

Transcript Prepared By the Clerk of the Legislature
Transcriber's Office

Nebraska Retirement Systems Committee
November 10, 2009

[CONFIRMATION]

The Committee on Nebraska Retirement Systems met at 12:15 p.m. on Tuesday, November 10, 2009, in Room 1525 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on gubernatorial appointments. Senators present: Dave Pankonin, Chairperson; Jeremy Nordquist, Vice Chairperson; LeRoy Loudon; and Heath Mello. Senators absent: Lavon Heidemann and Russ Karpisek. []

SENATOR PANKONIN: (Recorder malfunction)...open our confirmation hearings this afternoon as scheduled at 12:15. This is the Nebraska Retirement Systems Committee, if you're...hopefully, you're in the right room. Looks like everybody here knows that. And, obviously, probably one of the basic pieces of information we always share--if you have a cell phone, if you'd turn it off, or the manner mode, it would be appreciated. And, when recognized, please spell out your first and last names for our clerk and transcriber. And after testimony, stay seated so we can ask any questions that may come up. And we'll have the senators that are here introduce themselves and our page, and we'll start with Senator Loudon. []

SENATOR LOUDEN: Senator LeRoy Loudon. I represent District 49, which is in the northwest corner of Nebraska. []

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

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

SENATOR PANKONIN: I'm Dave Pankonin, Senator, District 2, live in Louisville, Nebraska. []

SENATOR NORDQUIST: Jeremy Nordquist, District 7, downtown and south Omaha. []

ERIN MACK: I'm Erin Mack, committee clerk. []

SENATOR PANKONIN: And... []

BLAIR : And I'm Blair. []

SENATOR PANKONIN: ...our page. Thank you. Okay, we will start. Our first confirmation hearing today is for Jeffrey States, who's been appointed by the Governor to replace David Bomberger, the previous State Investment Officer. Jeffrey, have a seat. After Mr. States has been interviewed, we will ask for anyone who wishes to testify as a supporter or opponent or in the neutral position. Mr. States, welcome to Nebraska, and let us...tell us a little bit about your background. I know we have some materials

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here, but we'll let you talk about that a little bit. []

JEFFREY STATES: Okay, certainly, Senator. Thank you, Mr. Chairman, members of the committee. I'm very excited and pleased to be here today as the selected person to become the State Investment Officer. And I come here from the retirement system in Sacramento, California, where I've been the direct...or the chief investment officer for the Sacramento County Employees Retirement System for the last 12 years and prior to that had spent a number of years in the state of New Mexico, the last position holding there is director of investments for the New Mexico Public Employees Retirement System. And prior to that I had been director of the state board of finance and worked in a variety of other finance positions. Born and raised in Indiana, attended Purdue University, where I received a B.S. with honors in management, and then shortly after graduation there had moved to New Mexico initially to pursue some additional education and then went to work for the state of New Mexico. I, as I say, have spent all of my career...professional career pretty much working in the public sector, in either public finance or investments and also some experience with taxation and revenue. But I worked closely at various times with the state treasurer's office and look forward to that relationship here as well as with the investments and the pension funds.

[CONFIRMATION]

SENATOR PANKONIN: Thank you. I'll start off with the first question. And in the spirit of disclosure, I was at...not a voting member, but I was able to attend the interview process and enjoyed that. Why don't you talk a little bit about your investment philosophy, and I know obviously we use a lot of outside groups that do that, but obviously with our target of 8 percent, some perspective on that, both from a philosophy and history. [CONFIRMATION]

JEFFREY STATES: Yes, sir. I would say from a philosophy standpoint, I tend to be, I think, a fiscal conservative. I believe that you need a well-balanced profile that balances risk versus return and that the risks taken should be appropriate for the assets that are being invested. And noting that the Council has a variety of asset bases, some of which are operating fund or related and General Fund monies--a much different profile than those that might be appropriate for the Retirement System. I have had the experience throughout my career--primarily working with external managers, some internal management for fixed income and short-term investments and governments and corporates, working in most asset classes. Obviously the bulk of the assets in the retirement systems I worked for were invested in domestic equity and fixed income, worked with international investments, real estate experience in California for the entire 12 years that I was there. And then more recently, similar to the plan here, I've had some experience with private equity and some of the alternative investment classes. So I think I've had some experience and worked in almost every asset class, some of it hands-on, much of it through a process similar to here, working with a consultant to make sure that we try to hire the best investment talent we can to manage the assets.

