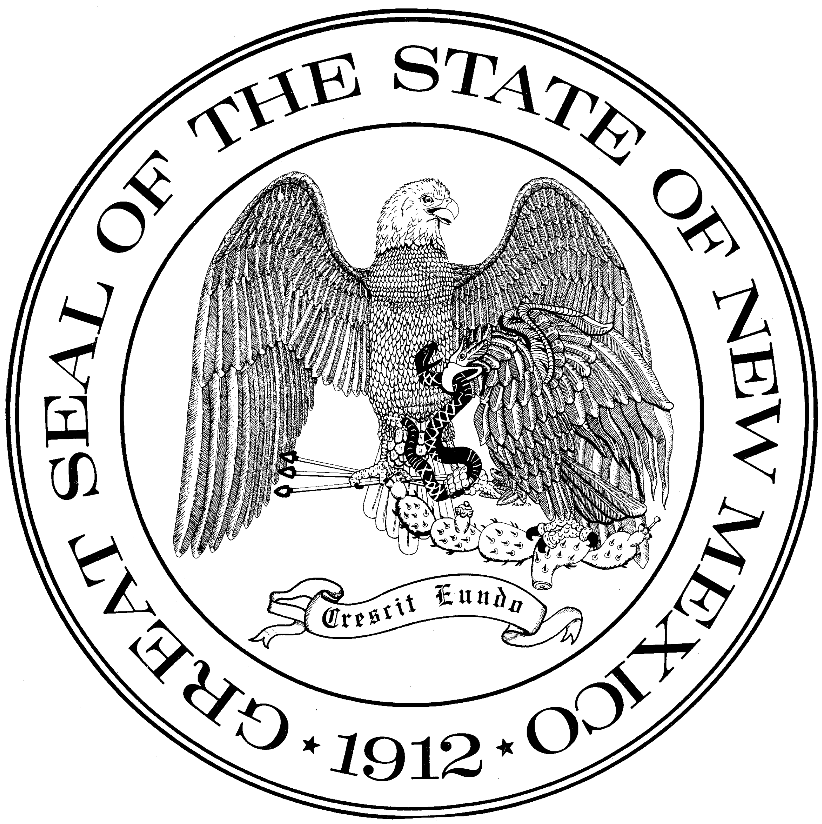
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

2014 INTERIM FINAL REPORT



New Mexico Legislative Council Service
Santa Fe, New Mexico
December 2014

INVESTMENTS AND PENSIONS
OVERSIGHT COMMITTEE

2014 Interim

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COMMITTEE MEMBERSHIP, APPROVED WORK PLAN AND MEETING SCHEDULE

2014 APPROVED
WORK PLAN AND MEETING SCHEDULE
for the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

The Investments and Pensions Oversight Committee (IPOC) was created by the New Mexico Legislative Council on May 5, 2014. Committee members are as follows:

Members

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

Advisory Members

Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Rep. William "Bill" J. Gray
Sen. Stuart Ingle
Rep. Emily Kane
Sen. Timothy M. Keller
Rep. Tim D. Lewis
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. William H. Payne
Sen. John C. Ryan
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton

Work Plan

During the 2014 interim, the IPOC will:

(1) receive reports from the Educational Retirement Board (ERB) and the Public Employees Retirement Association (PERA) on current projections related to the solvency of the pension funds for each member plan;

(2) receive testimony from the ERB, the PERA and the Retiree Health Care Authority and, as deemed necessary, their actuaries, employee representatives, fiscal experts and others regarding the status of the applicable funds and investments, investment earnings and fees paid on the investments;

(3) receive reports from the PERA regarding the legislative retirement plans;

(4) receive reports from the PERA regarding the magistrate and judicial retirement plans and changes in the retirement plans resulting from legislation enacted during the 2014 legislative session;

(5) receive reports from the Education Trust Board regarding investment earnings and 529 College Savings Plan program operations;

(6) review the manner in which investment policy and associated earning benchmarks were set for the investment funds by the governing bodies and investigate how each agency determines the proportional mix of types of investments, including mutual stock and bond funds, individual stocks and bonds, real estate and private equity, etc. The IPOC will focus on how investment policies for the retirement funds have changed in response to changes in projections regarding program solvency and unfunded liabilities;

(7) receive reports from the State Investment Council (SIC) related to the programs of the SIC aimed at enhancing the economic development in the state;

(8) receive testimony on the investment policies, practices and returns of the economically targeted investment programs of the SIC, particularly the Private Equity Investment Advisory Committee, the Small Business Investment Corporation and the film loan program;

(9) examine the performance of the investment portfolios of the SIC, the PERA and the ERB and funds in the state treasury in absolute terms and compared to policy benchmarks and comparable funds. This would include the returns on the entire portfolio, the returns on individual segments, including stocks, bonds, real estate and private equity, and all fees paid on the investments;

(10) receive reports from the Office of the Attorney General, private plaintiffs or others regarding the progress of current litigation and of potential claims by the state and the funds regarding "pay-to-play" allegations and investment fraud, etc.;

(11) receive reports from the SIC regarding ongoing litigation against the former executive director of the now-defunct Region III Housing Authority;

(12) receive reports from the Department of Finance and Administration regarding relevant Government Accounting Standards Board statements; and

(13) examine other issues related to the investment of public funds and the administration of pensions, as necessary.

Investments and Pensions Oversight Committee
2014 Approved Meeting Schedule

Date	Location
June 17	Santa Fe
July 28	Santa Fe
September 9	Santa Fe
October 13	Santa Fe
November 17	Santa Fe

EXECUTIVE SUMMARY

INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE
2014 SUMMARY

Concerned about the solvency of state retirement and investment funds, the New Mexico Legislative Council initially created the Investments and Pensions Oversight Committee (IPOC) in 2006 and has created the IPOC in subsequent years to oversee the investment functions of the State Investment Council (SIC), the Public Employees Retirement Association (PERA), the Educational Retirement Board (ERB) and the Retiree Health Care Authority (RHCA). Oversight includes review of overall investment policies and returns and of any pending litigation involving the various investment funds, as well as related contemporary issues. The IPOC continued to pay particular attention to the effects on the unfunded liabilities of the retirement funds resulting from changes in the retirement plans enacted during the 2013 legislative session.

During the 2014 interim, the IPOC held five meetings in Santa Fe at the State Capitol.

At its organizational meeting on **June 17, 2014**, the IPOC heard status reports from the SIC, PERA, ERB and RHCA and adopted a work plan and meeting schedule for the interim.

The SIC reported that the value of total assets under SIC management as of June 17 was $19.6 billion, an increase of more than $5 billion since 2010 when the SIC was statutorily restructured and when significant governance and investment reforms were implemented. The main state funds managed by the SIC include the Land Grant Permanent Funds (LGPF), Severance Tax Permanent Fund (STPF), Tobacco Settlement Permanent Fund (TSPF) and Water Trust Fund (WTF). The SIC has set an annual expected rate of return of 7.5 percent. The goal of its ongoing asset reallocation plan is to produce consistent returns rather than speculative gains and losses. The New Mexico assets managed by the SIC are performing better than the national average for similar-sized funds, with slightly higher-than-average returns and lower-than-average risk exposure. The LGPF were valued at $13.7 billion, with distributions in fiscal year 2015 expected to be $596 million. The STPF has $4.5 billion in assets. Contributions to the STPF are irregular and growth is primarily due to investment gains; the fund's valuation is still below the 2007 high of $4.8 billion. The TSPF was valued at $195 million. No statutory contributions have been made to the TSPF since 2008; in addition, revenue from the tobacco settlement has been reduced because the state was found to be not in compliance with the settlement agreement. The WTF was valued at $48 million, with a statutory $4 million distribution per year, which is predicted to deplete the fund by 2034 because there are no statutory provisions for contributions to the fund.

The PERA reported that total assets in the PERA funds had reached an all-time high of $14.5 billion, due in large part to fiscal year 2013 earnings of 13.25 percent and fiscal year 2014 (in June) earnings of more than 15 percent. The PERA is undergoing an asset allocation adjustment to ensure more consistent returns at moderate risk, with an expected annual rate of return of 7.75 percent. The PERA funds pay out $85 million monthly in benefits to members. Recent actuarial projections indicate that the PERA funds will be 100 percent funded by 2040. Legislation enacted in the 2014 session that suspended cost-of-living adjustments (COLAs) for two years and reduced the amount to 0.62 percent after that in the Judicial Retirement Fund and

Magistrate Retirement Fund put the Judicial Retirement Fund on track to be fully funded and the Magistrate Retirement Fund to be 88 percent funded by 2041.

The ERB reported that the Educational Retirement Fund had reached an all-time high of $11 billion in April, with a net return over the previous year of 9.8 percent, or approximately $1 billion. The ERB's expected annual rate of return is 7.75 percent. The ERB has reduced its public equity holdings from 70 percent in 2006 to about 38 percent today to significantly reduce volatility while ensuring consistent growth. Based on investment returns and legislative changes to benefits and contribution schedules made in 2013, the Educational Retirement Fund is expected to be nearly fully funded by 2043.

The RHCA reported that the Retiree Health Care Fund is invested by the SIC and is valued at $353.9 million. The RHCA offers Medicare supplemental and pre-Medicare health insurance plans for retired public employees. There are approximately 100,000 active employees contributing to the plan and 58,000 covered retirees. The RHCA operates with $2.9 million in program support and a $272 million health care insurance budget. The RHCA is adjusting its premium rates, subsidy levels and age and service requirements to increase the solvency of the fund.

At the **July 28, 2014** meeting, the Education Trust Board (ETB) explained that the ETB, which is administratively attached to the Higher Education Department, is the governing body for New Mexico's "529" College Savings Program and has approximately $2.3 billion in 156,062 participant accounts under management in two distinct investment plans. The ETB does not receive any general fund money and is funded entirely by fee revenues. On May 6, the ETB issued a request for proposals to manage both of the investment plans. New Mexico Student Loans (NMSL), a 501(c)(3) organization composed of the New Mexico Educational Assistance Foundation and New Mexico Student Loan Guarantee Corporation, which was statutorily established in 1982 to stimulate the availability of financial assistance for post-secondary education, is the designated Federal Family Education Loan Program administrator for New Mexico. It issues nontaxable student loan revenue bonds to originate federally guaranteed student loans; it receives no state support and its expenses are paid from revenue earned from the loan program. NMSL suggested that instituting a state-supported loan program in New Mexico could reduce the cost of financing a college education by offering lower interest rates and low or no origination fees and could expand access to low-interest loans by requiring less stringent credit criteria and providing local administration to reduce risk and losses. The meeting concluded abruptly because of an emergency evacuation order for the State Capitol.

The **September 9, 2014** meeting included reports by the SIC, the director of the Legislative Finance Committee and others on the costs and benefits of the various types of alternative investments in which the SIC engages and on status reports and updates from the SIC, the RHCA and the ERB.

The SIC reported that it invests about 10 percent of the LGPF and 15 percent of the STPF into private equity. Of those percentages, one-third of the STPF (about 5 percent) and a minimal amount of the LGPF is allocated toward economically targeted investments (ETIs) in New Mexico. The initial expectation of ETIs was that returns might be lower than other investments but that would be offset by positive economic development. However, the ETIs have had a negative impact on the overall investment returns of the STPF without showing any demonstrable positive economic impact. The SIC now only invests in New Mexico firms that have a good chance of returning market-rate returns. The SIC expects that a bill to target 0.25 percent of the STPF toward university technology ventures will be introduced again in the 2014 legislative session. The SIC will also ask the legislature for substantial increases in contractual services for fiscal year 2016, but it is unclear whether those increases can be justified by demonstrating higher earning potential.

The Small Business Investment Corporation (SBIC) is funded by a one percent allocation of the STPF to create new job opportunities across the state; it is not required to earn market-rate returns from its investments. After four years of losses, the SBIC earned $490,000 in fiscal year 2013 and will probably show net income for fiscal year 2014. It will soon exhaust all of its available capital for the loan program, which will mean that potential borrowers will have to wait until other loans are paid off before being able to receive a loan. The SBIC will need another infusion of money by the end of the year to expand its loan program.

The director of the Legislative Finance Committee informed the IPOC that since 2004, public pensions and other public institutional investors have explored investment in private equities, hedge funds and real estate to optimize the risk-versus-return ratio but those types of investments tend to have higher fee structures and profit-sharing requirements than more traditional investments such as stocks and bonds. The director noted that some large institutional investors in other states had recently reduced their private equity investments and increased their fixed-income investments. New Mexico seems to be heading in the opposite direction and its exposure is still far below other institutional investors' levels.

