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The Committee on Nebraska Retirement Systems met at 12:10 p.m. on Wednesday, March 11, 2009, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on Nebraska Employees Retirement System annual report and Nebraska Investment Council annual report and defined benefit plans. Senators present: Dave Pankonin, Chairperson; Jeremy Nordquist, Vice Chairperson; Lavon Heidemann: Russ Karpisek; LeRoy Louden; and Heath Mello. Senators absent: None. []

SENATOR PANKONIN: Good afternoon. I would like to start our public hearing this afternoon for the Nebraska Retirement Systems Committee. I want to welcome you and also remind you about turning off or manner mode or whatever on your cell phone so we don't have that disruption, please. I'm going to make some introductions. Some of the senators will be on their way, I'm sure, and when they come we'll try to acknowledge that. But we have Senator Karpisek that's missing right now; our Vice Chairman Senator Nordquist is here; I'm Dave Pankonin. We have our counsel, Kate Allen; Senator Mello and Senator Heidemann will be joining us I'm sure; and Senator Louden is here. And then we also...I want to introduce our committee clerk, Denise Leonard. And today is going to be a day of...we accept some reports from NPERS and the Nebraska Investment Council, so that is our main business. We do plan to have an Exec Session, so we want to keep this moving because Natural Resources has the room after we're done, so that's our agenda. And if...I guess if there are...we don't usually accept comment on the reports; were just accepting the reports so that will give the members the chance to look at them. So Ms. Chambers is here from NPERS so we'll let you begin. []

