MINUTES
of the
THIRD MEETING
of the
RETIREMENT SYSTEMS SOLVENCY TASK FORCE

August 9, 2010
Room 322, State Capitol
Santa Fe

The third meeting of the Retirement Systems Solvency Task Force (RSSTF) was called to order by Representative Mimi Stewart, co-chair, on August 9, 2010 at 10:10 a.m.

Present	**Absent**
Rep. Mimi Stewart, Co-Chair	Mr. Oscar Arevalo
Mr. Tito Chavez, Co-Chair	Mr. Diego Arencon
Mr. Charles Bowyer	Sen. Pete Campos
Ms. Jan Goodwin	Mr. Bill Fulginiti
Rep. John A. Heaton	Sen. Phil A. Griego
Mr. David Heshley	Ms. Emily Kane
Ms. Alexis Lotero	Ms. Michelle Lewis
Sen. Steven P. Neville	Mr. Bruce Malott
Mr. Andrew Padilla	Mr. Ronald Sanchez
Mr. Wayne Propst	Mr. Terry Slattery
Sen. John Arthur Smith	
Rep. Thomas C. Taylor	
Ms. Christine Trujillo	
Mr. Jeff Varela	
Rep. Luciano "Lucky" Varela	

Staff
Raúl E. Burciaga, Director, Legislative Council Service (LCS)
Tom Pollard, LCS
Doris Faust, LCS
Claudia Armijo, LCS

Guests
The guest list is located in the meeting file.

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

Monday, August 9

Representative Stewart welcomed the RSSTF and guests to the meeting. She reminded the members that the meeting was being audio webcast and asked them to introduce themselves when speaking and to turn their microphones on and off before and after speaking.

Educational Retirement Board (ERB) Sustainability; Fiscal Analysis; and Summary of Benefits

Ms. Goodwin, executive director of the ERB, presented to the members of the task force. She began by advising them that the numbers used in the ERB Status Report, which she provided for their reference, are the most up-to-date numbers available. She noted that the information is current as of June 30, 2010. Ms. Goodwin told the members that they could locate the definitions of defined benefit plans and defined contribution plans in the Status Report. Defined benefit plans are designed to provide employees with a predictable monthly benefit at retirement. The benefit amount is typically a function of the number of years an employee works at the employee's job and is based on the employee's pay, usually at the end of the employee's career. Defined contribution plans offer no implicit guarantee of retirement income. Rather, employers and, usually, employees, contribute to the plan over the course of the employee's career. Ms. Goodwin clarified that the ERB provides a defined benefit plan.

Ms. Goodwin explained that in a defined benefit plan, the longevity risks are pooled among a large number of individuals. The plan only needs to accumulate enough funds to provide benefits for the average life expectancy of the group. Unlike the individuals that are part of the plan, a defined benefit plan does not age. Consequently, the plan is able to take advantage of the enhanced investment returns that come from a balanced portfolio over long periods of time. A defined benefit plan can ride out bear markets and take advantage of buying opportunities without the concern about converting all of its money into cash for benefits in the near future.

Conversely, individuals in defined contribution plans need to set aside much more money to last for the "maximum" life expectancy. This is critical to ensure that individuals will not run out of money at retirement. Because the maximum life expectancy can be substantially greater than the average life expectancy, a defined contribution plan should set aside more money than a defined benefit plan to achieve the same level of monthly retirement income benefits.

Referring to the Status Report, Ms. Goodwin explained how the ERB's defined benefit plan works. She began by pointing out the differences between the retirement eligibility for current employees and for new hires who begin employment after July 1, 2010. Depending on when an employee begins working, the employee's retirement eligibility is calculated with the ERB retirement benefit calculation using the employee's final average salary multiplied by the employee's service credit multiplied by .0235. This calculation determines the employee's annual benefit at retirement.

