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

June 20, 2017
State Capitol, Room 307
Santa Fe

The first meeting of the Investments and Pensions Oversight Committee was called to order by Representative Tomás E. Salazar, chair, on June 20, 2017 at 10:05 a.m. in Room 307 of the State Capitol.

Present
Rep. Tomás E. Salazar, Chair
Sen. George K. Munoz, Vice Chair
Sen. Jacob R. Candelaria
Rep. Miguel P. Garcia
Rep. Larry A. Larrañaga
Rep. Jane E. Powdrell-Culbert
Rep. Patricia Roybal Caballero
Sen. John M. Sapien
Rep. Larry R. Scott
Sen. Elizabeth "Liz" Stefanics
Rep. Jim R. Trujillo

Absent
Sen. Gay G. Kernan
Sen. Carroll H. Leavell
Sen. Steven P. Neville
Rep. William "Bill" R. Rehm

Advisory Members
Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales
Rep. Sheryl Williams Stapleton
Sen. James P. White

Sen. William F. Burt
Sen. Stuart Ingle
Rep. Bill McCamley
Sen. Mary Kay Papen
Sen. William H. Payne

Staff
Tessa Ryan, Staff Attorney, Legislative Council Service (LCS)
Kathleen Dexter, Researcher, LCS
Diego Jimenez, Research Assistant, LCS

Guests
The guest list is in the meeting file.

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

Tuesday, June 20

Welcome

Representative Salazar welcomed the committee and audience members to the new interim, noting that the committee's strong experience will serve it well as it addresses the challenges faced by the state's public employee retirement funds and pension programs.

Update from the Public Employees Retirement Association (PERA)

Wayne Propst, executive director, PERA, and Jude Pérez, interim chief investment officer, PERA, presented the committee with a review of the funds managed and programs administered by the PERA.

Mr. Pérez reported that PERA programs currently serve more than 76,000 active members and more than 40,000 retired members. In fiscal year (FY) 2016, PERA benefit payments exceeded $1 billion for the first time, and more than 92 percent of that total was paid to retirees who live in New Mexico.

The funds managed by the PERA — commonly referred to in the collective as "the PERA Fund" and referred to in that manner for the purposes of these minutes — reached a high mark of $14.9 billion in April 2017, with the balance two months later reaching $15.1 billion. As of the end of April, year-to-date returns on the PERA Fund came to 9.24 percent after fees, up slightly from the fund's overall performance of 9.04 percent since its inception in 1985.

The PERA is in the process of shifting percentages within the PERA Fund's asset allocations. The four broad investment categories will remain the same: 1) global equity, for economic growth; 2) risk reduction/mitigation, for safety and liquidity; 3) credit-oriented investments, for hybrid exposure to growth and income; and 4) real assets, for inflation protection. However, the percentage of the fund allocated to each investment category has been revised in the past year, with the new structure providing a more defensive investment approach aimed at reducing volatility in the fund. The asset allocation transition that began in July 2016 should be complete by September 2017.

Major initiatives under way at the PERA include:

- upgrades to its Retirement Information Online system, or "RIO";
- long-term pension solvency education for the PERA board to broaden the focus beyond investments and include a better understanding of and planning for liabilities; and
- a survey of PERA members aimed at improving services, with results from the survey to be presented to the committee later in the interim.

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

PERA Fund solvency and performance. The goal for the PERA Fund is to be 100 percent solvent by 2043, but projections show it falling short. While public pension plans generally use a 30-year amortization period for liabilities, the PERA is using a 55-year period because: 1) it has recently lowered its investment return assumption for the next 10 years from 7.75 percent to 7.25 percent; and 2) returns in the last two years have been lower than initially projected. The PERA Fund dropped nearly 30 percent following the 2008 economic downturn and has underperformed since that time, leaving New Mexico with less equity in its retirement investment portfolio compared with other states.

Fees. Fees deducted from portfolio returns in calendar year 2016 came to 36 basis points, or $89 million, and covered administration, consultant, management and performance fees. When the portfolio performance does not meet its goal, the manager's fee is reduced. Overall fees for the PERA Fund have been reduced by 22 percent in recent years.

Pension plan stability. The judicial and magistrate plans are falling short of their solvency goals, and while they are not insolvent, they were 62 percent funded at the end of FY 2016 and are continuing a downward trajectory. The state general and municipal fire plans currently range from 65 percent to 70 percent funded and are projected to decline to 35.8 percent and 40.6 percent, respectively, by 2043. Some plans are doing well: by 2043, the municipal general and municipal police plans are projected to be nearly 100 percent funded, and the state police and adult correctional officer plans will be nearly 270 percent funded.

Chief investment officer. Interviews are in process for the chief investment officer position, which has been open since Jon Grabel left to serve as investment officer for Los Angeles County. A final candidate will be selected by the end of July.