PHYLLIS CHAMBERS: (Exhibit 1) Okay. Good afternoon, Senator Pankonin and members of the Retirement Committee. My name is Phyllis Chambers, P-h-y-l-l-i-s C-h-a-m-b-e-r-s, and I'm the director of the Nebraska Public Employees Retirement Systems. I appreciate this opportunity to present the annual report for our agency. NPERS administers six retirement plans: the state, county, school, judges, patrol, and a deferred compensation plan. The state and county also include both a defined contribution and a cash balance plan. At the end of 2008 we saw our plan membership grow to 108,434 members. As you know, 2008 was a disastrous year for the financial markets and we witnessed our plan assets decline by 28 percent. The markets have continued to spiral downward so far this year, so we're uncertain what the investment returns are going to be by the end of June 2009 when we value our defined benefits plans for next year. The magnitude of this economic crisis has been unsettling for our plan members and for all of them, but especially for the defined contribution and the deferred compensation plan members who bear the entire risk for their retirement accounts on an individual basis. It's indeed a challenging environment for the Retirement Committee, for the Public Employees Retirement Board, and our agency as we are the ones responsible for our public employees' retirement plans. While there have been serious economic matters in the news, NPERS has made substantial accomplishments during the past year and I'd like to highlight a few of those. The first and foremost major accomplishment we achieved was the conversion of our information technology system from the old Pioneer system to the new NPERS system. We actually converted just two weeks ago, the weekend of March 1, and we were able to do so without any downtime or any loss of service to the members. Obviously when you convert a system as complex as ours you would expect a few glitches, and we did have a few, however the main conversion itself went very smoothly. So I'm happy to report that at this present time we are going to be looking at any of the problems that we can identify over the next three months and document those for the warranty period, and then those will be covered by the vendor as far as fixing any of those problems. We also have some unfinished programming for some of the areas that weren't so critical that we delayed until after the conversion, and those will be taken care of in the months ahead. Our plan is to work with Saber, our vendor, and the Office of the Chief Information Officer, Brenda Decker, in transitioning our maintenance and support of the system over the next few years. And I'd like to say that Saber and the Office of the CIO have been excellent to work with on this conversion project. Their professionalism and expertise is one of the reasons I think it was very successful, and we were able to complete this within budget and within the time frame that we had committed to. Another accomplishment was that we contracted with Milliman, Inc., in Omaha to perform an actuarial audit of our system. That consultant is our actuary and has been for 10 years, and it is recommended by auditing standards that we audit the actuary every 10 years. You'll be happy to know that the audit showed no material concerns with our actuary valuations or our actuary services. Another accomplishment last year was the implementation of the State Patrol deferred retirement option plan, or the DROP. We spent over a year planning and developing the programming and the rules for the plan, and then we also designed the enrollment process and the training materials for the state patrolmen, and went out, and went to Grand Island and here in Lincoln and had training sessions for them. Here are some interesting 2008 statistics. We answered approximately 33,000 phone calls last year in our call center. That's an average of 650 calls a week. We met with over 1,300 members with office visits, which averages about 25 office visits a week. And we have five people that do that and they are constantly busy, and we have a few people that fill in when they are not available. We processed over 1,200 teacher retirements, 27 State Patrol retirements; 7 judges; and a number of state and county retirements. We estimated 393 purchases of service for school members, and actually processed 170 purchases of service. We also processed 24 disability retirements and 213 death claims. And we qualified 58 domestic relations orders and split the benefits per the divorce decree. Also we have...as you would imagine we have a large amount of mail. We processed 43,000 pieces of incoming mail; 497,000 pieces of outgoing mail, which includes our newsletters and statements; and we scanned over 500,000 documents, and we're currently in the process of entering 30,000 beneficiaries into the system from old paper documents that we want to get into the system digitally, electronically. We presented 72 different retirement seminars and employee workshops in a variety of locations around the state, and we received over 240,000 hits on our Web site, which is an average of about 660 hits per day. I've provided each of you with our annual report. I'd like to just highlight a few things that are in here. If you'll turn to page 1 you'll see the list of our Public Employees Retirement Board. Our board consists of nine members: eight who are appointed by the Governor and one who is an ex officio member. The board members come from each of the plans; there's one from each plan. And there are two school members, one of which is a school administrator. We also have two public members. You'll be interested to know that our two public members are both former senators and both former Retirement Committee members: Senator Elaine Stuhr and Senator Don Pederson, so they bring a lot of knowledge and background to the Retirement Board. If you turn to page 13, there's a longer list of our accomplishments on page 13 and 14, and on page 15 is a list of the action plan for 2009. On 16, 17, and 18, you'll find a list of the statutes that apply to each of the plans; and a list of the legislation, the bills that have been passed for the last eight years. You'll find that this particular annual report is a good reference for you if you want to pick it up and want to look at something. I look at it, I use it a lot just to find out information about plans numbers. You'll see the funded status of the pension plans on page 19, 20, and 21. The judges plan is 105 percent funded as of June 30 last year; it shows that the school plan was 90.6 percent funded last June; and the State Patrol plan was 93.6 percent funded, and those will obviously change based on the investment returns this year. The cash balance dividend is listed there. In September, the board issued a 5.18 percent dividend to state employees and a 5.34 percent dividend to the county employees. Some of our key numbers are on page 22 and 23. There's a three-year summary of our retirement plan assets per plan, so if you ever want to know how much is in each of the plans or whatever or how many people are in the plan. On page 23 it shows the member status. You'll see that there lists active members, inactive members, and retirees. The active members are those that are current employees contributing to the plan; inactive are those that still have an account with the Retirement Systems but have not annuitized it into a benefit but they are no longer working; and then the retired list are those that have actually annuitized and receive a monthly benefit from the Retirement Systems. The numbers down below show the enrollments for last year, refunds, and the retirements that were roll-overs or lump-sum distributions. Our operating budget is on page 25 and you will see that we operate the agency with approximately 10 basis points cost to the plan members, which we think is a very...we feel like we operate the agency very efficiently and at a very low cost to the members. Moving on down you'll find an appendix on page 33 that lists the various investment options that the members of the defined contribution and deferred compensation plan. So if you ever want to know what those investment choices are for those plans, they're listed here, and the 10-year returns are also listed. On the next page is the cash balance rate of return for the credited rate and the dividends that have been paid since the inception of the plan in 2003. And Appendix B shows you the average amount of monthly defined benefit payments that are made to members, and it lists them by county so you can see those counties that you represent, how much of the state defined benefit plans are going into your local economies on a monthly basis. And then it's also by state, and you'll notice that 90 percent of the benefit payments we pay out, stay in Nebraska. There's also a plan summary for each of the plans. And then our board policies are included at the very end. As I said, this is a valuable resource that hopefully you can use from time to time. I am also a valuable resource to you. If you would like to call me at any time I'd be happy to answer your questions. I think you're familiar with Joe Schaefer, our legal counsel. He's always working with your legal counsel and helping you with retirement information; as well as our board is very active, and our board chairman Denis Blank is here. If you ever have any questions for the board I'm sure he'd be happy to answer those questions for you. And then at any time if you want to look at our Web site, all of the information that we have published is on the Web site. All the plan information, contribution amounts for the plans, minutes of the meetings, all of our annual reports, all of our actuary reports, those are all on our Web site as well. And with that I'd be happy to answer any questions. []

