Legislative Services Agency

MINUTES

Public Retirement Systems Committee

December 7, 2007

MEMBERS PRESENT:

Senator Michael Connolly, Co-chairperson	Representative Pam Jochum, Co-chairperson
Senator Jeff Angelo	Representative Mark Davitt
Senator Staci Appel	Representative Jack Drake
Senator Frank Wood	Representative Marcella Frevert
Senator Mark Zieman	Representative Walt Tomenga

MEETING IN BRIEF

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I. Procedural Business

Convening and Adjournment. The meeting convened on Friday, December 7, 2007, at 9:34 a.m. in Room 22 at the Statehouse, and adjourned at 2:13 p.m.

Approval of Minutes. The minutes from the Committee's initial two meeting days on October 31, 2007, and November 1, 2007, were approved, with the modification that a reference on page 9 of the minutes to health care employees returning back to work be changed from "part-time" to "full-time."

II. Peace Officers Retirement System (PORS) — Follow-up and Actuarial Report

Overview. Mr. Gene Meyer, Commissioner, Department of Public Safety, Mr. Dave Heuton, Director of Administrative Services for PORS, and Ms. Patrice Beckham, Consulting Actuary, provided follow-up information relating to the funding and investment performance of PORS, and reviewed the results of the most recent actuarial report relating to the system. Mr. Meyer noted that the PORS Board of Trustees has requested that the Treasurer's Office perform a review of the system's investment portfolio, and that any recommendations from the board regarding a funding increase is intended as a starting point for discussion in order to attain or maintain a competitive advantage for the system.

Follow-up Information. Mr. Heuton distributed a series of graphs or charts depicting information requested by members during the Committee's first two meeting days relating to contribution rates and resulting shortfalls, historical benefit versus contribution levels, market and actuarial values of assets, membership levels, escalation provision impact, and investment returns, all spanning from the mid-1990s through the current fiscal year. He also provided draft language regarding two of the system's recommendations discussed during the previous meeting relating to modification of language regarding medical board certification to mirror that applicable to the Municipal Fire and Police Retirement System of Iowa (MFPRSI) and termination of accidental disability benefits if a member seeks and obtains another law enforcement position. He additionally indicated that PORS will be working with Legislative Services Agency Legal Services Division staff regarding the restructuring of statutory language to eliminate duplication relating to pension accumulation, reserve, and expense funds.

Actuarial Report. Ms. Beckham distributed copies of the most recent actuarial report of the system, and provided information regarding valuation results, findings based upon an experience study, and long-term funding issues. Ms. Beckham emphasized that actuarial valuations involve estimating ultimate costs and making assumptions representative of a best estimate of future experience, that periodic experience studies involve an in-depth analysis of the system's experience and how well actuarial methods modeled that experience, that there is no "correct" assumption, and that assumptions for PORS fall within an acceptable range from conservative to aggressive.

She stated a preference for the entry age normal actuarial method as opposed to the aggregate method currently employed by the system, indicating that entry age normal method yields more information in the valuation process, more direct calculation of gain and loss, and identifies short-term and long-term impact of benefit changes. Mr. Meyer stated that such a change is currently under consideration by the PORS Board, and that some members appear more comfortable retaining the aggregate method. Ms. Beckham mentioned that an actuarial method change, were one to occur, would probably not result in a significant alteration of current shortfall estimates.

Economic Assumptions. Ms. Beckham reviewed economic assumptions, stating that slightly lower expectations for inflation are in order, that the rate of return is heavily dependent on asset allocation, and that an asset allocation study should provide information relating to investment return performance. She also reviewed demographic assumptions, noting the significant impact of the system's change to more up-to-date mortality tables, indicated that a 14 percent market rate of return exceeded the actuarial rate of 13 percent, discussed the impact of utilization of a four-year smoothing method, and noted recognition of $12 million in favorable investment experience. Graphical representations of the present value of future benefits and resources to meet $506 million in liabilities were handed out, with a shortfall highlighted of approximately $97 million.

Ms. Beckham further noted an increase in the actuarially required contribution rate based on the June 30, 2007, actuarial valuation, displayed a chart containing historical contribution rate levels, a chart of contribution shortfalls dating back to 2002, discussed graphs depicting long-term funding projections, and discussed one alternative proposal regarding a 2 percent increase in the contribution rate each year and appropriation of $5 million per year for a 12-year period beginning in 2009. In general, she noted positive investment experience on both market and actuarial values, indicated that if only 17 percent is contributed by the state the actuarial contribution rate will increase, and that additional contributions are needed to cover the underfunding and counter the continually increasing actuarially required contribution rate trend.

Discussion. Committee discussion included concern regarding the downturn in the system's funded status in a relatively short period of time based on a variety of factors identified during the previous Committee meeting, and partial responsibility for the situation attributable to the failure by the state to fully fund its share beginning in 2002.

