
LEGAL UPDATE

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PUBLIC RETIREMENT SYSTEMS COMMITTEE MEETING—DECEMBER 11, 2019

Purpose. *Legal updates are prepared by the nonpartisan Legal Services Division of the Legislative Services Agency. A legal update is intended to provide legislators, legislative staff, and other persons interested in legislative matters with summaries of recent meetings, court decisions, Attorney General Opinions, regulatory actions, federal actions, and other occurrences of a legal nature that may be pertinent to the General Assembly's consideration of a topic. Although an update may identify issues for consideration by the General Assembly, it should not be interpreted as advocating any particular course of action.*

Co-Chairperson: Senator Charles Schneider

Co-Chairperson: Representative Mary Ann Hanusa

OVERVIEW

The Public Retirement Systems Committee received testimony from individuals involved with the Judicial Retirement System, the Iowa Public Employees' Retirement System, the Peace Officers' Retirement System, the Municipal Fire and Police Retirement System, and the State of Iowa Deferred Compensation Program for certain state and school employees. Additional materials presented for consideration by the committee are included on the Internet site for the committee.

JUDICIAL RETIREMENT SYSTEM

Mr. Todd Nuccio, State Court Administrator, and Ms. Patrice Beckham, Consulting Actuary, Cavanaugh Macdonald Consulting, LLC, provided background on the retirement system that covers all full-time judges and other judicial officers. Mr. Nuccio noted that the Judicial Retirement System is referenced in the Iowa State Constitution and is administered by the State Court Administrator. The State Treasurer is responsible for investing the assets of the retirement fund. Ms. Beckham provided the committee with a primer on actuarial concepts, discussed a plan maturity measurement, and then commented on the July 1, 2019, actuarial valuation of the system. Ms. Beckham discussed a plan maturity measurement referred to as the asset volatility ratio. The ratio, determined by dividing the market value of assets by covered payroll for a retirement system, tests the impact of varying investment returns. The ratio, determined as 7.22:1 for the Judicial Retirement System, means that a 10 percent actuarial investment loss would be the equivalent to 72 percent of payroll. Ms. Beckham then noted that the July 1, 2019, valuation took into account an experience study relative to the assumptions used in conducting an actuarial valuation that was conducted in 2018 and first used for the July 1, 2018, valuation. The experience study reduced the investment return assumption from 7.5 percent to 6.75 percent, updated the mortality table used for the system, and lowered the salary increase assumption. Based upon the actuarial value of assets, the funded ratio of actuarial assets to liabilities was 86 percent on July 1, 2019. As a result, the fixed statutory contribution rate still exceeds the actuarially required rate, which should assist in further improving the funded status of the system. Assuming all current assumptions are met, the system should be fully funded in 2026, dependent largely on future investment returns and maintenance of the existing statutory contribution rates.

IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (IPERS)

IPERS Staff. Ms. Donna Mueller, Chief Executive Officer, and Ms. Beckham provided an overview of the retirement system, focusing primarily on the June 30, 2019, actuarial valuation of the system. Ms. Mueller

noted that the historical goals for IPERS are to attract and retain a quality workforce and to provide a secure retirement with lifetime pension payments. Ms. Mueller noted that about \$1.9 billion of a total of \$2.2 billion in benefit payments are provided to beneficiaries through Iowa banks. Ms. Beckham then discussed the June 30, 2019, actuarial valuation of the system. Key funding measures based on the June 30, 2019, actuarial report include an increase in the ratio of actuarial assets to actuarial liabilities for the system as a whole from 82.4 percent to 83.7 percent, a decrease in the unfunded actuarial liability by \$338 million, and deferred investment gains of \$686 million. Based upon IPERS contribution rate policy, the total contribution rate for the regular membership classification will remain at 15.73 percent of pay, payable on a 60-40 employer and employee basis, beginning July 1, 2020. For members of the Sheriffs and Deputies Classification, the total contribution rate will decrease from 19.02 percent of pay to 18.52 percent, payable on a 50-50 employer and employee basis. For members of the Protection Occupation Classification, the total contribution rate will decrease to 16.02 percent of pay from 16.52 percent, payable on a 60-40 employer and employee basis. Ms. Beckham noted that the funded ratio for the Sheriffs and Deputies Classification is 99 percent, for the Protection Occupation Classification, 99.7 percent, and for IPERS regular membership, 82.7 percent. Ms. Beckham also commented on the asset volatility ratio of each IPERS membership classification. In response to committee questions on whether the current 7 percent investment return assumption is too high, Ms. Beckham noted that it is a forward-looking assumption and commented that while Wilshire Associates and the Chief Investment Officer believe that the real rate of return may be lower than the assumption in the short term, longer term returns are likely to be higher.

