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

August 3, 2017
State Capitol, Room 307
Santa Fe

The second meeting of the Investments and Pensions Oversight Committee was called to order by Representative Tomás E. Salazar, chair, on August 3, 2017 at 9:00 a.m. in Room 307 of the State Capitol.

Present
Rep. Tomás E. Salazar, Chair
Sen. Jacob R. Candelaria
Rep. Miguel P. Garcia
Rep. Larry A. Larrañaga
Sen. Carroll H. Leavell
Rep. Jane E. Powdrell-Culbert
Rep. William "Bill" R. Rehm
Rep. Patricia Roybal Caballero
Sen. John M. Sapien
Rep. Larry R. Scott
Sen. Elizabeth "Liz" Stefanics
Rep. Jim R. Trujillo

Absent
Sen. George K. Munoz, Vice Chair
Sen. Gay G. Kernan
Sen. Steven P. Neville

Advisory Members
Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales
Sen. Stuart Ingle
Rep. Bill McCamley
Sen. James P. White

Sen. William F. Burt
Sen. Mary Kay Papen
Sen. William H. Payne
Rep. Sheryl Williams Stapleton

Staff
Tessa Ryan, Staff Attorney, Legislative Council Service (LCS)
Kathleen Dexter, Researcher, LCS
Nancy Martinez, Staff, LCS

Guests
The guest list is in the meeting file.

Handouts
Handouts and other written testimony are in the meeting file.

Thursday, August 3

State Investment Council (SIC): Strategic Goals; Staff and Salary Structure

Steven K. Moise, state investment officer, SIC, Vince Smith, deputy state investment officer, SIC, and Charles Wollmann, director of communications, SIC, gave a presentation on the value of SIC-managed funds as of the end of fiscal year (FY) 2017 and the SIC's strategic goals in managing those funds. They also reviewed the SIC's agency staff and salary structure.

Funds in the SIC's portfolio ended FY 2017 with the following balances:

- Land Grant Permanent Fund (LGPF): $16.27 billion, a year-over-year increase of $1.59 billion;
- Severance Tax Permanent Fund (STPF): $4.91 billion, a year-over-year increase of $346 million;
- Tobacco Settlement Permanent Fund (TSPF): $147 million, a year-over-year decrease of $72.6 million;
- Water Trust Fund: $45 million, a year-over-year increase of $512,000; and
- funds managed for governmental clients: $966 million, a year-over-year increase of $156 million.

The SIC's mission, developed seven years ago by its staff, is "to protect and grow the state's permanent endowment funds for current and future generations, through prudent, professional investment management". The core values of its mission are accountability, excellence, integrity, pride and respect. Its vision "to become one of the best performing, most respected sovereign wealth funds worldwide" is already somewhat fulfilled: among the dozen sovereign wealth funds in the nation, New Mexico's portfolio ranks third, behind only the funds in Alaska and Texas.

The SIC has 31 full-time positions, five of which are currently vacant. Most SIC staff are paid more than the midpoint for the salary ranges associated with their positions — in one case, 41 percent more. Mr. Moise noted that higher salaries are necessary in order to recruit qualified people.

The SIC first developed its long-term strategic plan in 2013 and updates it every five years, with annual reviews of its implementation. At least every three years, the SIC conducts a fund asset allocation study, including a review of peer funds and their asset allocations. The SIC will review the most recent asset allocation study, as well as its annual investment plan, at its meeting this month. Other reporting compiled for the SIC's review includes an annual memorandum on accomplishments and goals, monthly "budget-to-actual" reports and monthly reports on investment holdings.

On questioning, the presenters and committee members discussed the following topics.

Fund distributions and earnings. Eighty-five percent of the distribution from the LGPF goes to public schools. For FY 2018, this comes to nearly $900 million, an increase of approximately $50 million over FY 2017. A one-half percent increase in distributions from the fund to public schools would benefit the schools in the short term but might harm them in the long term if distributions shrink as the fund corpus shrinks.