The RHCA reported that at the end of fiscal year 2014, the Retiree Health Care Fund balance was nearly $377 million and earned 12 percent for that year. The fund's unfunded liability is $3.6 billion, and its solvency period is 19 years as a result of various measures the RHCA has implemented to increase the solvency period.

The Educational Retirement Fund reached an all-time high of $11.3 billion on June 30, 2014, earning approximately $1.46 billion, a return of 14.5 percent, in fiscal year 2014. The fiscal year 2014 funded ratio was not known yet, but was expected to be higher than 2013's 60.1 percent. The ERB's funded ratio did not improve as much as the PERA's funded ratio because the PERA was able to implement an immediate, permanent reduction in the COLA from three percent to two percent; the ERB's COLA reduction is not statutory, so the actuarial valuation is calculated using a different methodology. The ERB noted that the legislature should have increased employer contributions in 2011 after the economy recovered to make up for planned increases that did not occur because of the recession.

At its **October 13, 2014** meeting the IPOC received status reports and updates from the PERA, RHCA and SIC.

Wayne Propst, executive director, PERA, and Jonathan Grabel, chief investment officer, PERA, informed the IPOC that the PERA funds balance returned 17 percent during fiscal year 2014 and reached an all-time high of $14.56 billion; the deferred compensation account balance was $485 million. The PERA board recently established a committee to review the asset allocation structure to optimize fees in each asset category and has set new asset allocation targets based on a recent asset allocation study. Mr. Propst stated that a new actuarial study of all of the plans managed by the PERA would be available in November; the municipal firefighters retirement plan is still in poor actuarial shape and needs reform. Mr. Propst said that the recent pension reforms, particularly regarding the delay of COLA increases, created a retirement spike. Mr. Propst cautioned the IPOC against recommending any new retirement benefits for public employees until the recently funded ratio gains are more established. Carter Bundy, state political and legislative director of the American Federation of State, County and Municipal Employees (AFSCME), told the IPOC that the AFSCME had issued a joint press release with its usual adversary in politics, the Rio Grande Foundation, to oppose efforts to reverse any of the pension reforms.

Mark Tyndall, executive director, RHCA, advised the IPOC that reforms instituted by the RHCA in the past seven years have resulted in an increase in the solvency of the Retiree Health Care Fund by an additional 12 years, a $267 million increase in the fund balance and a $500 million reduction in unfunded liabilities. The RHCA board has approved several additional reforms for implementation in 2015. Mr. Tyndall presented proposed legislation for the IPOC's consideration that would phase in over three years a 0.375 percent employee contribution increase and a .075 percent employer contribution increase, which are expected to make the fund solvent through fiscal year 2040 with no deficit spending projected until 2025. The IPOC took no action on the proposed legislation. Mr. Tyndall explained that subsidized RHCA health care plans provide more affordable coverage than comparable plans available under the federal Patient Protection and Affordable Care Act. If the RHCA were dissolved, it would affect more than 20,000 pre-Medicare retirees currently covered by the RHCA.

Steven K. Moise, state investment officer, SIC, presented two pieces of proposed legislation for the IPOC's consideration that would modernize the enabling statutes for the SIC and remedy the current imbalance of inflows to the STPF. The IPOC took no action on the proposed legislation. Evan Land, chief counsel, SIC, reported that settlements to date in the recovery litigation resulting from the "pay-to-play" scandal several years ago are approaching $30 million. Mr. Land said the litigation is ongoing and additional recoveries are likely.

At its **November 17, 2014** meeting, the IPOC received information from the PERA and the ERB regarding the implementation of Governmental Accounting Standards Board (GASB) Statements No. 67 and No. 68 and received status reports and updates from the ERB, PERA, RHCA and SIC.

Jeff Bridgens, senior manager, Moss Adams, LLP, said that GASB Statement No. 67 requires pension plans to report their net pension liability (NPL) in their annual financial statements. NPL consists of the total pension liability less the fiduciary net position of a retirement fund. Natalie Cordova, chief financial officer, PERA, and Jan Goodwin, executive director, ERB, informed the IPOC that the PERA and the ERB will implement GASB Statement No. 67 requirements in their fiscal year 2014 financial statements and will assist governmental employers in preparing their accompanying financial statements.

Mr. Bridgens explained that GASB Statement No. 68 requires employers that participate in cost-sharing plans, such as those of the PERA and the ERB, to report their share of the overall NPL. Ms. Cordova informed the IPOC that the PERA will report individual employers' shares of the overall NPL on the fiscal year 2015 financial statement. John Garrett, principal, Cavinaugh and McDonald, LLC, explained that pension plans that cannot cover all of their liabilities will be required to use a blended discount rate to project future earnings, which will significantly increase the NPL of the plan. Mr. Garrett noted that the only PERA pension plan that is required to use a blended discount rate is the magistrate retirement plan. Ms. Goodwin and Ms. Cordova said that the ERB and the PERA will assist each affiliated employer to properly calculate and report its share of the NPL.

Ms. Goodwin said that the actuarial funded ratio of the ERB increased from 60.1 percent in fiscal year 2013 to 63.1 percent in fiscal year 2014, the unfunded actuarial accrued liability (UAAL) decreased from $6.5 billion to $6.3 billion and the funding period dropped from 95.1 years to 42.1 years. Ms. Goodwin also presented proposed legislation for the IPOC's consideration that would exempt from the Personnel Act future investment employees of the ERB. The IPOC took no action on the proposed legislation.

Mr. Propst informed the IPOC that the PERA's actuarial funded ratio increased from 72.9 percent in fiscal year 2013 to 75.8 percent in fiscal year 2014 and the UAAL decreased from $4.6 billion in fiscal year 2013 to $4.3 billion in fiscal year 2014.

Mr. Propst presented proposed legislation for the IPOC's consideration that would request a five-year moratorium on the proposal and consideration of legislation affecting retirement benefits administered by the PERA. The IPOC endorsed the proposed legislation.

The IPOC discussed the City of Albuquerque's recent decision to provide retention pay to police officers nearing their retirement eligibility dates. The retention pay has the net effect of significantly increasing the final average salary of those employees, which will negatively impact the PERA funds. Mr. Garrett said there are many ways to structure retention bonuses that would not affect the PERA funds. Mr. Propst said that the PERA is currently researching the remedies that might be available to mitigate the negative effect of the retention pay. The IPOC directed staff to draft a letter from the IPOC to the City of Albuquerque objecting to the negative impact on the PERA from the city's retention pay program.

Mr. Tyndall presented proposed legislation for the IPOC's consideration that would phase in over three years a 0.375 percent employee contribution increase and a 0.75 percent employer contribution increase, which are expected to make the Retiree Health Care Fund solvent through fiscal year 2040 with no deficit spending projected until 2025. The IPOC took no action on the proposed legislation.

Mr. Moise and Vince Smith, deputy state investment officer, SIC, informed the IPOC that for calendar year 2014, the funds managed by the SIC have grown 5.23 percent as of September 30. Mr. Moise presented proposed legislation for the IPOC's consideration that would make technical and administrative changes to the SIC statutes, eliminate the Private Equity Investment Advisory Committee and limit the liability of the state investment officer and the Investment Office. The IPOC took no action on the proposed legislation.

Mr. Moise presented proposed legislation for the IPOC's consideration that would provide for increased distributions to the STPF by phasing in reductions to severance tax and supplemental severance tax bonding capacity, which would allow the STPF to grow steadily and allow for bigger distributions from the fund over time. The IPOC endorsed the proposed legislation.

AGENDAS

Revised: June 6, 2014

TENTATIVE AGENDA
for the
FIRST MEETING IN 2014
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

June 17, 2014
Room 307, State Capitol
Santa Fe, New Mexico

Tuesday, June 17

10:00 a.m.		**Call to Order** —Representative Jim R. Trujillo, Chair
10:05 a.m.	(1)	**Status Report from the State Investment Council (SIC)** —Steven Moise, State Investment Officer, SIC —Vince Smith, Deputy State Investment Officer, SIC
10:45 a.m.	(2)	**Introduction to the Public Employees Retirement Association (PERA) Chief Investment Officer (CIO); Status Report and Legislation Summary from the PERA** —Wayne Propst, Executive Director, PERA —Jon Grabel, CIO, PERA
11:30 a.m.	(3)	**Status Report from the Educational Retirement Board (ERB)** —Jan Goodwin, Executive Director, ERB —Bob Jacksha, CIO, ERB
12:15 p.m.	(4)	**Status Report on the New Mexico Retiree Health Care Authority (NMRHCA) Fund and Program** —Mark Tyndall, Executive Director, NMRHCA
12:45 p.m.	(5)	**2014 Interim Work Plan and Meeting Schedule Adoption** —Amy Chavez-Romero, Assistant Director for Drafting Services, Legislative Council Service
1:15 p.m.		**Adjourn**

Revised: July 15, 2014

TENTATIVE AGENDA
for the
SECOND MEETING IN 2014
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

July 28, 2014
Room 307, State Capitol
Santa Fe, New Mexico

Monday, July 28

10:00 a.m.		**Call to Order** —Representative Jim R. Trujillo, Chair —Senator George K. Munoz, Vice Chair
10:05 a.m.	(1)	**Education Trust Board (ETB): Management of College Savings Plans Nationally and in the State; Update on Investment Performance; Time Line for Program Manager Selection** —Jose Z. Garcia, Ph.D., Secretary, Higher Education Department (HED) —Kevin Deiters, Executive Director, ETB
11:10 a.m.		**Approval of Minutes**
11:15 a.m.	(2)	**Feasibility of Implementing a State-Guaranteed Student Loan Program** —Jose Z. Garcia, Ph.D., Secretary, HED —Kevin Deiters, Executive Director, ETB —Michael Nemelka, President, New Mexico Student Loans
12:00 noon	(3)	**Retiree Health Care Authority (RHCA): Board Approvals for: 1) Rate Hike; 2) Decreased Pre-Medicare Spousal Subsidy; 3) Increased Years of Service and Minimum Retirement Age; 4) Phased-In Contribution Increases; 5) Termination of Basic Life Plan Benefit** —Mark Tyndall, Executive Director, RHCA
		Public Comment
		Adjourn

TENTATIVE AGENDA
for the
THIRD MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

September 9, 2014
Room 307, State Capitol
Santa Fe, New Mexico

Tuesday, September 9

9:30 a.m. **Call to Order**
—Representative Jim R. Trujillo, Chair
—Senator George K. Munoz, Vice Chair

9:35 a.m. (1) **Alternative Investments — Costs and Benefits**
- **Private Equity**
- **Hedge Funds**
- **Economically Targeted Investments in New Mexico**
- **Film Loans**

—Steven K. Moise, State Investment Officer, State Investment Council (SIC)
—Vince Smith, Deputy State Investment Officer, SIC
—David Abbey, Director, Legislative Finance Committee
—Russell Cummins, Executive Director, New Mexico Small Business Investment Corporation (NMSBIC)
—Brian Birk, Managing Partner, Sun Mountain Capital
—Roxanna Meyers, Chair, NMSBIC Board of Directors

10:40 a.m. **Approval of Minutes**

10:45 a.m. (2) **SIC Status Reports and Updates**
- **Investments**
  - **Investment Holdings**
  - **Investment Strategies**
  - **Asset Allocation**
  - **Management Fees**
  - **Investment Returns**

—Steven K. Moise, State Investment Officer, SIC
—Vince Smith, Deputy State Investment Officer, SIC

11:45 a.m. (3) **Retiree Health Care Authority (RHCA) Status Reports and Updates**

- **Investments**
  - **Investment Holdings**
  - **Investment Strategies**
  - **Asset Allocation**
  - **Management Fees**
  - **Investment Returns**
- **Board Approvals**
  - **Rate Hike**
  - **Decreased Pre-Medicare Spousal Subsidy**
  - **Increased Years of Service and Minimum Retirement Age**
  - **Phased-In Contribution Increases**
  - **Termination of Basic Life Plan Benefit**

—Mark Tyndall, Executive Director, RHCA

12:30 p.m. (4) **Educational Retirement Board (ERB) Status Reports and Updates**

- **Investments**
  - **Investment Holdings**
  - **Investment Strategies**
  - **Asset Allocation**
  - **Investment Returns**

—Jan Goodwin, Executive Director, ERB
—Bob Jacksha, Chief Investment Officer, ERB
—Allan C. Martin, Partner, NEPC, LLC

