NEW MEXICO EDUCATIONAL RETIREMENT BOARD

ACTION SUMMARY

April 9, 2018

MINUTES OF THE

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

ANNUAL RETREAT

April 9, 2018

1. CALL TO ORDER: QUORUM PRESENT

The Annual Retreat of the New Mexico Educational Retirement Board was called to order on this date at 9:00 a.m. at the Prairie Star Restaurant, 288 Prairie Star Road, Santa Ana Pueblo, New Mexico.

Members Present:
Ms. Mary Lou Cameron, Chairwoman
Mr. H. Russell Goff, Vice Chairman
Mr. Larry Magid, Secretary
Mr. David Craig
Dr. Donald W. Duszynski
The Hon. Tim Eichenberg, State Treasurer

Members Excused:
None.

Staff Present:
Ms. Jan Goodwin, Executive Director
Mr. Rick Scroggins, Deputy Director
Mr. Bob Jacksha, Chief Investment Officer
Mr. Roderick Ventura, General Counsel
Ms. Susanne Roubidoux, Deputy General Counsel
Ms. Monica Lujan, Member Services Director
Ms. Liz Lorang, Executive Assistant

Others Present:
Mr. Ryan Falls, Gabriel Roeder Smith & Company (GRS)
Mr. Keith Brainard, National Association of State Retirement Administrators (NASRA)
Ms. Patricia Turner, Contract Attorney
Ms. Judith Beatty, Recorder

b. Approval of Agenda

Mr. Goff moved approval of the agenda, subject to reprioritization. Dr. Duszynski seconded the motion, which passed unanimously.

c. Introduction of Guests

Chairwoman Cameron welcomed staff and guests.

2. PUBLIC PENSION ENVIRONMENT PRESENTATION: KEITH BRAINARD, NASRA RESEARCH DIRECTOR

a. **Characteristics of well-funded pension plans**
b. **Income replacement data**
c. **Working requirements from other plans**
d. **Other states' approaches to COLAs**

Mr. Brainard made a slide presentation: "A National Perspective of State and Local Pensions."

-- In the public sector, nearly all full-time workers have access to an employer-sponsored retirement benefit; most have access to a traditional Defined Benefit (DB) plan. Eighty-seven percent of full-time employees participate in a pension plan. Virtually all others are in a Defined Contribution (DC) plan.

-- Of 6,000+ public retirement systems, the largest 75 account for 80+ percent of assets and members.

-- Public pensions in New Mexico have $28 billion in assets and 117,000 active participants. About 85,000 retirees and their survivors receive $2.2 billion annually in benefits.

-- Annual contributions are $1.3 billion, with $734 million from employers and $560 million from employees.

-- Spending on pensions as a percentage of all state and local government spending: 3.41 percent.

-- Since 2009, nearly every state modified public pension benefits and/or financing arrangements.

-- New hybrid plans are being created by legislatures nearly every year. Mostly DB-DC, with some cash balance plans. They usually apply only to new hires. The DB-DC plans maintain a

DB component, with a lower benefit accrual rate; and the cash balance plans contain key features of DB plans but also transfer some investment risk to workers.

Mr. Brainard cited ways that funding level improvements were instituted by West Virginia TRS, Maine PERS, and Oklahoma TRS. The common elements among these three entities are: 1) payment of the full required contribution; 2) COLA benefits modest to non-existent; 3) actuarial methods that expedite amortization of the unfunded liability; and 4) relatively low investment return assumptions. He pointed out that New Mexico's fixed rate employer contribution policy is a major impediment to improvement the plan's funding level.

-- Methods states are using to amortize unfunded pension liabilities:

- Pay the actuarially determined contribution
- Commit a portion of the budget surplus to the unfunded liability, either ad hoc or in statute (AK, HI, RI)
- Issue pension obligation bonds
- Establish a dedicated funding stream, such as revenue from tobacco, liquor, gambling or severance taxes (KS, MT, OK)
- Dedicate a portion of sales, use, and/or corporate income tax revenues (OK)
- Reduce the funding amortization period/change the method
- Transfer ownership of the state lottery to the pension fund (NJ)

3. <u>ACTUARIAL PRESENTATION: RYAN FALLS, GABRIEL ROEDER SMITH</u>

a. **<u>NMERB retiree profiles: income, age, years in retirement, gender</u>**
b. **<u>COLA data</u>**
c. **<u>UAAL breakdown: Actives and retirees</u>**
d. **<u>Annual Cost of UAAL</u>**

Mr. Falls made a presentation: "Actuarial Soundness and Sustainability."

