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Nebraska Retirement Systems Committee
March 24, 2014

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The Committee on Nebraska Retirement Systems met at 9:00 a.m. on Monday, March 24, 2014, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on presentation of the annual reports of the Public Employees Retirement System and the Nebraska Investment Council. Senators present: Jeremy Nordquist, Chairperson; Al Davis, Vice Chairperson; Danielle Conrad; Russ Karpisek; Rick Kolowski; and Heath Mello. Senators absent: None.

SENATOR NORDQUIST: Good morning, everyone. I'm State Senator Jeremy Nordquist from District 7, the Chair of the Retirement Systems Committee. Joining us today is Senator Rick Kolowski from Millard; Senator Al Davis from Hyannis; Senator Heath Mello from south Omaha; I believe Senator Karpisek will be joining us. We have Laurie Vollertsen, our committee clerk; Kate Allen, our legal counsel. Silence your cell phones. If you are testifying, I think...do we have testifier sheets today? Okay. No testifier sheets, just spell your name for the record. And today we will only be taking testimony from the presenters from the Public Employees Retirement Systems, Ms. Chambers, and Jeffrey States from the Investment Council. So with that, Ms. Chambers, please. Go right ahead.

PHYLLIS CHAMBERS: (Exhibits 1 and 2) Well, good morning. Good morning, Chairman Nordquist and Retirement Committee members. For the record, my name is Phyllis Chambers, C-h-a-m-b-e-r-s, and I'm director of the Nebraska Public Employees Retirement Systems. It is a pleasure for me to present the 2014 annual report to you today. I appreciate this opportunity to communicate to the committee NPERS' achievements over the past year. And hopefully you all have a copy of our report. I think our graphic artist did a good job of choosing a theme of hot air balloons this year. The report is formatted much the same as in previous years. And so if you want to turn with me on page 4, I will start with our accomplishments. One of our major accomplishments this year was relocating to the 1526 K Building last September. We moved the entire agency with 53 staff over a two-week period. We continued to answer phones, meet with walk-in visitors, process retirements, and pay benefits during the move. We kept both offices open with people staffed at little tables at the front doors, and we took...we accepted documents and answered questions for members if they came in. Everything went very smoothly thanks to our wonderful staff and all the planning and hard work that went into the move, the extra overtime and they really had a good, positive attitude about it. Moving on to our other accomplishments for the year, I think our total number of members grew to a record 119,420 members in all six plans, and our assets also grew to a record \$11.1 billion. Even with the additional burden of the move, especially during our busy school retirement season, NPERS' activity for the year increased in a number of areas. The call center answered over 38,000 phone calls, about 800 more than they normally would answer in a year, and that's just what they answer normally in one month. We met with over 2,400 members, even though we did not schedule any