Public Comment

Adjourn

Revised: October 7, 2014

TENTATIVE AGENDA
for the
FOURTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

October 13, 2014
Room 307, State Capitol
Santa Fe, New Mexico

Monday, October 13

10:00 a.m. **Call to Order**
—Representative Jim R. Trujillo, Chair
—Senator George K. Munoz, Vice Chair

10:05 a.m. **Approval of Minutes**

10:10 a.m. (1) **Public Employees Retirement Association (PERA) Status Reports and Updates**
- **Investments**
  - **Investment Holdings**
  - **Investment Strategies**
  - **Asset Allocation**
  - **Management Fees**
  - **Investment Returns**

—Jonathan Grabel, Chief Investment Officer, PERA

11:00 a.m. (2) **Retiree Health Care Authority (RHCA) Status Reports and Updates**
- **Proposed Legislation — Increasing Employee and Employer Contributions**

—Mark Tyndall, Executive Director, RHCA

11:45 a.m. (3) **State Investment Council (SIC) Status Reports and Updates**
- **Proposed Legislation**
  (1) Severance Tax Bonding Fund Contribution and Distribution Changes; and
  (2) Changes to SIC Enabling Law
- **Litigation Update**

—Steven K. Moise, State Investment Officer, SIC
—Evan Land, General Counsel, SIC

Public Comment

Adjourn

Revised: November 13, 2014

TENTATIVE AGENDA
for the
FIFTH MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

November 17, 2014
Room 307, State Capitol
Santa Fe, New Mexico

Monday, November 17

9:30 a.m.		**Call to Order** —Representative Jim R. Trujillo, Chair —Senator George K. Munoz, Vice Chair
9:35 a.m.	(1)	**Public Employees Retirement Association (PERA) and Educational Retirement Board (ERB) Status Reports and Updates** **• Governmental Accounting Standards Board Statement No. 67** **• Governmental Accounting Standards Board Statement No. 68** —Jan Goodwin, Executive Director, ERB —Jeff Bridgens, Senior Manager, Moss Adams, LLP —Wayne Propst, Executive Director, PERA —Natalie Cordova, Chief Financial Officer, PERA —John Garrett, Principal, Cavinaugh McDonald, LLC
11:30 a.m.		**Approval of Minutes**
11:35 a.m.	(2)	**ERB Status Reports and Updates** **• Actuarial Data Regarding Solvency** **• Proposed Legislation** —Jan Goodwin, Executive Director, ERB
12:30 p.m.		**Lunch**
1:45 p.m.	(3)	**PERA Status Reports and Updates** **• Fiscal Year 2014 Actuarial Valuation Results** **• Proposed Legislation** —Wayne Propst, Executive Director, PERA

2:45 p.m. (4) **Retiree Health Care Authority (RHCA) Status Reports and Updates**
- **Actuarial Data Regarding Solvency**
- **Proposed Legislation — Committee Consideration for Endorsement**

—Mark Tyndall, Executive Director, RHCA

3:45 p.m. (5) **State Investment Council (SIC) Status Reports and Updates**
- **Status Reports Regarding Third Quarter Performance of Funds**
- **Proposed Legislation — Committee Consideration for Endorsement**

—Steven K. Moise, State Investment Officer, SIC
—Vince Smith, Deputy State Investment Officer, SIC

Public Comment

Adjourn

MINUTES

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

June 17, 2014
Room 307, State Capitol
Santa Fe

The first meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2014 interim was called to order by Representative Jim R. Trujillo, chair, on Tuesday, June 17, 2014, at 10:10 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Rep. Jim R. Trujillo, Chair
Sen. Jacob R. Candelaria
Rep. Larry A. Larrañaga
Sen. Carroll H. Leavell
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Rep. William "Bill" R. Rehm
Sen. William P. Soules
Rep. Luciano "Lucky" Varela

Absent
Sen. George K. Munoz, Vice Chair
Sen. Sue Wilson Beffort
Sen. Steven P. Neville
Rep. Henry Kiki Saavedra

Advisory Members
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Timothy M. Keller
Rep. Patricia A. Lundstrom
Sen. John C. Ryan

Rep. William "Bill" J. Gray
Sen. Stuart Ingle
Rep. Emily Kane
Rep. Tim D. Lewis
Sen. Mary Kay Papen
Sen. William H. Payne
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton

Staff
Amy Chavez-Romero, Assistant Director for Drafting Services, Legislative Council Service (LCS)
Ric Gaudet, LCS
Randy Taylor, LCS

Guests
The guest list is in the meeting file.

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

Tuesday, June 17

Status Report from the State Investment Council (SIC)

Steven K. Moise, state investment officer, and Vince Smith, deputy state investment officer, SIC, gave an update on the investments and activities of the SIC during the seven months since the committee met in 2013. Mr. Moise reported that the total assets under SIC management as of June 17, 2014 was $19.6 billion. Those assets have grown more than $5 billion since 2010, when the council was statutorily restructured and significant governance and investment reforms were implemented.

The main state funds managed by the SIC include the Land Grant Permanent Funds (LGPF), Severance Tax Permanent Fund (STPF), Tobacco Settlement Permanent Fund (TSPF) and Water Trust Fund (WTF). The LGPF currently are valued at $13.7 billion, with distributions in fiscal year 2015 to be set at $596 million. Looking forward to fiscal year 2017, even with the scheduled drop in the distribution rate from 5.5 percent to five percent, distributions from the funds are expected to be around $640 million. The STPF, with $4.5 billion in assets, continues to have difficulty growing because contributions to the fund are irregular and too small to grow the fund. The fund is growing slowly due to impressive investment gains, but its valuation is still below the 2007 high of $4.8 billion. The TSPF currently has $194 million in assets. Statutory contributions to the fund have not been made since 2008 due to legislative appropriations for other purposes. In addition, revenue from the tobacco settlement with the major tobacco manufacturers has been reduced because the state was found to not be in complete compliance with the settlement agreement. The WTF has $48 million in assets, with a required statutory $4 million distribution per year. There are no statutory provisions for contributions to the fund, however. Actuarial studies have predicted that by 2034, the fund has a good chance of being completely depleted.

Mr. Smith discussed the recent investment return history of the SIC. The SIC has set an annual expected rate of return of 7.5 percent, which he feels is a realistic, but challenging, goal to reach. The SIC is continuing its asset reallocation plan by lowering equity holdings and reducing volatility and increasing income-producing assets. The SIC goal is to produce consistent returns rather than speculative gains and losses. The current asset allocation of the SIC looks very different than the 2009 allocation. According to the Sharpe ratio, which compares the five-year annualized return versus risk exposure, SIC assets are performing better than the national average for similar-sized funds. New Mexico has slightly higher-than-average returns and lower-than-average risk exposure.

Mr. Moise finished the presentation by discussing proposed legislation for consideration, including an STPF funding formula adjustment, SIC-enabling-statute updates and staffing flexibility.

Questions and comments from committee members included the following.

● Why are contributions to the STPF so volatile? Charles Wollmann, director of communications, SIC, said that severance tax bonds are issued based on severance tax collections the previous year, but contributions to the fund are based on current year receipts, after accounting for outstanding bonds issued. Volatility in the oil and gas sector can mean that the STPF gets no contributions one year followed by a windfall contribution the next year. In addition, under current statute, 95 percent of the severance tax bonding capacity is spent on issuing bonds, whereas historically 50 percent of that capacity was distributed to the STPF. Mr. Moise said that the SIC will soon reconvene the STPF funding study group to develop recommendations for obtaining regular contributions to the fund. A legislator commented that reform of the various funding mechanisms needs to be done incrementally.

● The New Mexico Finance Authority Oversight Committee should hear a presentation from the SIC about the potential depletion of the WTF.

● Although it may be a good idea to repeal the statutory authority for the SIC's unneeded Private Equity Investment Advisory Committee, it might also be a good idea to put into statute its current committees to ensure proper oversight of the state's trust funds.

● Would Congress need to approve a constitutional change to the distribution amount from the LGPF? Mr. Moise said that an attorney general opinion several years ago said that such a change would require congressional approval, but the distribution amount was changed anyway. He said that the SIC has no opinion on the correctness of that opinion. There has been much discussion that adding a distribution to fund early childhood education from the funds would require congressional approval because that change would, in effect, be creating a new recipient and purpose. Committee members requested that members of the New Mexico congressional delegation be consulted about what, if any, congressional approval would be necessary for changes in distribution amounts and recipients.

● Measuring growth of investment funds is not useful unless that growth is measured against the inflation rate.

Status Report and Legislative Summary from the Public Employees Retirement Association (PERA)

Wayne Propst, executive director, PERA, gave a report to the committee of recent activities of the PERA. He began by introducing the newly hired chief investment officer (CIO) for the PERA, Jon Grabel. Mr. Grabel then gave a brief financial summary of the PERA fund to the committee, saying that the fund had reached a new all-time high of $14.5 billion. In fiscal year 2013, the fund earned 13.25 percent; so far in fiscal year 2014, it has returned more than 15 percent. The PERA is undergoing an asset allocation change to ensure more consistent returns at moderate risk. The PERA fund pays out $85 million monthly in benefits to members, so it also needs sufficient liquidity to meet those obligations.

Recent actuarial projections of the PERA indicate that the pension system will be 100 percent funded by 2040. New actuarial studies will update that projection in October 2014. The PERA board recently voted to maintain its expected rate of investment return of 7.75 percent, based on experience studies and actuarial recommendations. The new Governmental Accounting Standards Board (GASB) Statements 67 and 68, which will take effect during the next two fiscal years, will place additional burdens on local governments to report their portion of net pension liability. The PERA board decided that it will pay for producing those local actuarial reports. The PERA's accounting firm will also be available to assist local governments in complying with those statements.

Mr. Propst discussed recent legislation enacted to reform the judicial and magistrate retirement plans. The legislation mirrored many of the changes made to regular state and local retirement plans in 2013. Severe underfunding prompted a two-year suspension of cost-of-living adjustments (COLAs) and provided for effective future yearly COLAs of .62 percent. With the recent statutory changes, the judicial retirement system looks to be fully funded by 2041, and the magistrate retirement system will be 88 percent funded by that date.

Questions and comments from committee members included the following.

- What is the status of the back-pay lawsuit for certain state employees? Susan Pittard, general counsel, PERA, said that the state has already made adjustments to current employee salaries, with corresponding changes to PERA contributions. The PERA will soon need to make adjustments to pension benefits to currently retired employees who were plaintiffs in the lawsuit. That will have an actuarial effect on the PERA fund, but the amount has not yet been determined.

Status Report from the Educational Retirement Board (ERB)

Jan Goodwin, executive director, and Bob Jacksha, CIO, ERB, gave a report to the committee on the activities and investment returns of the ERB. Investment earnings from the previous 12 months were approximately $1 billion, a net return of 9.8 percent for the year. Portfolio returns equaled or exceeded the actuarial target in most periods measured. The ERB fund reached an all-time high of $11 billion in April, and strong growth seems to be continuing. The ERB needs to maintain or exceed a 7.75 percent return on investment in order to maintain the actuarial soundness of the fund. Over the past 30 years, the fund has achieved a 9.5 percent return, but in the past 10 years, that rate has been only 6.8 percent, mostly due to the financial crisis of 2007-2009. Since 2009, however, the fund has achieved an investment return of 14.7 percent.

The ERB's goals to maintain at least a 7.75 percent investment return and to minimize the risks of volatility are being attempted through proper asset allocation. The ERB has reduced its public equity holdings from 70 percent in 2006 to about 38 percent today. This allocation reduces volatility significantly while ensuring consistent growth from equities and income-producing assets.

Based on investment returns and legislative changes made in 2013 to benefits and contribution schedules, the ERB is expected to be nearly fully funded by 2043. This actuarial valuation was based partly on experience studies to provide expected benefit expenses. The experience study, completed in 2012, was recently audited for accuracy. The audit validated the findings of the experience study and the actuarial valuation performed in June 2013.

Questions and comments from committee members included the following.

- The ERB staff was asked to provide data on the average age of retirement and the average annual pension benefit. Ms. Goodwin said that the data will need to be separated between K-12 retirees and higher education retirees to be useful. The ERB will provide the requested data at a future IPOC meeting.

