IPERS®
IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
Gregory S. Samorajski, CFA
Chief Executive Officer

Kim Reynolds
Governor
Adam Gregg
Lt. Governor

June 15, 2020

Iowa Department of Administrative Services
Office of the Director
Attn: Legal Counsel
Hoover State Office Building, Third Floor
Des Moines, Iowa 50319-0104

To Whom It May Concern:

Attached you will find IPERS petition for waiver regarding 11 IAC 118.11(1) and 11 IAC 118.11(3). IPERS is requesting a permanent waiver of the above referenced rules which require that contracts have a stated ending date and the prohibition on contracts exceeding a term of six years as it relates to investment management service contracts and agreements only. The attached petition provides further detail for the basis of the waiver.

If you have any questions regarding this Petition for Waiver, please feel free to contact me at (515) 281-0070.

Sincerely,

Gregory S. Samorajski
Chief Executive Officer

Director of Department of Administrative Services Department of Administrative Services Hoover State Office Building Iowa Public Employees' Retirement System Petitioner	 Petition for Waiver

The Iowa Public Employees' Retirement System (IPERS), through its Chief Executive Officer, Gregory S. Samorajski, petitions the Director of the Department of Administrative Services to **permanently** waive sections 11 IAC 118.11(1) and 11 IAC 118.11(3). This Petition for Waiver requests that the Director of the Department of Administrative Services permanently waive the requirement that service contracts have a stated ending date as set forth in 11 IA 118.11(1) and permanently waive the prohibition on contracts exceeding a term of six years as set forth in 11 IAC 118.11(3) as it relates to investment management service contracts and agreements only.

The statutory authority for this petition is Iowa Code § 17A.9A. The regulatory authority for this petition is 11 IAC Chapter 9 and 11 IAC 118.16.

On behalf of IPERS, I submit the following information as required by 11 IAC 9.6:

1. The name, address, and telephone number of the entity or person for whom a waiver is being requested and the case number of any related pending appeal.

   Answer: Chief Executive Officer Gregory S. Samorajski, Iowa Public Employees' Retirement System, P.O. Box 9117, Des Moines, Iowa, 50306-9117, (515) 281-0070. There is no pending or related appeal associated with this petition.

2. A description and citation of the specific rule (and the stated requirement in a procurement, auction or sale) from which a waiver is requested.

   Answer:
   a. 11 IAC 118.11(1) states:
      Each service contract signed by a state agency shall have a specific starting and ending date.
   b. 11 IAC 118.11(3) states:
      A service contract should be competitively selected on a regular basis so that a state agency obtains the best value for the funds spent; avoids inefficiencies, waste or duplication; and may take advantage of new innovations, ideas and technology. A service contract, including all optional renewals, shall not exceed a term of six years;

however, information technology service contracts entered into by the department or office of chief information officer may have a term length not to exceed ten years. Service contracts shall not exceed the term lengths set forth herein unless the state agency obtains a waiver of this provision pursuant to rule 11—118.16(8A).

3. The specific waiver requested, including the precise scope and duration, and any alternative means or other condition or modification proposed to achieve the purpose of the rule.

   Answer: IPERS is requesting that the administrative rules referenced in the preceding paragraph be waived permanently as it relates to all investment management service contracts and agreements awarded by IPERS. In the alternative, if the request for a permanent waiver is denied, IPERS seeks a waiver of said rules for an additional period of ten (10) years.

4. The relevant facts that the petitioner believes would justify a waiver under each of the four criteria described in subrule 9.4(1) or the criteria in subrule 9.4(3) if the request relates to a procurement, sale or auction. This statement shall include a signed statement from the petitioner attesting to the accuracy of the facts provided in the petition, and a statement of reasons that the petitioner believes will justify the waiver.

   Answer: The Director may issue an order waiving in whole or in part the requirements of a rule if the Director finds that there is good cause for a waiver. Good cause includes, but is not limited to, a showing that a requirement or provision of a rule should be waived because the requirement or provision would likely result in an unintended, undesirable, or adverse consequence or outcome. An example of good cause for a waiver is when a contract duration period of longer than six years is more economically or operationally feasible than a six-year contract in light of the service being purchased by the state agency. Additionally, a waiver may be granted if the director finds based on clear and convincing evidence each of the following:

   A. The application of the rule would pose an undue hardship on the person for whom the waiver is requested;
   B. The waiver from the requirements of the rule in the specific case would not prejudice the substantial legal rights of any person;
   C. The provisions of the rule subject to the petition for a waiver are not specifically mandated by a statute or another provision of the law; and
   D. Substantially equal protection or public health, safety and welfare will be afforded by a means other than that prescribed in the particular rule for which the waiver is requested.

   Rule 11-118.11(1) requires a service contract to have a stated ending date. Rule 11-118.11(3) prohibits a contract term beyond 6 years. IPERS has been operating under a temporary waiver to this rule, but that waiver will expire in January 2022. IPERS requests a permanent waiver to both rules because they result in unintended and adverse consequences for IPERS.

   In addition to the arguments previously made in IPERS past requests for waivers, see Attachment 3, IPERS states that Private Market investments (private equity, real estate, infrastructure, private credit, real assets like timberland and farmland, etc.) are critical to

IPERS achieving its investment and funding objectives. It is not practical in Private Market investments to have 6-year contracts where the underlying strategies cannot be fully executed in 6 years, or the expected life of the underlying assets substantially exceed 6 years. Private Market investment agreements usually have terms well beyond 10 years, or have no stated term if it is an open-end partnership that invests in long-lived assets such as infrastructure or commercial real estate. Strict adherence to the IAC provisions would effectively eliminate most Private Market investment in IPERS portfolio, reducing the diversification and potential return of the IPERS investment portfolio.

Furthermore, requiring IPERS to rebid its Public Market investment management services contracts every 6 years could be adverse to IPERS' interests, as it allows investment managers that have performed well to potentially request fee increases. A manager that is performing well for IPERS would probably have an advantage in a competitive rebid process anyway, and would also have an additional advantage because they realize that IPERS will incur transaction costs to fire them and hire a new manager. This gives a well-performing manager the opportunity to request higher fees, and IPERS could be forced to agree if it likes the product and doesn't want to incur the transaction costs of switching to a new manager.

IPERS' staff and Board continuously monitor investment manager performance on many levels, and should as fiduciaries to the IPERS members have the discretion to determine when to terminate or extend an investment management contract. Also, note the requested waiver would only apply to contracts or agreements for investment management services.

5. <u>A history of any prior contacts between the department and the petitioner relating to the activity that is the subject of the requested waiver including, but not limited to, a list or description of contested hearings relating to the activity within the past five years, and penalties relating to the proposed waiver</u>.

   Answer:

   a. **11 IAC 118.11(1):** IPERS has not previously requested a waiver of 11 IAC 118.11(1)—the requirement that each service contract signed by a state agency have a specific starting and ending date.
   b. **11 IAC 118.11(3):** On June 17, 2003, IPERS submitted a Petition for Waiver to the Department of General Services regarding rule 401 IAC 12.11(3) which is now rule 11 IAC 118.11(3). On June 30, 2003, Director Deluhery approved IPERS' Petition for Waiver.

   On January 26, 2012, IPERS submitted a Petition to renew, or make permanent, a waiver to rule 11 IAC 106.11(3) which is now rule 11 IAC 118.11(3). At that time, the Director of the Iowa Department of Administrative Services was Mike Carroll. On March 27, 2012, Director Carroll approved IPERS' Petition for Waiver for a period of ten years. This waiver expires January 26, 2022. (Attachment 3).

6. Any information known to the requester regarding the department's treatment of similar cases.
   Answer: IPERS is unaware of any information regarding the department's treatment of similar cases other than the information disclosed in response to section 5, above.

7. The name, address, and telephone number of any public agency or political subdivision which also regulates the activity in question, or which might be affected by the granting of a waiver.
   Answer: There are no other public agencies or political subdivisions that regulate the activity in question, or that would be impacted by granting the waiver.

8. The name, address, and telephone number of any entity or person who would be adversely affected by the granting of a petition, if reasonably known to the petitioner.
   Answer: IPERS is unaware of anyone or any entity that would be impacted by granting the waiver.

9. The name, address, and telephone number of any person with knowledge of the relevant facts relating to the proposed waiver.
   Answer:
   a. Gregory S. Samorajski, Chief Executive Officer
      IPERS
      P.O. Box 9117
      Des Moines, Iowa 50306-9117
      (515) 281-0070

   b. Karl Koch, Chief Investments Officer
      IPERS
      P.O. Box 9117
      Des Moines, Iowa 50306-9117
      (515) 281-0040

   c. Elizabeth A. Hennessey, General Counsel
      IPERS
      P.O. Box 9117
      Des Moines, Iowa 50306-9117
      (515) 281-0054

10. Signed releases of information authorizing persons with knowledge regarding the request to furnish the department with information relevant to the waiver or variance.
    Answer: See Attachment 2.

Conclusion:

IPERS believes that granting this permanent waiver will result in no unintended, undesirable, or adverse consequences or outcome. IPERS further believes that granting the petition would not pose an undue hardship on any person or prejudice the substantial legal rights of any person or entity.

For the reasons stated herein, IPERS is requesting a permanent waiver from 11 IA 118.11(1) and 11 IAC 118.11(3) for its investment management service contracts and agreements only. In the alternative, IPERS requests a waiver of said rules for an additional ten (10) years.

Dated this 15th day of June 2020

By: ______________________

Gregory S. Samorajski, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

Attachments: (1) Signed Statement of Petitioner
(2) Signed Release
(3) History of waivers relating to 11 IAC 118.11(3)

ATTACHMENT 1

Iowa Public Employees' Retirement System Petitioner	Signed Statement of Petitioner

I, Gregory S. Samorajski, the Petitioner in this action, attest to the accuracy of the facts and statements made in this petition. I make this statement in my capacity as the Chief Executive Officer of the Iowa Public Employees' Retirement System.