III. Public Retirement Systems — Recent Trends

Ms. Donna Mueller, Chief Executive Officer, Iowa Public Employees' Retirement System (IPERS), identified the following recent trends observable nationally relating to public retirement systems:

- The funding ratio decline has slowed and the downward trend should reverse as overall funding continues to strengthen. It was noted that IPERS is on the increase.
- The ratio of active members to those drawing benefits has decreased, and there is a negative median external cash flow among plans. This can be observed to be normal in mature retirement plans with prefunded benefits, however.
- Employer contribution rates have increased, in part due to frozen employee contribution rates in many states and periods of "frozen" employer contributions.
- In response to growing unfunded actuarial liabilities and declining funding ratios, states began to evaluate cost controls and ways to stabilize employer contributions, including

moving from defined benefit to defined contribution plans, although defined benefit plans remain more prevalent and popular with employees.

- Benefit changes are being considered not only as a way to control costs, but also to meet changing needs such as increased longevity and the baby boomer redefinition of retirement.

Ms. Mueller additionally distributed information in graph form regarding IPERS covered wages and current requests to change IPERS membership group or benefits status. Committee discussion included an additional trend toward more diversified investments based upon the application of professional investment theories to retirement plans, with concern expressed regarding a move toward private equities and away from fixed-income and other more traditional investments. Co-chairperson Connolly highlighted the necessity of publicizing this trend toward more sophisticated investment vehicles, adding that IPERS investment practices have been appropriately cautious towards these trends.

IV. IPERS Actuarial Report

Ms. Beckham reviewed the results of the most recent actuarial report relating to IPERS. She noted that the recent market rate of return exceeds the actuarial rate by 6 percent, that a favorable experience dividend of $622 million can be recognized, that the market value of assets exceeds the actuarial value, that a substantial deferred gain is available to offset unfavorable experience in the future or to improve funding, and that a 90 percent funded ratio across the protection occupation status and regular membership classifications can be observed based upon the actuarial value of assets with 98 percent observable if market value were used.

She presented an historical summary of changes in IPERS' unfunded actuarial liability, noting that 2003 was the first year when the contribution rate of 9.45 percent was not sufficient, and indicated that the most recent valuations do not yet reflect the increase to 11.45 percent. Additionally, Ms. Beckham supplied contribution rate figures supporting the lack of a funding shortfall for the protection occupation classifications and a 1.57 percent shortfall for regular members attributable at least in part due to an increase in normal cost. She made general observations based upon a 10-year projection study that there is a 73 percent probability that the actuarial contribution rate of 11.45 percent will be sufficient, and a 50 percent probability that a funded ration will be equal to or exceed 100 percent. She noted that these results did not reflect the recent increase in normal cost, suggesting that they would probably be somewhat less favorable were the increase incorporated, and indicated that overall she would render a cautiously optimistic opinion of the system's funded status at this point in time.

V. State Deferred Compensation Program

Ms. Mollie Anderson, Director, Department of Administrative Services (DAS), accompanied by Ms. Jennifer Sandusky, DAS, provided an overview of the program since its inception in 1979. Ms. Anderson indicated that the DAS director is the sole trustee of the program, in whom complete fiduciary responsibility for the program rests. She added that the program covers all of state government with the exclusion of the State Board of Regents, and that some additional entities such as cities, counties, and school districts have been added, in some instances paying DAS for local program administration. Ms. Anderson noted that in the program's early years it appeared that the program was governed more by the best interests of providers rather than program participants, and that this has since been reversed.

She indicated that the percentage of employees participating in the program has substantially increased, that the number of providers has been drastically reduced and those that remain have low administrative expenses, and that lower contract fees are now applicable. A significant development occurred in 2001, when an employer matching feature was added to the program. Ms. Anderson added that employee education efforts are ongoing, and that improvements relating to electronic contribution payroll deduction capability are under way. Ms. Sandusky noted that the name of the program has been revised to be the Retirement Investors' Club, that an investment consultant has been added for the program, and that it would ease administrative burdens if the Legislature would approve applicability of the employer matching provisions for legislators.

Committee discussion included commentary that it would be an improvement to move beyond insurance companies to include a mutual fund provider in the list of vendors, with the response that such providers have been solicited but declined participation. It was also noted that the defined contribution nature of the program supplements defined benefit retirement plans available within the state well, that the program is being run much more professionally under Ms. Anderson's directorship, that additional cities and counties may be added as time passes, and that it is in an employee's best interests that plan assets remain subject to relatively stringent access features.

VI. Committee Recommendations

Committee members approved the following recommendations on a unanimous basis, unless otherwise indicated:

1. IPERS should be maintained as a core defined benefit plan but IPERS should be encouraged to continually study and assess options that complement the core defined benefit plan to better recruit and retain public employees.

2. The House and Senate Appropriations committees and the Justice System Appropriations Subcommittee should fully fund the judicial branch request for state contributions to the judicial retirement system or at least provide a state contribution to the judicial retirement system at the statutory rate of at least 23.7 percent of payroll. Sentiment was expressed in favor of the state honoring all of its statutory commitments regarding contribution rates, with other comments that restraint should be exercised in questions of appropriations where competing priorities and limited state funds are an ongoing factor. Senator Angelo voted against this recommendation.