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appointments for a six-week period before and after the move. We processed 1,926 annuity retirements; 1,644 of those were school retirements; the remainder were state and county annuities, and those are on the increase. The school retirements increased 170 over the previous year. We also processed 4,700 refunds, rollovers, and distributions, 150 more than the previous year. All total, we distributed \$606 million in benefits to members in all six plans. Some of our other accomplishments during the year were we received the IRS favorable determination letters for the school, judges, state, and county plans. We did not receive an updated favorable determination letter for the State Patrol. We believe that's due to the DROP plan. A number of plans around the country also experienced that same thing. We have reapplied for the next five-year cycle, so we're hopeful that we will get a favorable determination letter in this five-year cycle. Our annual plan audits with the State Auditors continue to improve and we're very happy to report to you that we only had two audit points with the state and county plans and only one audit point with the schools plans. And usually we have eight to ten audit points. So we're just thrilled that we're doing good work and that the auditors think we're doing good work. And so I think you can appreciate that we like having a good report like that. We also issued an RFP for the new actuaries. As you know, Cavanaugh Macdonald was selected and began work on July 1. We worked with them on the fall valuations, and everything is going smoothly with the new actuaries. We completed the CEM benchmarking study of NPERS' costs and services compared with other public retirement systems in our size and peer group. NPERS' total administrative costs were \$62 per annuitant. That was \$53 below the average peer cost of \$121 per annuitant. The PERB held regular monthly meetings and we transitioned from paper documents to using iPads for our meetings. This has saved a lot of time as well as monthly mail and copying expenses. It's really great to have the iPad there with all of our documents on it. We've got our...we've got the statutes and we've got our annual reports. We've got audit reports, last month's minutes and records. So all of that is at our fingertips and all you have to do is carry around a little iPad and you don't have to carry around huge notebooks. I highly would recommend it for the Retirement Committee. I think it's been a big improvement for the PERB. And if you would turn to page 6, I'll talk a little bit about our action plan for the coming year. We are working on a 30-year projection model with the actuaries and hope to have some...part of that up and ready to go in the next month or so. The PERB plans to review the actuarial assumed rates this year. I don't know that they'll make any changes, but that is something that they're looking at. We will be implementing the new GASB changes this year. GASB 67 standard for financial reporting of public retirement plans is to be implemented in 2014. So we will implement that part of it, and then GASB 68 will be implemented in 2015. We are working on developing and testing a new tier in the school plan that the Legislature approved last year. We are programming that into our system and developing our...the IT programming for changing from three to five years average salary calculations and changing the COLA to 1 percent. We're also transitioning our IT system backups to the OCIO office at the end of the month, and we are looking at alternatives for our imaging system. IBM system that we currently use is...the version we use is going to be

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eliminated, and we are looking at maybe using OnBase, which is what some of the other state agencies are using. We want to continue working on our lease improvements at the new space at 1526 K. I think things are working out well other than the parking. The parking is still a major concern. And I've passed out a handout to you with a list of 65 written complaints that members have taken the time to put down on our comment cards. I think the comments speak for themselves. Most of them deal with inadequate parking. There are a number of handicapped members who have complained. There are people that during bad weather when the city puts a parking ban on K Street, L Street, and 16th Street, there is no place to park. People got ticketed. They also have to have a boatload of quarters if they're going to come to our office because the only parking available is on the street. Right now, the city is putting in some new parking along 16th Street and two spaces on K Street. I understand one of those will be handicapped, but it really isn't adequate for our members to be able to come. So I just want to pass that on to you that it is something we've talked about ever since we knew we would be moving to 1526 K, and so I want to share with you that it's still a problem for us and probably needs to be addressed. If you look on page 7 to 9, you'll see that we have passed seven years of retirement legislation for you to reference. And on pages 10 through 13, we have the funding status of the plans. The judges and Patrol plans went down slightly last year. The judges is 87 percent funded...87.7 percent funded; the Patrol is 76 percent funded. The schools, state cash balance, and county cash balance went up slightly. The school is 77 percent funded; the state cash balance is 93.6 percent funded; and the county cash balance is 94.5 percent funded. Turning to pages 14 and 15, these are the summary pages for our retirement plan assets and membership and activity that you're familiar with. So it kind of gives you a picture of each of the plans and what their assets are and their membership actives, inactive, and retired numbers. And also this year, we put in a row for the DROP plan so that you would be able to distinguish that from the regular Patrol members. There are 51 members or there were as of June last year in the DROP plan. On page 16, you'll find our operating expenses. And I'm pleased to report that we operated our agency using...with \$5.2 million, only \$50,000 over the previous year. We think that's remarkable and I wanted to say that our...one of our board members is a CPA, and Ron Ecklund mentioned at Friday's board meeting he can't believe that we operate our agency on so little compared to all the other retirement systems around the country. Also, you'll find our education services information about our seminars. And I would like to call your attention to page 19 where we have the additional services listed and our service delivery results. Because of the move and because we had so many more retirements and refunds this year, I've added a row for processing retirements within 91 to 100 days. And if you take a look at that, there were 10 percent processed during that time period, and basically 97 percent of our retirements are being processed within 100 days. So I think that's really good. Also, we have...our retirements seem to be getting more complex. There's no such thing as just a regular retirement when people come in that you can push a button and their retirement is calculated and estimated and all of that. So we hope that you're pleased with those...with those time frames. And then