The current distributions of five percent for the LGPF and four percent for the STPF are considered prudent.

The STPF earned $300 million in FY 2017, and all but $32.00 of the earnings was spent.

Investments and returns. The SIC did not have a structure in place for vetting investments during the previous state investment officer's tenure, but it does have such a structure in place now. All investments — in-state and out-of-state — undergo the same vetting.

The SIC forecasts a 5.5 percent rate of return on investments over the next seven to 10 years, which is down from returns seen in recent years. While 5.5 percent is the median rate of return for public funds, the SIC's long-term goal is seven percent.

Statute allows for nine percent of STPF investments to be made in New Mexico private equity. Currently, $400 million, or six percent, is invested in New Mexico; some investment consultants feel that five percent would be ideal. One challenge is finding New Mexico investments that will produce a good return. A member voiced concerns that the SIC's goal is to grow the largest permanent fund in the nation, not use the asset to improve conditions in the state.

Tobacco settlement funds. The TSPF balance decreased over the last year because money was pulled out to balance the state budget. While it is designated as a "permanent" fund, it has not been able to grow into a true permanent fund because it has been used several times since its creation to balance the budget.

It is the legislature's decision whether to "pay back" to the fund if state finances improve. Use of the funds is also up to the legislature; there are no constitutional limits imposed.

In 2013, tobacco companies sued New Mexico over its compliance with the Master Settlement Agreement and clawed back some of the funds paid to the state in 2003; however, the Office of the Attorney General (AGO) was successful on appeal of the 2013 ruling and recovered some of those funds. Tobacco companies continue to file challenges to payments they made in other years; the AGO expects clawbacks to increase and annual payments to decrease.

Strategic plan. Seventy-nine of the 82 improvements suggested by Hewitt EnnisKnupp are included in the strategic plan. Some improvements require legislative or executive action.

Water Trust Fund. The fund was created in 2006 and started with $1 million. It has not received any new funding since 2007.

- Mr. Smith agreed to provide:
  (1) information on the rate of return on "economic-driven" investments — those aimed at economic development in New Mexico rather than aimed at the highest yield — as well as the number of jobs created by those investments;
  (2) information on the decision to reduce the percentage of investment in New Mexico private equities from nine percent to six percent; and
  (3) a chart showing investment returns for the SIC portfolio.

Public Pensions: Overview of Key Terms and Concepts

Jan Goodwin, executive director, Educational Retirement Board (ERB), presented a handout that explained actuarial terms and suggested that members bring any questions they might have on the terms to the September meeting.

ERB: Strategic Goals; Staff and Salary Structure

Ms. Goodwin, who was joined by Bob Jacksha, chief investment officer, ERB, reported on the ERB's mission, goals and staff.

The ERB's mission is "providing secure retirement benefits for New Mexico's educational employees past, present and future" and its vision is "to be an effective and trusted manager of New Mexico's education retirement system". The values core to its mission are innovation, integrity, quality, respect, service, stewardship and transparency.

The ERB's four main goals center on improving and maintaining the ERB fund's financial condition; improving the quality of service to members and employers; identifying and controlling risk agency-wide; and building strong, collaborative relationships with all stakeholders. The presenters noted several challenges they face in meeting these goals:

- the fund's financial condition is negatively affected by the state's economy;
- staffing and salaries are insufficient;
- active membership is declining;
- the ERB needs a new building that can house the entire agency in one location;
- cybersecurity threats are increasing; and
- actuarial issues are complex and difficult to explain.

Ms. Goodwin presented a chart showing the ERB's staff structure and salaries. She noted that, according to a national survey conducted in 2015, most of the salaries paid to employees in the ERB's investment division are below the median for personnel working with public funds. Attracting and retaining qualified staff at current salary ranges have been significant challenges.