3. The Senate and House State Government committees should consider legislation which would include the following proposals:

a. Municipal Fire and Police Retirement System of Iowa.

- The current cap on state contributions to MFPRSI should be removed, thereby providing for a yearly state contribution of 3.79 percent of payroll to the system. Mr. Dennis Jacobs, Executive Director, MFPRSI, commented that this would conform to pre-1993 statutory law, and ease cities' property tax burden. Senator Angelo voted against this recommendation.

- Overtime should be included in earnable compensation if the cost is not significant. Mr. Jacobs indicated that it is unclear why overtime is not included in earnable compensation for the system, and Committee members indicated inclusion makes philosophical sense.
- Employees covered by MFPRSI should be provided choice of doctor when injured on the job and in need of medical assistance.

b. Peace Officers Retirement System.

- Modify language governing the designation of the medical board for the system to match language provided for in MFPRSI.
- Provide that accidental disability benefits cease if the member becomes employed in another public safety occupation.
- Eliminate references to multiple retirement funds in the Code to reflect that only one retirement fund exists.
- Allow the PORS Board of Trustees to adopt the actuarial method used by the system. It was noted by Department of Public Safety representatives that the PORS Board is not necessarily in favor of this proposal and is currently considering the issue, but Committee members in approving the recommendation emphasized that it merely offers a choice, rather than a mandate.
- Provide for a $5 million appropriation per year to the system for 12 years and an increase in the state's contribution percentage from 17 percent of payroll by 2 percentage points per year to a maximum of 27 percent. A higher state contribution shall be maintained until the fund is actuarially sound. Senator Angelo voted against this recommendation.
- A member of the system who was in service under MFPRSI prior to January 1992 and not eligible for a transfer of that service to PORS shall receive credit for that service under PORS at no cost to the member. A state appropriation of $50,000 shall be made to the system to assist in funding the cost of this credit.

c. Iowa Public Employees' Retirement System.

- Allow IPERS to adjust the employer and employee contribution rates for members in regular service on an actuarial basis with yearly changes limited to one-half a percentage point. Senators Angelo and Zieman voted against this recommendation, with sentiment expressed that state government needs to accept its responsibilities and the comment that the Legislature would still maintain the ability to override any adjustment.
- Eliminate bonuses and allowances from the definition of covered wages.
- Forego implementation of major plan design changes in IPERS during FY 2008-2009 while the system upgrades benefits administration technology.
- Eliminate the statutory cap on investment management expenses.

- Allow all public hospital employees, not just licensed health care professionals, to return to full-time work within one month of retirement and not lose retirement benefits. Committee discussion relating to this recommendation included comments by representatives from IPERS that a study is currently under way regarding the impact of the original legislation relating to licensed health care professionals, that a cost to the system exists when retirees return to work earlier, and that the potential exists that other employee groups might seek similar legislation. Committee discussion also noted that this recommendation is primarily public safety-oriented aimed at maintaining needed public safety personnel in rural areas of the state experiencing shortfalls.
- Allow a credit for the cost of purchasing prior service equal to the amount of the member's employer's contributions plus interest that were not paid when the member received a refund, prior to July 1, 1998, for that service.
- Create a new special service category for county attorneys and assistant county attorneys with benefits commensurate with the protection occupation category. Allow service as a county attorney or assistant county attorney prior to the creation of this new category to be credited as service under the new special category. It was noted that this would truly establish a new service category, rather than an additional protection occupation classification, and that a survey indicates support among the impacted attorneys for paying for the benefits.
- Include county jailers, Iowa national guard installation security officers, emergency medical services providers, and Polk County Attorney special investigators in the protection occupation category.

4. Legislative subcommittees assigned legislation in 2007 on substantive proposals affecting public retirement systems not otherwise recommended by the Committee for inclusion in proposed legislation should continue to examine that legislation during the 2008 Legislative Session. These proposals, and others not acted upon by the Committee during the meeting, are included in an attached listing of all potential proposals as an appendix to these minutes. Of the proposals not acted upon, Representative Frevert expressed support for a proposal that would have provided that the cost of a $100,000 line of duty death benefit be paid from an appropriation out of the State General Fund and not the MFPRSI's retirement fund.

VII. Appendix

The attached charts (listed as appendices A, B, C, and D) contain a complete listing of all proposals presented to the Committee for recommendation. Proposals not included as recommendations in Part VI of these minutes were not acted upon by Committee members, in many instances either because they were the subject of an existing study bill or because additional information relative to the proposal and support for the proposal was being gathered or analyzed.

VIII. Materials Filed With the Legislative Services Agency

The following materials listed were distributed at or in connection with the meeting and are filed with the Legislative Services Agency. The materials may be accessed from the <Additional Information> link on the Committee's Internet web page: http://www.legis.state.ia.us/aspx/Committees/Committee.aspx?id=57.

1. DAS — Retirement Investors' Club.
2. PORS — Actuarial Review.
3. PORS — System Presentation.
4. IPERS — Actuarial Review.

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