20TH ANNIVERSARY

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THINK NEW MEXICO

A RESULTS-ORIENTED THINK TANK SERVING NEW MEXICANS

SOLVING the HIDDEN CRISIS:

ACHIEVING RETIREMENT SECURITY FOR ALL NEW MEXICANS

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THINK NEW MEXICO

A Results-Oriented Think Tank Serving New Mexicans

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About Think New Mexico

Think New Mexico is a results-oriented think tank whose mission is to improve the quality of life for all New Mexicans, especially those who lack a strong voice in the political process. We fulfill this mission by educating the public, the media, and policymakers about some of the most serious challenges facing New Mexico and by developing and advocating for effective, comprehensive, sustainable solutions to overcome those challenges.

Our approach is to perform and publish sound, nonpartisan, independent research. Unlike many think tanks, Think New Mexico does not subscribe to any particular ideology. Instead, because New Mexico is at or near the bottom of so many national rankings, our focus is on promoting workable solutions that will lift New Mexico up.

Results

As a results-oriented think tank, Think New Mexico measures its success based on changes in law we help to achieve. Our results include:

- Making full-day kindergarten accessible to every child in New Mexico
- Repealing the state's regressive tax on food and successfully defeating efforts to reimpose it
- Creating a Strategic Water Reserve to protect and restore the state's rivers
- Redirecting millions of dollars a year from the state lottery's excessive operating costs to full-tuition college scholarships
- Establishing New Mexico's first state-supported Individual Development Accounts to alleviate the state's persistent poverty
- Reforming title insurance to lower closing costs for homebuyers and homeowners who refinance their mortgages
- Winning passage of three constitutional amendments to streamline and professionalize the Public Regulation Commission (PRC)
- Modernizing the state's regulation of taxis, limos, shuttles, and movers
- Creating a one-stop online portal to facilitate business fees and filings
- Establishing a user-friendly health care transparency website where New Mexicans can find the cost and quality of common medical procedures at any of the state's hospitals

Think New Mexico's Board of Directors

Consistent with our nonpartisan approach, Think New Mexico's board is composed of Democrats, Independents, and Republicans. They are statesmen and stateswomen, who have no agenda other than to help New Mexico succeed. They are also the brain trust of this think tank.

Clara Apodaca, a native of Las Cruces, was First Lady of New Mexico from 1975–1978. She served as New Mexico's Secretary of Cultural Affairs under Governors Toney Anaya and Garrey Carruthers and as senior advisor to the U.S. Department of the Treasury. Clara is a former President and CEO of the National Hispanic Cultural Center Foundation.

Jacqueline Baca has been President of Bueno Foods since 1986. Jackie was a founding board member of Accion and has served on the boards of the Albuquerque Hispano Chamber of Commerce, the New Mexico Family Business Alliance, and WESST. In 2019, she was appointed to the Federal Reserve Bank of Kansas City's Denver Branch Board of Directors.

Paul Bardacke served as Attorney General of New Mexico from 1983–1986. He is a Fellow in the American College of Trial Lawyers, and he currently handles complex commercial litigation and mediation with the firm of Bardacke Allison in Santa Fe. Paul was a member of the National Park System Advisory Board for seven years.

Garrey Carruthers served as Governor of New Mexico from 1987–1990 and as Chancellor of the system and President of New Mexico State University from 2013–2018. In between he served as Dean of the College of Business at NMSU and as President and CEO of Cimarron Health Plan. Garrey was instrumental in establishing the Arrowhead Center for economic development in Las Cruces.

LaDonna Harris, *Emeritus*, is Founder and Chair of the Board of Americans for Indian Opportunity. She is also a founder of the National Women's Political Caucus. LaDonna was a leader in the effort to return the Taos Blue Lake to Taos Pueblo. She is an enrolled member of the Comanche Nation.

Edward Lujan is the former CEO of Manuel Lujan Agencies, the largest privately owned insurance agency in New Mexico. Ed is also a former Chairman of the Republican Party of New Mexico, the New Mexico Economic Development Commission, and the National Hispanic Cultural Center of New Mexico, where he is now Chair Emeritus.

Liddie Martinez is a native of Española whose family has lived in northern New Mexico since the 1600s. She is the Market President-Los Alamos for Enterprise Bank and Trust, and also farms the Rancho Faisan. Liddie previously served as Executive Director of the Regional Development Corporation and as Board Chair of the Los Alamos National Laboratory Foundation.

Fred Nathan, Jr. founded Think New Mexico and is its Executive Director. Fred served as Special Counsel to New Mexico Attorney General Tom Udall from 1991–1998. In that capacity, he was the architect of several successful legislative initiatives and was in charge of New Mexico's lawsuit against the tobacco industry, which resulted in a $1.25 billion settlement for the state.

Roberta Cooper Ramo is the first woman elected President of the American Bar Association and the American Law Institute. Roberta has served on the State Board of Finance and was President of the University of New Mexico Board of Regents. In 2011, she was inducted into the American Academy of Arts and Sciences. Roberta is a shareholder in the Modrall Sperling law firm.

Dear New Mexican:

Think New Mexico is celebrating its 20th anniversary this year, and one major recurring theme of our work over these past two decades has been promoting policies that improve social mobility within New Mexico. This year's topic on expanding retirement security fits well within that framework.

Achieving true social mobility means being able to save enough to enjoy a comfortable retirement. Unfortunately, too few New Mexicans have this opportunity because of our broken retirement system.

If we were starting from scratch today, we would not build a retirement system that taxes Social Security benefits. Nor would we fail to provide access to retirement savings for hundreds of thousands of private sector employees. Nor would we establish a board to oversee more than $15 billion of public pensions and not require that any of its members have at least some relevant financial or investment qualifications. To the extent that we have a retirement "system" in New Mexico, it is clearly not working very well for the vast majority of New Mexicans.

However, during the course of conducting our historical research for this report, we were intrigued to discover that New Mexico was the only state in the nation that did not have poorhouses for its impoverished elderly residents prior to the enactment of Social Security. We believe that this is because New Mexico has always revered our elders, our *abuelas y abuelos*, and our families have always gone to great lengths to care for them.

The recommendations to improve retirement security in New Mexico in the following pages build on that long and venerable New Mexico tradition.

Our recommendations are also rooted in extensive research. For example, we traced the history of Social Security taxation in New Mexico by tracking down legislative session laws from decades ago, as well as digging through newspaper archives. We also unearthed studies of New Mexico's pensions dating back to 1934. In addition, we searched for the most innovative efforts to expand retirement security in other states and carefully analyzed what would work best in New Mexico. Finally, we interviewed national experts like Josh Gotbaum, former director of the Pension Benefit Guaranty Corporation and currently a scholar at the Brookings Institute, and Bill Hoagland, Senior Vice President at the Bipartisan Policy Center, as well as many local experts, who are listed in the acknowledgments.

Kristina Fisher, my co-author, and I benefited greatly from the extensive research completed by Think New Mexico's summer interns: Josue Gandarilla of Sunland Park who just graduated from New Mexico State University with a degree in Government; Rouzi Guo of Albuquerque who is a junior majoring in Political Economy at Georgetown; Natalie Longmire-Kulis of Santa

Fe who is a sophomore at Stanford; and Connor Schulz of Los Alamos, who is a first-year law student at Georgetown and a recent graduate of New Mexico State University.

We are also indebted to Othiamba Umi and Susan Martin, Think New Mexico's Field Director and Business Manager. Susan coordinated the printing of this report and its distribution to more than 14,000 people across New Mexico. Meanwhile, Othiamba is already working to build a broad bipartisan coalition of legislators and organizations to enact the reforms proposed in this report during the upcoming legislative session that begins in January 2020.

If you would like to be a part of this effort to build a better retirement system for all New Mexicans, I encourage you to visit our website at www.thinknewmexico.org where you can sign up for email updates or contact your legislators and the governor to express your opinion. You are also invited to join the hundreds of New Mexicans who invest in Think New Mexico's work each year by sending a contribution in the enclosed reply envelope.

Fred Nathan Jr.

Founder and Executive Director

Susan Martin, Business Manager; Fred Nathan, Executive Director; Kristina G. Fisher, Associate Director; Othiamba Umi, Field Director. Photo by Peter Ellzey

EXECUTIVE SUMMARY: A ROADMAP FOR ACHIEVING RETIREMENT SECURITY FOR ALL NEW MEXICANS

In this report, we describe the hidden and increasingly urgent crisis of retirement security in New Mexico and lay out a roadmap to address it.

Our state ranks third highest in the nation for the percentage of seniors living in poverty. Two out of three private sector workers in New Mexico lack access to retirement savings plans through their employers, and the pensions for state and local government workers are underfunded by a total of $12.5 billion.

We propose three reforms that will put money back in the pockets of today's retirees and ensure that more seniors in the future will have adequate savings to support a dignified retirement.

First, we recommend repealing New Mexico's income tax on Social Security benefits.

Second, we endorse an innovative reform that has been adopted by a growing number of states to ensure that every private sector worker in New Mexico has access to a retirement savings account that they can contribute to using automatic payroll deductions. The New Mexico Saves Act would create a system of Individual Retirement Accounts that would be offered to all workers whose employers do not already provide a retirement savings plan. These payroll deduction IRAs would be similar to 529 college savings plans, and would give small businesses a simple and inexpensive way to help their workers begin saving for retirement.

Finally, we propose three ideas to improve the stability and performance of New Mexico's public pension funds: invest a portion of the state's record budget surplus in a one-time, $700 million cash infusion or loan to the Public Employees Retirement Association (PERA); consolidate investment management of PERA and the Educational Retirement Board (ERB) pension funds to achieve higher returns and lower fees; and increase the qualifications of those who serve on the state's pension oversight boards.

INTRODUCTION: NEW MEXICO'S LOOMING RETIREMENT SECURITY CRISIS

A crisis is quietly growing in New Mexico. In October of 2018, researchers at the University of New Mexico released a report showing that two out of every three private sector workers in New Mexico have no money saved for retirement. Nearly 80% have less than $10,000 saved.