The ERB manages much of its portfolio internally rather than using outside investment managers. The ERB-managed investments have outperformed indexed funds, and the internal management has resulted in substantial savings on fees. The ERB also saves on fees by creating co-investment accounts in private equity, real estate, natural resources and infrastructure. The total annual savings from these strategies come to $24.5 million, with an additional $1.5 million in annual savings projected as more assets are brought in-house.

On questioning, the presenters and committee members addressed the following topics.

ERB building. The ERB requested $7 million for either purchasing land and constructing a building or purchasing and renovating a building. The appropriation would not have come from the General Fund or from severance tax bonds, but from the ERB trust, which currently totals $12.3 billion. The request was made both at a capital request committee meeting and in meetings with Legislative Finance Committee staff but was denied without explanation.

The old Public Employees Retirement Association (PERA) building does not have enough open space to accommodate the ERB. The building on Pacheco Street that once housed the Public Service Company of New Mexico might have worked but may no longer be available. The ERB is considering all location possibilities, including the area where the PERA has its offices.

Investments and returns. The rate of return on the ERB portfolio is currently 12 percent after fees; since its inception in 1983, the average rate of return is 9.1 percent. Seventy percent of the portfolio is in active management.

Employee recruitment. If the ERB recruits someone who is out of work, it checks to see why the person is unemployed and what the circumstances were when the person left his or her previous employment.

Representative Salazar suggested that committee members review House State Government, Indian and Veterans Affairs Committee Substitute for House Bill 58 (Laws 2017, Chapter 137), which makes changes to the agency rulemaking process and requires that proposed new rules be distributed to the appropriate interim or standing committees. Rod Ventura, general counsel, ERB, who spoke from the audience on invitation of the chair, explained the changes made to the Educational Retirement Act in Senate Bill 28 (Laws 2017, Chapter 21). In addition to making "cleanup" changes to the act, the bill clarifies requirements for provisional ERB membership and establishes requirements for disability determinations. Mr. Ventura noted that the ERB will hold a public hearing on August 25, 2017 regarding proposed changes to how protest hearings are conducted.

- Ms. Goodwin agreed to provide information on:
  (1) student populations since 2000 to track with the decline in active ERB membership; and

(2) vacancy rates in universities and public schools.

- Senator Candelaria requested a "dashboard" of the ERB fund, PERA fund and LGPF, broken down by asset class and investment strategy, that shows:
  (1) active versus passive management;
  (2) returns; and
  (3) fees.

Minutes

On a motion duly made, seconded and unanimously adopted, the minutes from the June 20, 2017 meeting were approved.

Update from the Education Trust Board (ETB): Transparency; Value; Strategic Goals; Staff and Salary Structure

Barbara Damron, Ph.D., secretary of higher education, and chair, ETB; and Ted Miller, J.D., executive director, ETB, reported on the ETB's structure and its work administering "529" college savings programs.

The ETB's mission is "to make post-secondary education more attainable by offering a flexible, low-cost, tax-efficient way to save for the costs of higher education". Its vision is "to enable as many New Mexico children as possible to become beneficiaries of 529 college savings accounts before age 10, and to promote continued contributions to the accounts until post-secondary education is complete". Goals for the board include increasing the number of new account owners in the state every year; being recognized as a top-rated 529 program; and becoming one of the top 15 college savings programs in the country by the end of FY 2020.

The five-member board includes the secretary of higher education, two members appointed by the governor and two members appointed by legislative leadership. The ETB's expenses — salaries for two employees and fees for various professional services — are covered entirely by fees paid by program participants. In addition, the program's marketing budget is supplemented annually with $650,000 from the program manager, currently Oppenheimer Funds.

As of June 30, 2017, there were 20,919 New Mexico resident accounts in the 529 program, for a total of more than $406 million. The average account size for New Mexico participants is $19,427. The program is open to non-residents as well, and accounts opened by out-of-state participants make up 83 percent of the ETB's managed assets. ETB assets totaled $2.437 billion as of June 30, 2017, ranking New Mexico's program twenty-sixth among the 49 states that have 529 college savings programs.

