NASRA

NEWS

FALL 2004

National Association of State Retirement Administrators

P.O. Box 14117

Baton Rouge, LA 70898

Ph 225-757-9558

Fax 225-757-9765

Celebrating Traditions and Innovations

Our meeting in Asheville continued the NASRA tradition of providing a forum for continuing education and networking among members, associates, and other public pension professionals. The speakers were exceptional – from the traditional retirement issues to the innovations of tax reform – and attendees found time to network during group dinners and other activities.

The program, organized by Program Chair Ed Hennessee, provided a diverse mix of topics and speakers. Topics included corporate governance, a perspective from the Employee Benefit Research Institute, economic overview, best practices presentations from member systems, media relations, long-term health care, and a panel on international markets. A highly anticipated session from the Americans for Tax Reform advocating a change to defined contribution plans was followed by a spirited panel addressing the benefits of maintaining defined benefit plans for public employees. Other presentations covered new developments in Congress, findings from the Public Fund Survey, and the ever-popular Roll Call of the States.

Attendees enjoyed hot doughnuts from Krispy Kreme, a company founded in North Carolina. The roar and excitement of a NASCAR race filled the room as attendees learned about the dramatic rise in the popularity of a sport that began in North Carolina.

Taylor Ranch provided a step back in time with an old fashioned Carolina mountain party. There were horse drawn wagons, fishing, horseshoes, clogging, square dancing, roasting marshmallows, and stick-horse races – something for everyone. The outdoor environment provided an opportunity for attendees to meet in a comfortable setting.

(continued on page 2)

Letter from the Past President

Dear Fellow NASRA Members:

Just two years ago in Providence, NASRA broadened its criteria for membership eligibility to permit directors of teacher and other statewide retirement systems to join the organization. In making this change, NASRA has brought a new level of energy and diversity to the organization, becoming not just bigger, but also more robust and more representative of our profession.

NASRA membership now includes 76 directors from all 50 states, the District of Columbia, and several territories. These members oversee retirement system with combined assets of more than $1.8 trillion and whose participants comprise more than two-thirds of all full-time state and local government employees in the U.S.

(continued on page 2)

E-MAIL – GLENDAC@NASRA.ORG • WEB – WWW.NASRA.ORG

Celebrating

(continued from page 1)

The conference experience wouldn't be complete without a mention of the hospitality provided by Michael Williamson, Director of the North Carolina Retirement Systems, and the people of Asheville. During meeting breaks, Michael entertained with his own special style of country humor and tidbits of information about the state. The conference provided a perfect blend of education and the opportunity to network with others in a relaxed atmosphere.

Letter

(continued from page 1)

The benefit of NASRA membership was conspicuous at the Directors' Meeting in Washington, D.C., in February, when NASRA members exchanged perspectives and experiences on the issues that unite us and define our community. NASRA members shared the challenges of administering a public retirement systems at a time of state and local government fiscal constraints, unreliable financial markets, a quickening pace of members seeking to retire, unrelenting media attention, and ongoing legislative interest in public pension issues. This and other real and virtual forums sponsored by NASRA provide insight for our members into more creative and effective administrative approaches.

During my year as NASRA president, we became involved in a number of issues and events affecting our membership, including:

- Played a role in dissuading Ohio policymakers from restricting that state's public retirement systems from operating in the best interest of their participants.
- Continued to develop material explaining defined benefit plans and their importance to the retirement security of public employees, including a tool kit of information to support members' efforts to defend DB plans.
- Led an effort by 38 public retirement systems to comment to the U.S. Securities and Exchange Commission on the issue of giving shareholders the ability to meaningfully participate in corporate board elections.
- Countered a misleading report from a national consulting firm on public pension funding levels, and responded to a national magazine's misrepresentation of public pension plans. Each of these responses provided NASRA members with antidotes for use in responding to inquiries from policymakers, the media, and plan participants.

The NASRA staff continues to provide what I believe is outstanding service to our members:

- Jeannine Markoe Raymond, NASRA's director of Federal Relations, is a well-connected Washington insider able to advance the interests of NASRA members through the formation of coalitions of diverse groups and interests. We are fortunate to have Jeannine's knowledge of the players and processes in our nation's capital.
- In his role as Research Director, Keith Brainard continues to compile a large and growing databank of news, studies, surveys, and reports pertinent to public pension administrators. His online database, the *Public Fund Survey,* is the resource of record for information about public pension funding levels and other data regarding public retirement systems in the U.S.
- Great conferences don't just happen; they are the result of careful planning and creative thought. NASRA's Executive Director Glenda Chambers has done the heavy lifting for annual conferences in Monterey and Asheville, and both were highly acclaimed by attendees. The annual conference is not just the most visible of NASRA's many functions, but also is essential to the organization's financial viability. The importance to the organization of planning and executing a first-rate conference cannot be understated, and Glenda has done so with flying colors two years in a row.
- Liz Antin, NASRA's administrative assistant, maintains the data base of members, prepares conference materials such as the program and badges, compiles the Roll Call of the States, and organizes the conference registration. She also keeps members and associates informed of important announcements such as job openings throughout the year and provides administrative support for other NASRA staff.

NASRA members are well-served by an executive committee whose members include your colleagues around the country and some associate members. It has been my pleasure to work with them for the past several years. In addition, I want to express my gratitude to Gary Findlay, who serves as the chairman of NASRA's membership development committee. NASRA Associate Members now include 156 of the industry's leading service providers. Associate members represent an important source of the organization's financial support.

I thoroughly enjoyed my term as NASRA president, and the reins of the organization have been passed into the very capable hands of Ed Hennessee of Tennessee. Thank you for the opportunity to serve you.

Kindest Regards, David Bergstrom

Tribute to Ray Lillywhite

By: Elizabeth Smith, AllianceBernstein

At the 50th Annual NASRA Conference in Asheville, the Executive Committee voted to honor the memory of Ray Lillywhite by naming the annual golf tournament "The Ray Lillywhite Memorial Golf Tournament." Glenda Chambers, Executive Director of NASRA, had asked me to write an article about Ray for the newsletter. Many of you knew Ray longer and better than I did, and I am including some stories from those of you who have a special memory to share.

I attended Ray's funeral on July 9 in Brigham City, Utah (Jim Mosman also attended) where we met his son-in-law, Boyd Christensen, and his wife, Sharon, who cared for Ray during his last months. Four of Boyd's children spoke at Ray's funeral. Their personal tributes to Ray clearly showed the positive influence he had on their lives – he put them all through college – and the deep affection and high regard they held for him.

Ray had a long, full life and died at 92. He was born on January 10, 1912, in Brigham City, one of ten children. He made his own way through college, earning a degree in Political Science at Utah State University and a degree in Public Administration at American University in Washington D.C.

At the age of 25, he became the first executive director of the Utah State Teachers Retirement System in 1937. I have been told that he was one of the first plan sponsors to invest in equities. He volunteered for the Navy during World War II where he received special recognition as the Outstanding Fighter Director in the Pacific. After the war, he returned to Utah State Teachers, later moving on to Wisconsin State Teachers Retirement System, where he spent eleven years as executive officer. His final plan sponsor position was at Ohio State Retirement System, where he was assistant director for seven years.

