[LR421]

The Committee on Nebraska Retirement Systems met at 11:00 a.m. on Tuesday, November 16, 2010, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LR421, an actuarial presentation. Senators present: Dave Pankonin, Chairperson; Jeremy Nordquist, Vice Chairperson; Lavon Heidemann; LeRoy Louden; and Heath Mello. Senators absent: Russ Karpisek.

SENATOR PANKONIN: Good morning. I want to welcome everyone to the LR421 hearing, which is our annual hearing regarding the actuarial report that is presented to this committee and we'll have that in a few minutes. I want to remind people that, as a courtesy, to turn off your cell phones or put them on a manner mode setting during the hearing and also, if you're going to testify, there's testifier sheets up on the table and in the corners. If you plan to testify, we need to have those turned in to Denise Leonard, our clerk. Let me introduce everyone here today. I'm Senator Dave Pankonin and to my right is Senator Jeremy Nordquist, Vice Chair; Denise Leonard I introduced, our clerk; Kate Allen, our legal counsel; Senator Heidemann is with us; and Senator Louden. Senator Mello I don't think is coming today or do you know? And Senator Karpisek I know is not coming. So those are the senators present. We will have, to start the hearing, Mr. Doug Fiddler from the actuarial company, Buck Consultants, come and go over his report with us. So if you'd like to come forward, we can do that. We'll probably have you spell your name for the record. That's usually how we do it so...

DOUG FIDDLER: Certainly. Good morning, Mr. Chairman. Doug Fiddler, that's F-i-d-d-l-e-r, and I'm an actuary with Buck Consultants. Should I just go ahead and jump in here? [LR421]

SENATOR PANKONIN: Yes, go ahead. We've all got...we have copies of the report,... [LR421]

DOUG FIDDLER: Perfect. [LR421]

SENATOR PANKONIN: ...so if you're going to refer to that we should have that ready. [LR421]

DOUG FIDDLER: Perfect. You're used to seeing Dave Slishinsky here delivering the report. Dave had an unfortunate incident with a ladder doing some home repairs, so you have the replacement here today. [LR421]

SENATOR PANKONIN: Okay. Well, please give him our best. I hope he's recovering okay. [LR421]