By: Gregg Samorajski

Gregory S. Samorajski, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

Before me appeared Gregory S. Samorajski, the Petitioner in this action, who attested to the accuracy of the petition and placed his signature on this document on the 15th day of June 2020.

By: Melinda McElroy

Melinda McElroy, Executive Assistant
Notary Public, Commission No. 745908
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

NOTARIAL SEAL IOWA
MELINDA McELROY
Commission Number 745908
My Commission Expires
8-19-22

ATTACHMENT 2

Iowa Public Employees' Retirement System Petitioner	Signed Release of Information

I, Gregory S. Samorajski, the Petitioner in this action, authorize the following people to release any information to the Department of Administrative Services that may assist it in making a determination relative to this Petition. I make this authorization in my capacity as the Chief Executive Officer of the Iowa Public Employees' Retirement System.

a. Gregory S. Samorajski, Chief Executive Officer
IPERS
P.O. Box 9117
Des Moines, Iowa 50306-9117
(515) 281-0070

b. Karl Koch, Chief Investments Officer
IPERS
P.O. Box 9117
Des Moines, Iowa 50306-9117
(515) 281-0040

c. Elizabeth A. Hennessey, General Counsel
IPERS
P.O. Box 9117
Des Moines, Iowa 50306-9117
(515) 281-0054

By: Gregg Samorajski
Gregory S. Samorajski, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

Before me appeared Gregory S. Samorajski, the Petitioner in this action, who placed his signature on this document on the 15th day of June 2020.

NOTARIAL SEAL IOWA
MELINDA McELROY
Commission Number 745908
My Commission Expires
3-19-22

By: Melinda McElroy
Melinda McElroy, Executive Assistant
Notary Public, Commission No. 745908
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

ATTACHMENT 3

Iowa Public Employees' Retirement System Petitioner	History of waivers relating to 11 IAC 118.11(3)

March 27, 2012

Donna M. Mueller, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive
Des Moines, Iowa 50306-9117

Dear Donna:

IPERS' waiver request of rules 11 IAC 106.11(3) and 11 IAC 107.4(1) dated January 26, 2012 is approved for a period of ten years.

The reasoning stated upon the face of the request is sufficient for its approval.

Please contact me if you have any questions or need any additional information.

Iowa Department of Administrative Services
DAS Government's Partner in Achieving Results

Mike Carroll

Mike Carroll, Director
Iowa Department of Administrative Services
Office: (515) 281-3273
Cell: (515) 868-2038
FAX: (515) 281-6140
mike.carroll@iowa.gov

Governor Terry E. Branstad
Lt. Governor Kim Reynolds

IPERS

Donna M. Mueller
CHIEF EXECUTIVE OFFICER

January 26, 2012

Director Mike Carroll
Department of Administrative Services
Hoover State Office Building, Level A
LOCAL MAIL

Dear Mike:

Attached you will find IPERS' petition to renew, or make permanent, a waiver that IPERS currently has of the application of two administrative rules to IPERS investment manager contracts.

The first rule is 11 IAC 106.11(3), which requires that a service contract, including renewals, shall not exceed a term of six years. The second rule is 11 IAC 107.4(1), which requires that a service contract must contain a payment clause based on meeting minimum requirements for performance criteria, outcomes, or outputs with incentives and disincentives.

The attached petition provides further detail for the basis of the waiver.

If you have any questions regarding this Petition for Waiver please feel free to contact me at 515-281-0070.

Sincerely,

Donna M. Mueller
Chief Executive Officer

Enclosure

IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
7401 Register Drive P.O. Box 9117
Des Moines, IA 50306-9117

TELEPHONE 515-281-0020
TOLL FREE 1-800-622-3849
BENEFITS FAX 515-281-0053
LEGAL & INVESTMENTS MANAGEMENT FAX 515-281-0045
OPERATIONS FAX 515-281-0055
E-MAIL info@ipers.org
WEBSITE www.ipers.org

Mike Carroll, Director
Department of Administrative Services
Hoover Building, Level A
LOCAL

Iowa Public Employees' Retirement System, Petitioner	**Petition for Waiver**

The Iowa Public Employees' Retirement System (IPERS), through its Chief Executive Officer, Donna Mueller, petitions the Director of the Department of Administrative Services, Mike Carroll, to waive certain administrative rules that are applicable to IPERS investment manager contracts.

The statutory authority for this petition is Iowa Code § 17A.9A. The regulatory authority for this petition is 11 IAC chapter 9 and 11 IAC 106.16(2).

On behalf of IPERS, I submit the following information as required by 11 IAC 9.6:

1. The name, address, and telephone number of the entity or person for whom a waiver is being requested, and the case number of any related pending appeal.

   Answer: Chief Executive Officer Donna Mueller, Iowa Public Employees' Retirement System (IPERS), 7401 Register Drive, P.O. Box 9117, Des Moines, Iowa, 50306-9117, (515) 281-0070. There is no pending or related appeal associated with this petition. A similar waiver was granted on June 30, 2003, for a 10-year period.

2. A description and citation of the specific rule (and the stated requirement in a procurement, auction or sale) from which a waiver is requested.

   Answer: The first citation is 11 IAC 106.11(3), which requires that a service contract, including renewals, shall not exceed a term of six years unless the department or establishment obtains a waiver of this provision pursuant to 11 IAC 106.16(2).

   The second citation is 11 IAC 107.4(1), which requires that a service contract must contain a payment clause based on meeting minimum requirements for performance criteria, outcomes, or outputs with incentives and disincentives to achieve other desired outcomes, outputs, or performance criteria. Up to 100 percent of the incentive may be placed at risk in order to meet or exceed performance criteria or achieve desired outcomes or outputs.

3. The specific waiver requested, including the precise scope and duration.

   Answer: IPERS is requesting that the administrative rules referenced in the preceding paragraph be waived permanently, or for a period of ten (10) years. The waiver that IPERS is requesting from 11 IAC 106.11(3) pertains to all investment management service contracts awarded by IPERS. The waiver requested from 11 IAC 107.4(1) pertains **only** to the performance fee requirement in IPERS' passive (index) and private market (i.e., private equity and private real estate) investment management service contracts. Both waiver requests are for investment management service contracts that presently exist or that may exist in the future if this waiver is approved.

4. The relevant facts that the petitioner believes would justify a waiver under each of the four criteria described in subrule 9.4(1). This statement shall include a signed statement from the petitioner attesting to the accuracy of the facts provided in the petition, and a statement of reasons that the petitioner believes will justify the waiver.

   Subrule 9.4(1) states a waiver may be granted if the director finds, based on clear and convincing evidence, each of the following:

   1) The application of the rule would pose an undue hardship on the person for whom the waiver is requested;
   2) The waiver from the requirements of the rule in the specific case would not prejudice the substantial legal rights of any person;
   3) The provisions of the rule subject to the petition for a waiver are not specifically mandated by statute or another provision of law; and
   4) Substantially equal protection of public health, safety, and welfare will be afforded by means other than the prescribed in the particular rule for which the waiver is requested.

   Answer: For the statement of reasons justifying the waiver, IPERS will respond in a narrative fashion.

   Background: IPERS is funded solely by employee and employer contributions to the IPERS Trust Fund and by investment earnings from the Trust Fund portfolio. Responsibility for establishing the IPERS investment policy is held by an eleven-member Investment Board comprised of seven voting Board members and four nonvoting members of the General Assembly. The Board approves the issuance of Request for Proposals (RFP) and holds final approval of all investment manager contracts based on recommendations of its investment consultant and IPERS staff. One of the policies adopted by the Board is the "Investment Manager Monitoring and Retention Policy." (Attachment 2) The purpose of the policy is to establish a formal quantitative and qualitative evaluation process to determine whether an investment manager should be retained or terminated. The Investment Board holds quarterly meetings (public meetings) in which investment manager performance is reviewed and public votes are taken related to retention of specific investment managers. The Investment Board routinely takes action to either: continue monitoring an investment manager; place the investment manager on a public "watch list"; terminate an investment manager; issue an RFP for a particular investment mandate; and, approve the selection of an investment manager who was evaluated and recommended via the RFP process. The Investment Board carefully scrutinizes the selection process and performance of all investment managers on a regular basis in a public forum. In fact, individual Board Members will often participate in the scoring of proposals, firm interviews, and recommendation to the full Board.

The spectrum of fee arrangements utilized by IPERS ranges from a flat-fee only structure to a performance-based fee structure. All investment manager contracts at IPERS contain a flat-fee base component that is calculated on the average dollar amount of assets managed by the firm. This base component is negotiated for all contracts and represents the minimum amount the manager will receive while under contract.

All current contracts with investment managers contain well-identified deliverables and evaluation criteria. Of IPERS' thirty-one current investment manager contracts, all but five have performance-based fee schedules. Those containing performance-based fee schedules comply with the Accountable Government Act and the Uniform Contracting Rules. However, there are valid reasons, as identified below, why a strict performance-based fee schedule should not be included in the five investment manager contracts.

IPERS' four passive debt and equity (index fund) management contracts utilize flat-fee arrangements. The primary reason for this is that the service being provided is very close to a commodity. Index fund managers are hired to passively match the return of the index by creating portfolios that replicate or closely mirror the holding in the index without taking the active risks associated with an active investment strategy. Such passive strategies have historically been priced on a flat-fee arrangement. Due to the very low margins that index fund managers earn on pure index funds, it is doubtful that IPERS would be able to implement a meaningful performance-based fee arrangement with index fund managers that would not increase the investment risk of the mandate.

