[NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT; NPERS ANNUAL REPORT]

The Committee on Nebraska Retirement Systems met at 12:10 p.m. on Tuesday, March 15, 2011, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on the Nebraska Investment Council Annual Report and the Nebraska Public Employees Retirement Systems Annual Report. Senators present: Jeremy Nordquist, Chairperson; Lavon Heidemann; Russ Karpisek; Heath Mello; and Dave Pankonin. Senators absent: LeRoy Louden, Vice Chairperson.

SENATOR NORDQUIST: Good afternoon. Welcome to this hearing of the Retirement Systems Committee. I'm State Senator Jeremy Nordquist, Chair of the committee. We'll have the committee introduce themselves. To my left, first, is Kate Allen, our legal counsel for the committee; to my far right, Trisha Clark, our committee clerk. And our page today is Lisa; she can help distribute any information or materials that you have. Please be sure to silence your cell phones before we begin and fill out a testifier's sheet if you are testifying and submit it to the clerk. We'll be hearing two reports today, first from the Investment Council, and then from the Public Employees Retirement Systems. And if there is any additional testimony related to either, we will entertain that as well. Starting to my right, Senator Mello, if you want to introduce yourself.

SENATOR MELLO: Senator Heath Mello, District 5, south Omaha and Bellevue.

SENATOR KARPISEK: Russ Karpisek, District 32, from Wilber.

SENATOR PANKONIN: Dave Pankonin, District 2, Louisville.

SENATOR HEIDEMANN: Lavon Heidemann, District 1, southeast Nebraska.

SENATOR NORDQUIST: All right, thank you. And I think Senator Louden will not be able to join us today. We'll start the hearing on the annual report of the Nebraska Investment Council. If you would be sure to state and spell your name for us.