DOUG FIDDLER: (Exhibit 1) He's getting there. I'm going to go through the items that are listed on page 2 here fairly briefly, the actuarial results for the school's plan, the Patrol's plan, and the judges' plan. I'll be brief. And if you want me to go into more detail on any of the items, please stop me as I go along. If there's any questions, please give me a yell here. Page 2 has the changes that we have valued since the last valuation, and really for all three systems it is just the extension of the Purchasing Power Stabilization Fund contribution to the fiscal year 2012-2013. Page 3 has starting some information on our asset returns. And if I could take just a moment, we generally smooth our market value of asset returns, the gains and losses from those, over five years to avoid severe fluctuations in the contribution requirements. And one of the things that I'm going to talk about several times here today, because it is the driving force behind the change in the numbers from last year, is that we're still recognizing losses, the market value losses, from 2008 and 2009, and as those continue to be recognized here, they are going to continue to drive the numbers up. Now we do have some good news this year. We do have some market value gains for fiscal '10, for the year ending June 30, 2010. We do have some demographic gains. But as you get in...we get into them, you'll see they're not of the magnitude to completely offset the losses of the last couple years. So you can see that graphically on the chart here on page 3, we do see some market recovery as that red line turns back up for June 30, 2010. But if we look at the departure from our assumed 8 percent long-term rate of return, 2010 we were up about 6 percent above that assumption. But if we look back at 2009, we were off about...19 percent losses, that puts us about 27 percent behind our assumption. So we've made up some of the ground. We've recognized some more of those losses, but there's still some more of those losses left to come. Page 4 has another representation of the smoothing that we do here and, as you an see, the blue line, what we're using for funding, the actuarial value of assets, does follow the same general trend as the market value, but we avoid some of the peaks and the valleys in that. And again, our goal is to smooth out the asset value in order to smooth out the contribution rates, the contribution requirements. And obviously that severe downturn in fiscal '09 has not yet been fully recognized. On page 5, we have one last representation of this, the smoothing that we do. And this graph shows the unrecognized gains and losses historically here. We do like that this is centered around zero. We do like that it's fairly symmetrical. But again, you can see the magnitude of the '09 losses. And we have gains in 2010 that are bringing that back up, we have another recognition, but you can see on this chart, and we'll touch on it later, there's still $1.1 billion in losses that we're going to recognize over the next three years. With that, we'll get into some of the school's results on page 7, and we're going to start with the assets and, again, the AVA this year is just...the actuarial value of assets, I'm sorry, is right at $7 billion. We see a reduction in our unrecognized losses from about $1.7 billion to $1.1 billion. It comes from two sources. We're recognizing 20 percent of prior year losses and we've also got some gains this year, that we're recognizing 20 percent of them but it also goes to decrease that unrecognized amount, the unrecognized loss. Our market value is up to $5.9 billion and the market value as a percentage of the actuarial value is up from 75 to 84 percent this year. The bottom two lines, the market value earned 13.6 above our long-term rate of return assumption for 2010, but the funding hangs on that actuarial value return. If that stays at 8 percent, our funding stays constant. The prior year losses that we're recognizing drag that down to just over 1 percent for this year, meaning we're going to see an increase in the contribution requirement. Page 8 has the development of a contribution requirement, and if I could start with line 5 there, the unfunded liability for the school's plan has gone from $1.1 billion up to about $1.5 billion, again, the 2009 losses. The actuarial value funded ratio there is 82 percent. When we look at surveys of other statewide plans, other public sector plans, the 2010 results aren't released yet but when we project 2009 forward we're looking at an average of 71 percent generally, is our prediction of where that's going to come in. So we expect Nebraska to be about 10 percent above the average there. The required contribution there is developed in line 7 and that has a couple of different parts. It has what we call the normal cost, which is the cost of benefits accruing during the plan year, and then we have an amortization of the unfunded. The normal cost is going down slightly as a percent of pay, and that's at about 11 percent of pay. But the amortization of the unfunded--because the unfunded grew, the amortization payment on it grew--and that went up from about 6 percent of pay to 8 percent of pay. And that 2 percent jump is directly reflected in the bottom line there in number 7 that the contribution requirement has gone from 17.2 percent to 19.2 percent. We compare that with line 8, our expected contributions of 18.05 percent, and that results in additional required contribution of about $18.8 million, $18.8 million this year, about 1.16 percent of pay. Now we're going to take that a little further on page 9, and page 9 has a projection assuming modest recovery in the market value, in