LifeTimes

NEWSLETTER FOR RETIRED IPERS MEMBERS | Iowa Public Employees' Retirement System | Winter 2008/2009

A Message from Governor Culver

Dear IPERS members:

As you know, our nation is in the midst of an economic challenge that is historic in its scope. The economic recession hitting businesses and factories and farms and families across our state and nation has an impact on each of us.

The current economic circumstance is a challenge we must face together. But like Iowans statewide, I am optimistic that we will shoulder the challenge and confident about what the future holds for our state. We have always met challenges with solutions and problems with answers. And we always will. I am confident our Iowa values of resilience, strength, and common sense will sustain us through this, and any, challenge.

Recently, I met with IPERS CEO Donna M. Mueller to discuss how the declining national economy has affected IPERS and its nearly 320,000 members.

IPERS remains a sound retirement plan with solid long-term funding. Even though IPERS has suffered losses similar to what all investors are experiencing, as a long-term investor IPERS is in a strong financial position.

Retirees' pensions are secure and IPERS will continue to pay them on time. The contributions of current employees are safe and rights to the benefits they have earned remain intact. We will continue working to make certain that retirees and current employees can depend on IPERS today and for years to come.

Fortunately, while Iowa has not escaped the fallout from the national financial crisis, we are in a much better position than most other states. Iowa has more than $620 million in cash reserves, and our state's AAA bond rating allows us to take some action that other states cannot take.

Although we did not cause this economic crisis, we must respond to it. Recently, I cut nearly $180 million in State spending, including an across-the-board cut that went into effect on January 1. This is not what I wanted to do as governor, but it is what I believe must be done in order to balance Iowa's budget.

I am proud of how Iowans respond to challenges. Last summer, 80,000 of us helped our neighbors when our state was hit with record-setting tornadoes and floods. Today, working together, more than $1.3 billion in disaster aid is already helping to rebuild our state.

I am confident the resilient strength of Iowans will continue as we face new challenges head-on, and as a result we will come out stronger than ever before.

Sincerely,
Chester J. Culver
Governor of Iowa

"IPERS remains a sound retirement plan with solid long-term funding."

What the bear market means for your IPERS benefits

The name may have come about when traders in the 1700s speculated on the price of bearskins before trappers had caught the bears. Or the name could have come about because a bear attacks its opponent by swiping down. Either way, bear markets have come and gone many times before. Investors expect both bear markets and bull (rising) markets to occur as normal parts of the market cycle.

Although you have heard by now that IPERS guarantees benefits for life, you may still have concerns about how a bear market affects your future with IPERS.

This special section on IPERS' investments explains how the market relates to your benefits and the overall financial condition of IPERS. Also review IPERS' 2008 annual summary for information on IPERS' investment returns and funding.

What is a bear market?

A bear market is a prolonged period of declining prices on stocks and bonds, accompanied by widespread pessimism. Bear markets usually occur when the economy is declining and unemployment is rising, or when inflation is rising quickly. Many investors say a bear market starts with a downturn of 20 percent or more in multiple broad market indexes, such as the Dow Jones Industrial Average or Standard & Poor's 500 Index, over a period of at least two months.

A bear market does not affect when IPERS pays pensions or how much the payments will be.

IPERS uses a formula to determine the amount of your benefits. Retirees receive this amount for life. It does not matter whether the market is up or down on the day you retire—your pension amount does not change.

A bear market does not change when members can withdraw money from IPERS or how much their refunds will be.

The contributions working members pay to IPERS always belong to them, regardless of how many years they work in public employment. IPERS also guarantees interest on nonretired members' accounts at an annual rate of 1 percentage point above the one-year certificate of deposit. When members become vested after four years of working (or at age 55 when contributing to IPERS), they are entitled to a portion of the contributions their employer made to the IPERS Trust Fund based on their wages.

Nonretired members may withdraw their money from IPERS only when they no longer work in an IPERS-covered job. An IPERS refund is made up of a member's contributions and interest, plus, if the member was vested, a portion of the employer's contributions plus interest, depending on how long the member worked in IPERS-covered employment.

When nonretired members withdraw money from IPERS, they give up all membership rights, including future lifetime monthly benefits.

A bear market does not reduce the long-term potential of investments.

Although a bear market is unsettling when it occurs, a bear market is less of a worry for long-term investors, and IPERS is a long-term investor. As a government entity with large sums of money and long-term promises to keep, we look forward 30 years. Long-term investors such as IPERS expect bear and bull markets to occur, and we don't try to time when these events will begin or end.

The stock market has produced good income in the long run; IPERS' annualized return since 1981 is 11.10 percent. However, if we find we don't have enough contributions to invest, or the

market does not produce returns as expected, we can adjust because we work in a 30-year time frame. While our funding condition can sometimes look grim in the short term, we stay focused on how best to maintain a healthy financial condition over the long term.