Ray joined Alliance Capital's San Francisco office in 1970, as senior vice president and national director of public fund marketing. I first met Ray and his wife Eloise in 1990 at the NASRA conference in San Diego. I had been assigned to work with Ray in public fund marketing and eventually took over the public fund business when Ray retired. I quickly learned how difficult it would be to fill Ray's shoes. Ray knew everyone at the conference, as well as the names of all their family members. He had a kind word for each person he met and was clearly respected and admired by those who knew him. You would never know from Ray's demeanor that he tragically lost his only son and daughter much too early in his and Eloise's married life. Eloise died several years before Ray, but Ray was by her bedside every day of her illness and no one had better care.

Over the years, many of you have enjoyed some wonderful times with Ray on the golf course and at the various NASRA and NCTR conferences, and some of you were kind enough to share your memories.

NASRA Remembers ...

Gary Findlay, MOSERS: In 1975 when I was director of the Missouri Local Government Employees Retirement System I was appointed to the Committee on Public Employee Retirement Administration of the Government Finance Officers Association (which

(continued on page 3)

Winners of the First Annual Ray Lillywhite Memorial Golf Tournament

1st place:
Pat Bauer
Clayton Johnston
Dean Ossanna

2nd place:
Jay Lingo
Frank Karpinski
David Sweeney
Tom Walsh

3rd Place:
Bill Hanes
Alexander Grant
Jim Heaton
Vincent Williams

Closest to the Hole – Men: Jack Gastler
Closest to the Hole – Women: Theresa Leatherbury

Longest Drive – Men: Richard Hartzell
Longest Drive – Women: Sally Kupferschmidt

Tribute

(continued from page 3)

at that time was called the Municipal Finance Officers Association.) The committee consisted of retirement system directors from around the country and advisors from the accounting, actuarial, and investment management professions. Ray Lillywhite was the investment management representative. He was a huge contributor to the committee's activities given his wealth of experience in plan administration in addition to his knowledge of investment matters. As a then very young retirement system director, it became obvious to me very quickly that when Ray spoke, everyone in the room was very interested in hearing what he had to say (including the seasoned veterans), and for good reason. Even when Ray did not agree with someone on an issue, he seemed to have the infinite capacity for treating them (and everyone else) with the utmost in dignity and respect. If you were to look up the word "gentleman" in the dictionary, it would not be surprising to see his picture. If I were restricted to using just one phrase to describe him, I would say that he was a person of good character. The World could use a lot more people like Ray Lillywhite – I consider it to have been my very good fortune to have been able to call him my friend.

Eddie Vandiver, AIG: Many years ago when Fred Walker was the president of NASRA, he and Ray traveled around California for several days looking for the best location to host the NASRA Mid-Winter Directors' Meeting. Needless to say, they played golf at every location, just to ensure that the course was acceptable for the quality of golf needed for the directors, of course!

After completing their appointed rounds, Fred inquired of Ray which hotel he liked the best. Ray responded and Fred asked, "Ray, I liked that hotel too, but why did you choose it?" Ray's response was "Because they have real glasses, instead of Dixie cups!" Fred said that he (Fred) knew then that Ray was a first class kind of person … a "real class act."

And I must share with you another true, first hand story, as well:

Once Ray, Fred, and Maxine Gregson (now Mrs. Fred Walker), and I teed off with Ray at his home course their in Alameda, CA. As always, Ray hit it down the middle, but only about 150 yards, but absolutely straight. I had already hit my ball about 240 yards, but way right… into trouble. After he had hit his down the middle Ray turned to me and said, nonchalantly, " "Mine is short, but not too bad for a 75 year-old white guy with two hip replacements, wouldn't you say?" Ray went on to card score in the mid 80s while I continued to hit the ball long, but staying in the bad rough most of the day and trying to scramble to break 100. I think he beat me every time I had the pleasure of sharing his day with him.

And another tidbit:

About the time in the early 90s when Ray was "retiring" from Alliance, and I was preparing to attend the black tie affair in NYC, I received a phone call from a headhunter, asking me if I would consider coming to the sales side of pension fund investing. I responded "yes" and we continued our interview. He asked me "What would be your long-term objectives on the sales side?"

My response was unusual, but sincere, when I said, "I would like to be a Ray Lillywhite." He was totally confused and asked, "What is a Ray Lillywhite?"

It was the easiest question that I ever had to address. "Ray Lillywhite is a gentleman who retired from the directorships of two or three large public pension funds, went into the sales and marketing business with Alliance Capital, was a success there, and is respected by everyone and anyone who ever knew him, regardless of what position he was in within the public pension fund industry!" The headhunter never asked another question of me that day.

And to this day, I would love to be a "Ray Lillywhite." It sounds so corny or mushy, but I mean every word of it. What a legend to attempt to emulate!

Jay Dirnberger announces the winners of The Ray Lillywhite Memorial Golf Tournament.

Notes on the Directors' Workshop

By: Keith Brainard, NASRA Research Director

The Directors' Workshop is a perennial conference event where NASRA members gather to renew old friendships, meet new colleagues, and participate in a program targeted to their role as directors and administrators of large statewide retirement systems. This year, following welcoming remarks from outgoing NASRA president David Bergstrom (MN SRS), Laurie Hacking (OH PERS) introduced the workshop topic–System Governance–and its speakers: Gail Stone (AR PERS), Gary Findlay (MOSERS), Ray Henry (TX CDRS), and Jeanna Cullins (Independent Fiduciary Services and formerly with the DC RB).

Gail cited her overarching concerns with the governance structure in Arkansas: legislative resistance to allowing Arkansas PERS to function in ways that serve its membership; and mandatory obedience to the state's budget, procurement, and personnel rules.

Much of the source of these challenges can be traced to legislative term limits. Term limits effectively erase legislative knowledge and memory of public pension issues, leading to continual legislative efforts to reinvent the public pension wheel and to "fix" perceived pension problems. The requirement that the system adhere to state budget, procurement, and personnel rules obstructs the ability of trustees and staff to fulfill their fiduciary responsibilities. This impediment is manifest in assorted ways, including inadequate staff salaries and a lack of flexibility needed to manage the system's assets. These concerns make increasingly appealing the idea of seceding from state processes.

Gary Findlay recalled that the last time the NASRA annual conference was held in Asheville, one of the speakers was John Carver, founder of the Carver Policy Governance model. Some of the observations Mr. Carver made during his 1996 presentation were:

- effective governance among boards is a relatively rare and unnatural act;
- trustees are often high-powered, well-intentioned people engaging in low-level activities;
- most boards are not doing what they are legally, morally, and ethically supposed to be doing;
- boards have been largely irrelevant throughout most of the 20th century;
- boards tend to be incompetent groups of competent individuals.