SENATOR PANKONIN: Ms. Chambers, thank you for presenting your report, and I know for myself I will spend time and I'm sure I'll have some questions maybe later in particular of how things work. We'll see if there's any other questions, and then thank you for your offer to be a resource at any time as people have questions. You've been very accessible in my new role, so I appreciate that, and I'm sure you will continue to be. Any questions by the committee? Senator Louden. []

SENATOR LOUDEN: Yeah. What I was...I think it's on page 22 there, I was looking here, the assets, and I was noticing that in 2008, like your school employees, their assets are still considerably higher than what they were in 2006. Is that going to continue or do you think there will be some erosion or...? []

PHYLLIS CHAMBERS: Well, the 2008 numbers are of last June... []

SENATOR LOUDEN: Last June? []

PHYLLIS CHAMBERS: Right. []

SENATOR LOUDEN: Okay. []

PHYLLIS CHAMBERS: And there is an asterisk on that page that indicates that, and those are the audited figures so we will not have any new figures until June of this year. But yes, right now I would say they're at $6.7 billion at the present time, for the whole...for the plan, the total plan as of December 31, for the whole assets of all of the plans. And the school would be less than that. []

SENATOR LOUDEN: I was just wondering how this system is going to compare to

2006, you know, if...to get some kind of a landmark to know how big of a hole we're digging, I guess, and that's what... []

PHYLLIS CHAMBERS: Hopefully it won't be any lower than 2006 but we'll have to see what happens by June. []

SENATOR LOUDEN: Okay, because there was quite a lot of growth in 2007, and I don't know if that was natural or not in the marketplace all the time or if this is the adjustment we're seeing now from that. []

PHYLLIS CHAMBERS: Well, we did have some very good returns in 2007, and I know that the Investment Council will be giving you a report. We do have on the market summary. It tells you what the investment returns were for the last five years on page 19, so you can kind of compare that to why you're seeing that growth from 2006 to 2007. []

SENATOR LOUDEN: Okay. Thank you. []

PHYLLIS CHAMBERS: Yes, sure. []

SENATOR PANKONIN: Seeing no other questions, thank you, Ms. Chambers, and we'll contact you if we have others individually or committeewise. Okay, now we'll have the Investment Council folks. I think they're going to maybe bring a chair or two up and we'll tag-team a little bit and we'll pass out those reports as well. Obviously, since we started Senator Karpisek is here, Senator Mello, and Senator Heidemann have joined us, and I didn't introduce our clerk. Michael does a great job for us and--our page, excuse me--and as he passes out this report. []

