

December 17, 2003

Honorable Senators and Representatives, it is my pleasure to appear before you today in response to your request for updated information about the Iowa Public Employees' Retirement System (IPERS).

One year ago, IPERS presented you with the results of its actuarial valuation for the fiscal year ended June 30, 2002, in which the actuary signaled that the System would need to see an increase in its contribution rates in order to remain in fiscal balance. In response to that report, IPERS initiated a long-range asset-liability study.

In my brief remarks today, I wish to review with you the results of that study, the recommendations of IPERS' Benefits Advisory Committee regarding needed contribution rates and related issues, as well as the results from the most recent actuarial valuation study for the fiscal year ended June 30, 2003.

An in-depth collection of data - an updated copy of our presentation to the Legislature's joint pension interim subcommittee on October 14, 2003 - was previously forward to this committee electronically. I would like to take a few moments to highlight some areas from that presentation (referred to herein as IPERS' submission) for your particular attention today.

## IPERS' Governance

Thanks to recent legislation passed by the General Assembly, I have the pleasure and distinction of serving as IPERS' first-ever Chief Executive Officer (CEO). The Governor appoints the CEO, but such is not binding unless and until confirmation by the Senate.

In addition, the System has two important bodies that provide vital guidance in the governance, accountability, and services of IPERS:

- An Investment Board which oversees investment policy, as well as the selection and implementation of investment-related and actuarial contracts. Its Board has four non-voting representatives of both chambers (and of both parties) of the General Assembly, as well as the Treasurer and six other members appointed by the Governor (three of whom are not members of the System).
- Benefits Advisory Committee, whose primary task is to consider and make recommendations to IPERS and the General Assembly on matters involving benefits, member services, and plan design. Its voting membership is balanced between employer and employee association representatives, with an additional person representing the public at large.

The Legislature is both the Plan's sponsor - a role shared with the Governor of Iowa - as well as its ultimate policy council.

## IPERS' Valuation Tools

IPERS has long used two important tools in helping it assess its long-term funding status:

- An annual valuation report for the year ending the previous June 30 - this instrument, valuable as it is, is but a snapshot in time. Extremely useful for knowing the current health of the System, it can reveal even more information when compared to similar reports from preceding years. IPERS'

valuation reports have for some time used many charts that depict multi-year experience.

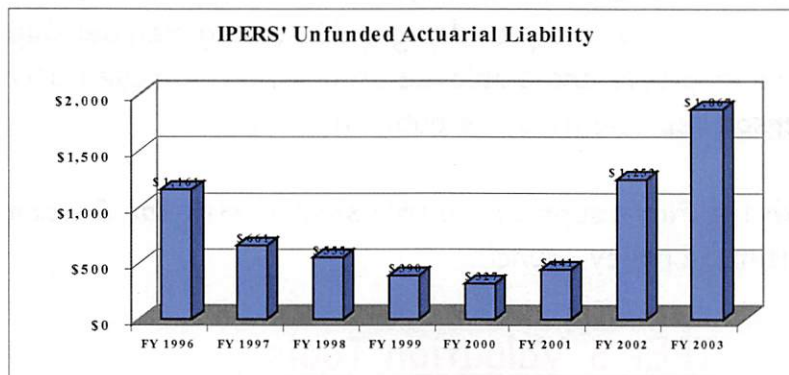
- An asset liability study is a long-range prospective study that looks out thirty years and incorporates multiple "what if" scenarios involving investment return, demographic experience, and contribution rate changes.