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From an asset-allocation standpoint and just structure, I mean, I believe, you know, that we should have clear and very precise policy guidelines. And I think the Council here believes that, too, so that we have made conscious decisions with respect to how the funds will be managed. I think we understand the risk profile of each of the investments we're making and then try to monitor the performance of the managers to make sure they stick to those rules and aspects. As it relates to the investment return, we certainly know 2008 certainly proved that the best planning can, you know, derail any program. But historically, a mix of primarily stocks and bonds have been able to achieve a return somewhere in the neighborhood of 8 percent with a proper mix. That seems to be achievable again here still. I think over a longer period of time, a little bit of additional return through diversification through incorporating some alternatives like private equity and some real estate. But I think it's important--I think I said this in my interview with the Council--to look at the sources of where our return's coming from, and to the extent that we can build a solid base through income-generating vehicles rather than just all capital appreciation and more risk-averse, that we can weather the storm a little bit better in these more difficult periods. And so I think that would be one of the things that we try to assess, is how we're achieving the returns we're getting and looking at where the sources of return are coming from as we go forward--try and make sure as much of that's in income-based versus just more capital appreciation, which tend...although risk-based programs have to be included in order to achieve that 8 percent level, that we want to try and make sure that we diversify it as much as possible and build a solid base to get there. [CONFIRMATION]

SENATOR PANKONIN: Thank you. I also want to note that Senator Karpisek has joined us for the hearing. And any other questions? Senator Nordquist. [CONFIRMATION]

SENATOR NORDQUIST: Yeah. Thank you, Mr. States. Yesterday in Appropriations we had a little discussion on this...it's been a discussion we've had in the committee both here and in Appropriations multiple times regarding the most efficient staffing pattern for the Investment Council, how we can best make use of resources, what, you know, what percentage or what funds should be managed internally versus externally and how we can come up with the absolute best, most efficient model for the state. I'd like to hear some of your thoughts on that. [CONFIRMATION]

JEFFREY STATES: Sure. You know, I think most important to me, of course, is to make sure that we are employing resources--whether they're internal or external--that are professionally qualified to manage the assets that are...that we're responsible for. So, if we can hire the qualified staff to do things internally...and it's both a question of hiring the professional training but also have a depth of staff so you have some protection and backup when people aren't there. I think it...you know, it's good to assess how we're doing things. As the operating investment pool has been run, you know, in-house for a long period of time, I think you can continue to look at those aspects that tend to lend themselves because they're publicly traded and maybe, you know, whether it's

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investment grade or even in some cases maybe some of the indexing that's done and the equity programs, where the functions can be internalized or systematized, I think we'll look at that. I'm not going to promise you that we're going to make any quick changes or that we will, but I think the resourcing is the protection. And the trade-off that you get--although it's expensive for outside management at various times--is both their expertise as well the depth of the resources, particularly as you lose managers or...and the kinds of, you know, the research that they can do and the background, that when markets are generally calm isn't always obvious and you can make money fairly easily, and sometimes we get kind of relaxed and complacent. And that...the value of some of that outside assistance probably jumps forward, particularly in the alternative spaces, when the markets get more stressed. And so, philosophically I believe we should try and do things as efficiently and effectively as we can and, to the extent that there's an ability to add the internal resources, if they're needed, is to do things in-house. I think the Council is interested in doing that. I am too. If the internal staff can't be built, then I would, you know, continue to be a proponent of using external management to make sure that we have that depth of resource. [CONFIRMATION]