John Carver's presentation inspired Gary to encourage his board to initiate changes in board governance at MOSERS. Gary recounted the findings of two anthropologists, William O'Barr and John Conley, coauthors of the book, *Fortune and Folly: The Wealth and Power of Institutional Investing*. Following is a brief summary of the book's findings:

While decision making at each of the nine funds had all the trappings of rigorous analysis, in fact it seemed to be more grounded in organizational culture and history, in how responsibility and blame might be deflected, and how personal relationships might be affected. The organizational structures appeared to be more a response to culture and history rather than the result of a careful study of the mission-driven alternatives. The most pervasive cultural theme encountered was the need to manage responsibility for blame. An extraordinary amount of attention was paid to maintaining and nurturing good personal relationships with outside suppliers.

In light of these findings, according to Gary, a strong case can be made for encouraging policymakers to focus on *policy*, getting their arms around it, and keeping their fingers out of it; and delegating implementation to investment professionals, whose interests are aligned with the interests of the fund.

To really pursue excellence, retirement system boards must have the latitude necessary to get their job done. That should include controlling the investment policy, actuarial assumptions, operating budget, and payroll and purchasing processes; and to contract for services needed to administer the fund, including legal and internal audit services. In Gary's opinion, the best example of language giving a public retirement board the tools and authority necessary to pursue excellence is California Proposition 162 (accessible on the Board Governance page of the NASRA website Resources section).

Until the late 90s, the Missouri SERS board held monthly meetings, had five committees, set policy on the basis of past events, and established its asset allocation primarily to remain in the middle of the public retirement system pack. Then the MOSERS board chair agreed to take a fundamental look at the board's governance model.

After hearing from some experts on the subject, the board elected to adopt the Carver Governance model. This model establishes a well-defined policy and framework with a clear mission and the ends to be achieved. The model also establishes specific goals for the board, man-

agement, and service providers. Finally, the executive director is given wide latitude to manage the system; rather than listing the permissible actions the director may take, the limitations placed on the position take the form of things the director may *not* do. Today, the MOSERS board focuses on policy and monitoring performance, meeting quarterly with no committees.

MOSERS continues to use an outside governance consultant, for two purposes: new trustee education; and to ensure policies are being followed and to recommend adjustments as needed. (*A PowerPoint presentation of Gary's remarks is available to NASRA members and conference attendees by sending an e-mail to liza@nasra.org.*)

Ray Henry described his board experience when he became director in 2002: the board was erratic and unfocused, and the level of interest among board members ranged from those wanting to micromanage to those wanting simply to "review and ratify." Generally, the board lacked confidence in the staff; policies were not codified; and the board relied heavily on "tribal" knowledge–unwritten information passed down from one person to another. The staff was in disarray; turnover was high; vision and values were inconsistent; and the system staff operated like a collection of fiefdoms.

After reading John Carver's book, *Boards That Make a Difference*, conducting some research, and talking with others, Ray found a board member to champion the Carver model to the other board members. The process of adopting Carver principles into Board policy took about nine months, culminating in a mock meeting run by one of the governance consultants.

Today, TCDRS has cut its meeting times by half. The director, not the board, has control over personnel rules, salaries, administrative operations, organizational policies, and other aspects of the operation. Rather than a highly detailed budget, the board approves a general, high-level budget. The board evaluation process now focuses on organizational results, and the staff spends much more time achieving results rather than avoiding criticism. The new structure promotes accountability and ownership of responsibilities, rather than blame-shifting and blame avoidance. With no committees, the board speaks with one voice, and its policies are completely codified.

According to Ms. Cullins, the philosophy of a board is typically determined by its culture. The challenge for directors is to change the culture by a) challenging the board and b) finding a champion for change on the board. Succeeding at this task requires a director who is a consensus builder to help in persuading the board to buy in to new ways of functioning. In order for a board to be willing to make changes in the organization and the way it operates, it must have confidence in the organization. Directors and administrators can establish that confidence by building relationships and keeping board members informed.

The basic elements of good governance are accountability, transparency, consensus-driven, responsiveness, equitable, participatory, and compliant with the rule of law.

If such a thing exists, the "perfect" governance model includes board independence in key areas, particularly personnel, procurement, and investment policy. (Unfortunately, some states do not permit boards to delegate, requiring trustees in those places to make decisions they should not have to be making.) It also includes responsibilities for everyone, from the board to the entire staff. Board members should be trained in their role, agree with the mission and goals of the organization, and understand their fiduciary responsibility.

Session attendees were divided into groups to share and discuss what system governance strategies have worked and what have not worked.

What's worked:

- Foster board education by making resources available for travel and education, and encouraging board members to take advantage of training opportunities such as the Certificate of Achievement in Public Plan Policy (CAPPP), offered by the International Foundation of Employee Benefit Plans.
- Ensure that a written governance policy is adopted, followed, and kept up-to-date
- Establish a board mentor system, in which an experienced board member takes responsibility for familiarizing a new member with board policies and culture
- The board should have a self-evaluation. Not only does it assist in monitoring the board's performance, but also it board acceptance of its policies
- The staff auditor and legal counsel should have direct access to the board
- Be proactive and maintain a dialogue with the media
- Instead of reinventing the wheel, emulate policies from other states

What hasn't worked:

- The lack of a written governance policy can allow rogue trustees to dominate and can lead to other problems
- Weak trustees
- A politicized board
- Board members with hidden agendas
- Sole fiduciaries

Politics and Kittens?

Presentation by Howard Fineman
By: Lindy J. Beale

Howard Fineman, who has been described not only as a "standout in the press corps," but a "standout at the podium" was the lead presenter at the 2004 NASRA Annual Conference. Fineman is one of America's foremost political reporters and commentator and is Newsweek's Chief Political Correspondent, Senior Editor, and Deputy Washington Bureau Chief. He is deemed a Washington insider and, with his humor and insight, he lived up to his reputation as he entertained the conference attendees with an insightful presentation on the state of the presidential race. While outlining the patterns and trends of past political races for president, Fineman explained why neither George W. Bush nor John F. Kerry had a chance to win the election.

Howard Fineman and Lindy Beale

Why Kerry Cannot Win and Bush Has to Win

- History predicts that as a general rule, the incumbent has a two out of three chance of winning.
- We are at war and "war time" presidents usually win.
- The Republican money machine is dominant and has more money.
- Kerry is not a master campaigner like Bill Clinton, who was a master of empathy! Bush has the ability to "size up a group."
- Kerry has no gimmick like Jimmy Carter did as the "outsider" with a move for fundamental change.

Why Bush Cannot Win and Kerry Has to Win

- The stock market is not doing well and in the 20th century there has only been one president who presided over a simultaneous decline in the stock market and decline in the number of hourly wage earning workers (Herbert Hoover).
- The Democrats are united.
- Democrats will come close to matching Republicans in terms of raising money.
- The war in Iraq has defined Bush's philosophy on how to fight the war on terrorism and is a tremendous commitment of money and people power.

After discussing why neither candidate could win the election, Fineman shared his insights and conclusions about each candidate. He spoke candidly about their personalities, characteristics, talents, habits, and how each affects their leadership. He concluded by stating that although as a reporter he must be skeptical, he also has an appreciation for those who want to step forward to lead this country, which he described as an "unleadable herd of kittens"!