### IPERS' FY 2003 Valuation and Multi-Year Trends

(Further detail is provided in IPERS' submission: pp. 34-52)

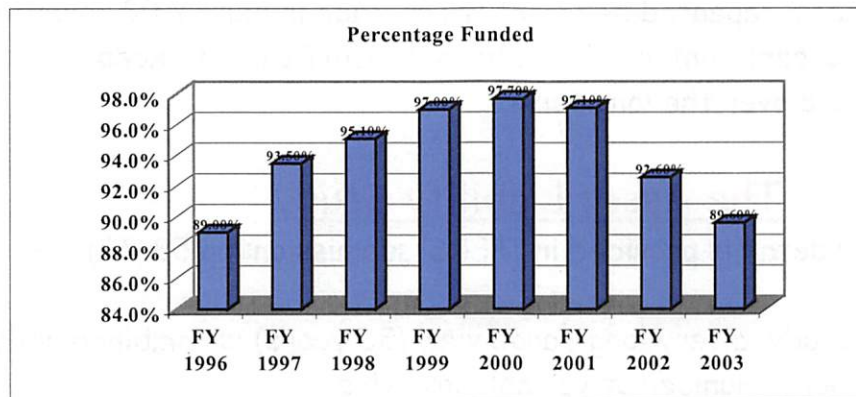
Key numbers from the actuary's report indicate IPERS experienced a positive investment return of 5.59% in FY 03 (our first positive return in three fiscal years).

- Market value of the fund as of June 30, 2003 was \$14.9 billion and actuarial value was \$16.1 billion.
- Our unfunded actuarial liability increased from 1.25 billion one year ago to \$1.87 billion in FY 03.



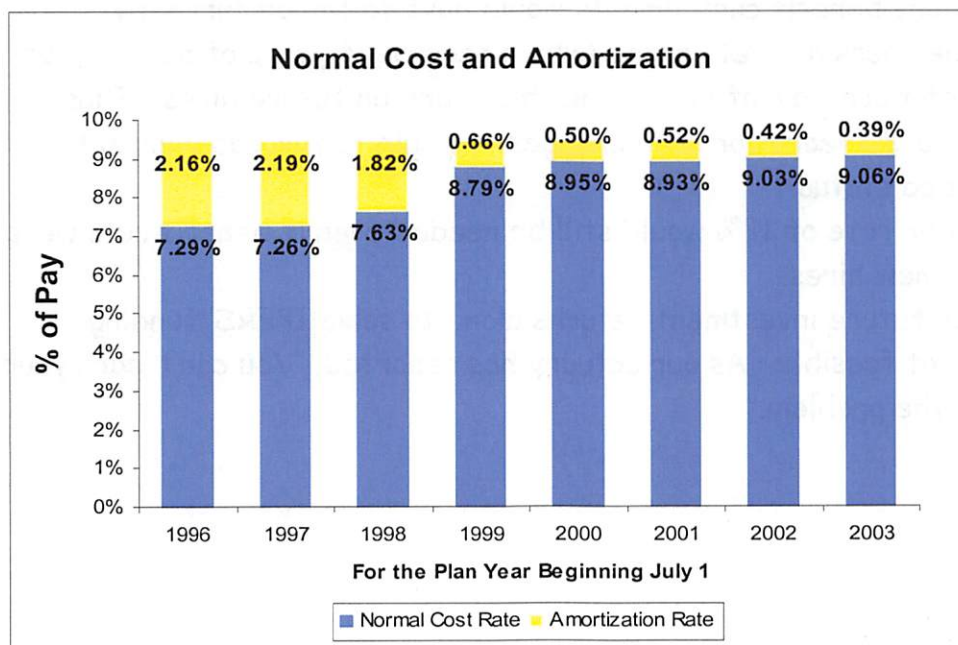
- IPERS' funded ratio declined from 92.6% in FY 02 to 89.6% in FY 03





- For the second valuation in a row, the time to amortize our existing unfunded liability remains at "infinite." Normal cost increase from 9.03% to 9.06%. The remaining margin of .39% from the current (and since 1979) contribution rate of 9.45% (the difference between "normal cost" and the statutory rate) leaves IPERS unable to pay off its unfunded actuarial liability in a timely manner. Our own funding policy - and the requirement of the Governmental Accounting Standards Board - stipulates that any unfunded actuarial liability should be amortized within 30 years or less.