DAVID BOMBERGER: (Exhibits 2 and 3) Chairman Pankonin, members of the Retirement Committee, thank you for the opportunity to present the Nebraska Investment Council's annual report this afternoon. My name is David, D-a-v-i-d, Bomberger, B-o-m-b-e-r-g-e-r. I served as the State Investment Officer from July 2006 through February 2009. Joining me today is Kevin, K-e-v-i-n, Vandolder, V-a-n-d-o-l-d-e-r. Kevin is the lead consultant for the Nebraska Investment Council and he is with the firm Ennis Knupp. Ennis Knupp has served as the independent investment advisor to the Investment Council for several years now and plays a very critical role in the operation of the Investment Council in assisting the council is establishing investment policies, asset allocation, and manager selection, due diligence, and review. What you have in front of you is a very lengthy presentation. We don't intend to go through all 70 pages. There from about page 33 on are some supplemental tables that provide you information about the market environment in 2008, some thoughts about 2009, and some of the opportunities that Ennis Knupp and the Investment Council believe may be available to the Investment Council to take advantage of, given the dislocations that have occurred in the financial markets. Slide 2 presents a pie chart that shows a summary of the investment portfolios that are managed by the Investment Council. As of December 31, 2008, the Investment Council was responsible for about $12.1 billion. That figures is down from $15.3 billion at the end of calendar 2007. So Senator Louden, that may--and we'll get more specific to the defined benefit plan asset value changes in a couple of minutes--but that will give you an order of magnitude. About 55 percent of the assets that the Investment Council is responsible for are related to retirement plans, and we're going to limit our comments this afternoon just to the retirement plans. The full annual report that the Investment Council prepares covers all 31 different entities that the council manages money for. Our production schedule was anticipating a hearing more in line with when the hearings occurred previously, which was later in the month of March, and our full annual report, which we certainly will get you a complete copy of when it's published, should be done shortly. I believe the page also had a folder that we brought along that had the excerpts from the annual report that dealt specifically with the retirement plans, and so we wanted to be sure that you all had the--it would have been a piece that looks like this. There was a separate file folder. So with that, 55 percent of what the Investment Council manages is related to retirement plans, and the balance are the college savings plans, the operating investment pool, and a variety of endowments and foundations. For a few comments on the environment last year, I want to turn to Kevin. []

KEVIN VANDOLDER: Thank you for the opportunity of discussing a very challenging market environment. The slide that's identified next is--I don't believe there's a page number on that slide. It's right after...it follows Slide 2. It's labeled "A Time of Challenging Markets, 2008." []

DENISE LEONARD: Excuse me. I need for you to spell your name. []

KEVIN VANDOLDER: Okay. It's Kevin Vandolder, K-e-v-i-n, last name is Vandolder, V-a-n-d-o-l-d-e-r. And the pictures here on the far right-hand side of this slide shows the dramatic decline in yields as there's really only two asset classes that delivered well in 2008: that was either Treasuries or gold. All other asset classes that benefit from risk-seeking behavior earned a negative result, and the spreads on similar dated bonds that were not Treasury related are shown on the bottom right-hand corner. You can see what we refer to in our industry, the spreads have blown out sizably in a way that we're never seen before in the market environment, even surpassing that of the 1930s. So the deleveraging that is occurring in the marketplace continues to persist, leading to significant volatility. Many folks, including those in our office, refer to it as we're in about the sixth inning of a baseball game in terms of deleveraging. The key question is to anticipate the market movements. And the stock market generally moves about six months ahead of future economic activity, and if indeed we're in that stage of the deleveraging cycle, that may present sizeable opportunities for the council to take advantage of. []

