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

May 19, 2016
Room 322, State Capitol
Santa Fe

The first meeting of the Investments and Pensions Oversight Committee was called to order by Representative Monica Youngblood, vice chair, on May 19, 2016 at 10:10 a.m. in Room 322 of the State Capitol.

Present	Absent
Rep. Monica Youngblood, Vice Chair	Sen. George K. Munoz, Chair
Rep. Miguel P. Garcia	Sen. Sue Wilson Beffort
Rep. Larry A. Larrañaga	Sen. Jacob R. Candelaria
Sen. Bill B. O'Neill	Sen. Carroll H. Leavell
Rep. William "Bill" R. Rehm	Sen. Steven P. Neville
Sen. William P. Soules	Rep. Jane E. Powdrell-Culbert
Rep. Jim R. Trujillo	
Rep. Luciano "Lucky" Varela	

Advisory Members

Sen. Ted Barela	Sen. Carlos R. Cisneros
Rep. Roberto "Bobby" J. Gonzales	Rep. Patricia A. Lundstrom
Sen. Stuart Ingle	Sen. Mary Kay Papen
Rep. Tomás E. Salazar	Sen. William H. Payne
Rep. James E. Smith	Sen. John C. Ryan
	Sen. Michael S. Sanchez
	Rep. Sheryl Williams Stapleton

Staff
Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Diego Jimenez, Research Assistant, LCS
Tessa Ryan, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

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

Thursday, May 19

Update from the Public Employees Retirement Association (PERA)

Susan Pittard, chief of staff, PERA, conveyed the regrets of Wayne Propst, the executive director of PERA, for his absence at the meeting. She then introduced several PERA staff members who were in the audience, including Natalie Cordova, chief financial officer, PERA, and Jude Perez, deputy chief investment officer, PERA. Greg Trujillo, deputy executive director, PERA, joined Ms. Pittard in updating the committee on key PERA-related information and figures, as follows.

Employees served by the PERA. The PERA administers pension plans for nearly 50,000 members categorized as state and municipal employees. It also administers a host of smaller plans that include the "Smart Save" deferred compensation plan and plans for volunteer firefighters, legislators and judges.

Membership and retirements. In April 2016, active members numbered 48,439. In the period from May 2015 to April 2016, the number of retired members rose marginally but steadily to a peak of 38,157. Across all PERA-administered plans, there have so far been 1,809 retirements in fiscal year (FY) 2016. Statutory changes to cost-of-living-related payment adjustments are not prompting a noticeable spike in retirements.

Recent benefit payments. For FY 2015, the PERA paid about $1.021 billion in benefits. Of that amount, about $900 million was paid to retirees in New Mexico; about $75 million was paid to retirees outside New Mexico; and about $46 million was paid to non-retiree members who withdrew their contributions upon terminating employment.

Net pension liability; reporting. The PERA's public employee plans' net pension liability increased almost $1 billion from FY 2014 to FY 2015. In response to the recent implementation of new Governmental Accounting Standards Board (GASB) statements, the PERA plans to inform each of its participant employers of the employer's allocation of total net pension liability.

PERA accomplishments. In FY 2015, in an effort to improve its services, the PERA contracted with a third party to conduct an internal audit. The PERA has followed through on several of that contractor's recommendations, and the agency plans action on the remaining recommendations. The PERA has also: 1) reduced its FY 2017 operating budget; 2) secured an FY 2017 appropriation for enhancements to the retirement information online system; 3) transitioned seamlessly to a new custody bank; 4) updated its branding and website; 5) made it clearer to the public that the PERA administers the deferred compensation plan; and 6) improved its member services. Adding to those achievements, the PERA received an unmodified opinion with no findings for its FY 2015 financial audit.

Strategic asset allocation; fund performance. Redesigning asset allocations with risk reduction in mind, the PERA established new distribution targets for its investments in each of four categories. The proportion of assets invested in "global equity" and "risk reduction/ mitigation" will decrease, and the proportion in "credit oriented" and "real assets" will increase.

