LEGISLATIVE SERVICES AGENCY
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MINUTES
Public Retirement Systems Committee

Thursday, December 10, 2015

MEMBERS PRESENT

Senator Thomas G. Courtney, Co-chairperson
Senator Jeff Danielson
Senator Matt McCoy
Senator Charles Schneider

Representative Dawn E. Pettengill, Co-chairperson
Representative Gary Carlson
Representative Kevin Koester
Representative Vicki S. Lensing
Representative Mary Mascher

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I. Procedural Business

Call to Order and Adjournment. The meeting of the Public Retirement Systems Committee was called to order by Co-chairperson Courtney at 9:41 a.m., Thursday, December 10, 2015, in Room 103, Supreme Court Chamber, State Capitol of the State Capitol, Des Moines. The meeting was adjourned at 2:17 p.m.

II. Presentation Concerning the Iowa Public Employees' Retirement System (IPERS — Iowa Code Chapter 97B)

Ms. Donna Mueller, Chief Executive Officer, Iowa Public Employees' Retirement System (IPERS), noted that IPERS is the state's largest public retirement system and explained how the state serves as the plan sponsor, with Iowa Code chapter 97B serving as the IPERS plan document. Ms. Mueller described the system's mission statement and the roles of the Legislature and the executive branch with respect to the system. She also described the roles of the IPERS Investment Board and the work of investment staff and described the IPERS Benefits Advisory Committee serving as the plan's trustee. Ms. Mueller noted that IPERS exists to provide a Defined Benefit (DB) plan to eligible public service employees, and provides member retirees with a lifetime monthly annuity. She stated that there are currently 111,000 IPERS retirees receiving $1.7 billion in annual benefits, of which $1.5 billion go to retirees who live within the state of Iowa. She stated that the additional $200 million mostly goes to retirees in neighboring states and in retirement states, such as Arizona and Florida.

Ms. Mueller stated that 52 percent of members are education employees, that 15 percent are state employees, and that the remaining members are employees of cities, counties, and other local government districts. Ms. Mueller discussed the three distinct IPERS systems: for the general population, for protection occupations, and for sheriffs and deputies. She stated that the protection occupation class includes state correctional officers, jailers, and emergency medical technicians, and that the Legislature specifies classes of employment that are covered as protection occupations.

Ms. Mueller stated that IPERS is a prefunded system and described the different calculations employed by the system, stating that certain system calculations project 10, 20, 30, 40, 50, and even 100 years forward. Ms. Mueller described the system's annual work with its actuary, relative to contribution rates and benefits. Ms. Mueller also provided information on IPERS' recent actuarial audit and noted that the audit uncovered no measurable errors.

Ms. Patrice Beckham, Principal and Consulting Actuary, Cavanaugh Macdonald Consulting LLC, provided information on IPERS' June 30, 2015, actuarial evaluation and noted that funding a retirement system is a long-term proposition and noted that, despite actuarial assumptions and monitoring, the ultimate outcome of the benefits provided is not definitively known. She stated that actuaries utilize a number of assumptions on salary, retention, and mortality to project benefit costs in today's terms and elaborated that such assumptions, including investment and demographic assumptions, are examined regularly through experience studies. Ms. Beckham discussed year-to-year variability as requiring retirement systems to engage in regular experience studies. She noted that the 2015 actuarial evaluation serves as a point-in-time representation for determining the actuarial contribution rate and provides IPERS with the opportunity to evaluate a year's experience against prior years for actuarial gains and losses, to evaluate trends, and to request legislative changes based on those evaluations.

Ms. Beckham provided a side-by-side analysis of the 2014 and 2015 evaluation results and described the difference between actuarial valuation of assets when compared to market valuation of assets. She stated that the required contribution rate beginning July 1, 2016, will remain unchanged from the current contribution rate. She noted that this year's static contribution rate, formulated pursuant to the Iowa

Code, is marginally higher than actuarially required, but that this will help IPERS to pay down unfunded liabilities. She also noted that market valuation of assets proves to be problematic given market volatility, and stated that actuarial smoothing allows for short-term volatility to be averaged over a given period of time, resulting in delayed gains and losses.

