NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

AUDIT & BUDGET COMMITTEE MEETING

April 8, 2014

This meeting of the Public Employees Retirement Board Rules & Administration Committee was called to order by Chair Stewart Logan at 9:10 a.m. on the above-cited date in the PERA Building, Fabian Chavez Board Room, 33 Plaza La Prensa, Santa Fe, New Mexico.

Executive Director Wayne Propst called roll and a quorum was established with the following members present:

Members Present:
Stewart Logan, Chair
John Reynolds
Loretta Naranjo-Lopez
Louis Martinez

Member(s) Excused:
Jackie Kohlash, Vice chair
Dianna Duran

Other Member(s) Present:
Roman Jimenez
Paula Fisher
Patricia French
James Lewis

Staff Present:
Wayne Propst, Executive Director
Susan Pittard, General Counsel/Chief of Staff
Jonathan Grabel, Chief Investments Officer
Sylvia Barela, ASD Director
Judy Olson, Executive Assistant
Karen Risku, Assistant General Counsel
Greg Trujillo, Deputy Director
LeAnne Larrañaga-Ruffy, Portfolio Manager
Roderick Ventura, Assistant General Counsel
Jason Goeller, Portfolio Manager
Joaquin Lujan, Portfolio Manager
Sonam Rapten, Financial Analyst
Mark Montoya, Financial Specialist

Others Present:
John Garrett, Cavanaugh Macdonald Consulting [via Skype]
Jonathan Craven, Cavanaugh Macdonald Consulting [via Skype]
Jamie Feidler, Cliffwater
Michael Schlachter, Wilshire

2. APPROVAL OF AGENDA

Ms. Naranjo-Lopez moved to approve the agenda. Mr. Reynolds seconded and the motion passed by unanimous [4-0] voice vote.

3. CURRENT BUSINESS

A. Informational Item: GASB 67 and 68 Update

Actuary John Garrett discussed the basis for the changes and the measurements under GASB 67 and 68 that are driven by the revisions of the GASB 25 and 27. GASB 67 is the financial reporting for the pension plans. Plans that operate under qualified trusts are required to report under GASB 67; this includes PERA. GASB 68 is the required reporting for employers who participate in plans that operate under qualified trusts. Mr. Garrett stressed that GASB's authority extends only to accounting and financial reporting, not to funding. The reporting has no meaning in regard to the plan's actuarial condition; funding or budgeting required to maintain the plan on an actuarially sound basis.

Plans reporting under GASB 67 are required to disclose the numbers for fiscal year ending June 30, 2014. The employers begin reporting one year later.

Mr. Garrett provided a comparison of the actuarial valuation terminology versus the GASB accounting information and a summary of changes. The changes with GASB 67 and 68 have separated accounting and funding. The net pension liability (NPL) will now be reported on a balance sheet of all participating employers. Under GASB 68 employers will not report the NPL but rather a pension expense (PE) which is basically the difference between the beginning of the year liability and the end of the year liability. The PE will be used as a proxy for the cost of the plan but it has very little relevance to the required funding for the plan.

Actuary Jonathan Craven reviewed the assumed investment for GASB purposes and the expected return on assets for funding the plan which includes the use of a discount rate for the liabilities. A long-term projection of plan assets is required and if the assets are depleted, GASB requires the use of a blended discount rate. The expected return on asset rate until depletion and then a bond index rate of non-taxable 20-year bond with a AA rating or better must be used: it's a proxy for what the employer would have to borrow money at in order to fund the benefits. PERA is solvent and 7.75 percent is the used discount rate. The Judges and Magistrates plans were projected to become insolvent and discount rates less than 7.75 percent were used. Based on the current plan design and statutory rate, Mr. Garrett said the PERA plan remains solvent for the next

110 years. He also noted that the plans will have more assets due to turnover than recognized in the GASB calculations.

Mr. Craven said the discount rates can be confusing and noted that different rates are used for bonding, funding, and accounting.

Mr. Propst noted that the NPL with regard to the Judges and Magistrates plan does not reflect the changes that were made during the last legislative session and a different calculation on the discount rate may apply. Mr. Craven confirmed that.

Mr. Garrett said to determine the investment rate of return assumption – 7.75 percent for PERA – the actuaries perform an experienced study and review the component parts which include rate of inflation and the real rate of return. The capital market assumptions are provided by the Board's investment providers.

Mr. Craven reviewed the pension expense as being made up of the service cost, interest on the total pension liability and deferring some of the impact of assumption changes and experience gains and losses. Assets which are invested aggressively are volatile and every year there is either a gain or a loss due to the asset performance. For GASB purposes, assets can be spread over five years. Liability gains and losses are spread over the average future working lifetime of the total active member population. For PERA that time period is 9.7 years; however, GASB requires the inclusion of the inactive members in the calculations. Inactive members have zero future years of expected service and that reduced the average to 5.03 years. Future working lifetime is a common actuarial calculation to spread cost.

Mr. Garrett said this set of numbers from the employers will not support the actuarial valuations and will create additional confusion.