Pension payments' economic effect. The U.S. Bureau of Economic Analysis estimates that PERA retirement benefit payments account for 1.07 percent of New Mexico's overall economy.

- Mr. Propst and Mr. Pérez offered to:
  (1) make a presentation to the committee later in the interim on the results of the PERA member survey; and
  (2) report to the committee in August or September on the PERA's pension plan liabilities and ways to address them.

- Senator Munoz requested that the PERA provide modeling on cost-of-living-adjustment (COLA) reductions, especially in the magistrate and judicial retirement plans.

- Representative Garcia requested county-level data that show PERA benefits as a percentage of each county's per capita gross domestic product.

Update from the State Investment Council (SIC)

Steven K. Moise, state investment officer, SIC, and Vince Smith, deputy state investment officer, SIC, gave a status report on the public funds under SIC management.

The SIC currently manages $22.18 billion in assets. These include the land grant, severance tax, tobacco settlement and water trust permanent funds, as well as funds under the control of state agencies, local governments and affiliated entities such as university foundations. Investments are divided among fixed-income investments (23.7 percent), private market investments (31 percent) and public equity investments (45.3 percent). In a move to create a stronger and more stable income for the portfolio, the SIC has recently restructured investment allocations to steer away from the stock market and into less volatile real assets.

Distributions from the state's permanent funds into the General Fund have increased from nearly $300 million to nearly $900 million in the past two decades, and they currently account for up to 15 percent of the state's annual budget. The annual tax savings attributed to distributions from all permanent funds total about $450 per New Mexico resident, or $1,100 per household.

The bulk of the distributions come from the Land Grant Permanent Fund and the Severance Tax Permanent Fund, with distributions from the former earmarked in their entirety and distributions from the latter available for expenditure by the legislature. Eighty-five percent of the Land Grant Permanent Fund distribution currently goes to public schools, while the remainder is split among higher education institutions; constitutionally established special schools and institutions; public buildings; prisons; hospitals; and reservoirs.

Investment returns on both the Land Grant Permanent Fund and Severance Tax Permanent Fund exceeded their long-term targets in the past year and over the past five years; however, returns measured at the three-year and 10-year marks show the funds below their targets due to market conditions during those periods. Returns over the coming decade are projected to be below the target as well.

On questioning, the presenters and committee members addressed the following topics. They were joined by Charles Wollmann, director of communications, SIC, and Brent Shipp, chief financial officer, SIC, both of whom spoke from the audience on invitation of the chair.

Land Grant Permanent Fund beneficiaries. Each beneficiary receives a distribution tied to revenue generated by state lands. While the distributions are governed by that act, the use of the money is not; it is left to the discretion of each beneficiary.

Carrie Tingley Hospital was added to the list of beneficiaries by way of a land swap that took place while Patrick Lyons was commissioner of public lands.

A committee member suggested that the distribution to the Miners' Colfax Medical Center be adjusted now that there is no longer any mining in Colfax County.

Peer ranking of investment portfolios. New Mexico's portfolio ranking against other states is ahead of the median performance; however, this ranking falls to slightly below the median if a different set of data is used for comparison. In such peer rankings, short-term performance measures are greatly affected by temporary deviations and, thus, prove to be less valuable than long-term measures. The SIC is focused on the long term.

Investment strategy. Unlike investment entities in most other states, the SIC makes its investment strategy available to the public on its website. The website includes information on growth patterns from high-risk investments versus conservative investments, as well as the range of risk included in the SIC's investment strategy. Fees are enumerated on the website as well.

- Mr. Wollmann will provide information on how the Land Grant Permanent Fund distributions are used for the New Mexico Behavioral Health Institute at Las Vegas and for "saline lands".

Update from the Educational Retirement Board (ERB)

Jan Goodwin, executive director, ERB, and Bob Jacksha, chief investment officer, ERB, presented an overview of the ERB's membership and services, a status report on its investment portfolio and an overview of ERB-related legislation in the 2017 regular session.

As of the end of FY 2016, the ERB had just over 60,000 active members and nearly 46,000 retirees and beneficiaries, with membership remaining essentially flat for the past several years. Retirement benefits paid out in FY 2016 totaled $973.7 million, while contributions from active members and participating employers for the same period came to $693 million. The difference was covered by earnings on the ERB's portfolio, which totaled $11.5 billion at the end of FY 2016 and has grown since that time to more than $12 billion.

After deducting manager fees, the portfolio showed returns as of March 31, 2017 that range from 8.9 percent (fiscal year to date) to 5.4 percent (10 years), with the 30-year return rate at 8.7 percent. A month later, fiscal-year-to-date returns rose to 10.3 percent, while 10-year returns fell to 5.2 percent. The ERB's target for returns was 7.75 percent until April of this year, at which time it was reduced to 7.25 percent.