Contracts with investment managers that pursue active investment strategies (i.e., those that do not passively manage index funds) generally are suitable for performance-based fee arrangements because the manager is hired to add value above the index representing its benchmark. However, IPERS believes that its private market investment contracts (private equity and private real estate) should be exempt from performance-based fee requirements. One reason for this is that valuations in these markets are usually "stale" because by necessity the prices are set only once a quarter, and often with a "lag" to what is happening with valuations in public market assets. Another reason to not use performance fees in private market mandates is the lengthy time (usually ten years) it can take before the ultimate performance of these long-term investments is known, as well as the volatility of interim valuations. Finally, private investment values are often established by or can be influenced by the investment manager themselves (with external independent verification about every three years). IPERS has some concerns about the potential conflict of interest and risks that could arise when the contractor can influence the calculation of its performance record, which can in turn impact how much they get paid. While IPERS has historically created performance-based fee arrangements for its real estate managers, and we believe we have taken steps to mitigate the conflicts and risks described in those contracts, we also acknowledge that discontinuing use of performance-based fee arrangements in private market mandates would allow us to avert the potential risk altogether.

IPERS' Specific Request for Waiver of 11 IAC 106.11(3): IPERS is also requesting a waiver that would exclude its investment manager contracts from the provisions of 11 IAC 106.11(3) that would require it to rebid all investment manager contracts upon the six-year anniversary of the contract. IPERS strongly believes that requiring a formal RFP process every six years will put too much focus on cost and not enough focus on the skill and net-of-fee investment returns produced by the investment manager. IPERS also believes that the six-year rebid requirement could significantly increase the fees paid by IPERS for investment management services when it rehires an existing, top-performing investment manager who can at the time of the rebid demand higher fees because of its strong performance. IPERS has extremely favorable fee arrangements with some of our investment managers, such arrangements having not been available for years now in the general marketplace, because the inception of our contractual relationship with those managers occurred at a time when they could not command the fees they can now. These exceptional fee arrangements will be put at risk by a continuous rebid requirement.

Firms that have successful long-term track records tend to charge more in the investment business. Rebidding investment manager contracts every six years sets up the possibility of chasing "the lowest cost provider" with less emphasis on the net-of-fee performance (demonstrated skill) of an existing manager. It is not a useful or cost-effective exercise to issue RFPs in cases where the investment manager has produced strong net-of-fee returns for the system, and the manager is willing to periodically renegotiate fees based on market data. If the manager has performed in accordance with IPERS' policies and has done what they said they would do, then all IPERS needs to know is whether it is paying a fair price for the services received. That information can be much more efficiently obtained by surveying other public pension funds that utilize the same manager, by reviewing various market surveys, and by reviewing marketing information of competing firms. IPERS can, and does, use this information to periodically review and if appropriate renegotiate fees of its managers, without the use of an RFP process.

The mandatory six-year rebid requirement in 11 IAC 106.11(3) is also inappropriate because it could result in substantial transition costs if the result is that IPERS changes managers every six years. Every time a new manager is hired, there will be the need to sell assets in the legacy portfolio that the new manager does not want and buy the assets the new manager does want in its portfolio. This process subjects IPERS to some significant trading costs, which can sometimes be as much as 1-2% of the asset value for a publicly traded equity mandate.

IPERS also respectfully submits that 11 IAC 106.11(3) is in conflict with Iowa Code § 97B.7, Iowa Code § 97B.8, and the common law applicable to the investment and administration of trusts. The Investment Board, as trustees of the IPERS Trust Fund, must act exclusively for the benefit of the Trust Fund. The Investment Board must fulfill its fiduciary duties to members of the System and are subject to strict accountability for a breach of this fiduciary duty. By requiring the Investment Board's service contracts to rigidly comply with 11 IAC 106.11(3), which was intended for other non-fiduciary state actors, this would in effect exercise an improper degree of control over the Investment Board's choice of service providers. This type of interference impairs the ultimate ability of the Investment Board, as the lawful trustees of the IPERS Trust Fund, to receive the best possible investment advice and services on behalf of IPERS members and beneficiaries. The Investment Board annually reviews investment management costs and utilizes third-party benchmarking firms to assess the cost-effectiveness of the investment management services at IPERS. Finally, all investment management costs are annually disclosed in IPERS' Comprehensive Annual Financial Report, which is available to the public at IPERS' website. **It should be noted that the Investment Board at its September 21, 2011, meeting, did vote unanimously to support this Petition for Waiver.**

<u>IPERS' Specific Request for Waiver of 11 IAC 107.4(1):</u> IPERS is requesting a waiver that would exclude its passive debt and equity investment manager contracts and its private market investment management contracts from the provisions of 11 IAC 107.4(1) that would otherwise require performance-based fee arrangements.

As explained above, it is unlikely that IPERS will be able to negotiate satisfactory performance-based fee arrangements with the established providers of index funds without increasing the investment risk the manager takes when investing the funds. Therefore, strict adherence to 11 IAC 107.4(1) could force IPERS to possibly forego investment in high quality index funds, and to utilize the services of less-experienced and possibly riskier index funds for its passive management mandates. Either option would be considered irresponsible and impermissible from a fiduciary standpoint. This is an unintended consequence of strictly applying 11 IAC 107.4(1).

We believe that requiring the use of performance-based fees for IPERS' private market investment managers may be inappropriate due to the lack of timely market pricing for some of the investments in these portfolios. IPERS' private equity investments generally take ten years or longer before the ultimate performance (realized investment gain or loss) is known, and the investment returns in the interim can be very volatile due to estimation error in the valuations. An annual performance-based fee arrangement for IPERS' private equity manager could result in payouts of huge sums of money when interim valuations are too high, with IPERS then left with the prospect of trying to recover those payments if final performance results (realized gain or loss) are markedly different than interim estimates.

Furthermore, as explained previously, private investment values are often established by or can be influenced by the investment managers themselves. IPERS could mitigate some potential conflict of interest risks caused by this industry practice by simply using flat-fee arrangements rather than performance-based fee arrangements.

5. <u>A history of any prior contacts between the department and the petitioner relating to the activity that is the subject of the requested waiver</u>.

   Answer: On June 17, 2003, IPERS submitted a Petition for Waiver to the Department of General Services for the same rules in this Petition for Waiver. (Attachment 4). At this time the Department of General Services director was Patrick Deluhery. The Department of General Services was the predecessor of what is now statutorily known as the Department of Administrative Services. At that time the Department of General Services' administrative rules were in Part 401 of the Iowa Administrative Code. The Department of

Administrative Services, as the successor statutory organization, implements its administrative rules in Part 11 of the Iowa Administrative Code.

On June 30, 2003, Director Deluhery approved IPERS' Petition for Waiver. (Attachment 5). The approval contained conditions upon IPERS. In summary, these conditions consisted of reporting requirements to the Department of General Services. IPERS has been in full compliance with these conditions. In essence, this Petition for Waiver is basically seeking a permanent waiver, or another 10-year period waiver under the same conditions as the previous waiver granted on July 30, 2003.

6. Any information known to the requestor regarding the department's treatment of similar cases.

   Answer: IPERS is unaware that the Department of Administrative Services has addressed similar cases. It is doubtful that there are similar cases given that IPERS is unique among public entities of state government.

7. The names, address, and telephone number of any public agency or political subdivision which also regulates the activity in question, or which might be affected by the granting of the waiver.

   Answer: There are no other public agencies or political subdivisions that regulate the activity in question, or would be impacted by granting the waiver.

8. The name, address, and telephone number of any entity or person who would be adversely affected by the granting of a petition, if reasonably know to the petitioner.

   Answer: IPERS is unaware of anyone or any entity that would be impacted by granting the waiver.

9. The name, address, and telephone number of any person with knowledge of the relevant facts relating to the proposed waiver.

   Answer: See Attachment 3.

10. Signed releases of information authorizing persons with knowledge regarding the request to furnish the department with information relevant to the waiver or variance.

    Answer: See Attachment 3.

Conclusion: IPERS believes that granting this Petition for Waiver will result in no unintended, undesirable, or adverse consequences or outcomes. IPERS further believes that granting the petition would not pose an undue hardship on any person or prejudice the substantial legal rights of any person or entity.

For the reasons stated above, IPERS hereby requests a permanent, or 10-year waiver from 11 IAC 106.11(3) for its investment management service contracts. IPERS additionally requests a permanent, or 10-year waiver from 11 IAC 107.4(1) for its passive (index) and private market (real estate and private equity) investment management service contracts.

Dated this 26th day of January 2012.

By: Donna M. Mueller

Donna M. Mueller, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

Attachments:
(1) Signed Statement of Petitioner
(2) Investment Manager Monitoring and Retention Policy
(3) Signed Release of Information
(4) June 2003 Petition for Waiver
(5) Approval of IPERS Petition for Waiver, July 2003

Attachment 1

Iowa Public Employees' Retirement System, Petitioner	**Signed Statement of Petitioner**

I, Donna M. Mueller, the Petitioner in this action, attest to the accuracy of the facts and statements made in this petition. I make this statement in my capacity as the Chief Executive Officer of the Iowa Public Employees' Retirement System.

By: Donna M. Mueller

Donna M. Mueller, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

Attachment 2

Iowa Public Employees' Retirement System, Petitioner	**Investment Manager Monitoring and Retention Policy**

APPENDIX - C -

INVESTMENT MANAGER MONITORING AND RETENTION POLICY

I. POLICY OBJECTIVES AND PRINCIPLES

Investment manager retention and termination decisions have high costs, whether it be the decision to retain unskilled managers for too long, or the decision to terminate a skilled manager prematurely. Not only are the costs of redeploying assets considerable, but the variability of most manager returns complicates straightforward evaluations of manager skill. Without reliable assessments of manager skill, IPERS has little assurance that a new manager will perform better than a previously terminated manager.

This manager monitoring and retention policy provides a systematic, consistent, and rational framework for manager retention and termination decisions, thereby avoiding untimely and haphazard actions that may adversely impact Fund returns. In addition, the policy is intended to:

- Foster a long-term approach to manager evaluations.
- Provide a logical and statistically valid framework to evaluate manager skill.
- Improve client/manager communication by apprising each manager of the quantitative and qualitative standards by which they will be judged, and the near-term and long-term consequences of failing to meet these standards.
- Promote timely and appropriate responses to actual and potential performance issues.
- Provide flexibility to allow application across all asset classes, management styles, and market environments.

This policy shall apply to all of IPERS' external managers, except where otherwise noted.