SENATOR NORDQUIST: Would you say now...is it any different at this point in time, as far as finding qualified people? Is it easier, do you think, or more difficult or same as...? [CONFIRMATION]

JEFFREY STATES: You know, I would think, having had some recent experience, I mean--not myself in interviewing for this job--but in doing some searches in California for staffing and helping some other plans do that, that the talent pool is reasonably good right now. A lot of respondents...people have found the public sector, to some extent, to be a little more job-secure, in some cases. But also you do have people that are just looking for employment. I think one of our concerns has been that, yeah, the talent is there, but many times you find people are just looking for a place kind of to park for a short period of time, and then they're going to jump back off. So... [CONFIRMATION]

SENATOR NORDQUIST: Thank you. [CONFIRMATION]

SENATOR PANKONIN: Any other questions? Senator Louden. [CONFIRMATION]

SENATOR LOUDEN: Yes, thank you, Senator Pankonin. Jeffrey, on...do you think 8 percent is feasible and sustainable at this market nowadays for these investment portfolios we have? [CONFIRMATION]

JEFFREY STATES: Senator, I do. And I think our investment consultant still believes that it is. I would not tell you, necessarily, in the next three years that it's going to be achievable over that cycle. We've had some strong recovery recently, but given the outlook for the economy and some issues, it may be a challenge to get there. But I think over longer periods that it certainly still is an achievable objective. [CONFIRMATION]

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SENATOR LOUDEN: I was wondering, there is quite a hole dug, you know, over the last few years. And I guess my concern is that they're trying to get 8 percent. What...are they getting into some higher-risk investments than they should be for trying to meet that 8 percent? Would they be getting into something more speculative than they should be? [CONFIRMATION]

JEFFREY STATES: I don't think we will. And, as I say, I would never encourage the Council, and I don't think the Council itself would--to chase returns in order to try and recover quickly. I think we want a stable program that would be expected over a longer period of time to achieve that objective. And so I wouldn't see us changing our asset allocation dramatically to chase returns. The reality, you know, for this current year is that because the market was down so much that with, what, two months left to go that 2009 may on a relative basis look like a pretty good year. Fiscal year to date through September 30, the plan was up about 17 percent from where it was. The reality is that we lost 28 percent, roughly, in 2008. So an 8 percent return, if you're going to measure it year by year, we may see. It's when you bridge it over those cycles that we have to kind of...that's what I was saying, I think, a three-year rolling return until you...until we pass that 2008 into the cycle is going to be hard to see it kind of disappearing over a longer term. It's going to take a lot of time to work it off. But I don't think we're going to chase it, but I do think we can build into the plan an annualized return that would be in that range on a regular basis and over time will get back to a stable plateau for longer rolling periods. [CONFIRMATION]

SENATOR LOUDEN: Okay. We always...I think we have a college professor out there who always sends his students down here every year, and they interview us to find out if we're investing in stocks that are in countries that are, what would you say, have civil rights problems or human rights problems. [CONFIRMATION]

JEFFREY STATES: Yes, sir. [CONFIRMATION]

SENATOR LOUDEN: Are you familiar with that since you come from California? Has that been an issue out there? Are you careful where you invest in companies or corporations that do business in these kind of places? [CONFIRMATION]

JEFFREY STATES: I'm certainly familiar with the issue, yes, Senator. We generally, and I think it's true here, you know, have hired managers who invest within their guidelines. Generally...I don't know that we have an express policy but would not look favorable on them investing in countries that the United States government, in particular, has not said, you know, are appropriate. There are some countries that are kind of off limits. Generally we're investing in stocks in countries that are open markets and are fairly traded. So they have to have an index and a working, functioning market. Pretty much that tends to exclude those most extreme areas, because they aren't really

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open to do business in a way that we would want to. So I'm conscious of it, and, to the extent that I have an awareness of the managers who are using...I'm relatively comfortable in saying we're not invested in any of those countries and wouldn't expect to be and certainly don't have a program that would be designed to go out and do that. [CONFIRMATION]