Ms. Beckham stated that pension liabilities and funding retirement benefits are both long-term concepts by their nature, and stressed that most pension systems attempt to fund a person's retirement while the person is working. She noted that actuarial liability is the amount of the total value of expected benefits and that factors such as entry age, years of service, salary, inflation, and mortality impact any system's actuarial liability. She stated that IPERS contributions are set as a percent of payroll and are based on a statutory financing mechanism. She also defined unfunded actuarial liability as the remainder when the actuarial value of funds is subtracted from the actuarial liabilities. Ms. Beckham explained that 2015 contribution rates will remain above the actuarially required rate, and that the additional contributions will serve as extra funds to further drop the unfunded actuarial liability for IPERS' general population system. She noted that 95 percent of IPERS members are part of the general system, that 1 percent are sheriffs or deputies, and the remaining 4 percent are protection occupation members.

Ms. Beckham noted the unfunded actuarial liabilities for each of the three different groups, including an 82.7 percent funded status for the general IPERS population, while the sheriffs and protection occupation funding rates were substantially higher as a result of those groups consistently contributing amounts equal to the full actuarial liability of those systems. She more closely examined the mechanisms for determining actuarial contribution rates and normal costs, and IPERS amortization policies. She noted that IPERS adopted a 30-year closed amortization for the general population plan in June 2014, stating that the unfunded actuarial liability, established in June 2014, will be fully extinguished in 2044. She indicated that IPERS has adopted the goal to reach fully funded status as quickly as possible.

Ms. Beckham detailed historic regular membership and historic contribution rates among general population members. She provided additional information relative to the sheriffs and protection occupation groups, analyzing both the rates comparatively and again stressing conservative actuarial practices to improve funding status as rapidly as possible. She detailed the relative contribution rates for employers and employees across the three groups, before noting the 100 percent funded ratio for the protection occupation group. She stated that, as a result of being fully funded, protection occupations do not make unfunded actuarial liability payments, but that the contribution rates remain unchanged and that the surplus can not be spent until the fund remains 110 percent funded for three years. In the context of these discussions, Ms. Beckham also described the 2010 legislative changes that impacted actuarial liability and valuation from both the benefit and contribution perspectives; she noted that the required contribution rates for all three IPERS groups are lower than the actual contribution rates, but that unfunded actuarial liabilities will decrease more rapidly as a result of paying the mandated rates.

In response to a question from Representative Carlson, Ms. Beckham provided information on IPERS sensitivity analyses in relation to new governmental accounting standards, noting that those standards differ from actuarial standards. She stated that the sensitivity analyses are done at 1 percent above and below the system's 7.5 percent discount rate, based on market value of assets. Ms. Mueller also responded to a question from Representative Carlson by noting that the average retirement age for IPERS falls between 61 and 62 years of age with an average of 22 years of service. She also stated that only about one-third of IPERS regular service members have historically retired during their first year of eligibility under the Rule of 88. Ms. Beckham expanded on these comments by noting that some individuals will collect monthly retirement payments for longer than their IPERS careers, but that this is accounted for actuarially through pooling of longevity risks in each of the group plans.

In response to a question from Representative Mascher, Ms. Mueller noted that IPERS completes regular actuarial investigations every four years and Ms. Beckham confirmed that four-year periods are typical, with a three-to-five-year standard in other pension systems. Ms. Mueller noted that the four-year period is statutorily mandated and opined that there is no compelling need to change that set period. Ms. Mueller also stated, in response to Representative Mascher, that, of 111,000 members, IPERS currently has 137 members over the age of 100 who are drawing benefits. Ms. Beckham discussed IPERS' adoption of generationally fluid mortality tables over static tables, which are no longer as useful. Ms. Beckham also provided additional mortality and longevity information between and within the different IPERS groups.