Although quantitative assessments of manager success are useful in judging whether managers have been successful in the past, they can be poor predictors of future success. Since IPERS' goal is to determine the likelihood of future success, it is critical that the ultimate retention/termination decision focus on the qualitative aspects of each manager relationship, as well as quantitative assessments of past performance.

Staff will utilize quantitative tools such as cumulative and rolling excess return[1] analysis to identify performance shortfalls, while qualitative assessments of organization, personnel, and investment approach will be used to diagnose the source of the shortfall. Regular qualitative assessments are also valuable in flagging potential problems by drawing attention to developments that might lead to future poor performance.

In addition to identifying existing and potential problems, an important purpose of the manager monitoring and retention policy is to outline how and when IPERS addresses specific issues and events. Depending on the significance of the issue or event, staff will select one of four possible courses of actions: do nothing and continue to monitor the situation, place the manager on IPERS' Watch List, initiate a Comprehensive Review, or, under extraordinary circumstances, terminate the manager immediately without a Comprehensive Review.

Inevitably, each retention/termination decision will be unique. Accordingly, it is intended that this manager monitoring and retention policy be flexible enough to account for specific manager, asset class, and market-related factors, but it is also intended that exceptions to this policy be rare.

II. MANAGER MONITORING

A. Manager Meeting Frequency and Content

Staff will meet with each investment manager not less than once every twelve months, and staff shall meet with each manager at the manager's place of business whenever staff believes it is necessary. Each meeting will include a review of the manager's near-term and long-term performance, the manager's current investment strategy and capital market outlook, and any other pertinent issues related to the manager's organization, personnel, or investment process. Each manager shall make periodic presentations to the IPERS Investment Board. The frequency, content, and timing of specific manager presentations will be subject to staff and the Board's discretion.

B. Qualitative Assessments

The qualitative aspects of each manager relationship will be monitored through frequent oral and written contacts by staff with each manager and IPERS' consultants, and, when appropriate, through quarterly evaluations utilizing attribution, style, and peer universe analyses. Qualitative assessments will focus on organizational and staff stability, adherence to investment philosophy and process, asset/client turnover, and the quality of client service.

A significant and potentially adverse event related to, but not limited to, any of the following qualitative issues or events will generally cause staff either to place the firm on the Watch List or to initiate a Comprehensive Review, depending on the impact of the event or issue:

- A significant change in firm ownership and/or structure
- The loss of one or several key personnel

- A significant loss of clients and/or assets under management
- A profound shift in the firm's philosophy or process evidenced by style drift[2], increases or decreases in tracking error[3], or value-added coming from an unexpected source
- A significant and persistent lack of responsiveness to client requests
- A change in IPERS' capital market beliefs which eliminates the need for a particular manager's investment style or strategy
- A significant decrease in the quality or volume of deal flow and/or a marked change in the investment types or deal terms negotiated by the manager
- Consistent failure to meet investment allocation targets
- Chronic violations of IPERS' investment guidelines

C. Quantitative Assessments

In order to evaluate manager skill, cumulative or rolling assessments of excess return will be calculated for each external manager. Public market managers will be evaluated quarterly using skill analysis graphs. The illiquid and longer-term nature of private market investments necessitates a different quantitative assessment methodology from that utilized in the public markets. The sections below describe in detail the methodologies employed in public and private market manager performance evaluations.

Judgments as to whether a manager has achieved IPERS' investment objectives, and judgments as to whether a manager will achieve IPERS' investment objectives in the future, ultimately rest with IPERS' staff and Board. Accordingly, IPERS' staff and the Board reserve the right under this policy to pursue, at any time, any course of action in response to absolute, relative, historic, or perceived future investment performance. Notwithstanding the foregoing, the following decision rules will generally apply to quantitative assessments of manager performance.

1. Public Market Managers - Because of the large degree of variability in manager returns, it is often very difficult to assess whether a manager's over/under performance is the product of randomness or true investment skill. IPERS' quantitative skill analysis considers the variability of a manager's excess return, in addition to the absolute magnitude of the excess return, when making judgments about manager skill.

   Skilled managers often have periods of underperformance, just as unskilled managers often experience periods of outperformance. Over long time periods, however, skilled managers will produce a larger average excess return more frequently than their unskilled peers. The use of confidence bands[4] in the cumulative and rolling skill analysis graphs explicitly embrace these principles.

a. Active Managers - Depending on the availability and appropriateness of each manager's historic excess return series, IPERS will utilize either a cumulative or a rolling five-year skill analysis graph with 80 percent confidence bands to evaluate manager skill on a quarterly basis. IPERS will not construct a cumulative or rolling five-year skill analysis graph until two years after the inception date of the account. At that time, IPERS will combine its actual two years of excess returns with the manager's previous five-year, net-of-base-fee, quarterly excess returns to produce a rolling five-year skill analysis graph. If the previous five years of excess returns are unavailable or are inappropriate, staff can elect to use a shorter historical time series if available. In this case, a cumulative skill analysis graph will be used to assess quarterly performance. Once seven years of combined historic and actual excess returns are available, IPERS will convert from the cumulative to the rolling five-year skill analysis graph. If a manager does not have a return history that is appropriate or available as of the manager's date of hire, IPERS will postpone drawing the cumulative skill graph until three years of actual, excess return history is available.

   The cumulative and rolling skill analysis graphs will be utilized as follows:

   i. If the manager's cumulative or rolling five-year excess return plots below the benchmark for four consecutive quarters, the manager shall be placed on the Watch List.

   ii. If the manager's cumulative or rolling five-year excess return plots below the lower confidence band for two consecutive quarters, a Comprehensive Review will be initiated. The Watch List is bypassed in this case because breaching the lower confidence band indicates a serious performance problem which should be addressed in an in-depth manner as soon as possible.

b. Passive Managers - The skill analysis methodology applied to IPERS' active management strategies is inappropriate for passive management strategies because of the low variability of manager returns and a zero alpha[5] expectation. Therefore, IPERS shall utilize the annual performance ranges outlined in each manager's investment contract to monitor passive manager performance. Enhanced passive strategies with explicit alpha expectations will be considered active management strategies for the purposes of monitoring performance. As such, enhanced passive strategies will be subject to the "Active Manager" performance guidelines outlined above.

Beginning one year after the inception date, staff will monitor the manager's four-quarter rolling returns. If the manager's trailing four-quarter annual return exceeds the range set forth in the manager's investment management contract for two consecutive quarters, staff shall place the manager on IPERS' Watch List.

2. Private Market Managers - Annually after each calendar year end, staff will evaluate each private market manager's performance relative to its performance objective and, when appropriate, to an asset class benchmark. Managers who fail to achieve their performance objective and, when appropriate, fail to outperform their asset class benchmark, on a rolling basis for three consecutive years shall be placed on the Watch List. In general, staff will utilize a rolling ten-year evaluation period for IPERS' private equity managers and private market real estate managers.

D. Reporting

On a quarterly basis, staff shall prepare the skill analysis graphs for each of IPERS' active, public market managers. Where appropriate and available, staff shall also prepare reports to support the qualitative assessments including style measurement reports, attribution analysis, tracking error reports, and peer universe comparisons.

III. COURSES OF ACTION

A. Watch List

A manager will be placed on the Watch List as a result of a significant and potentially adverse development involving the manager as described above. Being placed on the Watch List communicates to the manager IPERS' concern about a particular situation. A manager will be placed on the Watch List for a specified length of time, normally twelve months. Staff will meet with the manager within 90 days of their being placed on the Watch List to discuss the situation and the steps needed to be taken to resolve the issue to IPERS' satisfaction. A manager will generally remain on the Watch List until the specified time period expires, or until the issue is resolved to IPERS' satisfaction. If the issue has not been resolved by the expiration of the specified time period, a Comprehensive Review may be initiated. Also, a manager may be removed from the Watch List and a Comprehensive Review initiated at any time if a situation deteriorates.

B. Comprehensive Review

A Comprehensive Review of a manager will be undertaken as a result of serious underperformance of a manager relative to its benchmark or as the result of a significant and adverse change to the manager's organization, personnel, or investment process. These categories of events cause staff to seriously question the firm's ability to achieve IPERS' investment objectives in the future. A Comprehensive Review is a thorough, in-depth, due-diligence effort, similar in scope to IPERS' manager selection process. A Comprehensive Review explores all elements of a manager's organization, personnel, and investment philosophy and process. Comprehensive Reviews will be completed within 90 days of initiation.

In undertaking a Comprehensive Review, staff is ultimately deciding whether the firm should be rehired today given the current events and prevailing circumstances. Thus, the outcome of a Comprehensive Review is a decision to retain or terminate the manager.

The nature of certain private-market investment vehicles may severely restrict or prohibit the immediate withdrawal of funds and/or the transfer of assets to another manager. In such cases, the decision to terminate a manager is infeasible and, therefore, IPERS' actions may be limited to filing a withdrawal request with the manager and waiting until the investments can be liquidated in a prudent manner, or seeking other disposition strategies.

The Comprehensive Review will focus on whether the firm currently embodies enough of the following characteristics to provide reasonable assurance that IPERS' investment objectives in the future will be achieved. The list below represents characteristics that IPERS believes are important to the success of a manager's investment program.

Organization:
- Stable ownership structure
- Experienced, dynamic leadership
- Clearly delineated lines of authority and responsibility
- Sound financial condition
- Planned growth
- Strong compliance and internal control systems

Personnel:
- Experienced and competent investment staff
- Low turnover in key positions
- Employees highly motivated to meet client objectives
- Sufficient backup and ongoing training

Investment Process and Philosophy:
- Well-articulated philosophy as to how value is added in a particular market
- Investment process is systematic, focused, and consistent
- Investment process exploits a perceived competitive advantage
- Investment process has been successfully applied in different market environments
- High-quality research base
- Investment process/style can be benchmarked
- Strong trading capabilities
- High-quality deal flow and investment opportunities

The Comprehensive Review shall also address whether the problem can be resolved within the scope of the existing relationship, and if not, how and to whom the assets should be redeployed. A decision to rehire a manager may also be subject to the manager's satisfying specified conditions and may include a probationary period.

