 50% or less of the total amount deposited into the Severance Tax Bonding Fund in the previous year.

In closing, Mr. Moise told the members that Representative Larrañaga asked the SIC to develop a long-term plan to increase the corpus of the STPF. He noted that the SIC would be providing the requested information soon. He added that the policy decision regarding possible increases to the fund would ultimately be made by the legislature, saying that it may want to consider making increases to the fund in a gradual manner while considering other capital outlay sources.

Mr. Wollmann proceeded with a discussion regarding the SIC's legislative initiatives for the 2012 session. He told committee members that the SIC would:

1) seek support form the IPOC for a constitutional amendment for the Land Grant Permanent Funds (LGPF) and Water Trust Funds (WTF). He reminded the members that Senator William F. Burt carried Senate Joint Resolution 17 in the 2011 regular session. The joint resolution would increase the standard of care under which the two funds are managed from "ordinary prudence" to a "prudent investor" standard. Additionally, the joint resolution would

increase the SIC's allowable investment in international equity investments from the current 15% to 25%;

2) seek to "clean up" language that currently requires the WTF be "invested as" the LGPF. The SIC asserts that with less than $45 million in the fund, the WTF should not be invested as a mirror of the LGPF. Rather, long-term strategic investments, such as real estate and private equity, with 10-plus-year commitments are more appropriate for the fund. Mr. Wollmann reminded members that Representative Larrañaga previously carried the bill, which, if passed, will require a constitutional amendment;

3) seek "clean-up" language regarding its governing statute, which may include removing the Private Equity Investment Advisory Committee (PEIA). The SIC will continue to review private equity investments, but it would do so through its existing investment committee rather than through the PEIA;

4) ask to remove specific budget restrictions in House Bill 2 relating to how the SIC best deploys its resources. The SIC will seek a flat budget, but it hopes to be able to allocate its budget according to needs for growing the permanent funds as determined by the SIC; and

5) consider options it has with the Small Business Investment Corporation and, as such, may propose legislation regarding that relationship.

There was a discussion regarding the mechanisms that have pulled money out of the STPF. Mr. Wollmann explained that in 1999, severance tax bonding changed. Prior to that time, 50% of bonding funds were put into the STPF and 50% into the Severance Tax Bonding Fund. After 1999, that changed, and, currently, only 5% is placed in the STPF, with the remaining 95% used for bonding, primarily for capital outlay, infrastructure projects and public school facilities. Members discussed the policy questions associated with decisions about the use and direction of funds into the STPF.

Some members also expressed a preference that elected officials be excluded from membership on the SIC.

Members discussed the 20 state beneficiaries of the LGPF, primarily public schools. Some members voiced the opinion that the public would likely not approve a constitutional amendment regarding the SIC's desired changes to the investment standards imposed for the WTF.

A motion was made and seconded and passed without objection to request that a panel, including the SIC and other appropriate representatives, be invited to the IPOC's December 2, 2011 meeting to discuss the impact on the STPF, public school facilities and other capital outlay projects financed with severance tax bonds or proposals to increase the amount of severance tax revenue flowing into the fund.

Prior to recessing for lunch, the members, upon a motion and without objection, approved the minutes from both the July 2011 and August 2011 committee meetings.

Actuarial Valuation Report and Progress Report on Development of Reticent Benefit Plan Changes to Ensure the Public Employees Retirement Association (PERA) Pension Fund Solvency

Kurt Weber, interim executive director for the PERA, along with John Garrett and Jonathan Craven from the PERA's actuarial firm, Cavanaugh Macdonald Consulting, addressed the members regarding the solvency of the PERA funds. Mr. Weber expressed his appreciation for speaking at the meeting. Mr. Garrett began by directing the members' attention to the handout provided for the meeting. He then led a discussion regarding the actuarial process for the valuation of the PERA and similar funds. Mr. Garrett provided information regarding the distinction between "actuarial funding" and "pay-as-you-go" funding, explaining that actuarial funding occurs over the entire lifespan of the plan, while pay-as-you-go funding occurs each year during the plan's life. The basic funding equation consistently applied among pension plans is:

"contributions plus investment income equals benefit payment plus expenses" (C + I = B + E). Provided in the handout are graphs that visually depict these two methods for funding.

In closing, Mr. Garrett advised members of the committee that there are certain things to consider when evaluating the PERA retirement plans, including the four-year smoothing process applied to the fund and how the process affects the valuation. He opined that recent market returns have improved the outlook because most of the 2008 and 2009 investment losses have been offset by market gains in the smoothing process. Mr. Garrett also opined that, absent contribution increases and/or benefit changes, most of the PERA plans will be unable to pay off their respective unfunded actuarial accrued liabilities within the GASB recommended 30-year period.

Members asked for more specifics regarding each of the plans within the PERA and were told that the final version of the valuation would be completed soon and would contain the desired information. Members also inquired as to the impacts of the new GASB reporting standards.

Lastly, members expressed concern with what is viewed as the PERA board's seeming inability to develop and put forth a plan for proposed changes to the PERA plans. Some of the PERA board members present at the meeting expressed frustration with a perception that they are not working on the issue. Board members told the IPOC members that they have been working tirelessly to determine what changes could be implemented to ensure the solvency of the PERA plans.

After a lengthy discussion, the committee requested that the PERA provide its members with accurate information on the solvency challenges facing the retirement fund and that this be done on the PERA's web site as well as in its member newsletter.

Retiree Health Care Authority (RHCA) Plan Design Changes to Ensure Fund Solvency

Wayne Propst, executive director for the RHCA, and Mark Tyndall, RHCA deputy director, spoke to the members. Mr. Propst began by thanking the committee for including the RHCA on its meeting agenda. He said that for the past five years, the authority has felt a sense of urgency regarding its solvency issues. He reminded the members that in 2007, the RHCA was projected to be insolvent in 2014. He noted that the projection got a lot of attention, and the board set out to make significant changes. Next, he asked the members to view page 4 of a handout provided by the RHCA with information regarding the RHCA outlook. Among the highlights is that the RHCA plan is projected to be solvent until 2027. Mr. Propst noted that the RHCA board plans to adopt a five-year sustainability plan that includes a balancing of cost increases among the plan's stakeholders. The five-year plan is intended to ensure that the program remain solvent through shared responsibility, including increasing active employees' contributions, increasing public employee contributions and adjusting the amount paid by current retirees, who pay about 50% of their total premium costs.

Some of the changes being considered include increasing the pre-Medicare plan deductibles; combining the current two plans into one plan; increasing prescription co-payments; increasing active employer and employee contributions by 1% over three years beginning in FY 16; and reducing subsidies for younger retirees.

Mr. Tyndall provided demographic information regarding the makeup of the members of the RHCA. Referring to page 7 of the handout, he noted that roughly 40% of current retirees are younger than 65. He noted that implementing a minimum retirement age for RHCA eligibility could affect the program positively, but it must be balanced with the potential negative impacts it could pose to current employees. Page 8 of the handout provides information regarding the impact that a minimum retirement age could have on solvency.

After a brief discussion, and with no further business, the committee adjourned at 4:45 p.m.