Status Report on the Retiree Health Care Authority (RHCA)

Mark Tyndall, executive director, RHCA, gave the committee an update on the activities of the RHCA. The RHCA offers Medicare supplement and pre-Medicare health plans for retired public employees. There are approximately 100,000 active employees contributing to the system and 58,000 covered retirees. The authority operates with $2.9 million in program support and a $272 million health care budget.

In 2014, the RHCA attempted to have legislation enacted that would increase employee and employer contribution rates over a period of six years. This rate change would have increased the solvency of the RHCA fund by many years. The RHCA will propose similar legislation for the legislature's consideration in 2015. In addition to legislation, the RHCA is continuing to reform its benefit plans to increase the solvency of the fund, including adjusting premium rates, subsidy levels, age requirements and service requirements. All of the stakeholders involved have contributed to the solvency of the fund.

The RHCA fund currently has $353.9 million in assets, which are invested by the SIC. The fund will soon be able to have investments in private equity funds, a change recently approved by the SIC.

Questions and comments from committee members included the following.

- There have been many complaints about the RHCA's current prescription provider, Medco. The RHCA should look for a different entity. Mr. Tyndall agreed and said that the RHCA used to contract with ExpressScripts, but due to poor performance and service, the RHCA fired that company and hired Medco. Soon after that switch, ExpressScripts bought Medco. He said that service needs to be improved.

- Some new prescription drugs to combat illnesses that seniors face may be too expensive for retirees to purchase because the RHCA imposes financial disincentives to purchase name-brand prescriptions instead of generics. Mr. Tyndall said that the RHCA requires a lower co-pay for generic drugs. However, retirees who choose formulary drugs only have to pay a maximum of $50.00 extra per month.

Public Comment

PERA Service Credit Rule Change

Robin Gould, staff representative, Communications Workers of America, and Jean Smith and Jennifer Smith, part-time employees at the Department of Health (DOH), commented to the committee about the PERA's proposed rule increasing the number of hours required to work per month in order to receive full service credit. Ms. Gould said that many public employees work part time to care for family members or because of a disability. The rule change would unfairly target that population. Jennifer Smith said that her office at the DOH is composed of 20 federally mandated part-time employees who do not have the option of becoming full time. The rule change now means that those employees may have to work 40 to 50 years to receive the same retirement benefits they were previously promised at one-half those years. She said that after petitioning the PERA board, the board suspended the rule until further studies were done. Now a modified rule is being proposed, which grants one-half service credit to those employees who are not yet vested and who work fewer than an average of 30 hours per week. Vested employees would continue to earn full service credit for an average of 20 hours per week worked.

Mr. Propst was asked to comment on the proposed rule. He said that several years ago, the IPOC and other legislative committees requested that the PERA do whatever it could through rule changes to increase the solvency of the PERA fund. One of those changes identified by the PERA included modifying the part-time service credit rule. The modified rule was adopted in May 2014. After complaints about the rule surfaced, many PERA board members were concerned that the rule could inadvertently affect some employees unfairly. The board suspended the rule, and a new rule (described above) was proposed. That rule will be voted on by the PERA board on June 26. The old rule would have affected 660 current members. The new rule, which exempts vested members, will affect approximately 240 members.

Questions and comments from committee members included the following.

- This decision is really up to the PERA board to decide and not the legislature.

- How much money will the PERA fund save with this change? Mr. Propst said that there has not been an actuarial study on this rule change. However, any rule change that affects fewer than 300 members will not have much of an impact. He said the rule change is more a matter of principle and not economics.

- Are there any potential legal liabilities associated with this rule change? Mr. Propst said that changes that affect vested members could be legally suspect.

- Public employees should not get the same benefit as other employees for working less and contributing less.

ERB Financial Solvency and Discount Rate Calculation

Brad Day, board member, ERB, presented concerns he has with how the ERB calculates its discount rate, which could have profound impacts on the perceived and actual solvency of the fund. The ERB uses a discount rate of 7.75 percent to calculate its unfunded total pension liability (TPL). That discount rate is based on its expected average investment earnings. Using that rate, the ERB's unfunded TPL is currently at $17 billion. However, that projected rate is far too aggressive and full of assumptions and risks. A risk-free rate should instead be used, such as the 30-year treasury bond rate of 3.5 percent. That rate would provide a more accurate measure of unfunded TPL, probably in the $25 billion to $40 billion range. In addition, the statutory COLA provisions enacted recently are too risky. The ERB should only provide a COLA when it can afford to, actuarially. He cautioned the committee that not too long ago, Detroit's retirement plan was projected to be 95 percent funded, and now it is seen as a major contributor to the city's bankruptcy.

Questions and comments from committee members included the following.

- What discount rate should be used to calculate the TPL? Mr. Day said that in the private sector, companies are not allowed to use a discount rate higher than the corporate bond rate, currently around four percent. However, in the public sector, most retirement boards use artificially high discount rates to pretend that the state can afford the benefits it has promised.

2014 Interim Work Plan and Meeting Schedule Adoption

Ms. Chavez-Romero presented the proposed work plan and meeting schedule for the committee's consideration. The work plan proposed that during the 2014 interim, the IPOC will:

- receive reports from the ERB and the PERA on current projections related to the solvency of the pension funds for each member plan;

- receive testimony from the ERB, the PERA and the RHCA and, as deemed necessary, their actuaries, employee representatives, fiscal experts and others regarding the status of the applicable funds and investments, investment earnings and fees paid on the investments;

- receive reports from the PERA regarding the legislative retirement plans;

- receive reports from the PERA regarding the magistrate and judicial retirement plans and changes in the retirement plans resulting from legislation enacted during the 2014 legislative session;

- receive reports from the Education Trust Board regarding investment earnings and 529 College Savings Plan program operations;

- review the manner in which investment policy and associated earning benchmarks are set for the investment funds by the governing bodies and investigate how each agency determines the proportional mix of types of investments, including mutual stock and bond funds, individual stocks and bonds, real estate and private equity, etc. The IPOC will focus on how investment policies for the retirement funds have changed in response to changes in projections regarding program solvency and unfunded liabilities;

- receive reports from the SIC related to the programs of the SIC aimed at enhancing the economic development in the state;

- receive testimony on the investment policies, practices and returns of the economically targeted investment programs of the SIC, particularly the Private Equity Investment Advisory Committee, the Small Business Investment Corporation and the film loan program;

- examine the performance of the investment portfolios of the SIC, the PERA and the ERB and funds in the state treasury in absolute terms and compared to policy benchmarks and comparable funds. This would include the returns on the entire portfolio, the returns on individual segments, including stocks, bonds, real estate and private equity, and all fees paid on the investments;

- receive reports from the Office of the Attorney General, private plaintiffs or others regarding the progress of current litigation and of potential claims by the state and the funds regarding "pay-to-play" allegations and investment fraud, etc.;

- receive reports from the SIC regarding ongoing litigation against the former executive director of the now-defunct Region III Housing Authority;

- receive reports from the Department of Finance and Administration regarding relevant GASB statements; and

- examine other issues related to the investment of public funds and the administration of pensions, as necessary.

The work plan and meeting schedule were adopted, with the caveat that legislators could contact staff if new areas of study were to come up during the interim.

Adjournment

There being no further business, the committee adjourned at 2:33 p.m.

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

July 28, 2014
Room 307, State Capitol
Santa Fe, New Mexico

The second meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2014 interim was called to order by Representative Jim R. Trujillo, chair, on Monday, July 28, 2014, at 10:15 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Rep. Jim R. Trujillo, Chair
Sen. George K. Munoz, Vice Chair
Rep. Larry A. Larrañaga
Sen. Carroll H. Leavell
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Rep. William "Bill" R. Rehm
Rep. Luciano "Lucky" Varela

Absent
Sen. Sue Wilson Beffort
Sen. Jacob R. Candelaria
Sen. Steven P. Neville
Rep. Henry Kiki Saavedra
Sen. William P. Soules

Advisory Members
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. John C. Ryan
Rep. William "Bill" J. Gray
Rep. Emily Kane
Sen. Timothy M. Keller
Rep. Tim D. Lewis
Sen. William H. Payne
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton

Staff
Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Celia Ludi, Staff Attorney, LCS
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
John Mitchell, Law Student Intern, LCS

Guests
The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Monday, July 28

Education Trust Board (ETB): Management of College Savings Plans Nationally and in the State; Update on Investment Performance; Time Line for Program Manager Selection

Dr. José Z. Garcia, chair, ETB, explained that the ETB is the governing body for New Mexico's 529 college savings programs, is responsible for making rules and regulations for the development and implementation of the Education Trust Act and has approximately $2.3 billion in 156,062 separate accounts under management in two distinct investment funds. The ETB does not receive any general funds and is funded entirely by fee revenues. It is administratively attached to the Higher Education Department (HED).

Dr. Garcia introduced Kevin Deiters, executive director, ETB, who explained that a 529 plan is an education savings plan operated by a state or educational institution to help families set aside funds for future college costs. The 529 plan allows any interested person to establish an account to save money for the expected college expenses of any beneficiary. The person who establishes the account is the account owner and is the only person who can withdraw money from the account.

Mr. Deiters stated that 529 plans offer both federal and state tax benefits to the account owner and to the beneficiary. Earnings and qualified distributions on 529 accounts are not taxed to either the account owner or the beneficiary at either the federal or state level. In addition, contributions by the account owner may be deducted from net income for New Mexico individual income tax purposes. A non-New Mexico resident may not deduct contributions to the New Mexico 529 plan from other state taxes unless the applicable state specifically allows the deduction. Mr. Deiters said he would research the question of whether only the account owner is eligible to deduct the contributions from net income tax in New Mexico even though anyone may contribute to an account.

Upon a question from a committee member, Mr. Deiters clarified that qualified higher education expenses include tuition and fees at any New Mexico or out-of-state eligible institution, room and board, books and supplies, including computers.

Mr. Deiters summarized the amendments made to New Mexico's college savings programs by House Bill 215, which became effective after the 2014 legislative session.

Mr. Deiters stated that national college savings plan assets grew to approximately $230 billion in 2013. In New Mexico, college savings assets increased to approximately $2.3 billion in 2013. He added that growth is flattening because many beneficiaries are reaching college age and accounts are being depleted for college expenses. Eighty-five percent of account owners are non-New Mexico residents.

Mr. Deiters described the two types of ETB-administered 529 plans. The first type is the Scholar's Edge plan, which is "advisor-sold". An "advisor-sold plan" is sold to account owners by investment advisors who are paid a fee by the account owner. The second type is The Education Plan, a "direct-sold plan" that the account owner may purchase without the assistance of an investment advisor. The Scholar's Edge plan has 125,650 accounts, with a total value of $1.84 billion.

Mr. Deiters described administrative fees charged by the ETB to account owners. Administrative fees for the Scholar's Edge plan are higher than for The Education Plan because there are more investment options in the Scholar's Edge plan.

Mr. Deiters stated that the ETB issued a request for proposals for a fund manager on May 6, 2014. The fund manager would manage both the Scholar's Edge and The Education Plan. The ETB combined the plans for management purposes to make the corpus large enough to appeal to fund managers. Both funds are currently managed by Oppenheimer Funds, Inc. (Oppenheimer). Proposals were due on July 2, 2014. A list and analysis of the proposals will be provided to the ETB and the committee on August 20, 2014. The ETB will hear presentations from the proposers on October 15, 2014 and will vote on the proposals on December 10, 2014. The new contract will begin on July 1, 2015, allowing for a six-month transition period if a manager other than Oppenheimer is selected.

In response to questions from members, Mr. Deiters informed the IPOC that litigation initiated by various plaintiffs against Oppenheimer resulting from losses to the 529 funds because of inappropriate investment decisions by Oppenheimer has been resolved. There were four actions: a class action against Oppenheimer undertaken by the New Mexico attorney general with attorneys general from several other states and three suits against the ETB. The New Mexico attorney general's suit was settled in 2010, resulting in recovery of $67 million to be distributed to account owners of New Mexico funds. That recovery represents approximately 60 percent of losses incurred by the account owners. Three separate lawsuits were filed by private account owners against the ETB. Two of those lawsuits have been dismissed. The third, a class action, *Ping Lu et al. v. ETB*, was settled in September 2013; the settlement was finalized in March 2014. The settlement provided for payment of $3.57 million to the plaintiffs by the ETB, with indemnification rights, if any, of the ETB by Oppenheimer assigned to the plaintiffs. In response to questions from committee members, Mr. Deiters said he would provide more specific information about the indemnification conditions. David Mathews, general counsel for the HED, said that the state has no liability under the contract with Oppenheimer but that the ETB may have liability for "gross negligence". The funds are not insured by any federal or state agencies, but they are regulated by the Internal Revenue Service, the Municipal Securities Rulemaking Board and the Securities and Exchange Commission.