Senate Bill 28 from the 2017 regular legislative session, which passed both chambers and was signed into law, made "cleanup" and clarification changes to statutes regarding ERB provisional membership and disability benefits. Senate Bill 29, which did not receive a hearing in committee, would have revised the ERB director's authority to hire and set salaries for staff and would have required that salary classifications and ranges be modeled on those used for governor-exempt employees. Senate Bill 2, which passed both chambers but was vetoed by the governor, would have required that the ERB and certain other state agencies provide additional financial information to the state auditor.

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

COLAs. The COLA applied to ERB retirement benefits is based on the Consumer Price Index (CPI): if the CPI increases, the subsequent year's COLA is calculated at 50 percent of the change in the CPI over the previous year. The COLA is currently reduced, rather than suspended, until the ERB plan is 100 percent funded. The reduction was made on a sliding scale based on a retiree's years of service and benefits total. Retirees who receive disability benefits had no COLA reduction.

Unfunded liabilities. The ERB's current unfunded liability is approximately $7.4 billion. Some of this shortfall can be attributed to market forces; however, the primary cause is a decrease in the number of active members making contributions, and this is due to shrinking employment in public and higher education. To address the shortfall, the ERB has shifted to using generational mortality assumptions, which are conservative. Another measure to address the shortfall — adjusting contribution rates — could only be taken by the legislature because the rates are set by statute.

Revisions to Governmental Accounting Standards Board (GASB) Statement 68 require a new calculation of unfunded liabilities, which must now be apportioned to each participating employer's balance sheet and paid down through contributions.

- Representative Garcia requested county-level data that show ERB benefits as a percentage of each county's gross domestic product. Ms. Goodwin noted that the ERB has tried to get this information from the Bureau of Business and Economic Research at the University of New Mexico in the past, but the bureau does not have county gross domestic product data.

Update from the Retiree Health Care Authority (RHCA)

David Archuleta, executive director, RHCA, gave an update on the system that provides comprehensive core group health insurance to retired public employees.

Mr. Archuleta reported that approximately 10 percent of the adult population of New Mexico are RHCA members — nearly 100,000 enrolled active employees and about 61,000 participating retirees and eligible dependents. He cited 2016 findings projecting that a couple who retires at age 65 can expect to incur $260,000 of medical expenses during retirement — a significant burden given that the average monthly pension from public retirement plans ranges from $1,800 to $2,400.

The RHCA FY 2018 operating budget is $323 million. Of that amount, less than one percent is used for administrative expenses, and the balance is paid out in health care benefits. Retiree premiums and active employee contributions account for just over 84 percent of the RHCA's revenue, while the balance comes from miscellaneous revenue sources, such as interest, and a distribution from the Tax Administration Suspense Fund. Senate Bill 7 from the 2016 special session reduced that distribution, and as a result, the RHCA plan's solvency projection has been extended by two years, to 2032. Unaffected by the reduction, however, the trust fund underlying the RHCA continues to grow, with its balance currently over $550 million.

Like the ERB, the RHCA will be affected by recent changes to GASB standards. Unfunded liabilities for the plan will increase under the new reporting requirements, and participating employers will report the liabilities on their financial statements.

The RHCA is currently developing its strategic plan for 2018 through 2022 and expects to finalize the plan by November of this year. Elements of the plan address self-insured costs; subsidy levels; wellness and population health programs; value-based purchasing initiatives; demographic trends; and contribution increases. The RHCA is also looking into establishing a minimum retirement age.

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

Medicare. RHCA members who qualify for Medicare are offered the option of enrolling in the Medicare supplement plan.

Pharmacy benefits management. The RHCA will issue a request for proposals for pharmacy benefits management in August to cover the period from July 1, 2018 to June 30, 2022. Companies bidding to provide these services to state entities are required to include local pharmacies in their proposals.

Competition from other health plans. Some retirees have chosen not to participate in the RHCA because they have gotten less expensive health coverage elsewhere. Increases in contribution rates must be weighed against possible enrollment losses.

2017 Interim Work Plan and Meeting Schedule

Ms. Ryan presented a proposed work plan and meeting schedule for the 2017 interim for the committee's consideration. A copy of the work plan may be found in the meeting file.

On a motion duly made, seconded and unanimously adopted, the committee approved the work plan with the following additions:

(1) a presentation on the use of Land Grant Permanent Fund distributions by the beneficiaries;

(2) a presentation of COLA adjustment modeling on all funds; and

(3) a presentation on the effects of recent, temporary changes to employee and employer contribution rates on pension fund solvency.

Adjournment

There being no further business, the committee adjourned at 12:40 p.m.