SENATOR LOUDEN: Okay, well, thank you because we get interviewed every session on that. So I thought we're probably going to have to be prepared to answer them sometime. So I thank you for your statements. [CONFIRMATION]

JEFFREY STATES: You're welcome. [CONFIRMATION]

SENATOR PANKONIN: Any other questions? Seeing none, Jeffrey, thank you for being available today. [CONFIRMATION]

JEFFREY STATES: Thank you for having me. []

SENATOR PANKONIN: Will just briefly ask--after you have left the chair there--if there's anybody else that want to testify on your behalf or opposed or neutral. But otherwise we'll get to Mr. Dinkel if we don't have anybody else on Mr. States. Thank you. Is there any other testifiers regarding Mr. States' appointment? Seeing none, Mr. John Dinkel, please come forward. Mr. Dinkel has been reappointed by the Governor to continue his service on the Nebraska Investment Council. He began serving on the Council in 2006. We will do the same type of procedure and let him visit a little bit about his background and his service on the Council. And I do want to note that Mr. Dinkel is in the farm equipment business like myself. And so for him to take off from work today during a late harvest and big push, I really appreciate him coming down to Lincoln and...so he could be with us. Mr. Dinkel, go ahead and start. []

JOHN DINKEL: No problem. I appreciate the comments, Senator. Good afternoon to all the other senators here. First of all, I want to thank each and every one of you for your service, because, you know, especially now in the budget-cutting session and all your other issues, I know sometimes it's not fun being a state senator. But I appreciate what you're doing for Nebraska. As he mentioned, I was here three years ago--some of you were on this committee. And it's been an interesting three years. To be honest with you, I hesitated a little bit when the Governor called me for reappointment for a variety of reasons. You know, my background is not strong in financials, as far as a professional investment adviser, that type of thing. I personally do and have invested for many years for myself. I enjoy reading all the financial publications. And I think the other board members can attest that I do come prepared to the meetings. I read, as far as all the backup information, before the meetings. And I also read Wall Street Journal, Forbes, all those, except during the fall I can run out of time a little bit. But anyway, I do enjoy that part of it. But in the end I decided to give it a shot here again. I think I do offer some

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balance on the Council. There's three people that are very, very qualified with financial backgrounds; in fact, that's what they're done for a living. There's myself and one other board member who I would call more lay members. So...and I would say that's really a good balance on the Council, to have us that way. So from that standpoint...and geographically, of course, I'm from the northeast corner of Nebraska. So that part's probably okay, too, to have a little geographic balance on the Council. So anyway, as far as my philosophy goes, I'm probably to the extreme end. Senator Louden, you'd probably be happy to hear I'm very, very conservative when it comes to investing with the state. If you go back and look at some of the votes--in fact, not all votes have been unanimous by a long shot. I've been a "no" vote more than once on a couple issues that I didn't 100 percent feel comfortable with. So anyway, I am humbled and honored to be considered for this. And I look forward to working very hard, and this...I tell you what, this is a huge responsibility. You know, you interview probably 95 percent of the citizens of Nebraska, and they've probably never heard of this Council before. And the dollars involved are just tremendous. It's caused me some short nights of sleeping, quite honestly. It's a huge responsibility. And I don't take it lightly at all. So...and I do appreciate Senator Nordquist's question. I would like to talk about that at the appropriate time, about internal versus external. But first I guess you want to ask some questions. Go ahead. [CONFIRMATION]

SENATOR PANKONIN: Questions? Well, I'm going to ask that one if you want to comment on that a little bit. Senator Nordquist had to join in on a conference call, but I also will tell you, when he left he says: I'm for Dinkel, too; he's good. [CONFIRMATION]