On March 31, 2016, the PERA fund totaled $14 billion, and the deferred compensation plan balance was $494 million. Since the start of the fiscal year, the fund's return, net of fees, was -1.33%. The PERA expects the new strategic asset allocation to improve returns.

Questions and Discussion

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

Internal audit. Ms. Pittard explained that the internal audit is a management tool for identifying the agency's internal, systemic weaknesses. Mr. Trujillo added that, as part of the audit process, the external auditor reviews the findings of the internal audit and ensures that the agency is following through on the recommendations made in the internal audit.

PERA's custody bank. Ms. Pittard said that before BNY Mellon, the PERA used J.P. Morgan as its custody bank. The PERA has found that BNY Mellon customizes its services to meet the state's needs and that using it saves the agency money. Mr. Trujillo added that the new custody bank's reporting to the PERA allows better monitoring of its portfolio and risk exposure. He said that only a small number of banks in the nation would be capable of handling the amount of money that the PERA manages, and none of them is a local bank.

Stresses on system caused by disparity between contributions and payments. Remarking on the ratio of active members to retirees, several members expressed concern about the strain on the system caused by the increasing longevity of retirees. Mr. Trujillo said that the PERA's actuaries study mortality figures and adjust assumptions accordingly. He acknowledged that baby boomers put strain on the system, but he also asserted that recent legislative changes to the Public Employees Retirement Act and the growing emergence of millennials will help temper that strain.

PERA investments; investment returns. Mr. Perez elaborated as follows on the reasons that the current financial environment can be characterized as "muted". Twenty years ago, U.S. bonds yielded returns of about 6% to 8%. Today, returns on those investments are closer to 1.75%. From a global economic standpoint, there is no catalyst for major growth. Mr. Perez added that it is not known when return rates will begin to rebound.

In response to a member's suggestion that the PERA, like many private retirement savings plans, silo assets for investment according to members' nearness to retirement and choose investments with corresponding risk levels, Ms. Pittard stated that the PERA pools the assets. The Public Employees Retirement Board monitors the market environment and uses that information to decide on strategic asset allocations, she said. She added that the pooled assets are divided and invested at a range of risk levels; some investments temper risk, and others drive returns. The need for liquidity, she said, directs that approach. Mr. Perez elaborated by saying that risk-mitigating investments constitute much of the PERA's investment portfolio, but the proportion of those investments can change if financial markets improve; furthermore, the PERA's requirement to provide defined benefits, as distinguished from defined contribution plans, supports the PERA's approach.

Smart Save deferred compensation plan. Ms. Pittard elaborated on the deferred compensation plan, including by noting that: 1) the PERA's efforts at improving its branding extend to the deferred compensation program; 2) the agency is trying also to improve awareness of the program; 3) the PERA contracts with a third party, Nationwide Retirement Solutions, to administer the plan and has an advisor dedicated to making investment recommendations; and 4) participants select from asset allocation options, which range from aggressive to conservative. Karyn Lujan, PERA Smart Save plan manager, who was in the audience, added the following remarks about the plan: 1) most enrollees are between the ages of about 30 and 50; 2) interest among those eligible to participate tends to increase after their PERA vesting; 3) the agency is boosting its advertising to younger eligible participants; 4) some investment options are designed to perform based on the timing of projected withdrawals; and 5) Nationwide has four representatives in the state who can educate prospective or active participants on fund strategies and projected outcomes, but, ultimately, investment decisions are left to participants.

Ms. Lujan summarized some features of the plan: severance from employment is generally a prerequisite to withdrawal; a participant might qualify for withdrawal if the participant experiences an unforeseen emergency; distributions are taxable as ordinary income but are not subject to the 10% penalty imposed on other types of retirement-savings withdrawals under federal law; and some plans include a loan option; those loans range in amount from $1,000 to 50% of the account balance, up to $50,000.

A member requested that the committee add the topic of the deferred compensation program to the committee's proposed work plan.