### Allocation of Statutory Contribution Rate of 9.45%



The actuary again repeated her alert (first made in her FY 02 valuation report) that current contribution rates are insufficient to keep IPERS financially stable over the long term.

### The Asset Liability Study

(Further detail is provided in IPERS' submission: pp 53-72)

In an asset liability study, a very long-range view (30 years) is combined with computers running a large number of variable involving:

- Changes in asset mix within the investment portfolio
- Benefit plan provisions
- Varying contribution levels

The intent is to identify the most likely outcomes, while also isolating those which are clearly "outliers" and, therefore, very unlikely to occur.

With our instructions, the actuary also rigorously looked at alternative benefit plan reductions to see if such would cancel or reduce the magnitude of future increases in contribution rates. You should know that:

- Our best legal advice warns us that any attempt to reduce vested benefits would run a high risk of failing in court challenges; and
- Therefore, any benefit curtailments would have to fall on currently employed members not yet vested (which requires 4 years of service), on future benefit accruals of vested members, and on future hires. Thus, it would take 15-20 years for such changes to begin to favorably impact IPERS' funded status.
- A contribution rate of 12% would still be needed even if benefit cuts were enacted for new hires.
- Relying upon future investment returns alone to solve IPERS' funding problem is not feasible. As our actuary has reported, "You can't 'earn your way out' of the problem."

- ❖ An investment return of over 11% would be needed for each year through 2014
- ❖ IPERS' highest expected 10-year return for any asset class is 11% for private equity, which is but one (relatively small) component of IPERS' diversified portfolio.

Accordingly, the actuary identified that our current contribution rate structure - unchanged since 1979 - must be increased to 13.25% beginning in FY 06 if we are to bring our amortization period to within 30 years by 2014.

### Recommendations of the Benefits Advisory Committee

The Benefits Advisory Committee (BAC) began studying various alternatives shortly after the asset-liability study was launched at the end of the calendar year 2002. The minutes of their deliberations can be found in their section on IPERS' web site ([www.ipers.org](http://www.ipers.org)). In brief, they support:

- Beginning July 1, 2005, raising contribution rates ultimately to 13.45% by phasing in the increases over four years at 1.0% a year.
- Maintaining the current benefit structure for current members and new hires.
- Maintaining the existing 60/40 sharing split between employer and employee contribution rates.
- Inserting into the IPERS Code section a provision allowing IPERS to adjust rates (up or down) in the future if/when the actuary signals the need for such a change.
- Pledging to work with IPERS, the Governor and the General Assembly in finding a suitable replacement program for the Favorable Experience Dividend (FED) for members who retired after June of 1990. (There are sufficient funds in the FED reserve fund to allow IPERS to make distributions to the two-thirds of retirees dependent upon the FED for an estimate 7 years, buying us all the time we will need to create an alternative program.)



The Benefits Advisory Committee did not recommend any benefit curtailments for the following reasons:

- Only a reduction in benefits for vested members - if legally possible - would have a fiscal impact significant enough to offset some of the needed contribution increase.
- Any reductions that could be made for non-vested members and future hires would not, frankly, bring in amounts at all close to the monies needed in time to avoid a continuing erosion in IPERS' fiscal situation, nor would they offset the need for an increase in contribution rates;
- The major employer associations represented on the BAC (the State of Iowa, the League of Iowa Cities, the Iowa Association of Counties, and the Iowa Association of School Boards) did not request such curtailments. In fact, they were emphatic in supporting the benefit levels it has taken IPERS 15 years to attain because they are such an effective tool in recruiting and retaining valuable employees; and, lastly,
- As any benefit curtailments do not cancel the need for contribution increases, the result would be asking future members to pay more for a reduced level of benefits, something which employer and employee associations alike believe it wise to avoid.