Federal Update

By: Jeannine Markoe Raymond,
NASRA Director of Federal Relations

Despite this being a presidential election year with an increasingly limited legislative schedule, a number of benefit-related initiatives were forwarded this session of Congress. A handful of provisions affecting public pension plans were eventually enacted into law and a number of regulatory proposals were forwarded and/or finalized as well. Issues remained in play as the 108th Congress was drawing to a close, including a few surprises that got added to what was thought to be unrelated legislation. A brief summary of those, as well as issues expected to carry over to the next Congress are summarized below. More information can be obtained from the *NASRA Newscast* and other federal e-mail alerts.

President's Savings Proposals

While these were expected to receive a big push this year, progress on these initiatives was slow. Given the

(continued on page 8)

Federal Update

(continued from page 7)

outcome of the elections, a renewed effort may be needed to educate Congressional offices regarding the potential impacts the proposals could have on public retirement plans and employee savings. The proposals include the creation of a new Lifetime Savings Account (LSA) that allows tax-free savings for any purpose, a new Retirement Savings Account (RSA) to replace traditional and Roth IRAs, and a new Employer Retirement Savings Account (ERSA), which, would replace all types of funded plans with employee contributions, including 401(k) plans, 403(b) plans, and governmental 457 plans.

Federal Tax Reform

Discussion is already underway regarding an overhaul of the tax system in the next presidential term, including reports that under consideration by the Administration is eliminating the tax deduction for employment-based health insurance and the deduction of state and local taxes on federal income tax returns in return for tax cuts on dividends and capital gains, expanded tax breaks for business investment, and other tax-code changes intended to simplify the system and encourage economic growth. There is growing concern that the employment-based benefits system will clearly be a target for change in the federal tax code if the objective is to raise revenue to pay for other changes.

Governmental Excess Benefit Plans Exempted from New Rules

The corporate and international tax reform legislation included executive compensation reforms that substantially change the rules that apply to nonqualified deferred compensation plans. While 457(b) plans are specifically excluded from the new requirements, original versions of the legislation could have applied to 415(m) governmental excess benefit plans, which would have proven extremely problematic. The final version signed into law on October 22, 2004 specifically excludes 415(m) plans.

Investments in Companies with Terrorist Ties

Interest in this topic intensified following a *60 Minutes* broadcast, a sensationalist report titled *Terrorism Investments of the 50 States*, letters to state and plan officials from Senator Lautenberg (D-NJ), and software vendors pushing resolutions in certain legislatures. NASRA, NASACT, NCSL, NCTR and NCPERS directly responded to the "50 States" report and Treasurer Hafer (PA) agreed to issue our press release with the letter attached. Public pension advocates had been alerted that Senator Lautenberg was readying a related amendment to Intelligence overhaul bill (S 2845), although the amendment was eventually tabled and Lautenberg agreed to drop the issue for now. Public sector representatives met with Lautenberg's office to discuss this issue further and will be meeting with the new SEC Office of Global Security Risk to ensure the new disclosures they will be requiring of companies will be useful to state pension funds.

Pension Tax Packages

A number of helpful public sector provisions were included in a broad legislative package (HR 1776) introduced by pension champions Rob Portman (R-OH) and Ben Cardin (D-MD) and in a separate measure forwarded by Senate Finance Committee Chairman Chuck Grassley (R-IA) and Ranking Member Max Baucus (D-MT). For differing reasons, each is not expected to receive further consideration in this Congress, but the sponsors of the measures stated they will be reintroduced in some form next Congress. Public pension provisions included in one or both bills, include: Clarifications of permissible purchases of service credit; a provision providing a floor 415(b) benefit limit at age 55 for non-public safety employees; relief from minimum required distribution regulations; early distribution penalty relief for DROP/PLOP distributions to public safety officers; and permitting after-tax rollovers to DB plans.

New Notice Required for Non-Social Security-Covered Employees

The final version of the Social Security legislation (HR 743) that was enacted last spring did NOT include new 1099-R reporting for all public plans (as was in a former version of the bill), but it did include a requirement that a new GPO/WEP notice be furbished to new-hires in positions not covered by Social Security and submitted to the employer **and the pension system**. The noticed was finalized and made available by the Social Security Administration (www.ssa.gov/form1945). SSA officials also relayed that there will be no rulemaking on the notice and reinforced that the statute has no enforceable duty (no penalty for noncompliance).

Social Security Reform

While no major Social Security reforms were seriously addressed this Congress, they are expected to receive strong consideration in the next Congress and/or term of the Administration. Privatization of a portion of Social Security is apt to be center stage in any of the discussions, although there is currently no agreement on the form this privatization will take. Mandatory

coverage of all State and local employees will likely again be on the table as lawmakers look for solvency options, including money to pay for the transition costs inherent in creating private accounts.

GPO/WEP Proposals

Retiree groups are showing increased interest in not only reform, but full repeal of the Government Pension Offset and Windfall Elimination Provision. These issues continue to receive heightened attention from members of Congress and have raised concerns that they may prompt additional interest in mandatory coverage as well. The newest proposal, however, would modify the existing WEP formula with an individualized calculation based on all earnings. The Congressional Budget Office has contacted NASRA and is interested in learning to what degree public plans could provide data on past earnings if asked by Social Security (who only has post-1978 earnings available). While the current analyses by public plans show most employees would be better off under the new provision, and it would be easier to understand, it appears as though it could be extremely difficult to administer.

Keith Brainard, Jeannine Markoe Raymond, and Dave Bergstrom

Medicare Prescription Drug Benefits

Public retiree health care plans were specifically included in the definition of "sponsor" under the newly enacted Medicare prescription drug bill. Also, language was retained requiring Medicare Part A eligibility **or** enrollment in Medicare Part B to participate in the new prescription drug benefit program. NASRA and other public sector employer and plan groups submitted comments on the proposed regulations surrounding the new law calling for parity and consideration for public plans. NASRA members were also encouraged to submit plan-specific comments.

Retiree Health Care

Beyond the Medicare Rx legislation, a host of retiree health care proposals have been forwarded in federal legislation, including a number of new tax incentives (retiree premium conversion plans, rollovers of flex accounts, etc). Unfortunately, cost is an overwhelming factor and no action is expected on these tax measures anytime in the near future.

Drug Reimportation

The issue of drug reimportation continues to stir much discussion among federal policymakers. While passage of legislation will likely not happen this year, a number of state and local governments, along with their retirement systems, are pursuing their own initiatives, despite warnings from the Federal Food and Drug Administration (FDA) that their actions could be in violation of federal law.

Phased Retirement Proposed Regulations Released

The IRS released its proposed rules (REG-114726-04) on allowable distributions under a phased retirement program, setting forth requirements for a bona fide phased retirement program—which generally permits employers to allow employees (those age 59 ½ to normal retirement age) to receive a pro rata share of their accrued benefits based on the extent of their reduced working hours. The proposed regulations do not address return-to-work arrangements, the excise tax on early distributions, or ADEA implications. Written comments and requests for a public hearing are due by February 8, 2005. NASRA has asked for input on any issues/concerns member systems identify in the proposed regulations (please send to jeannine@nasra.org).