Mr. Deiters introduced Kay Ceserani, principal and chief compliance officer, Pension Consulting Alliance (PCA), which has been the ETB's investment consultant since December 2011, to provide an update on investment performance. Ms. Ceserani explained that PCA is strategically allied with AKF Consulting Group, and together they develop and implement a monitoring and guideline process for the ETB. PCA itself does not manage the investment of the funds. Prior to contracting with the ETB in 2011, PCA did not provide consulting services to any 529 programs run by Oppenheimer. PCA provides the ETB with monthly and quarterly investment performance reports and an annual assessment of Oppenheimer's annual program review. In addition, the ETB and PCA conduct site visits with Oppenheimer for review of risk management.

According to Mr. Deiters, most participants in each plan tend to select an age-based portfolio option that uses a "glide path structure", typically 20 years to 22 years in length, adjusting the asset allocation over time away from volatile equities and toward more stable fixed-income and short-term bond classes as the beneficiary comes closer to college age. The three-year risk-adjusted results show that both funds have better risk-adjusted results and achieve a higher return per unit of risk than the median of their peers. The New Mexico plans rank in the top three of the eight states' 529 plans for which PCA provides consulting services, according to Mr. Deiters.

Mr. Deiters said that PCA is paid from a combination of fees generated from the investment of the funds, fees from the program manager and fees from the ETB.

Mr. Deiters indicated that the ETB has approved $750,000 for scholarships that may be applied to tuition, fees, supplies and books for new and continuing students who have graduated from a New Mexico high school with a minimum 3.0 grade point average (GPA) and who demonstrate that their families are unable to pay $1,000 toward college expenses. The scholarship funds are allocated to New Mexico educational institutions, which then award the scholarships to applicants who meet the criteria. Historically, 76 percent of scholarship funds have been allocated to the University of New Mexico and New Mexico State University, but for fiscal year (FY) 2015, scholarship funds were allocated among all institutions based upon student need and GPA. This resulted in a shift of funding away from the research institutions to the comprehensive universities and two-year colleges; the research institutions were allocated 33 percent of scholarship funds in FY 2015. The scholarships are primarily funded from fees paid by Oppenheimer to the ETB. In response to a request from committee members, Mr. Deiters indicated that the ETB would provide the committee with a diversity and ethnicity breakdown of scholarship recipients and with more specific information about the sources, amounts and disbursement of funds for scholarships.

Mr. Deiters stated that the ETB has approved $450,000 for a marketing campaign for television, radio and print to encourage more parents and others to open 529 college savings accounts. Mr. Deiters added that the ETB aims to promote discussion of college preparation and financial preparation to attend college in financial literacy courses, preferably starting in the fifth grade. Committee members suggested that the ETB collaborate with the Public Education Department toward that goal.

Minutes

The minutes from the June 17, 2014 meeting of the IPOC were approved without amendment, upon a motion duly made and seconded.

Feasibility of Implementing a State-Guaranteed Student Loan Program

Michael J. Nemelka, president, New Mexico Student Loans (NMSL), explained that NMSL is a 501(c)(3) organization composed of the New Mexico Educational Assistance Foundation and New Mexico Student Loan Guarantee Corporation, which were statutorily established in 1982 to "promote the public welfare and prosperity of the people of New Mexico [and] stimulate the availability of financial assistance for post-secondary education". NMSL is the designated Federal Family Education Loan Program administrator for New Mexico. It issues nontaxable student loan revenue bonds to originate federally guaranteed student loans in New Mexico. NMSL receives no state support; its expenses are paid from revenue earned from the loan program.

Mr. Nemelka provided an overview of the federal student loan program, which is funded by the United States Treasury and disbursed by schools to students who are enrolled at least half-time, who are making satisfactory academic progress and who are subject to annual borrowing limits. The origination fee is four percent, and interest rates vary between classifications of students, including undergraduate, graduate direct and graduate/parent; interest rates for all classifications are reset on July 1 every year. Mr. Nemelka noted that federal loan volumes in New Mexico have been decreasing substantially since a high of $386,333,676 was reached in 2011-2012. In 2014, to date, the federal loan volume is approximately $359 million. Federal education loans are used by both undergraduate and graduate students.

Mr. Nemelka then provided an overview of private education loans, which are made by states, nonprofits, banks and credit unions to borrowers attending certified schools. Although eligibility criteria for private education loans do not include an academic component, there may be incentives for criteria such as school program completion and on-time payments. Instead, eligibility is based solely on financial criteria such as borrower credit score, debt-to-income ratio and income level. There are rarely origination fees, and interest rates in New Mexico may range from 2.25 percent to 11 percent. In New Mexico, the volume of private education loans is low, estimated at $5 million to $8 million annually. Private education loans are used primarily by graduate students, out-of-state students paying nonresident tuition, programs with costs and fees exceeding federal borrowing limits and students seeking low interest rates.

Mr. Nemelka stated that he believes there is no educational loan funding crisis in New Mexico. He said that instituting a state-supported loan program in New Mexico could reduce the cost of financing a college education by offering lower interest rates and low or no origination fees and could expand access to low-interest loans by requiring less stringent credit criteria and providing local administration to reduce risk and losses. It would also retain loan earnings in New Mexico.

Mr. Nemelka described three national models of state-supported education loan programs that vary in cost, risk and complexity.

The first model, used by Texas, funds loans with state-issued general obligation bonds. In this model, the state holds and services the loans, combines academic and financial eligibility criteria, offers fixed interest rates of one percent to five percent and low or no origination fees and frequently requires cosigners. Mr. Nemelka said this is the highest cost and most complex program, with the greatest risk to the state. No other states use the Texas model.

The second model is the state guarantee/risk share model. Under this model, the state appropriates money to create a loss reserve fund; private lenders make the loans based on academic and financial eligibility criteria and cosigners are frequently required. This program was implemented in New York and New Jersey, but both states have closed the programs. No other states are currently using this model.

The third model is the state-supported loan securitization model. Under this model, private lenders make loans and secure them through student loan revenue bonds, which the state has pledged a "moral obligation" to support. Loans are made based on academic and financial criteria and frequently require cosigners. According to Mr. Nemelka, this model offers low rates and costs to borrowers, lowest cost and risk to the state and the simplest implementation. Mr. Nemelka said it is the most common state model.

In response to questions from committee members, Mr. Nemelka briefly described a federal teacher loan forgiveness program and the William D. Fort Federal Direct Loan Program. Mia Candelaria, HED, also briefly described an existing state medical loan-for-service program.

A committee member asked whether adopting a plan like the third model would put New Mexico in the education lending business and involve the sale of bonds. The question remained unanswered because the meeting was adjourned unexpectedly due to evacuation of the building.

Adjournment

After receiving an announcement regarding an emergency evacuation of the State Capitol, the chair announced that any remaining presentations on the IPOC agenda would be rescheduled for a later date. The committee adjourned at approximately 12:25 p.m.

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

September 9, 2014
Room 307, State Capitol
Santa Fe

The third meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2014 interim was called to order by Representative Jim R. Trujillo, chair, on Tuesday, September 9, 2014, at 9:45 a.m. in Room 307 of the State Capitol in Santa Fe.

Present
Rep. Jim R. Trujillo, Chair
Sen. George K. Munoz, Vice Chair
Sen. Sue Wilson Beffort
Sen. Jacob R. Candelaria
Rep. Larry A. Larrañaga
Sen. Steven P. Neville
Sen. Bill B. O'Neill
Rep. Jane E. Powdrell-Culbert
Rep. Luciano "Lucky" Varela

Absent
Sen. Carroll H. Leavell
Rep. William "Bill" R. Rehm
Rep. Henry Kiki Saavedra
Sen. William P. Soules

Advisory Members
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Roberto "Bobby" J. Gonzales
Sen. Stuart Ingle
Sen. John C. Ryan

Rep. William "Bill" J. Gray
Rep. Emily Kane
Sen. Timothy M. Keller
Rep. Tim D. Lewis
Rep. Patricia A. Lundstrom
Sen. Mary Kay Papen
Sen. William H. Payne
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton

Staff
Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Ric Gaudet, LCS
Celia Ludi, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Tuesday, September 9

Alternative Investments — Costs and Benefits

Steven K. Moise, state investment officer (SIO), State Investment Council (SIC); Vince Smith, deputy SIO, SIC; David Abbey, director, Legislative Finance Committee (LFC); Russell Cummins, executive director, New Mexico Small Business Investment Corporation (SBIC); Brian Birk, managing partner, Sun Mountain Capital; and Roxanna Meyers, chair, SBIC, gave presentations to the committee about various types of alternative investments in which the SIC engages. Mr. Moise introduced the panel and reported that the total assets under SIC management for fiscal year 2014 reached a record level of $19.8 billion, with a 15.9 percent annual investment return for that year.

SIC

Mr. Smith discussed the historical and current investment strategy of the SIC. Historically, most institutional investors followed a 60/40 approach to investing: 60 percent stocks and 40 percent bonds and cash investments. Today, most investors, including the SIC, use a more diversified investment strategy that reduces the percentage of stocks and bonds in favor of some investment in real estate, hedge funds, real return and private equity. The SIC has been shifting its investment strategy for several years, but that effort increased beginning in 2009 with the appointment of the current SIO and restructuring of the council. Previously, the SIC had a maximum commission for its contract investors of 25 basis points (.25 percent), which most high-yielding investors regarded as too low. Consequently, the SIC only had mediocre investors with average returns.

The SIC invests about 10 percent of the Land Grant Permanent Funds (LGPF) and 15 percent of the Severance Tax Permanent Fund (STPF) into private equity. Of that percentage, one-third of the STPF's investments are allocated toward New Mexico private equity, and a minimal amount of the LGPF is allocated for that purpose. These investments in New Mexico, called economically targeted investments (ETIs), have had a negative impact on the overall investment returns of the STPF. The SIC used to offer zero-percent loans for film companies wishing to film in the state plus a portion of the profits. The SIC has yet to realize any positive revenue from those investments. It now only offers market-rate loans for New Mexico films. The SBIC, in which the SIC invests about $40 million annually, no longer offers venture capital investments, preferring instead loans for small businesses. Finally, the SIC now only invests in New Mexico firms that have a good chance of returning market-rate returns, rather than the previously lower expectations of returns in exchange for economic development.

Questions and comments from committee members included the following.

- There was a bill in 2013 to require the SIC to invest in more university-generated ETIs. Was the SIC in support of that bill? Charles Wollman, public information officer, SIC, said that legislation to target .25 percent of the STPF toward university technology ventures would be reintroduced in the upcoming legislative session. Mr. Moise said that there would be no guarantee that these kinds of investments would generate any returns for the state's trust funds, which is why the SIC is wary of being required to make such investments.
- The SIC is asking the legislature for substantial increases in contractual services for fiscal year 2016, but it is unclear whether those increases can be justified by demonstrating higher earning potential.
- Is having five percent of the STPF invested in New Mexico private equity an adequate percentage? The Association of Commerce and Industry of New Mexico recently called on the SIC to invest in more New Mexico companies. Mr. Smith said that the SIC has the statutory authority to invest up to nine percent of the STPF in such ventures. Sun Mountain Capital, the SIC's consultant about New Mexico private equity, has determined that currently there is only about five percent capacity to invest responsibly in New Mexico firms. Mr. Birk said that there is often a trade-off between investment returns and job creation in private equity investment decisions.
- As the state's permanent funds keep growing, the state should use a portion of those funds to improve New Mexico's economy and educational system.
- Investments in private equity should include clawback provisions if the investments fail. Mr. Birk said that New Mexico equity investments use nationwide investment standards. Including clawback provisions in such investments would seriously limit the ability of New Mexico businesses to attract capital.
- The SIC should also focus on loans to mid-sized New Mexico companies that need up to $1 million, since major banks tend to ignore that sector. Mr. Birk agreed and mentioned that the primary purpose of the SBIC is to provide such loans to businesses.
- How does the SIC ensure that it is not investing in equities that unduly harm people or the environment? The SIC should not get an investment return based on the misery of other people. Mr. Smith said that the SIC does not have a policy regarding socially responsible investments, but it does due diligence in hiring responsible asset managers.