### Benchmarking - How Does IPERS' "Measure Up"?

(Further detail is provided in IPERS' submission pp. 23-34)

### Who Performs Such Assessments?

Cost Effectiveness Measurement, Inc. (CEM) assists with benchmarking member services and costs related to administration and plan design, as well as with investment policy asset mix, value added through investment policy and management, and total investment costs.

### Key Findings - Investment Program and Administration

IPERS' investment performance places the System in the "high value added/low cost quadrant."

IPERS' investment performance consistently ranks in the top quartile of large U.S. public pension funds. CEM comments: "Your 5-year policy return of 3.3% was above the U.S. median of 2.6% and the peer median of 2.9%."

Our diversified portfolio delivers more return with less risk than those of our peers. CEM comments: "Your 5-year implementation risk of 1.7% was below the U.S. median of 2.4%."

The investment program is wisely managed and administered. CEM comments: "Implementation value added measures the contribution from active management. Your 5-year implementation value added was 1.4%. This compares to a U.S. 5-year median of 0.6% and a peer median of 0.6%."

It is also administered in an efficient and cost-conscious manner. CEM comments: While CEM's "benchmark cost analysis suggests that your fund was normal cost ... Your Governance and Administration costs were lower than your peers" by an average \$1.7 million.

### Key Findings - Benefits and Member Services Program and Administration

CEM made the following principal findings that support our long-held belief that IPERS provides high quality services to its membership at a very low administrative cost:

- IPERS' plan complexity "was equal to the peer group median."
- Nonetheless, "IPERS total cost of \$26 per active member and annuitant is [the] third lowest of [its] peers (peer median cost is \$50)."
- "IPERS' total relative work per active member and annuitant is above peer median."

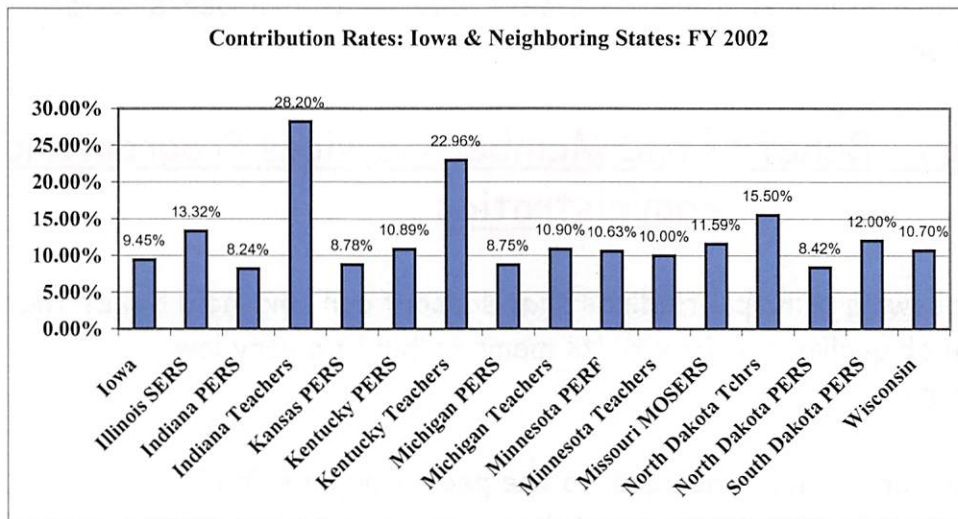
CEM says that IPERS' low costs are "surprising" given the complexity of our plan provisions and the high level of services offered our members.



## IPERS' Benchmarking of Plan Provisions and Contribution Rates

IPERS' combined employer-employee contribution rates of 9.45% (unchanged in 24 years) are below the national median of public pension plans' 11%. The 60%-40% sharing ratio between employer and employee contributions is also right "on the mark" of the national sharing average.

