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

June 5, 2019
State Capitol, Room 321
Santa Fe

The first meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2019 interim was called to order by Senator George K. Munoz, chair, on Wednesday, June 5, 2019, at 9:13 a.m. in Room 321 of the State Capitol in Santa Fe.

Present	**Absent**
Sen. George K. Munoz, Chair	Sen. Gregg Fulfer
Rep. Patricia Roybal Caballero, Vice Chair	Sen. Gay G. Kernan
Sen. Jacob R. Candelaria	
Rep. Natalie Figueroa	
Rep. Miguel P. Garcia	
Sen. Steven P. Neville	
Rep. William "Bill" R. Rehm	
Rep. Tomás E. Salazar	
Sen. John M. Sapien	
Sen. Elizabeth "Liz" Stefanics	

Advisory Members	
Rep. Phelps Anderson	Sen. William F. Burt
Rep. Roberto "Bobby" J. Gonzales	Sen. Carlos R. Cisneros
Sen. Stuart Ingle	Sen. Mary Kay Papen
Rep. Sheryl Williams Stapleton	Sen. William H. Payne
Sen. James P. White	

Staff
Anthony Montoya, Staff Attorney, Legislative Council Service (LCS)
Rebecca Griego, Records Officer, LCS
Carrie McGovern, Researcher, LCS

Guests
The guest list is in the meeting file.

Handouts
Copies of all handouts and written testimony are in the meeting file and posted on the legislature's website.

Wednesday, June 5

Update from the Public Employees Retirement Association (PERA)

Wayne Propst, executive director, PERA, and Dominic Garcia, chief investment officer, PERA, provided an overview of the PERA retirement system. According to Mr. Propst, the PERA has 48,610 active members and 39,374 retired members spread out among different pension plans. He provided data showing, for the PERA as a whole, the average annual pension ($29,964) and age of retirement (59.39 years) for fiscal year (FY) 2018, as well as this information for each separate plan. In addition, Mr. Propst described FY 2018 benefit payments by county and for retired members living in and outside of New Mexico, as well as the projected funded ratio, using 2018 as a baseline, which is expected to be 74.4% in 2043. However, Mr. Propst stated that while the PERA has an investment asset return goal of 7.25%, this year has seen lower than expected returns of 3% to 5%, mainly due to market volatility. If there is a 5% return for 2019, this would result in a projected funded ratio in 2043 of 69.3%, which Mr. Propst noted is a concern for the PERA board and the newly created task force convened by Governor Michelle Lujan Grisham to study ways to shore up the PERA's finances.

Mr. Garcia next described the PERA's five-year strategic plan goals, including: maintaining the 7.25% investment rate of return, which was adjusted downward last year from 7.75%, and making portfolio enhancements to achieve this; working toward a 30-year funding period of unfunded actuarial accrued liability (UAAL), which currently stands at $6 billion; and meeting 10-year annualized returns to equal or exceed the policy benchmark and maintaining a total investment cost at or below 85 basis points, both of which have occurred. As of March 31, 2019, the PERA fund balance was $15.3 billion, and in the fiscal year to date (July 1, 2018 to March 31, 2019), the PERA's investment returns were 3.22% net of fees, and it paid out $905 million in benefits. Mr. Garcia added that in order to pay benefits to members, the PERA has had to sell assets every month and has a negative cash flow of -4%.

A committee member asked for clarification on the -4% cash flow, to which Mr. Garcia replied that, while a negative number, it is in a healthy range, and this means the PERA is selling the equivalent of 4% of the return on its assets to pay its members. In the next 10 to 15 years, as the number of retirees is projected to increase, this negative cash flow is expected to grow to -5.5%, which is considered unhealthy.

Another member asked if the PERA's investment policy is a document of 20 pages or longer, and if so, whether it could be summarized in a one- or two-page document. Mr. Garcia said the policy is over 20 pages, but that a one- or two-page summary could be provided at a future meeting. The member requested that the PERA also provide information about how the investment cost of 85 basis points compares to other states and what information the PERA's actuary has regarding future state employment in 10 years and 20 years.

After a member requested information on what happened to PERA-related legislation during the recent legislative session, Mr. Propst replied that: House Bill (HB) 338, which contained significant pension reform proposals, did not make it out of the house; HB 501, which passed and was signed, increases employer contributions by 0.25%; Senate Bill (SB) 235, which would have changed compensation structures, did not pass the house; HB 544, concerning PERA solvency, did not make it out of the house; and SB 307, which passed and was signed, makes changes to the legislative retirement system.