This lack of savings means that more and more seniors will depend entirely on Social Security benefits to support them when they are no longer able to continue working. In fact, Social Security is already the sole source of income for one in three retired New Mexicans.

The problem is that the average Social Security benefit in New Mexico is only about $13,900 a year, and the cost of food, housing, and health care averages $28,000 a year for older Americans. This leaves seniors facing impossible choices between buying food or medicine or keeping the lights, heat, and water on. Meanwhile, their families struggle to support them while living paycheck to paycheck themselves.

As more and more seniors fall into poverty, the effects ripple out and touch all New Mexicans. Local businesses lose out on sales as seniors don't have enough money to purchase their goods and services. Costs go up for state taxpayers who are funding Medicaid, housing assistance, and food aid for destitute seniors.

Percent of Seniors (Age 65+) Living in Poverty

STATE	POVERTY RATE	STATE	POVERTY RATE
D.C.	14.2%	Delaware	8.5%
Mississippi	13.7%	Michigan	8.5%
New Mexico	12.2%	Nevada	8.5%
Louisiana	12.0%	Pennsylvania	8.5%
New York	11.4%	New Jersey	8.4%
Texas	10.8%	Wyoming	8.4%
Kentucky	10.3%	Idaho	8.1%
Arkansas	10.2%	Maine	8.1%
California	10.2%	South Dakota	8.0%
Florida	10.2%	Washington	8.0%
West Virginia	10.2%	Maryland	7.9%
Georgia	10.1%	Colorado	7.8%
Alabama	9.9%	Wisconsin	7.8%
North Dakota	9.9%	Indiana	7.7%
United States	9.3%	Ohio	7.7%
Hawaii	9.3%	Alaska	7.4%
South Carolina	9.2%	Kansas	7.3%
Tennessee	9.2%	Montana	7.2%
North Carolina	9.1%	Nebraska	7.2%
Oklahoma	9.1%	Vermont	7.1%
Arizona	9.0%	Virginia	7.1%
Massachusetts	9.0%	Connecticut	7.1%
Rhode Island	9.0%	Minnesota	7.0%
Missouri	8.7%	Iowa	6.6%
Oregon	8.7%	Utah	6.4%
Illinois	8.6%	New Hampshire	5.8%

Source: U.S. Census Bureau, 2017 American Community Survey

Illustration by Jeff Stahler, Cartoonstock image #jsh130223

A major cause of this crisis is that nearly two out of every three private sector workers in New Mexico lack access to any sort of retirement savings plan through their employers. This is the highest rate in the nation.

New Mexico's public sector workers are also in a precarious position, as state and local pensions currently do not have the money necessary to pay all the benefits that have been promised to their members. As of 2018, the pensions managed by New Mexico's Public Employees Retirement Association are only 71.6% funded on average, while the Educational Retirement Board pensions for teachers and school staff are just 63.5% funded.

A pension's funded ratio or "fundedness" is calculated as its ability to pay out all the benefits owed to its members if they were due immediately. A pension in good fiscal condition should be at least 90% funded (i.e., have enough money to pay at least 90% of the total benefits currently owed to workers and retirees). This is the average funded ratio of the top third of public pension plans in the U.S., according to a 2018 analysis by the Center for Retirement Research.

New Mexico's total pension shortfall, according to a 2018 analysis by the state's Legislative Finance Committee, is $12.5 billion.

If we fail to act, New Mexico's retirement security crisis will continue to worsen. To address this growing crisis, we propose a three-part plan: repeal the state's income tax on Social Security benefits to immediately put money back into the pockets of New Mexico seniors, increase access to retirement savings plans for private sector workers, and stabilize pensions for state and local government employees.

THE SOLUTION, PART I: REPEAL THE TAX ON SOCIAL SECURITY BENEFITS

One effective way to increase retirement security in New Mexico would be to end the state's practice of taxing Social Security benefits.

Only 13 states tax Social Security benefits, and of those states, New Mexico has the second harshest tax. This is despite the fact that New Mexico's poverty rate among those 65 and older is the third highest in the nation, behind only the District of Columbia and Mississippi.

New Mexico's tax on Social Security benefits is at odds with the purpose of the Social Security program, which was enacted by President Franklin D. Roosevelt and Congress during the New Deal as a way to reduce poverty among the elderly.

Prior to the establishment of Social Security, more than 50% of America's elderly lived in poverty, according to David Hackett Fischer, a professor at Brandeis University. Back then, there was no safety net other than a small Civil War pension program for injured veterans that only covered 0.6% of the entire U.S. population.

If the elderly poor did not have a private pension or family or a religious institution that could support them, they often turned to panhandling or poorhouses.

"Of course, you can always supplement your retirement income with panhandling."

Illustration by Christopher Weyant, Cartoonstock image #BA500287

During the signing ceremony for the Social Security Act on August 14, 1935, President Roosevelt declared, "We can never insure 100 percent of the population against 100 percent of the hazards and vicissitudes of life, but we have tried to frame a law which will give some measure of protection to the average citizen and to his family…against poverty-ridden old age."

Social Security remains an enormously popular government program probably because it has worked so well. Today, the poverty rate among those 65 and older has declined dramatically from around 50% nationally in 1935 to 9.3% nationally and to 12.2% in New Mexico, according to the U.S. Census Bureau.

The Center on Budget and Policy Priorities has observed that "without Social Security, 22.1 million more Americans would be poor," based on data from the Census Bureau's March 2018 Current Population Survey. This means that Social Security has lifted approximately 111,000 New Mexicans out of poverty.

It should be noted that President Roosevelt and Congress never envisioned Social Security as a revenue source for state governments. In fact, no federal or state taxes were imposed on Social Security benefits for nearly half a century after the program's enactment.

In 1983, the federal government began imposing a limited income tax on a portion of Social Security benefits as part of a larger overhaul of the law. The majority of states refused to follow suit, as just 18 states imposed their own taxes on Social Security benefits.

New Mexico was not initially among them. In fact, the New Mexico legislature voted unanimously to keep Social Security benefits free from income tax during the 1984 legislative session. Representative John J. McMullen, the bill's sponsor, told the *Albuquerque Journal*, "When Social Security…first started…the government always stated that these income benefits would always be exempt….I wanted to make sure that the state did not tax these benefits."

Unfortunately, just six years later, the legislature was looking for ways to raise some revenue to pay for state programs. The governor proposed modest increases of the gross receipts (sales) and cigarette taxes, but the Senate rejected that plan. Instead, they passed Senate Bill 310, a long and complex bill that changed the way that pensions are taxed and raised more than $13 million for state government.

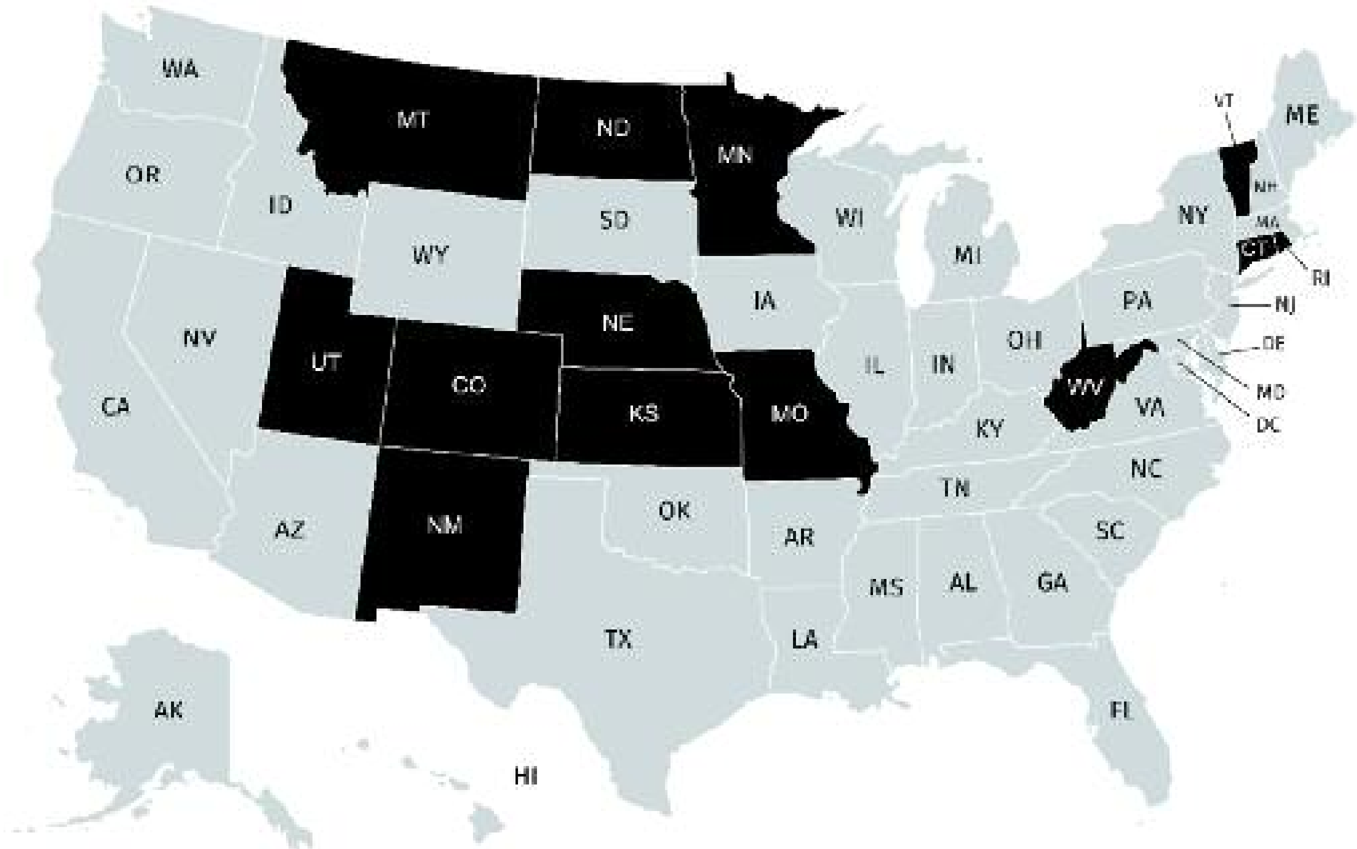
A single line on the second to last page of Senate Bill 310 quietly repealed New Mexico's tax exemption for Social Security benefits. The bill passed and was signed into law with no public reporting on the new tax on Social Security benefits.

