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The Committee on Nebraska Retirement Systems met at 12:15 p.m. on Tuesday, November 17, 2009, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a presentation of the Defined Benefits Plans for the Judges, State Patrol, and Schools. Senators present: Dave Pankonin, Chairperson; Jeremy Nordquist, Vice Chairperson; Lavon Heidemann; and Heath Mello. Senators absent: Russ Karpisek; and LeRoy Louden. []

SENATOR PANKONIN: I want to welcome you to the Nebraska Retirement Systems Committee hearing this afternoon. I'm Senator Pankonin. I represent District 2; I live in Louisville, Nebraska. I'll have people introduce themselves. We have a number of senators gone. Some could be joining us in the next few minutes. A couple of them are going to be absent today for different reasons, and so I'll start to my left. []

KATE ALLEN: I'm Kate Allen, legal counsel for the committee. []

SENATOR NORDQUIST: State Senator Jeremy Nordquist, District 7 downtown in south Omaha. []

SENATOR PANKONIN: Our clerk. []

BARB KOEHLMOOS: Barb Koehlmoos, committee clerk. []

SENATOR PANKONIN: And our page. []

SARAH: I'm Sarah McCallister and I'm from here in Lincoln. []

SENATOR PANKONIN: Thank you. Just to also remind you, if you have cell phones on, if you could silence them, it would sure be appreciated. Today we have one agenda item, and as I told our guests, it's a little anti-climatic because this is, I think, his fourth presentation here on his trip to Nebraska from the Buck Consultants office in Denver, if I remember right. But we'll have Dave come forward and go through his report, and then we'll be able to ask questions as time allows. We hope to be done by 1:00, because of the general session starting at 1:30 today. Welcome. []

DAVID SLISHINSKY: Okay. Thank you, Senator. I have a presentation here to go through. It's the results of the actuarial valuations of the Nebraska Retirement Systems... []

SENATOR PANKONIN: Dave, I'm going to have you, first of all,...thank you, Kate...spell your name, full name. []

DAVID SLISHINSKY: Okay. My name is David Slishinsky spelled S-l-i-s-h-i-n-s-k-y. I'm a principal and consulting actuary with Buck Consultants in Denver, Colorado. []

SENATOR PANKONIN: You got that, Barb? []

BARB KOEHLMOOS: Yes, I did. []

SENATOR PANKONIN: Good. Okay, thank you. []