Mr. Craven said participating employers will report a proportionate share of NPL and PE. Mr. Garrett noted that the PERA net pension liability is less than the unfunded actual accrued liability in the same date and measurements in GASB terminology.

Mr. Craven reviewed the total pension liability, plan fiduciary net position and net pension liability results for the new GASB reporting requirements. The total pension liability of PERA and funds is $17.5+ billion. The same number is from the actuarial valuation because PERA passed the solvency test.

Mr. Craven reviewed the plan fiduciary net position or market value of assets. The difference between the total pension liability and the plan net fiduciary position is $4.375 billion, the net pension liability of all the divisions of PERA. It was noted these were trial numbers. For all the plans there is a $4.65 billion net pension liability.

Chair Logan asked how total pension liability differed from what the actuarial study produced. Mr. Propst said the net pension liability is actually about $300 million less than the unfunded accrued actuarial liability. Mr. Craven described how the discount

rate has a big impact on liabilities. Mr. Garrett reminded the committee that the figures were based on the pension plan in place as of 6/30/2013.

Mr. Craven said the effect of the new GASB reporting could be negative for the employers because in the past there was no number on the actual balance sheet.

Mr. Craven reviewed the net pension expense calculations that the employers will have to use on their financial statements. This will be the annual cost of the pension according to GASB methodology.

Mr. Garrett reviewed the differences between the methodologies and assumptions used in determining the valuation for PERA compared to the GASB accounting. The discount rate will be the same providing that the solvency testing does not result in a depletion of assets at any point in time in the future. GASB will use a different amortization period. Asset values also differ with PERA funding using an actuarial value of assets representing a smoothing over 5 years. GASB uses a fair market value which is a more volatile measure. The annual cost for PERA funding relying on statutory rates which are constant while GASB relies on service cost plus interest on pension liability plus recognition of deferred inflows and outflows. Many of the GASB results will make it more confusing rather than increasing transparency or decision usefulness.

Mr. Garrett said Cavanaugh Macdonald feels confident and on track with the implementation of GASB 67 and 68.

Ms. French said employers have expressed great fear regarding bond or credit rating in the reporting of GASB 68. Mr. Craven said the accounting numbers are going to show the net pension liabilities. As far as bond rating, many of the bond credit rating businesses have developed measurements to determine pension liabilities and may ignore GASB for bond rating purposes.

Mr. Garrett noted that bond raters were aware of employers participating in pension plans and the funded position of those plans before the new GASB rules were established. He said he hoped this was not a source of information that would impact ratings for employers. The numbers under the GASB disclosure have meaningful terminology but are not actually a credible measure for determining how the plan is being funded or its condition. The measures important for decision making and assessment of the plan's actuarial conditions are the actuarial valuation reports.

Cavanaugh Macdonald recommends keeping the GASB numbers in an entirely different addendum to the valuation. Mr. Craven said they would be separate reports: an accounting result and a funding valuation.

Mr. Lewis asked about cost-sharing employers and how that would affect audit reports. Mr. Garrett said cost efficiency has been discussed in producing the GASB 68 numbers for the employers participating in cost-sharing plans. The idea was that the plan's actuary would produce the numbers for participating employers and the plan's

auditor would review that and provide an opinion as to reasonableness and accuracy. That opinion would be deemed sufficient for reliance by each participating employer's auditor.

Mr. Propst advised the committee that an administrative decision that PERA, using Cavanaugh Macdonald, would calculate the net pension liability for all PERA's participating entities and provide that information at no cost.

In regard to accounting purposes, Mr. Propst said the agency will either use the Board's independent audit firm, Moss Adams, to provide an opinion, or hire a second independent audit firm. He said the agency will do all it can to assist the employers.

Mr. Garrett provided a timeline stating that the 2014 actuarial valuation will be presented to the Board in October. With the Board's approval the valuation will be used to provide the GASB 67 information required for reporting. Shortly thereafter, the actuaries would begin work on the GASB 68 information that the employers are required to have. The information will go to the auditors and be available to the employers in April/May.

Sylvia Barela, ASD Director, clarified that the employers will be using FY14 data for their FY15 audit. The information will be provided in the spring before the fiscal year ends.

Mr. Garrett noted that GASB anticipates the amount of work required may cause delays and allows the plan to report information based on valuation up to two years prior to the date of reporting. Employers are allowed even more time.

Ms. Barela said PERA has run some employer numbers for FY13 contributions as a test.

In terms of coordinating the information, Mr. Propst said he and Ms. Barela have met with representatives of both the Municipal League and the Association of Counties offering PERA as a resource. PERA will be attending their annual meetings to present additional information regarding GASB and provide training sessions. Staff is considering additional resources – training and education – to assist the participating members.

4. OTHER BUSINESS

None was presented.

6. ADJOURNMENT

Upon motion by Ms. Naranjo-Lopez and second by Mr. Martinez, Chair Logan declared the meeting adjourned at approximately 10:30 a.m.

Approved by:

Stewart Logan

Stewart Logan, Chair
Audit & Budget Committee

ATTEST:

Wayne Propst

Wayne Propst, Executive Director