Ms. Goodwin explained how the ERB's cost-of-living adjustment (COLA) works. She noted that the first COLA to a retiree's benefit is made on July 1 of the year in which the retired member reaches the age of 65 or on July 1 of the year following the member's retirement date, whichever is later. The COLA is tied to the Consumer Price Index (CPI). If a change in the CPI is less than 2%, the COLA is the same percentage as the change in the CPI. If, however, the change in the CPI is greater than 2%, the COLA is one-half of the change in the CPI, but not less than 2% and no greater than 4%. Ms. Goodwin noted that 2009 was the first time in 54 years that the CPI declined. At that time, the COLA statute required a negative adjustment, which would have resulted in an annual average decrease of $69.00 in a retiree's pension benefits. However, House Bill 239, passed in the 2010 regular legislative session, amended the COLA statute to prohibit a decrease in the retirement benefits for retired members over the age of 65 if there is a decrease in the CPI.

Ms. Goodwin explained the options available to ERB retiring members: Option A, Option B and Option C. Option A provides no reduction to the monthly benefit received by a retiree other than any "Rule of 75" deductions for any community property or child support reductions. Pursuant to this option, there would be no continuing benefit to a beneficiary or estate upon the retiree's death, except the balance, if any, of contributions. Ms. Goodwin advised that such contributions are usually exhausted in two to three years. She noted that approximately 63% of ERB retirees select Option A.

Option B provides that the retiree's monthly benefit be reduced to provide for a 100% survivor's benefit. The reduced benefit is payable during the life of the member, with the provision that, upon the retiree's death, the same benefit is paid to the beneficiary for the beneficiary's lifetime. The named beneficiary may not be changed after the effective date of retirement because the amount of the option is calculated by using both the age of the member and the age of the beneficiary. If the beneficiary predeceases the member, the member's benefit will be adjusted by returning it to the Option A benefit amount. The Internal Revenue Service prohibits selection of Option B for a non-spouse beneficiary more than 10 years younger than the member. Approximately 25% of the ERB retirees select Option B.

Ms. Goodwin explained that Option C provides that the retiree's monthly benefit be reduced to provide for a 50% survivor's benefit. The benefit is payable during the life of the member with the provision that, upon the retiree's death, one-half of the member's benefit is paid to the beneficiary for the beneficiary's lifetime. Again, the named beneficiary may not be changed after the effective date of retirement. If the beneficiary predeceases the member, the member's benefit is adjusted by returning it to the Option A benefit amount. Approximately 12% of ERB retirees select Option C.

According to Ms. Goodwin, the Educational Retirement Fund is a "mature fund", meaning that each year the plan is designed to pay out more in benefits than the contributions it takes in. As a result, the difference between the amount of contributions and retiree payroll is paid from the money in the Education Retirement Fund balances. Ms. Goodwin directed the members' attention to the Status Report, which illustrates the contribution rate history by the members and employers. Ms. Goodwin noted that employer payroll has increased 61.65% from 2000. Additionally, retiree payroll has increased 111.2% from 2000. Active members have increased 5.34% from 2000, and retired members have increased 59.3% from 2000. In 2000, there were three active members working for each retired member. In 2010, there are two active members working for each retired member.

According to Ms. Goodwin, the Governmental Accounting Standards Board (GASB) establishes financial reporting standards for defined benefit pension plans. The GASB Statement 25 provides that the funding period, also known as the amortization period, should not exceed the maximum 30-year period. The ERB's current funding period is 45 years. The ERB's funding period will be in compliance with the GASB statement in 2032, when the funding period reaches 28.4 years. Ms. Goodwin said that the funding ratio (the ratio of the actuarial value of assets to the actuarial accrued liability) for the ERB stands at 67.5% in 2010. Five years ago, the ratio stood at 75.4%, and 10 years ago the ratio was 85.9%. The ratio reached an all-time high in 2001 at 91.9%. However, it began to decrease as the negative investment experience in the 2001 to 2003 fiscal years was phased into the actuarial value of assets.