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if...the appendices have the usual reports. We have the investment returns for the defined contribution, deferred comp, and DROP plan for the investment funds that are in those plans. We also have the monthly defined benefit pension, monthly pension benefits that are paid, broken down by county and by state to show where those benefits are being paid. And then you also find summaries of the plans, and you'll find the board policies on there. I hope you're pleased with the administration of our agency, and I hope you'll find that this report is a valuable reference for you throughout the year. I hope if you have any questions you'll feel free to give me a call if at any time during the year you have a question. And now that we're just across the street, I would like to invite each of you to come over and visit our office and attend one of our PERB meetings. Senator Davis has been over and attended our meetings. The PERB and I would like to thank the Retirement Committee and your legal counsel for your commitment and support of NPERS and our members throughout the year. We know that you serve on other committees and have other responsibility as legislators and we appreciate the time that you devote to retirement matters. Now with that, I would be happy to answer any questions.

SENATOR NORDQUIST: Thank you. Well, thank you for testifying and thanks for all your work and all your staff's work. We certainly appreciate the efficiency that you're running this agency with. So thank you. Questions? Senator Conrad.

SENATOR CONRAD: Hi! Thank you so much. This is a wonderful report. It's very informative and very comprehensive. It's helpful I think not only to this committee but our colleagues and the public at large. Phyllis, I wanted to go back just to the feedback that you'd received from citizens in regards to the access in relation to parking. Can you walk me through whether or not those issues were contemplated during the move and then what ultimately made you decide to move in that regard if we knew that this was going to be an issue?

PHYLLIS CHAMBERS: I think, well, briefly just to say that we were informed that we were moving...

SENATOR CONRAD: Okay.

PHYLLIS CHAMBERS: ...and we really didn't have a choice of whether to move or not. So we were told we would be moving. We...

SENATOR CONRAD: By DAS?

PHYLLIS CHAMBERS: Yes.

SENATOR CONRAD: Yeah. Okay.

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PHYLLIS CHAMBERS: And we did send communications that we were concerned about parking and access, and we were told we would have some visitor parking. Three months before we moved, we were told there would be no visitor parking. And that has remained.

SENATOR CONRAD: And in your former space just remind me, was there some reserved parking available for citizens or how did that work in the old situation?

PHYLLIS CHAMBERS: We did not have reserved parking but we did have metered parking right at the front door.

SENATOR CONRAD: Okay.

PHYLLIS CHAMBERS: And we had several handicapped parking spaces where they could literally park at the front door. It was just 10 or 15 steps into the building, and then another 20 steps to the elevator and you were up on third floor to our office. Now you have to park on the street. The only handicapped parking right now are on the north side of L Street and on the south side of K Street, so the people have to go down the block, across the stoplight. And then right now since the front door, they're making that handicapped accessible, but it hasn't been for the last six months. So people have to go around the building to the back and down a sloped parking lot and then come in the basement, the basement level. So it's very cumbersome for people, especially in wheelchairs. There's one man that was talking about how difficult it was to get his scooter to come in. And we have people on walkers. So and just by and large just sometimes there's parking on the street with the meters, sometimes there are not, there is not parking. And people drive around and around and then they get frustrated and then they come in and they're really angry with us.

SENATOR CONRAD: Sure. Do you...have you taken any steps in your communications with citizens as they prepare for an appointment to maybe alert them to those challenges or to help them think about that before they arrive?

PHYLLIS CHAMBERS: Well, we certainly are...

SENATOR CONRAD: Okay.

PHYLLIS CHAMBERS: ...you know, now that, you know, all of these different things come up. We can't control the weather.

SENATOR CONRAD: No.

PHYLLIS CHAMBERS: We can't control the parking bans. And so...and we can't control whether, you know, whether...if legislation and session is going on, parking is a

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premium. The circus was in town last week. I mean, it's just depending on what's going on,...

SENATOR CONRAD: Right.

PHYLLIS CHAMBERS: ...and the students need parking. And so there...sometimes there is parking and sometimes there isn't.