JOHN DINKEL: (Laugh) Well, I appreciate that vote. And in fact, I've worked with a couple senators through the process of hiring Jeff and so forth, and so we had a lot of different players involved in that process. So I think it was very good to have all the players involved early. So...well, as far as internal versus external, I've been personally, I guess you'd call it, a pusher of trying to do more internal. Just looking at numbers, I think we spend, I want to say, roughly \$24 million to \$25 million in the last year, calendar year, for managers. It's going to be a slow process to get staff up to adequate staff to handle more internally. We've met, like, with South Dakota. They do a lot of theirs internally, and they have, like, 20-some staff members. I mean...so it's not an overnight deal. But if you look at the numbers and the people you could hire for that, I personally think that we at least should start edging into that. In fact, the Legislature has committed some resources to us, and we have not actually hired a couple staff members. And part of it was due to a new person coming on board, and we want him to be a part of that. So that's part of the reason why we haven't filled some of those positions. So I don't know how all of this budget cutting is going to work, but, hopefully, at the end, when we're done, we'll still have some resources that are left to use. So I think that's very important. One example of internal versus external--we just farmed out some of the OIP management. And I think, Senator Pankonin, you're probably for sure knowledgeable on that. I believe, correct me, that the outside fee for managing part of

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that is around \$600,000. And that's one example. You know, you can hire a lot of people for \$600,000. So...now, granted, as Jeff said, they have a depth of resources and so forth. You've got to take all that into account. But that's just one example of dollars that were sent outside the state that I would hope that, personally, I would push very hard to get that phase back into local in-house management, personally. So--I'm not sure how the rest of the board feels on that. But in the relatively near future, that's just one example, I guess. So anyway, I'm a believer in that. [CONFIRMATION]

SENATOR PANKONIN: Appreciate your comments on that. Other questions? Seeing none, you're going to get off easy. [CONFIRMATION]

JOHN DINKEL: Can I make one comment about the percent return? [CONFIRMATION]

SENATOR PANKONIN: Sure. [CONFIRMATION]

JOHN DINKEL: Senator--and I hope I won't get into trouble with Jeff right off the bat here. But personally, again--and I know this has huge repercussions on the state budgets if you change that 8 percent. But personally, I'm a little bit uneasy with 8 percent. I think that's just a shade high. And sometimes I think we do push a little bit to the fringe for higher returns--a little bit higher on the risk spectrum than I'm comfortable with, personally at least--to try to achieve that 8 percent. So I personally think that should be scaled back a little bit, but I know there's huge repercussions with the budget projections and all that. So anyway. [CONFIRMATION]

SENATOR PANKONIN: Right. Well, I appreciate your comments on that. And as you said, there's not only...and as Mr. States also commented on the 8 percent, it's not going to be 8 percent every year. [CONFIRMATION]

JOHN DINKEL: No, right. [CONFIRMATION]

SENATOR PANKONIN: Some years might be 15, some years might be 5, but it's that rolling...but the ramifications both financially and politically of moving off that, as you know, it's big numbers. So--appreciate your comments on that. [CONFIRMATION]

JOHN DINKEL: Right. Yup. Yup. [CONFIRMATION]

SENATOR PANKONIN: And thanks for your...thanks for coming today, and thanks for your service and your continued service. [CONFIRMATION]

JOHN DINKEL: You bet. Thank you again. Do I...I don't need to fill this out, or do I? [CONFIRMATION]

SENATOR PANKONIN: I think that would be good. [CONFIRMATION]

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JOHN DINKEL: I do. Okay. [CONFIRMATION]

SENATOR PANKONIN: Go ahead and fill it out. [CONFIRMATION]

JOHN DINKEL: Okay. [CONFIRMATION]

SENATOR PANKONIN: Then we will go into a brief Executive Session...
[CONFIRMATION]

JOHN DINKEL: Okay. [CONFIRMATION]

SENATOR PANKONIN: ...to vote on these gentlemen. [CONFIRMATION]

JOHN DINKEL: Very good. Thank you for your time. [CONFIRMATION]

SENATOR PANKONIN: Thank you. [CONFIRMATION]

JOHN DINKEL: Have a great day. [CONFIRMATION]

Chairperson

Committee Clerk