There are two plans available through the ETB: 1) The Education Plan, which is sold directly through the ETB and makes up 22 percent of ETB assets; and 2) Scholar's Edge 529, which is sold through Oppenheimer Funds and makes up 78 percent of ETB assets. ETB marketing efforts include improvements to its website; a billboard advertising campaign;

outreach to employers that have not yet implemented 529 account payroll deductions; and attendance and sponsorship at events such as the state spelling bee, the National Honor Society and Junior Honor Society state summit, KidFest and the Roswell UFO Festival. Increased and improved marketing and outreach efforts, both online and in the community, are planned for FY 2018.

The presenters noted certain impediments they face in managing the 529 program and urged the committee to consider statutory changes to remedy the situation, including:

- providing the ETB with the same exemption from the Procurement Code given to the ERB, the PERA, the SIC and the New Mexico Finance Authority; and
- providing explicit authority to create grant programs.

On questioning, the presenters and committee members discussed the following topics.

Professional services contracts. The ETB's public relations contract and marketing contract are with separate firms.

Financial literacy. The ETB plans to offer a financial literacy program for students and parents, possibly in conjunction with the National Honor Society.

Withdrawing money from an account. If a student does not need the money that a parent has invested in a 529 account, the parent can transfer the money to another 529 account for another child or leave the funds in the account for future education expenses. If money is removed for a purpose other than education, the parent pays a 10 percent penalty and pays taxes on the withdrawn amount. Very little of the money in the ETB 529 program is withdrawn for non-educational use.

Grant program. The AGO is reviewing the ETB's proposal for a pilot 529 grant program that would increase the number of New Mexico residents who open 529 accounts and be funded from the Program Administration Fund. The ETB has established a private foundation that will be able to receive donations for the grant program, including land donations.

Plan elements. The ETB is working to align the investment structures in the two plans with one another. An account holder can choose to actively manage investments; otherwise, the money is put into a series of age-based investment portfolios that become increasingly conservative over time.

Eligibility. 529 accounts can be used for expenses at any post-secondary school that qualifies to receive federal financial aid.

Virginia's 529 program. The Virginia program is the largest in the country in part because the state has a well-compensated population and a strong culture of education.

Marketing and outreach. The ETB spends approximately $750,000 annually on marketing and outreach. Enrollment in The Education Plan has increased as the marketing efforts increase. The board is also stepping up its efforts to get large employers and public employers — including the state — to offer 529 payroll deductions.

Mr. Miller agreed to provide information on public employee participation in the ETB education savings plan.

PERA: Strategic Goals; Staff and Salary Structure

Wayne Propst, executive director, PERA, and Jude Pérez, interim chief investment officer, PERA, reported to the committee on the PERA's goals and progress and gave an overview of its staff and salary structure relative to other state agencies.

The PERA began its strategic planning in 2013 and revised its initial plan in 2016. It currently has four strategic goals.

- *Sustaining the trust fund for current and future retirees.* The PERA's target investment return rate is 7.25 percent over the long term, and it recently reduced risk in the portfolio. It also has increased its focus on unfunded liabilities.
- *Improving PERA information technology (IT) infrastructure.* The IT system is being upgraded and will allow members to retire online.
- *Improving customer service.* The PERA serves 40,000 retirees and 50,000 active members.
- *Improving organizational effectiveness.* Effectiveness improvements include an accounting process improvement project, an expansion to the Albuquerque PERA office, increased outreach efforts and a new custody bank (The Bank of New York Mellon).

The PERA has 84 full-time positions, six of which are currently vacant. Salaries paid to its directors, officers and legal counsel are comparable to those paid for the same personnel in other state agencies that manage investments and pensions. However, according to the 2016 National Association of State Retirement Administrators Salary Survey, salaries for PERA directors, officers and legal counsel range from five percent to 34 percent lower than the average salaries for those personnel nationwide. The presenters noted that it is difficult to recruit qualified investment staff when other states offer incentive pay and performance-based bonuses.