JEFFREY STATES: (Exhibit 1) Good afternoon, Senator Nordquist and members of the committee. My name is Jeffrey States; that's J-e-f-f-r-e-y S-t-a-t-e-s. I'm the Nebraska State Investment Officer. On behalf of the council and the agency staff, I'd like to start by thanking the committee and expressing our appreciation for your continued support for our efforts to make sure we're properly resourced and staffed to manage the assets that the state has entrusted to our supervision. You should each have a copy of the Annual Report for 2010, which was distributed in advance. If not, I do have a couple extras. The council manages, as you probably know, over 30 different entities, and a single entity in some cases consists of multiple funds, the biggest of those being the operating investment pool, which has innumerable assets from various state agency cash accounts as well as highway department funds and various other things that flow into that asset base. The broad categories, as represented in the report, are broken down and there's a tab in the report for each one, to the defined benefit plans; state and county retirement plans and deferred comp plan; the operating investment pool; Nebraska educational savings plan trust, which is the 529 College Plan; a group of general endowments that we administer; health care endowment fund; some university funds; and miscellaneous trusts. An important aspect of this for the council is to remember that our responsibility is for investment management, and we don't determine the amount of funds that are contributed to the various programs nor do we control basically what's paid out. The distributions are managed by statute. If you turn to page 5, and I'll just begin at the beginning of the report and try and move you through this, you'll see a picture and a list of the current council members. And we appreciate the executive and the legislative's support for the council and continuing the continuity of that group. It certainly helps us maintain a good program by having council members that are very familiar with what we're doing and understand the issues. And in the beginning of this year, John Maginn was reappointed by the Governor to that process, so we appreciate that and the Legislature's approval of that. Page 6, and I won't read it, is the council's mission statement that just verifies that we take our fiduciary duties extremely as...or view them as very highly important and work as hard as we can to prudently manage the assets that are given to us. Beginning on page 7 is the report, and I'll start by just giving you a couple high-level reviews of events in 2010 that were market activity that impacted what was going on. And part of the reason we mention those is because many of those events continue to be the types of issues that are impacting us today. We began 2010 on the back of a very sharp recovery that began after the markets bottomed in 2009, into the spring. And in the spring of last summer we saw the first event which continues to kind of impact and moving it out of distraction, which are concerns about the euro credit crisis, the potential for defaults in certain countries, which continues today to not have totally been addressed, and it keeps resurfacing itself. Greece, Ireland, Portugal, and a number of others, there were concerns about defaults, and that's raised concerns about the ongoing fiscal management in those countries, which does have an impact on future growth also. In the U.S., the primary factors that affected the growth and made our ride during 2010 kind of bumpy were the fact that we've continued to experience relatively weak GDP growth. Many recoveries, you would see a much sharper recovery and increase because of improved productivity; growth of demand that's been somewhat weak. That has not happened. We certainly know housing has continued to be weak, and so we're not seeing a pickup there and prices continue to decline to some extent in various areas of the country. That's resulted in there being little to no job growth, and weak job growth keeps unemployment high. And it means that we're not seeing earnings going up, so people don't have disposable income, and so that translates into also weak consumer income. In response of that--and we finished the fourth quarter actually with a kind of a second rebound, which got us out of the year fairly well--was the action by the Federal Reserve primarily to adopt what they called QE2. It was an event to buy Treasury securities over an eight-month period to try and keep interest rates low; an activity also designed to provide some liquidity in the market to encourage investment and inequities. By keeping the returns from bonds low, they're trying to encourage us to move where the returns are. And last, they had an effort to try and reverse suggestions that we might have deflation to create some inflation. As you can see, that resulted in the overall markets rebounding strongly. And if you move to, as we summarize here, the assets under management, but the council ended the year being up about 10.7 percent. That was selective in its experience. Those portfolios though that have equity exposure did reasonably well. Obviously, the portfolios and the endowments in some places where we're restricted to fixed income investing, the returns were different. But overall, 2010 did end up being a good year. From the council's standpoint, a couple highlights with respect to our activities. The council did conduct and complete a new asset liability study looking at how we, from a policy level standpoint, are allocating the assets of the trust. In July, considering the results of that, and the uncertainty that the council felt existed in the marketplace in the summer, it decided to maintain the asset allocation that we previously had and their numbers--and we'll look at that asset allocation when we talk about the DB plans--but the general feeling was that it wasn't the time to try and become more aggressive. It also, given the fact that there (inaudible) much return in fixed income markets, the time to try and become more conservative. And so our approach is to try and ensure that over time we achieve a good risk adjusted return that approaches the actuarially planned return, but also is consistent, and we don't want to introduce a lot of additional volatility. Two other events for the council that occupied our time, or a couple others: one, we were able to add two additional investment staff. And that was the first time that the Investment Council had added staff since about 2001 or 2002, and we can appreciate the recognition of the need for the council to have additional staff. And given the complexity of the programs, the program and the dollars under management, we added a securities investment analyst II who is responsible for helping us do our back office operations, track the accounting for the portfolios, and have a much more deep insight with respect to, particularly, our private investments. That did allow us, adding that position, to pull back from a portion of our contractual relationships with our consultant, and we eliminated some back office support that they were providing us which we found we were able to replace, and we feel it gives us a lot better control of what we're doing also. The second position was the portfolio manager I position which was created and assigned the duty to work principally with the operating investment pool. And as the committee knows, the council in 2009, because of the concerns about the credit markets, had divided the responsibilities for that operating investment pool and government agency investments which we continue to manage in-house, but shifted to an external manager, Galliard Capital Management, about 30 percent of the assets that were invested in corporate credits, to make sure