<u>SBIC</u>

Ms. Meyers and Mr. Cummins discussed the activities of the SBIC, which is funded by a one percent allocation of the STPF in order to create new job opportunities across the state. Ms. Meyers said that the SBIC had previously lost money by investing in private equity and had also lost money through its loan participation agreement with Accion New Mexico. The SBIC now only loans money rather than investing, and it amended its agreement with Accion to minimize loss potential. After four years of losses, the SBIC earned $490,000 in fiscal year 2013 and will probably show net income for fiscal year 2014.

Since its inception, the SBIC loan program has earned money and created more than 8,000 jobs. Compared to other job incentive programs that cost the state as much as $30,000 per job created, the loan program has earned $88.00 per job created. The SBIC is not charged with receiving market-rate returns from its investments but is charged with helping to create jobs.

The SBIC recently partnered with the New Mexico Mortgage Finance Authority (MFA) to help create affordable housing in the high-job-growth area of Lea County. The lack of affordable housing in that county is actually slowing job growth. The MFA identified the area as needing more multifamily housing units and approached the SBIC to assist it with the financing. In this arrangement, the MFA has assumed all of the financial risk of the program.

The SBIC will need another infusion of money by the end of the year in order to expand its loan program. It will soon exhaust all of its available capital for the loan program, which will mean that potential borrowers will have to wait until other loans are paid off before being able to receive a loan.

Questions and comments from committee members included the following.

- Taos County also has a shortage of affordable housing, which may affect future job growth. Ms. Meyers said that the SBIC is always looking for new opportunities across the state to assist in job creation. The partnership with Lea County is not limited to that county only.
- SBIC staff was requested to provide the committee with the dollar value invested per county, the number of loans per county and details of the losses that the SBIC incurred in the past several years.

New Mexico Private Equity Investment Program

Mr. Birk reviewed the SIC's New Mexico private equity investment program. The program, created in 1993, used to be managed as a differential rate program designed for job creation rather than for returns. In 2004, the program's primary focus changed to financial return, which has resulted in significantly better returns. Currently, the SIC has allocated five percent of the STPF toward New Mexico private equity, with about $30 million to $40 million invested annually. The program's impact on New Mexico's economy has been substantial, with 67 New Mexico-based companies receiving investments and an estimated multiplier effect of more than $2 billion of capital being invested in those companies.

Questions and comments from committee members included the following.

- How much money was invested in the New Mexico private equity program when its primary focus was economic development? Mr. Birk said that prior to 2004, $120 million was invested; since then, about twice that amount has been invested.
- In addition to SIC investment in ETIs, the state should spend general fund money on those investments to encourage job growth and economic development.
- What kind of placement fees, if any, have been involved in the selection of firms in which to invest? Mr. Birk said that Sun Mountain Capital has never been involved with

any funds or firms that used third-party marketing placement agents. No placement fees have been paid in the selection of investments.

LFC Report

Mr. Abbey reported to the committee on the historical change of the SIC's investment strategy toward more alternative investments. Before 2004, public pensions and other institutional investors largely invested in stocks and bonds. Since then, pension managers have looked toward other kinds of investment, including private equity, hedge funds and real estate, in order to optimize the risk-versus-return ratio. However, these kinds of investments tend to have higher fee structures and profit-sharing requirements than traditional investments.

Other large institutional investors, such as the California public employee retirement system and Yale University, have recently reduced their private equity investments and increased their fixed-income investments. New Mexico's retirement funds and the SIC seem to be heading in the opposite direction. However, although New Mexico's funds are increasing their exposure to private equity, their percentage of private equity investments are still far below other large institutional investors' levels.

Questions and comments from committee members included the following.

- An SIC member recently resigned because he believed that the return target of 7.75 percent was too high and unrealistic for the long term.

Approval of Minutes

The minutes from the July 28, 2014 IPOC meeting were approved without changes.

New Mexico Retiree Health Care Authority (RHCA) Status Report and Updates

Mark Tyndall, executive director, RHCA, gave the committee an update of RHCA investment earnings and the solvency status of the Retiree Health Care Fund. At the end of fiscal year 2014, the fund balance was nearly $377 million and earned 12 percent for that year. The SIC invests the fund for the RHCA, but the RHCA provides, through its contract consultant NEPC, asset allocation ranges. The RHCA has a constant need for liquidity in a portion of the fund in order to pay for insured claims, so it has a higher investment in liquid assets than a permanent trust fund would typically have. The fund currently has about 67 percent invested in equities and the remainder in bonds. The SIC has recently begun to allow its client agencies to invest a portion of their portfolios in alternative assets, into which the RHCA is looking.

The RHCA pays no management fees to the SIC for its services. It does pay fees indirectly to the SIC's asset managers as a percentage of revenues earned. In fiscal year 2014, the RHCA paid $853,000 on assets of $376 million, or 22 basis points. This low fee rate is because the SIC's much larger portfolio enables it to negotiate lower rates with asset managers.

Since 2007, when the RHCA began reforming its insurance program to increase the fund's solvency, the program's unfunded liability has been reduced $500 million to $3.6 billion. In addition, the fund has grown by $250 million, and the solvency period has increased from seven years to today's 19 years. The RHCA board recently approved further solvency measures, including:

- increasing all pre-Medicare rates by eight percent and Medicare supplement rates by five percent;
- reducing the pre-Medicare spousal subsidy by two percent;
- instituting a minimum age of 55 in order to receive any subsidy for most new retirees after 2019;
- increasing the years of service required for the maximum subsidy from 20 to 25 for most new retirees after 2019;
- converting current $6,000 basic life insurance policies to supplemental life insurance and phase out that subsidy beginning in 2017; and
- proposing legislation to increase employee contributions .375 percent over a three-year period and increasing employer contributions .75 percent over the same period.

If the RHCA proposals are fully implemented, the solvency period for the fund would be extended through 2040.

Educational Retirement Board (ERB) Status Reports and Updates

Jan Goodwin, executive director, ERB, Bob Jacksha, chief investment officer, ERB, and Allan Martin, partner, NEPC, presented an update on the ERB's activities and investment allocations. Investment earnings from the Educational Retirement Fund for fiscal year 2014 were approximately $1.46 billion, a return of 14.5 percent. For the previous five years, investment returns were 12.6 percent. The fund reached an all-time high on June 30, 2014 of $11.3 billion. The ERB has set an expected rate of return of 7.75 percent in order to meet actuarial liabilities in the future. The secondary goal of management of the fund is to decrease volatility through diversification, which is achieved by proper asset allocation.

NEPC and ERB staff recommended that the current asset allocation strategy be slightly modified to decrease public equity investments by two percent to 35 percent of the fund; decrease fixed-income investments by one percent to 28 percent of the fund; and increase alternative investments such as private equity, real estate and real assets by three percent to 26 percent of the fund. The NEPC recommendation also divests completely the ERB's investment in hedge funds.

Questions and comments from committee members included the following.

- How is the ERB's Governmental Accounting Standards Board (GASB) report going to look compared to fiscal year 2013's report? Ms. Goodwin said that the June 13, 2013 net pension liability statement said that the ERB was 60.1 percent funded. The actuarial report for this year is not yet finished, but it will have an even higher funded ratio.

- Why did the Public Employees Retirement Association (PERA) see a major increase in its funded ratio after the reform legislation of 2013, but the ERB saw only a modest increase? Ms. Goodwin said that the PERA was able to implement an immediate, permanent reduction in the cost-of-living allowance (COLA) from three percent to two percent. The ERB COLA reduction is not a permanent reduction in statute, so the actuarial valuation of the reduction has to be taken using a different methodology.
- Can the Educational Retirement Fund ever get to a funded ratio of 90 percent if the investment target of 7.75 percent is not met? Ms. Goodwin said that the 90 percent goal can only be met by achieving those investment targets.
- The legislature should have funded the Educational Retirement Fund after the economy recovered in 2011 to make up for the planned employer contribution level increases that never happened.
- Will the new accounting requirements of the GASB pose any problems in the next few years? Ms. Goodwin said that with the new requirement to use a snapshot discount rate valuation of the fund, rather than a "smoothed" five-year average, the funded ratio probably dropped by five percent from 67 percent. However, the ERB is not required to use a blended rate of corporate bond and the discount rates, which would have reduced the funded ratio even more.

Adjournment

There being no further business, the IPOC adjourned at 2:05 p.m.

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

October 13, 2014
Room 307, State Capitol
Santa Fe

The fourth meeting of the Investments and Pensions Oversight Committee for the 2014 interim was called to order by Representative Jim R. Trujillo, chair, on Monday, October 13, 2014, at 10:09 a.m. in Room 307 of the State Capitol in Santa Fe.

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

Advisory Members

Rep. Donald E. Bratton	Rep. Miguel P. Garcia
Sen. Carlos R. Cisneros	Rep. William "Bill" J. Gray
Rep. Roberto "Bobby" J. Gonzales	Sen. Stuart Ingle
Rep. Patricia A. Lundstrom	Rep. Emily Kane
Sen. Mary Kay Papen	Sen. Timothy M. Keller
	Rep. Tim D. Lewis
	Sen. William H. Payne
	Sen. John C. Ryan
	Sen. Michael S. Sanchez
	Rep. Sheryl Williams Stapleton

Staff
Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Ric Gaudet, Researcher, LCS
Celia Ludi, Staff Attorney, LCS

Guests
The guest list is in the meeting file.

Handouts

Handouts and other written testimony are in the meeting file.

Monday, October 13

Public Employees Retirement Association (PERA) Status Reports and Updates

Wayne Propst, executive director, PERA, and Jonathan Grabel, chief investment officer, PERA, gave an update to the committee on the activities and investment returns of the PERA. The PERA fund balance on June 30, 2014 reached an all-time high of $14.56 billion, and the deferred compensation account had $485 million. The fund returned 17 percent during fiscal year 2014, which amounted to $2.1 billion earned. The PERA fund has a volatility rating of 9.6 percent, below the national median of 10 percent, according to CEM Benchmarking.

Mr. Grabel said that the PERA board recently established a committee to review the structure of all asset categories and is trying to optimize fees in those categories. The committee is expected to issue a report to the board soon. Asset allocation is the driving force behind investment returns, and the PERA periodically reviews its allocation targets. New asset allocation targets include reducing total equity from 60 percent to 53 percent, but with an increase in private equity; increasing fixed income assets from 26 percent to 31 percent; increasing real assets and real estate from six percent to 12 percent; and decreasing hedge fund investments from eight percent to four percent. The decision to reduce hedge fund exposure was made a few months before the announcement that the California public employees retirement system (CalPERS) would eliminate all investment in hedge funds, given financial market prognostications. Mr. Grabel said that the PERA fund, with $14 billion in assets, has much more flexibility than the $300 billion CalPERS fund, and hedge funds continue to play an important role in asset allocation for the PERA fund.

Questions and comments from committee members included the following.

- How did the PERA arrive at the new asset allocation targets? Mr. Grabel said that the targets are based on an iterative modeling exercise in which thousands of scenarios were compared in order to arrive at the most desirable return-versus-volatility scenario. He said that the PERA performs such an asset allocation study at least every three years. The strategy is also predicated on the liquidity needs of the PERA in order to pay for its ongoing retiree pensions. Seventy-six percent of the PERA fund is in somewhat liquid assets, which can be converted to cash in just a few weeks if necessary.

- The municipal firefighters retirement plan is still in poor actuarial shape, and reforms need to be made to that plan. Mr. Propst said that a new actuarial study of all of the plans managed by the PERA will be available in November. He predicted that all of the plans, with the possible exception of the municipal firefighters plan, would show significant increases in their funded ratios.

● The recent pension reforms probably created a retirement spike, especially with employees who wanted to avoid a reduction in the cost-of-living allowance. Mr. Propst said that most members retire when they become eligible to retire, regardless of pension reforms. However, the increase in the maximum retirement benefit from 80 percent to 90 percent of final average salary for most plans should mean that more public employees will work longer before retiring. He cautioned the committee against recommending any new retirement perks for public employees until the recent funded ratio gains are more established.

● Carter Bundy, state political and legislative director of the American Federation of State, County and Municipal Employees (AFSCME), was asked to comment on recent newspaper articles that speculated that political deals with some legislators may have already been made to reverse some of the recent pension reforms. Mr. Bundy said that he has heard that some groups are trying to reverse some of the pension reforms, especially the "double-dipping" restrictions, and want to enact new recruitment and retention perks for certain classes of public employees. The AFSCME does not favor such reversals of pension reforms, and it issued a joint press release with its usual adversary in politics, the Rio Grande Foundation, to oppose such efforts.