-- The board's current funding policy is to eliminate the UAAL by June 30, 2042:

- Actuarial Funded Ratio: 62.9%
- Unfunded Actuarial Accrued Liability (UAAL): $7.4 billion
- Normal Cost Rate: 13.62% [based on 60,000 active members to cover their benefit for the rest of their career)
- Funding Policy Contribution (Employer): 20.19%. Current contribution rate of 13.90% is not enough to cover the normal cost and interest on the UAAL.
- Based on the current contribution rate, it will take 61 years, not 25, to eliminate the unfunded liability.

Responding to Chairwoman Cameron, Mr. Falls said it is more common for plans to require that the contribution rate be automatically adjusted based on the annual valuation. New

Mexico is in a quadrant of the country where it is less common, however; for instance, Oklahoma and Texas also have fixed rate plans.

-- Expected FY 2018 contributions of $298 million have been allocated to eliminating the UAAL. Total expected contributions are $668 million; however, the first $370 million is allocated to normal cost.

-- UAAL at June 30, 2017 was $7.4 billion. At 7.25% per year, interest on UAAL was $533 million.

-- Contributions are expected to exceed interest on UAAL in about 40 years.

Mr. Falls stated that, ten years from now, the UAAL is expected to be about $10 billion, half of which will be interest on the unfunded liability that is not being paid down through contributions.

Mr. Ryan reviewed a checklist that rated each of the NMERB's funding policies in terms of sustainability.

Mr. Falls discussed risk factors, noting that investment risk (return volatility) is the largest risk facing the NMERB, and because of the fixed contribution rate structure of the plan, the timing of returns is very important.

Mr. Falls reviewed a series of illustrative projections showing a 7.25 percent return over a 20-year time horizon, incorporating historical volatility patterns.

Mr. Falls discussed demographic risks. While the NMERB has assumptions for future active members, future payroll and contribution levels, lifespan, etc., it is possible that the actual experience could be different. For example, mortality might improve faster than expected or the number of teachers in New Mexico could change over time.

Mr. Falls said plan design changes should be considered to improve sustainability. Even with a path to full funding, the fund could experience setbacks because of risk factors, e.g., investment risk, maturity risk or demographic risk. One modest economic shock event could change the depletion date.

Mr. Falls reviewed a hypothetical set of plan design changes.

-- Increase employer contribution percentage to 16.90% (3% increase); suspend all COLAs until NMERB is 100% funded; future active members have a 2% benefit accrual rate (currently 2.35%). Result: Lowers funding period to 21 years, UAAL increases for two years and then begins to decrease quickly. Once UAAL is eliminated, COLA would be restored and contributions could be lowered.

-- Consider incorporating contribution triggers in the plan now.

Mr. Falls stated that the NMERB should be hearing a lot more about risk going forward, as there is a new actuarial standard of practice that has been finalized and will be part of the 2018 valuation. He said a new ASOP (Actuarial Standards of Practice) has been published; in addition, a draft of "The Pension ASOP" will be coming soon that will also touch on areas of risk.

This concluded Mr. Falls' presentation.

Mr. Goff stated that New Mexico is facing significant revenue challenges, with not enough money to meet its existing needs. For example, teachers just received their first raise in many years. He said this is problem facing many other states.

Mr. Falls responded that something has to adjust, and if the money can't come from the contribution side, then it has to come from the benefits side.

Mr. Falls discussed various ways that COLA payments have been adjusted in other states. For example, Rhode Island pays a COLA every five years and this will continue until the plan's funding improves.

Mr. Falls said he and Ms. Goodwin have discussed applying a COLA based on a minimum income level of $20,000.

Ms. Goodwin commented that, if the NMERB were to do something like that, she would like it to be applied to people who have worked 25 years or more. She said the NMERB has an increasing proportion of retirees who've worked short careers and therefore have smaller benefits.

[Lunch break: 12:00-1:00 p.m.]

[Agenda was reprioritized.]

7. **<u>EXECUTIVE SESSION</u>: 1:00 p.m.**
   a. **Limited Personnel Matters (session closed pursuant to NMSA 1978, Section 10-15-1(H)(2): Compensation of Executive Director, Deputy Director, General Counsel and Chief Investment Officer and agency practices in regards to <u>Compensation</u>**

Chairwoman Cameron moved that the board go into executive session pursuant to Section 10-15-1(H)(2) of the Open Meetings Act for purposes of discussing limited personnel matters. Mr. Magid seconded the motion, which passed on the following roll call vote:

For: Chairwoman Cameron; Vice Chair Goff; Secretary Magid; Mr. Craig; Dr. Duszynski.