we could manage through that process and restructure the portfolio and also make sure that we were adequately resourced to do that. We're still working on the resources, but this was the first step. In conjunction with that, at the end of the year, Gayle Wrasse, who was a 42-year state employee, who had managed that investment program and the in-house product for a long period of time, did retire. And so we're now back out in the market right now recruiting to hire a second person for the operating investment pool. We felt very fortunate to hire, in that position in the first place, a person who had good background and experience in Chicago with the fixed income money manager, and very quickly learned the day-to-day operations and became involved in the process. So we were able to promote him to fill Gayle's spot and take over the primary responsibility with our other portfolio manager II who works with the other endowment programs. But we feel it's important to have that second person assigned to make sure we're maintaining the research and the oversight, and we are in the process, right now, of looking at candidates to do that. Once that's completed and we finish the installation of some software packages that--for research and analytics--that we're in the process of doing, we'll begin the transition of those assets back in-house. And we're working with Galliard to try and develop a plan so we can maintain, with their help, I think what we think they bring or an advisor like them brings to the table, which is their knowledge of the market's insights with respect to how to position the portfolios a little bit and some awareness. So we do have a commitment...I have a commitment to the council that will maintain the ability in some form to resource someone like that to make sure that we have that deeper bench to help give us some insights as we go forward with the pool. But we will significantly bring those assets back in-house later this year, once we're comfortable that's all in place and that it's working. The last thing was the conversion or transition of the College Savings Plan, which was completed during the year. And, of course, the council's role in that was to review the investment options that are provided as that program moved from Union Bank to First National--and that transition was completed on December 20. Moving on, maybe we'll just flip to page 11, and I'll start going through the report. You'll see the allocation of the assets that are our responsibility. Fifty-nine percent of those assets are really in the defined benefit plans, the state and county retirement systems, as shown in the pie chart on page 11. And turning to the next page, you can see what's happened and where the balances are in the various programs during the year. Change in value: We saw earnings to the defined benefit and the state and county plans during the year that were--well, total earnings to all the plans--that were $1.6 billion. If you found the typo in my letter, I said we had $1,635 billion--we would have wished that--but still a significant contribution; and, you know, as you can see there, $1.1 billion of that being in the investment results related to the defined benefit and retirement plans. We also do see that we continue to have negative outflows related to contributions, which are the employer and employee contributions coming in, and, of course, the payments of benefits and withdrawals. That's significantly a function of the fact that these are somewhat mature plans, and so we have people that are retiring at a faster rate today. And I'll just move on here to page 13 and look at what was going on in the defined benefit plans, and I say, as the next two sections, because it relates to 59 percent of what we manage and I think has the biggest fiscal impact on the state. See that the defined benefits plans--which are the schools, the State Patrol, and the judges--totaled, at the end of December 31, $7.25 billion. We had investment earnings over that period of about $859 million. As the pie chart shows when you turn to the next page, the asset allocation to those funds and the council's allocation today is 31.5 percent to U.S. equity, 15 percent to global equity portfolios, and 13.5 to non-U.S. equity. So the public equity markets represent about 60 percent of our investments, 30 percent to fixed income, and then a 5 percent allocation to private equity and real estate. In whole, the council believes that provides a well-diversified portfolio which has enough equity risk embedded in it to give us long-term returns that achieve our results and still look to the fixed income portfolio to kind of be the anchor to wayward in those times when there's a little more volatility. At the bottom of the page we added, this year, just a chart that shows the historic asset allocation for the plan. And you can see, prior to 1991, a little more than 50 percent of the assets were actually in fixed income, and the rest were in equities and all U.S. equities. So you can see kind of the progression over time as we've added additional exposure to non-U.S. equities and global equities, and then added the private equity and real estate over time. Page 16, probably one of the things you're most interested in is the returns for the fund. The DB plans, in general, for calendar year 2010, had a return net manager fees of 13.4 percent--so a second good year on the back of 2009, in a year that provided some additional contribution over and above the actuarially assumed rate. We hope we can continue to do that. I would note that while the return since inception for the plan are 9.3 percent, so we have been, over the long period of time, achieving that desired result over the 3- and 5- and 10-year periods--as we know, the last decade was not a good decade for equities--we have underperformed, which is the partial reason that the, and maybe the majority of the reason, that the plans have experienced some underfunding. They said with 2009, 2010, and we were off to a good start for 2011--we'll see where that goes--we continue to build our way back towards increasing that annualized return so that we can move back towards the 8 percent target. We believe over time we will. I will only address individual managers in performance if there's anyone on the committee that wants to ask questions about any of those individual items; otherwise, we'll just move on. And I would point out, on page 22--and Ms. Chambers will talk about this I'm sure much more fully and can answer your questions--it's just the funding status for the various plans, and so you can see how that progression has gone over the last couple of years. In comparison though, to other states, from my knowledge and information, we're still an extremely well-funded state in all of our plans. It doesn't eliminate the fact that it has to be paid for, but comparatively, we're doing pretty well. Page 23 begins the review of the state and county retirement plans. This represents the defined contribution plans that exist for the state and counties, which were programs available to employees prior to 2002. And so you can see there, the split since that time between the defined contribution and then the newer cash balance plans is about equal today, and so the cash balance plans are catching up, but $1.7 billion between those two pools. And then the state deferred comp program and the state DROP program are also shown there because they participate in the same investment choices, to a big extent. You can see that the returns we will get there...well, the defined...or the deferred comp and the defined contribution plans are employee-directed, so they make their choices, and so you'll find...on page...now I'm missing it. Oh, 27--yes, I'm sorry--are the various portfolios that the folks can choose from, and...but the