SENATOR CONRAD: Okay. And then I know that you also travel or go on the road, so to speak, and make presentations from time to time. Have you considered maybe utilizing some off-site space for some of these meetings or maybe to convene larger gatherings where they may have more parking available, more access available?

PHYLLIS CHAMBERS: We do have our retirement seminars.

SENATOR CONRAD: Yes, that's what I mean.

PHYLLIS CHAMBERS: But we don't do those...when we're meeting with a group of people like 60 or so people, we don't meet individually with them.

SENATOR CONRAD: Okay.

PHYLLIS CHAMBERS: And what we're...primarily what you're talking about are people that are working with their individual retirement plan. They make an appointment with us sometimes a month or two in advance. And because we only have five people that answer all the phones and take care of all the visitors when they come in. So...and if anybody is gone or sick, we're down to four, sometimes three. We don't have staff out in the community. We don't have a branch or anywhere else. Like in Denver you've got a big system. They actually have a branch out in the suburbs where they can...people can either come downtown or go to the branch. New York, I think of several where, you know, they can...they have branches so they can do that kind of thing. We don't. We're small enough that we just have our one office.

SENATOR CONRAD: Okay. I just didn't know logistically with technology or otherwise if it was possible for people to make appointments in conjunction with the seminars off site or something like that maybe.

PHYLLIS CHAMBERS: When we don't meet with people, some people waive their right to a counseling session. It seems like those are the ones we have...

SENATOR CONRAD: Yeah.

PHYLLIS CHAMBERS: ...issues with that, oh, I didn't realize I picked the wrong option.

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Would you please redo my retirement for me? And after we've already purchased an annuity and set it all up. So, you know, we really encourage people to take the opportunity to come in and talk with us so that they understand. It's a one-time shot for them.

SENATOR CONRAD: Right.

PHYLLIS CHAMBERS: They're retiring and they don't get a do over for most of these things.

SENATOR CONRAD: And roughly how many citizens take advantage of that option? Just to ballpark it. Ninety percent? Ninety-five percent? Fifty percent? I don't...I'm just curious.

PHYLLIS CHAMBERS: I want to say we have about 200 a month...

SENATOR CONRAD: Okay.

PHYLLIS CHAMBERS: ...coming in. Some of those are...and some of them if they don't get an appointment they just walk in...

SENATOR CONRAD: Right.

PHYLLIS CHAMBERS: ...because they can't get an appointment. So we...but on average we have about 200 a month coming in. Some people are going to be dropping off paperwork for a refund or some other type of paperwork, a beneficiary form, and it's really frustrating to walk two blocks to drop off a beneficiary form. A lot of people do mail their paperwork in.

SENATOR CONRAD: Okay. Thanks.

SENATOR NORDQUIST: Any other questions? Senator Davis.

SENATOR DAVIS: Just to follow up on that a little bit, Phyllis, is there no parking in the building at all? It's just an office building with no parking behind it or anything.

PHYLLIS CHAMBERS: The parking on the north side is designated for staff, for the state...parking for state employees. And not everybody in that lot works in our building. So it could be somebody working at the Legislature. It could be somebody working at the State Office Building. And it's a seniority system for if your name is in the list, then you would get to park there.

SENATOR DAVIS: How many other entities that are in that building are sort of

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consumer driven, which I would say you are?

PHYLLIS CHAMBERS: We're probably the biggest. And then personnel has people that do come in and drop off their applications sometimes or they come in and use the computers because most everything with the personnel I believe is you are able to do that on-line, apply for jobs on-line.

SENATOR DAVIS: So if the lot is for state employees, is there a gate then to get into it?

PHYLLIS CHAMBERS: They're putting in a gate this week. There has not been. Primarily we've had a lot of workers the last six months, so we have a lot of trucks and workers coming in working on the building still. And so it's either staff or it's workers in the lot right now. And occasionally I will say some of the members will park in there. They get frustrated and the sign says...you know, the signs say they aren't allowed to park in there but they do sometimes anyway.

SENATOR DAVIS: Have you got any idea about what can be done about the parking problem?