Approval of Minutes

The minutes from the September 9, 2014 meeting of the committee were adopted without changes.

Retiree Health Care Authority (RHCA) Status Reports and Updates

Mark Tyndall, executive director, RHCA, gave an update of the activities of the RHCA and discussed proposed legislation with the committee. The RHCA board approved several reforms for implementation in 2015, including increasing all pre-Medicare rates by eight percent and Medicare supplement rates by five percent; reducing the pre-Medicare spousal subsidy by two percent; instituting a minimum age of 55 for most retirees to receive subsidies from the RHCA; increasing the years of service required for most employees to receive the maximum subsidy from 20 to 25 years; and converting the current $6,000 basic life insurance plan to supplemental life insurance and beginning to phase that subsidy out.

The reforms instituted by the RHCA in the past seven years have resulted in an increase in the solvency of the Retiree Health Care Fund by an additional 12 years; a $267 million increase in the fund balance; and a $500 million reduction in unfunded liabilities. However, one major piece of the RHCA reform strategy remains to be implemented: enactment of legislation to increase the employee and employer contributions over a three-year period. This legislation would extend the Retiree Health Care Fund solvency period an additional seven years, to 2040, and would reach a funded ratio of 50 percent. The legislation would increase the employee contribution three-eighths percent over a three-year period and the employer contribution by three-fourths percent. The general fund impact would be an additional $5 million for each year the increase is phased in, for a long-term $15 million general fund impact.

Questions and comments from committee members included the following.

● Does the Martinez Administration support the RHCA proposed legislation? Mr. Tyndall said that he has discussed the proposal with administration officials but it has not yet received an endorsement.

● What real benefit does the RHCA provide, now that the provisions of the federal Patient Protection and Affordable Care Act (ACA) are in effect? Mr. Tyndall said that subsidized RHCA health plans provide more affordable coverage than comparable ACA-based plans. If the RHCA were to be dissolved, more than 20,000 pre-Medicare retirees currently covered by the RHCA would be dumped into the New Mexico Health Insurance Exchange. Besides it being difficult for the exchange to absorb that many insureds, the net result would be that everybody's insurance premiums would increase.

● Can legislators participate in the RHCA plans? Mr. Tyndall said that legislators are eligible, but they do not receive any subsidy in their coverage.

State Investment Council (SIC) Status Reports and Updates

Steven K. Moise, state investment officer, gave an update on the activities of the SIC and discussed proposed legislation with the committee. The SIC has two pieces of proposed legislation that it is seeking to be endorsed by the committee. The first proposal would modernize the enabling statutes for the SIC, including cleaning up dated or inconsistent language; clarifying experience requirements of the council and staff; adding disclosure requirements for prospective council members and staff; removing the Private Equity Investment Advisory Committee from statute; and adding indemnification language for the council, similar to what currently exists for the PERA board and Educational Retirement Board.

The second legislative proposal seeks to remedy the current imbalance of inflows to the Severance Tax Permanent Fund (STPF) by gradually decreasing the amount of severance tax bonds and supplemental severance tax bonds from 95 percent to 87 percent of each year's bonding capacity. The amount of unsold bonds would then be transferred to the STPF. Prior to the establishment of supplemental severance tax bonds issued for school construction as a result of a court decision requiring the state to uniformly provide for the capital outlay needs of school districts, the STPF typically received 50 percent of the bonding capacity each year. Currently, if there is no last-minute legislative "sweep" of the remainder and if the prior year's severance tax receipts are not lower than the current year's receipts, the STPF receives five percent of bonding capacity. The proposed legislation would gradually increase that percentage to 13 percent by uniformly reducing the bonding allotment for school, legislative, tribal, colonias and water infrastructure capital outlay projects. In addition, distributions to the STPF would be ensured each year by limiting total bonding capacity to the lesser of the newly established percentage of severance taxes collected the previous fiscal year and the estimate of the current year's tax revenue.

Evan Land, chief counsel, SIC, gave the committee an update on recovery litigation related to the "pay-to-play" scandal several years ago. Settlements to date with the SIC are approaching $30 million. SIC litigation against various placement agents, individuals and funds is ongoing and will enter a new phase in 2015. Mr. Land said that additional recoveries are likely and that some settlements will require court approval.

Questions and comments from committee members included the following.

● What consultants did the SIC employ in 2007 versus today? Vince Smith, deputy state investment officer, SIC, said that all consultants since 2009 have been replaced, with the exception of Sun Mountain Capital, the SIC's New Mexico private equity consultant. That company was not involved in any way in the misconduct. Mr. Land said that the SIC has a policy in place to never pay any third-party marketing fees or to allow such fees in any business arrangement into which it enters. Mr. Moise said that every consultant and manager that the SIC works with must sign a transparency, disclosure and prohibited practices agreement.

● Would the two former legislators now serving on the SIC still qualify to be members with the addition of language requiring "professional experience" in one of the listed areas of expertise? Mr. Moise said that Leonard Lee Rawson and Tim Jennings would still qualify to serve on the council.

● Staff was instructed to review the benefits versus drawbacks of codifying in statute some of the SIC enabling statute proposals.

Adjournment

There being no further business, the committee adjourned at 12:05 p.m.

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

November 17, 2014
Room 307, State Capitol
Santa Fe

The fifth meeting of the Investments and Pensions Oversight Committee (IPOC) for the 2014 interim was called to order by Representative Jim R. Trujillo, chair, on Monday, November 17, 2014, at 9:40 a.m. in Room 307 of the State Capitol in Santa Fe.

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

Absent
Sen. Jacob R. Candelaria
Sen. Steven P. Neville
Rep. Henry Kiki Saavedra

Advisory Members
Rep. Donald E. Bratton
Sen. Carlos R. Cisneros
Rep. Miguel P. Garcia
Rep. Emily Kane
Sen. Timothy M. Keller
Sen. Mary Kay Papen

Rep. Roberto "Bobby" J. Gonzales
Rep. William "Bill" J. Gray
Sen. Stuart Ingle
Rep. Tim D. Lewis
Rep. Patricia A. Lundstrom
Sen. William H. Payne
Sen. John C. Ryan
Sen. Michael S. Sanchez
Rep. Sheryl Williams Stapleton

Guest Legislator
Sen. Phil A. Griego

Staff
Lisa Sullivan, Staff Attorney, Legislative Council Service (LCS)
Amy Chavez-Romero, Assistant Director for Drafting Services, LCS
Ric Gaudet, LCS

Celia Ludi, Staff Attorney, LCS

Guests

The guest list is in the meeting file.

Minutes Approval

Because the committee will not meet again this year, the minutes for this meeting have not been officially approved by the committee.

Handouts

Handouts and other written testimony are in the meeting file.

Monday, November 17

Public Employees Retirement Association (PERA) and Educational Retirement Board (ERB) Status Reports and Updates Related to Governmental Accounting Standards Board (GASB) Statements 67 and 68

Jan Goodwin, executive director, ERB; Jeff Bridgens, senior manager, Moss Adams, LLP; Wayne Propst, executive director, PERA; Natalie Cordova, chief financial officer, PERA; and John Garrett, principal, Cavinaugh McDonald, LLC, gave a presentation to the committee on the implementation by the ERB and PERA of GASB Statements 67 and 68.

Mr. Bridgens summarized the changes that governments will be required to make for reporting periods beginning after June 15, 2014. The most significant change will be that governments will be required to recognize a net pension liability (NPL) in their annual financial statements, which could have a significant impact on the balance sheets of some governments. NPL, in its simple definition, consists of the total pension liability (TPL) less the fiduciary net position of a retirement fund. TPL is calculated from an accounting perspective, using a set of standard assumptions to generate an estimate of the actual liability for a given set of employees. The calculation of a fund's net position is also subject to new requirements, including the use of a blended discount rate for those pension plans deemed to have a higher-than-desired TPL. The use of a blended discount rate can have a huge impact on the NPL of a retirement system. For employers in New Mexico that participate in cost-sharing plans, each employer will be required to report its share of the overall NPL.

Mr. Garrett discussed the PERA position in relation to the new GASB statements, particularly the strict new requirement that pension plans that do not have a sufficient fiduciary net position to cover all of their liabilities will be required to use a blended discount rate to project future earnings. Those pension plans can use their selected discount rate for their assets until the assets are projected to be depleted, at which point the plans must use a much lower rate to calculate the remainder of the liability. The net result of such a calculation would be to significantly increase the NPL of such plans. Mr. Garrett said that the only pension plan under the purview of the PERA that is required to use a blended discount rate is the magistrate retirement plan. All of the other plans are able to use the PERA's investment discount rate of 7.75 percent.

Ms. Cordova discussed the PERA's implementation of the new GASB requirements. GASB Statement 67, which requires pension plans to report NPL, will be implemented for the PERA's fiscal year 2014 financial statement. GASB Statement 68, which requires governmental employers to report their individual NPL for their pension plans, will be reported for the fiscal year 2015 financial statement. The PERA will calculate each participating employer's NPL as a percentage of the overall PERA NPL. The PERA will also assist governmental employers in preparing their financial statements, since many employers do not have the resources to correctly report pension liability.

Ms. Goodwin reported to the committee the progress that the ERB has made in implementing GASB Statements 67 and 68. The ERB has already implemented the requirements of GASB Statement 67, and it is devising a plan to assist local governments in implementing GASB Statement 68. The ERB will provide its participating employers with reports of the proportionate share of NPL, pension expense and deferred inflows and outflows. The employers, however, will need to provide member data for their reports and assume responsibility for presentation of the information used in their own financial statements. This "middle-of-the-road" assistance will significantly reduce the chance of adverse audit findings for local employers, but still requires those governments to have accurate information about their own members.

Questions and comments from committee members included the following.

- How will the new GASB requirement affect bond ratings of state and local governments? Mr. Garrett said that he does not understand why some ratings agencies started using a blended discount rate to rate some local governments' creditworthiness, which has already had a negative impact on their credit ratings.

- Will the PERA and ERB need to change some of their assumptions under the new GASB guidance? Both Mr. Propst and Ms. Goodwin said that their agencies will not need to modify their assumptions. Both agencies perform experience studies and economic assumption studies every few years.

- What is the biggest impact on local governments from the new requirements? Mr. Garrett said that previously, governments participating in cost-sharing plans were not required to report their individual NPL.

- The PERA's discount rate of 7.75 percent may be unrealistically high. Mr. Garrett said that investment professionals believe the PERA's rate is adequate, based on current projections and past experience. Ms. Goodwin said that the ERB sets its discount rate by asking five consultants to give an investment prediction for each asset class in the portfolio. The average of each estimate is then chosen and weighted according to the percent of the fund invested in each asset class.

The committee requested that the PERA and the ERB report their possible pension liabilities using a plus or minus one percent range from the selected discount rate. Mr. Propst said that he would be happy to provide that kind of analysis to the legislature. He said that the GASB statements actually require pension plans to perform such studies.

Approval of Minutes

The minutes from the October 13, 2014 meeting of the committee were approved without changes.

ERB Status Reports and Updates — Actuarial Data Regarding Solvency; Proposed Legislation

Ms. Goodwin briefly discussed with the committee the ERB's actuarial valuation for fiscal year 2014. The actuarial funded ratio of the ERB increased from 60.1 percent in fiscal year 2013 to 63.1 percent for fiscal year 2014, and the unfunded actuarial accrued liability (UAAL) decreased from $6.5 billion to $6.3 billion. The funding period dropped from 95.1 years to 42.1 years. Ms. Goodwin said that the fiscal year 2014 report represents a single point of time and does not reflect projected lower costs for future members, future cost-of-living adjustments (COLAs) of less than two percent for the foreseeable future and an expected one-half percent average increase in membership each year. Each of these benefits will be realized incrementally and cumulatively over time.

Ms. Goodwin also presented proposed legislation for the committee's consideration that would exempt from the Personnel Act future investment employees of the ERB. Ms. Goodwin said that the ERB needs to attract the best investment professionals in order to keep its fiduciary responsibility to its members intact. After a brief discussion by committee members, no action was taken on the proposed legislation. The ERB was requested to further research the issue and get input from staff of the PERA and State Investment Council (SIC) about legislation that could be jointly proposed next year.

PERA Status Reports and Updates — Actuarial Data Regarding Solvency; Proposed Legislation

Mr. Propst discussed with the committee the PERA's actuarial valuation for fiscal year 2014. The PERA's total funded ratio for fiscal year 2014 is 75.8 percent, up from fiscal year 2013's 72.9 percent funded ratio. Thirty-year projections of the funded ratio of the PERA funds have improved significantly since 2012 from a 29 percent funded ratio projection to today's 133 percent funded ratio projection. In addition, the PERA's UAAL decreased $321 million and currently stands at $4.3 billion.