A letter to the editor of the *Albuquerque Journal* published on Christmas Eve of 1990 expressed surprise that the media had not covered this major change to state taxation. The writer, a senior from Corrales named Gerald McDonald, noted that he had first learned of the change when he received his income tax form just before Christmas, and saw to his surprise that his Social Security benefits were now taxed.

Social Security benefits have been taxed in New Mexico ever since. Today that tax costs the average Social Security recipient in New Mexico nearly $700 a year.

Taxing Social Security benefits is counterproductive because doing so drives up the number of New Mexico seniors living in poverty.

States that Impose Income Taxes on Social Security Benefits



Source: *States That Tax Social Security*, Kiplinger's Personal Finance, 2015. Map created with mapchart.net

The tens of thousands of older New Mexicans who rely on Social Security as their sole source of income have worked their entire lives and are not living especially large. If they were able to keep the money that they now pay in taxes on their Social Security benefits, much of it would be spent immediately and those dollars would go right back into New Mexico's economy. State government would still receive significant revenues through the gross receipts taxes that would be generated by that economic activity.

Research by Bob Grassberger, professor emeritus at the University of New Mexico, has found that retirees benefit the economy by starting businesses, continuing to work part-time, and engaging in recreational activities. He estimates that every household of retirees in New Mexico generates half a job.

The National Conference of State Legislatures notes that one of the main reasons that most states do not tax Social Security benefits is to attract or retain retired people as "an economic development tool." Indeed, our Social Security tax harms New Mexico in the "best states to retire" lists. Last year, for example, *Kiplinger*'s magazine profiled the 13 states that still tax Social Security benefits, and listed New Mexico among the least tax-friendly states for seniors.

State Taxes on Social Security, Heaviest to Lightest

STATE	SOCIAL SECURITY TAX
Utah	Fully taxed. Seniors with incomes under $25,000 single/$32,000 married receive a non-refundable tax credit of up to $450
New Mexico	Fully taxed. Seniors with incomes under $28,501 single/$51,001 married receive tax exemption of up to $8,000
Montana	Taxable under the same rules that apply to the federal income tax
Minnesota	The first $3,500–$4,500 of Social Security benefits are tax-exempt for seniors with incomes under $60,200 single/$77,000 married
Colorado	The first $20,000–$24,000 of Social Security benefits are tax-exempt
Nebraska	Tax-exempt for seniors with incomes under $43,000 single/$58,000 married
Vermont	Tax-exempt for seniors with incomes under $45,000 single/$70,000 married
West Virginia	Tax-exempt for seniors with incomes under $50,000 single/$100,000 married
North Dakota	Tax-exempt for seniors with incomes under $50,000 single/$100,000 married
Connecticut	100% tax-exempt for seniors with incomes under $75,000 single/ $100,000 married, 75% tax-exempt for higher-income seniors
Kansas	Tax-exempt for seniors with incomes under $75,000
Rhode Island	Tax-exempt for seniors with incomes under $83,550 single/$104,450 married (exemption level increases with inflation)
Missouri	Tax-exempt for seniors with incomes under $85,000 single/$100,000 married

Source: State statutes, compiled by Think New Mexico

One does not need to be a policy wonk to understand that the state tax on Social Security benefits is a form of double taxation. When New Mexicans receive their paychecks, the money that is taken out for Social Security is subject to federal and state income taxes. So New Mexicans pay income tax on the money they put into Social Security, and then they are taxed again on the benefits they receive.

All of these reasons may explain why five of the 18 states that began taxing Social Security benefits have since repealed those taxes, and why more and more of the remaining 13 states that tax Social Security benefits are significantly reducing them.

In fact, eight of the 13 states that still tax Social Security benefits have reduced their taxes in the last decade or so, beginning with Kansas, which in 2008 exempted Social Security benefits for Kansans whose adjusted gross incomes (AGI) were less than $75,000.

Missouri followed in 2012 by exempting Social Security benefits for married taxpayers with AGIs of $100,000 or less and $85,000 or less for all other taxpayers. Next was Nebraska in 2015, which exempted Social Security benefits for married taxpayers with AGIs of $58,000 or less and $43,000 for all other taxpayers. In 2017 Rhode Island followed suit by exempting Social Security benefits for married taxpayers with AGIs of $100,000 or less and $80,000 for all other taxpayers. In 2018 Vermont exempted Social Security benefits for married taxpayers with AGIs of $60,000 or less and $45,000 for all other taxpayers.

Earlier this year, Connecticut, North Dakota, and West Virginia became the most recent states to reduce their taxes on Social Security benefits.

Despite this growing trend, New Mexico continues to tax Social Security benefits very heavily. In New Mexico, taxpayers aged 65 and older with incomes up to $18,000, or $30,000 for married couples, are eligible to exempt just $8,000 from their total income, which includes Social Security benefits. That tax exemption is phased out as a senior's income increases, so that by the time an individual's income reaches $28,501, or $51,001 for a married couple, they receive no exemption for any of their income – including Social Security benefits. (The good news is that if you are a New Mexican aged 100 or older, you are fully exempt from income tax, unless you are claimed as a dependent.)

We believe that New Mexico needs to repeal this burdensome and counterproductive tax.

However, if policymakers have concerns about the cost of this repeal, which the Legislative Finance Committee estimates would be about $73 million a year, a good alternative option would be the laws enacted by West Virginia and North Dakota earlier this year. Both of those states targeted their tax exemptions to lower and middle income residents by repealing their taxes on Social Security benefits for married taxpayers with AGIs of less than $100,000 and for all other taxpayers with AGIs of less than $50,000. (Unlike those states, if New Mexico follows this model, we would recommend that our state automatically adjust those income levels to account for inflation, as Rhode Island does.)

These tax decreases resulted in revenue reductions of about $25 million for West Virginia (with a population of approximately 1.8 million) and approximately $7 million for North Dakota (with a population of approximately 700,000). We estimate that if the West Virginia/North Dakota model were adopted by New Mexico (with a population of approximately 2.1 million), it would reduce state tax revenues between $21–$29 million.

That represents about one third of one percent of New Mexico's $7 billion state government budget.

Lawmakers and the governor could simply repeal or reduce New Mexico's tax on Social Security benefits without any offsetting revenues, since taxes were already raised last year on automobiles, tobacco products, and internet sales.

On the other hand, lawmakers could make the repeal revenue neutral by coupling it with a tax increase of a similar amount. A 2017 report commissioned by the Thornburg Foundation provides a menu of more than $200 million in special interest tax exemptions that could be repealed in order to bring in additional revenue for the state. New Mexico currently provides tax exemptions for everything from boxing matches to spacecraft fuel.

Think New Mexico is not the first to conclude that New Mexico's harsh tax on Social Security benefits is overdue for reform. New Mexico legislators from both sides of the aisle have introduced bills in recent years to repeal or significantly reduce New Mexico's tax on Social Security benefits, including Representatives Gail Armstrong (R-Socorro), Daymon Ely (D-Albuquerque), and Patricia Roybal Caballero (D-Albuquerque).

Three decades after slipping Social Security into New Mexico's income tax code, the time has come for our state to join the 37 states that exempt Social Security benefits from taxation and put nearly $700 a year back into the pockets of the average New Mexico senior.

THE SOLUTION, PART II: INCREASE ACCESS TO SAVINGS FOR PRIVATE SECTOR WORKERS

While Social Security has kept many New Mexicans from falling into absolute poverty, Social Security benefits alone are generally insufficient to meet all the needs of a retiree. Yet, as noted in the introduction to this report, four out of five New Mexicans have little to no retirement savings.

A major reason why New Mexicans aren't saving for retirement is that nearly 62% of private sector workers in the state do not have access to a retirement savings plan through their jobs.

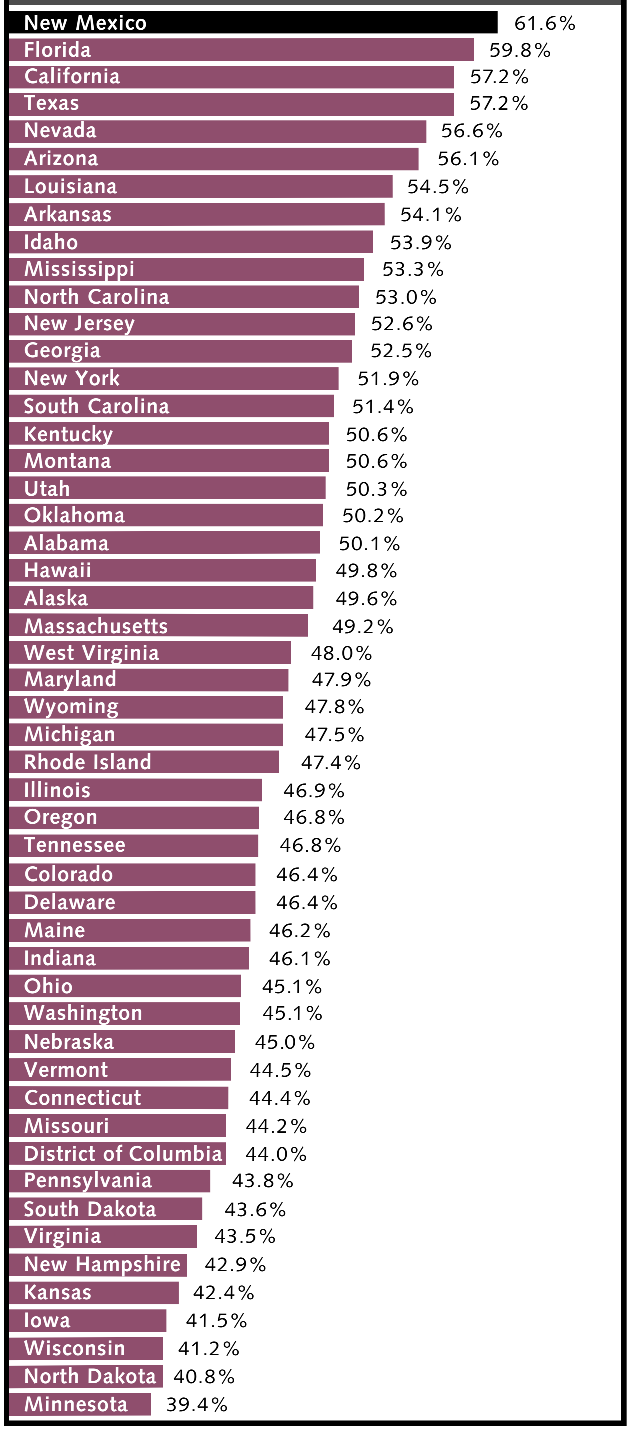
That is the lowest rate of access to workplace retirement savings in the nation.