A bear market can affect the overall condition of the IPERS Trust Fund.

IPERS benefits are intended to be prefunded. That means employees and their employers pay into IPERS during the employees' working years for future retirements. IPERS pools and invests the contributions from employees and employers in the IPERS Trust Fund. The amount of money from contributions plus investment income should be enough to cover the estimated cost of future benefits for those employees when they retire. A bear market decreases the value of the Trust Fund, reducing the percentage of future promised benefits that is prefunded.

A bear market can lead to contribution rate increases for members currently working.

Investments provide the largest percentage of IPERS' income. During the last ten years, over 70 percent of IPERS' income has come from investments.

When calculating future income, IPERS assumes we will earn 7.5 percent on investments each year, knowing investments will earn more in some years and less in others. A bear market means IPERS is not meeting its annual 7.5 percent investment return assumption. That is not a problem if the bear market is short-term or the loss is limited.

If markets stay down for a long time or returns are extremely bad in several successive years, the bear market can affect the financial condition of the IPERS Trust Fund. To restore balance between assets and liabilities, at some point IPERS would need to raise contribution rates to fund the same benefits for future retirees.

A bear market can lead to new actions by IPERS to ensure we have cash on hand to pay benefits.

IPERS has built up a larger cash reserve than normal to ensure we can continue paying benefits and issuing refunds. We are building up our cash reserve by selectively selling some securities and holding principal and income that we would normally reinvest. We have increased our cash reserve from about $25 million–$30 million to about $200 million.

A bear market does not affect when IPERS pays pensions or how much the payments will be.

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IPERS and the financial markets: Answers to the top 10 questions

1 *Are retirees' benefits safe during declining financial markets?*

Yes. Pensions are secure and guaranteed for life. IPERS has enough cash and other liquid assets it can easily convert to cash to pay all pensions for many years.

2 How are IPERS' investments doing?

The overall return for fiscal year (FY) 2008 was –1.33 percent. Although a negative return, it was better than the returns of most large public funds that have at least $1 billion in assets.

Since July, IPERS has experienced the same negative returns that every investor is experiencing. IPERS' return for the quarter ending September 30 was –7.08 percent.

Between June 30, the end of fiscal year 2008, and November 30, the U.S. stock market was down 30.74 percent, and international stocks were down 42.55 percent. The value of bonds, usually a safer investment, decreased 2.20 percent over the same time period.

IPERS diversifies its portfolio to manage investment risk. The table shows how IPERS distributes assets among different markets and how a diversified portfolio may gain value in some areas while losing value in others.

FY2008 Investments by asset class

Asset Class	Allocation Target*	Return
Core plus fixed income	34%	5.19%
Domestic equity	28%	–15.12%
International equity	15%	–7.57%
Private equity	10%	20.50%
Real estate	8%	6.12%
High-yield fixed income	5%	1.29%

***Target allocation, or percent, of total portfolio.**

3 With negative investment returns, how can IPERS continue to pay pensions for more than 85,000 retirees?

Contributions and some income-producing investments provide ongoing cash flow and, if needed, IPERS can selectively sell some of its liquid assets. In response to the extreme volatility in the markets, IPERS has increased its cash reserve from a typical amount of $25 million–$30 million to about $200 million.

4 Did retirees receive the November dividend in 2008? Will retirees receive the Favorable Experience Dividend (FED) in January 2009?

Yes. Because IPERS does not have a traditional cost-of-living adjustment to the monthly pension payment, the legislature created these once-a-year dividends to offset some of the negative effects of inflation. Although it sounds like the payments depend on investment returns, they do not.

The law guarantees a November dividend payment for pre-July 1990 retirees. However, the law does not guarantee an increase in the November dividend payment and the amount was frozen for the sixth consecutive year.

Those who retired after June 1990 are part of the FED program, but the FED is not a guaranteed payment. IPERS pays the FED from the FED Reserve Account established several years ago by law with money transferred from the regular IPERS Trust Fund.

The title of the FED (Favorable Experience Dividend) is misleading. Payments depend on whether IPERS has money in the reserve account, not on favorable investment performance. There is money in the reserve account to pay the FED for a few more years. However, the multiplier used in the FED formula was frozen for the sixth consecutive year.

5 Why does IPERS pay the FED when the market is down?

IPERS' CEO and the Benefits Advisory Committee, made up of employee, retiree, and employer representatives, felt paying the FED to retirees was the best alternative.

First, IPERS has money in the FED Reserve Account. The law restricts use of funds in the reserve account, established by Iowa Code section 97B.49F(2)(b), to dividend payments.

Second, people are experiencing financial hardship because of losses on other retirement savings and increases in the cost of living. The Social Security cost-of-living increase for 2009 is 5.8 percent, the largest increase since 1982.

