NEW MEXICO

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION

AUDIT & BUDGET COMMITTEE MEETING

May 13, 2014

This meeting of the Public Employees Retirement Board Rules & Administration Committee was called to order by Chair Stewart Logan at 11:35 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
Jackie Kohlasch, Vice Chair
John Reynolds
Loretta Naranjo-Lopez
Louis Martinez

Member(s) Excused:
Dianna Duran

Other Member(s) Present:
Dan Esquibel
Paula Fisher
Patricia French
Dan Mayfield

Staff Members Present:
Wayne Propst, Executive Director
Susan Pittard, General Counsel
Sylvia Barela, ASD Director
Judy Olson, Executive Assistant
Jonathan Grabel, Chief Investment Officer
LeAnne Larrañaga-Ruffy, Portfolio Manager
Christina Keyes, Portfolio Manager
Roderick Ventura, Assistant General Counsel

Others Present:
John Garrett, Cavanaugh Macdonald Consulting
Jonathan Craven, Cavanaugh Macdonald Consulting
Michael Schlachter, Wilshire
Anne Hanika-Ortiz, LFC
Hector Dorbecker, LFC

2. APPROVAL OF AGENDA

Ms. Kohlasch moved to approve the agenda. Mr. Reynolds seconded and the motion passed by unanimous [5-0] voice vote.

3. APPROVAL OF CONSENT AGENDA

Chair Logan said the April 8, 2014 and March 11, 2014 minutes had been reviewed and appear to be correct and accurate; he then asked for a motion to approve the consent agenda.

Mr. Reynolds moved to approve the Consent Agenda. Ms. Kohlasch seconded and the motion passed by unanimous [5-0] voice vote.

4. CURRENT BUSINESS

A. Action Item: Presentation and Approval of Actuarial Experience Study [*Exhibit 1: PERA Experience Study for the five-year period ending 6/31/13*]

Cavanaugh Macdonald (CM) Principal and Consulting Actuary John Garrett thanked the Board for extending their contract earlier this morning.

Mr. Garrett said typically they'll produce an experience study for a four-year period but with the pension reforms that postponed the study, this one includes five years. Actuarial valuation performed yearly is a process that anticipates benefit payments to be paid by the fund. In doing that, several assumptions about future occurrences are necessary: the investment rate of return, rates of salary increases, rates of mortality, rates of retirement and several others. This provides a basis for determining what the stream of future payments will be and then discounts it back to the valuation of today which defines the actuarial liabilities and the present value of the benefit to be paid.

Every time an actuary makes an assumption, Mr. Garrett said, it is also a source of a gain or loss. The best hope is to be right on average with assumptions.

In developing the experience study, CM looks back over the basis for the prior assumptions and that incorporates additional experience. Actuaries do not overly rely on short-term experience but instead look at longer-term historical information in an effort to forecast trends. Data is never 100 percent credible for setting assumptions. Mortality rates and other plan trends regarding withdrawal and retirements are taken into account.

Jonathan Craven, CM Senior Actuary, reviewed the economic assumptions which are based on the general economy and are not plan-specific. The major building block is the rate of price inflation in the economy, followed by real rate of return, investment rate of return, rate of rate inflation and rate of payroll growth. Currently, the rate of inflations is assumed to be 3.5 percent annually. CM is recommending that be lowered to 3 percent. Currently, the real rate of return – the amount of investment return above inflation – is assumed at 4.25 percent. Combining the real rate or return with the price inflation of 3.5 percent creates the investment return assumption of 7.75 percent. CM recommends increasing the real rate of return to 4.75 percent based on the investment consultant's expected returns on the target asset allocations. The alternative suggestion recommended by CM recommends 4.5 percent resulting in a total investment rate of return of 7.5 percent. The rate of wage inflation went down to meet the CPI and payroll growth from 4 percent to 3.5 percent.

Mr. Craven reviewed a 50-year look at the CPI. The trend since the 1980s has been lower inflation. The standard deviation has been less volatile since the 1980s. Rates of return from the bond market are also used. Inflation assumptions are gathered from the biggest 125 public plans in the US and 52 plans assume inflation at 3 percent.

CM constructs a reasonable range for what the inflation assumption range should be – 1.75 percent to 3.75 percent. Social Security Administration in their 75-year projections has a range of 1.8 percent to 3.8 percent and they use 2.8 percent. CM recommends using 3 percent.

Mr. Garrett stated CM conducted an economic-only experience study in 2010 and recommended a change to the inflation assumption from 4 percent to 3.5 percent. Typically, systems review assumptions every five to seven years.

Mr. Reynolds said on his review he feels the recommendations as well as the alternative are on the high side and he recognized that it was already a significant change from 3.5 percent to 3 percent. Mr. Garrett said this is a component in many assumptions which create a building block approach – the idea is to move toward a trend but not be committed to in it in order to measure liabilities for over 100 years. Changing the price inflation does change the entire scale of salary increases for all the plans.

In terming the investment rate of return, Mr. Craven said the expected returns of the different target assets are the targeted allocations and deviations to arrive at a variability of the portfolio going forward. The median return is expected to be 8.07 percent.

Mr. Garrett explained the importance of using the assumptions of PERA's investment consultants. He noted that between the reasonable proposed ranges are an opinion – there is not empirical data.

Mr. Reynolds appreciated that point and opined that the investment rate or return was too high.

Mr. Garrett pointed out that CM's assumptions are focused on the long term, much longer than 10 years.

Mr. Garrett stated that every year a valuation is conducted which includes an analysis of the gains and losses that have occurred due to the assumptions and the actual performance that occurred in that plan year. To develop demographic assumptions CM went back five years to tally them up as a measurement of the experience in the performance of the assumptions of each of those plan years. They look at withdrawal, disability, retirement, and post-retirement mortality. Over the five-year period of time, 32 percent more withdrawals occurred than were expected. The current assumption underestimated the number of members who take retirement at first eligibility. More retirements at a younger age have very high liability to the fund. The change in retirement rate is recommended to change by 8 percent. He reviewed the other demographic assumptions noting male mortality has shifted and increased the liability.

Mr. Garrett reviewed the recommended adjustments to the rates of salary increase. For all divisions, CM have maintained a sufficient margin above the actual rates of increase to reflect that the future outlook will be for greater rates of increase in salaries than recently experienced.

Mr. Craven reviewed the actuarial cost methods stating CM uses the entry age normal cost method on all the plans except the legislative division. No changes were recommended. To the amortization rate which determines how unfunded liabilities are amortized, no change is recommended. In regards to the assets smoothing method, Mr. Craven said the current method is working and other methods may need review.

Ms. Kohlasch asked whether a study was conducted on the part -time employees and how their retirements affect the plan. Mr. Garrett said the valuation does not differentiate between part-time and full-time members.

Responding to Ms. Naranjo-Lopez' question, Mr. Garrett said CM does an experience study for magistrates, judges, and volunteer firefighters. Assumption changes are made on credible data but neither economic assumptions nor mortality are looked at on those smaller plans. He understood all the studies were available on the PERA website and he mentioned the adjustments made to those plans.

Mr. Garrett said in general the recommendations are for tightening of retirement assumptions, reducing the impact and measurement of liability for withdrawal assumptions. Some of the assumptions will cost more money. By increasing the