DROP Plans

IRS officials have indicated they intend to review deferred retirement option plans (DROPs) and recent concerns that they do not conform to federal laws. Public pension advocates are concerned about the indication that these plans are under review, but heightened press attention to DROP plans, particularly plans that have reportedly compounded fiscal strain in certain munici-

(continued on page 10)

Federal Update

(continued from page 9)

palities, have stirred interest in these plans by many federal policymakers. Congressional staff removed provisions from pension packages that defined DROPs in order to address early distribution penalties.

ADEA Issues

Potential Age Discrimination in Employment Act (ADEA) concerns have surfaced surrounding a number of pension and benefit areas. While the EEOC reversed its decision to enforce the ADEA against Medicare Bridge plans, the agency and the courts continue to look at the application of ADEA to retiree benefits, particularly those that have an age-based component. The EEOC has appealed federal court decision to throw out a case brought by EEOC against Kentucky's disability program. The notable *"Cooper"* case surrounding cash balance plans, could affect all hybrid plans, even contributory defined benefit programs, finding them structurally age discriminatory as younger employees have a greater advantage due to longer periods of compounding contributions and interest.

Treatment of Pension Assets under New Bankruptcy Laws

Bankruptcy legislation (H.R. 975) this Congress would again codify existing favorable case law regarding the protection of public pension assets from bankruptcy creditors, as well as remedy conflicts that have arisen regarding the treatment of governmental 457 plan assets, mandatory public employee pension plan contributions, and pension plan loans. This bill was again not enacted.

Social Security Numbers

Public and private pension organizations again worked to ensure that legislation regarding identity theft and the use of Social Security numbers would not adversely affect retirement plan operations. This year's legislation included provisions excluding public entities and employee benefit plans to varying degrees, but technical issues have been identified with regard to public benefit plans. It is hoped that these will be resolved in next year's legislation.

EGTRRA Permanency

The Economic Growth and Tax Relief Reconciliation Act of 2001, which included many long-sought public pension provisions, contained a sunset provision in order to meet procedural requirements in the Senate. Many bills were forwarded to make the pension provisions or the entire package permanent and remove the uncertainty likely to surface as the expiration date draws nearer. However, the cost of the proposals makes them unlikely to be passed anytime soon, particularly in this budget environment.

Access to the Proxy

NASRA submitted a letter to the SEC in support of its proposed rule to reform proxy voting rules. A joint signatory letter from NASRA and NCTR directors was also sent to the SEC. In addition, NASRA signed onto a letter with CII and NCTR. Unfortunately, the proposed rule has yet to be finalized, with SEC commissioners split on how to proceed amid criticism from big business.

Stock Option Expensing

NASRA updated its investor protections resolutions at the 2004 business meeting to include support for requiring companies to expense stock options. Unfortunately, FASB delayed until June 15, 2005 the date for implementation of its new rule requiring all options to be expensed. There is concern that this setback opens the door for more lobbying calling on either Congress or the SEC to halt or delay FASB from adopting an expensing standard. The House passed legislation that would have limited the requirement to the top five executives, and there were concerns this could be added to an appropriations bill during the lame duck session.

Default IRAs

The IRS is currently working on guidance for default IRAs, a new provision that requires small involuntary cash-outs ($1000-$5000) on or after March 28, 2005 to be transferred to a designated IRA unless a participant elects a lump sum or rollover. There are concerns that the application of these rules to governmental plans would result in unwarranted fiduciary liability and administrative costs/burdens. The IRS is reportedly strongly inclined to apply these new rules to governmental plans that contain an involuntary cash-out provision, but have asked for more specific information on the nature and extent of state law conflicts that could arise if the default IRA rules were applied.

Minimum Distribution Regulations

Final regulations were released on June 14, 2004. Many public plan issues were addressed in some fashion, including a grandfather rule permitting pre-April 17, 2002 provisions to meet a "good faith" compliance with statute. Post-2002 provisions must meet new rules, including new restrictions on nonspouse J&S options, cost-of-living allowances, types of survivor benefits, and changes to annuities. NASRA members were provided with summaries of the new regulations and urged to relay whether the grandfather rule was broad enough and if legislative relief was still necessary.

Research Roundup

By: Keith Brainard, NASRA Director of Research

Perhaps the most striking feature of the public retirement system community is its size: 10 percent of the U.S. workforce is employed by a state or local government, and most of these workers participate in an employer-sponsored defined benefit plan. Although there are more than 2,000 public retirement systems in the nation, approximately 80% of all public retirement assets and participants are affiliated with the 75 largest systems. Most of these systems are administered by NASRA members.

Public retirement systems comprise a key portion of the nation's financial activity: combined, their assets exceed $2 trillion. They collect more than $60 billion annually in contributions and distribute over $100 billion each year in benefits. The superior investment returns of public pension funds relative to the returns realized by individuals participating in self-directed accounts, provide an estimated economic stimulus of 2.0 percent, or $200 billion.

Despite efforts by some groups in recent years to switch public defined benefit plans to defined contribution plans, nearly 90 percent of all full-time employees of state and local government continue to participate in a DB plan. Michigan state employees, public school teachers in West Virginia, and general employees in the District of Columbia are the only broad groups of statewide public employees who do not have access to a DB plan as their primary retirement benefit.

Hybrid plans, which combine features of DB and DC plans (but are considered a form of DB plan) are increasing in popularity among public employers. For many years, most public employees in Indiana and participants in the Texas Municipal Retirement System and the Texas County District Retirement System have participated in hybrid plans. More recently, many workers in Washington, Oregon, and Nebraska have begun participating in hybrid plans, and many more in Florida and Ohio may elect to participate in a hybrid plan.

It may be surprising to learn that one-fourth of public employees in the U.S. do not participate in Social Security. This includes more than 40% of public school teachers and three-fourths of public safety employees. The absence of Social Security as part of a worker's compensation package magnifies the importance of a DB plan, as that plan in most cases represents the worker's only certain source of lifetime income in retirement.

As a group, public employees appear to be much better positioned financially for retirement than employees outside the public sector: although they represent just 10 percent of the nation's workforce, assets held by or for these workers comprise more than 20 percent of the nation's $12 trillion pool of retirement assets. This includes assets held in public defined benefit plans, 403(b)'s and 457's.

From 1983 through 2002, investment earnings made up 62 percent of all public retirement system receipts. Employer contributions accounted for about one-fourth of the total, and employee contributions were around 12 percent. The fact that investment gains make up such a large portion of retirement system receipts indicates the importance of making required contributions in a timely manner.

The Public Fund Survey, an online compendium of key characteristics of public retirement systems sponsored jointly by NASRA and NCTR, currently reports on 101 retirement systems and 125 plans. Combined, the participants and assets included in the survey comprise more than 85% of all participants and assets in the public retirement system community.