Retirements; refunded member contributions. Ms. Pittard stated that, for purposes of service credits and benefit payments, the PERA and the Educational Retirement Board have a reciprocal relationship. Mr. Trujillo stated that June is a peak month for retirements and that the number of retirements in the past year is about the same as or lower than in the previous year, when recently enacted legislation would have had a more pronounced effect. Mr. Trujillo also said that when members withdraw their contributions before retirement, it is usually the case that their need for that money is dire.

New GASB standards. Ms. Cordova clarified that: 1) though the PERA is not required to inform participant employers of their net pension liability, it does so because it is helpful to those entities; and 2) while the net pension liability calculation introduces volatility to the measurement of a government's long-term obligations associated with its pension benefit provision, over time, reporting under the new GASB standards will improve the assessment of a pension fund's health.

Other comments. In response to a member's question of whether the PERA has ever considered giving members the option of wholesale, one-time payments upon retirement, Ms. Pittard replied that the Public Employees Retirement Act is set out as a defined-benefit, 401(a) plan and that the board is committed to maintaining that structure. Another member remarked on the benefit to the economy and to governments, in the form of taxes, of the retirement payments, which annually exceed $1 billion, disseminated throughout the state.

Requests for more information. Members requested of the presenters more information on: 1) the characteristics of the deferred compensation program's participants, including data showing the ages of enrollees; 2) terms of the contract that PERA entered into with Nationwide Retirement Solutions; 3) the projected and actual ages of death of primary beneficiaries for each of the pension plans and the projected ages of death of secondary beneficiaries; 4) the economic effects of pension payments, as shown by the ratio of those payments in each county to the county's gross domestic product; and 5) the number of retirements in recent periods.

Update from the State Investment Council (SIC)

Steven K. Moise, state investment officer, SIC, Vince Smith, deputy state investment officer, SIC, and Charles Wollmann, director of communications and legislative affairs, SIC, updated the committee as follows on the status of SIC-managed assets. Mr. Moise expressed gratitude to the committee for its help in passing several bills designed to improve SIC-managed funds' health.

Assets, investments and investment performance. SIC-managed assets, which include money in the Land Grant, Severance Tax, Tobacco Settlement and Water Trust permanent funds and governmental clients' assets, totaled $20.17 billion on April 30. That figure represents a nominal increase from the beginning of the first quarter, a period characterized by volatility but a relatively insignificant overall change in fund value. As of April 30, 44.4% of SIC-managed assets are invested in public equities, 31.9% in private markets and 23.4% in fixed income investments. The percentage returns on investments of assets in the permanent funds, as seen over several historical ranges, have fallen short of the SIC's target. Slack in oil and gas extraction revenues is compounding the problem of weak returns.

Fund inflows and distributions. Increasingly, inflow amounts to the Land Grant and Severance Tax permanent funds are weak in comparison to the amounts of distributions made from those funds. For the month of April, distributions from those funds exceeded inflows by $45.6 million. If the trend of depressed inflows continues, the amounts of distributions from those funds will decrease.

Largely because of a statutory change to the rate used in calculating distributions from the Land Grant and Severance Tax permanent funds (from 5.5% to 5%), the SIC projects a $10.8 million decrease in year-over-year distributions from those funds for FY 2017. Meanwhile, it forecasts FY 2018 distributions of $51.8 million more than FY 2017 distributions.

Investment outlook. The SIC expects low return rates in the next seven to 10 years; the outlook for the macroeconomic environment and the financial market is dim. In that time, the SIC projects that rates of return will range from about 6.5% to 7%. The SIC's peers, too, are lowering their return targets.

Meanwhile, stocks and bonds, two traditionally productive investment vehicles, have simultaneously become relatively expensive. To contend with that circumstance, the SIC began in 2011 to pursue a reduction in exposure to those investments. Like many of its peers, the SIC is gradually shifting away from stock and bond investments and — within certain risk parameters — shifting its assets toward investments, such as real estate, that it believes will yield higher returns. It is also building its protection against downside risks and positioning itself to fare well in the face of rising interest rates and inflation.