Ms. Goodwin highlighted a summary of the ERB's investment results. For the fiscal year ending June 30, 2010, the Educational Retirement Fund returned 8.6%, outperforming its policy index by 5.9% and ranking in the top second percentile of public funds greater than $1 billion. Ms. Goodwin attributed the positive performance of the fund to the ERB's improved investment tools. She continued by saying that over the last 12 months, the fund experienced a gross investment gain of $1.3 billion, which includes a gross investment loss of $333 million during the second quarter. The fund's total assets decreased from $8.6 billion at the beginning of the quarter to $8.2 billion on June 30, 2010, with $38.9 million in net distributions. Over the past five years, the fund returned 4% per annum, outperforming its policy index by .8% and ranking in the top tenth percentile of the Independent Consultant Cooperatives Public Funds greater than $1 billion universe of funds. For the quarter, the fund posted a -3.9% return, outperforming its policy index by .6% and ranking in the top thirty-second percentile of public funds greater than $1 billion. All asset classes were within policy ranges on June 30, 2010.

Ms. Goodwin directed the members' attention to the Status Report, which outlines the ERB's fund allocations. She said that the Educational Retirement Fund weighs heavily toward equities and has a large exposure to international allocations. When looking at the total fund performance, particularly when compared with like portfolios, the ERB's diversification of investments is providing better returns. According to Ms. Goodwin, since 2005, with the passage of House Bill 389, the fund has had wider choices in investment products that produce good returns over long periods of time. She added that the ERB is well-poised for economic recovery.

Ms. Goodwin closed her presentation by noting that the ERB and its actuaries will be looking at all aspects and issues related to the fund at its September board meeting. Additionally, the board may be reviewing the ERB members' vesting period as the ERB tries to determine a sustainable benefit.

There was a lengthy discussion involving the long-term solvency of the Educational Retirement Fund. Members were concerned about the large unfunded liabilities and the fund's ability to meet those liabilities in years to come. Some of the members asked questions concerning exactly what the board and actuaries would be considering and reviewing at the upcoming meeting. Ms. Goodwin said that everything is on the table and up for discussion, including the 8% benchmark. She noted that the ERB is aware of its unfunded liabilities but does not want to cause undue panic on behalf of retirees. She noted that there have been investment losses. For example, one of the hedge funds lost $10 million with Madoff. Even though that is a lot of money, it is not a lot in the scheme of the huge Educational Retirement Fund itself. Ms. Goodwin noted that the ERB tries to be balanced in its portrayal of its financial situation.

There were further discussions regarding the legislators' concerns about potential costs to the state in view of the fact that the state's budget continues to deteriorate. Some members noted that a debate regarding a minimum retirement age might be a fruitful topic of discussion, and perhaps the actuaries could review the economic impact of such a provision. A brief discussion of the COLA and exactly how it is calculated followed.

Some members asked if the ERB has a benefit cap. Ms. Goodwin said that the ERB benefit formula has three components: final average salary, subject to the $225,000 federal 401 (A)(17) limit; the number of years of service, which is not capped; and the 2.35% multiplier, which is in place for everyone.

A discussion ensued regarding the average retirement age for ERB members. Ms. Goodwin said that to the best of her recollection, the average ERB member retirement age is about 57 or 58. When asked what percentage of teachers continue to teach in excess of 30 years, Ms. Goodwin said that a very small percentage teach for that many years. When asked what the economic value of the Educational Retirement Fund was prior to the economic downturn, Ms. Goodwin told the members that the fund value was just under $10 billion in 2008, and today it is $8.2 billion as of June 30, 2010.

Some of the members inquired as to when the legislature would receive the ERB's recommendations. Ms. Goodwin said that she hopes the recommendations would be presented by October 20, which is when the board plans to hold its legislative agenda meeting.

Some of the members asked if the layoffs and the cuts to the salaries of workers are affecting contributions. Ms. Goodwin stated that it is a constantly shifting picture, which the board continues to monitor. When asked what the average retirement benefit from the ERB is, Ms. Goodwin replied $23,000 annually. The co-chair asked if the ERB staff could provide more information on the benefits that are being paid out, specifically those to the highest wage earners. It was noted that it might be beneficial to look at the median benefit as well. Ms. Goodwin agreed to provide the information at a future meeting. There was a motion and a second to approve the minutes from the July 2010 meeting. The motion passed unanimously.