the capital markets here in the next couple years. We're assuming 13.5 percent return in fiscal '11. That's right at the bottom of the page there. The market return so far has been on track with heading towards that target. We're assuming a 10 percent return or bounceback recovery here in fiscal '12, and then we assume 8 percent market on a long-term basis after that. These have improved from the projections we saw last year. They've improved for a couple reasons: number one, the market returns above the 8 percent and, number two, we had some demographic gains as well. These reflect a couple of contributions here either decreasing or sunsetting into the future. And the top line there underneath the bars shows our projection of the additional contribution requirement. One thing to note here, that over the last 20 years I believe there's been one additional contribution required, and the member and employer and appropriated contributions have been sufficient to fund the benefits. But right now, because of those market losses in '08 and '09, we are looking at a period where we're going to require an additional contribution and we expect this contribution to increase up to about $117 million in fiscal '15 and then start to decrease there, decrease slightly as we recognize this last year's gains. And that will be the only gains that we're projecting out here. Again, these are our projections, assuming a modest recovery in the market. We can't predict the future. We can't tell you what the markets are going to do. But based on what we know now, this is a fair representation of where we see the trend heading with these contributions. We go on to page 10. This has the same information for the Patrol's. We're developing a contribution requirement here. Line 5 again, net unfunded is going up from $31 million to $49 million, and the funded ratio likewise is going down 5 percent as we recognize more of those prior year losses. Again, our normal cost or our ongoing cost is remaining unchanged, but as we recognize those losses our amortization of that unfunded is going up significantly. And the total required contribution we've got at 43.5 percent of pay. When we compare that to the expected contributions, there's an additional contribution required of, believe, $2.77 million. And again, these projections on page 11, we show these increasing for the next three years. And you can quite clearly see, as we recognize three more years of the 2009 losses, that that's going to drive our total contribution requirement up. And we expect that additional contribution to peak at about $6.4 million before beginning to reduce. And again, the same results for the judges' system. We do have a scale change. We're talking about thousands here on this page rather than millions. The judges' fund had a reserve, an overfunding, of the accrued liability last year of $2.4 million and that is reduced to about $100,000 this year, and the funded ratio is down right to 100 percent, again, the recognition of the prior year losses. The annual required contribution we have is 21 percent or 21.2 percent of pay this year, which is still within the expected contributions of 26.6 percent, leaving no additional contribution for this year for the judges' plan. However, when we look at the projections on page 13, again with a modest recovery, we see these additional contributions beginning to be required in fiscal '13 and those contributions going up to about $1.5 million. There is one factor with these that we might see some reduction on the judges' plan. We expect to see some increase in the court fees coming in because of a temporary increase in those levels, and we have not seen that reflected in the actual receipts yet. If that does occur, we would see these reduced a little bit further. Page 14 has calendar results for the state and county cash balance funds. This is not new information. This is just here to make sure that we're not leaving those out. The funded ratio at January 1, 2010, for those two funds were 94 and 95 percent, and the required contribution was less than the statutory contributions for those two funds as of January. And with that, I'm going to move on here to just some summary statements on page 16 about the changes from last year and where we're going. The market value of assets return was about 14 percent--a good year, helped soften some of the pain in these numbers but not nearly enough to completely wipe out the losses from '08 and '09. And as we said, the '08 and '09 losses do put more pressure on the contributions. The 1 percent return on our actuarial value of assets is what's driving these contributions up. And the bottom point there has $1.1 billion yet to be recognized in the next three years generally of losses from 2008-2009, and you saw those numbers reflected in the projections that we looked at. On page 17, we have our funded ratios from last year and this year. Both the school's and the State Patrol's dropped about 5 percent, recognizing those losses. The judges' dropped about 2 percent. The judges' contributions, those that are scheduled to come in, are sufficient to meet the actuarial required contribution but there are additional contributions required for the State Patrol and the school's. And as was reflected in those projections, without a significant, substantial recovery in the market, we are expecting those additional contribution figures, those required contributions, to increase in the next few years. I have sped through these results and hit on the highlights. If there's anything you'd like for me to go into more detail, if there's any questions I can entertain, I'd be happy to do so at this time. [LR421]