The central provisions of IPERS' benefits plan design are also comfortably in the middle range of its peers (please see pp. 31-33 of IPERS' submission for further details). The benefit enhancements of the late '80s and the '90s did not make IPERS "too rich" or "too generous" a plan; rather, they brought this System into a reasonably competitive position vis-à-vis that of public pension systems nationally and in neighboring states. To illustrate:



- Years to Vest: IPERS 4 years; Nationwide average: 5.78
- Average of Wage Years Used in Benefit Formula: IPERS 3; Nationwide average: 3.37

- Benefit Formula: % Value of Each Year of Service: IPERS (using 35 years) 1.89%; Nationwide average: 1.86%
- Cap on Years of Service Beyond Which No Further Accrual Value is Allowed: IPERS: 35 years; Nationwide Standard: NONE! (Only 3 systems other than Iowa have such a limitation.)
- Normal Retirement Age: IPERS: 65; Nationwide average: 62.05
- Early Retirement Provisions: IPERS: 62/20 and Rule of 88; Nationwide Standard: 38 systems have NO minimum early retirement age; rather they use various "rules" stipulating that when "X" years of service have been served the member may leave at any time. Rules of 60/10, 62/20, 88 and 85 are not uncommon

The average public employee at retirement leaves public service with only 21 years of service, meriting an average 42% of his/her average highest three years of covered salary. While respectably, and fully reflective of the service time spent for public employers in Iowa, this is not by any reasonable measure "overly generous."

### Value of IPERS to All of Iowa

Not only does IPERS provide important services to its 337,897 membership and it's over 2,400 public employers, but it also funnels significant dollars into Iowa's economy via retirees residing in every Iowa County each month. (Please see county listing attached to this document.)

Last year, for example, IPERS contributed 2/3 of a billion dollars to Iowa's economy via payments to its retirees, beneficiaries of deceased members, and members terminating from public employment who take refunds.

### Conclusion

For fifty years, IPERS has been a proven resource for all levels of government in Iowa and an important partner for rural and urban Iowa alike. We are hopeful

that the Legislature will respond to our request for the modest annual increases in the contribution rates, which our actuary has said, are needed to continue IPERS' tradition of fiscal stability and prudent management.

### Attachments

IPERS' payments in FY 03 to members throughout Iowa  
IPERS' relationship with Putnam



COUNTY	AMOUNT	AVERAGE	PAYEES
Adair \$	2,103,914	\$ 8,155	258
Adams	1,196,232	7,339	163
Allamakee	3,683,073	8,896	414
Appanoose	2,955,085	8,371	353
Audubon	1,715,323	7,590	226
Benton	4,555,611	7,774	586
Black Hawk	26,091,799	10,086	2,587
Boone	7,574,770	8,954	846
Bremer	6,095,593	9,569	637
Buchanan	6,300,555	9,079	694
Buena Vista	4,448,050	8,688	512
Butler	3,560,264	8,280	430
Calhoun	3,278,891	7,997	410
Carroll	3,619,529	8,189	442
Cass	4,084,001	8,598	475
Cedar	3,723,679	8,762	425
Cerro Gordo	12,158,510	10,518	1,156
Cherokee	5,292,479	9,640	549
Chickasaw	3,447,010	9,821	351
Clarke	2,186,194	8,037	272
Clay	4,212,835	9,040	466
Clayton	4,709,328	8,852	532
Clinton	9,199,283	9,735	945
Crawford	4,260,646	8,913	478
Dallas	8,634,646	9,285	930
Davis	2,283,736	7,768	294
Decatur	2,274,175	7,581	300
Delaware	4,451,935	9,392	474
Des Moines	9,478,757	10,314	919
Dickinson	6,533,606	10,962	596
Dubuque	13,188,223	9,953	1,325