DAVID BOMBERGER: Slide 4 presents a history of the total return, the investment performance of the assets supporting the defined benefit plans. 2008, the return was a negative 27.8 percent. I think it's important though for...we believe these are very long liabilities. And we think it's important to keep the long-term performance of the fund in sight, and over the period since June 20, 1983, the fund has produced a return in excess of 8 percent. Page 5 is a slide that shows the asset allocation for the defined benefit plans. The council did complete, with the assistance of Ennis Knupp during 2008, an asset liability study to compare the cash flows of the assets with the cash flows of the underlying liabilities. It was determined that the general asset mix would not change, 70 percent equity-related investments, 30 percent fixed income, but the allocation within the equity component did change. We increased the allocation to global equities from 5 percent to 15 percent; increased non-U.S. equities from 12.5 percent to 13.5 percent; and reduced U.S. equities from 42.5 percent to 31.5 percent. And Senator Louden, to your earlier question, the total assets for the defined benefit plans at the end of calendar 2008 were $5.4 billion, and that was down from $7.5 billion at the end of calendar 2007. The actual allocation of the assets can be seen on page 6. We're very close to the target allocations. Slide 7 looks at the state and county retirement systems and the deferred comp plans. There was about $1.4 billion of total assets in the state and county retirement system and deferred comp plans. That's down from $1.8 billion the previous year, and you can see the split between defined contribution representing a little over half of those assets and the cash balance benefit representing just under half. Page 8 shows the asset allocation for the cash balance benefit, and it is identical to the defined benefit plans. The assets in the cash balance benefit plan were $596 million at the end of calendar '08. That's down from $611 million. And by comparison that doesn't seem like as big a decline as we saw in the defined benefit plans, but remember that participants in the defined contribution plan had an option at the end of calendar '07 to shift their balance from defined contribution to the cash balance benefit. And so there was a significant movement out of defined contribution into cash balance, and that shift of assets offset the market decline that would have otherwise occurred. The performance for the cash balance benefit is presented on Slide 10, and it's substantially the same as the defined benefit plan and that's what you would expect since those two plans share investments. During calendar 2008, we continued to implement the asset allocation and the manager structure. We added 13 new managers during 2008. We added three long-only equity managers: one in non-U.S. growth equities and two in global equities. We added five commitments to new private equity funds. We added a commitment to a private equity fund of funds for the state's endowments. We added two new private equity funds for the defined benefit plans, and we added commitments to two private real estate fund of funds for the endowments. The council is involved in a number of initiatives this year, and I'd like to turn to Kevin to talk about those initiatives. []

KEVIN VANDOLDER: First and foremost, the gentleman sitting to my right has a new business card, so we have to, first, find a replacement for some very big shoes, so there's been a subcommittee that the council has created and they are in the process of identifying such a replacement. We have continuous council education. They put our feet to the fire in terms of what the market environment looks like, how they can take advantage of it, how the performance of the underlying platforms they invest in they're delivering, and how they should be thinking about the current market crisis. That leads to the second to the last piece is just to continue to review of the dislocation opportunities that are available. That will be a sizeable component of our March 31 council meeting together. And then last but not least is continuing to move forward with careful implementation of the private equity program. And we've slowed the real estate down a little bit in favor of the private equity, and one of the key things--there's a slide later on in the presentation that speaks to the vintage year benefits. History has told us that years where we have economic challenge is good years to be defining an entry point into private equity. So if you look at historical returns, whether it's 1990-92 or 2001-03, those vintage years of private equity have delivered extremely well in terms of the capital market valuation expansions. And it's like fine wine, and we are indeed observing this and the council is reacting to it by continuing on the same path of the private equity implementation. []