Senator Schneider inquired as to why IPERS has adopted a 30-year closed amortization period when the Society of Actuaries' Blue Ribbon Panel on Public Pension Plan Funding recently recommended that public pensions adopt 15-to-20-year amortization plans. Ms. Beckham responded that 30-year closed amortization periods are acceptable according to the Governmental Accounting Standards Board (GASB) and that the 30-year plan is actuarially sound; she also noted that a recent white paper from another actuarial organization advocated for a 20-year benchmark but that a movement from a 30-year closed amortization period to a 20-year closed amortization period would prove both difficult and costly. She stated that a 20-year closed amortization period would be preferable if moneys were not constrained, but noted that the 30-year closed period would extinguish existing unfunded actuarial liabilities by 2044. She also noted that IPERS imposes 20-year closed amortization periods on any new actuarial liabilities on closed, layered, year-to-year bases. She clarified that all of these liabilities are added together annually to arrive at the required annual contributions.

Ms. Beckham noted that once each individual group plan is fully funded that the systems would shift to 30-year open amortization periods of any surplus. She stated that a 20-year closed amortization period is conservative when there is unfunded actuarial liability, but that a 30-year open amortization period is conservative once a pension is fully funded. Ms. Beckham also discussed concepts including Generally Accepted Accounting Principles, European accounting standards, discount rates, rates of return, and explained differences between corporate accounting and actuarial valuations for public pension systems. She and Senator Schneider discussed IRS and Pension Benefit Guaranty Corporation requirements imposed on private sector pension providers. Senator Schneider then expressed interest in seeing additional information from stress testing on valuations to be completed in January. Senator Schneider requested that the Public Retirement Systems Committee meet during the coming legislative session to receive information on the stress test results, while Senator Danielson suggested that the Standing Committees on State Government could also serve as appropriate presentation venues.

III. IPERS Investment Board

Mr. David O. Creighton, Sr., Chairperson, IPERS Investment Board, noted that he has served on the board since 2003, and stressed the importance of longevity and institutional knowledge to the functioning of the board. Mr. Creighton explained the fiduciary duties of the board in serving the interests of participants and beneficiaries and approving payment for reasonable administrative fees before discussing the structure of the board itself. He noted that the Treasurer of State also serves on the board, as required by statute. He stated that the board establishes investment policy, sets risk guidelines and actuarial tables, administers investment protocols, and hires the actuary and other individuals for IPERS.

Mr. Karl Koch, Chief Investment Officer, IPERS, stated the system oversees five investment professionals and $28 billion in funds. He stated that the job of the board is to manage risk by setting risk guidelines for investment professionals. He detailed the composition of the IPERS investment portfolio by investment class, noted that IPERS investment professionals have consistently beaten their policy benchmarks, and stated the IPERS return on investments has exceeded the median return among other large public funds. He stated that the most recent actuarial 10-year annualized rate of return was at 7.21 percent. He also stated that the 20-year and 30-year returns exceed the assumed rate of return. Mr. Koch also discussed IPERS' asset mix and shifts in asset allocations over time, stating that the current mix represents a well-diversified asset portfolio. Mr. Koch noted that investment management expenses increased over last year as a result of those managers exceeding performance expectations. He also reported that IPERS has recovered 96 percent of the principal at issue in the 2009 Westridge fraud case.

In response to a question from Representative Carlson, Mr. Koch clarified that 75 percent of IPERS real estate holdings are in direct real estate ownership, such as timber lands, and that the other 25 percent of real estate assets are in differing investment arrangements. Mr. Koch provided information on IPERS' 30-year relationship with Pathway Capital, relating to the system's private equity investment classes. Mr. Koch explained, in responding to Senator Schneider, that IPERS pays a flat fee to Pathway Capital, which selects private equity managers. IPERS compensates the private equity managers under a standard arrangement, set at 2 percent of total asset value and 20 percent of realized profits. Mr. Koch noted that private equity investment by public retirement funds raises issues of transparency, but also expressed hope that governmental accounting and disclosure standards could be agreed to, noting that unilateral disclosure would place a system at a competitive disclosure. Mr. Koch explained that IPERS is seeking GASB and Securities and Exchange Commission guidelines for uniform disclosure of private equity costs.