A member inquired how PERA benefits affect gross domestic product by county, a request the member has made previously, to which Mr. Propst answered that attempts to find someone to provide this information have proven unsuccessful. The member suggested contacting the Bureau of Business and Economic Research at the University of New Mexico and explained that he wanted the information to determine how PERA and Educational Retirement Board (ERB) benefits affect rural counties. The member further requested information on how vacancies in state government positions impact PERA benefits. Mr. Propst said that the PERA's actuary has determined that a 1% increase in vacancy rates affects the 25-year funded ratio by 1%; thus, reducing vacancy rates will help the PERA's funds. The member also expressed concern about recent media reports concerning the PERA board. Mr. Propst stated that while there are serious challenges at the PERA, his focus is on reducing the UAAL and fulfilling the promises made to PERA members. Lastly, the member requested that the committee be invited to actuarial presentations at PERA board meetings.

Another member asked how many states have cost-of-living adjustments (COLAs) for pension retirees. Mr. Garcia replied that about 25% of states do not have COLAs. The member inquired about the average age of retirement for PERA members. Mr. Propst explained that the average age is inching up to almost 60 years old and that New Mexico has historically had a young retirement age, although there is not a minimum retirement age. He stated that Tier 1 state employees have the most generous benefits in the country, closely followed by Tier 2 employees. Tier 2 employees are not eligible for COLAs until seven years after retirement. New Mexico allows its pension recipients to participate in social security, except for public safety employees, and PERA members may also receive benefits through the 457b plan. He also stated that with PERA benefits, social security and the 457b plan, an employee could be eligible for 100% of income replacement after age 62.

A legislator reminded members that the IPOC is charged with overseeing how the PERA, the ERB and the Retiree Health Care Authority (RHCA) can reduce their UAAL and that there is a lot of work to do in this regard.

Update from the State Investment Council (SIC)

Steven K. Moise, state investment officer, SIC, and Vince Smith, deputy state investment officer, SIC, made a presentation on recent developments at the SIC. According to Mr. Moise, as of April 30, 2019, the SIC had assets under management of $25.06 billion, with about 95% of this in the Land Grant Permanent Fund (LGPF) and the Severance Tax Permanent Fund (STPF). The SIC manages the Tobacco Settlement Permanent Fund (TSPF) and the Water Trust Fund, as well as long-term assets for many governmental clients, with the RHCA being the largest client.

In the past year, the LGPF has seen the most growth at $956 million, and the STPF has grown by $138 million, primarily due to changes in oil and gas law that increased inflows into the STPF. He stated that while the TSPF has performed well, the Water Trust Fund could have a zero balance in 20 years if new appropriations are not made.

Mr. Moise continued by noting that, beginning July 1, 2019, the LGPF and the STPF will pay $1.009 billion to the General Fund and land grant beneficiaries, the first time these payouts have crossed the billion-dollar threshold. Also beginning July 1, 2019, the SIC will take over management of the Tax Stabilization Reserve, the state's "rainy day fund", which has a current balance of $528 million that is expected to surge to $650 million at the end of 2019. He also stated that the SIC has voted recently to settle an ongoing civil case.

Mr. Smith next discussed market volatility, noting that the stock market has entered into a late economic cycle. He stated that, as of July 1, this economic cycle will be the longest economic cycle in United States history. Mr. Smith described the SIC's ranking with peers, noting that 60% to 75% of peers have lower returns and 75% to 85% of peers have higher volatility. Since March 2014, investment returns relative to peers have been more stable.

A committee member asked for clarification on the legal contingency fees paid to the law firm that represented the state. Mr. Moise said that firms usually charge 33.3% in contingency fees, but the SIC was able to negotiate a fee of 20%. The member further inquired about how much the SIC invests in equities versus fixed income. Mr. Smith responded that about 39% is invested in publicly traded equities and that the SIC has greatly restructured the fixed income portfolio. Also, the member asked how withdrawals affect distribution of the permanent funds. Mr. Moise answered that as the fund assets have grown, distributions have increased.

Another member asked if there are any concerns over the possibility of the United States imposing tariffs on Mexico. Mr. Smith replied that the economic impacts would be much greater on Mexico, although it has played into stock market volatility, but he does not consider it a great concern.

After a member asked for information about bond markets, Mr. Smith said that the corporate bond market has doubled in size, mainly due to lower interest rates, which has pushed down the yield curve and could be a cause for concern. The member cautioned that tapping into the permanent funds may not be prudent with the negativity lurking under the surface of the economy from the expansion of the corporate bond market, and he suggested exploring the possibility of creating a permanent fund for early childhood education. Mr. Smith replied that regular inflows are what is important in a permanent fund.