This matters because a growing body of research has shown that workers who can participate in retirement plans through their jobs are much more likely to save. In fact, the National Institute on Retirement Security has found that workers are 15 times more likely to enroll in an employer-offered retirement plan than they are to open up an Individual Retirement Account (IRA) on their own.

The explanation for this enormous difference can be found in something called "nudge theory," which was developed by Cass Sunstein, a prominent legal scholar, and Richard Thaler, a Nobel Prize-winning behavioral economist. Nudge theory explains that people tend to make the decision that is easiest for them in the moment, taking the path of least resistance even if it isn't the best decision in the long term. Moreover, when we are given a default option, most of us will stick with that default.

It is much easier for someone to simply sign up for a retirement plan provided by an employer than to

Percent of Workers Without Access to Workplace Retirement Plans



Source: U.S. Census Bureau's Current Population Survey, March Supplements, 2012–2014, compiled by AARP Public Policy Institute go through the hassle of figuring out how to set up their own IRA. It is even easier to be automatically enrolled in a retirement plan by an employer and given the option to opt out, rather than having to actively do something to opt in.

In a 2012 study conducted by the investment firm Fidelity, when young workers were automatically enrolled in a retirement plan, 76% of them stayed in it. When they had to enroll on their own, only 20% signed up.

Even highly educated scientists – who presumably know the benefits of saving for retirement and have plenty of capacity to save – respond to a nudge, as the managers of the 401(k) plan for Los Alamos National Laboratory (LANL) employees discovered. Starting in 2015, LANL employees were automatically enrolled unless they opted out, and the participation rate rose by 11%. The savings rate increased as well, with employees saving an average of 10% of their salaries after the auto-enroll, compared with 7.5% before.

Nine out of ten New Mexicans over the age of 35 wish they were saving more for their retirement, according to a 2018 poll by AARP. They just need a nudge to make it easier for them to do so.

The Growing Movement to Expand Access to Retirement Savings

In 2015, Oregon became the first state to enact and implement an innovative strategy for increasing access to retirement savings. The Oregon Saves Act created what came to be known as an "Auto-IRA," an Individual Retirement Account that would be automatically offered to all workers whose employers did not already provide a retirement savings plan.

Illustration by Christopher Weyant, Cartoonstock image #CC140017

Oregon Saves was designed using the principles of nudge theory. Workers are automatically enrolled in the plan unless they choose to opt out, and they have monthly contributions automatically deducted from their paychecks, just as they would for an employer-sponsored retirement plan like a 401(k). The default rate of savings starts at 5% of a worker's income, and this rate automatically increases by 1% a year until it reaches 10%. Workers can opt out of any increases or set a lower level of savings at any time. Savings are placed into a safe money market fund until they reach $1,000, at which point additional savings are invested in a target date retirement fund.[1] The annual fees are capped at 1%, which includes the investment fees as well as the state's cost of running the program.

1] A target date retirement fund contains a mix of stocks and bonds that are automatically adjusted, so that when an investor is younger, the fund contains riskier investments that are likelier to earn higher returns, and as the investor's retirement date approaches, the fund shifts toward more conservative assets to minimize the risk of loss.

The system is designed to be simple for employers as well as workers. All an employer has to do is provide their employees with an information packet provided by the state about the Auto-IRA and set up automatic payroll deductions for any workers who do not opt out. Oregon Saves is being phased in over five years, starting with employers with over 100 employees in 2017, and then adding smaller employers each year, reaching employers with fewer than four employees in 2020.

The initial results of Oregon Saves have been very promising. By the end of 2018, over 2,600 employers had begun offering the Auto-IRAs and more than 52,000 participants had enrolled and had saved a total of $10.9 million. Many businesses signed up to participate before they were required to do so, and only about one in four workers who were offered the plans have opted out of participating.

One early Oregon Saves participant, the owner of a hair salon, said that he had been trying unsuccessfully for a decade to set up a retirement plan for his employees. He told a reporter: "We met with four different companies but the plans were either too expensive or the fees were too high." Instead, he encouraged his workers to begin saving on their own, but it took ten years for him to persuade ten of his employees to start their own IRAs. With Oregon Saves, he was able to sign up 26 of his employees in ten minutes.

By early 2019, California, Connecticut, Illinois, Maryland, and New York had followed Oregon's lead and were in the process of establishing Auto-IRAs for private sector workers in those states.

Illustration by Harley Schwadron, Cartoonstock image #hscn1880

Meanwhile, New Jersey and Washington initially attempted a different approach. Rather than creating Auto-IRAs, these states passed laws to create marketplaces where employers and individuals could shop for retirement plans, similar to the health insurance exchanges established by the Affordable Care Act.

Just like the health insurance exchanges, the states would provide a basic level of oversight, vetting the plans offered on the marketplace and capping fees charged to participants. However, unlike the health insurance exchanges, purchasing a retirement plan from the marketplace would be entirely voluntary. The costs of setting up and running the marketplaces would be covered by fees on the financial services companies that offer plans on them.

The Washington marketplace launched in March of 2018, but it failed to attract much interest from investment companies, businesses, or potential savers. Earlier this year, the same state senator who had sponsored the legislation creating the marketplace introduced a bill to create an Auto-IRA program.

New Jersey never ended up implementing its marketplace. Instead, in March of this year, that state's legislature and governor enacted a law to create an Auto-IRA program.

Tailoring These Reforms to New Mexico

With over 336,000 New Mexicans currently lacking access to retirement savings through their jobs, these reforms are even more urgently needed in New Mexico than they are in most states.

Not only is there enormous opportunity for a New Mexico Saves Act to make a huge positive impact on the lives of New Mexicans, there is also a strong coalition that is already laying the groundwork to get it done.

In 2017, the New Mexico legislature unanimously passed Senate Joint Memorial 12, which put together a retirement security task force with all the key stakeholders: legislators, state agencies, businesses, unions, nonprofits, financial services companies, and representatives from AARP New Mexico. This group met regularly throughout 2017 and 2018, and produced a report recommending that New Mexico establish a payroll deduction IRA program, supplemented by an online marketplace. Unlike an Auto-IRA, participating in the payroll deduction IRA would be voluntary for both employers and workers; however, if the voluntary program did not sufficiently increase access to workplace retirement savings plans over the first several years, a provision would take effect requiring employers to offer the accounts to their employees.

The recommendations in the task force report were championed by New Mexico State Treasurer Tim Eichenberg, AARP New Mexico, and legislative sponsors Senator Bill Tallman (D-Albuquerque) and Representative Tomás Salazar (D-Las Vegas). During the 2019 session, the Senate unanimously passed Senate Memorial 119 supporting the development of a New Mexico Saves Act to implement the recommendations in the report.

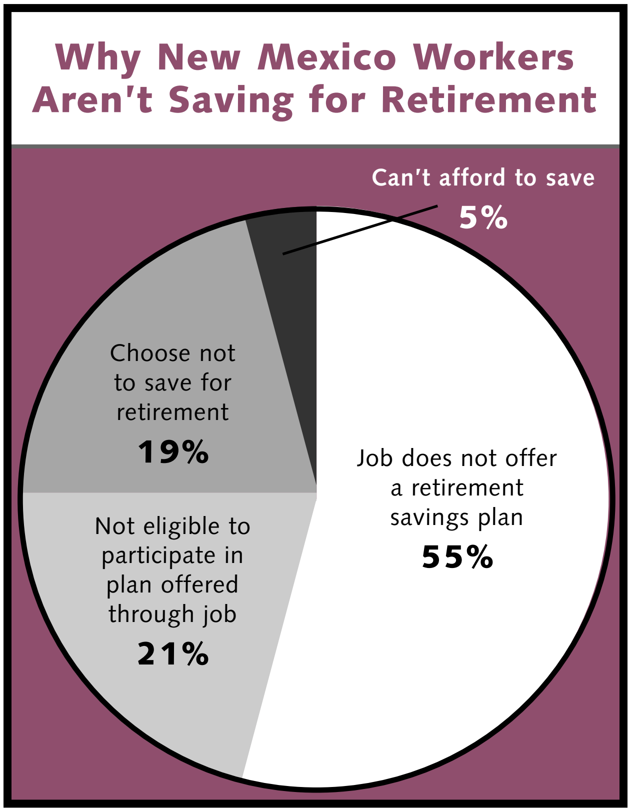
As we consider how to tailor a New Mexico Saves Act to the unique needs of our state, there are three key issues to address: ensuring that New Mexicans have the ability to save, ensuring that the program is business-friendly, and ensuring that the plans are well-managed.

New Mexicans' Capacity to Save

Because New Mexico is a relatively poor state, some might question whether New Mexicans can afford to save for retirement. After all, the Federal Reserve reports that 41% of Americans cannot afford to cover a $400 emergency expense, so how could they possibly put money away for retirement?

Yet most New Mexicans do not see cost as the main barrier to saving for their retirement. A 2018 study by the Bureau of Business and Economic Research at the University of New Mexico found that only 5% of New Mexicans say that they are not saving for retirement because they cannot afford to do so (compared with 9% nationally). By contrast, 55% say they are not saving because their employer does not offer a plan.