IV. IPERS Benefits Advisory Committee

Mr. Len Cockman, Chairperson, IPERS Benefits Advisory Committee, noted that Iowa is unique in the dual structure between its Investment Board and Benefits Advisory Committee (BAC). He stated that while the Investment Board focuses on returns and money, the BAC is focused on members and benefits. Mr. Cockman provided information on the composition of the committee members and their diverse backgrounds, and noted that this diversity also helps them fulfill their responsibility in conveying system information to active and retired members. He also stressed the hard decisions made by the committee to ensure sustainability of IPERS' funds and to ensure generational equity within the individual employment groups.

Mr. Brad Hudson, Vice Chairperson, IPERS Benefits Advisory Committee, noted that the main goal of the BAC is to consider and ensure the long-term viability of the trust fund and to make decisions on that basis, even when difficult. He stated that IPERS provides a basic retirement benefit that does not include either medical insurance or cost-of-living adjustments (COLA), generally. He also discussed IPERS' past experience in offering the Favorable Experience Dividend (FED) through January 2014, but noted that the lack of a traditional COLA is one of the great weaknesses of the system. In response to Co-chairperson Courtney, Mr. Hudson stated that the FED was never anything more than a stopgap measure, and that the BAC and IPERS had long stressed the temporary nature of the FED to IPERS membership.

Mr. Hudson noted that, over the course of the next 12 to 18 months, the BAC would investigate the actuarial costs of adding a COLA benefit, stating that such a benefit would likely require a 4 percent increase in contribution rates. He stated that proposals would need to take generational equity into account, and only be proposed once unfunded actuarial liabilities are extinguished or greatly lowered.

Representative Carlson, Representative Koester, and Mr. Hudson discussed return assumptions and return experience. Mr. Hudson noted that IPERS four-year experience studies look at all assumptions and that IPERS recalibrates assumptions and tables based upon actual experience at those intervals. Mr. Hudson indicated that in those terms, IPERS is self-correcting, but that the single greatest weakness of the system is the lack of a COLA. He stated that IPERS has consistently ranked at the bottom by cost per active member compared to other large public retirement systems. He also noted the low staffing levels, and that IPERS could conceivably see greater returns if the system could hire in-house investment professionals.

In response to questions from Senator Danielson, Ms. Mueller stated that she was comfortable with the system governance provisions and the security of moneys in the IPERS trust fund, with statute guaranteeing that the trust fund be used for the exclusive benefit of IPERS beneficiaries. Ms. Mueller stated that administrative costs for IPERS come entirely from the IPERS trust fund, but noted that some legislative changes might be welcome to allow IPERS to attract in-house investment managers, outside of the traditional state salary scales and compensation constraints. In response to Co-chairperson Pettengill, Ms. Mueller said that IPERS would not be submitting any departmental bills this session, though Mr. Hudson indicated that recommendations on staffing and COLAs may be forthcoming in future sessions. Ms. Mueller noted that Wisconsin and South Dakota lowered their system costs by bringing some of these investing functions in house.

V. Presentation Concerning the Peace Officers' Retirement System

Ms. Chari Paulson, Director of Administration, Department of Public Safety (DPS), Peace Officers' Retirement System (PORS), provided information on the system's plan document contained in Iowa Code chapter 97A and on the system's board. She noted that PORS provides retirement benefits across DPS' five separate divisions, and that DPS employees are not covered by Social Security. Ms. Paulson provided information on the seven different plan options available to PORS members, discussed program contours along with PORS' disability and death benefits, and explained benefit formulas. She provided additional information on membership demographics, noting that PORS currently covers 589 active employees and 575 beneficiary members. She noted that the current number of beneficiary members is the highest that the system has ever experienced, and noted that large retirement classes track with the career timelines for large law enforcement academy classes. Ms. Paulson described PORS asset allocations, and provided comparative analysis of actual allocations relative to target allocations.