Emmet	2,806,647	8,967	313
Fayette	5,000,374	8,504	588
Floyd	4,343,686	8,956	485
Franklin	2,663,205	8,323	320
Fremont	1,950,039	7,617	256
Greene	3,004,487	7,346	409
Grundy	3,346,950	8,367	400
Guthrie	3,891,683	8,885	438
Hamilton	5,148,097	10,035	513
Hancock	2,731,852	8,591	318
Hardin	6,528,849	9,018	724
Harrison	3,366,490	8,523	395
Henry	5,384,047	8,914	604
Howard	2,623,435	8,328	315
Humboldt	3,245,155	8,585	378
Ida	1,585,068	8,299	191
Iowa	2,945,239	7,939	371
Jackson	4,036,317	8,154	495
Jasper	8,102,439	9,443	858
Jefferson	3,622,753	9,434	384
Johnson	15,557,763	9,452	1,646
Jones	5,427,610	9,886	549
Keokuk	2,989,589	7,888	379
Kossuth	3,416,999	8,294	412
Lee	7,917,926	10,023	790
Linn	39,503,339	11,424	3,458
Louisa	2,977,266	9,859	302
Lucas	2,527,284	8,153	310
Lyon	1,972,110	8,149	242
Madison	3,014,996	8,590	351
Mahaska	4,429,628	8,601	515
Marion	5,459,868	8,736	625
Marshall	10,483,595	9,319	1,125
Mills	4,459,130	8,830	505
Mitchell	2,991,369	8,747	342

Monona	2,490,875	8,114	307
Monroe	1,926,825	7,995	241
Montgomery	3,002,123	7,778	386
Muscatine	7,630,668	9,261	824
O'Brien	3,184,466	7,673	415
Osceola	1,263,016	8,201	154
Page	5,243,303	8,753	599
Palo Alto	3,218,583	8,107	397
Plymouth	4,736,404	8,820	537
Pocahontas	1,876,306	8,158	230
Polk	76,709,031	10,759	7,130
Pottawattamie	13,567,628	9,249	1,467
Poweshiek	4,302,862	9,374	459
Ringgold	1,938,833	7,914	245
Sac	2,399,410	7,429	323
Scott	25,902,353	11,361	2,280
Shelby	3,071,578	8,392	366
Sioux	4,452,660	8,096	550
Story	21,212,600	10,991	1,930
Tama	4,462,698	9,336	478
Taylor	1,986,445	7,852	253
Union	4,096,811	8,625	475
Van Buren	2,599,921	7,975	326
Wapello	8,754,418	9,434	928
Warren	9,762,254	10,180	959
Washington	4,767,868	7,740	616
Wayne	1,989,382	7,341	271
Webster	8,963,595	9,260	968
Winnebago	2,724,316	8,760	311
Winneshiek	4,891,264	9,281	527
Woodbury	19,538,340	10,718	1,823
Worth	1,735,078	8,632	201
Wright	3,804,620	8,647	440



## IPERS' Relationship with Putnam

IPERS hired Putnam in 2000 to manage a European Equity portfolio.

Up to that time, Putnam's performance and staffing had been relatively strong and stable.

Putnam was placed on IPERS' Manager Watch List in September 2003 for underperformance and staff turnover since their hire by IPERS.

In late October 2003, Putnam became the subject of an investigation by the SEC for inappropriate securities trading practices in their mutual funds.

On October 27, IPERS became aware that two Putnam portfolio managers in the organizational unit that oversees IPERS' Putnam portfolio had been charged by SEC with securities fraud, and had been terminated.

While there is no indication that IPERS' \$600 million in assets (which represent less than 4% of the total IPERS investment portfolio) with Putnam had been disadvantaged by the alleged inappropriate trading, the continuation of key staff turnover and organizational chaos expected to follow the SEC charges would put IPERS' assets at further risk.

On October 30, IPERS notified Putnam that they were being terminated, and IPERS prohibited Putnam from further trading in IPERS' account.

Assets in IPERS' Putnam account were temporarily moved to another manager effective November 10, and IPERS will receive a European Equity index return on these assets while a formal search for a permanent replacement manager is conducted.