PHYLLIS CHAMBERS: I would suggest that we designate some of those spaces for visitors. And even if they put a gate on it, we can have them call...you know, you can push the button, you can tell security that you're there for a retirement appointment and be able to come in and park, come upstairs, and go to parking.

SENATOR DAVIS: Yeah, that seems like a really logical solution to me. How many spots do you think you would have to have?

PHYLLIS CHAMBERS: I think three maybe, three or four. I mean...

SENATOR DAVIS: Three to five maybe?

PHYLLIS CHAMBERS: Yeah, I mean, not...just some. And then we...personnel could use them too. Although I don't know that they would need them. But I think it would be appropriate to designate a few of those spots. Once the workers get out of there, there will be a few extra spaces that haven't been...I don't know if...I shouldn't speak for Building Division because I don't know if all of the spaces are taken at the present time. I know there are four or five handicapped spaces in there, and they are being used by staff that have handicapped parking access.

SENATOR DAVIS: Looks like we need to find a solution for it to me. Thank you.

PHYLLIS CHAMBERS: Okay. All right.

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SENATOR NORDQUIST: Senator Kolowski.

SENATOR KOLOWSKI: Thank you, Mr. Chairman. Phyllis, thank you for an excellent report. It was very well done and it's very nicely laid out. The same as Senator Davis, the parking is really a negative feel to people when they want to come to your building, and I can't imagine the number of frustrations that lends itself to. Senator Conrad asked about technology solutions. On your Web site, do you have any like special instructions if you try to come to our building, parking, have someone drop you off or, you know, so you're not walking five, six blocks or all the things that go with that? Is there anything in there at the current time?

PHYLLIS CHAMBERS: Well, we do have a map that we have on there showing parking of, you know, where the street parking is.

SENATOR KOLOWSKI: But any explanation, big letters, you know, parking is a problem. Please try to follow some of these clues?

PHYLLIS CHAMBERS: We are trying to communicate that to our members.

SENATOR KOLOWSKI: Thank you. I think it's...

PHYLLIS CHAMBERS: We can certainly do more of it. I mean, we certainly try.

SENATOR KOLOWSKI: Just a heads up if they don't know compared to where you were downtown before compared this location doesn't sound very user friendly, and that's really a put off to people. Thank you.

SENATOR NORDQUIST: Thank you, Senator Kolowski. Any other questions? Note that I believe Senator Mello and I sent a letter, was it last year, do you remember, last year to DAS before the move suggesting that this problem be remedied, and I believe the response was no. (Laughter) So we will certainly...it appears to be a ongoing problem that we will need as a committee to express our frustration with the current situation and try to remedy it.

PHYLLIS CHAMBERS: Thank you.

SENATOR NORDQUIST: Thank you. All right. Director States. Welcome.

JEFF STATES: (Exhibit 3) Good morning. Chairman Nordquist and members of the Nebraska Retirement Systems Committee, thank you for the opportunity to appear before you today and to present the annual report for the Nebraska Investment Council. My name is Jeffrey States, it's J-e-f-f-r-e-y S-t-a-t-e-s, and I serve as the Nebraska State Investment Officer. I would like to express the appreciation of the council and my staff