IV. Other Termination Conditions

This policy depicts circumstances where IPERS may elect to terminate a manager for cause. However, all of IPERS' investment management contracts permit IPERS to terminate the manager, with or without cause, after 30 days' written notice. The investment management contracts also permit IPERS to terminate a manager immediately upon learning of a breach of duty or confidentiality. IPERS also has the right under its investment management contracts to terminate a manager after 30 days' written notice in the event of the nonavailability or nonappropriation of funds.

---

[1] Difference between the manager's return and the benchmark return

[2] Changes in a portfolio's predominant style characteristics over time (i.e. shifts from growth to value or large cap to small cap)

[3] Standard deviation of excess return

[4] The range the manager's excess return is anticipated to fall a specified percentage of the time based on the past variability of excess returns

[5] Risk-adjusted excess return

Attachment 3

Iowa Public Employees' Retirement System, Petitioner	**Signed Release of Information**

I, Donna M. Mueller, the Petitioner in this action, authorize the following people to release any information to the Department of Administrative Services that may assist it in making a determination relative to this Petition. I make this authorization in my capacity as the Chief Executive Officer of the Iowa Public Employees' Retirement System.

Donna Mueller, Chief Executive Officer IPERS 7401 Register Drive, P.O. Box 9117 Des Moines, IA 50306-9117 (515) 281-0070	Karl Koch, Chief Investment Officer IPERS 7401 Register Drive, P.O. Box 9117 Des Moines, IA 50306-9117 (515) 281-0030
Kelly Lovell, Lead General Counsel IPERS 7401 Register Drive, P.O. Box 9117 Des Moines, IA 50306-9117 (515) 281-3081	Gregg Schochenmaier, General Counsel IPERS 7401 Register Drive, P.O. Box 9117 Des Moines, IA 50306-9117 (515) 281-0054
David O. Creighton, Sr., Chairman IPERS Investment Board 12525 Diamond Ridge Court Des Moines, IA 50325	Dr. Phyllis S. Peterson, Vice Chair IPERS Investment Board 101 Stoney Point Road, SW Cedar Rapids, IA 52404

By: Donna M Mueller

Donna M. Mueller, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

Attachment 4

Iowa Public Employees' Retirement System, Petitioner	**June 2003 Petition for Waiver**

Patrick Deluhery, Director
Department of General Services
Hoover State Office Building
LOCAL

Iowa Public Employees' Retirement System, Petitioner	**Petition for Waiver**

The Iowa Public Employees' Retirement System (IPERS), through its Chief Executive Officer, Donna Mueller, petitions the Director of the Department of General Services, Patrick Deluhery, to waive certain administrative rules that are applicable to investment manager contracts. Investment managers are utilized by IPERS to invest the assets of the IPERS Trust Fund.

The statutory authority for this petition is Iowa Code § 17A.9A. The regulatory authority for this petition is 401 IAC 12 and 20.

On behalf of IPERS, I submit the following information as required by 401 IAC 20.6:

1. The name, address, and telephone number of the entity or person for whom a waiver is being requested, and the case number of any related pending appeal. **Answer:** Chief Executive Officer Donna Mueller, Iowa Public Employees' Retirement System, P.O. Box 9117, Des Moines, Iowa, 50306-9117, (515) 281-0070. There is no pending or related appeal associated with this petition.

2. A description and citation of the specific rule (and the stated requirement in a procurement, auction or sale) from which a waiver is requested. **Answer:** The first citation is 401 IAC 13.4, which requires that a service contract must contain a payment clause based on meeting minimum requirements for performance criteria, outcomes, or outputs with incentives and disincentives to achieve other desired outcomes, outputs, or performance criteria. Up to 100 percent of the incentive may be placed at risk in order to meet or exceed performance criteria or achieve desired outcomes or outputs. The second citation is 401 IAC 12.11(3), which

requires that a service contract, including renewals, shall not exceed a term of six years unless the department or establishment obtains a waiver of this provision pursuant to 401 IAC 16(18).

3. <u>The specific waiver requested, including the precise scope and duration</u>. **Answer:** Because the Department of General Services is prohibited from granting a permanent waiver, IPERS is requesting that the administrative rules referenced in the preceding paragraph be waived for a period of ten (10) years. The waiver that IPERS is requesting from 401 IAC 12.11(3) pertains to all investment management service contracts awarded by IPERS. The waiver requested from 401 IAC 13.4 pertains **<u>only</u>** to the performance fee requirement in IPERS' passive (index) and private market (real estate and private equity) investment management service contracts. Both waiver requests are for service contracts that have been consummated prior to the adoption of the Department of General Service's Uniform Contracting Rules in 2002, and for contracts that have been or will be consummated after the adoption of the Uniform Contracting Rules.

4. <u>The relevant facts that the petitioner believes would justify a waiver under each of the four criteria described in subrule 20.4(1) or the criteria in subrule 20.4(3) if the request relates to a procurement, sale, or auction. This statement shall include a signed statement from the petitioner attesting to the accuracy of the facts provided in the petition, and a statement of reasons that the petitioner believes will justify the waiver</u>.

Subrule 20.4(1) states a waiver may be granted if the director finds based on clear and convincing evidence each of the following:

a. The application of the rule would pose an undue hardship on the person for whom the waiver is requested;

b. The waiver from the requirements of the rule in the specific case would not prejudice the substantial legal rights of any person;

c. The provisions of the rule subject to the petition for a waiver are not specifically mandated by statute or another provision of law; and

d. Substantially equal protection of public health, safety, and welfare will be afforded by means other than the prescribed in the particular rule for which the waiver is requested.

Subrule 20.4(3) is not applicable.

Answer: For the statement of reasons justifying the waiver, IPERS will respond in a narrative fashion.

Background: IPERS is currently an independent division of IDOP. Effective July 1, 2003, IPERS becomes an independent state executive branch agency. IPERS is funded solely by employer and employee contributions to the IPERS Trust Fund and by investment earnings from the Trust Fund portfolio. Responsibility for establishing the IPERS investment policy is held by an eleven-member Investment Board, comprised of seven voting Board members and four nonvoting members of the General Assembly. The Board approves the issuance of Request for Proposals and holds final approval of all investment manager contracts based on recommendations of its investment consultant and IPERS staff. One of the policies adopted by the Board is the "Investment Manager Monitoring and Retention Policy." (Attachment 2) The purpose of the policy is to establish a formal quantitative and qualitative evaluation process to determine whether an investment manager should be retained or terminated. The Investment Board holds quarterly meetings (public meetings) in which investment manager performance is reviewed and public votes are taken related to retention of specific investment managers. The Investment Board routinely takes action to either: continue monitoring an investment manager; place the investment manager on a public "watch list," terminate an investment manager; issue an RFP for a particular investment mandate; and, approve the selection of an investment manager who was evaluated and recommended via the RFP process. The Investment Board carefully scrutinizes the selection process and performance of all investment managers on a regular basis in a public forum.

The spectrum of fee arrangements utilized by IPERS ranges from a flat-fee only structure to a performance-based fee structure. All investment manager contracts at IPERS contain a flat-fee base component that is calculated on the average dollar amount of assets managed by the firm. This base component is negotiated for all contracts and represents the minimum amount the manager will receive while under contract.

All current contracts with investment managers contain well-identified deliverables and evaluation criteria. Of IPERS' twenty-six current investment manager contracts, all but four have performance-based fee schedules. Those containing performance-based fee schedules comply with the Accountable Government Act and the Uniform Contracting Rules. However, there are valid reasons, as identified below, why a strict performance-based fee schedule should not be included in the four investment manager contracts.

IPERS' three passive debt and equity (index fund) management contracts utilize flat-fee arrangements. The primary reason for this is that the service being provided is very close to a commodity. Index fund managers are hired to passively match the return of the index by creating portfolios that replicate or closely mirror the holding in the index without taking the active risks associated with an active investment strategy. Such passive strategies have historically been priced on a flat-fee arrangement. Due to the very low margins that index fund managers earn on pure index funds, it is doubtful that IPERS would be able to implement a meaningful performance-based fee arrangement with index fund managers that would not increase the investment risk of the mandate.

Contracts with investment managers that pursue active investment strategies (i.e., those that do not passively manage index funds) generally are suitable for performance-based fee arrangements because the manager is hired to add value above the index representing its benchmark. (All but one of IPERS' active investment management contracts currently utilizes a performance-based fee structure.) IPERS' active investment managers are allowed to participate in the value they have added to IPERS' portfolios. Negotiating a participation rate with the active manager does this. The participation rate is the percentage of the benefit that the investment manager receives as compensation if they outperform their benchmark. By including a participation rate, the interests of the investment manager become aligned with that of IPERS. When the investment manager does not perform well, it is penalized by being paid only the flat-fee basis, which is substantially less than what it would be paid under its normal published fee arrangements. However, if the investment manager performs well, it is rewarded by being paid a portion of the added value it created. A maximum fee is established which sets a cap on the total fees the manager is paid in a year.

<u>IPERS' Specific Request for Waiver of 401 IAC 13.4:</u> IPERS is requesting a waiver that would exclude its passive debt and equity investment manager contracts and its private market investment management contracts from the provisions of 401 IAC 13.4 that would otherwise require performance-based fee arrangements.

As explained above, it is unlikely that IPERS will be able to negotiate satisfactory performance-based fee arrangements with the established providers of index funds without increasing the investment risk the manager takes when investing the funds. Therefore, strict adherence to 401 IAC 13.4 could force IPERS to possibly forego investment in high quality index funds, and to utilize the services of less-experienced and possibly riskier index funds for its passive management mandates. Either option would be considered irresponsible and impermissible from a fiduciary standpoint. This is an unintended consequence of strictly applying 401 IAC 13.4.