Finally, not paying the FED could cause retirees to worry about IPERS even though IPERS is financially solid.

6 Why doesn't IPERS transfer money out of the FED Reserve Account to help the general IPERS Trust Fund?

IPERS could not meet the legislature's goals for the FED without money in the reserve account. Even if the legislature changed the law and transferred the money from the FED Reserve Account to the general IPERS Trust Fund, there would be no discernible impact on IPERS' funding status. The amount in the reserve account is just too small.

The FED Reserve Account also has experienced market losses. Even before the market downturn, the amount in the account was sufficient to pay the FED for only a few more years as the number of retirees eligible for the payment continues to increase.

7 Are the retirement benefits for people who are still working safe?

Yes. Benefits earned so far are guaranteed. Also, as a long-term investor, IPERS has a time horizon of 30-plus years. Better investment earnings in the future and suitable contributions should fund future pensions. As long as IPERS continues to pool contributions, share expenses among a large group of people, and invest for the long term, IPERS can continue to provide a solid retirement plan.

8 Can an IPERS member get a loan or withdraw money from IPERS for hardship reasons?

By law, IPERS cannot provide loans or allow hardship withdrawals of contributions.

IPERS is a defined benefit, or traditional, pension plan. While the money members contribute to IPERS, plus interest, is always earmarked for them, IPERS pools

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contributions to help pay for the future retirements of all members in IPERS. This may make it harder right now for some current public employees, but they are likely to be thankful that they kept their money in IPERS when they reach retirement age.

Participants in other types of retirement plans may face a less secure future. Hewitt and Associates, a global human resources consulting company, has reported 45 percent of employees cash out their 401(k)s when they change jobs. Hewitt is now reporting a trend of increased hardship withdrawals from 401(k) plans. The Center for Retirement Research at Boston College is raising concerns that individuals who do not have a defined benefit plan must bear full market risk. This points to a predicament in financing future retirements the country will have to face.

9 Will IPERS need extra contribution rate increases or money from the state's General Fund because of the market?

IPERS' entire income comes from member and employer contributions plus investments. IPERS does not get money from the state's General Fund and IPERS will not ask the legislature for a General Fund appropriation.

Because investments provide most of IPERS' income, IPERS may need the legislature to adjust contribution rates beyond what it already approved, depending on future investment returns and whether the legislature adds benefits in the next few years. We know from previous experience in a down market that in the long run, it costs more to delay increasing rates than it does to act quickly.

After the 2001–2002 market downturn, IPERS and the Benefits Advisory Committee recommended a 4 percentage point increase based on the actuary's analysis. The legislature increased contributions by 2 percentage points and phased in the increase over four years. The first 0.5 percentage point increase was not effective until FY2008. The law passed last year (Senate File 2424) directs IPERS to adjust rates as actuarially determined, beginning in FY2012, by no more than 0.5 percentage point each year.

10 Why doesn't IPERS stay out of the stock market and avoid losses?

To fund promised benefits without requiring exorbitant contribution rates, IPERS must take some investment risk. Stocks are an important part of a well-diversified portfolio for a long-term investor. Although it is the nature of the market to fluctuate, the market has proven itself over time.

IPERS' stock market investments have returned 11.10 percent on an annualized basis since 1981. IPERS could reduce losses in times like these if the entire portfolio was invested in less risky bonds, but IPERS also would have lower gains when times are good.

Investment terms you may hear IPERS use

Asset allocation. Determining how much of the full portfolio is invested in each asset class.

Asset class. A group of securities that exhibit similar characteristics and marketplace behavior. They are also subject to the same laws and regulations. IPERS' asset classes are domestic equity (U.S. stocks), international equity (foreign stocks), fixed income, private equity, real estate, and high-yield bonds.

Diversify. Including a variety of investments in multiple asset classes in a portfolio.

Index. A group of stocks representing a part of the market. The percentage of change in an index is more important than the index's actual numeric value. The Standard & Poor's 500 and the Dow Jones Industrial Average are examples.

Investment policy. A document that defines how an investor manages a large portfolio to increase the likelihood of meeting return and risk goals. IPERS' Investment Board adopts IPERS' investment policy and publishes it on our Web site and in our Comprehensive Annual Financial Report.

