



FINAL REPORT

Public Retirement Systems Committee

March 2014

MEMBERS:

Senator Thomas G. Courtney,
Co-chairperson
Senator Jeff Danielson
Senator Tim L. Kapucian
Senator Matt McCoy
Senator Roby Smith

Representative Dawn E. Pettengill,
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Representative Jack Drake
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AUTHORIZATION AND APPOINTMENT

The Public Retirement Systems Committee was established pursuant to Code section 97D.4 and charged with reviewing and evaluating public retirement systems in Iowa. The committee reviewed the Iowa Public Employees' Retirement System (IPERS), the Municipal Fire and Police Retirement System of Iowa (MFPRSI), the Department of Public Safety Peace Officers' Retirement System (PORS), and the Judicial Retirement System.



I. Committee Proceedings

The committee conducted meetings on three days during the 2013 Legislative Interim. The committee met on October 23, 2013, December 11, 2013, and January 14, 2014.

II. Iowa Public Employees' Retirement System (IPERS) and Governmental Accounting Standards Board (GASB)

Ms. Donna Mueller, Chief Executive Officer, IPERS, provided an overview of IPERS, described the general financial condition of the system, and discussed the impact of the recent GASB changes on pension fund reporting requirements. Ms. Mueller provided a historical perspective on the financial status of the plan, reviewing long-term historical investment returns of the system as well as contribution rates. The current unfunded actuarial liability of the system had its genesis in the late 1990s and early 2000s when the system used fund assets to provide for a nonguaranteed favorable experience dividend payment to certain retirees, adjusted the mortality tables used by the system, and experienced investment losses relating to the end of the "technology bubble." As a result of this "perfect storm," the unfunded liability of the system increased while contribution rates were not adjusted until later in the 2000s. After the recession in FY 2008-2009, the General Assembly adopted a series of changes in 2010 that increased contribution rates while reducing benefits for current and future members of the system.

Ms. Mueller then discussed the impact on IPERS and employers covered by IPERS of the GASB changes relative to public defined benefit plans. GASB sets accounting standards for governmental pension plans and covers employers who report using generally accepted accounting principles (GAAP) accounting. The changes break the link between actuarial funding and financial accounting so that instead of focusing on whether an employer is paying the actuarially required contribution rate to a retirement plan, employers are required to report a share of the plan's net pension liability, similar to unfunded actuarial liability, on their balance sheet. One aspect of the change is requiring pension systems to utilize a blended discount rate in calculating the net pension liability of a system if projected net assets are not sufficient to cover projected benefit payments. Based on the 2012 actuarial valuation, IPERS will not have to use the blended rate. Still, the net pension liability will be recalculated each year, and employers using GAAP accounting will be required to report their share of this liability beginning with fiscal years starting after June 15, 2014.

Ms. Mueller then discussed other pension systems that have recently experienced problems and compared those systems to IPERS. She noted that most of the pension systems in trouble were caused by a combination of significant underfunding, rich benefits, and the diversion of pension assets to pay for retiree health care. She noted that none of these factors are applicable to IPERS. Ms. Mueller further commented that long-term investment returns for IPERS have exceeded the current investment return assumption of 7.5 percent and that state and local government spending on pension systems in Iowa based on 2010 U.S. Census Bureau information is only 1.73 percent of total spending.



III. Pension Funding

Ms. Gretchen Tegeler, Executive Director, Taxpayers Association of Central Iowa, addressed the committee concerning funding concerns relative to public pension systems in Iowa, and in particular, the Municipal Fire and Police Retirement System of Iowa (MFPRSI). She noted that the goal of the association is to ensure pension plans give the best value for the dollar by balancing the needs of public employees with the needs of the community. As it relates to MFPRSI, she noted that pension costs for MFPRSI-covered cities are significant and are putting pressure on city budgets and property tax rates. In addition, Ms. Tegeler noted that the GASB requirement for cities to report net pension liabilities as well as the recent focus of credit rating agencies on pension liabilities could negatively impact cities. Ms. Tegeler then compared certain health and pension costs associated with police officers and fire fighters under the protection occupation category of IPERS and those under MFPRSI. Ms. Tegeler concluded that it is important that current pension promises be kept, but prospective changes may need to be made to ensure the financial viability of the pension systems. She noted that a comprehensive review of all of Iowa's public pension systems' goals and structures is needed while the situation is still manageable.

