

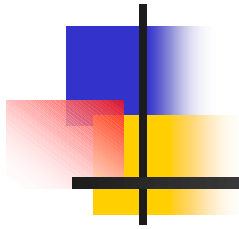


IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

8:15 TODAY'S DEFINED BENEFIT PLANS-STILL UNDER THREAT OF EXTINCTION?

The heavy declines in the corporate pension offerings, Bush's pending social security overhaul and mounting costs for healthcare coverage have all ravaged the once glorious employer-sponsored retirement system. What are local and state governments doing to preserve what is left? What actions should be taken and how can we band together?

**IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA**



**A LOOK AT THE FACTS ABOUT PUBLIC EMPLOYEE PENSION
AND RETIREE HEALTH CARE**

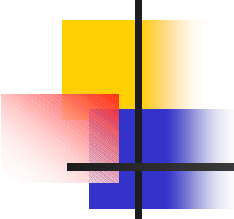
PREPARED BY:
EDWARD H. FRIEND, PRESIDENT
EFI ACTUARIES
1001 CONNECTICUT AVE., N.W., SUITE 315
WASHINGTON, D.C. 20036
(202) 785-4985 (Voice)
(202) 463-0347 (Facsimile)
edfriend@efi-actuaries.com



IMN PUBLIC FUNDS SUMMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **A – THREE ISSUES MERIT ATTENTION**

1. Defined benefit pensions are demonstrably superior to DC in design, effectiveness and cost.
2. Naysayer's are either:
 - ÿ Motivated for reasons other than the demonstrable truth.
 - ÿ Misinformed.
3. Retiree health care has recently and suddenly become an expensive coverage which needs to be retooled by society. Its tumultuous financial condition is not a public sector issue.



IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **B. IRREFUTABLE EVIDENCE OF
SUPERIORITY OF DB OVER DC**

1. Despite pressures, almost 90% of public employees are in DB plans.
2. Careful studies among many states have reinforced the desirability of DB over DC
3. In West Virginia, the actuaries demonstrated to the legislature superiority of DB over DC and, accordingly, after a brief period of years, the West Virginia Teachers' Retirement System has returned to DB
4. Only Alaska has moved from DB to DC effective July 1, 2006, and even this politically motivated result will be challenged.



IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **B. IRREFUTABLE EVIDENCE (CONTINUED)**

5. During the last decade 75% of the funding of DB benefit programs have been from investment returns and employee contributions. Only 25% comes from the taxpayers of public jurisdictions.

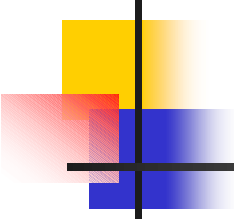
6. Volatility of cost of DB systems can be overcome by introducing "fixed cost" type DB programming in lieu of DC systems. This concept is being explored in at least one state which is concerned about changes in annual cost due to market volatility.



IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n B. IRREFUTABLE EVIDENCE (CONTINUED)

7. Under-funding of DB plans reflects public employer diversion of resources to other areas.
- n** The only reason DC plans have not had a similar fate is that the failure to finance them currently would immediately be brought to spotlight.
 - n** This provides a lesson to public employees in jurisdictions which do not fund their plans.
 - n** Because the failure to fund does not affect individual accounts, there is perceived to be less reason to be concerned.
 - n** As we have seen, however, our reasons to be concerned are made evident by the under-funding problem which has risen.

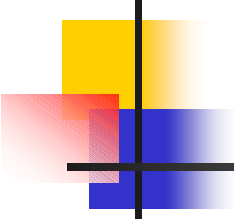


IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **B. IRREFUTABLE EVIDENCE (CONTINUED)**

8. Because public sector leaders prefer career minded employees (police, fire, teachers, and municipal workers), DB systems are designed so that short service employees lose credit for contributions toward their retirement when they leave their employment. These forfeited dollars remain in the trust funds which are set aside for career employee retirement. This is one aspect of effective financing of public pension objectives.

9. Professionally managed investments produce 1% to 2% more per annum (net of expenses) than do employee-managed investments in individual accounts. Moreover, employees approaching retirement who manage their individual accounts will be more inclined to go to fixed income investments because of the danger of volatility negatively impacting on their assets. This "life-style" investment planning is not necessary when DB plans are used.



IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **B. IRREFUTABLE EVIDENCE (CONTINUED)**

Over a 30 year period a 1% to 2% difference in investment returns will lead to 50% or more in additional retirement benefit availability.

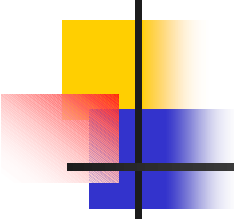
10. DB plan participants have no right to access their retirement funds until eligible for benefits. DC participants have the right to claim their funds at anytime and often do so, leaving insufficient funds available for retirement.
11. DB programs provide lifetime benefits. DC accounts often run dry before the end of the time for their need.
12. Although DC plans enable employers to contribute less than they would have had to contribute toward their old DB plans, it would be better for them to reduce the level of a DB program in a new tier than to expose their employees to the issues addressed in this presentation.



IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **C. NAYSAYER'S WITH MOTIVES**

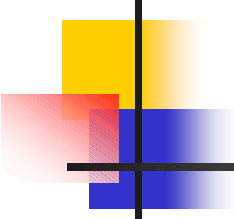
1. Financial institutions interested in the generation of fees for the investment of individual accounts are motivated to encourage the collapse of DB plans and the substitution of DC programs.
2. Administrative organizations which would be needed to maintain the individual account records of DC participants are similarly inclined.



IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **C. NAYSAYER'S WITH MOTIVES
(CONTINUED)**

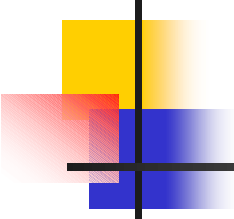
3. Legislators, such as those who want to run for office based upon a platform of saving taxpayer money will pounce upon the DC/DB debate as a means of advancing their own political ambitions . . . without taking the time to research and understand the preferability of a DB concept.
4. Media (TV, newspapers and magazines) have attached themselves to the DC/DB issue as a means of provocation to fuel controversy . . . often without careful research of the facts.
5. Taxpayer organizations, motivated to attract membership interest, will disseminate flyers for similar purposes, despite the evidence.



IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **D. NAYSAYER'S WHO ARE MISINFORMED**

Recently, Michael H. Moskow, President and CEO, of the Federal Reserve Bank of Chicago spoke to the State and Local Government Pension Forum observing that public pension payouts have grown substantially during the last several years, that workers and retirees of state and local government are owed upwards of \$2.5 trillion dollars by more than 2,000 different public entities, that these entities in 2003 contributed almost \$50 billion dollars to pension plans which is approximately 20% more than was done in 2002 and that pension funding has increased from slightly over 2.15% of all state and local spending in 2002 to almost 2.5% in 2003.



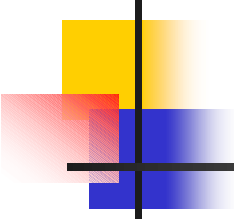
IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **D. NAYSAYER'S WHO ARE MISINFORMED
(CONTINUED)**

He continued that it is estimated that the largest state and local pension funds face a funding gap of almost \$300 billion dollars in 2003 and that midwest jurisdictions are much more likely to succumb to the same kinds of problems domestic automakers face.

He proposes to solve the problem by:

- (i) More uniform accounting standards, enabling a better grasp of the size of the pension obligation
- (ii) Change pension plans structurally
- (iii) Be sure these programs are actuarially sound and meet the needs of today's employees which includes job mobility support using 401(k) type planning.



**IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA**

**n D. NAYSAYER'S WHO ARE MISINFORMED
(CONTINUED)**

A thoughtful response to this unfortunate talk was developed by Keith Brainard, Director of Research for The National Association of State Retirement Administrators and by Paul Zorn, the former director of research for another national organization.

They pointed out:

- (i) a public pension funds are in decent financial shape with a least 7 of 10 plans at least 80% funded;
- (ii) the dramatic decline in the domestic equity market that occurred during the early part of the 21st century is the single largest factor influencing recent growth in unfunded liabilities
- (iii) public plans were not the only ones affected in the aftermath of the decline in these assets values and that they impacted on both defined contribution plans and as well as defined benefit plans



IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **D. NAYSAYER'S WHO ARE MISINFORMED
(CONTINUED)**

(iv) regularized amortization of declines are impacting employer contribution rates but asset smoothing has overcome some of the difficulties

(v) any savings from a switch to a lower costing DC would take 10 to 15 years to realize because of transition costs [mostly because moving to DC doesn't make the UAL go away (doesn't affect it at all)]

Among other advices, these gentlemen propose that to the extent benefits cannot be sustained in the DB area that a new benefit tier should be established to provide more sustainable pension benefits to new hirers.



**IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA**

- n E. RETIREE HEALTHCARE PROGRAMS MUST BE RETOOLED**
 - 1. Public jurisdictions are increasingly confronted with the recognition that they can no longer afford to provide the kinds of retiree healthcare coverage which they have in the past.
 - 2. This recognition has been exacerbated by the recent promulgations by the Government Accounting Standards Board (GASB) which has announced that public retiree health care programs must report their unfunded obligations and the annual contribution required for the funding of same.



IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

n **E. RETIREE HEALTHCARE PROGRAMS MUST
BE RETOOLED**

3. While commitments which cannot be changed will continue to require recognition, public employers have the opportunity to take two important steps as described below:

(i) The first important step is to design retiree healthcare so that it reflects the availability of monthly stipends which can be spent on retiree healthcare coverage, including premiums and out-of-pocket expenses . . . this rather than attempting to cover benefit programs such as hospital stays, surgical procedures and other particularized healthcare coverage's.

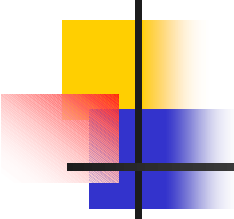


IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA

**n E. RETIREE HEALTHCARE PROGRAMS MUST
BE RETOOLED (CONTINUED)**

Under such an arrangement, public jurisdictions are enabled to contribute a certain amount as a percent of pay to retiree healthcare programs and not be confronted with ever-escalating premiums for basic coverage's.

While some of the cost of retiree healthcare is shifted to the employee, the employer is saved the task of over burdensome costs to provide services which have become unsustainable.



**IMN PUBLIC FUNDS SUMMIT
APRIL 3-5, 2006
HYATT LAKE LAS VEGAS
LAKE LAS VEGAS, NEVADA**

**n E. RETIREE HEALTHCARE PROGRAMS MUST BE
RETOOLED (CONTINUED)**

(ii) The second important step is to recognize that these public retiree healthcare programs must often be modified and should not reflect on the financial soundness of the jurisdiction providing same.

Under current GASB Standards, joining together with other jurisdictions and introducing risk sharing/benefit sharing healthcare programs, costs are shifted to a trust rather than to the jurisdictions and pronouncements of obligations of unfunded liabilities are reduced to the cost of contributing to these trusts pursuant to collective bargaining arrangements, returning the financing to a sane and simple obligation approach.