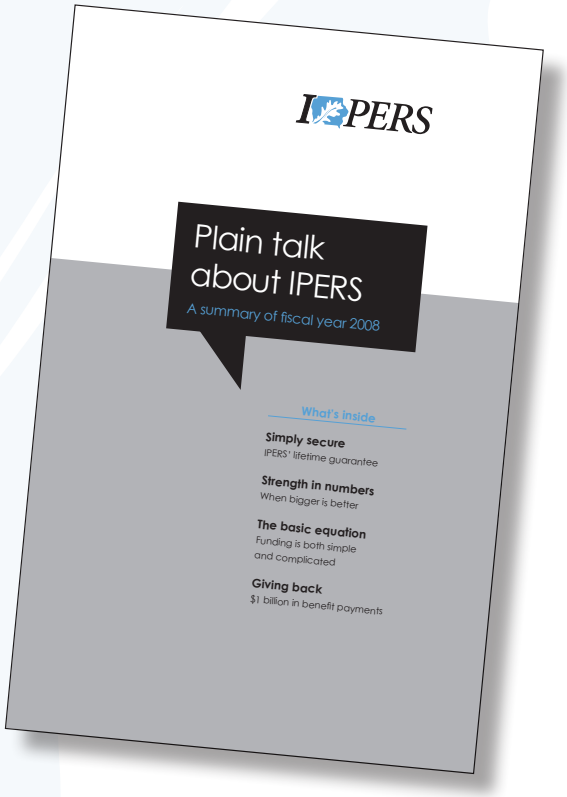
Long-term investing. Holding an asset for an extended period of time. Depending on the type of security it is, a long-term asset can be held for 30 years or more.

Portfolio. A grouping of financial assets that are held by an investor and managed according to the investor's investment policy. A portfolio contains different asset classes.

Realized loss. A loss recognized when assets are sold for a price lower than the original purchase price. Until then, the loss is only "on paper." The loss may never be realized if the investor holds on to the asset and prices increase after they fall.

Securities. Financial instruments that are assigned values and traded. Examples of securities include stocks and bonds or virtually any other financial asset.

For easy-to-find definitions of investment terms, visit Investopedia at <www.investopedia.com/dictionary>. There is also a link from the Investments section on IPERS' Web site.



Don't miss the investment and funding information in *Plain talk about IPERS,* the fiscal year 2008 annual summary.

Income tax news from the Iowa Department of Revenue

FREE electronic filing of federal and Iowa returns for taxpayers 65 or older

In mid-January, the Iowa Department of Revenue posts links to Free File Options on its Web site at <www.state.ia.us/tax>. You will be able to file both returns online free of charge. When you e-file, you receive your refund in days, not weeks.

If you owe additional Iowa tax, you may pay online by direct debit. This is a free service through the Department's eFile & Pay system. Also check out the option to make estimated payments online through the same system. You mail nothing when you use this system! In addition, you can access your payment history at any time.

Filing thresholds for taxpayers 65 and older

If you are single with an income of $18,000 or less, you do not need to file an Iowa income tax return, unless you are getting a refund. The income limit for married and other filers is $24,000 or less. The incomes of both you and your spouse must be combined, and any pension/retirement exclusion and social security phase-out amounts must be added back.

If you are married, the higher threshold amounts apply even if only one of you was 65 years old or older as of December 31, 2008. To claim this benefit, you must check an informational box on the Iowa return.

Additional exemption if 65 or older

On Step 3 of the IA 1040, you may take an *additional* exemption if you are 65 or older. An additional $20 is subtracted from the tax you owe.

Social Security phase-out

Social security benefits are calculated differently by Iowa than the IRS. The taxable amount on your Iowa return will be less than the amount on your federal return.

The phase-out of Iowa income tax on social security is 32 percent for tax year 2008. The taxable amount is calculated on the worksheet for line 13 of the IA 1040.

Deduction for health, dental, and long-term care insurance premiums

If not deducted on Schedule A, you may deduct, on line 18 of the IA 1040, 100 percent of the amount you paid for:

- Health insurance.
- Dental insurance.
- Supplemental health insurance, such as Medicare B supplemental medical insurance and Medicare D voluntary prescription drug insurance (not "Medicare tax withheld" on your W-2).
- Long-term nursing home coverage.

Pension exclusion if 55 or older or disabled

Single filers may deduct up to $6,000 of their pension on line 21 of the IA 1040. Married filers may deduct up to $12,000. To qualify, the taxpayer or spouse must be at least 55 years of age or disabled as of December 31, 2008.

To reduce withholding on your pension income, contact the Iowa Department of Revenue for form IA W-4P. You may also print a copy from the retiree forms page of IPERS' Web site at <www.ipers.org/retirees/forms/forms.html>.

Alternate tax calculation for taxpayers 65 or older

Use the alternate tax calculation if:

- Your filing status is married, head of household, or widow(er), and
- You are 65 years old or older, and
- Your income is more than $24,000.

If you are married, the alternate tax can be applied even if only one of you was 65 years old or older as of December 31, 2008.

If you have questions about the information in this article, contact the Department of Revenue's Taxpayer Services.

515-281-3114
1-800-367-3388

Taxpayer Services
P.O. Box 10457
Des Moines, IA 50306-0457

Federal economic stimulus check received in 2008

The Iowa Department of Revenue reminds taxpayers *not* to include the amount of the federal rebate/economic stimulus check on line 27 of your IA 1040. It is not taxable to Iowa.