There is also a federal tax incentive that can help put money back into the pockets of low-income New Mexicans who begin saving for retirement. The Saver's Credit is available to individuals with incomes under $32,000 or married couples with incomes under $64,000, and it reduces federal taxes by up to $1,000 for an individual or $2,000 for a couple. Anyone who saves money in any sort of retirement plan is eligible for the credit, but few people know about it or claim it – only about 3–5% of eligible tax filers claim the credit each year. If



Source: University of New Mexico Bureau of Business & Economic Research. *Report of Senate Joint Memorial 12 Retirement Income Security Task Force.* October 16, 2018

information about this federal tax credit were included in the information packet for New Mexicans signing up for the payroll deduction IRAs, the percentage claiming the credit would likely increase.

Finally, there is an additional financial advantage from a New Mexico Saves Act that will particularly benefit lower-income New Mexicans. Payroll deduction IRAs are generally set up as Roth IRAs (meaning that federal income tax has already been paid on the funds put into the IRA), and the money that a saver puts into a Roth IRA can be withdrawn from the account without penalty. For New Mexicans with insufficient savings, putting money into an IRA will build up a source of funds that they can draw on for emergency car repairs or medical needs – without having to take on the high cost and high risk of a payday loan.

A Business Friendly Savings Plan

A high proportion of businesses in New Mexico are small businesses. Eighty-eight percent of companies in the state employ fewer than 19 workers, and 60% employ fewer than five, according to the UNM Bureau of Business and Economic Research. Smaller businesses and nonprofits tend to struggle the most with the expense and complexity of setting up retirement savings plans for their workers.

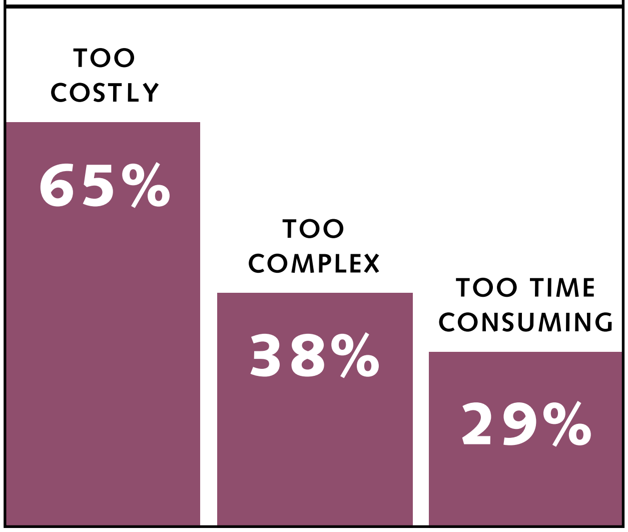
The good news is that small businesses in New Mexico want to expand access to retirement savings for their employees, as long as it's done in way that's fair to them. When New Mexico businesses with fewer than 100 employees were surveyed by AARP in 2017, 78% said they supported legislation that would make it easier for them to help their employees save for retirement. Two out of three said that they would voluntarily sign up to offer their employees a payroll deduction IRA if one were available.

The three main reasons that New Mexico small business owners gave for not currently offering a retirement plan were that it was too costly (65%), too complicated (38%), or too time-consuming (29%).

A payroll deduction IRA would address each of these challenges. The only cost to businesses and nonprofits would be adding one more payroll deduction for their employees, which costs less than $2.50 a month per employee for most small businesses according to the payroll processor ADP. It is simple and quick to participate because all a business has to do is share an information packet provided by the program with their employees and set up the automatic payroll deductions.

There are also several design features that a New Mexico Saves Act might consider borrowing from

Main Reasons Why New Mexico Small Businesses Do Not Offer Retirement Plans



Source: AARP New Mexico, *2017 New Mexico Small Business Survey*

other states that have already enacted similar laws. In particular, the bipartisan Maryland Saves program includes four features designed to address specific concerns of the business community.

First, rather than making it mandatory for all employers to offer the payroll deduction IRA to their employees, Maryland made it voluntary and provided an incentive: the state waives its annual business filing fee for any business that offers either the payroll deduction IRA or their own retirement plan. Waiving this fee more than covers the cost of setting up the automatic payroll deductions for workers. New Mexico could similarly waive its annual $25 filing fee for businesses and nonprofits that participate in the state plan or offer their own. The cost of this waiver to the state would be less than $4 million annually.

Second, Maryland makes it extremely easy for businesses that already offer retirement savings plans to their employees to certify to the state that they do not need to enroll in the Maryland Saves program. Under federal law, businesses with retirement savings plans for their employees already have to file a Form 5500 with the Internal Revenue Service every year. Maryland simply asks businesses filing the Form 5500 to send a copy to the state, so there is no extra paperwork for them to complete.

Third, some small businesses that still complete their payroll by hand, rather than automatically, raised concerns that creating a new payroll deduction could be burdensome for them. So the Maryland Saves law specifies that it only applies to companies that process payroll automatically; businesses processing payroll by hand are exempt.

Finally, one other concern raised by some businesses was that even though the law does not require them to match employee contributions, they worry that might change in the future, making the program unaffordable for them. Under federal law, an employer cannot contribute to an Individual Retirement Account, so since the accounts are set up as IRAs, employers would never be required (or even permitted) to contribute to them.[2]

2] Other states rolling out Auto-IRAs have taken the additional step of including language in their laws stating that if the Auto-IRAs were ever determined to be subject to the federal Employee Retirement Income Security Act (ERISA), then the Auto-IRA program would be halted. This ensures that Auto-IRA programs will not result in businesses having to comply with burdensome ERISA regulations.

Making Sure the Payroll Deduction IRAs Are Well-Managed

The payroll deduction IRA programs being rolled out in other states are similar to the 529 college savings plans that have been widely available in all fifty states for the past two decades. A 529 plan is an individual investment account where people can save for college expenses. Like payroll deduction IRAs, 529 accounts are overseen by the state, but the funds in the accounts belong to the individual investors and are not mingled with any state assets.

New Mexico's 529 plan was started in 2000, and it is overseen by the Education Trust Board (ETB), appointed by the governor and legislative leaders. The ETB is housed in the New Mexico Higher Education Department.

After facing serious challenges in the wake of the Great Recession, the ETB hired better qualified staff and contracted with an outside firm to monitor and evaluate the performance of the investment firms who manage their funds. By 2018, New Mexico's 529 plans had fees low enough and investment returns strong enough that they were even drawing many savers from out-of-state.

In designing a New Mexico Saves Act, we can learn from the lessons of the 529 plans. The oversight structure could parallel the Education Trust Board, with a New Mexico Saves Board appointed by the governor and legislative leaders and housed in the Office of the State Treasurer. Board members would be required to have relevant expertise in finance and investment management.

Management of the investments themselves would be contracted out to professional investment companies (e.g., Fidelity or Vanguard), with safeguards such as the outside monitors that have helped improve the performance and accountability of the 529 plans.

Achieving a New Mexico Saves Act

We join State Treasurer Tim Eichenberg, AARP New Mexico, and others in recommending that the legislature and governor enact a New Mexico Saves Act, similar to the one proposed by the retirement security task force and enacted in other states, that will dramatically increase access to retirement savings for private sector workers in New Mexico.

THE SOLUTION, PART III: MAKING PUBLIC PENSIONS SUSTAINABLE

History of New Mexico's Public Pensions

New Mexico's first public pension plan was signed into law on March 19, 1925. That initial pension was limited to state university faculty, and retirement benefits were provided at the discretion of university boards of regents. Two years later, the legislature expanded pensions to firefighters in the state's large cities (with populations over 5,000 people), funding those retirement benefits entirely with state tax dollars, with no contributions from public employees.

Illustration by Jorodo, Cartoonstock image #jdon523

Over the following two decades, the state continued to experiment with providing pensions to different categories of public employees. The first pension for public school teachers was created in 1933, and in 1945, the Educational Retirement Board (ERB) was established to oversee the retirement plans for all New Mexico educators.

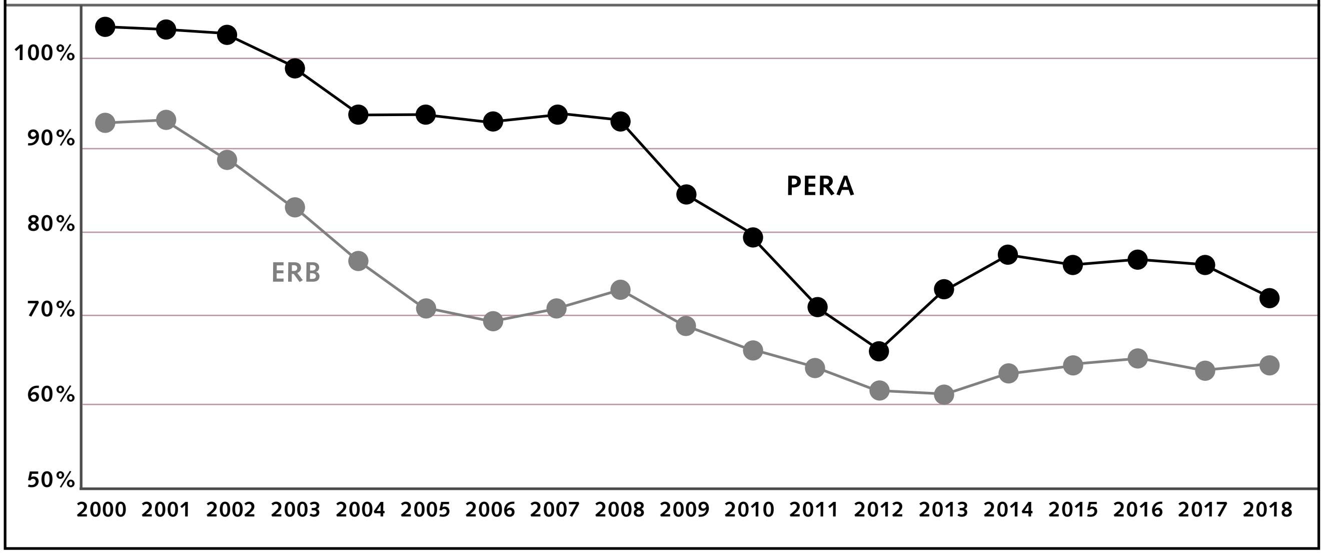
Prior to 1949, the pension funds for teachers had not had any systematic record-keeping of payments coming in or going out. So the ERB was in for a shock when it completed its first actuarial analysis in 1950 and learned that it had $7.9 million in assets and $55.4 million in liabilities – the plan was less than 15% funded. In response, the legislature overhauled the ERB pension plan and began requiring teachers to contribute toward their pensions.