mix of those and the asset allocation is a decision made by the participant. And that was the change as we moved to the cash balance plan, because basically we shifted to give employees, even though a more fixed allocation which put them into exposure that mirrors that set for the defined benefit programs, for the other retirement programs. And I think that in the long term is to the benefit of the employee, because it gets the professional experience of our management, which we think contributes, and we find that employees, self-directed, as most folks tend to have too much fixed income over time in their portfolios sometimes or to make allocation decisions that aren't always in their best interest. So we think that gets a more professional result. Move on to note that the returns for the cash balance plans were--because they do mirror--were almost identical to the returns for the defined benefit plans. Actually a slightly higher return, about 13.5 percent for those funds, because there's some difference in the way the cash flows, come and go. But generally, they're invested identically otherwise. I'll just skip on. And again, pages 31-34 kind of look at the manager performance by asset class in each portfolio. I would point out that in 2010 we did begin to see some positive results and improvement in our real estate portfolio and our private equity, which were newer--and I think we've talked to you about J-curve events for a long time. Private equity portfolios actually broke even and we've begun to see some distributions, and expect them to continue now to start to be a positive contributor. The real estate portfolio--is again a division between what's happening a little bit in commercial real estate versus individuals--has begun to see some recovery. And so there was a good bounce-back in that area as values were marked back up. We principally invested in core real estate that's high quality and look for properties in an office space--you know, multifamily and various others--that are highly leased and maintain their income. And we're seeing an improvement there and we're hearing good information. So we have a little division in the economy today with respect to what is happening in corporate America versus to the individual, and I think that's also true in our balance sheets. You know, corporate America had a good year; profitability was strong. And that kind of factored its way into the way the financial markets viewed it, where I think a lot of the impact to the individual, personally, is that people still have uncertainty and don't feel probably as good about their financial position as the companies do. I would maybe just turn you to the operating investment pool, which is page 39, and just comment there. As I mentioned before, $2.8 billion invested in this pool, short to intermediate money--a significant portion of the state's cash flow. Any asset belonging to the state that's not needed for immediate expenditure is swept into this pool. General Fund balances make about 11.4 percent of that. But a significant portion of it--86, almost 87 percent--is in the various state agency accounts, which includes in that category, the university's, which is about $500 million or $600 million also--the funds that we pick up for them; and a very small allocation to the TDOA program, which is the time deposit open account, which provides deposits to Nebraska banks. We've already talked a little bit about the movement over time or intent of the council to kind of bring the OIP back in-house, and we'll continue to work on that. It's a high priority for us and, both because we'd like to manage those assets appropriately, but also recognition that the council wants to try and make sure that it's official in managing its assets. And so we think the scenario where we can shift costs and also, as we begin to develop staff, look at some of our other smaller programs that we may have some exposure to outside managers to see whether we can over a longer period of time do more of the things on our own, principally probably focused on what we're doing in the short to intermediate area with fixed income exposure for some of the endowments where there might be some opportunity, probably much longer-term focus, if it's ever to look at the equity programs and the things that are less investment grade, and I think we believe, you know, benefit extremely from having a highly diversified exposure through the outside management. The report then moves on, and I won't run through these things except to remind you that the Nebraska educational savings plan, the College Savings Plan, on 43, has in excess of $2.2 billion in it, and it did continue to grow over the year. Page 47 would show you that there was an increase both in contributions of about $109 million, as well as almost $250 million in earnings, that went back to the various participants. So a program that continues to do a good job I think for the folks that choose to participate in it. And then we move on to the various endowment programs and other items. Again, I would be happy to answer any questions you might have about any of those but I won't belabor the point by going through them. Again, they're principally fixed income invested...well, the 50/50--the general endowments have a 50/50 allocation: 50 percent equity and then fixed income on the other half. A couple of the others have some equity exposure but it varies depending on the nature of the fund. The back part of the book, supplemental information, are copies of the various policies the council has adopted for governance, and then the report finishes by providing you with some supplemental information at the very last that I just want to bring to your attention because of the fact that, on page 116, it costs us, including internal costs and expenses paid to outside managers, $33.7 million to provide oversight and custody and monitoring of the various assets under our control, and that's about 26 basis points, which we think...you know, the nominal dollars sound like a big amount, but in comparison to the total assets under management we feel it's a very cost-effective program. The council has continued to look at that. A couple things that we're doing besides looking at the internal staff is we did just recently take action to move about 25 percent of the global equity portfolio to a passive management. Some of that is to smooth out performance but also in recognition of wanting to improve the cost economics and that. Twenty-five percent is about $320 million that it will save us in management fees because the lower fees for the indexing, about $1.3 million in fees on an annual basis. We'll look selectively at doing things like that in other asset classes where there's an opportunity, and we don't think we're trading off long-term returns at the expense of just saving a few what are smaller dollars. But we think here we're saving money that will in the long-term provide benefits to the program. And I believe, Senator, I will end my report there and be happy to answer any questions that you might have. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: Thank you, Mr. States. Any questions from the committee? Senator Pankonin. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR PANKONIN: Thank you, Chairman Nordquist. Mr. States, thanks for being with us today. I did take the report home last night and enjoyed looking at both reports. Obviously, what's happened, over this last week in Japan, and listening to the markets on the way down this morning, the disruption it just I guess proves once again we can plan and plan, but those circumstances will be interesting not only in the short term but more of the longer term frame about how that influences. Any ideas at this point? [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