New Mexico investments. The SIC recently approved the release of $10 million to invest in New Mexico-based start-up companies. The money will be deposited into a fund, the "New Mexico Catalyst Fund, LP", managed by Sun Mountain Capital, LLC. The U.S. Treasury has helped capitalize the fund with approximately $5 million.

Questions and Discussion

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

Investment strategy; federal interest rate. Responding to members' questions, Mr. Smith indicated that: 1) the SIC designed its investment strategy with an eye to a possible rise in federal interest rates, which would improve stock and bond yields, though it is not known when any interest rate change will occur; 2) the strategy also reflects the trend of worsening bond performance; 3) the Federal Reserve is struggling to overcome the scarcity of tools at its disposal to fight the recession; 4) the economy is strengthening, but it is not strong; 5) the SIC has recently increased its investments in real estate, real assets (e.g., timber) and infrastructure (e.g., power companies, power distribution, shipping and airports) because it expects them to generate income; 6) increasingly, the number of stocks attractive to invest in has dwindled; and 7) the SIC is moving away from cap-weighted indices and toward a more diverse portfolio. A member commented that the SIC should be careful in shifting its investment strategy just because of uncertainty in the new investments' performance but also acknowledged that economic conditions have generally put an end to investments that hold more promise.

Changes to the Land Grant Permanent Fund distribution rate. Mr. Wollmann indicated that if voters approved an increase in the Land Grant Permanent Fund distribution rate, the timing of the first higher-rate distribution would depend on factors that include the legislation's provisions and the possible requirement for congressional approval of the change.

Projected distributions. Commenting on the SIC's projections of future distributions from the Land Grant and Severance Tax permanent funds, Mr. Wollmann said that many factors, including increased distributions or decreased inflows, could dramatically change the reported figures. Mr. Moise added that the projections are unlikely if the distribution rate exceeds 5%.

Governmental clients. Mr. Wollmann elaborated on the SIC's governmental clients and their relationship with the SIC. Only certain such investors qualify for and are suited to take advantage of the SIC's services. The SIC's governmental clients include universities, cities, counties, agencies and school districts. To become a client, the SIC and the entity enter into a joint powers agreement approved by the Department of Finance and Administration. The agreement provides for low fees; a given rate is based on the size of the client's permanent fund. Since the SIC has no budget to advertise its services, clients generally learn of the services by word of mouth.

New Mexico Catalyst Fund. A member stressed the importance of venture capital investments to economic growth in light of reports predicting that a majority of the jobs of the future do not exist today.

Mr. Moise elaborated as follows on the New Mexico Catalyst Fund. It includes money, available from the U.S. Treasury's State Small Business Credit Initiative, that was very likely to otherwise remain unused before the spending deadline. The Economic Development Department, the New Mexico Finance Authority and the governor proposed to the SIC that it create a program to use and leverage the money in the fund for economic development. The SIC agreed and voted to invest $10 million. The fund administrator, Sun Mountain Capital, which is based in Santa Fe, will soon solicit applications for access to the fund assets. Mr. Moise suggested that, though the investment is high risk and might yield losses before it yields gains, ultimately, the fund's performance would satisfy high expectations.

Mr. Wollmann added some related comments. He said that: 1) the fund's structure is unique because it aligns federal, state and private interests; 2) while it may appear that New Mexico's second-stage investing is adequate, this program will help fill a deficiency in early-stage investments; and 3) the SIC hopes that the fund is self-perpetuating. A member praised the fact that the pursuit's risk is spread among several entities.

Update from the Education Trust Board (ETB)

Theodore Miller, executive director, ETB, presented to the committee on the ETB's mission, goals and 529 program as follows. He prefaced his presentation by stressing that, unlike other state-created entities, the ETB operates like a business and relies exclusively for its funding on fees for service.