DAVID BOMBERGER: The slide that Kevin has referred to is page 55 in the presentation and we won't get that far into the presentation, so if you'd like, at your leisure, to see the graphic presentation of what Kevin was referring to, that would be the page. The defined contribution and deferred comp plans have total assets of $743 million at the end of calendar 2008, and that's down from $1.1 billion at the end of calendar 2007. A majority of the assets in those plans are in premix funds, and Slide 15 presents the relative performance of each of those premix funds. And not surprisingly, the more conservative funds had less negative returns, and the more aggressive funds had more negative returns. But I think in nearly every case the premix funds did outperform the benchmarks that were assigned to them. We have a few history slides to give you a sense of the growth of the Investment Council. Slide 16 shows the growth of assets under management from 1995 to present. You can see the decline in 2008 due to the market performance. Slide 17 shows the total investment return that's been produced by the Investment Council over a similar period of time--about $4 billion. Slide 18 presents net contributions to the assets under management of the Investment Council. The big positive contributors has been, most recently, the college savings plan. Last year the college savings plan, and while I know it's not part of the retirement system, had net contributions of $183 million. Slide 19 presents probably the one bright spot of the investment performance of 2008, and that's securities lending. Over the five years that we present here, the securities lending program has produced about $19 million of income; $12 million of that, nearly two-thirds of that was achieved in calendar 2008. And it's the result of a higher utilization, a bigger portion of the securities held by the council were out on loan earning a modest income, and it's also a result of the custodian requests for a proposal that was conducted by the State Treasurer's Office and the Investment Council in early 2008 that resulted in an improved revenue sharing from the securities lending program. Previously, 75 percent of the income from the program went to the council; 25 percent stayed with the custodian bank who is the lending agent. We negotiated better terms and now 82 percent of that income flows to the council and 18 percent stays with the bank. Slide 20 looks at the total expenses incurred by the Investment Council in managing the state's assets--a total of just short of $30 million. $1.7 million of that is appropriated; $3.9 million are expenses related to various services that the custodian provides; and $24.1 million, or just over 80 percent are fees that are paid directly to outside investment management firms. Page 21 shows the growth of those costs over time. Page 22 shows, in terms of basis points, the cost. And I think the point that Ennis Knupp has made with the council, over time, is that while these are increasing it does reflect the increased use of the private investment vehicles, the private equity and private real estate, and that the fees that are paid by the council on behalf of the state are still very competitive relative to peers. The custodian fees I mentioned a minute of so ago that the council and the State Treasurer did complete an RFP during 2008. We did achieve substantial savings in the costs paid to the custodian for safekeeping the state's assets. During the last six months of calendar 2008, which was the period of time that the new arrangements was in place, those fees were about a half million dollars lower than they would have been under the previous arrangements. So I think it's far to annualize that, that process saved the state about a million dollars on an annual basis. If you turn to page 25 then we'd like to wrap up with Kevin giving you a sense of the council and Ennis Knupp's expected returns going forward and it does provide to the council regularly their expectation for future returns. And what I have provided in this package is what their expectations were a year ago and what they are today so you can see how they've page. Page 25 is a year ago and page 26 is their current outlook. []

KEVIN VANDOLDER: Thank you, Dave. Our clients represent roughly about 1.5 percent of the world's stock market, so there's a lot of importance to this type of expectations. And Slide 26 actually shows our more recent expectations that are modestly higher than they were if we were sitting here last year at this time. One of the biggest drivers is the level of income coming from global stocks continues to grow, and that's reflected in these 15-year projections, and that indeed is the time horizon the council utilizes to be able to set the most efficient portfolio. I know looking for a positive risk premium between stocks versus bonds, and after the fact of getting rewarded for taking on private equity like risk as illustrated at the bottom of Slide 26 where private equity is a sizable risk premium relative to publicly traded securities, either U.S. or non-U.S. stocks. Essentially these numbers represents three major building blocks: growth in the economy, the assumed inflation rate over 15 years, and the level of income. And you add up those three building blocks, roughly 4 percent for growth of the global economy over the next 15 years; 2.3 percent for inflation; and about 2.7 percent related to overall growth in income or income levels that are retained by stocks, you come up to the 9.1 percent. And we all live in that single year return on the far left-hand side and it would be a second-year statistics course to talk about why we live in a geometric world, but the far right numbers is exactly what the council is utilizing when setting efficient portfolio relative to what you hear on CNBC and all the other money/news talk shows that are living in the far left-hand side. The key takeaways: We remain bullish on stocks. Some of the biggest bears in the market today or in the past 7 or 8 years are now some of the biggest bulls. And it's largely driven by valuation and the attractiveness of the current entry point is the equity markets today. And you can see at the next slide over illustrates just our expectations as we have set an asset liability study last April with the council. And the expectations of the total reached funds results and the potential range of outcomes. And we have a high degree of confidence over the next 15 years to be able to achieve a rate of return somewhere between 5 and 9 percent with the current level of risk that's taken into the investment program. And then Slides 28 and 29 just identifies why we feel so confident about that type of methodology employed, by looking at growth in the economy, inflation levels, and income levels. When you take that model that we've been utilizing through all the years and back test the results and look out 15 years, it's pretty darn close to the actual results, with the exception of time periods where there'e sizable evaluation adjustments, like the tech bubble in the last '90s or the leveraging bubble that we just recently are in the process of extinguishing. And then the last thing on Slide 30, if I may Dave, just there's a sub-bullet point second from the bottom on Slide 30 which is the continuing mantra of our firm around the world is revising fiduciaries like the Nebraska Investment Council is continuing to focus in on risk control and cost contained investment strategy while placing your active bets with the most skillful investors that can deliver an active result that's a greater than just investing in an index fund. []