Due chiefly to highly diversified portfolios and to actuarial smoothing methods, public pension plans appear have weathered the recent three-year decline in equity markets with surprising strength: For FY 03:

- The aggregate funding level of all plans in the survey declined to 91.1 percent, from 96.3 percent in FY 02 and 100.9 percent in FY 01.
- The median funding level is 91.5 percent.
- More than three-fourths of all plans have a funding level above 80 percent.
- Since FY 01, the median funding level has declined by 8.2 percent.
- Although growth in actuarial liabilities far outpaced growth in assets, the good news is that liability growth of 7.0% was lower than the median assumption of 8.0%. Unless future investment returns significantly exceed assumptions, a lower-than-assumed rate of liability growth is essential for plans to move toward full funding.
- Although the median assumption for the nominal rate of investment return did not change during FY 03, the assumption for the underlying inflation rate declined, from 4.0 percent to 3.75 percent, resulting in an increase in the assumed real rate of return, from 4.0 percent to 4.25 percent.

(continued on page 12)

Research

(continued from page 11)

- Continuing a trend seen in recent years, the rate of growth for FY 03 in the number of retired members substantially outpaced the increase in active members. The result is a declining ratio of actives to annuitants, from 2.48:1 in FY 01 to 2.29:1 in FY 03, a decline of more than 7.6 percent in just two years. Because public pension plans are primarily prefunded, they are less sensitive to a declining active/annuitant ratio than their pay-as-you-go counterpart plans, like Social Security. Nonetheless, fewer contributors relative to annuitants does affect a pension plan, both actuarially and operationally.

This declining ratio is chiefly a result of demographics, as Baby Boomers approach retirement age while a smaller number of younger workers enter the workforce. This demographic trend has been bolstered in recent years by fiscal constraints among state and local governments, leading to incentives for older workers to retire, accompanied by slower employment growth. The fact that life expectancies continue to increase while fertility rates continue to decline suggests that the active to annuitant ratio is likely continue to become smaller, complete with its accompanying effects on public retirement systems.

Twenty five years ago, public retirement systems functioned largely as obscure back-office operations of state and local government. They received little attention from the media, policymakers, and participants. In 1982, combined public retirement system assets were $262 billion, and more than 75 percent those assets were held in bonds, mortgages, and cash. This is no longer the case: with assets in excess of $2 trillion and nearly 20 million active members and annuitants, public retirement systems now operate in a high-profile fishbowl. The media and policymakers are increasingly and sometimes painfully attuned to public pension issues, and participants are more familiar with and knowledgeable about their retirement finances than any previous generation. The responsibilities inherent in administering a public retirement system–including working with a governing board, a legislature, and the media, in service to thousands of participants–are undoubtedly greater today than ever.

Media Relations

Presentation by Mark Weaver,
attorney, crisis manager and media relations expert

By: John R. Doner, Deputy Director,
Public Employee Retirement System of Idaho

Mark Weaver, a practicing attorney and graduate-school instructor in political science and media law, provided an extremely entertaining and enlightening presentation dealing with the news media. Weaver has some twenty years of experience at all levels and with all branches of government dealing with the media.

He began by pointing out differences in media relations between the private and public sectors. It is Weaver's contention that reporters approach government with skepticism and view employees as overpaid, underworked, and employed by virtue of patronage. It is the job of the public sector administrators to show reporters this is not the case.

Most of us think of the term "objective" as meaning fair, balanced, open, two-sided, etc. According to Weaver, reporters see it simply as Side A + Side B = Objective. Reporters are generally not interested in all the facts and usually come to the story with preconceived notions and biases. For example, a retiree from your system tells a reporter that they were promised lifetime health-care benefits, but now they are being charged $250 a month. The reporter now has Side A and will not research the facts regarding what the retiree was actually promised. To get Side B, the reporter will merely come to your office to get your side of the issue. Weaver noted that several of his clients say they would not dignify such a situation with a response and would rather just say "no comment." But, to the reporter, that "no comment" represents Side B. The public will read that the pensioner has been lied to. Unless there is a legal or privacy reason for not responding, Weaver recommends that you provide a response. "No comment" will be perceived as guilt, or a cover-up. The bottom line is you must provide your side of the story. In a crisis situation, get to the press quickly and let them hear the issue from your perspective first.

Weaver noted it is important to understand what a reporter defines as newsworthy. The issue must be timely and of current relevance. It must have an impact. How many people are affected by the topic? Does it have a level of prominence? For example, does it affect a high-level elected official or a system board member? Is there conflict? Reporters and the public like to hear about con-

flict which, therefore, makes those stories newsworthy.

Weaver also provided an overview of how print, radio, and television differ. These media should be treated differently for the simple reason that their formats are different.

- Print is a great format for written statements. It offers the best opportunity to provide details because the newspaper generally has the space to print it. Readers are, in general, more educated, follow local issues more closely, and are more interested in governmental topics. However, Weaver cautioned that in print you are the most likely to be caught off guard. You spend more time with the reporter. After several minutes or sometimes hours, you become more likely to make a remark that comes off poorly in print. In print you also have to rely on the reporter to portray how you acted or came across.

- Radio uses only your voice to get your message across. It provides a good format for using a fact sheet while doing an interview. Most often you will do radio interviews over the phone and only occasionally in the studio.

- TV is frequently the place where most people get their news. Therefore, it is the media with the most impact. TV needs sound but especially visuals. It is the hardest format to work with as most people must learn by experience how to do interviews, including where to look, hand gestures, facial expressions, and body language. TV is, by far, the least likely to get the story accurately. The average sound bite on TV is currently 11 seconds, which is minimal time to get your message across in an accurate and believable manner.

Weaver also explained the advantage of getting to know key persons in the media during a non-news or non-crisis situation. If you know the local paper's government reporter and they understand what your agency is about, it saves time when a story comes up. Get to know the editors who oversee stories about your agency so that if an issue between you and a reporter arises, you know you can call that editor and they will take your call and at least hear you out. In TV you are likely to get whatever reporter is available at the time. Therefore, if possible get to know the station assignment editor or the news director. Radio is usually pretty straightforward in that the reporter usually does not have someone between them and the listener.

As a basic courtesy when you are contacted by a member of the press, always ask the deadline. Let the reporter know you will do everything you can to help meet that deadline.

It is also important to know what the following terms mean, and it is imperative that both you and the reporter agree on what these mean.

John Doner and Mark Weaver

- On the record – everything I say can be used in the story and I can be quoted.

- Off the record – you cannot quote me nor use any of my comments in the story.

- On background – you can use my information, but you cannot in any way associate my name with the information used in the story.

Finally, you must always be truthful with the press. Never lie. Do not say "no comment." The cover-up is always worse than the crime. Act professional when dealing with the press as you represent your system, its staff, board and, in many cases, your state. This does not mean you have to tell the whole story all the time. Sometimes silence is best. Tell only what is needed to get your side of the story out. You can selectively share information, just don't lie or give false information. If you don't know the answer to a question, say so. Never answer a negative question by beginning with a negative response.

Weaver concluded his informative presentation with some entertaining and effective role-playing that involved stressful situations with the press. It provided excellent reinforcement of his presentation.