Overview of the ETB. The board's mission is to help students get a post-secondary education, including at four-year colleges, trade schools and junior colleges, by administering the 529 college savings program. With an eye to the importance of improving the lives of New Mexico children, other residents and the New Mexico economy, the board strives to enable as many New Mexico children as possible to become beneficiaries of 529 college savings accounts before they reach age 10. The board has identified as its goals: 1) consistent year-over-year growth in the number of account owners; and 2) recognition as one of the top-15 529 college saving programs in the nation. It is now ranked as number 25.

Board governance and oversight. The ETB is governed by a five-person board, has only two paid employees on staff — Mr. Miller and a financial coordinator — and uses a host of consultants for its industry/investment and operations needs. As part of the board's oversight process, the board's investment consultant and industry consultant report to the board, and the board and the investment consultant conduct site visits of the organization's program manager, Oppenheimer Funds, to review its operations, investment management and risk management. A recent site visit in New York left the reviewers with positive overall impressions.

New Mexico 529 program. The 529 program consists of two plan options: the Education Plan and the Scholar's Edge. The Education Plan is sold directly to participants, has 20,858 accounts, has an average Morningstar rating of 3.7 stars and offers investment options whose risk levels are either based on age or are static. Within those investment options, plan participants may choose from an index or blended portfolio. Meanwhile, the Scholar's Edge plan is sold indirectly through commission-based investment advisors, has 117,467 accounts, has an average Morningstar rating of 3.5 stars and offers investment options whose level of risk is either based on age, is static or conforms to individual preference. Each program offers three risk-based track levels.

On March 31, both plans' assets totaled about $2.257 billion. The figure represents a slight drop from the June 30, 2015 total. Assets in the Education Plan constitute approximately 21% of the March 31 balance, and assets in the Scholar's Edge plan constitute about 79% of it. The $355.6 million in assets held in New Mexico on March 31, which equals 15.8% of the total, represents a slight decrease from that figure as recorded on June 30, 2015.

Program marketing and improvement. The ETB has ramped up its marketing efforts and its efforts at improving the public's ease in understanding and applying to its programs. These efforts include advertising in local publications, strengthening the ETB's presence on social media, improving the ETB's website usability and allowing for pauses in online application form completion. Moreover, the ETB will increase its financial investment in marketing, introduce new advertising messages, pilot a matching-grant program, reach out more to employers and continue its distribution of promotional materials. To further boost the ETB's visibility, ETB representatives promoted its college savings programs at the National Honor Society-National Junior Honor Society state summit held in April at the University of New Mexico's main campus.

Program performance. Overall, the ETB's programs and investments have been performing well.

Questions and Discussion

On questioning, the committee and Mr. Miller addressed the following topics.

Program assets. Mr. Miller explained that the figures marked as assets on page 15 of the handout associated with his presentation represent the sum of all program assets held in trust, money in all accounts and investment gains.

Litigation. Mr. Miller noted that the lawsuit related to alleged mismanagement of the New Mexico college savings plans has been resolved.

College savings plan and student debt. Mr. Miller indicated that, though information on the relationship between college savings plans and student debt is scarce, recent reports suggest that debt is not as high as it used to be. Research further suggests that children of families that save for their educations are more likely to graduate from college, he said. A member expressed an interest in hearing more on the relationship between college savings programs and debt, and the member encouraged Mr. Miller to explore the topic.

2016 Interim Work Plan and Meeting Schedule

Ms. Sullivan presented the committee's 2016 proposed work plan and meeting schedule. In response to suggestions made during the meeting, she proposed two additions to the proposed work plan: 1) to Item (7), a provision that the committee receive testimony from experts about public employee participation in 457 deferred compensation plans; and 2) to Item (8), a provision that the committee receive reports on proposed legislation concerning changes to the Public Employees Retirement Act that would establish certain return-to-work measures.

A member suggested that the committee also consider a piece of legislation, which it endorsed in the 2015 interim, that would allow a municipality to establish a post-employment life insurance benefits trust. Ms. Sullivan noted that the current wording of the work plan encompassed the topic and that the committee could hear the item with the chair's approval.

With no opposition, the committee adopted the work plan and meeting schedule.

Adjournment

There being no further business before the committee, the committee adjourned at 1:20 p.m.