In 1947, the legislature and governor established the Public Employees Retirement Association (PERA) to oversee pensions for state and local government workers across New Mexico. Employees and the agencies that employed them each contributed 3.5% of the employees' salaries to support the pension. Over the years, PERA came to manage 31 separate pension plans for public workers ranging from judges to volunteer firefighters, and the contribution rates for both workers and the agencies that employ them steadily increased.

The Growing Crisis

As the pension plans matured, the number of retirees receiving benefits increased relative to the number of active workers paying into the pensions. For example, in 1966, PERA had 21,034 active members supporting 1,117 retirees, a ratio of nearly 19-1. As of June 2018, PERA had 56,542 active members and 39,673 retirees, a ratio of about 7-5.

Fundedness of New Mexico's Pension Plans



Source: Comprehensive annual financial reports for PERA and ERB, 2000–2018

These changing demographics increased the pressure on pension funds to bring in more income through their investments. At the same time, the rate of return on relatively low-risk investments – like 30-year U.S. Treasury bonds – fell substantially. So pension managers had no choice but to shift an increasing proportion of their funds to riskier, more volatile investments.

The downside of these changes could be seen after the dot-com stock market crash of the early 2000s and even more so following the Great Recession. In 2000, PERA was 106% funded and ERB was 91.6% funded. By 2012, however, PERA had slid to 65.3% funded and ERB was only 60.7% funded. Those numbers have only improved slightly in the past six years, with PERA now 71.6% funded and ERB 63.5% funded. (It should be noted that PERA's fundedness is an average of its 31 plans, which range in fundedness from 55.6% for magistrate employees to 141.5% for volunteer firefighters.)

If the fundedness of New Mexico's pensions isn't improved, they could become insolvent. This has happened to municipal pension funds across the country from Central Falls, Rhode Island to Prichard, Alabama to Stockton, California. When these pension funds declared bankruptcy, payments to their pensioners were drastically reduced, and many retirees ended up filing personal bankruptcies or having to return to work in their old age.

As pension liabilities grow, state and local governments have to put more and more money into them, crowding out spending on schools and social services. For example, a recent study published by Bellweather Education Partners found that nationally, the education dollars going to instruction grew by 2.6% between 2005–2014, while the spending on benefits (health care and pensions) grew by 24%.

Illinois, with one of the least funded pensions in the nation, spends about 36% of its state funding for education on pensions. The growing costs of pen-

Fundedness of Main PERA Pension Funds	
Volunteer Firefighters Fund	141.5%
Legislators	137.7%
State Police/Corrections	130.2%
Municipal General	76.3%
Municipal Police	74.8%
State General	63.1%
Municipal Fire	60.2%
Judicial Fund	56.3%
Magistrate Fund	55.6%

Source: Public Employees Retirement Association, Comprehensive Annual Financial Report 2018, pages 150–157

sions mean that there is less money available for take-home pay for teachers.

There is another way in which New Mexicans are already paying a price for our underfunded pensions. When the state wants to borrow money by issuing bonds to pay for things like infrastructure projects, the interest rate we pay is determined by our bond rating, essentially a credit score for the state. Just as credit rating agencies look at how well an individual pays back debts to determine their credit score, bond rating agencies look at how well states are keeping up with their obligations–including the money they owe to pensioners.

In 2016, the credit rating agency Moody's downgraded New Mexico's bond rating from AAA to Aa1. Two years later, Moody's further downgraded New Mexico's bonds from Aa1 to Aa2, explaining that the downgrade "is primarily attributable to the state's extremely large pension liabilities." This year, even though New Mexico's finances benefited from a more than $1 billion surge in state tax revenues thanks to high oil and gas production, Moody's refused to raise the bond rating, calling New Mexico's pension liabilities a "fundamental challenge."

The lower our bond rating, the more state taxpayers have to pay when the state borrows money. Already, the lowered rating is costing taxpayers in the range of an additional $3–$5 million in interest payments every year. If the rating drops further, those costs will continue to rise. According to a recent estimate by the New Mexico Finance Authority, falling from an A rating to a B rating would cost the state an additional $21–$75 million annually.

Recent Pension Reforms

In order to protect the retirements of New Mexico teachers and public workers, lawmakers have enacted a series of reforms over the past decade to shore up the state's pension funds. These reforms have increased contributions from employees and employers, increased the age and years of work required to qualify for pension benefits, and reduced annual Cost of Living Adjustments (COLAs). The most recent reforms to ERB pensions, which were enacted earlier this year, are projected to improve ERB's long-term fundedness by $529 million.

The most impactful changes came in 2013, when bills sponsored by Senators George Muñoz (D-

Gallup) and Stewart Ingle (R-Portales) created new tiers of reduced pension benefits for PERA and ERB members who begin working after July 1, 2013. (Legally, benefits cannot be reduced for current workers, only future ones.) The new tiers are designed to be financially sustainable, so that public workers will be able to count on their pensions being there when they retire. These reforms averted a crisis that was projected to leave PERA just 18.8% funded by 2043.

However, while the 2013 reforms stabilized the PERA pension system for the future, that fund is still projected to be in a serious cash crunch between today and the mid-2040s.

The challenge PERA is facing is that 70% of the obligations the pension owes are for its current retirees. While PERA should be able to pay all the benefits it owes to workers who retire in the 2040s and beyond, changes must be made in order for the fund to be able to pay out pensions that are due to state employees over the next 30 years.

Although ERB is currently less funded than PERA (63.5% funded compared to PERA's 71.6% funded), its long-term outlook is more positive, primarily because ERB bases its COLA on inflation and reduces that COLA as the fundedness of the plan falls below 100%. According to an August 2018 analysis by the New Mexico Legislative Finance Committee, "ERB estimates that it will take 61 years for the fund to pay off [its unfunded liability]...while PERA reports an infinite amortization period meaning that there is no way for current contribution and investment income to pay for benefits."

As Senate Finance Committee Chair John Arthur Smith (D-Deming) said in the summer of 2018: "I think it's time the beneficiaries become aware that their pension is not in good shape. I think it's time we be very, very candid with people."

2019 Governor's Pension Solvency Task Force

In early 2019, newly elected Governor Michelle Lujan Grisham signed an Executive Order creating a Solvency Task Force to recommend reforms to stabilize PERA. After a series of public meetings and private workshops, in late August the Task Force recommended several reforms. These included increasing employee and employer contributions and replacing the annual 2% COLA with an adjustable formula in which the COLA would increase in years when the pension's investments perform well and when the fundedness improves. The governor and task force should be commended for taking on the difficult task of developing these proposals for consideration by the legislature during the 2020 session.

In the following pages, we recommend three additional reforms that would improve the long-term stability and performance of PERA and ERB and that have so far not been included in the pension solvency discussion. All of the recommendations we make here complement the proposals brought forth by the Governor's Solvency Task Force, and would help enhance the impact of those reforms.

Recommendation I: Make a One-Time, $700 Million Cash Infusion or Loan to PERA

A presentation by the Governor's Solvency Task Force included a sobering analysis stating that: "PERA is expected to be in an unhealthy negative cash flow situation peaking in 2034–2035."

Why is there a negative cash flow situation? It is because the benefits owed to PERA retirees over the next 30 years will very likely outpace investment returns and employer and employee contributions going into the fund. This year, for example, PERA will pay out $1.3 billion in benefits while only collecting $630 million in contributions, leaving a $670 million gap that must be made up with investment returns.

This challenge is hard to address, not due to a lack of political will, but because of legal constraints. Courts in New Mexico and elsewhere have consistently found that public workers cannot have their pension benefits changed during the course of their employment. The pension benefits that are in effect when a worker begins a public service job are a promise made to that worker that cannot be breached.

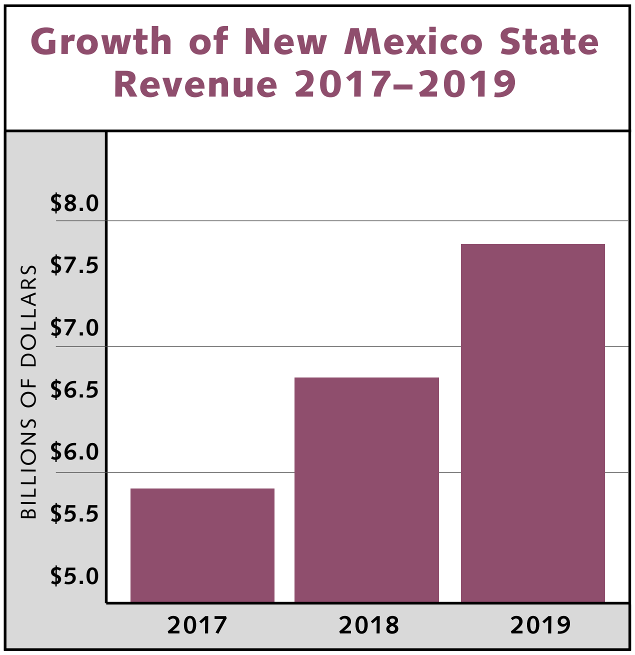
As a result of this caselaw, the 2013 reforms primarily adjusted benefits for public workers who began working after the law was enacted on July 1, 2013, and who will be retiring in 2043 and beyond.[3] The reforms did little to address the cash flow crunch caused by the benefits owed to public employees who began working prior to 2013.

Thus, the challenge is to find a way to create a bridge from today to at least 2043 by addressing the negative cash flow issue.