JEFFREY STATES: You know, the current activity in what I'm reading and seeing, you know, is event-driven. And so to that extent some of the current market movements should be fairly short-term. I mean it's viewed as volatility trading as managers and folks try to move to be defensive in some cases in their portfolios. So the trading down, which could end up being, though, as much as 5 or 10 percent in some cases, from that perspective I think is expected to be short-lived. And partially the reason is that...well, it seems crass, but to say that there's no example that an earthquake has ever kind of derailed the global economy; that we seem to be able to go through events that we never anticipated, so that may not be fair to say. But in the context of Japan, the region that was impacted is only about 6-8 percent of their GDP. The real short-term impact is the fact that it hurts their infrastructure, and so it's going to slow their economy down, and the impact there is expected to be significant. It may be a 1.7, you know, 2 percent decline in their GDP. But beyond that, the impact on the rest of the market seems to be expected to be kind of something that the global economy will weather, concerns clearly about the impact on the energy markets to some extent and what happens there and the thoughts about how we replace that. But I think the overall view is that it may have a slight impact on slowing the economy a little bit but it won't derail the global economy and the economic recovery. And in the short term, although short term could be 3-5 months or longer, that we will move past this from an event as the Japanese...I guess, you know, as their infrastructure gets replaced and things start to operate again, that as soon as that happens the markets will calm and the volatility trading, anyway, will disappear. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR PANKONIN: Thank you. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: Other questions from the committee? Senator Heidemann. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR HEIDEMANN: I read in the paper, and I should know better than to get information from the newspapers, but on defined benefits plans I've read that you can't...that's the best rate of return that you can get; you can't match that with defined contribution or cash balance. But it appears here that you can get just as good a rate of return on cash balance as you can with defined benefit. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