IV. 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 reviewed the goals of the system and noted that the source of the system's existing unfunded liability is the market downturns of 2007 and 2008. He noted that the system is undergoing an asset/liability review to improve the risk/return performance of portfolio assets. Mr. Slattery noted that the annualized return of system assets since the inception of the combined system in 1992 is 7.65 percent, in excess of the current 7.5 percent investment return assumption. Based on the most recent actuarial valuation of the system for the fiscal year ending June 30, 2013, the funded status of the system is 74 percent and, based on deferred investment gains of around \$100 million, the funded ratio should improve in the coming years. Mr. Slattery noted that the MFPRSI Board of Trustees is currently developing a funding policy with the goal of fully funding the system over a 25-year period using a steady contribution rate. Mr. Gahan discussed future trends in the actuarial contribution rate to be paid by cities over the next 25 years using current assumptions. After the city contribution rate increases to 30.41 percent for the fiscal year beginning July 1, 2014, city contribution rates in future years will steadily decline, if all actuarial assumptions are met.

Iowa League of Cities. Mr. Scott Saunders, MFPRSI board member and Finance Director, City of Des Moines, Mr. Jon Burmeister, PFM Group, Mayor Tom Hanafan, City of Council Bluffs, and Mr. Mike Schrock, City Manager, City of Oskaloosa, addressed the committee. Mr. Saunders discussed recent activities of the board in conducting an asset/liability study and in developing a funding strategy to eliminate the system's unfunded liability. Mr. Burmeister discussed the impact of GASB and the increasing focus of credit rating agencies on city pension liabilities. He noted that a key focus for credit rating agencies as it relates to a city's pension system is whether a commitment to funding exists, the investment performance and trends of the pension system, pension affordability for the city, efforts to sustain the system, and level of pension contribution. Mr. Hanafan and Mr. Schrock discussed the impact of increasing pension costs on their cities, noting that increased costs have made it more difficult to provide needed services to citizens.



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Both expressed a desire that a stronger partnership between the state, cities, and employees be forged as it relates to pension funding. In particular, they noted that the state contribution to the system should be restored.

Iowa State Police Association and Iowa Professional Fire Fighters. Mr. Don Cougill, trustee, Iowa Professional Fire Fighters, and Mr. Eric Snyder, President, Iowa State Police Association, addressed the committee. The associations believe that the system is working as designed, is managed well, and is sustainable without any changes. In particular, they noted a 2012 report by two Maryland think tanks that lists the MFPRSI as one of the top 10 performing public pension funds across the country over the past 10 years. The associations noted that members are not covered by Social Security for their service and that the system is unique in providing retirement, disability, workers' compensation, and death benefits to members. The associations also requested that the state restore its funding partnership with the system, noting that the services provided by police officers and fire fighters covered by MFPRSI provide a benefit to the entire state. They stated that the MFPRSI system is strong, healthy, unique, sound, and sustainable, and created for those who serve and protect the public.

V. Judicial Retirement Systems

Mr. David Boyd, State Court Administrator, and Ms. Patrice Beckham, Consulting Actuary, provided background on the retirement system which covers all full-time judges and other judicial officers. Mr. Boyd, noting that the Judicial Retirement System is referenced in the Iowa State Constitution, provided a history of the system from its origin in 1949. In 1994, the system was significantly underfunded and legislation was enacted shifting the funding from court revenues to contributions with the state contribution fixed at 23.7 percent. However, for six years during the 2000s, the state failed to make the required contribution, resulting in a total shortfall in state contributions of around \$16.5 million. Mr. Boyd expressed appreciation for legislative action during the 2013 session addressing the state contribution shortfall by directly appropriating \$18 million to the fund. However, Mr. Boyd noted that this provision was item vetoed by the Governor.

In response to questions from the committee, Mr. Boyd noted that the State Treasurer is responsible for investing the assets of the retirement fund. Ms. Beckham then discussed the July 1, 2013, actuarial valuation of the system. Over the past four years, favorable investment returns, coupled with lower than expected salary increases, has improved the system's funded status of the actuarial value of assets to the actuarial accrued liability to 71.3 percent. As a result, the fixed statutory contribution rate now slightly exceeds the actuarially required rate which should assist in further improving the funded status of the system, assuming all other assumptions are met. In response to a question from the committee, Mr. Beckham indicated that the new GASB changes will not, at this time, require the system to use a blended discount rate in determining liabilities. No recommendations for changes to the system were made.

VI. Peace Officers' Retirement System (PORS)

Mr. Martin Deaton, PORS Director of Administrative Services, and Ms. Beckham, Consulting Actuary, provided background on the system. Based upon the July 1, 2013, actuarial valuation of the system, the shortfall in contributions to the system is only 1.11 percent of payroll, down from



15.79 percent for the previous year, due largely to the \$5 million standing supplemental state appropriation to the fund. Due to improved investment experience, the funded status of the system based upon the market value of assets improved to 66 percent from 61 percent from the prior fiscal year. Long term, the impact of the changes to the system during the 2010 Legislative Session in benefits and contributions will result in the funded status of the system improving to 86 percent by the year 2024, assuming all other assumptions are met.