Against: None.

Not present for the vote: Mr. Eichenberg.

Mr. Craig moved to come out of executive session. The only matters discussed during the executive session limited personnel matters, as set forth in the agenda. Mr. Magid seconded the motion, which passed unanimously.

8. ACTION FROM EXECUTIVE SESSION: 2:10 p.m.

Mr. Magid moved to move forward with the letter from counsel, with the exception that the board limit the last paragraph to the first two sentences. Dr. Duszynski seconded the motion, which passed with Mr. Craig voting against.

4. SUSTAINABILITY AND PLAN DESIGN:
JAN GOODWIN, EXECUTIVE DIRECTOR AND RICK SCROGGINS, DEPUTY DIRECTOR

a. **Guiding principles**
b. **Plan demographics**
c. **Retirement changes over time**
d. **Social Security**
e. **Income replacement and retirement eligibility**
f. **Return to work**
g. **Substitute teachers**

Ms. Goodwin said she has been working on the "NMERB Statement of Beliefs and Guiding Principles" with staff for the past few weeks. This document sets out a framework with regard to all of its decisions and policies in five areas: General; Plan Design; Funding; Investments; and Agency.

Ms. Goodwin commented that some of this follows what Ryan Falls discussed earlier today in his actuarial presentation: Does the board want to take a position on what automatic changes should happen if funding does not meet its target? Ms. Goodwin said she was not expecting any decisions on this document today, but thought it would be useful when the board next meets to discuss various possible plan design changes, and affirm the principles or make changes to them.

Item 10 under General was amended to state, "The purpose of the retirement benefit is to replace the income of our member, and beneficiary, if any~~, rather than to be a wealth creation device~~."

Ms. Goodwin noted that nearly all NMERB members are in Social Security, which provides a substantial amount of income replacement for many members. She suggested the board keep that in mind when coming up with what the benefit should be. She said this drives another question: How long should people be working to get the benefit, and should there be a minimum retirement age?

Ms. Goodwin commented that the benefit has changed very significantly over time; in 1962, it was 30 years of service with actuarial reduction if younger than age 60. At that point. If you were 65 and a female then, your life expectancy was another 17.4 years, or 82.4, and if you were a male, it was 13.2 more years, or 78.2. Now, because of increasing longevity, members are retired far longer, making the benefit more expensive. What can the board do to reduce these costs while making the benefit more affordable and meaningful?

Ms. Goodwin said the NMERB has always had as a threshold for membership in statute for anyone who works more than .25 FTE, which is important and distinguishes it from PERA, which has a much higher threshold. She said someone can come in and start working for the NMERB on a temporary basis as a substitute teacher and start earning service credit right away, which is a one of its greatest strengths.

Ms. Goodwin said the Return to Work statute expires at the end of 2021. She said she would like the board to look at this before then and decide whether they want this to continue or not. She pointed out that, when Return to Work originally came into play, it was to help the rural schools fill positions that were normally hard to fill, e.g., math, science, special ed and English as a Second Language. In reality, the people who are using Return to Work tend to be administrators in bigger cities, which sends a message to younger teachers that the system is rigged. In addition to this, the NMERB ran the numbers and reviewed them with GRS, and people are better off working those extra years and retiring with a higher benefit. The NMERB already allows members to suspend retirement, so it already has that provision in statute.

In discussing the Funding section, Ms. Goodwin said the board has a policy of being fully funded in 25 years, but in fact it is 36 years beyond that. Does the board want to change its funding policy, stretch it out, or have a shorter funding period? She commented that one of the advantages of having a shorter period (25 years) is that it gets out of negative amortization, which the credit agencies refer to as "not making tread water payments." In the past month, Moody's has downgraded the City of Albuquerque, Bloomfield and Bernalillo County, and are preparing to downgrade APS and a lot of other New Mexico entities. She said she is very concerned between GASB 68 and the pressure from the rating agencies that employers such as UNM and APS will come in and tell the NMERB that they want it to shorten the funding period because it was hurting their bond rating.