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for the support we've received from the committee and I think the extremely good working relationship we have both with your staff as well as the Legislative Fiscal Office. It's very helpful to have open communication. You do have a copy of the report, and so we'll start on page 5. Just to highlight I think how fortunate the state of Nebraska is to have the citizens who are appointed here because of their long-term service and involvement in the...professionally in the investment community in Nebraska. Also, I think it's fortunate that we've had good continuity with that and the council is fortunate again this year to have the Governor reappointment Gail Werner-Robertson to a new five-year term and to continue to serve as council chair. I will not read it to you, but the council's mission statement is on page 6. Along with that is just a highlight of the history of the council, beginning in 1969 when it first became an effort with the state to centralize the investment of state funds. And that effort has continued, as you can see, over a period of time to kind of consolidate all assets that are financial that belong to the state under its administrative supervision. Pages 7 through 10 are a summary of the highlights and some brief comments about the capital markets which I'll let you read if you choose. Turning to page 8 and 9, I would start with some of the highlights of the accomplishments of the council over the last year. I'd begin with the one that's not actually in the list because I think probably the most relevant and most important thing to you is the performance of the system. And although the numbers are there in the various reports, I did not summarize them here and I realize that was probably a shortcoming. For the 12-month period ending for calendar year 2013, the fund returned 18.3 percent from the defined benefit and cash balance plans. As important to me is that the three-year return on an annualized basis is 10.3 in the five-year return, noting that this is pretty much from the bottom of where the market ended in March of 2009 of 13.2 percent. I would also point out as we look at that that those performance numbers, those returns rank the Nebraska Investment Council's performance for these funds in the top quartile over those periods. Going from...for the last year in the 11th percentile to the 5th year in the 22nd. Even for the ten-year period, the return on an annualized basis is 7.1, which continues to highlight the council's one concern about the ongoing ability to produce a higher assumed rate. And the rank for that in the peer group comparisons was in the 34th percentile. So the state of Nebraska has received good and quality performance from the leadership of the council in managing the assets. I would turn you next to pages 11 and 12, the executive summary. I guess I kind of skipped over the other accomplishments and I shouldn't maybe. A couple of the things I would mention that were significant last year because what produces that performance is the fact that the council regularly scrutinizes the investment policy and routine, and a major portion of that is the cyclical study of the asset allocation. We did complete a full-blown asset liability study last year looking at the breakdown and composition, expected return, and adopted a new strategic asset allocation but with minor changes because the council feels that accomplishing a good steady return from the major asset classes is where our returns are coming from. We will be over the next year, a couple of years increasing our allocation to real estate a little bit and will continue to build out our private equity allocation, but we did not choose to change it because it was not fully

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funded today. A couple other things was focusing a lot in 2013 from a portfolio standpoint on how we prepare for an economic environment that's kind of uncertain. But a high expectation of interest rates will rise over the next few years. The Federal Reserve is clearly communicating that as they pull back their tapering, they're prepared to respond as the economy continues to improve if it's necessary. Because of that, we spent time diversifying, particularly our fixed income portion of the portfolio so that it would not be as impacted by rising rates. To do that, we've taken a portion of our 30 percent allocation and put it in some slightly nontraditional investments or we've added a bank loan exposure which we'll begin funding this year. The attraction of the bank loans, which will be about 15 percent of the asset allocation for fixed income, is that they reset on a quarterly basis so the rate will float. And so as rates rise, we will not have any real principal fluctuation as long as the loan portfolio itself does not have defaults. We also have incorporated a couple of more opportunistic strategies that we think because of the active management of those will keep us positioned to have that portion of the portfolio give us the kind of defensive protection we need for downside movements if there's another black swan or credit event of some type, but also as important will help offset the downward movement as interest rates rise. We, as I said, made a first-time commitment to a real estate debt fund as part of that process also. As Director Chambers noted, we also relocated to the 1526 Building. We were the first tenant on the first floor. It was very interesting to be the...I shouldn't say the guinea pig, but we were the...but we were a small group and so the move went fairly uneventful in the few things I think that occurred in the coordination of our move made the move for many others run much more smoothly just to make sure that the rest of the building was in a position to take on new staff. We continue to be audited on a regular basis as you would expect with the State Auditor's Office because of the close relationship with the retirement systems six-month almost systematic ongoing process as we rotate through the retirement funds. We continue to be fortunate I think that we haven't had any audit points for a few years and continue not to. So we work very hard to be transparent. We hit the GASB requirements and with oversight of the council's audit committee and the internal auditor, we work very hard to make sure that we can demonstrate that we're overseeing the assets as effectively as we think we're investing them. We did just recently expand the internal auditor position from part time to full time with the support of the Legislature through funding and hired a new person for that who has good accounting background and experience. So we think we'll be well-served with that. Now I will turn you to the executive summary. Just to point out that on pages 11 and 12 are a summary of the assets that are managed by the council and besides the retirement system assets know there are some 30 different entities that are there. We break them down into the eight major categories that are on the page. The council's responsibilities again for each of these is investment management and we do not determine spending policy because that really is the responsibility of the Legislature and the executive branch outside our agency. Fifty-eight point three percent of the assets managed by the council are in the defined benefit plans and the state and county retirement plans. Page 12 gives you a summary just of the assets in each of the plans and the changes in