Illustration by Chris Wildt, Cartoonstock image #cwln3894

Some legislative leaders, including Senate Finance Committee Chair John Arthur Smith, have suggested using a massive cash infusion of one-time money to stabilize the pensions. There is precedent for this in other states. For example, in 2017, California Governor Jerry Brown and that state's legislature made a $12 billion one-time cash infusion to the California Public Employees' Retirement System (CalPERS). That amounted to about 10% of California's total general fund revenues (the equivalent of $700 million of New Mexico's general fund revenues). Half of the $12 billion came from California's general fund revenues and the other half came from an obscure surplus cash account. California lawmakers noted that making this cash infusion would save taxpayer dollars in the long run by reducing the need to increase employer contributions to the pension.

3] The only exception is COLAs, which the New Mexico Supreme Court ruled in *Bartlett v. Cameron* are not included in the core pension benefits and may be changed at any time by the legislature, not only for future workers but also active workers and current retirees. This is why the 2013 reforms and the reforms proposed by the Governor's Solvency Task Force both include reductions in COLAs for current retirees as well as future ones.



Source: New Mexico Legislative Finance Committee, *2019 Post-Session Review.* May 2019

New Mexico is currently experiencing a revenue windfall driven by an oil boom in the Permian Basin that has made New Mexico the nation's third-highest oil producing state. As of August 2019, state revenues were estimated to be $333 million higher than expected for the budget year that ended on June 30, 2019, primarily due to increased oil and gas revenues. While New Mexico lawmakers generally aim to hold about 20% of revenues in reserve each year, in 2019 that amount was nearly 27%, and during this fiscal year the percentage is projected to increase to 32%. The state is on track to have nearly $2.3 billion in reserves by the end of the current fiscal year.

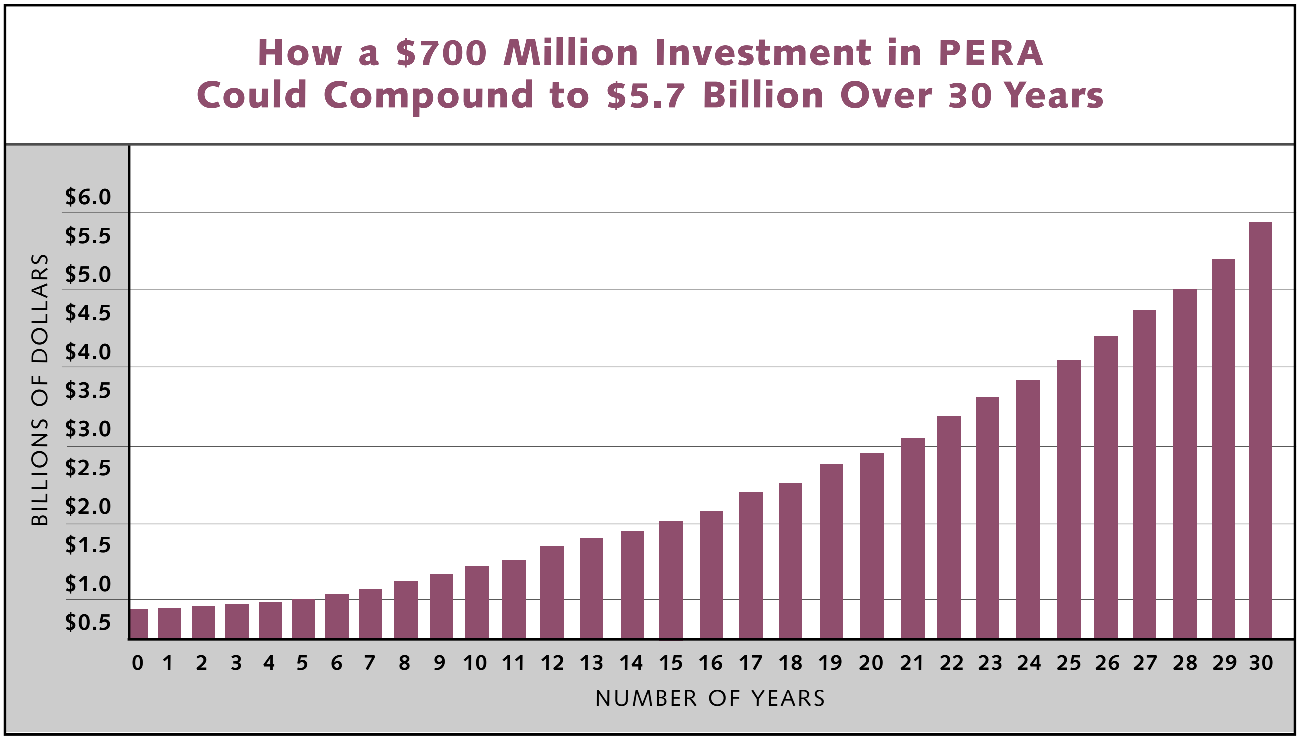
So why not just plow some of the budget surplus into the public pensions, particularly PERA? The primary objection is that there are more urgent competing needs for that money, such as school construction and renovations, drinking water systems, and road repairs, which are especially needed in southeastern New Mexico.

However, the alternative to a cash infusion is increasing employer contributions to the pensions, which also raises objections. Since employers are public agencies, their budgets come from taxpayers – most of whom do not have pensions of their own.

In an August 19, 2019 editorial entitled, "NM's pension fixes can't put even more on taxpayers' backs," the *Albuquerque Journal* highlighted the fact that taxpayers already contribute 26.37% of the salaries of juvenile correction officers to their pension fund, while those employees pay just 6.28% of their salaries toward their pensions. Most state government workers contribute 8.92% of their salaries, while state taxpayers pay an additional 17.24%. The editorial concluded: "And so despite the amazing work many of our public sector workers do, we have to say, 'Enough.' It's not right for lower and middle classes to shoulder more of the state pension burdens when they will struggle terribly in retirement."

Instead of raising taxpayer contributions to pensions further, and instead of using recurring money from other worthy government programs like K-12 education to reduce pension liabilities, we would recommend that the state make a one-time cash infusion of $700 million to PERA in the upcoming legislative session from the budget surplus and reserves.

If there are objections to making such a sizeable appropriation to PERA, the $700 million could be structured as an interest-free loan that would be paid back to the state in 2050, when the negative cash situation has abated – sort of like a 30-year mortgage with a fixed interest rate of zero. By the time PERA pays back the loan, the state would likely need the money more than it does right now.



Source: Calculated by Think New Mexico, assuming PERA meets its target 7.25% growth rate and the funds compound annually

The one-time cash infusion or bridge loan could consist of $333 million in surplus funds from the last fiscal year and another $367 million from reserves. (Alternatively, some of the funds could come from next year's surplus, as state revenues are projected to grow by $907 million, an increase of 12.8% over the current budget year.)

PERA could invest that cash infusion or bridge loan and use the investment return it earns to offset its massive short-term cash flow needs.

The net result of a cash infusion or bridge loan of this magnitude to PERA would be to reduce the burden of unfunded pension liabilities that would otherwise be passed along to future generations of New Mexicans, while helping to make the pension more solvent and more fairly balancing the burden between state retirees and taxpayers. It could also partially pay for itself by lowering the state's borrowing costs (by increasing our bond rating) and lowering government spending on pension payments going forward.

As a result of compounding, if PERA meets its 7.25% target investment returns, that $700 million will generate $5.015 billion worth of earnings in 30 years, covering 80% of PERA's current $6.2 billion unfunded liability. Even assuming a more conservative return of 5%, a $700 million cash infusion or bridge loan would generate $2.3 billion in investment returns over the next three decades.

This cash infusion or bridge loan should be made contingent on implementing some of the recommendations of the Governor's Solvency Task Force (e.g., adjustable COLAs) and the management reforms that are detailed in the following pages.

It is urgent that the legislature and governor make this cash infusion or bridge loan during the upcoming session. Acting sooner reduces long-term pension costs because the earnings from the funds have more time to compound investment returns, reducing the need for future contributions by taxpayers. Conversely, the longer the state waits to address the underfundedness, the deeper the hole will become, and it will become increasingly difficult to dig out as the deficit itself begins to compound.

Recommendation II: Consolidate Investment Management of PERA and ERB

The retirees of both PERA and ERB would benefit if the investment management of New Mexico's pensions were consolidated under one investment management team. In doing so, New Mexico would be joining at least 11 other states that manage all pension investments through a single entity. Half a dozen states have consolidated their pension investment management since 1970 and all are performing well, as shown in the chart below. (We are not aware of any states that have de-consolidated their pension investment management.)

It is important to note that combining investment management would not mean combining governing boards for PERA and ERB. Each would continue to exist as they do now and exercise the sole and exclusive fiduciary duty and responsibility for the investment of their respective trust funds, as provided for in the New Mexico Constitution.

Both governing boards have the same primary objective: to prudently invest the trust fund's assets in order to provide retirement benefits for their members. The New Mexico Constitution does not require that separate investment management teams serve

State Pensions that Have Consolidated Investment Management Since 1970

STATE	YEAR CONSOLIDATED	PENSION SIZE	RETURNS (2018)	FUNDEDNESS
Florida	**1970**	**$134 billion**	**8.9%**	**84.3%**
Indiana	**2011**	**$34.1 billion**	**9.3%**	**88.3%**
Maine	**1985**	**$10.8 billion**	**9.0%**	**81.4%**
Nevada	**1987**	**$25.4 billion**	**8.6%**	**75.1%**
Tennessee	**1972**	**$34.1 billion**	**8.2%**	**96.5%**
West Virginia	**1991**	**$10.2 billion**	**9.7%**	**79.0%**

Source: State statutes and state pension fund websites, compiled by Think New Mexico each board. Just the opposite: the requirement to prudently invest argues for one comprehensive and more efficient investment management team.

In fact, this is already an element of PERA's structure, since PERA consists of 31 different pensions managed by one investment management team. There is no reason why the assets of ERB could not be managed in conjunction with those of PERA's 31 funds, and there are several key advantages to doing so.

First, a consolidated investment management team could reap lower fees by combining PERA's $15.7 billion with ERB's $13.3 billion. The largest savings would be in external investment management fees. Bigger pension funds make bigger investments in private equity, venture capital, and real estate, and as a result can receive fee discounts from external fund managers. These discounts would add up to millions of dollars, considering that ERB spent more than $80 million in the 2018 fiscal year on investment management and consulting fees, while PERA spent more than $50 million, according to the pensions' most recent annual reports.