DAVID SLISHINSKY: (Exhibit 1) What I'd like to do is go through those results, identify any changes from last year, give you a little information on the history of the investment returns and then answer any questions that you have. Turning to page two of the handout, there were changes made during the last legislative session in contributions on the judges' plan under LB414. Member contribution rates were increased by 1 percent and they're effective from July 1, 2009, through July 1, 2014. Also, the court fees were increased from $5 to $6 per case over that same period. On the patrol's plan under LB188, contribution rates were increased on member contributions from 13 to 15 percent effective July 1, 2009. And then July 1, 2010, both the member and employer rates go from 15 to 16 percent of pay. In the school system under LB187, the member contribution rate was increased from 7.28 percent to 8.28 percent, here again, for a window period, a five-year period, starting September 1, 2009, and ending September 1, 2014. Now when the member rate is increased, the school districts--the employers are contributing 101 percent of the member rate, so the school district contributions also go up. There is also an increase in the state matching contribution rate from 0.7 percent to 1 percent of pay during a five-year window period of July 1, 2009, through July 1, 2014. Turning to page three, this is a graph that shows the history of investment returns from 1998 through 2009. The blue line shows the returns on the actuarial value of assets. We use a five-year smoothing method which dampens the changes of increases and decreases on the market value as recognized for actuarial purposes, so you'll see that blue line change slightly from year to year. The green line represents the assumption which is at 8 percent per year, and the red line shows the investment return on the market value of assets. You'll see the amount of volatility that is inherent in the market value of assets, and also particularly, the last two years where returns were actually negative; 2008 was a minus 5.8 percent return and 2009 was a minus 19 percent return. So those recent losses are being smoothed into the actuarial value of assets and affecting the actuarial valuation. Turn to page four, this shows a history of the amount of the assets themselves, and when I look at this, this is for the school plan. Other plans are similar. The blue line represents the actuarial value of assets; the red line, the market value of assets. Here again, you can see that over the last couple of years with the negative rates of return, the market value of assets has dropped, and is affecting the actuarial value. The actuarial value now is absorbing some of those losses, and as we...over the next four-year period continue to recognize those losses for actuarial purposes, it'll have an impact on the actuarial requirements over the next four years. Turn to page five. This shows the amount of the deferred gains and losses that we recognized each year from 1996 through 2009. You can see that this year, 2009, there were significant losses of around $1.7 billion in the school system. Now, turning to the actuarial valuation results themselves, I want to start with the school system on page seven. This is an illustration of the way in which we calculate the actuarial value of assets. We're showing the previous year's calculation for comparison purposes. What I'll do is I'll run through the...how this calculation is made. We begin with the actuarial value of assets from last year which was 6 billion 933 million dollars, and then we recognize the cash flow contributions coming in of 241 million. Benefit payments to retirees, beneficiaries, and refunds of contributions coming out of $301 million, and then we add to that the expected return on the market value, and that expected return is at 8 percent of $525 million to arrive at a preliminary actuarial value of close to 7.4 billion. Now, because of the deferred gains and losses we're smoothing that in. We're recognizing 20 percent of each of the last five years gains and losses, and there's a net loss for that period that's recognized which is $390 million in loss. And that brings down the actuarial value to about $7 billion as of July 1, 2009. Now to reconcile back to the market value, that means that there is about $1.7 billion left of deferred losses yet to be recognized over the next four years. And it reconciles to the market value as of June 30 of five billion 266 million, and that represents 75 percent of the actuarial value, so the market value is significantly below the actuarial value even under these calculations. And here again, the annual return on market value was a -19.1 percent, and there was actually a return on the actuarial value due to prior gains, and that amount for the year was 1.9 percent, but missed the assumed rate of 8 percent by 6.1 percent. Turning to page eight, this shows the calculation of the actuarial contribution under the entry age cost method. We do that by, first of all, collecting all of the information, all the data on everyone that is participating in the retirement system including actives, inactive members that have terminated and eligible for future pensions as well as active members. And we take all of those people, and we project forward based on their information what their expected benefits are likely to be, and we take all of those future benefit payments--we discount those back to the valuation date to determine a total present value of future benefits. For the school system, the calculation as of July 1, 2009, was about $9.5 billion for the school system. Present value of future normal costs represents the cost of the accruing benefits for active members between the valuation date and their assumed retirement dates, and that's roughly $1.4 billion. So the difference between those two calculations is the amount of the actuarial accrued liability, and compare that to the actuarial value of assets to determine how well funded the plan is as of the valuation date. There is an unfunded liability since the actuarial accrued liability exceeds the actuarial value of assets. By subtracting the actuarial value of assets from the accrued liability, we calculate an unfunded actuarial accrued liability of 1 billion 84 million. And the ratio of the assets to the liabilities as of the valuation date is 87 percent. That compares to 91 percent last year. So there's a decline in the funded ratio, an increase in the unfunded liability. When we determine the actuarial contribution for the year, we then take the cost of accruing benefits which is called the normal cost. We calculate that to be $174 million for the active members, and then we amortize the $1 billion of unfunded liability; that amortization payment is $95 million for a total of $269 million for the year or 17.2 percent of payroll. We then compare that to the amount of the expected contributions defined under statutes, rate of pay contributions coming from the members, from school districts, and even the state matching contribution of $270 million, an appropriation of $6 million, so that the total expected contribution for the year is $276 million which represents 17.66 percent of pay. Since the expected contribution coming in exceeds the actuarial requirement for the year, there's no additional contribution required for the next year. []

SENATOR PANKONIN: I'm going to stop you just a second. Senator Heidemann, we're on page--it's in that notebook, we're on page eight of the School Retirement System. The numbers are at the bottom of the page, so thanks for joining us. []

DAVID SLISHINSKY: Item number ten is the Omaha Service Annuity calculation, and we calculate that separately. It is, again, the sum of the normal cost plus an amortization of unfunded liabilities for monies that are set aside to fund Omaha service annuities, and this year the amount is roughly $900,000 for the Omaha Service Annuity. Now, if you turn to the next page, what we've done in addition to this valuation is we've done a projection of what the contributions might be under a set of assumptions that we call the modest recovery assumptions. If we assume that the rates of return of the fund for FY2010 are 11.5 percent, for FY2011 are 13.5 percent, for FY2012 are 10 percent, and for every fiscal year thereafter is 8 percent, then we can calculate the impact of the amount of the deferred losses that are recognized over the next four years and any additional gains that may occur under a modest recovery assumption. []