JEFFREY STATES: Senator, I would say that is the case because, in our program anyway, the cash balance is invested identical to what we're doing with the defined benefit. So I think the difference depends on who makes that decision. And so if it's self-directed, you end up with having mixed results similar to what we had in the deferred comp or the defined contribution plan. And so, yes, I mean you can match the returns if they're invested in the same basis. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR HEIDEMANN: Thank you. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: I guess related to the defined contribution/cash balance issue, is there, I guess I didn't see it in here, but a comparison, maybe over time? And this was I think the reason that part of it was changed was long-term people were making, maybe on the conservative side, not appropriate investment choices. Do we have a...maybe it's you, maybe it's the Retirement Board, but over the...since cash balance was...the inception of cash balance, an investment return in the aggregate of the defined contribution versus cash balance? [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

JEFFREY STATES: You know, we don't generally do that, primarily because of the fact that the investor makes the allocation. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: Sure. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

JEFFREY STATES: But I think we do have the cash flow information, as you can see in the back, where we could give you at least an estimate of the trade-off. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: Yeah, that would be interesting. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

JEFFREY STATES: What I can tell you is that an example of where the returns are going to be different is the fact that a significant portion of the DC program--at least in 2002, when we took it over--was in the stable value product, and there's still probably 25 percent of the assets. I think it's about $150 million to $160 million that are invested in that stable value product. That's probably worked for folks in the short term, but it's designed, because of the nature of it, to return about 3 percent. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: Sure. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

JEFFREY STATES: So it's not a growth vehicle and it's not going to serve people well in the long term, and so that's...but I'll go back and see if we can't provide you the information, because I think we can do a general comparison, but it just by looking at how the assets have changed over time, but. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: Sure. Sure. As we looked at the additional staff you've hired this year, what kind of measurement can you provide to us, or in the future will be able to provide to us, I guess to assess the efficiency of that versus having that managed on by an outside firm? [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

JEFFREY STATES: Senator Nordquist, I think that's one of the reasons again that the council wants to maintain a relationship in some form with a manager that may run or give us advice on a similar pool so that we can kind of compare over time how our internal management does. But our...and we do want to make that comparison to make sure that we're not being shortsighted and just saving a few dollars at the expense of returns. But I think that's our intent is to try and keep some sort of a model portfolio in a form that we can track, and the best way to do that is to probably have an advisor kind of construct what they would do. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: Um-hum. And then I guess the last question I have, and this is kind of a crystal ball question. But I mean we don't know when we're going to start with pulling back on QE2, but what impact is that going to have? [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

