

# Public Retirement Systems Committee

November 1, 2007

10:00 a.m. – 10.15 a.m.

IPERS Investment Board

David O. Creighton, Sr., Vice-chairperson

Karl Koch, IPERS Chief Investment Officer

**Mr. Creighton:**

## **1. Introduction**

- a. Thank you for the opportunity to speak on behalf of the IPERS Investment Board
- b. Chairperson and Chief Executive Officer of The Bryton Companies in West Des Moines
- c. Have served on the Investment Board since 2003
- d. Elected vice-chairperson of the Board in September

## **2. Investment Board roles and responsibilities**

- a. Adopt policies governing diversification and investment of assets
- b. Hire investment managers and consultants
- c. Review investment performance at fund, asset class, and manager levels
- d. Select the actuary and adopt the mortality tables, actuarial methods, and assumptions to be used by the actuary for the annual valuation of assets
- e. Evaluate the performance of the chief investment officer and chief executive officer
- f. Review investment management expenses and IPERS administrative budget

## **3. Investment Board structure**

- a. Composition defined in chapter 97B
- b. Seven voting members
  - (1) Six members appointed by the Governor and confirmed by the Senate
    - Three public members with investment and financial experience  
Joanne Stockdale (Chair), David Creighton, Sr., and Jay Ingram
    - Three IPERS members  
Phyllis Peterson (retired), Michael Beary (active not in education), and  
Lana Dettbarn (active IPERS member who is in education)
  - (2) State Treasurer Michael Fitzgerald (by statute)
- b. Four nonvoting members
  - Representatives Jochum and Boal
  - Senators Connolly and Zieman

#### **4. Fiduciary duty of the Investment Board**

- a. The Investment Board is trustee of the IPERS Trust Fund
- b. A fiduciary with a legal duty to act in accordance with all of the following:
  - (1) Solely in the interest of the participants and beneficiaries
  - (2) For the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses
  - (3) Using the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use
  - (4) Impartially, taking into account any differing interests of participants and beneficiaries
  - (5) Incurring only costs that are appropriate and reasonable
  - (6) In accordance with a good-faith interpretation of the law governing the retirement program and system
- c. The Investment Board recently reaffirmed its policy that, due to its fiduciary duty, IPERS cannot support any type of social investing strategy or agenda.

#### **5. IPERS Chief Investment Officer will address implementation of policies and strategies adopted by the Board, and review investment performance**

- a. Karl Koch was selected IPERS Chief Investment Officer in May
- b. Mr. Koch has earned the right to use the distinguished Chartered Financial Analyst (CFA) designation
- c. He has over 20 years of financial experience, and has been involved with Iowa public pension fund investment programs for 15 years
- d. Before coming to IPERS, Koch served in various capacities in the Office of the Iowa Treasurer of State, including the State Treasurer's chief finance officer from 1994 to 1998.

**Mr. Koch:**

#### **6. Fiduciary Duty and Implementation of Sudan Divestment Legislation**

- a. Staff's role is to implement policies and strategies adopted by the Investment Board
- b. The Investment Board has adopted a policy to oppose social investment strategies or mandates. Fiduciary principles support this stance:
  - (1) Mandates often impose real costs for the retirement system
  - (2) Often difficult to prove that divestment campaigns or social investment mandates actually create the intended social benefits or accrue to the benefit of the members
  - (3) The Investment Board recently reaffirmed by consensus that IPERS cannot support any legislation that promotes specific social issues or agendas through investment or divestment of IPERS' assets. Therefore, IPERS staff will oppose legislation mandating the use of social investment screens, requiring investment in specific areas, or strategies

- c. Rest assured IPERS will comply with all laws enacted by the Legislature and Governor, even if such laws include a social investment mandate. The Sudan Divestment legislation (Senate File 361), for example:
  - (1) Using Sudan Divestment Task Force's Highest Offender List
  - (2) Sent letters of engagement to 45 firms; 10 responded
  - (3) Updated lists of Prohibited Investments and Holdings are on IPERS Web site [www.ipers.org](http://www.ipers.org)
  - (4) Direct holdings estimated at \$5.8 million as of 6/30/07

## 7. Investment Strategy and Performance

- a. IPERS has produced total fund returns in recent years that are well above the actuarial investment rate assumption of 7.5% (16.29% FY2007; 12.86% annualized over three years; 11.64% annualized over five years)
- b. However, many of our active investment strategies in our stock portfolios have not consistently beaten the market over the past five years
  - (1) Objective of active management is to earn an incremental return that exceeds a benchmark or index
  - (2) While active management strategies can potentially add value over the market benchmark, they are also more complex and can have higher fees and transaction costs
- c. To improve IPERS' returns from active management., IPERS has been replacing or reducing some active management strategies that are not producing desired results with ones that are more consistent or have more "breadth" (more investment choices):
  - (1) Fewer restrictions on managers
  - (2) Exploit multiple sources of return
- d. While these active management strategies are more expensive, in the long run we hope to achieve more consistent, positive investment returns after fees.
  - (1) Recommend eliminating the current investment management expense cap of 0.40%
  - (2) IPERS uses performance-based contracting consistent with the Accountable Government Act to control fees, and the Investment Board has a fiduciary duty to conserve costs while also trying to maximize risk-adjusted return
- e. Biggest challenge: Finding skillful managers
- f. Board and Staff continue to review portfolios and evaluate ways to improve active returns

## 8. Analysis of Recent Market Events

- a. The sub-prime lending fiasco and the severe drop in housing values hit the markets in July and August, and continue to cast a long shadow:
  - (1) Credit crunch and a liquidity crisis in some areas of the fixed income markets
  - (2) Continued worry about the longer term impact on the economy
- b. Most of IPERS' investment managers currently expect a significant slowdown, but no recession

- c. So far, IPERS' portfolio appears to be in good shape
  - (1) Expect a positive return of over 2% for the third quarter, despite the effects of the sub-prime mess on fixed income markets
  - (2) However, if we are heading into a recession, the returns for fiscal year 2008 will probably be much lower than what we have seen in the past several years
- d. IPERS is a long-term investor, and we are confident that our portfolio, which is well diversified by asset class and strategy, will weather the storms ahead