International Markets Panel

Moderator:
Carol Wardlaw, Dimensional Fund Advisors

By: Mark McNair, Counsel,
Kaplan Fox & Kilsheimer LLP

The International Markets Panel focused on opportunities in low and mid cap international stocks. Moderated by Carol Wardlaw of Dimensional Fund Advisors, the speakers were Noel O'Halloran of KBC Asset Management and Andrew Beal of Nicholas-Applegate.

Ms. Wardlaw began by noting a shift in conclusions related to portfolio diversification and performance in international markets. She suggest that studies have shown that while such gains in EAFE large cap stocks have been limited, the diversification gains have been much greater in international small cap stocks. She specifically referenced a seminal article titled "Where Are the Gains from International Markets." She then introduced Noel O'Halloran who would discuss investment opportunities in developed international markets and Andrew Beal who would discuss opportunities of small stocks in developing international markets.

Noel O'Halloran, Andrew Beale, Carol Wardlaw, and Mark McNair

Mr. O'Halloran suggested that in the next five years investments in international stocks will be worth more than investments in the U.S. While U.S. stocks outperformed EAFE stocks in the 1990s, the past few years EAFE markets had outperformed U.S. markets. He noted that last year in particular, EAFE markets had strongly outperformed the U.S. market. He stated several reasons this trend would continue in Europe and Asia.

In Europe, long-standing economic problems are being addressed. From his perspective, needed political and economic changes were happening. He highlighted that increasingly governments and corporations were successfully taking on unions. As a result of union concessions, such as longer work hours, increased productivity was taking place. Another trend he noted that would drive international returns was that the dollar will probably continue to weaken over the next several years. Additionally he noted that European markets should thrive because European consumers have substantial built-up savings and now they have confidence to spend.

With regard to Asia, he stated that their markets would be attractive for many of the same reasons. In his view, significant economic, central banking, and market reforms were taking place all over Asia. While all the desired reforms in Japan were not in place, he did see positive significant changes in Japan for shareholders, such as the first hostile take-over. Most importantly, throughout Asia there has been a dramatic focus by corporations on their shareholders.

Mr. O'Halloran concluded that, in the medium term, the U.S. market is less attractive than international stocks. He suggested that this will be true for both large cap international stocks as well as low and mid cap international stocks.

Mr. Beale then discussed emerging markets, noting that when the emerging market debt crisis hit several years ago, the affected emerging markets had to change. In his view, the emerging markets made the necessary changes – institutional building, reform and restructuring. Among other things, better financial systems are now in place and investors now have improved basic safeguards, such as the protection of minority shareholder rights.

As a result of these changes, according to Mr. Beale, the small to mid cap sector of emerging markets is about to take off. This will happen partly because emerging markets are now generating returns on equity that are as good as the rest of the world. In the past four or five years through both good and bad cycles emerging markets have demonstrated slow and sustainable out performance.

To leverage yourself in emerging markets, you want exposure to the emerging market economies. The reason to invest in small and mid cap stocks in emerging markets is this gives you greater exposure to the potential supercharged growth in the domestic economies. Also because of greater inefficiencies in such small stocks, there are substantial opportunities to add value through research.

Finally, Mr. Beale stated there is a trend toward better comparative performance in small stock where you can achieve real diversification benefits.

In summary, it was a very information panel. Mr. Wardlaw suggested that investors consider small and mid international stocks in particular rather than international stocks in general. Mr. O'Halloran then discussed the opportunities in developed European and Asian markets. Mr. Beale concluded by highlighting the value of investing in small stocks in emerging markets.

Roll Call of the States

By Amy B. Fagelman, Director of Communications
Texas County and District Retirement System

At NASRA's Annual Roll Call of the States, David Shimabukuro, Administrator of the State of Hawaii Employees' Retirement System, eloquently summed up the past year by telling a story about his grandmother, an expert fisherwoman in Maui. She would entice crabs into a can by putting something smelly in the can. Once in the can, the crabs could not escape because they would pull each other down. This past year, Shimabukuro has "felt like that crab trying to get out of the can." And judging by the crowd's laughter, many other directors agreed.

The annual NASRA Roll Call of the States provides each attending system director an opportunity to talk about the major issues, current events and projects their systems face. As the roll call progressed, certain issues began to emerge as primary concerns for many systems: funding, process and systems changes, and services and communications, among others.

Funding challenges are confronting many systems due to investment market volatility over the past few years, contribution reductions and benefit increases. Systems throughout the country are addressing these situations in many different ways. The California PERS is delaying employee participation in the retirement plan for two years from hire. Some states are considering pension obligation bonds. Others are either thinking about or implementing increases in the employees' contributions to fund the benefits. According to Gail Stone, Executive Director of the Arkansas PERS, state employees will be required next year to contribute 5% of compensation to the system, while earning 4% interest on those funds with an increased multiplier at retirement. Still others are attempting to secure higher contributions from the state legislatures. Many are also considering changes in asset allocation in order to achieve investment returns.

Several systems are grappling with replacing outdated processes and IT systems that are inefficient and expensive to maintain. Terry Slattery, Executive Director of the Public Employees' Retirement Association of New Mexico, described the development of their pension administration system as "an ordeal … but we're confident that it is going to work." Slattery is not alone. Larry Dickerson of the Arkansas State Highway Employees Retirement System talked about the challenges of changing the culture along with the technology. The Vermont system and others mentioned that they are developing internal audit processes.

Many retirement systems are trying to improve services and communications to participants. Ronnie Jung, Executive Director of the Texas Teachers' Retirement System, talked about new training available to their members online via streaming video. Michael Williamson, Executive Director of the North Carolina Retirement System, mentioned that their new call center has reduced their call hold time from 20 minutes to 44 seconds. The Office of Retirement Services of Michigan has implemented many processes to support their customer service, including call center technology, video conferencing and targeted communications products called LifeStages. Several systems, such as the Illinois Municipal Retirement Fund and the Kansas Public Employees Retirement System, now use a benchmarking program to measure the effectiveness of their customer service activities.

Perhaps the most shocking report was that of Meredith Williams, Executive Director of Colorado PERS. He relayed the story of a member who tore off the system office's front door in order to purchase service before a deadline. After hearing that report, Steve Yoakum of the Public School Retirement System of Missouri commented, "This is always one of the most valuable parts of the NASRA conference – to share with everyone…. Not only do we get good ideas … [but] I also personally feel better because I think I have problems until I get here and hear everyone else's [problems]. They've never taken my door off."

Eric Stanchfield, Amy Fagleman, and Michael O'Connor

NASCAR Means Business

Presentation: Steve Brown,
Director of Marketing, Dale Earnhardt, Inc.

By: Jay A. Dirnberger,
Managing Director, Lyster Watson and Co.

NASCAR, an acronym for the National Association of Stock Car Racing, organizes and officiates a large number of automobile races throughout the United States. Dale Earnhardt, Inc. (DEI) operates and manages racing teams led by Theresa Earnhardt, the widow of one of the most successful stock car drivers ever. Dale Jr. leads the teams and has achieved a success that belies his youth.