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those assets. Tracking since 1996 and you can see how they've grown over a period of time fairly significantly and particularly in the last several years, a recovery of almost...a growth of almost 70 percent since 2008 in the retirement assets recovering from the downturn. Turn you to page 13 behind the defined benefit tab, see that the assets that we track as of December 31 were \$9.44 billion in investment added \$1.48 billion in return over the year. The net contributions as you would see on the page, on 14, were slightly negative. That's just a reflection of the fact that the payouts particularly for distributions for retirements and some withdrawals exceed the contributions that we bring in so that the investments aren't making a contribution towards making current events or current liabilities as well as growing the pool for long-term purposes. Page 15 is the summary of the strategic asset allocation of the portfolio through September of this last year and November. You can see the distribution. We still have a high reliance in trying to be as supportive of growth as we can on what we would consider to be equity related or based assets, and 70 percent of this pool are in that box if you include real estate and private equity. Thirty percent of exposure is to fixed income and assets that we've been a little bit more defensive and help provide consistent income for distributions. The November meeting, the council did act to make a minor change to that strategic allocation by increasing the allocation to real estate. Page 16 begins the summary of portfolio performance for the defined benefit and the cash balance plans because they're administered on the same basis with the same asset allocation. So there...as I said, the defined benefit plan had a return on an annualized basis net of fees and expenses of 18.3 percent. As you can see, since 1983 the portfolios when inception of the modern day performance returns began anyway has been about 9.4 percent. However, again, as I stressed over the more recent 10-year period, the numbers have been somewhat lower and I think that's...the 7.1 percent is more reflective of what our expectations are today going forward. The median annualized return I think, as I've reported to this committee before from our investment consultant, is that over the next ten years they would expect us to earn a return of about 6.8 percent. There is a variability to that and they do some probability testing and their distribution would say that we have probably somewhere around a 40 percent chance of achieving an 8 percent return on an annualized basis. We certainly will have some of years that are higher but we expect others to be lower. As you turn through this, pages 18 and 19 will give you a summary of the performance of the various asset classes and the investment managers that handle the assets for the council. If we turn to page 23, you'll see similar information for the state and county retirement system plans. As you can see, the state and county retirement systems \$787.8 million in the defined contribution plan and \$1.574 billion in the state and county cash balance plans. That asset base did go up as you would expect at the beginning of the year because of the transfer in of monies from the conversion that state employees made from the DC plan to the cash balance plans. Page 27 is a report on the state and county defined contribution plans and deferred comp, which you've just seen. We think participants have a range of selections there for their asset allocation and the menu of the funds that are available to them are provided in the book. Council monitors each of these investment choices on a regular basis and