SENATOR PANKONIN: I'm going to stop you there for just a second. []

DAVID SLISHINSKY: Okay. []

SENATOR PANKONIN: You've got one quarter in the books from June 30 to September 30. You were assuming a return on the plans of 11.5 percent. Is it safe to say with our start, obviously we did that, made that in the quarter, didn't we? []

DAVID SLISHINSKY: Yes, that's a very good question, Senator. We met with the investment council yesterday and their investment consultants gave us the news that the fund in the first quarter earned 13.3 percent, so already one quarter into the year the fund has done better than what we were assuming for the entire year. If you take that one step further and say, okay, now that we've got 13.3 percent in the books, what if over the next nine months we just meet our assumption. If that happens, then for this year the return would be 20 percent. And with the 20 percent return for FY2010 the numbers look lower, okay? For instance, in 2014 we're showing $125 million annual additional state contribution. That would drop to 87.6 million with better returns, depending upon the length and the strength of the recovery and the impact on the retirement system's assets and asset performance. That will have an impact on what actually occurs during this period. []

SENATOR PANKONIN: Thank you. []

DAVID SLISHINSKY: Okay. Turn to page ten, the State Patrol System we use the same methodology, so we start from the calculation, the present value of future benefits of about $370 million on the State Patrol System. It's a smaller system; less members are participating in it. There's a normal cost for the active members of about $65 million, so the actuarial accrued liability for the patrol system is about 305 million. The actuarial value of assets are calculated in the same way, and that is $274 million, so there's an unfunded liability of $31.2 million up from $18.6 million last year. Here again, the reason is the losses from last year and the year before are now being recognized, and it's slowing the growth of the returns of the actuarial value of assets and increasing the unfunded liability. The normal cost is determined for active members, and it's equal to $7.2 million. When we amortize the unfunded liability of 2.7 million, add it to the normal cost, the contribution then for the year on an actuarial basis is 9.9 million or 38.16 percent. The expected contribution for the year comes from the 15 percent member contribution and the 15 percent employer contribution or $7.8 million. Some appropriation of about 300,000 is added in for a total of $8.1 million or 31.21 percent of pay. Since that is less than the actuarial requirement, an additional required contribution of the state is $1.8 million or roughly 6.95 percent of pay. Turning to page 11 and looking at the projections, one thing I want to point out is that for 2010 that number for the additional state contribution, what we have done in this calculation is come and calculate these projections based on some estimates before the final valuations were complete. By completing the final valuation, that number is the $1.8 million number. []

SENATOR PANKONIN: So the 1.8 is correct versus the 1.7? []

DAVID SLISHINSKY: Correct. Instead of $1,696,000 for 2010 that should be $1,802,000. []

SENATOR PANKONIN: Okay. []

DAVID SLISHINSKY: Okay, and that's based on the final valuation that was just completed, and it was completed after these projections were made. We did incorporate the actual returns on the assets in these projections, so here again, over the next four years, as the losses from the investments are recognized in each of these years, there are additional annual contribution amounts that would be required under this set of assumptions. Here again, depends on what the rates of return are going to be over this four-year period. If we do the same exercise and say, well, we think it's going to be 20 percent for FY2010 instead of 11.5 then by 2014 the annual contribution increases to $5.8 million as opposed to 7.2 million. []

SENATOR PANKONIN: Sure. []

SENATOR NORDQUIST: I notice the employer contribution level stays pretty flat. Is that due to the work force not growing? I mean, where we have seen a decline in our State Patrol officers? []

DAVID SLISHINSKY: Well, yeah, this year there was a decline in the total number of State Patrol officers covered by the plan. In addition, this plan has a drop program so what happens is is the officers that are eligible drop into the drop program, and once they do they continue to work. But the plan treats them as a retiree, so the employer does not pay the 15 percent of pay on their salary and neither does the member, so those contributions cease. So what we're doing is we're showing the amount of the employer contribution on a payroll that doesn't grow as fast. []

SENATOR NORDQUIST: Sure, okay. []