SENATOR PANKONIN: I've got a couple, but we can start with any. Doug, my first question is you know a little bit about our history in that Nebraska has usually come up, when we've had situations like this with employer-employee matches, increasing contributions... [LR421]

DOUG FIDDLER: Right. [LR421]

SENATOR PANKONIN: ...to help solve these problems. Is that in the realm of possibility again with that type of a plan? I know investment returns are a big part of this as well,... [LR421]

DOUG FIDDLER: Right. [LR421]

SENATOR PANKONIN: ...but obviously that does make a dent if we had to, correct? [LR421]

DOUG FIDDLER: Right. Right, that would make a dent in it. The contribution deficit here or the gap that needs to be filled is rather substantial. You can increase contributions on both sides to try and address that. The danger is if you go too high on the contributions, you've got members already making 8.28, I believe, percent of pay on top of their Social Security contribution, and if you go too high you might actually price people out of keeping their jobs. If they have to put too much of their salary towards retirement, they might not be able to afford to stay on the job. That's the danger with going that route. Certainly any increase, any temporary increase or any marginal increase would help offset these numbers. [LR421]

SENATOR PANKONIN: Okay. Thank you. Other questions? Senator Nordquist. [LR421]

SENATOR NORDQUIST: Yes, thank you, Chairman. Thank you for being here, Mr. Fiddler. The additional state contribution for all these plans, is it...all of them driven completely by the market downturn of '08-09 or would there be a requirement in these plans if we hit the 8 percent (inaudible)? [LR421]

DOUG FIDDLER: If we had hit the 8 percent in 2008 and 2009, certainly there would not be this requirement. [LR421]

SENATOR NORDQUIST: Okay. [LR421]

DOUG FIDDLER: Historically, as I said, historically the plans have functioned without that additional contribution and it is those losses that we're seeing reflected in these numbers. [LR421]

SENATOR NORDQUIST: Okay. On the school retirement plan, you mentioned some demographic gains. Can you elaborate? Do you know what those were? [LR421]

DOUG FIDDLER: Sure. We saw some gains from the COLA being less than what we anticipate. The COLA's limit is based on CPI, limited to 2.5 percent. CPI came in lower than that. I think it was just over 1 percent this year, which gave us some significant gains. There were fewer retirements than we expected, which is something that we're seeing consistently from system to system on the states that we work with. There were lower salary increases than we anticipated. Again, that's generally going on in the market right now. Those were offset slightly because there were fewer terminations. If somebody terminates before eligibility for retirement, they get less value. And nobody really is leaving their jobs or very few people are leaving their jobs in this economy, and we had some losses from there. So those are the main sources of the gains. [LR421]

SENATOR NORDQUIST: Okay. I also notice on the school retirement plan, I guess I don't know if it's the same...not...the troopers' isn't, I guess. I see the employer contribution drops off in 2015 and '16. Is that the statutory rate? [LR421]

DOUG FIDDLER: Right, I believe there's a... [LR421]

SENATOR NORDQUIST: A sunset. [LR421]

DOUG FIDDLER: ...temporary increase... [LR421]

SENATOR NORDQUIST: Okay. [LR421]

DOUG FIDDLER: ...that sunsets at that point. [LR421]

SENATOR NORDQUIST: Okay. So then would the number, the $153 million, continue to increase from that point if we got rid of the sunset and maintained the... [LR421]

DOUG FIDDLER: Exactly. [LR421]

SENATOR NORDQUIST: Okay. [LR421]

DOUG FIDDLER: And any increase in the following year's number would come right off of that top line then. [LR421]

SENATOR NORDQUIST: Okay. And then you just mentioned, I guess on some of these demographic issues, the lower salary and fewer retirements. I guess maybe globally here, as we're looking at the school plan and at the troopers' plan, as state and local governments are tightening their belts, maybe, you know, maybe there's going to be reduction in spending in schools, more layoffs, less people in the system, same with, you know, State Patrol could fluctuate. I'm not sure where those numbers are going to be. What does that do to the plan if we're contracting the number of employees just kind of globally? [LR421]

DOUG FIDDLER: Well, there's two pieces to the contribution requirement. There's normal cost, what goes on, what members accrue from year to year, and there's a payment of the unfunded. If the school systems or if the employment generally contracts, the normal cost contracts with it. But you have an underfunding right now of

$1.5 billion that you're amortizing and we have some more losses to recognize in the next couple years as a dollar amount. So if we contract employment, that dollar is spread over fewer members and it will actually draw the contribution as a percent of payroll up without changing the dollar amount. So the dollar amount generally would be less,... [LR421]

SENATOR NORDQUIST: Uh-huh. [LR421]