The 2010 legislative changes included reducing the years of disability retirement counted as service credit as well as limiting postretirement benefit increases. In addition, the employer and employee contributions were increased and a supplemental \$5 million standing annual appropriation to the system began on July 1, 2013. While the funded ratio remains low, the long-term funding outlook is positive, largely dependent on investment returns and contributions, including the supplemental standing appropriation of \$5 million. Mr. Deaton noted that the PORS board supports and recommends that the General Assembly enact a cancer and infectious disease presumption for PORS members, financed by an initial increase of .05 percentage points in the member's contribution rate.

State Police Officers Council. The council discussed the recommendation from PORS members, supported by the board, to enact a cancer and infectious disease presumption for PORS members. The recommendation is prospective only and will be financed by an initial increase in the contribution rate of PORS members by .05 percent, subject to future modification based on the actual cost of the benefit.

VII. Iowa Public Employees' Retirement System (IPERS)

Ms. Donna Mueller, Chief Executive Officer, and Ms. Beckham, Consulting Actuary, provided an overview of the retirement system, focusing primarily on the July 1, 2013, actuarial valuation of the system. Based on this valuation, the funded status of the entire system based upon the actuarial value of assets has increased from 79.9 percent to 81 percent. In addition, the total contribution rate for the regular membership classification will remain at 14.48 percent, payable on a 60-40 employer and employee basis, resulting in an additional contribution to the fund of .28 percent above the actuarially required contribution rate. For members of the sheriffs and deputies classification, the total contribution rate will remain at 19.76 percent, payable on a 50-50 employer and employee basis, resulting in an additional contribution to the fund of .46 percent above the actuarially required contribution rate. For members of the protection occupation classification, the total contribution rate will remain at 16.90 percent, payable on a 60-40 employer and employee basis, resulting in an additional contribution to the fund of .29 percent above the actuarially required contribution rate.

In summary, positive investment returns and the new contribution rate funding policy indicate a positive trend in the funded ratio of the system if all other assumptions are met. Ms. Mueller then discussed a recent update on a study relative to working after retirement. The study indicates that costs are higher for those employees who return to work following retirement and that licensed health care professionals tend to retire younger, earn twice as much as other retired reemployed persons, and represent a higher portion of new retirees. As a result, IPERS supports allowing the shortened waiting period for licensed health care professionals to sunset. For the 2014 Legislative



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Session, IPERS is proposing eliminating the favorable experience dividend program as the last payment will be made in January 2014, modifying service purchase requirements, and requiring spousal acknowledgment for refunds.

IPERS Investment Board. Mr. Dennis Young, Chairperson, and Mr. Karl Koch, Chief Investment Officer, addressed the committee relative to the role of the investment board and IPERS investments. Mr. Young 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. Mr. Koch noted that IPERS investment returns on a risk-adjusted basis ranks within the top 15 percent of all public retirement funds.

IPERS Benefit Advisory Committee (BAC). BAC supports IPERS' proposed changes and supports IPERS' staff recommendation allowing the shortened retirement waiting period for licensed health care professionals to sunset.

Iowa Hospital Association. The association requests the General Assembly to eliminate the July 1, 2014, sunset of the shortened retirement waiting period for licensed health care professionals.

VIII. Deferred Compensation Programs

Department of Administrative Services (DAS). Ms. Michelle Minnehan, Chief Operating Officer, DAS Human Resources Enterprise, discussed the two supplemental deferred compensation programs operated by DAS. The programs, known by referencing the Internal Revenue Code section numbers, 457 and 403(b), are the governmental employee programs similar to private sector section 401(k) plans. The 457 Program is available to primarily state employees, includes an employer match, has six investment providers, and is utilized by about 59 percent of eligible employees. The 403(b) Program, which covers primarily educational employees, was established in 2009 and allows educational employers and their employees the ability to utilize the state program to provide this option. About 92 percent of eligible educational employers use the state program. The initial state 403(b) Program was started through a request for proposals (RFPs) process with employee input, has six vendors, and is scheduled to continue until December 2015. Currently, DAS has undergone a new RFP process to add additional agents and investment options to the 403(b) Program. Committee discussion centered around why the new RFP was issued prior to the end of the initial 403(b) contract, the reasons for issuing the new RFP, and the fact that the new RFP has no provision limiting investment fees on the new options.