SENATOR PANKONIN: But with the drop program then, people are working longer, less years in retirement. Is that...? []

DAVID SLISHINSKY: Well, I mean there... []

SENATOR PANKONIN: ...is that a fair...is that...? []

DAVID SLISHINSKY: ...they have five years to work before they have to retire. But during that drop period, there is no COLA adjustments on the benefit. The amount of their pension in essence gets paid into a drop account within the plan. It's not distributed to them, so that when they finally do retire they get their retirement benefit as well as any accumulations in their drop account. []

SENATOR PANKONIN: Okay. []

DAVID SLISHINSKY: Okay, turning to page 12 on the Judges' Retirement System, here again, the same process, calculation here that we've got fewer participants, members in the judges' system. The total present value of benefits under the judges' system is about 145 million with $26 million in future normal cost payments. So then we have an accrued liability of a little less than 119 million with an actuarial value of assets of about 121 million, so here we have actuarial value of assets that exceed the actuarial accrued liability. So there is a reserve of 2.4 million in the judges' system. That compares to a reserve of 5.7 million last year, so here again, the same impact of the investment losses are being recognized, and in the judges' system it's reducing that reserve. If this continues, then in the future years, over the next four years we would see unfunded liabilities in the judges' system. Funded ratio is down then from 105 percent to 102 percent and calculating the actuarial contribution, we take the calculation of the normal cost of the benefits for all active judges of 3.8 million. We do an amortization of that reserve which is a credit of $208,000 that reduces the actuarial requirement from the normal cost down to roughly $3.6 million or 19.74 percent of pay. And then looking at the expected contributions, member contributions coming in are a little less than 1.4 million. The amount of the court fees expected to come in is a little over $4 million with a $72,000 appropriation. So the total contributions coming in are expected to be 5.5 million or 30.03 percent of pay. Since that exceeds the amount of the actuarial requirement, there's no additional state contributions required. Okay? Turn to the next page, page 13, here again is a five-year projection of the contribution requirements. We're not projecting any additional state contributions necessary until 2013 when under this set of assumptions a contribution of 577,000 on the part of the state would be required and a little over a million dollars in 2014. Here again, using the same 20 percent instead of the 11.5 percent by 2014, instead of a million dollars, that would be 317,000. So the extent of the rebound, the extent of investment returns are going to have a significant impact in the next five years of what the additional state contributions would be for all three plans. []

SENATOR PANKONIN: At this point, I'm going to ask one of the questions that I could have saved to the end. When we're trying to make policy decisions on these, and we have that June 30th cutoff date, when it seems like that's kind of where we're getting out of our regular sessions or, you know, closer to the end date, is that date set in statute or has that been a long-standing policy or, and if we're going into session the second week of January, would a cutoff...is there a more appropriate cutoff for folks like ourselves that are trying to look at policy that would be closer? Just like we talked about this last quarter a huge change or relatively. []

DAVID SLISHINSKY: Yeah. Typically, the actuarial valuations are done on a fiscal year basis, and they're done June 30th, because that's the state's fiscal year. []

SENATOR PANKONIN: Okay. That's the state's fiscal year. []

DAVID SLISHINSKY: We've done some discussions with regards to providing information updates to not only the retirement system but also to the Legislature especially considering these projected state contributions. And what I think makes sense is to look at this on a quarterly basis as we get information from the investment council on what the actual returns are and then update these projections based upon those actual returns much like I just did for you in getting a more accurate projection of FY2010 rates of pay, and we can do that on a quarterly basis and give you updates quarterly, so that you have, you know, more recent information to make policy. []

SENATOR PANKONIN: That might be something we need to look at. I know there's obviously costs involved, and it's not maybe a full fledged, but if...just like the numbers you've had, if we need to think about that. []

DAVID SLISHINSKY: Right. []

SENATOR PANKONIN: If the numbers on December 31...when would they be...how soon can an update be provided for our use? I mean, obviously, that depends on the investment office as well? []

DAVID SLISHINSKY: Yeah. Exact... []

SENATOR PANKONIN: But is there about a month lag? []

DAVID SLISHINSKY: About a month lag, I'd say and...Jeff. []

SENATOR PANKONIN: Okay. []

JEFF STATES: We expect senators to have performance for 2009 by early February (inaudible). []