Ms. Goodwin said another advantage of being fully funded is that the NMERB can dramatically reduce the amount of contributions being paid by the employer and employee, the COLA could be put back, and there will no longer be any of the GASB 68 allocation of liabilities to the employers. She cited Mr. Falls' statement during his presentation that the NMERB would be paying $50 billion dollars in interest alone on its unfunded liability over the next 61 years.

Ms. Goodwin stressed the importance of solving this problem as realistically and humanely as possible in terms of coming up with solutions that will receive support from the board, the members, and legislators.

Mr. Craig said he did not see any statement about intergenerational equity. In terms of whether the NMERB plans to ask its current and future employees to do more, it is important to keep in mind that at some point in time there will be a breaking point. He said this is particularly true for the younger generation, which is serving increasingly less time with less participation. This group may look at how much they are expected to put in and how much they will get in return and decide they could do better in an index fund, for instance.

Ms. Goodwin reviewed a Retirement Type Age Grouping comparing how the members have been retiring over time under the three different retirement eligibilities: 25 and Out; Rule of 75; and 65 and 5. Almost two-thirds of the members are retiring under Rule of 75 and age 65 and 5. She said this is very important because it goes back to what Mr. Falls was discussing earlier, which is that contributions plus investment income have to equal benefits plus expenses. Because those contributions aren't on deposit very long for the shorter career people, there isn't as much time to make as much investment income to cover their benefits. The older someone starts as an NMERB member, the higher their normal cost. She stated that the NMERB currently does not adjust for the fact that the people who work for much longer periods are subsidizing the people who work for short periods. She said this is a compelling reason to move toward a tiered multiplier in ten-year increments, with the lowest multiplier paid for the first ten years.

Ms. Goodwin commented that, as a state, there needs to be a conversation about what the value of education is in New Mexico and what the state is willing to pay to have the education its students deserve. She noted Mr. Falls' comments about declining membership. Last June, the NMERB had the same number of active members that it had in June 2000, which is not a good story.

Dr. Duszynski said that, as of 2017, there were 50 percent as many tenure track faculty at universities in the U.S. as there were 20 years ago. In order to save money because of "iffy" state funding, universities are hiring more part-time faculty, lecturers and adjuncts that they don't have to pay benefits to. He commented that these people are paying less in contributions, and also aren't necessarily as dedicated to the interests of their students as a full-time faculty member would be.

5. WRAP UP AND NEXT STEPS: JAN GOODWIN, EXECUTIVE DIRECTOR

Ms. Goodwin said the survey closes at the end of this week, and the results will be reported to the board on April 20. She plans to work with the stakeholder group this summer to come up with a legislative proposal, and asked the board to develop the broad parameters of the plan that the stakeholder group could then review and fill in.

Board members discussed first inviting key legislators and/or officials involved in education to a work session with the board to hear their ideas. The work session was scheduled on May 24 at 9:00 a.m. (to include review of scenarios), with the second round (actuarial and principles) scheduled on June 21 at 9:00 a.m. Ms. Goodwin said she would meet with the stakeholders following the May work session to review the scenarios with them.

6. DISCUSSION ON PLACING "PUBLIC COMMENT" ROUTINELY ON AGENDA: MARY LOU CAMERON, CHAIR AND ROD VENTURA, GENERAL COUNSEL

Mr. Ventura stated that, as discussed at the last meeting, there is no requirement to add "public comment" to an agenda under the Open Meetings Act. The only requirement is that the meeting be open to the public so people can listen to the proceedings. In the past, when people have wanted to talk to the board, it has been done on an ad hoc basis.

Mr. Ventura said his concern is that, under the NMERB administrative appeal process, an aggrieved party involved in the appeal may try to address the board, which is an ex parte communication and could create serious legal problems. Also, it is improper for anyone on either side of an issue involving pending litigation to discuss any aspect of that with the board. He added that, under the board policies and procedures, when a member has a complaint, the board is supposed to direct the complaint to the Director. He said all of these concerns should be considered.

Chairwoman Cameron commented that there have been very few requests for public comment in her years on the board. When she is contacted directly by a member over a matter, she refers that to the Director and it has always been dealt with that way. She noted that the board does hold public hearings when there are rule changes.

Following discussion, the board agreed that it was not necessary to make changes at this time to the agenda to routinely include public comment.

9. ADJOURN

The Annual Retreat adjourned at 3:30 p.m.

Mary Lou Cameron

Mary Lou Cameron, Chairwoman

ATTEST:

Larry Magid, Secretary