DAVID BOMBERGER: Senators, I think that really concludes the comments. I would wrap up by saying I think we feel very fortunate that we missed a lot of the headlines. We were not heavily invested in some prime mortgages when that began to melt down. We have not invested in hedge funds. We had no exposure to the headlines like Madoff and Stanford that you've read about recently. But we weren't immune to the macro impact that those developments had on our economy and on the financial markets, and while the returns that we experienced last year were unprecedented in my career, I hope to never see them again in the rest of my career. I think we feel really confident that the Nebraska Investment Council's asset allocation and manager line up is in great shape. Even though I'm not involved anymore, I still will pay very close interest because it's something near and dear to me, and I feel very good that I have left the Investment Council in great hands. Joe Jurich is in the audience. Joe is the acting state investment officer. He'll be a great resource to you during this transition process. Kevin Vandolder and Ennis Knupp will also be actively engaged with the council, more so than normal during the transition, but they will continue to be a very important resource to the council and to all of you, and I hope that all of you feel free to contact Joe directly if there is information that you can get. Contact Kevin directly. And frankly, Joe will know where to get me. And any of you, you know if you want to reach out to me, I'm happy to be a resource to answer questions, too, if there's a bit of history or background that I might be helpful with, although frankly, even after two and a half years I was very much the short-timer in the Investment Council. We have very long-tenured staff there and very capable and I'm confident that the council will move forward and be in great shape. Thank you very much. []

SENATOR PANKONIN: Thank you for your report. I've got a couple questions and there may be others. Explain to me again the securities lending. You know, obviously that was an income source but how does that...what specifically happens in that type of a program? []

KEVIN VANDOLDER: Quite simply, you are holding securities in a separately managed account from investment managers, and there are, from time to time, organizations that would like to borrow those securities for a short period of time. []

SENATOR PANKONIN: Now is that to sell short? []

KEVIN VANDOLDER: There is an element of that. Hedge funds would be a very significant consumer of that type of activity, yes. []

SENATOR PANKONIN: Okay. And so that's what you do and you get income for doing it. []

KEVIN VANDOLDER: Yes, by managing the excess cash that is delivered from that transaction. It's a rather complex eight-step process that's documented in a research paper. []

SENATOR PANKONIN: So it's fee income then or do you get some of the advantage of the short sales, as well? []

KEVIN VANDOLDER: No, it would be...it is...you could describe it as other income to the council, and it is based on the management of the excess cash that that transaction delivers on a little bit more rebate rate that you earned or the rate of interest that you earn on that cash collateral to pay to the organization that's given you the up-front cash to support the transaction. So it's a complex process that time does not allow us to (inaudible). They put up, like $1.03 for every dollar of securities, and you've managed that a little bit more...or you provide a rate of interest on that $1.03 less than what you are actually earning. []

SENATOR PANKONIN: But we still own the securities and the safety of that, right? []

KEVIN VANDOLDER: You still hold the securities. Yeah, we watch that extremely carefully. The legal agreements are written in such a way that it protects the council from any administrative snafus that may occur as a result of that transaction. In other words, you want the security back because the manager wants to sell it, and you want to make sure that that's not a botched trade. []

SENATOR PANKONIN: Okay. Mr. Vandolder, also just a question in general. Obviously, based on your past experience and the past experienced of the American economy that has come back from times like these, although this fairly severe, my bigger concern is duration and the fact that the Japanese economy stock market downturn has lasted for almost 20 years. Is that a fair statement? []

KEVIN VANDOLDER: Yeah. It's referred to as the lost decade. So it would be more the last... []

SENATOR PANKONIN: Or decades. Why do you think it's different in the American economy versus the Japanese that we should hopefully see an uptick where they haven't for many years? []

KEVIN VANDOLDER: It's a great question, and quite simply can be answered by what's taken the Japanese six or seven years to assemble, it's only taken us six or seven months. We have a greater degree of brutal capitalism in this country and we reflect those challenges right away into our financial statements. Our markets reflect it immediately, and as a result we fix things fast and we can recover more quickly. []