On questioning, the presenters and committee members addressed the following topic.

Unfunded liabilities. The target for the portfolio investment return rate over the next seven to 10 years is 7.25 percent, with 7.75 percent after that. If the actual rate is lower, the PERA's unfunded liabilities will increase and its projected date for being 100 percent funded will be delayed. The PERA board directed PERA staff to conduct portfolio and liability "stress tests" to show the effects of higher or lower returns than are projected.

- Dominic Garcia, incoming PERA staff member, will provide information on performance incentives paid to investment personnel in the Wisconsin public employee retirement system.
- Mr. Propst will include scenarios in his September presentation that show the potential effect of a five percent increase in PERA contribution rates.

PERA Deferred Compensation Plan

Mr. Pérez was joined by Karyn Lujan, deferred compensation plan manager, PERA, to explain SmartSave, a 457(b) tax-deferred compensation retirement plan available to PERA members.

In contrast to the pension plans managed by the PERA, SmartSave is an optional defined contribution plan and, as such, carries no liability for the PERA. Participants set aside a portion of their salaries for investment in a series of portfolios that carry progressively lower risk as a participant nears retirement. Participants pay taxes on their SmartSave funds as the money is withdrawn. As of June 30, 2017, SmartSave had 20,466 participants — an increase of more than 1,200 over the previous year — and a net asset value of nearly $566.9 million.

The fee structure in the SmartSave plan was recently revised to make the plan more affordable to members with small account balances, a group that comprises two-thirds of the plan's participants. Rather than the previous annual fee of $52.00 per participant, each participant is now charged $30.00 plus 0.135 percent of the account balance.

On questioning, the presenters clarified that:

(1) annual contribution limits in the SmartSave plan are $18,000 per year, $24,000 per year if the participant is 50 years old or older and $36,000 per year when the participant nears retirement age;
(2) funds from 401(k) plans and any IRA other than a Roth IRA can be rolled into the SmartSave plan; and
(3) there is no penalty for early withdrawal of funds.

Retiree Health Care Authority (RHCA): Strategic Goals; Staff and Salary Structure

David Archuleta, executive director, RHCA, gave an overview of the RHCA's goals, plans and staff and salary structure, as well as changes RHCA members can expect in 2018.

The RHCA's mission is to "maintain comprehensive and affordable health insurance benefits for public retirees and eligible dependents", and its goals include extending the program's solvency and more smoothly meeting customer service needs. Its staff includes 27 full-time employee positions, with salaries ranging from $29,000 (customer service representatives) to $125,000 (executive director). The RHCA's trust fund balance is currently $564.1 million, with solvency projected for 2035.

Major challenges that the RHCA faces include a continuing escalation in prescription drug costs; a stagnant public payroll; volatility in the health insurance market due to uncertainty surrounding the federal Patient Protection and Affordable Care Act; and a disposition in Congress and in the White House to increase the Medicare eligibility age. To meet these challenges and to address solvency over the last five years, the RHCA made several changes to increase cost-sharing by retirees. Through action taken at its July meeting, the RHCA board will continue this approach for 2018 with a combination of premium increases and subsidy reductions while also making changes to prescription drug benefits, offering higher-deductible plans and expanding options for Medicare enrollment. The RHCA board also proposes employer and employee contribution increases, which would require legislative action.

On questioning, Mr. Archuleta and committee members addressed the following topics.

Plans and programs. The RHCA is encouraging members to switch to plans that have higher out-of-pocket costs for the member but lower costs for the RHCA. It also encourages members to enroll in wellness programs.

Higher education institutions. All state higher education institutions are part of the RHCA except for the University of New Mexico, New Mexico State University, New Mexico Institute of Mining and Technology and San Juan College. If one of these institutions chooses to join, the entrance fee for the institution is set in statute.

A member expressed concern that solvency is becoming more of a focus for the RHCA than the hardships being imposed on participants through increased cost-sharing.

Adjournment

There being no further business, the committee adjourned at 4:05 p.m.