IPERS Investment Board. Ms. Lisa Stange, Chairperson of the IPERS Investment Board, Mr. Karl Koch, Chief Investment Officer, and Mr. Ali Kazemi, Wilshire Associates, discussed the role of the board and IPERS investments. Ms. Stange noted the fiduciary responsibility of the board as a trustee of the IPERS fund and its role in setting and reviewing investment policy and actuarial assumptions. Ms. Stange noted that the board, after considerable study, recommends establishment of the ability to internally manage assets with the hope of providing cost savings and providing good paying jobs for Iowans. Most funds of IPERS' size see at least partial internal management of assets as a best practice. The next steps, if internal management is to be implemented, are governance reform and empowering the investment board to determine the number, qualifications, and compensation structure of investment professionals within IPERS. Currently, around \$54 million is paid by IPERS to external managers of IPERS' portfolio. Internal management could reduce this cost while still providing competitive salaries for IPERS-employed investment managers. In response to committee questions, it was noted that salaries for internal investment managers could be considerable, depending on asset class and performance-based pay measures. Mr. Koch expressed support for the internal investment proposal and then commented on the investment performance of IPERS. Mr. Koch noted that IPERS remains a well-diversified portfolio with an increasing effort in managing risk. Mr. Koch discussed the asset allocation of the IPERS portfolio, noting that the determination of this allocation is critical in determining the rate of return. Mr. Koch noted that the rate of return for fiscal year 2019 was 8.35 percent net of fees, that investment management expenses were 0.20 percent of assets, and that IPERS has significantly reduced active management in its U.S. stock portfolio. Mr. Koch further noted that IPERS focuses on risk-adjusted returns and IPERS performs well based on these measures relative to other pension funds. Mr. Kazemi then addressed the committee regarding the role of Wilshire Associates, as consultant for the board, in the asset allocation process and in determining the assumed rate of return. Mr. Kazemi noted that an appropriate asset allocation policy is determined by an investor's risk tolerance and return expectation viewed in the context of the liabilities that the assets are supporting. Concerning determining an appropriate investment return assumption, Mr. Kazemi noted that both 10-year and 30-year forward-looking horizon return assumptions are examined. Based on the asset allocation policy adopted in September 2019, the current 10-year projected rate of return is 5.96 percent while the 30-year expected return is 7.28 percent. Mr. Kazemi noted that the trends, even for the 30-year return horizon, are declining and it remains prudent for the investment board to continue looking at possibly reducing the investment return assumption in the future.

IPERS Benefit Advisory Committee (BAC). Mr. Len Cockman, Chair, addressed the committee. The goal of membership groups represented on the BAC is the long term viability of the IPERS trust fund. Mr. Cockman noted that the BAC supports initiatives that include internal investment management, actuarially

determined contribution rates, anti-wage spiking legislation, and excluding bonuses and allowances in calculating IPERS benefits. Mr. Cockman further noted the positive impact of the 2012 pension reforms, including modification of benefits.