SENATOR PANKONIN: Okay, but obviously, the third quarter would then be available like it is currently in mid-November so that would be closer too. Okay. []

DAVID SLISHINSKY: Yes. []

SENATOR PANKONIN: Go ahead. []

DAVID SLISHINSKY: Okay, and then page 14, we also wanted to show you the results from earlier in the year on the state and county cash balance plans. We do those calculations as of January 1st. Both systems have had some investment losses that have declined and decreased their funded ratios, increased their unfunded liabilities or diminished their reserves. But both plans still as of the valuation date in this year did not have any additional state contribution requirements. Here again, you know, these plans need to be watched as well as returns because they're suffering the same kinds of negative returns as the other traditional defined benefit plans are. So that concludes my presentation, and I'll address any questions that you have. []

SENATOR PANKONIN: I'll start with one other, and then there may be...my colleagues may have some others. How many other states do you work with...your consulting firm work with? []

DAVID SLISHINSKY: Yeah, well, our consulting firm works with 14 states. []

SENATOR PANKONIN: And as you look at some of our peer states and other states around the country, how would you look at our situation versus other states overall? []

DAVID SLISHINSKY: Your funded ratios are probably a little bit above average. You know, other states are dealing with the same kinds of issues. They're dealing with increases in contributions and sometimes in cases where the states can make adjustments, they're even looking at adjustments in benefits. []

SENATOR PANKONIN: But overall, is it a fair statement to say because we were in better shape going in, we have weathered it better than a lot of other states? []

DAVID SLISHINSKY: Yes, yes. The statement that... []

SENATOR PANKONIN: that's still a true...in your...from your perspective. []

DAVID SLISHINSKY: ...yeah, from my perspective, this year, the fact that you're still meeting the actuarial requirement, that's difficult for other states to do, and you're able to do it. So you're better funded than the average state, and you're in a better situation than the average state, but the same things that are affecting those other states are affecting you as well, and that is when the markets take a severe drop the way that they did, it impacts everyone. It impacts all of the...not only pension funds but people that are in defined contribution plans and 401K plans and anybody that has any money invested, you know, in normal equity-like investments in this country. I mean, people have lost value in their investments. []

SENATOR PANKONIN: From your long time of working with our plans and some of the moves that we made last year, and we know and Senator Heidemann and I have talked, and I think the Appropriations people here realize the State Patrol plan is going to need the first attention, and that probably will be addressed most likely when we get back into session. But as far as the school plan being the large one, in your opinion, do you think we need to look at things this next session or do we need to wait and see what these investment...this rebound does, or what would be your opinion on that? []

DAVID SLISHINSKY: Well, yeah. My opinion would be that, you know, a rebound is going to help, but I think that the system in the next four years is still going to need an infusion of state money, so if you can, it would be better to fund...to get a start on it, to fund it because if you fund it sooner, you'll do a better job at reducing the future requirements. The sooner you get money into the pension system, you get money working in the pension system, the better it is because that money is then invested, and it can reduce future state obligations. []

SENATOR PANKONIN: So situations like the one percent increase we already had in the Education, if that went up another one and one match and things like that would make a difference, and the sooner the better over the next couple of years? []

DAVID SLISHINSKY: Yes. []

SENATOR PANKONIN: Okay. Other questions? []

SENATOR NORDQUIST: With your work in other states, and what's the range of smoothing periods? Is five pretty much average and your thoughts on that, does that give us a good...? []

DAVID SLISHINSKY: Yeah. Five is the most common and with this methodology, we typically see three to five years. I know Colorado uses a four-year period. Other states have been extending that smoothing period. We've seen seven; we've seen ten. When you do that, what it does is it slows the recognition of the losses, and there is a widening of value between the actuarial and market value. And then some people looking at it will start questioning the validity of the actuarial value of assets that you're using for funding purposes. []

SENATOR NORDQUIST: So five gives us a pretty reasonable snapshot long term. []

DAVID SLISHINSKY: Yeah. And it...you can defend it because most states use the five years. []

SENATOR NORDQUIST: Okay, okay. []

SENATOR PANKONIN: I don't see any other questions. You must have done a really good job. []

DAVID SLISHINSKY: Okay, great. []

SENATOR PANKONIN: All right. Well, I think that's our...that is our only item of business today, so we thank you for coming. And that will conclude our hearing. Thank you. []