Update from the ERB

Jan Goodwin, executive director, ERB, and Bob Jacksha, chief investment officer, ERB, gave the committee an update on the ERB. Ms. Goodwin said that the ERB has 60,358 active members and 48,919 retired members, with a retiree payroll of $1.07 billion and member and employer contributions totaling $676,047,787. She also provided a summary of HB 360, which passed the legislature and was signed by the governor. She explained that while the changes effected by HB 360 will not result in an immediate change to the ERB's UAAL, they should cause the UAAL to grow more slowly in the future, and full funding should occur in 46 years, based on the June 30, 2018 valuation. Ms. Goodwin noted that, according to the ERB's actuary, if no additional money is available for an increase in employer contributions, in order for the ERB to reach full funding in 25 years, the COLA would have to be capped at 0.5% and the multiplier for all active and new members would have to be reduced by 0.35%.

Mr. Jacksha continued the presentation, noting that the ERB is diversifying its portfolio to reduce volatility. As of April 30, 2019, the ERB's asset value totaled $13.2 billion. He said that the ERB's strategy is working very well and that the ERB has one of the better performing pension funds in the United States.

A member asked if the ERB's expenses include investment advisor fees, to which Mr. Jacksha replied that the fees are not included in the figures. These fees are reported by the ERB once a year, usually in August or September, and the ERB would be happy to provide these numbers to the committee at that time.

Another member asked whether any ERB members participate in the PERA's 457b plan. Mr. Garcia replied that a handful of schools participate, and he can provide the exact numbers at a future meeting.

Another member asked if there have been any unintended consequences to return-to-work provisions due to the changes in HB 360. Ms. Goodwin replied that thus far there have not been push backs from school districts. The member said that a retired constituent claimed that the Albuquerque Public School District (APS) told her she could no longer be a substitute teacher. Ms. Goodwin said she had heard of a similar issue with APS, and she has contacted APS about this.

Another member expressed concern that the reforms in HB 360 do not change the UAAL. Ms. Goodwin emphasized that the UAAL will be growing at a smaller rate due to these reforms, a statement that she recently relayed to Moody's credit rating agency. The member noted that if the ERB employs its own advisors, it could save a significant amount of money, and he suggested examining this issue more closely this interim.

Lastly, a member suggested that the IPOC look at court rulings regarding COLAs to determine what rights the state does and does not have.

Update from the RHCA

David Archuleta, executive director, RHCA, summarized updates from the RHCA, which represents 302 public employer groups and has 93,349 active members and 63,372 retiree members. Its operating budget is $361 million, with main sources of revenue that include retiree contributions, employer and employee contributions and a distribution from the Tax Administration Suspense Fund. He stated that the RHCA has significantly improved its financial status since April 2009. According to Mr. Archuleta, the RHCA annually performs a solvency study that will next occur in July 2019. Currently, the RHCA's expected year of insolvency is 2037.

Mr. Archuleta stated that, effective January 1, 2021, the minimum age that members can receive a subsidy will increase to 55, and the years of service necessary to receive the maximum subsidy will increase from 20 to 25 years. He also noted that the health insurer fee, which was suspended in 2019, will be reinstated in 2020 and will cause Medicare Advantage plans to increase by 20% to 68% in 2020. Additionally, he explained that Medicare Part D rebates will likely be moving to point of sale in the near future, which could have an adverse impact on Medicare Supplement and Medicare Advantage plan rates.

A member asked for more information on the Medicare Part D rebates. Mr. Archuleta said that currently, the RHCA receives about $25 million in the form of rebates for being a Medicare Part D provider.

Another member asked if the RHCA has examined the practices of other states. Mr. Archuleta replied that practices vary among states, such as limiting the Medicare Supplement program or changing the minimum age to receive benefits to 65.

Proposed 2019 Interim Work Plan and Meeting Schedule

Mr. Montoya presented the IPOC's proposed work plan and meeting schedule for the 2019 interim. After discussion, members requested that the committee also address the following:

- review retirement, pension and investment plans from other states to compare and determine the efficiency of and potential improvements for state investment and pension agencies;
- receive a report on the efficiency and costs associated with employing professional investment staff within each investment agency;
- review potential funding and state investment plans for early childhood education;
- receive a report on the legal standards applied to policies relating to COLAs;
- review benefits of retiree health care recipients;
- review return-to-work policies of the PERA and the ERB;

- receive reports from the PERA, the ERB, the SIC, the RHCA and the state auditor on the Governmental Accounting Standards Board statements; and

- receive expert testimony, studies and reports on issues relevant to the investment of public funds and the administration of pension programs.

The committee adopted the proposed work plan and meeting schedule without objection.

Adjournment

There being no further business before the committee, the committee adjourned at 12:26 p.m.