Furthermore, we believe that requiring the use of performance-based fees for some of IPERS' private market investment managers may be inappropriate due to the lack of timely market pricing for some of the investments in these portfolios. IPERS' private equity investments generally take ten years or longer before the ultimate performance (realized investment gain or loss) is known, and the investment returns in the interim can be very volatile due to estimation error in the valuations. An annual performance-based fee arrangement for IPERS' private equity manager could result in payouts of huge sums of money when interim valuations are too high, with IPERS then left with the prospect of trying to recover those payments if final performance results (realized gain or loss) are markedly different than interim estimates.

IPERS' Specific Request for Waiver of 401 IAC 12.11(3): IPERS is also requesting a waiver that would exclude its investment manager contracts from the provisions of 401 IAC 12.11(3) that would require it to rebid all investment manager contracts upon the six-year anniversary of the contract. IPERS' strongly believes that requiring a formal RFP process every six years will put too much focus on cost and not enough focus on the skill and net-of-fee investment returns produced by the investment manager. IPERS also believes that the 6-year rebid requirement could significantly increase the fees paid by IPERS for investment management services when it rehires an existing, top-performing investment manager who can at the time of the rebid demand higher fees because of its strong performance. IPERS has extremely favorable fee arrangements with some of our investment managers, such arrangements having not been available for years now in the general marketplace, because the inception of our contractual relationship with those managers occurred at a time when they could not command the fees they can now. These exceptional fee arrangements will be put at risk by a continuous rebid requirement.

Firms that have successful long-term track records tend to charge more in the investment business. Rebidding investment manager contracts every six years sets up the possibility of chasing "the lowest cost provider" with less emphasis on the net-of-fee (demonstrated skill) of an existing manager. It is not a useful or cost-effective exercise to issue RFPs in cases where the investment manager has produced strong net-of-fee returns for the system, and the manager is willing to periodically renegotiate fees based on market data. If the manager has performed in accordance with IPERS' policies and has done what they said they would do, then all IPERS needs to know is whether it is paying a fair price for the services received. That information can be much more efficiently obtained by surveying other public pension funds that utilize the same manager, by reviewing various market surveys, and by reviewing marketing information of competing firms. IPERS can, and does, use this information to periodically review and if appropriate renegotiate fees of its managers, without the use of an RFP process.

The mandatory six-year rebid requirement in 401 IAC 12.11(3) is inappropriate for investment manager contracts in terms of manager performance, and as it relates to the nature of investments acquired by investment managers for IPERS. The quantitative analysis done by IPERS staff on many managers considers investment manager performance over a five-year period (ten years for our private equity manager). It makes little sense to reach the determination whether IPERS has a good investment manager at the end of five years, and then issue an RFP for the mandate at the end of the sixth year of the contract. If the investment manager has met the performance objectives set for them in the contract, and the fees appear to still be fair in relation to other mandates and providers, wouldn't it be more efficient to just retain the investment manager? It makes more sense to retain a well performing investment manager who has survived the quantitative analysis after five years of performance. Further, the six-year rebid requirement could result in substantial transition costs if the result is that IPERS changes managers every six years. Every time a new manager is hired, there will be the need to sell assets in the legacy portfolio that the new manager does not want and buy the assets the new manager does want in its portfolio. This process subjects IPERS to some significant trading costs, which can sometimes be as much as 1-2% of the asset value for a publicly traded equity mandate.

IPERS staff has also been told by some people involved in our prior attempt at obtaining an exemption from these rules that we can increase our odds of keeping a manager that has performed well if we simply lower the weight that cost carries in the overall selection decision. However, this seems like a waste of valuable Investment Board and staff resources if the RFP rebid process becomes nothing more than an exercise in giving the appearance that the mandate was competitively bid. It also still subjects IPERS to the possibility of having to pay an existing manager more in fees simply because that is what the manager can demand at the time the contract is rebid. IPERS would like the discretion to retain a well-performing investment manager under favorable fee arrangements, where that is demonstrably the case.

IPERS also respectfully submits that 401 IAC 12.11(3) is in conflict with Iowa Code § 97B.7, Iowa Code § 97B.8, and the common law applicable to the investment and administration of trusts. The Investment Board, as trustees of the IPERS Trust Fund, must act exclusively for the benefit of the Trust Fund. The Investment Board must fulfill its fiduciary duties to members of the System and are subject to strict accountability for a breach of this fiduciary duty. By requiring the Investment Board's service contracts to rigidly comply with 401 IAC 12.11(3), which was intended for other nonfiduciary state actors, this would in effect exercise an improper degree of control over the Investment Board's choice of service providers. This type of interference impairs the ultimate ability of the Investment Board, as the lawful trustees of the IPERS Trust Fund, to receive the best possible investment advice and services on behalf of IPERS members and beneficiaries. Finally, we would note that a significant statutory control exists relative to the cost of IPERS' investment management contracts (as well as our other noncontractual program costs): Iowa Code § 97B.7 requires that IPERS' annual investment management expenses not exceed 0.40% of the Fund's market value.

The Uniform Contracting Rules have been thoroughly discussed with the Investment Board, and it is at the request of Board members that this petition is submitted. Of note is the fact that an Investment Board member and floor manager of the Accountable Government Act, Representative Jeff Elgin, concurs with this waiver request. IPERS Investment Board member Senator John Kibbie also supports this waiver request.

5. <u>A history of any prior contacts between the department and the petitioner relating to the activity this is the subject of the requested waiver</u>. **Answer:** In August 2002, IPERS submitted

written comments to the Department of General Services during the rule-making process associated with the Uniform Contracting Rules. These comments were submitted to Patti Schroeder. IPERS requested to be exempted from the same proposed administrative rules that are the subject of this petition. Because the Department of General Services did not want to go before the Administrative Rules Review Committee with yet another revision of the Uniform Contracting Rules for the sole purpose of responding to IPERS' comments, the Department of General Services agreed to favorably act upon or review an IPERS' Petition for Waiver. The agreement or suggestion was that at the time IPERS was preparing to issue a RFP for which it would need a waiver, the Department of General Services would grant the waiver. Presently, IPERS plans to issue a RFP to acquire an investment manager(s) for its passive domestic equity and fixed income portfolios in August 2003.

6. Any information known to the requestor regarding the department's treatment of similar cases. **Answer:** IPERS is unaware that the Department of General Services has addressed similar cases. It is doubtful that there are similar cases given that IPERS is unique among public entities.

7. The names, address, and telephone number of any public agency or political subdivision which also regulates the activity in question, or which might be affected by the granting of the waiver. **Answer:** There are no other public agencies or political subdivisions that regulate the activity in question, or would be impacted by granting the waiver.

8. The name, address, and telephone number of any entity or person who would be adversely affected by the granting of a petition, if reasonably know to the petitioner. **Answer:** IPERS is unaware of anyone or any entity that would be impacted by granting the waiver.

9. The name, address, and telephone number of any person with knowledge of the relevant facts relating to the proposed waiver. **Answer:**

a. Donna Mueller, Chief Executive Officer
IPERS
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-0070

b. Kathy Comito, Chief Investment Officer
IPERS
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-0030

c. Gregg A. Schochenmaier, General Counsel
IPERS
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-0054

d. Karl Koch, Lead Investment Officer
IPERS
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-0040

e. Kelly Lovell, Deputy General Counsel
IPERS
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-3081

f. The Honorable Jeff Elgin, Iowa House
IPERS Investment Board
6949 Bowman Lane N.E.
Cedar Rapids, IA 52402
(319) 377-2218

g. The Honorable Jack Kibbie, Iowa Senate
IPERS Investment Board
112 Oakwood
Emmetsburg, IA 50536
(712) 852-4140

h. Chairman Bruce Kelley
Investment Board
14 Glenview Drive
Des Moines, IA 50312
(515) 280-2950

i. Vice Chair Michael Logan
Investment Board
1398 10th Street
Coralville, IA 52241
(319) 354-2556

10. Signed releases of information authorizing persons with knowledge regarding the request to furnish the department with information relevant to the waiver or variance.

Answer: See Attachment 3.

Conclusion:

IPERS believes that granting this petition will result in no unintended, undesirable, or adverse consequences or outcomes. IPERS further believes that granting the petition would not pose an undue hardship on any person or prejudice the substantial legal rights of any person or entity.

For the reasons stated above, IPERS hereby requests a 10-year waiver from 401 IAC 12.11(3) for its investment management service contracts. IPERS additionally requests a 10-

year waiver from 401 IAC 13.4 for its passive (index) and private market (real estate and private equity) investment management service contracts.

Dated this 17th day of June, 2003

By: Donna Mueller

Donna Mueller, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

C: DGS Legal Counsel
Persons Referenced in Question 9

Attachments: (1) Signed Statement of Petitioner
(2) Investment Manager Monitoring and Retention Policy
(3) Signed Release of Information

Attachment 1

Iowa Public Employees' Retirement System, Petitioner	**Signed Statement of Petitioner**

I, Donna Mueller, the Petitioner in this action, attest to the accuracy of the facts and statements made in this petition. I make this statement in my capacity as the Chief Executive Officer of the Iowa Public Employees' Retirement System.

By: Donna Mueller

Donna Mueller, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

Before me appeared Donna Mueller, the Petitioner in this action, who attested to the accuracy of the petition and placed her signature on this document on the 17 day of June, 2003.

By: Gregg A. Schochenmaier

Gregg A. Schochenmaier, General Counsel
Notary Public, Commission No. 179501
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

GREGG SCHOCHENMAIER
Commission Number 179501
My Commission Expires
23 May 2004

Attachment 2

Iowa Public Employees' Retirement System, Petitioner	**Investment Manager Monitoring and Retention Policy**

Revised September 2001

ADDENDUM -B-

INVESTMENT MANAGER MONITORING AND RETENTION POLICY

I. Policy Objectives & Principles

Investment manager retention and termination decisions have high costs, whether it be the decision to retain unskilled managers for too long, or the decision to terminate a skilled manager prematurely. Not only are the costs of redeploying assets considerable, but the variability of most manager returns complicates straightforward evaluations of manager skill. Without reliable assessments of manager skill, IPERS has little assurance that the manager we hire today will perform better than the manager we terminated yesterday.