Ms. Beckham provided the committee with an update from PORS' annual evaluation from July 1, 2015. Ms. Beckham described PORS' funding by reference to PORS' presentation materials, and noted that the assumed rate of return for PORS is currently set at 8 percent. She provided a comparative analysis of system performance between 2014 and 2015, noting that the actuarial liabilities for ongoing systems always increase, but that PORS' unfunded actuarial liability is expected to decrease. She provided information on asset and liability gains and historical trends, and noted that PORS' unfunded actuarial liability peaked in 2012, but has reduced in the past three years. She noted that the PORS' funding status has increased from 61 percent in 2012 to 74 percent in 2015, stating that the increase is largely due to investment performance.

Ms. Beckham additionally provided historical information on PORS' actual statutory contribution rates in comparison to actuarially required contribution rates, noting that the discrepancy between the two from 2003-2013 resulted in the system's large unfunded actuarial liability. She stated that since the implementation of 2010 legislative changes to the PORS funding mechanism, that the last two years have provided contribution margins. She further noted that the state's $5 million annual contribution, established in the 2010 legislation, will continue until the PORS funding ratio reaches 85 percent. She stated that PORS' long-term financial health is dependent both on making actuarially required contribution rates and on positive investment returns. Ms. Paulson responded to a question from Co-chairperson Pettengill by stating that the PORS board meets monthly to review investment information and asset allocations. Ms. Paulson also noted that the Treasurer of State reviews investments and presents information to the board, and that the board approves investment recommendations made by the Treasurer.

Ms. Beckham responded to a question from Representative Carlson by confirming that the system may soon serve more beneficiary members than active employees, but noted that this is a general trend in mature retirement systems. She also stressed that this generational shift should not create actuarial difficulties for the system, because a member's retirement is prefunded during the course of the employee's career, and in that way differs from the federal Social Security system, where today's employees pay for the benefits of current retirees. Ms. Beckham did qualify that statement by noting, however, that greater beneficiary numbers do require greater liquidity of system assets. Also in response to Representative Carlson, Ms. Beckham stated that the assumed rate of return for the system is set by the board, but is informed by five-year experience studies performed by the system. Ms. Beckham noted that the Treasurer of State is currently completing a study of investment return assumptions and that the board may decide to lower its rate of return assumption if the forthcoming study provides impetus for such a reduction. She noted that the Treasurer has recently contracted with a new investment consultant and that the consultant's recommendations will also be considered.

Ms. Paulson confirmed for Representative Mascher that the PORS board is not served by legislative ex officio members. Representative Mascher recommended that such members be added and expressed concern regarding the ratio of active PORS-covered employees to PORS beneficiaries. Ms. Paulson noted that the ratio is not broadly problematic for a prefunded retirement benefit system, but that the fact that DPS is operating with fewer employees is problematic for other reasons and further noted that approximately one-third of eligible members retire from covered employment when they are first eligible. She agreed to provide the committee with information including projections of expected retirements along with other career and retirement statistics. By unanimous consent of the committee, Mr. John Cacciatore, Senior Vice President, PolicyWorks, noted to the committee that the state's $5 million annual appropriation to PORS will cease once the system's funding ratio reaches 85 percent and noted that the Legislature picked that percentile in recognition of national standards that declare pension funds healthy once they reach an 80 percent funding ratio.

Senator Schneider voiced criticism of PORS' 8 percent expected rate of return and advocated lowering that expectation. Ms. Paulson responded that the Treasurer of State makes recommendations on the expected rates of return and noted that the findings of the coming experience study might merit lowering that expectation, but that the 8 percent rate was set conservatively under median analysis and that the expected rate of return was not set at 8 percent for any other motive. She noted, however, that the board has expressed concern on the same issue and stated that PORS would provide members of the committee with copies of the Treasurer's asset liability study.