Update on Request for Proposals for Consulting Actuarial Services

Mr. Pollard, Ph.D., legislative fiscal analyst for the LCS, addressed the members regarding the request for proposals (RFP) for consulting actuarial services issued on behalf of the RSSTF. He explained to the members that Buck Consultants of Denver, Colorado, won the contract. A number of competing firms submitted proposals, and after review, it was determined that Buck Consultants will do the following:

A. audit the actuarial valuations of the pension plans administered by the Public Employees Retirement Association (PERA) and the ERB for the period ending June 30, 2009, or the most current valuation available at the time of contract execution;

B. audit the multiyear experience studies for the PERA and the ERB pension plans for the period ending June 30, 2008, or the most current experience studies available at the time of contract execution;

C. audit a comprehensive pension reform plan being produced by the PERA that will be available at the time of the execution of a contract or shortly thereafter;

D. prepare written recommendations to the RSSTF of an actuarial nature, including a review of existing actuarial value impact estimates of contribution or benefit modification;

E. provide general or specific actuarial or pension consulting advice to the RSSTF during its development of legislative proposals for the 2011 regular session of the New Mexico Legislature; and

F. upon request by the LCS, attend meetings of the RSSTF during the interim leading up to the convening of the New Mexico Legislature in January 2011 to present information or reports on assigned topics or to provide actuarial and technical information and advice on pending pension issues.

There was a brief discussion about the firm and actuarial services that will or could be provided. Some members stressed their desire for the firm to use an accounting approach instead of an actuarial approach. The co-chair asked Mr. Pollard if he thinks the firm would be able to provide information regarding specific scenarios upon request by the RSSTF in time for the October meeting. Mr. Pollard replied that he believes the firm would be able to supply the information. The co-chair asked that the topic be made an item on the agenda for the September meeting and the members bring forward ideas regarding specific scenarios on the subject. It was noted that the RSSTF should not come up with a laundry list of ideas; rather, certain specific ideas should be reviewed by the consulting firm. Mr. Pollard noted that because the consulting firm would be using an audit approach, the firm will be able to evaluate some of the scenarios. Additionally, the firm will work closely with the existing retirement funds and actuaries to run the numbers that will be validated independently. It was decided that Mr. Pollard would speak with the consulting firm to determine approximately how many scenarios could likely be analyzed and what information might be produced.

Retiree Health Care Authority (RHCA); Recent Measures Addressing Sustainability; Fiscal Analysis; Projections

Mr. Propst, executive director for the RHCA, and Mark Tyndall, deputy director for the RHCA, spoke to the members. Mr. Propst explained to the members that the RHCA provides medical care for pre-Medicare retirees, a population that currently includes about 44,000 members and their dependents.

Mr. Tyndall said that the challenges faced by the RHCA are clearly identifiable and, as such, are manageable. He talked about the assumptions used by the Retiree Health Care Fund and the fact that the reserve fund currently has about $160 million. He said that the moving parts associated with the fund are active employers and employee payroll and how much the fund will grow over a specific period of time, noting that historically it has grown by about 4%. He said that about half of the RHCA membership is from the public schools, about 25% consists of state employees and the rest of the membership consists of former employees of municipalities and local governments.

Mr. Tyndall spoke about recent measures addressing the sustainability of the Retiree Health Care Fund. He said that the fund was previously projected to be insolvent in 2014. In order to extend solvency to 2019, effective in fiscal year 2010, employer/employee contribution levels have increased from 1.95% to 3%. This change took effect on July 1, 2010. To extend solvency to 2025, beginning with fiscal year 2010, there was a reduction in the number of available plans to stabilize the rating structure. The RHCA board is reviewing the years of service criteria as they pertain to subsidy levels. Mr. Tyndall noted that the GASB liability has been reduced from $5 billion to $2.9 billion. Additionally, the RHCA has instituted disease management and wellness programs for all retirees; instituted cost-sharing for 20,000-plus members' Medicare supplement plans; submitted an application for the federal early retiree reinsurance program to keep the budget surpluses in both health benefits and program support funds for three consecutive years; and achieved more than $20 million in cost savings to plan design and prescription benefit manager changes. Regarding the application for the federal early retiree reinsurance program, Mr. Tyndall said that New Mexico could receive between $18 million and $20 million in reimbursements.