DOUG FIDDLER: ...but as a percent of payroll you'll see that figure go up. [LR421]

SENATOR NORDQUIST: Okay. Thank you. [LR421]

DOUG FIDDLER: Welcome. [LR421]

SENATOR PANKONIN: Senator Heath Mello joined us today. Senator Louden, question? [LR421]

SENATOR LOUDEN: Yes. Thank you, Senator Pankonin. Do you evaluate any of the assets that these investments have? I mean are they speculative or where are they at? Because, you know, well, like the ones went up 14 percent so...and you're looking at 8, so is this some speculative assets that they have in there to cause that much of a jump or what? [LR421]

DOUG FIDDLER: That question might be directed better towards the Investment Council or the people responsible for that. We do not evaluate the assets. We do look at what they're invested in and take a long...a very long-term horizon to come up with our 8 percent assumption. But as far as the specific investments, that's probably outside of my realm to comment on. [LR421]

SENATOR LOUDEN: Okay. Thank you. And as Senator Nordquist mentioned, if you have fewer employees, this is going to affect your contribution rate considerably, won't it, and especially in like State Patrol, where I think they're...percentagewise, it's down quite a ways when they have about 25 less troopers than they did have? So how are we going to figure that in there, because you have...you don't have as many people in the force now as you probably had when you were getting the retirees in there? So how did you handle that in this? [LR421]

DOUG FIDDLER: Our projections are based on generally a consistent level of employees, so we're not recognizing a reduction in the size of the staff there, of the employees. If there is a reduction, we would see some reduction in dollar amount for the actual total required contributions but we would see that go up as a percent of pay as that payroll shrinks. [LR421]

SENATOR LOUDEN: Okay. Then in other words, we could be looking at a little bit bigger hole in safety Patrol's retirement than what's actually showing up here, since they're...I think they're at their lowest number of troopers that they've ever been for years. [LR421]

DOUG FIDDLER: Right. But is that expected to shrink from the number at 6/30/2010? I mean the basis of our projection was the active members at 6/30/2010, which if I'm hearing you right was already reduced. And if it stays at that level, we expect our numbers to be in the ballpark. [LR421]

SENATOR LOUDEN: Oh, okay. Then you used those numbers for your actuarial study of what they have. The amount of members they have now in 2010 is what you've projected these on then. [LR421]

DOUG FIDDLER: That is the basis of our projection, you know, exactly who was there June 30. And let me again reiterate, we can't get everything right in these projections. We can't know the future. This is the general trend that we're seeing, to give you some idea of, based on what we know now, this is the trend of where we see these contributions going. [LR421]

SENATOR LOUDEN: Well, I thought we paid you the big bucks to get the right answers. [LR421]

DOUG FIDDLER: (Laugh) I don't have a crystal ball, Senator. [LR421]

SENATOR LOUDEN: Okay. On the teacher retirement system, is there...with your consulting and everything, is there anything that you could see in there that could be done to change on some of the benefit systems or something like that? Or do you go into that kind of work? [LR421]

DOUG FIDDLER: We do know...we do work with systems in making changes to the benefits and how they will impact it, and we do know what some of the other states have done to try and address these funding needs. Of course, increasing contributions is the easiest and the most direct, and we do have systems that automatically increase contributions each year to address the...to fund it on an actuarially...what's actuarially required. They split that up between employer and employee each year. Other than that, there are a variety of changes that systems have done. Generally, the changes are for new members because if they're made for current members generally that's challenged in court. And I could speak to some of the changes that we have seen. There are a wide variety. Is that something you'd like me to address here? [LR421]

SENATOR LOUDEN: Well, yeah. What I was wondering is they talk about changing the retirement age or something like that. Do you have any information, if you change that retirement age one year, how much of a difference will that make in the less cost of benefits, you know, on your new members coming in? [LR421]

DOUG FIDDLER: Right. [LR421]

SENATOR LOUDEN: Now that won't affect anything for several years but... [LR421]