According to a 2018 study on pension investment consolidation by the management consulting group McKinsey, when it comes to lowering investment fees, there is "clear evidence of economies of scale." For example, Indiana consolidated the investment management and administration of its five statewide pension plans in 2011, and the consolidated fund realized savings of approximately $370 million in its first five years.

Another area of savings would be reducing the number of consultants providing duplicate services to both governing boards. For example, ERB hires two firms to advise them on private equity investment and PERA hires a third. Similarly, there would likely be savings related to accounting services, investment management software, and investment research services.

By combining investment teams, both PERA and ERB could also have deeper and broader coverage of various asset classes. Neither fund currently employs enough staff to properly oversee specialized fields like real estate and hedge fund investing. If the staffs were combined, it would improve the overall expertise serving both funds.

Larger pools of investment assets also have the benefit of attracting more qualified investment managers who generate stronger returns. A 2010 report by the federal Government Accountability Office found that "in addition to the financial benefits of asset pooling,…consolidated plans have the advantage of attracting higher-quality managers….[because] investment firms are more likely to assign a more highly skilled, knowledgeable manager on a high-profile, larger pool of assets."

In 2014, the New Mexico Senate sought to study going even further than we are suggesting here. Senate Joint Memorial 15 (SJM 15) proposed that the state consider combining investment management of not only ERB and PERA, but also the State Investment Council, which currently manages more than $25 billion of assets, including the Severance Tax Permanent Fund and the Land Grant Permanent Fund. The Senate passed SJM 15 on a vote of 31-9, but it died in the House without a hearing.

Consolidating the investment management of all of New Mexico's pension funds is common sense, and it makes tremendous financial sense for New Mexico's public sector retirees.

Recommendation III: Increase Qualifications for the Pension Governing Boards

Our final reform focuses on governance. If designed correctly, the composition of a pension board can improve that fund's performance.

Joshua Rauh, a professor at the Stanford Graduate School of Business, published a study in the October 2018 *Journal of Finance* which concluded that, "the more [elected] state officials that serve on the board, the worse the performance of the…investments made by the pension fund." His conclusion, which was based on data from thousands of investments by 212 pension funds between 1990–2011, is supported by a growing body of research.

Professor Rauh explains that his findings indicate that the decline in investment performance results from elected officials being overly influenced by campaign contributions and politics.

New Mexico provides a cautionary example of how this can occur. A decade ago, the State Investment Council (SIC) became ensnared in multiple pay-to-play scandals. For example, from 2004–2009 Aldus Equity Advisors advised the SIC on more than $1 billion of private equity investments, and in 2006, Aldus became the advisor on private equity to the ERB. Aldus did similar work for New York state pensions. In the spring of 2009, the company was fired by both the SIC and ERB when Aldus founding partner Saul Meyer pled guilty to a pay-to-play scheme in New York, which involved paying fees in return for New York pension fund business.

In his guilty plea, Meyer also told the judge about his dealings in New Mexico: "I had a fiduciary duty to act exclusively in the best interests of the state of New Mexico. On numerous occasions, however, contrary to my fiduciary duty, I ensured that Aldus recommended certain proposed investments that were pushed on me by politically connected individuals in New Mexico. I did this knowing that these politically connected individuals or their associates stood to benefit financially or politically from the investments and that the investments were not necessarily in the best economic interest of New Mexico."

Educational Retirement Board Members
The Secretary of Public Education or a designee who works for the Education Department and has relevant financial experience
The State Treasurer or a designee who works in the Treasurer's Office and has relevant pension or investment management experience
One member elected by members of the New Mexico Association of Educational Retirees
One member elected by the members of the National Education Association of New Mexico
One member elected by the New Mexico members of the American Association of University Professors
Two members appointed by the Governor who have backgrounds in investments, finance or pension fund administration.

Source: New Mexico Statutes, section 22-11-3.

Public Employees Retirement Association Board Members
The State Treasurer (ex officio)
The Secretary of State (ex officio)
Four members of a state pension plan, elected by state members
Three members of a municipal pension plan, elected by municipal members
One municipal plan member employed by a county elected by municipal members
Two retired members elected by PERA retirees

Source: New Mexico Statutes, section 10-11-130

Indeed, the SIC's investment performance was in the 99th lowest percentile among all public endowments for the year ended June 30, 2009.

Professor Rauh concludes that it is better to have elected officials appoint members to serve on public pension fund boards rather than serving themselves. "Before this study, people might have assumed there wouldn't be anything better about [an elected official] picking a board member, because they would just appoint their friends," Professor Rauh observes, "but empirically that's not what happens. They're typically appointing an outside director with financial expertise, somebody who's not conflicted."

This raises another important aspect of pension governance: qualified independent professionals generally make better investment decisions than those without qualifications, according to Rauh.

So let's take a look at who serves on the pension boards in New Mexico:

The PERA board is composed of a dozen members. Eight are elected by current state and local government employees; two are elected by retirees who receive PERA pensions; and two are elected officials: the Secretary of State and the State Treasurer.

The ERB board consists of seven members: one elected by educational retirees; one elected by members of the New Mexico Education Association; one elected by New Mexico university professors; two members appointed by the Governor; and the State Treasurer and the Public Education Department Secretary or their designees.

All PERA and ERB board members are required by New Mexico law to receive eight hours of investment training annually. However, for those board members without a financial or investment background, it is doubtful that this is enough time to understand how hedge funds, private equity, venture capital, and real estate investment trusts operate. Nor is it enough time to master investing concepts like asset allocation, asset liability modeling, asset class construction, J Curve, Sharpe Ratio, Smart Beta, and the complicated nuances of investment performance management.

By contrast, a Chartered Financial Advisor who advises individuals about their personal investments – which are many times smaller than the funds that PERA and ERB oversee – is required to have three years of experience in the finance industry, take 27 semester credit hours of classes, complete a multi-day exam, and receive 30 hours of training every two years.

In 2011, on the heels of the pay-to-play scandal that cost the ERB $40 million, the New Mexico legislature unanimously passed and the governor signed a law requiring that the two members of the ERB who are appointed by the governor "shall have a background in investments, finance or pension fund administration." In addition, if the Treasurer and the Secretary of Education choose to designate people to serve on the board in their place, these appointees must also have relevant financial experience.

This means that if the New Mexico Treasurer and the Secretary of Education were required to appoint designees rather than serve on the ERB themselves, then four of the seven members of the ERB would be well qualified for the job. We would recommend grandfathering the current Treasurer and Secretary of Education and requiring that their successors appoint qualified board members rather than serving on the board themselves.

On the other hand, PERA's statute does not require any of its board members to have any relevant financial or investment qualifications.

During the 2019 legislative session, Senator George Muñoz stated: "The [PERA] board is completely dysfunctional. It's a clown show over there. They're yelling at each other down the halls. We have to fix it."

In May of 2019, State Auditor Brian Colón sent a stern letter to the PERA board expressing his extreme concern about "the Board's failure to uphold its fiduciary responsibilities....This failure to act to submit the budget by the statutory due date was reckless or negligent, or both, and coupled with the Board's lack of focus on its fiduciary responsibilities puts our retirees and future generations of retirees at risk."

We recommend that PERA follow the lead of ERB and require relevant financial or investing backgrounds for at least a majority of its members. As with the ERB, we would recommend grandfathering the current Treasurer and the Secretary of State and requiring their successors to appoint qualified board members rather than serve on the board themselves.

That leaves ten members who are elected by current workers and retirees. Here, we would recommend that persons running for those positions be required to have relevant financial or investment backgrounds, such as MBAs and CPAs. Fortunately, there are many local and state government workers who already meet these qualifications.

Reforming PERA and ERB governance so that members have the experience and qualifications to do their jobs would go a long way toward ensuring the funds are well-managed over the long term.

CONCLUSION

One decade from now, New Mexico is projected to rise from 16th to fourth highest in the nation for the percentage of our population that is over the age of 65, according to a recent analysis by the Con Alma Health Foundation.

New Mexico's current lack of retirement security means that the state is headed for a future in which one of every five New Mexicans is a senior struggling to afford food, shelter, and medicine. This growing population of seniors living in poverty will be costly for all of us, forcing taxpayers to spend more and more on basic safety net services rather than investing in infrastructure, early childhood education, and other priorities.

The good news is that we still have time to chart a different path, toward a future in which older New Mexicans have the savings necessary to enjoy their retirements and generate economic development that creates jobs for their children and grandchildren.

The reforms detailed in this report show us how we can get there.

By bringing New Mexico in line with the vast majority of states that do not tax Social Security benefits, we can put money back into the pockets of seniors today and make the state more attractive and affordable for seniors into the future.

By making Individual Retirement Accounts funded by automatic payroll deductions accessible to every New Mexican, we can provide all workers with the opportunity to save for retirement – and give small businesses a tool they have been wanting to help their employees.

Think New Mexico's Retirement Security Reforms

ENACT LEGISLATION TO:

- **Repeal New Mexico's tax on Social Security benefits**
- **Establish Individual Retirement Accounts funded by automatic payroll deductions that are offered to every New Mexican who does not have access to retirement savings through their job**
- **Secure New Mexico's pensions by making a one-time $700 million cash infusion or loan to PERA, contingent on the adoption of some of the Governor's solvency recommendations; consolidating the investment management of ERB and PERA; and increasing the qualifications of pension governing board members**

By professionalizing the state's pension governance, consolidating pension investment management, and investing some of the state's budget surplus in a one-time cash infusion or bridge loan, we can ensure that public workers will be able to count on the pensions that have been promised to them.

Together, these reforms represent not only a solution to a growing crisis, but also a remarkable opportunity: if we seize it, we can achieve the largest expansion of retirement security in New Mexico since Social Security was first created nearly a century ago.

TAKE ACTION! Visit www.thinknewmexico.org and sign up for email alerts to join the fight to achieve retirement security for all New Mexicans!

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