VI. Presentations Primarily Concerned with the Peace Officers' Retirement System

Ms. Sue Brown, State Police Officers Council, expressed the council's appreciation for making the difficult legislative changes in 2010 and noted that the council would not be seeking any legislative changes during this session. She did, however, express concern for the lowered numbers of active PORS-covered employees and asked that the committee keep in mind the fact that officers do not receive Social Security.

Sgt. Marland Winter, Iowa State Patrol Supervisors Association, noted his prior service on the PORS board and expressed agreement that the 2010 legislative changes would allow the system to become fully funded.

VII. Presentation Concerning the Judicial Retirement System

Ms. Peggy Sullivan, Director of Finance and Personnel, Judicial Branch, noted that the provisions of the Judicial Retirement System are laid out in Iowa Code chapter 602 and that the Iowa Constitution requires the state to provide a retirement system for state judges. She noted that the State Court Administrator oversees the system, and is appointed to do so by the Supreme Court. Ms. Sullivan noted that the system has a small membership which includes the Justices of the Supreme Court, the Judges of the Court of Appeals, along with district, district associate, and juvenile court judges. She provided an overview of the state's senior judge program, of retirement benefits under the system, and the system's provisions for surviving spouses. She noted that the system's membership includes 202 active employees and 195 collecting beneficiaries. She also stated that 48 of the collecting beneficiaries are surviving spouses.

Ms. Beckham provided information on the system's funding formula, target allocations, and actual allocations and again provided definitions for actuarial assets, unfunded actuarial liabilities, funded ratio, and actuarial contribution rate. Ms. Beckham described the system's actual experience in terms of rates of return and value of assets from 1997 through 2015. Ms. Beckham noted that investment returns have helped to improve the system's funding ratio from 64 percent to 84 percent in the past five years. Ms. Beckham stated that the system is expected to be fully funded by 2022, though investment returns are difficult to predict. Responding to an inquiry from Representative Carlson, Ms. Sullivan confirmed that the system utilizes the same investment consultant used by PORS, noting that the Treasurer of State selects the consultant for both systems. Representative Mascher then expressed concern that the Judicial Retirement System is not overseen by a board of directors, and noted the benefits of having ex officio legislative members serve the state's different retirement systems.

VIII. Committee Discussion

Co-chairperson Pettengill directed that Mr. Ed Cook complete a final committee report without committee recommendations, but requested that the final report request a report for the committee and General Assembly related to the health and disability coverages for 411 System cities. Co-chairperson Pettengill also suggested that the committee could provide educational opportunities for members during session to meet the committee's charge and allow members to stay abreast of the shifts in the public and private sector pension systems.

The committee unanimously approved making the request for such a report and asked that the request be included within the report. Mr. Cook also noted that he will post information and materials that he receives to the committee's Internet site and on LSA's new pensions-focused Internet site.

Representative Carlson expressed interest in the committee offering learning sessions during the upcoming legislative session with information from various sources. Senator Schneider expressed his agreement and asked that presentations specifically be organized from the Society of Actuaries, related to their blue ribbon panel, and from the Pew Charitable Trusts, to provide a comparative overview of state pension systems. Co-chairperson Courtney also agreed that educational sessions could prove valuable for members and requested that one such presentation focus on the feasibility of incorporating cost-of-living adjustments into state pension plans. Representative Mascher agreed on the value of educational sessions.

Representative Mascher noted the value of LSA-provided information and side-by-side data comparisons. She also expressed concern that some system boards and the Retirement Investors' Club are not served or overseen by ex officio legislative members. Senator Schneider expressed concerns over the long-term viability of the state's pension systems based on expected rates of return and stated that the 411 System is of concern, as cities bear all of the investment risk as a result of that system's cap on employee contributions, and that when cities bear that risk it is ultimately city taxpayers who bear the burden.

IX. 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 "Committee Documents" link on the committee's Internet Site: https://www.legis.iowa.gov/committees/meetings/documents?committee=655&ga=ALL

1. IPERS — System Presentation.
2. JudRet — System Presentation.
3. PORS — System Presentation.
4. Taxpayers Association of Central Iowa — Written Presentation.

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