PEACE OFFICERS' RETIREMENT SYSTEM (PORS)

Mr. Jim Wittenwyler, Administrative Services Director, Iowa Department of Public Safety, and Ms. Beckham provided background on the system. Mr. Wittenwyler noted that the system is governed by a board of trustees and covers sworn peace officers of the Iowa Department of Public Safety, and that members of the system are not covered by social security. Mr. Wittenwyler reviewed benefit provisions and the target asset allocation applicable to the system, and noted that the board is monitoring the current 7.5 percent investment return assumption. Ms. Beckham then discussed the July 1, 2019, actuarial valuation of the system. Ms. Beckham provided a historical overview of the funded status of the system, noting that the funded ratio has increased from a low of 61 percent in 2012 to 78 percent as of July 1, 2019. Ms. Beckham noted that after failing to pay the actuarially determined contribution rate for 12 years, the current statutory contribution rate has generally exceeded the actuarially determined rate resulting in the improved funded status of the system. Still, the current asset volatility ratio for the system has increased from 7.45:1 to 11.49:1, meaning that as of 2019, a 10 percent investment loss is equivalent to 115 percent of payroll. In summary, the current funded ratio and outlook is positive, with a funded ratio of 78 percent and statutory contributions, taking into account the additional \$5 million in state contributions, providing a contribution margin for FY 2020 of 6.36 percent. Long term, the financial health of the system is dependent on future investment returns and scheduled contributions, including continued payment of the state supplemental payments of \$5 million until the system is 85 percent funded. If all assumptions are met, the system will achieve fully funded status in 2038. Some committee members noted that the overall reduction in active state troopers from 662 in 2009 to 551 in 2019 is a concern as to public safety generally, especially as it relates to increasing use of overtime and trooper burnout, and the funded status of the system.

MUNICIPAL FIRE AND POLICE RETIREMENT SYSTEM OF IOWA (MFPRSI)

Mr. Terry Slattery, Executive Director, MFPRSI, and Mr. Glen Gahan, Actuary, Silverstone Group, provided background information concerning the retirement system. Mr. Slattery noted that the mission of the system is to provide a comprehensive set of retirement and disability benefits to eligible local police officers and firefighters in a sound, sustainable, and efficient manner, in accordance with the requirements of the program's governing statute. The vision statement for the system provides additional background on the mission goals of providing a comprehensive, efficient, sound, and sustainable retirement system. Mr. Slattery then discussed the responsibilities and major activities of the system and continuing challenges for the system. Current challenges for the system include investment return expectations, increasing post-traumatic stress disorder disability applications, and data security. Mr. Slattery reviewed the asset allocation for the system and noted that the plan performance since the inception of the statewide system in 1992 is 7.7 percent. Mr. Slattery noted that the board of trustees report on the system supports having the state resume its contribution to the retirement system at 3.79 percent of earnable compensation in order to reinstate the funding agreement between the state and the participating cities from 1976. Mr. Gahan then discussed the July 1, 2019, actuarial valuation of the system. As of July 1, 2019, the funded ratio of the system based on the actuarial value of assets is 81.04 percent and the city contribution rate beginning July 1, 2020, will increase to 25.31 percent. Mr. Gahan noted that of the total required contribution, about half is used to address the unfunded actuarial accrued liability of the system. Mr. Gahan discussed future trends in the actuarial contribution rate to be paid by cities and the system's funded ratio over the next 25 years using current assumptions. By the end of the 25-year period, the system would be over 100 percent funded and, by 2039, the city contribution rate would decrease to the required minimum city contribution rate of 17 percent.

DEFERRED COMPENSATION PROGRAMS

Department of Administrative Services (DAS). Mr. Jim Kurtenbach, Director, DAS, discussed the supplemental deferred compensation programs operated by DAS collectively called the Retirement Investors' Club (RIC). The programs are differentiated by the three applicable Internal Revenue Code

sections describing public employee deferred compensation programs — sections 457, 401a, and 403b. The 457 program is available primarily to state employees, includes an employer match component (401a), and is used by about 65 percent of eligible state employees. The state's 403b program, which primarily covers educational employees, was established in 2009, is available to educational employers and their employees who participate in the program, does not provide an employer match, and is used by about 13,000 participants, which reflects a fairly low participation rate. All programs offer core providers of investment products which providers were selected pursuant to certain requirements relating to fees and other service and performance metrics. In addition, the 403b program offers optional providers that are available to school districts. Committee members hoped that participation rates would increase.

COMMITTEE DISCUSSION

The committee did not adopt any formal recommendations. The co-chairpersons indicated that it was not their intent to enact any pension plan changes next session other than possible consideration of allowing IPERS internal investment management authority.

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