DOUG FIDDLER: Exactly. [LR421]

SENATOR LOUDEN: ...it still works in your actuarial study, wouldn't it? [LR421]

DOUG FIDDLER: It would slowly start to change the numbers here. The numbers coming in are generally your cheapest members. You're paying the least for them. So that number would be lower for new members. If you make the benefits available later, if you make the benefits less, if you reduce the COLA on them, that would slowly start to take the edge off those numbers, yes. But it does take a few years for that to work in as the new members become a significant portion of the population. [LR421]

SENATOR LOUDEN: Okay. Thank you. [LR421]

DOUG FIDDLER: You're welcome. [LR421]

SENATOR NORDQUIST: I just have a couple more. [LR421]

SENATOR PANKONIN: Do you have another question? [LR421]

SENATOR NORDQUIST: Yeah. [LR421]

SENATOR PANKONIN: Senator Nordquist. [LR421]

SENATOR NORDQUIST: First of all, the projections on rate of return, are those based on...did you guys project those or were those made in conjunction with the Investment Council or...the 13.5 and then 10 percent for FY '12 and 8 percent after? [LR421]

DOUG FIDDLER: And you'll have to forgive me for subbing in here late into the process this year. [LR421]

SENATOR NORDQUIST: That's all right. [LR421]

DOUG FIDDLER: They were discussed, Dave, with the staff and at least yesterday at the joint meeting with the PERB Board and the Investment Council, they were discussed, these projections were gone over, and the investment consultant yesterday, he said that they thought that these were within a good possible range for the next two fiscal years. [LR421]

SENATOR NORDQUIST: Okay. Okay. And then last question I see, why are we amortizing the unfunded liability on the state and county cash balance? You know, is there a...I guess maybe it's statutory, but we're amortizing that over 25 years as opposed to 30 years in the other plans. Would there be a reason for that or...? [LR421]

DOUG FIDDLER: I can't answer that. [LR421]

SENATOR NORDQUIST: Okay. Okay. [LR421]

DOUG FIDDLER: I don't...the top of my head, I don't know. [LR421]

SENATOR NORDQUIST: I just noticed it. I didn't know why, what the reason was, but that's okay. [LR421]

DOUG FIDDLER: I'm sure there's somebody in the audience that could answer that, but I don't know. [LR421]

SENATOR NORDQUIST: All right. We'll look into that. Thanks. [LR421]

SENATOR PANKONIN: Mr. Fiddler, I have another question. You brought up about some of the changes that other states have, and you mentioned that some states have an automatic system that the contributions go up for the employer, employer-employee matches. There are states that just...that are kind of on an autopilot system? [LR421]

DOUG FIDDLER: Right. Right. [LR421]

SENATOR PANKONIN: Can you mention a couple of those states or do you...are you familiar with which ones might have that? [LR421]

DOUG FIDDLER: I am familiar that Arizona is set up that way. However, the contribution rate is going pretty high there and it's causing pressure on both employers and members as well. But they generally calculate the whole required contribution to fund the system on an actuarially sound basis and the employer pays half of that and the members pay half of that. [LR421]

SENATOR PANKONIN: Do you have an idea what those rates are in Arizona right now, like on the teachers' plan or the educational plan? [LR421]

DOUG FIDDLER: It's one system there and they're generally in the neighborhood of 10. [LR421]

SENATOR PANKONIN: Ten and ten. [LR421]

DOUG FIDDLER: Ten and ten, yes, in that range. [LR421]

SENATOR PANKONIN: Okay. Thank you. Other questions? Seeing none, thank you for subbing in, coming. Did a great job and tell Dave that we wish him the best. [LR421]

DOUG FIDDLER: Thank you. [LR421]

SENATOR PANKONIN: Is there any other testifiers today at this hearing for this hearing? Okay, seeing none, we'll close the hearing on LR421. [LR421]