will make changes if they're deemed necessary. Then turn to pages 28 and 29 where you'll see a list of several individual funds that are available for the members to choose from. So believe those are good. We provide them a couple of options for those folks who don't feel comfortable with doing their asset allocation. On page 29, those are reflected through a conservative, moderate, and aggressive premixed form. You can see by the numbers that those three levels of risk kind of perform as you would expect with the aggressive premix providing the best return and the conservative, which is more like a 60-40 with 40 percent being the fixed income, a more conservative return but giving people what they feel comfortable with from their perspective. For those people who are in the DC plan and want to return, that would be fairly comparable to what is available from our management of the defined benefit and cash balance plans, the investor select fund provides that in as close as we can through a mutual fund structure replicates what we do on a more active basis for the other funds. Pages...well, as I said, the remainder of this section just by various strategy, an investment manager kind of goes through the performance of each of those and identifies who's managing the funds on behalf of the council. A lot of the council's time and our staff time is monitoring those entities to make sure they're fulfilling their objectives. Page 37 provides a summary of performance of the deferred compensation plan that's managed by Mass Mutual and The Hartford, it's a residual plan prior to 1996 that the state had had. Our involvement with this is to review the performance of the investments and just try and make sure that they remain competitive with respect to what's available through the other funds. There are no new participants in that. Behind the next tab is the operating investment pool. As you know, this is a compilation of all the various cash balance funds that belong to various state agencies. The assets from the chart, as you can see, show that about 83.9 percent of those are state agency cash fund balances and I would say that also includes monies belong to the university and some other groups. Fifteen point two percent of that block are general fund monies, and then there's a less than 1 percent piece that's invested in the time deposit open account, the TDOA account, which you've discussed earlier this year in some legislation. The end of 2012 and the beginning of 2013, we completed the full return to internal management of the administration of the operating investment pool. As you may remember, in 2009 the council had moved a portion of that to external management to manage us through the credit crisis, build out the portfolio to expand it into a more diversified portfolio. A complement to that with your committee's support, we did add staff at that time and we spent the three years trying to...or adding two staff positions that are dedicated to the management of that with fixed income background and experience and have trained these so we feel that what we're doing internally is comparable to what we would get if we continued to have it done outside. And as you can see, the total assets of the operating investment pool are now \$3.7 billion. Very healthy cash position throughout the public sector to help fund the needs of the state and its various entities. I would be happy to answer any questions you have about the other items in the portfolio, but it summarizes a variety of cash funds that the state has created and some summary data on the educational...on the NEST program, the educational savings plan. And the back

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of the report then provides you information that's supplemental. Policies that the council...I would draw your attention on page 109 to start investment manager expense report that shows that our cost for the administration of the various externally managed portfolios is averaging about 21 basis points. So it's significant in that that's kind of the low end of what other public funds do. I think that demonstrates the council's constant focus on trying to make sure that when we pay for outside management, that we're getting cost-effective management. So we index those areas where we believe that that gets the best result and have cautiously added some active management where we think that provides a better return. And there is a summary of what's being done in securities lending program that adds about \$5.2 million on an annual basis to help offset the administrative costs of the programs. And with that, I can only say that we continue to seek new opportunities to generate returns that are needed to support the needs of the DB plans and the various endowments and trusts of the state and the council and as an investment consultant analyze a variety of investment strategies on a regular basis, looking for additional opportunities to enhance return while carefully managing risks. And with that, I'd conclude and we'd be happy to answer any questions you might have.

SENATOR DAVIS: Thank you, Mr. States. Senator Nordquist had to step out for another meeting. Are there any questions? I guess I just have one. Your long-term look ahead is at a return of around 7.1 rather than...

JEFF STATES: Yes, sir.

SENATOR DAVIS: And we are at 8 for our retirement. So how soon do we need to address or start thinking about finding a solution to the difference?

JEFF STATES: Well, I mean, from the council's position we just want to make sure that the Legislature and the executive understand what we see as a reality. And think now that we have come back, I mean, we still have an obviously an unfunded liability, I think the direct answer to your question was the council would prefer to see us move to that number as quick as the state feels comfortable in being able to absorb it. But it's a decision that really is a retirement board decision not ours and should be done jointly between the executive and the Legislature. But we think progressively we should do it not because we may not and historically it shows we have gotten there, but we would like to have I think a little more margin of error so that the volatility of the cycle can be absorbed more comfortably without creating new unfunded obligations going forward once we catch up.

SENATOR DAVIS: How much exposure do we have to the Russian market? Any idea?

JEFF STATES: It would be very small. I mean, I would venture to say it's less than 1 percent if it's even that much. We do in our emerging markets portfolio have some ability to end some investment there. The firm that invests that specific portfolio for us

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has been cautious on Russian, does not have any Russian exposure. But we may indirectly through some of the investments that would be in the region.

SENATOR DAVIS: Thank you. Any other questions?

JEFF STATES: Thank you.

SENATOR DAVIS: I see none. I appreciate you coming.

JEFF STATES: Sure. Thanks.

SENATOR DAVIS: Any other testimony? No. That concludes our hearing.