Mr. Tyndall explained that firefighters, police and other law enforcement employees can retire with the same benefits after 20 years of service as other retirees would have with 25 years of service. He noted that about 9% of actual employees fall into the law enforcement category.

Mr. Tyndall also noted that the RHCA receives premiums from retirees. Historically, and varying from year to year, the Retiree Health Care Fund has grown at a rate of about 3.5%. Mr. Tyndall explained that retirees that are pre-Medicare recipients pay 35% of their premium and the RHCA pays the rest. Dependents are allowed to participate until they reach age 26, but their premium is not subsidized. If a retiree is of Medicare age, the RHCA will pay 50% of the retiree's premium and 25% for the retiree's spouse, and the retiree's dependents will have access to the plan but receive no subsidy benefit.

The RHCA offers a prescription drug program that provides prescription coverage, and the RHCA gets about $12 million a year from the federal government for providing the benefit.

Mr. Tyndall told the members that the majority of the RHCA expenses are associated with medical and prescription claims. The fund uses an 8% rate of return as a projection figure, and over the last three years, 8% is very close to what has been achieved.

When talking about solvency, Mr. Tyndall directed the members' attention to the RHCA handout. He said that the actuarial projections indicate that the Retiree Health Care Fund will begin to deteriorate by the year 2017. This conclusion is based on the assumptions in the plan design remaining the same. The conclusion is also based on an 8% annual increase to retirees and the same increase in medical costs over that time. The two areas that could result in the biggest change in the fund are a change in the employee contribution rates and the lowering of the subsidy provided to retirees. Mr. Tyndall noted that, unlike the ERB and the PERA, the RHCA is a recently created program and, therefore, the return on investments does not affect the Retiree Health Care Fund as the return on investments would a large fund.

There was a general discussion about ways of lowering medical costs. It was noted that many high medical costs are driven by diseases like diabetes or by lifestyle choices such as obesity or smoking. Members wondered if there are programs in place to combat these medical conditions. Mr. Tyndall noted that health plans like Presbyterian offer a number of different lifestyle changing programs, and the key to their success is to start early. When asked, Mr. Tyndall said that the average age of the RHCA retiree is 50 years, but subsidy levels are not based on age requirements.

Mr. Tyndall reminded the RSSTF members of the RHCA's statutory obligations. He noted that the statute provides in part that the board shall provide for the collection of premiums from eligible retirees and eligible dependents. That money, when combined with other money appropriated to the Retiree Health Care Fund, shall be sufficient to provide the required insurance coverage and to pay the expenses of the authority. Notwithstanding any other provision in the Retiree Health Care Act, the legislature shall review and adjust the distributions pursuant to statute and shall review and adjust the employer and employee contributions to the RHCA to ensure the actuarial soundness of the benefits provided under the Retiree Health Care Act.

With regard to the RHCA handout, members noted that the graph depicting contributions versus subsidies paid was misleading because an employee does not get the subsidy until the employee retires; prior to that, the employee is using the employee's health insurance. Mr. Propst and Mr. Tyndall took the criticism under advisement and said that they would produce the information in a more accurate format in the future.

The members turned their attention to the topic of solvency in general and what it means pursuant to discussions regarding the various state retirement-related funds. There seemed to be a consensus that the RSSTF needs to determine a practical, logical model and decipher how to analyze the moving parts in a time and manner pertinent to the accuracy of the model. There was an interest in staff inquiring into the National Conference of State Legislatures sending experts to address the task force and provide additional information on the various subjects that the RSSTF is charged with addressing.

With no further business, the meeting was adjourned at 3:50 p.m.