This manager monitoring and retention policy provides a *systematic*, *consistent*, and *rational* framework for manager retention and termination decisions, thereby avoiding untimely and haphazard actions that may adversely impact fund returns. In addition, the policy is intended to:

- Foster a *long-term* approach to manager evaluations.
- Provide a *logical* and *statistically valid* framework to evaluate manager skill.
- Improve client/manager communication by *apprising* each manager of the quantitative and qualitative standards by which they will be judged, and the near-term and long-term consequences of failing to meet these standards.
- Promote *timely* and *appropriate* responses to actual and potential performance issues.
- Provide *flexibility* to allow application across all asset classes, management styles, and market environments.

This policy shall apply to all of IPERS' external managers, except where otherwise noted.

Although quantitative assessments of manager success are useful in judging whether managers have been successful in the past, they can be poor predictors of future success. Since IPERS' goal is to determine the likelihood of *future* success, it is critical that the ultimate retention/termination decision focus on the qualitative aspects of each manager relationship, as well as quantitative assessments of past performance.

Staff will utilize quantitative tools such as cumulative and rolling excess return[1] analysis to *identify* performance shortfalls, while qualitative assessments of organization, personnel and investment approach will be used to diagnose the *source* of the shortfall. Regular qualitative assessments are also valuable in flagging *potential* problems by drawing attention to developments that might lead to future poor performance.

In addition to identifying existing and potential problems, an important purpose of the manager monitoring and retention policy is to outline how and when IPERS addresses specific issues and events. Depending on the significance of the issue or event, staff will select one of four possible courses of actions: do nothing and continue to monitor the situation, place the manager on IPERS'

Watch List, initiate a Comprehensive Review, or, under extraordinary circumstances, terminate the manager immediately without a Comprehensive Review.

Inevitably, each retention/termination decision will be unique. Accordingly, it is intended that this manager monitoring and retention policy be flexible enough to account for specific manager, asset class, and market-related factors, but, it is also intended that exceptions to this policy be rare.

II. Manager Monitoring

A. Manager Meeting Frequency and Content

Staff will meet with each investment manager not less than once every twelve months, and staff shall meet with each manager at their place of business whenever staff believes it is necessary, but not less than once every four years. Each meeting will include a review of the manager's near-term and long-term performance, their current investment strategy and capital market outlook, and any other pertinent issues related to the manager's organization, personnel, or investment process. Each manager shall make periodic presentations to the IPERS Investment Board. The frequency, content, and timing of specific manager presentations will be subject to staff and the Board's discretion.

B. Qualitative Assessments

The qualitative aspects of each manager relationship will be monitored through frequent oral and written contacts by staff with each manager and IPERS' consultants, and, when appropriate, through quarterly evaluations utilizing attribution, style and peer universe analyses. Qualitative assessments will focus on organizational and staff stability, adherence to investment philosophy and process, asset/client turnover, and the quality of client service.

A significant and potentially adverse event related to, but not limited to, any of the following qualitative issues or events will generally cause staff to either place the firm on the Watch List or initiate a Comprehensive Review, depending on the impact of the event or issue:

- A significant change in firm ownership and/or structure.
- The loss of one or several ***key*** personnel.
- A significant loss of clients and/or assets under management.
- A profound shift in the firm's philosophy or process evidenced by style drift[2], increases or decreases in tracking error[3], or value-added coming from an unexpected source.
- A significant and persistent lack of responsiveness to client requests.
- A change in IPERS' capital market beliefs which eliminates the need for a particular manager's investment style or strategy.
- A significant decrease in the quality or volume of deal flow and/or a marked change in the investment types or deal terms negotiated by the manager.
- Consistent failure to meet investment allocation targets.
- Chronic violations of IPERS' investment guidelines.

C. Quantitative Assessments

In order to evaluate manager skill, cumulative or rolling assessments of excess return will be calculated for each external manager. Public market managers will be evaluated quarterly using Skill Analysis Graphs. The illiquid and longer-term nature of private market investments necessitates a different quantitative assessment methodology from that utilized in the public markets. Sections II.C.1.a., II.C.1.b., and II.C.2. below describe in detail the methodologies employed in public and private market manager performance evaluations.

Judgments as to whether a manager has achieved IPERS' investment objectives, and judgments as to whether a manager will achieve IPERS' investment objectives in the future, ultimately rest with IPERS' staff and Board. Accordingly, IPERS' staff and the Board reserve the right under this policy to pursue, at any time, any course of action in response to absolute, relative, historic or perceived future investment performance. Notwithstanding the foregoing, the following decision rules will generally apply to quantitative assessments of manager performance:

1. Public Market Managers - Because of the large degree of variability in manager returns, it is often very difficult to assess whether a manager's over/under performance is the product of randomness or true investment skill. IPERS' quantitative skill analysis considers the *variability* of a manager's excess return, in addition to the absolute *magnitude* of the excess return, when making judgements about manager skill.

   Skilled managers often have periods of under performance, just as unskilled managers often experience periods of outperformance. Over long time periods, however, skilled managers will produce a *larger* average excess return more *frequently* than their unskilled peers. The use of confidence bands[4] in the cumulative and rolling Skill Analysis Graphs explicitly embrace these principles.

   a. Active Managers - Depending on the availability and appropriateness of each manager's historic excess return series, IPERS will utilize either a cumulative or a rolling five-year Skill Analysis Graph with 80% confidence bands to evaluate manager skill on a quarterly basis. IPERS will not construct a cumulative or rolling five-year Skill Analysis Graph until ***two*** years after the inception date of the account. At that time, IPERS will combine its actual two years of excess returns with the manager's previous five-year, net-of-base-fee, quarterly excess returns to produce a *rolling* five-year Skill Analysis Graph. If the previous five years of excess returns are unavailable or are inappropriate, staff can elect to use a shorter, historical time series if available. In this case, a *cumulative* Skill Analysis Graph will be used to assess quarterly performance. Once seven years of combined historic and actual excess returns are available, IPERS will convert from the cumulative to the rolling five-year Skill Analysis Graph. If a manager does not have a return history that is appropriate or available as of their date of hire, IPERS will postpone drawing the cumulative skill graph until three years of actual, excess return history is available.

The cumulative and rolling Skill Analysis Graphs will be utilized as follows:

i. If the manager's cumulative or rolling, five-year excess return plots **below the benchmark** for four (4) consecutive quarters, the manager shall be placed on the Watch List.

ii. If the manager's cumulative or rolling, five-year excess return plots **below the lower confidence band** for two (2) consecutive quarters a Comprehensive Review will be initiated. The Watch List is bypassed in this case because breaching the lower confidence band indicates a ***serious*** performance problem which should be addressed, in-depth, as soon as possible.

b. Passive Managers - The skill analysis methodology applied to IPERS' active management strategies is inappropriate for passive management strategies due to the low variability of manager returns and a zero alpha[5] expectation. Therefore, IPERS shall utilize the annual performance ranges outlined in each manager's investment contract to monitor passive manager performance. Enhanced passive strategies with explicit alpha expectations will be considered active management strategies for the purposes of monitoring performance. As such, enhanced passive strategies will be subject to the "Active Manager" performance guidelines outlined above in II.C.1.a.

Beginning ***one*** year after inception date, staff will monitor the manager's four quarter rolling returns. If the manager's trailing four-quarter annual return exceeds the range set forth in the manager's investment management contract for two (2) consecutive quarters, staff shall place the manager on IPERS' Watch List.

2. Private Market Managers - Annually after each calendar year end, staff will evaluate each private market manager's performance relative to its performance objective and, when appropriate, to an asset class benchmark. Managers who fail to achieve their performance objective and, when appropriate, fail to outperform their asset class benchmark, on a rolling basis for three consecutive years shall be placed on the Watch List. In general, staff will utilize a rolling ten-year evaluation period for IPERS' private equity managers and a rolling five-year evaluation period for real estate managers.

D. Reporting

On a quarterly basis, staff shall prepare the Skill Analysis Graphs for each of IPERS' active, public market managers. Where appropriate and available, staff shall also prepare reports to support the qualitative assessments including style measurement reports, attribution analysis, tracking error reports, and peer universe comparisons.

III. Courses of Action

A. Watch List

A manager will be placed on the Watch List as a result of a significant and potentially adverse development involving the manager as described in sections II.B. and II.C. above. Being placed on the Watch List communicates to the manager IPERS' concern about a particular situation. **A manager will be placed on the Watch List for a specified length of time, normally twelve months**. Staff will meet with the manager within ninety (90) days of their being placed on the Watch List to discuss the situation and the steps needed to be taken to resolve the issue to IPERS' satisfaction. A manager will generally remain on the Watch List until the specified time period expires, or until the issue is resolved to IPERS' satisfaction. If the issue has not been resolved by the expiration of the specified time period, a Comprehensive Review may be initiated. Also, a manager may be removed from the Watch List and a Comprehensive Review initiated at any time if a situation deteriorates.

B. Comprehensive Review

A Comprehensive Review of a manager will be undertaken as a result of serious under performance of a manager relative to its benchmark per section II.C., or as the result of a ***significant*** and ***adverse*** change to the manager's organization, personnel, or investment process per section II.B. These categories of events cause staff to seriously question the firm's ability to achieve IPERS' investment objectives in the future. A Comprehensive Review is a thorough, in-depth due diligence effort, similar in scope to IPERS' manager selection process. A Comprehensive Review explores all elements of a manager's organization, personnel, and investment philosophy and process. Comprehensive Reviews will be completed within 90 days of initiation.

In undertaking a Comprehensive Review, staff is ultimately deciding whether the firm should be re-hired today given the current events and prevailing circumstances. **Thus, the outcome of a Comprehensive Review is a decision to retain or terminate the manager.** The nature of certain private market investment vehicles may severely restrict or prohibit the immediate withdrawal of funds and/or the transfer of assets to another manager. In such cases, the decision to terminate a manager is infeasible and, therefore, IPERS' actions may be limited to filing a withdrawal request with the manager and waiting until the investments can be liquidated in a prudent manner, or seeking other disposition strategies.