JEFFREY STATES: You know...and I didn't mention that and I should have. I mean, you know, one of the big unknowns today, you know, is whether even the U.S. economy has significantly recovered to be able to continue to grow and function without government support. And I'd venture to say that I read, and I think it was probably in The Wall Street Journal, yesterday, that there are already conversations about the fed thinking about needing to continue to provide additional stimulus by extending the program beyond June 30 if the jobs market doesn't...you know, unemployment doesn't start to come down and the economy start to pick up. I think there's getting to be more and more resistance to that but it's still talked about, and so, no certainty. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: Sure. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

JEFFREY STATES: But I think there's a lot of concern that as the government backs out, it does take a significant amount of stimulus with it. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

SENATOR NORDQUIST: Um-hum. Any additional questions? Seeing none, thank you. Is there any additional testimony related to the report from the Nebraska Investment Council? Seeing none, thank you. We'll now hear the annual report from the Nebraska Employees Retirement Systems. Director Chambers. Thank you for being here. [NEBRASKA INVESTMENT COUNCIL ANNUAL REPORT]

PHYLLIS CHAMBERS: (Exhibits 2 and 3) Good afternoon, Chairman Nordquist and Retirement Committee members. My name is Phyllis Chambers, P-h-y-l-l-i-s C-h-a-m-b-e-r-s, and I'm the director of the Nebraska Public Employees Retirement Systems. I appreciate the opportunity to appear before you today and present our annual report. Despite all the negative publicity that you're hearing about public employees retirements systems across the country, I'm pleased to report that it has been a good year for the Nebraska Retirement Systems. Our investment funds continue to improve, and that has helped maintain the funding status of our defined benefit and cash balance plans, and the improved performance has also helped the individual members of the defined contribution, deferred comp, and DROP plans. We've continued to progress with our IT systems, our benefit processes, and services to our members. The 2011 Annual Report is a valuable resource for you in providing you with important information about our agency. I hope you will use it as a reference if you have any questions about the plan, and the report is also available on-line, on our Web site, for any member of the public to view. At the end of December 2010, NPERS had a record number of member accounts--112,827 accounts now--and with assets of $8.2 billion. As of the last actuary report, the school plan is 82 percent funded, the State Patrol plan is 85 percent funded, and the judges plan is 100 percent funded. The state cash balance plan is 94 percent funded and the county cash balance plan is 95 percent funded, and those numbers are from a year ago. The actuary is currently evaluating the plans and will be presenting a new report in April of this year, which will have the December 31 numbers. I'd like to walk through the report with you at this time--I think you have a copy of it--and point out to you some of the key items in the report. On pages 1-4 you'll find the agency overview, which talks about our mission statement, agency goals, statutory authority, and our organizational structure. On page 4, you will find--4 and 5--you will find our 2010 accomplishments for the year. I would like to highlight a few of those. The call center answered 36,000 calls this year and we met with over 2,300 members who visited our office for appointments and for other retirement information. The benefits department processed 1,387 school retirements this year, 445 estimates for purchase of service, 214 actual purchases of service, 50 qualified domestic relations orders, and 31 disabilities. NPERS also distributed $474 million in benefits to plan members in all six plans, and those include: annuity benefits, rollovers, refunds, systematic withdrawals, and required minimum distributions. NPERS also transitioned our IT support and maintenance from Hewlett Packard, our vendor, over to the Office of the CIO. We currently have three employees in our office. One is our IT manager and two of them are IT developers, and that has worked out very well. So I think that that has been a good plan; we'll see how it goes in the future. But I'm very pleased with our cooperation and collaboration with the Office of the CIO. Our data services department processed over 35,000 pieces of incoming mail, 195,000 pieces of outgoing mail, and scanned over 380,000 documents. And we've entered 5,600 old beneficiary forms into the system, and we still have a number of those old beneficiary forms to input as well as verified service for another 700 school retirees, and we also verify their service as they retire. So we continue to do our daily work as well as try to get caught up on a lot of the old work that we're doing. You'll see, on page 6, our 2011 action plan. We are planning to implement a process improvement/quality assurance function where we can address changes to our IT system and our benefit processes. We also want to introduce SharePoint technology in place of our old intranet system. We are finishing up our disaster recovery plan for the agency. We have our backup site for our computer systems and data, so that is all taken care of. We are working with the Building Division on moving our agency to the Assurity building. We were informed last year that we were to be moved from our current location. I do have two concerns about that. One is our space that we have for our agency employees and the members as they come into the office, and so I'm working with their space planner to make sure we have adequate space. When we moved to our current location at the Tier One building, which is now Great Western, we had 40 employees. We now have 53 employees and we have three auditors there about 8-9 months of the year, so we are very crowded in the space that we do have. And my second concern would be the parking. And we do want to make sure that we have adequate parking for the employees, for the members who come in to our office. They travel from all over the state. We had quite a few members here during the girls and boys state basketball tournaments. They make their appointments ahead of time, and so we want to be able that they have adequate parking so they can find our agency and be able to come for their appointments. We also will be issuing an RFP for our compliance audit which occurs every ten years--and a number of other actions plans there. The report includes a summary of our legislative bills for the last ten years which might be helpful to you. On page 10 is our investment return and asset allocation which Jeff States has already discussed with you. Our funded status is also explained on pages 11 and 12. And Program 515 is explained on page 13. We have submitted a request to the Appropriations Committee for funding of Program 515, and we also have several bills in the process, as you are aware, for increasing contributions to the school and State Patrol plan to meet the actuarially required funding recommended by the actuary. On pages 14 and 15, you'll find our retirement plan assets summary and our membership summary. Currently, we have about 68 percent of our membership is in the school plan; about 19 percent is in the state plan; and about 8.5 percent are county members. We have 3.5 percent of our membership are in the deferred comp plan and less than 1 percent in the judges and the State Patrol plan. Page 16 shows our operating budget. This year we are operating just over $5 million. Our operating budget has been coming down over the years, and we are very...we've been very conservative with our operating budget. We are operating at 6 basis points right now. And if you include 2.3...or 2.8 basis points for the operating of the Investment Council and the 26 basis points that Jeff States talked about for the investment managers and consultants, we are operating the entire Retirement Systems with 35 basis points. Our education services department has been very active. We've had over 40 seminars for retirement planning for members and five retirement planning seminars for financial planning, and we had seven employer workshops where we have the school employees come in. We meet with them to bring them up to speed on any changes that we have in the system. I'd like to point out, on page 19, the service delivery results. This was omitted from last year's report and we've included it this year. The Public Employees Retirement Board revised its policy this year to process retirements within 90 days instead of 60 days. I think that was a concern that we were not processing them in an appropriate amount of time. I did a lot of research on this the last year, and I've provided you with a handout, a color handout, that shows the number of retirements we processed last year. The handout shows each month how many were processed and how long each of those retirements took. So if you look at the top of the chart, in January we processed 29 retirements. Twenty-six of those were done in 30 days, 60 were done in two days (sic), one was done in 70 days, and so forth down the chart. If you look at the graph at the bottom, you will see that the majority of our retirements are done in the summer, in July, August, and September into October. That is when we are the busiest. I will tell you that for an active person who just retired and is applying for retirement, their benefit will not be processed any sooner than 40 days. It takes 40 days from when they terminate till we get their final contribution and their final contribution data. So anyone that retires in the heat of the summer in our major system is going to be at least 40 days. And so those that are processed in 60 days, it only took us really 20 days to do those. And then if you look, you will see that some of them take 60-90 days. And those that take over 90 days are usually those that we don't have correct documentation for, whether it's a birth certificate, a marriage license if they're applying for joint and survivor, if we have exemption forms, and so forth. So there are a number of reasons we might have to look at a contract. Yes. [NPERS ANNUAL REPORT]