Mr. Propst presented proposed legislation for the committee's consideration that would request a five-year moratorium on the proposal and consideration of legislation affecting retirement benefits administered by the PERA. The non-binding memorial requests legislators to defer acting on such legislation, except to correct an unforeseen emergency situation. Mr. Propst said that the recently enacted pension reforms need a few years of experience before making new changes to the plans. He cautioned the committee to not undo the changes made before their effects can be accurately measured and understood.

Questions and comments from committee members included the following.

- If municipalities can pay for the cost of providing return-to-work (RTW) incentives, would the PERA support such changes? Mr. Propst said that it is possible to design a RTW plan that appears revenue-neutral, but there would be many assumptions involved in the actuarial analysis.

- The mayor of Albuquerque wants to allow RTW employees again, mostly to retain qualified police officers. The legislature should only allow such a proposal in a way that does not negatively affect the PERA funds.

- How are mortality rates calculated between regular PERA members and public safety members? Mr. Garrett said that actuaries use standard mortality tables for all employees. There is no significant difference in mortality rates between regular retirees and public safety retirees, including firefighters, he said.

- How could it be bad for the PERA to provide for RTW if employees continue paying into the PERA funds, with no expectation of future benefits from those contributions? Mr. Propst said that if both the employee and employer make contributions and the COLA is suspended, it could have a neutral impact on the funds. However, the main problem with RTW is that if it is allowed, then every employee will retire at their exact retirement eligibility date, rather than waiting until their full retirement benefit has accrued. The PERA benefits by keeping employees at work as long as possible.

The committee discussed the City of Albuquerque's recent decision to provide retention pay to police officers nearing their retirement eligibility. The additional pay has had the net effect of significantly increasing the final average salary of those employees, which will negatively impact the PERA funds, because those employee retirement benefits will also be increased. Mr. Garrett said that the PERA expects to be liable for an additional $110,000 in retirement benefits over the lifetime of a retiree because of the way the retention pay was structured. In addition, the pay was given to employees before they were actually eligible to retire. He said that there are many ways to structure retention bonuses that would not affect the PERA. Mr. Propst said that the PERA is currently researching what remedies it has available to mitigate the recent decision. In some states, the pension plan is allowed to charge an entity for the costs of negatively impacting a pension fund. The general PERA membership should not be forced to pay for Albuquerque's retention pay program, he said.

The committee directed staff to draft a letter from the committee to the City of Albuquerque objecting to the negative impact on the PERA pension system from the city's retention pay program.

The committee endorsed the proposed PERA legislation.

Retiree Health Care Authority (RHCA) Status Reports and Updates — Actuarial Data Regarding Solvency; Proposed Legislation

Mark Tyndall, executive director, RHCA, briefly discussed with the committee the recent activities of the RHCA and efforts taken to ensure the Retiree Health Care Fund's long-term solvency. The last piece of the solvency puzzle involves enacting legislation to phase in over three years a three-eighths percent employee contribution increase and a three-fourths percent employer contribution increase. If this legislation is enacted, the fund is expected to be solvent through fiscal year 2040, with no deficit spending projected until 2025.

The committee took no action to endorse the proposed legislation.

SIC Status Reports and Updates — Actuarial Data Regarding Solvency; Proposed Legislation

Steven K. Moise, state investment officer, and Vince Smith, deputy state investment officer, SIC, gave the committee an update on the SIC's investment performance and also presented proposed legislation for the committee's consideration. In the first three months of the fiscal year, the total fund composite performance has actually declined .29 percent. For calendar year 2014, however, the funds have grown 5.23 percent, as of September 30.

Mr. Moise discussed a proposed bill that would make technical and administrative changes to the SIC statutes. The bill also eliminates the Private Equity Investment Advisory Committee and limits the liability of the state investment officer and the Investment Office.

The committee took no action on the proposed bill.

The second proposed bill that Mr. Moise presented would provide for increased distributions to the Severance Tax Permanent Fund (STPF) by phasing in reductions to severance tax and supplemental severance tax bonding capacity. Currently, transfers into the STPF only occur after 95 percent of the deposits into the Severance Tax Bonding Fund during the preceding fiscal year have been sold as severance tax bonds or supplemental severance tax bonds, and if there is enough money in the bonding fund to service the next two debt payments on existing bonds. This often means that transfers to the STPF are minimal. The bill would phase in reductions to bonding capacity from the current 95 percent of the previous year's deposits into the bonding fund to 85.8 percent over four years, resulting in a significant increase in transfers to the STPF. This will allow the STPF to grow steadily, which will allow for bigger distributions from the fund over time.

The committee endorsed the proposed bill.

Adjournment

There being no further business, the committee adjourned at 4:25 p.m.

COMMITTEE-ENDORSED BILLS

HOUSE JOINT MEMORIAL

52ND LEGISLATURE - STATE OF NEW MEXICO - FIRST SESSION, 2015

INTRODUCED BY

A JOINT MEMORIAL

REQUESTING A MORATORIUM ON THE PROPOSAL AND CONSIDERATION OF LEGISLATION AFFECTING RETIREMENT BENEFITS ADMINISTERED UNDER THE PUBLIC EMPLOYEES RETIREMENT ACT AND REQUESTING THAT MEMBERS BE URGED TO DEFER SUCH LEGISLATION.

WHEREAS, in 2013, the legislature reformed the Public Employees Retirement Act; and

WHEREAS, many stakeholders agreed upon the necessity of the enacted reform measures to improve the fiscal health of the funds administered under the Public Employees Retirement Act in order to continue provision of benefits that rank among the best in the nation; and

WHEREAS, the enacted reform measures represent shared sacrifices among retirees, active members and future members of the public employees retirement system; and

WHEREAS, the enacted reform measures, particularly the new tier benefits and the provisions regarding the reemployment of retired members, need to be in place for several years to demonstrate actuarial gains; and

WHEREAS, although recent investment gains have improved the funded ratio of the funds:

A. investment market volatility and economic uncertainty continue to be a major concern;

B. the funded ratio has only begun to recover;

C. the implementation of newly mandated accounting standards is likely to increase the volatility of the plan's funded ratio and the net pension liability well into the future; and

D. there remains a significant unfunded liability; and

WHEREAS, the recently improved funded ratio could lead to efforts to modify the enacted reform measures through proposals that could alter the cost-of-living eligibility periods, age and service retirement requirements, deferred retirement option plans and other retirement options or benefits; and

WHEREAS, even slight modifications to the enacted reform measures could adversely affect the legislature's goal of reaching a funded ratio of at least one hundred percent by 2043, as projected by the actuaries; and

WHEREAS, the public employees retirement system should be

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protected from premature calls for statutory changes that could erode the funds or otherwise undermine the funding and fiscal health objectives promoted by the legislature through its passage of the enacted pension reform measures; and

WHEREAS, Article 20, Section 22 of the constitution of New Mexico vests the retirement board of the public employees retirement association, as trustees, with the sole fiduciary duty and responsibility for the administration of the funds and for holding all assets in trust for the sole and exclusive benefit of its members, beneficiaries and retirees; and

WHEREAS, Article 20, Section 22 of the constitution of New Mexico states that the legislature shall not enact any law that increases public employee retirement benefits or that changes the funding formula for a retirement plan unless adequate funding is provided; and

WHEREAS, a five-year moratorium on benefit changes under the Public Employees Retirement Act would allow sufficient actuarial experience to be aggregated in order to properly evaluate the enacted reform measures and their effects on the long-term solvency of the funds; and

WHEREAS, a fiscally responsible and reasonable course of action combining contributions, plan assets and future investment earnings must continue to be employed, without reversals or reconsideration of the enacted reform measures; and

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WHEREAS, the public employees retirement system must remain an enduring, dependable and actuarily sound defined benefit plan in order to provide the retirement benefits promised to public employees;

NOW, THEREFORE, BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF NEW MEXICO that a moratorium on the consideration of legislation affecting benefits administered under the Public Employees Retirement Act be requested through December 31, 2020, absent an unforeseen emergency situation such as a drastic downturn in the economy or investment markets or a significant increase in the funded ratio of the funds included under the Public Employees Retirement Act to one hundred percent; and

BE IT FURTHER RESOLVED that legislative committee members be urged to defer any proposed legislation affecting the benefits administered under the Public Employees Retirement Act; and

BE IT FURTHER RESOLVED that copies of this memorial be transmitted to the directors of the legislative council service and the legislative finance committee; the house appropriations and finance committee; the senate finance committee; the office of the governor; and the retirement board of the public employees retirement association.

HOUSE BILL

52ND LEGISLATURE - STATE OF NEW MEXICO - FIRST SESSION, 2015

INTRODUCED BY

ENDORSED BY THE INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

AN ACT

RELATING TO PUBLIC FINANCE; PROVIDING FOR INCREASED DISTRIBUTIONS TO THE SEVERANCE TAX PERMANENT FUND BY PHASING IN REDUCTIONS TO SEVERANCE TAX BONDING CAPACITY AND SUPPLEMENTAL SEVERANCE TAX BONDING CAPACITY.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF NEW MEXICO:

SECTION 1. Section 7-27-14 NMSA 1978 (being Laws 1961, Chapter 5, Section 11, as amended) is amended to read:

"7-27-14. AMOUNT OF TAX--SECURITY FOR BONDS.--

A. The legislature shall provide for the continued assessment, levy, collection and deposit into the severance tax bonding fund of the tax or taxes upon natural resource products severed and saved from the soil of the state that, together with such other income as may be deposited to the fund, will be sufficient to produce an amount that is at least the amount

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necessary to meet annual debt service charges on all outstanding severance tax bonds and supplemental severance tax bonds.

B. Except as otherwise specifically provided by law, the state board of finance shall issue no severance tax bonds unless the aggregate amount of severance tax bonds outstanding, and including the issue proposed, can be serviced with not more than [~~fifty percent~~] the following percentages of the annual deposits into the severance tax bonding fund, as determined by the lesser of the deposits during the preceding fiscal year or the deposits during the current fiscal year as estimated by the division:

(1) for fiscal year 2016, forty-nine and one-tenth percent;

(2) for fiscal year 2017, forty-eight and two-tenths percent;

(3) for fiscal year 2018, forty-seven and three-tenths percent; and

(4) for fiscal year 2019 and subsequent fiscal years, forty-six and four-tenths percent.

C. The state board of finance shall issue no supplemental severance tax bonds with a term that extends beyond the fiscal year in which the bonds are issued unless the aggregate amount of severance tax bonds and supplemental severance tax bonds outstanding, and including the issue proposed, can be serviced with not more than [~~sixty-two and one-half percent~~] the following percentages of the annual deposits into the severance tax bonding fund, as determined by the lesser of the deposits during the preceding fiscal year or the deposits during the current fiscal year as estimated by the division:

(1) for fiscal year 2016, sixty-one and six-tenths percent;

(2) for fiscal year 2017, sixty and seven-tenths percent;

(3) for fiscal year 2018, fifty-nine and eight-tenths percent; and

(4) for fiscal year 2019 and subsequent fiscal years, fifty-eight and nine-tenths percent.

D. Except as otherwise specifically provided by law, the state board of finance may issue supplemental severance tax bonds with a term that does not extend beyond the fiscal year in which they are issued if the debt service on such supplemental severance tax bonds when added to the debt service previously paid or scheduled to be paid during that fiscal year on severance tax bonds and supplemental severance tax bonds does not exceed [~~ninety-five percent~~] the following percentages of the lesser of the deposits into the severance tax bonding fund during the preceding fiscal year or the deposits into the severance tax bonding fund during the current

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fiscal year as estimated by the division:

(1) for fiscal year 2016, ninety-two and seven-tenths percent;

(2) for fiscal year 2017, ninety and four-tenths percent;

(3) for fiscal year 2018, eighty-eight and one-tenth percent; and

(4) for fiscal year 2019 and subsequent fiscal years, eighty-five and eight-tenths percent.

E. The provisions of this section shall not be modified by the terms of any severance tax bonds or supplemental severance tax bonds hereafter issued.

F. For the purposes of this section, "division" means the board of finance division of the department of finance and administration."

SECTION 2. EFFECTIVE DATE.--The effective date of the provisions of this act is July 1, 2015.