TIAA-CREF. Mr. Martin Noven, Regional Vice President for TIAA-CREF, a national financial services organization and one of the current six providers to the state's 403(b) Program, addressed the committee relative to its concerns over possible changes to that program. Mr. Noven noted that the 403(b) provider universe has had a history of charging high fees and that Iowa's statewide 403(b) plan has been a model in providing investment options at significantly reduced fees. While Mr. Noven agreed that while increased participation in 403(b) plans should be a goal, the way to increase participation is through automatic enrollment, employer matches, and vendor consolidation and control, not added higher fee investment options.



National Tax Sheltered Accounts Association (NTSAA). Mr. Chris DeGrassi, Executive Director, addressed the committee in favor of adding additional provider options to the state's 403(b) Program. He noted that a primary goal of any 403(b) plan is increased participation by eligible employees and that increasing investment options with added professional investment advice will increase participation levels. He noted that the current state 403(b) plan is primarily focused on cost and investment policy requirements and has resulted in decreased participation by employees. Investment options that offer enhanced investment advice are preferable.

Iowa Association of School Business Officials (IASBO). Mr. Kurt Subra, Past President of IASBO and Chief Financial Officer, Heartland AEA, addressed the committee concerning the origins of the statewide 403(b) plan. He noted that establishment of a statewide 403(b) plan was beneficial to local educational employers from both a cost and compliance perspective. The goal of the plan was increased participation with high-quality investment options. The initial RFP met these goals by providing DAS oversight and monitoring of the investment options offered by the selected providers. He noted that the new RFP does not contain these controls and that it was issued without any input from IASBO. He requested that the new RFP be deferred and that DAS should work with customers in addressing how to improve the existing 403(b) plan. Other non-403(b) retirement options, such as individual retirement accounts (IRAs), can be used to provide additional options.

IX. Committee Report

The Public Retirement Systems Committee, having met and received testimony during the 2013 interim, forwards the following to the General Assembly for the 2014 session:

A. Judicial Retirement System

- A proposal to appropriate \$18,900,000, or similar amount, to the retirement fund to address reduced state contributions to the fund during the 2000s.

B. Peace Officers' Retirement, Accident and Disability System (POR)

- Retain the annual \$5 million state appropriation to the retirement fund until the funded ratio of the fund reaches 85 percent.
- A proposal from the members, endorsed by the POR board, to establish that certain cancers and infectious diseases are presumed to be in the line of duty with the cost for this prospective benefit paid by an increase in the member's contribution rate by .05 percent.

C. Municipal Fire and Police Retirement System of Iowa

- A proposal, endorsed by affected cities and members, to provide an annual state contribution to the retirement fund of 3.79 percent of earnable compensation.

D. Iowa Public Employees' Retirement System (IPERS)

- A proposal by IPERS to, among other items: rescind the Favorable Experience Dividend (FED) and Supplemental Account for Active Members (SAAM); change service purchases to require vesting by service, not age, and require that a service purchase be



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made within six months of retirement; and require spousal acknowledgment of refund applications. IPERS does not support the proposal by the Iowa Hospital Association.

- A proposal by the Iowa Hospital Association to permanently eliminate the sunset of the bona fide retirement exception for licensed health care professionals.

E. Deferred Compensation Programs

- Conflicting testimony and proposals, reflected in the minutes of the December meeting, relative to a current request for proposals by DAS to add vendors to the state's deferred compensation program provided to education employees.

X. Material Filed With the Legislative Services Agency

The 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:

www.legis.iowa.gov/committees/meetings/documents?committee=655&ga=ALL

1. IPERS GASB Presentation
2. Taxpayers Association of Central Iowa - Presentation
3. MFPRSI - System Presentation
4. MFPRSI - 2013 Actuarial Valuation Report
5. MFPRSI - Iowa League of Cities Presentation
6. MFPRSI - Iowa Professional Fire Fighters and Iowa State Police Association Presentation
7. Judicial Retirement System - System Presentation
8. Judicial Retirement System - 2013 Actuarial Valuation Report
9. Judicial Retirement System - Fund Asset Allocation Report
10. PORS - System Presentation
11. PORS - 2013 Actuarial Valuation Report
12. PORS - State Police Officers Council Presentation
13. IPERS - System Presentation
14. IPERS - 2013 Actuarial Valuation Report
15. IPERS - Iowa Hospital Association Presentation
16. IPERS - Probation-Parole Officers - Protection Occupation Request
17. DAS - Deferred Compensation Program Information



- 18.** IASBO - Kurt Subra - Iowa's 403(b) State Plan
- 19.** NTSAA - Presentation on 403(b) Plans
- 20.** TIAA-CREF - 403(b) Expert Quotes
- 21.** TIAA-CREF - 403(b) Study Handout
- 22.** Legislative Services Agency - Pending Pension Proposals
- 23.** Public Retirement Systems Committee Report

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