The Comprehensive Review will focus on whether the firm currently embodies enough of the following characteristics to provide reasonable assurance that IPERS' investment objectives in the future will be achieved. The list below represents characteristics that IPERS believes are important to the success of a manager's investment program.

Organization:
- Stable ownership structure
- Experienced, dynamic leadership
- Clearly delineated lines of authority and responsibility
- Sound financial condition

- Planned growth
- Strong compliance and internal control systems

Personnel:

- Investment staff is experienced and competent
- Low turnover in key positions
- Employees are highly incented to meet client objectives
- Sufficient back-up and on-going training

Investment Process and Philosophy:

- Well articulated philosophy as to how value is added in a particular market
- Investment process is systematic, focused and consistent
- Investment process exploits a perceived competitive advantage
- Investment process has been successfully applied in different market environments
- High quality research base
- Investment process/style can be benchmarked
- Strong trading capabilities
- High quality deal flow and investment opportunities

The Comprehensive Review shall also address whether the problem can be resolved within the scope of the existing relationship, and if not, how and to whom the assets should be redeployed. A decision to re-hire a manager may also be subject to the manager satisfying specified conditions and include a probationary period.

IV. Other Termination Conditions

This policy depicts circumstances where IPERS may elect to terminate a manager for cause. However, all of IPERS' investment management contracts permit IPERS to terminate the manager, with or without cause, after thirty days written notice. The investment management contracts also permit IPERS to terminate a manager ***immediately*** upon learning of a breach of duty or confidentiality. IPERS also has the right under its investment management contracts to terminate a manager after thirty days written notice in the event of the non-availability or non-appropriation of funds.

[1] Difference between the manager's return and the benchmark return

[2] Changes in a portfolio's predominant style characteristics over time (i.e. shifts from growth to value or large cap to small cap)

[3] Standard deviation of excess return

[4] The range the manager's excess return is anticipated to fall a specified percentage of the time based on the past variability of excess returns

[5] Risk-adjusted excess return

Attachment 3

Iowa Public Employees' Retirement System, Petitioner	**Signed Release of Information**

I, Donna Mueller, the Petitioner in this action, authorize the following people to release any information to the Department of General Services that may assist it in making a determination relative to this Petition. I make this authorization in my capacity as the Chief Executive Officer of the Iowa Public Employees' Retirement System.

a. Kathy Comito, Chief Investment Officer
IPERS
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-0030

b. Karl Koch, Lead Investment Officer
IPERS
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-0040

c. Gregg A. Schochenmaier, General Counsel
IPERS
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-0054

d. Kelly Lovell, Deputy General Counsel
IPERS
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-3081

e. Chairman Bruce Kelley
Investment Board
14 Glenview Drive
1398 10th Street
Des Moines, IA 50312
(515) 280-2950

f. The Honorable Jack Kibbie, Iowa Senate
IPERS Investment Board
112 Oakwood
Emmetsburg, IA 50536
(712) 852-4140

g. The Honorable Jeff Elgin, Iowa House
IPERS Investment Board
6949 Bowman Lane N.E.
Cedar Rapids, IA 52402
(319) 377-2218

h. Vice Chair Michael Logan
Investment Board
1398 10th Street
Coralville, IA 52241
(319) 354-2556

By: Donna Mueller

Donna Mueller, Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

Before me appeared Donna Mueller, the Petitioner in this action, who placed her signature on this document on the 17 day of June, 2003.

By: Gregg A. Schochenmaier

Gregg A. Schochenmaier, General Counsel
Notary Public, Commission No. 179501
Iowa Public Employees' Retirement System
7401 Register Drive, P.O. Box 9117
Des Moines, IA 50306-9117

NOTARIAL SEAL IOWA
GREGG SCHOCHENMAIER
Commission Number 179501
My Commission Expires
23 May 2004

Attachment 5

Iowa Public Employees' Retirement System, Petitioner	**Approval of IPERS Petition for Waiver, June 2003**

RECEIVED

JUL 07 2003

IPERS
INVESTMENTS

Thomas J. Vilsack
GOVERNOR
Sally J. Pederson
LT. GOVERNOR

Department of General Services
STATE OF IOWA

Request for Waiver by: Waiver Request No. IPERS1

Iowa Public Employees' Retirement System

Pursuant to Iowa Code section 18.3 and 401 Iowa Administrative Code rules 12.16 and 20, the Interim Director of the Iowa Department of General Services, Patrick J. Deluhery makes the following ruling on the Iowa Public Employment Retirement Systems' (IPERS) Petition for Waiver.

COURSE OF PROCEEDINGS

1. On June 25, 2003, IPERS filed a petition for waiver of two rules: 401 IAC 12.11(3), which requires that a services contract cannot exceed six (6) years in length; and, 401 IAC 13.4 (services contracting rules that require payment clauses based on minimum requirements for performance criteria, outcomes, or outputs with incentives or disincentives).

2. The Director has reviewed and given full consideration to the Petition for Waiver.

3. First, IPERS offers that due to the nature of its business, the services contracting rules under 401 IAC 13.4 present undue hardship on it for a number of reasons:

    a. It is doubtful that IPERS could implement, or negotiate a meaningful performance-based contract with index fund managers due to the low margins that index managers earn on pure index funds, or its private market investment managers, due to the participation rate negotiated with these managers (a participation rate rewards the manager if the portfolio outperforms a benchmark, and is penalized if the fund under performs).

    b. Additionally, due to the time that it may take for a fund to perform (a realized loss or gain), an annual performance-based fee arrangement could create huge payouts when interim valuations are high.

4. In its second request, IPERS offers that compliance with the provisions under 401 IAC 12.11(3), which governs the length of services contracts, will also hinder its ability to effectively carry out its business mission:

Thomas J. Vilsack
GOVERNOR
Sally J. Pederson
LT. GOVERNOR

DGS Department of General Services
STATE OF IOWA

a. Rebidding investment contracts after six years will put too much focus on the cost, and too little focus on the skill and net-of-fee investment returns produced by the investment managers.

b. The six-year limitation could significantly raise fees paid by IPERS for investment management services if it rehires an existing, top-performing investment manager who can at the time of the rebid demand higher fees because of strong performance.

c. IPERS currently reviews performance on a five-year basis for investment managers, and offers that mandatory rebidding after the sixth year is unnecessary if they have determined good performance at the five-year review.

d. The six-year rebid requirement could result in substantial transition costs if portfolio managers are changed every six years, due to preferences of stocks to be bought or sold.

SUMMARY OF RULES

The Director may issue an order waiving in whole or in part the requirements of a rule in 401 Iowa Administrative Code Chapter 12 if the Director finds that there is good cause for a waiver. Specifically, 401 IAC 12.16(3) states, "good cause includes, but is not limited to a showing that a requirement or provision of a rule should be waived because the requirement or provision would likely result in an unintended, undesirable, or adverse consequence or outcome. An example of good cause for a waiver is when a contract duration period of longer than six years is more economically feasible than a six-year contract in light of the service being purchased by the department or establishment."

While Chapter 13 of 401 Iowa Administrative Code has no special provision for waiver, Chapter 20 provides a process for granting a waiver or variance. 401 IAC 20.4 states, in relevant part, the following information:

A waiver may be granted if the director finds based on clear and convincing evidence each of the following:

a. The application of the rule would pose an undue hardship on the person for whom the waiver is requested.

b. The waiver from the requirements of the rule in the specific case would not prejudice the substantial legal rights of any person;

c. The provisions of the rule subject to the petition for a waiver are not specifically mandated by statute or another provision of law; and

d. Substantially equal protection or public health, safety and welfare will be afforded by a means other than that prescribed in the particular rule for which the waiver is requested.

DECISION ON WAIVERS

Good cause exists for waiving the requirement of 401 IAC 12.11, as IPERS wants to control the amount of fees paid to investment managers, control transition fees, and currently reviews performance after five years, and the waiver is granted in that IPERS does not need to comply with the six-year term for service contracts entered into for the next 10 years. IPERS will supply to the Department of General Services, or its successor department, the contracts entered into on an annual basis so that a review of the waiver can be performed.

Additionally, it is determined that a waiver from 401 IAC 13.4 is required, so long as IPERS continues to use the monitoring techniques and criteria (or substantially similar terms) stated in the waiver, and as evidenced from the addendums attached to its Petition for Waiver so that the terms are consistent with the fiduciary duties IPERS has with respect to managing the trust fund, and so that the contracts are written within the spirit and intent of the administrative rules governing services contracts.

Cancellation of the waiver, as provided for under 401 IAC 20.13 is reserved based on the annual review of the contracts as provided for above.

IT IS THEREFORE ORDERED:

The requirement of 401 IAC 12.11 (services contracts shall not exceed six years in length) is hereby granted for a period of 10 years.

The requirements of 401 IAC 13.4 are waived, so long as IPERS continues to use the monitoring techniques, and performance criteria (or substantially similar terms) as those stated in the waiver, and evidenced from the addendums attached to its Petition for Waiver so that the terms are consistent with the fiduciary duties IPERS has with respect to managing the trust fund, and so that the contracts are written within the spirit and intent of the administrative rules governing services contracts.

Patrick J. Deluhery, Interim Director • Hoover State Office Building, Level A • Des Moines, IA 50319-0104 • Phone (515) 242-5120 • Fax (515) 242-5974

Thomas J. Vilsack
GOVERNOR
Sally J. Pederson
LT. GOVERNOR

Department of General Services
STATE OF IOWA

Dated this 30 day of June, 2003

Patrick J. Deluhery
Interim Director
Iowa Department of General Services
Level A
Hoover State Office Building
Des Moines, Iowa 50319

Approved as to legal form

Patricia J. Lantz
General Counsel

Copy to:

Donna Mueller
Chief Executive Officer
Iowa Public Employees' Retirement System
7401 Register Drive
P.O. Box 9117
Des Moines, Iowa 50306-9117