SENATOR PANKONIN: But brutal isn't fun, is it? []

KEVIN VANDOLDER: It is not. It is ugly on the way down. And we, as Americans, have to lead on this issue and to ensure that capitalism is and the confidence in capitalism is continuing to be maintained globally. []

SENATOR PANKONIN: Senator Nordquist. []

SENATOR NORDQUIST: Thank you, Mr. Bomberger and Mr. Vandolder. First, Dave, thank you for all your service to the state. We're going to miss you. []

DAVID BOMBERGER: It's been an honor. Thank you. []

SENATOR NORDQUIST: The 15-year projection that you do, can you kind of explain again the 15...why 15 years? Is that our just best projection? []

KEVIN VANDOLDER: Yeah, it's not short enough with which you would...there's a significant potential range of outcomes that would just cloud the issues and it's not forever. So it is the mid...it's an art as opposed to a science. It's one that our clients have utilized for many years and have become very comfortable with and allows you the greatest degree of efficiency with which to set an efficient portfolio. Also just think about a reversion to the mean is a very powerful theory that's proven out time and time again through history, and that's a seven-year period, generally speaking, so that's why we're essentially taking two reversion mean cycles, for example. []

SENATOR NORDQUIST: Sure. We have...as you guys know, you know, we smooth our investment returns over a five-year period. I know several states have taken actions to extend that, partly probably to help out their bottom line. But is there something to be said about having a longer period, it gives us a better projection, smoothing those returns out over a longer period? []

KEVIN VANDOLDER: Yeah, that's a difficult question to answer in a short period of time, as well, but you could smooth out those results to make it a bit...to reflect the forever time horizon of this plan. And however I think it's best left with your actuary who is the subject matter expert in this area to be able to conclude what is the best smoothing period of time. And it's certainly going to be one of the mechanisms that regulating authorities will be able to pull in order to assist in making the brutal plunge in the markets a little bit more easier to swallow. []

SENATOR NORDQUIST: Sure, sure. A question for Mr. Bomberger. We spend, you went over it, $29.7 million, nearly $30 million in outside investment managers from outside the state--over 81 percent of our expenditures. Is there something that we can do instate, getting more with less? I mean, is there, looking at the structure of the Investment Council, are there ways we can make better investments with our staff here, and not hurt our returns? []

DAVID BOMBERGER : Well, there are a number of surrounding states...my current employer being one, about 75 percent of the assets that Colorado manages or managed internally, there's an inherent cost advantage by having staff do the work as opposed to an outside firm that has a profit motive. The other side of that equation is the large firms, the large outside firms can invest in infrastructure, they can invest in technology, they can invest in staff and staff development. And it's...the states that have been successful in managing more money internally have been doing it a long time. They addressed the staffing issue. They addressed the appropriation process some time ago when the environment was less difficult. I don't know that there's ever an easy period to have funds appropriated, but South Dakota, for example, has been managing money internally for 25 years, and they developed a compensation scheme 25 years ago that has grown with them. Colorado has been managing for a long time. So I think it's...and I think this is a difficult time, frankly, to try to make the case to in-source, because unless you were able to lift out an investment team from some other organization that has a proven track record, to some extent it's research and development. It's hiring staff and it's putting technology in place over probably 3-5 years to be able to make the case that some portion of what's being managed externally could be done as effectively internally. So I think there's an opportunity if the council and Nebraska state government takes a long-term view of things and be willing to have some money that really could be viewed as R&D, in place, building a team. But I don't think you could flip a switch and say tomorrow we could be managing all this money internally. []

SENATOR NORDQUIST: All right. Thank you. []

SENATOR PANKONIN: Other questions? Seeing none, gentlemen, thank you for attending today and we'll look forward to the finalized report. And I don't know that we got that other piece that you talked about, Mr. Bomberger, so we may need to get that to make copies. I assume the committee is going to go into Exec Session. We'll have a motion for that in a minute and we will then ask to clear the room, please. []

Chairperson

Committee Clerk