SENATOR PANKONIN: Well, if I could ask a question. [NPERS ANNUAL REPORT]

SENATOR NORDQUIST: No, go ahead. No, that's all right. [NPERS ANNUAL REPORT]

SENATOR PANKONIN: And I'm going to have to leave fairly soon here for another meeting, Ms. Chambers, and I appreciate this information. I'm just curious, on page 4, and you mentioned it, the benefits process: 1,387 school retirements and other places in the report it talked about the 1,229. [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: The difference are the beneficiary retirements that were processed for deceased members. [NPERS ANNUAL REPORT]

SENATOR PANKONIN: Okay. So that difference... [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: So there was about 150 death members. [NPERS ANNUAL REPORT]

SENATOR PANKONIN: Okay. That helps me understand. [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: Yes. [NPERS ANNUAL REPORT]

SENATOR PANKONIN: Right. [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: Yes. So there is a... [NPERS ANNUAL REPORT]

SENATOR PANKONIN: So these would be the active retirees here. [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: These are the active retirees. That's correct. [NPERS ANNUAL REPORT]

SENATOR PANKONIN: Thank you. I'm sorry. [NPERS ANNUAL REPORT]

PHYLLIS CHAMBER: Sure. So consequently, I just want to say that those members that are retired within 30 days, the 11 percent on this chart and the ones that show up as 30 days here, those are members who actually retired a year, several years ago, several months ago, but they're waiting for the Rule of 85 for their age and service to equal 85 and/or they're waiting to be at least 60 to retire so that they do not receive a reduced benefit. So those are not...the ones that are processed in 30 days are not active retirees that are just now completing work and retiring. The remainder of the report contains information about our internal audit process. The appendices are similar to what they've been in the past containing the information about the amount of benefits being paid, by state and by county, and information that also contains our board policies in there. I do want to acknowledge the Nebraska employees that work for NPERS, because they do a terrific job and they really do care about the members. They work extremely hard for the state of Nebraska, and we strive to find ways to improve our process and make the best use of our resources. And I'd also like to acknowledge the Public Employees Retirement Board. You could not have a finer group of individuals. They are very dedicated to making sure that NPERS is administering the plans to the highest standards. They're very conscientious about their fiduciary duty. And I would like to say it's an honor for me to serve as your director. I want you to know that the PERB and I are very willing to work with the committee on any retirement issues. It's clear that the public employees retirement systems around the country have some challenges. And so I think it's important that we examine our plans for the long term, and I think we have some...we're going to be doing some studies this summer on our long-term funding. I also...I just want to thank the members of the Retirement Committee for their commitment and support of the Retirement Systems and your leadership. And I hope that you are proud of the work we are doing. I hope, as you talk to your constituents and other colleagues here and around the country, that you can be confident that our system is well funded and it's well managed, and that you have made good decisions about the plans and about the benefits that Nebraska is providing for its public employees. And I don't know how much time you have, but I'm willing to answer any questions you have. [NPERS ANNUAL REPORT]

SENATOR NORDQUIST: Yeah. I know a few members have got to take off here, but I guess I have two quick questions. First, on the...comparatively, have you seen any data...you said we have a...we manage our entire system within 35 basis points for everything, from the investment side to the administration side. Do we...is there numbers out there to compare that to? [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: Well, from the administrative side, they range from about 7 to 12 to 14 basis points, so we're very much on the low side. [NPERS ANNUAL REPORT]

SENATOR NORDQUIST: Okay. [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: For administrative. And I do not know about the investment part. [NPERS ANNUAL REPORT]

SENATOR NORDQUIST: I know I've seen some numbers before from the council, but I can follow up with Director States about that. And then just on the issue of processing, I guess why the change to 90 days? And then I seem to remember in the past there really weren't a lot that went over 90 in the past. Now we're seeing about 10-11 percent. Kind of maybe the reasons for that. [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: Well, some of those would be our exemptions, which we are addressing with the exemption bill the last five years that has substantially gone up. Again, some of those are people that don't get in their documentation. We have people that retire, try to retire early, but they may have a 10- or 11-month contract, and in order to get an extra benefit, and then we have to check with them and get the contract back in, and say, you know, you're not eligible to retire yet. So there's some contract issues and just a...there's always going to be a few that we have some issues with. [NPERS ANNUAL REPORT]

SENATOR NORDQUIST: Okay. [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: I will tell you that we changed the policy to reflect our practice, that retirements are...we're not going to be any less efficient in processing our retirements. We will continue to process them as quickly as we can. And I will also say that the way we process, there's a couple different approaches on processing retirements, but we try...we look at every retirement before it goes out the door. We are committed to making sure the benefit is correct, before it's paid than afterwards. And what happens in a lot of the larger systems where they have 5-10 times as many retirements, is they push the buttons. They calculate the benefits and they send the checks out. And then they go back and they find the mistakes, and then they try to fix them. Well, we...and I think the auditors can attest to the fact that we have very few mistakes and we do...our approach is to be proactive and make sure the benefits are correct before they go out the door. It takes a lot more time to correct them than it does to make sure they're correct ahead of time. [NPERS ANNUAL REPORT]

SENATOR NORDQUIST: Great. Thank you. Any questions from Senator Karpisek? [NPERS ANNUAL REPORT]

SENATOR KARPISEK: (Laugh) No, I don't have any, Senator. [NPERS ANNUAL REPORT]

SENATOR NORDQUIST: No, all right. Seeing none...(laugh). [NPERS ANNUAL REPORT]

PHYLLIS CHAMBERS: Thank you for staying around. [NPERS ANNUAL REPORT]

SENATOR NORDQUIST: Seeing none, thank you. Any additional testimony related to the Nebraska Public Employees Retirement System? Seeing none, that will conclude the hearing on both agency reports today. Thank you. [NPERS ANNUAL REPORT]