Stock car racing has become the second most popular sport in the country, trailing football. It has grown from a regionally oriented summertime sport to a nationally produced year-round sensation. It has 75 million fans and plays to a broad audience in terms of age and gender. Televised NASCAR events are broadcast in 150 countries every week. Each major race draws 400,000 people–as many as for the Super Bowl and World Series combined.

NASCAR is a marketing powerhouse and a leader in promotional innovations in the sports/entertainment industry. It generates enormous revenue from television rights and ticket sales and produces $2.3 billion in licensed product sales. However, the "driver" of this business is corporate sponsorships. NASCAR invites advertisers to display their corporate image on virtually every possible facet of the sport. You can name the race (Winston Cup), the series (Nextel), or put your logo on any piece of equipment and clothing. You can also put your logo on the competitor. This feature makes NASCAR different from the Major League Baseball and the National Football League, and it links the fans to the product even more strongly than television advertisements using famous spokespeople. Seeing a Budweiser label on a speeding stock car for 500 miles is more effective than watching Joe DiMaggio demonstrate a Mr. Coffee machine for 30 seconds.

Baseball and football are starting to move in this direction. Note the Nike swoosh on cleats, the demise of the Houston Astrodome, and the subsequent succession of Enron Field and Minutemaid Park.

Jay Dirnberger, Steve Brown, and Russell Poggensee, winner of the drawing for the NASCAR hat signed by Dale Earnhardt, Jr.

Product identity enhances the excitement of a race in the same way team rivalry enhances the excitement of a football or baseball game. The contest is thrilling in its own right, the rivalry of the driving teams is compelling, but the product identification with the competitor solidifies the fans' backing.

Dale Earnhardt, Inc., is a business woven deeply into the fabric of NASCAR. DEI racing teams compete with other teams, which are almost all associated with similar companies. DEI has 270 employees located in Mooresville, North Carolina. Its brand new director of marketing, Steve Brown, gave a lively and informative presentation on NASCAR and DEI. Steve's motor was running during the presentation. He was transporting his family from Michigan to Mooresville on the day of the presentation. He was to start his new job the next Monday, take possession of his new house on Tuesday, and send the kids to their new school on Wednesday. All of us at NASRA appreciated the effort that Steve made to be with us.

DEI assembles teams of drivers and mechanics. NASCAR drivers are of the highest caliber in terms of skill and daring. The mechanics or pit crews are physically and mentally fit and drilled to perfection through daily rehearsals. The automobiles are crammed with the absolute latest engine, transmission, braking, and suspension and safety systems technology. They should not be called "stock" cars. The only feature that a showroom customer would recognize is the physical contour of the body. Can you imagine your Chevy Malibu at 212 mph?

A privately owned company, DEI generates income from corporate sponsorships and sales of licensed goods. Its website gets 500,000 hits per month. Major sponsors such as Chevrolet and Goodyear can pay DEI up to $12 million a year.

DEI is active in community affairs. Theresa Earnhardt established the Dale Earnhardt Foundation in 2002 to support organizations that serve children in need of food and education and promote wildlife preservation.

A colorful action video enhanced the presentation. It focused on the races, drivers, mechanics, and technicians. Questions naturally related to stock car performance. Later in the day, many of us realized the true genius of the NASCAR phenomenon. Simply stated, NASCAR has figured out how to make enormous amounts of money promoting itself. IPO shares, anybody?

EBRI - The First 25 Years

Presentation: Dallas Salisbury

By: Karen Steffen, Consulting Actuary, Milliman, Inc.

Dallas Salisbury reviewed the major shift in benefits that has taken place over the past 25 years, since ERISA was passed. He also described current changes that may represent a shift in basic philosophies and a challenge to future retirees' expectations.

When ERISA passed in 1974, there was initial concern regarding PERISA for public plans. But this did not come about because whatever was passed for state and local governments would need to apply to the federal plans as well, and due to the National League of Cities vs. Usery decision. At that time, the cost of the amount to fund those plans was $1.2 billion, now it would be in excess of $1 trillion for the civil and military plans, which are not currently prefunded with other than federal debt securities.

Karen Steffen and Dallas Salisbury

Since 1974 there has been an extraordinary decline in defined benefit (DB) plans. The percentage of active participants covered in a private DB plan has decreased from 43.7% of the workforce in 1974 to only 17% in 2003. Only recently, some public plans, particularly at the state level, have been moving from DB to defined contribution (DC) plans. EBRI data indicates that for public plan participants, the percentage covered has remained about the same: 90% in a DB plan. But now, 17% are in a DC plan, with 40% of the participants now able to have some type of savings deferral.

The recent IBM lawsuit and its decision, if adverse, could impact the nearly 25% of the private sector participants currently covered in a cash balance plan. This could force employers to convert to DC plans, resulting in the private sector having less than 10% of the workforce covered in a DB plan. This is a dramatic change from the original intent of ERISA, which was to protect participants' DB benefits.

The second area of major change over this period has been in the area of health care benefits. This is due to the remarkable cost growth over the past 25 years. At the same time, individual employees are paying less as a percentage of the total cost of health benefits than they were in 1974, with the percentage declining from 29% to 14% of expenditures. At the same time, the type of coverage has changed from 90% being covered by indemnity plans to more than 60% in PPO plans, shifting decision responsibility from employers to employees and leading to more consumer-driven health plans.

Demographic changes in the workforce have led to increasing costs resulting in benefit design decisions. We have seen relatively little shift up until now, but the 55-64 age group population will increase 50% over the next 10 years. By the time the baby boomers retire, 22% of the total population will be over age 65. Increasing longevity is impacting the size of the obligation of benefits, particularly if you use realistic assumptions. The number of years spent in retirement has increased due to longer life expectancy from 11.5 years in 1955 to 18.1 years in 2000. Future retirees could be looking at adding another 10 years to their retirement.

In both the public and private sectors, more benefit programs are focusing on individual responsibility and a shifting of risks to the employees, away from a pooled protection against risks provided by the employers. As employers in the public sector look at their total fiscal status, they may come to the same conclusion as private employers and decide this is the area they are going to manage and to cut funds, even if they would prefer not to do so.

Based on EBRI studies, about 34% of the current over-65 group has some form of guaranteed annuity income for life, but they project that in 10 years this will decline down to 18%. So, while baby boomers may have more wealth, they will have to manage that wealth against a longer life expectancy and choose how they will spend their wealth with fewer guaranteed lifetime benefit payments. Particularly, since there has been a dramatic decline in retiree health care in the private sector and the beginning of a decline for state and local government employees.

The results of this year's election may determine if individual responsibility or the "ownership society," which moves away from traditional DB and retiree medical benefit programs, becomes the new public policy as has been advocated by President Bush. This would result in employers facilitating access to benefits, rather

(continued on page 18)

EBRI

(continued from page 17)

than providing the benefits. As it is, the new government will need to deal with the uninsured, cash balance plans, DB funding, the status of the PBGC, financial literacy and inadequate savings, health care costs, Medicaid, Medicare, Social Security, and supplemental retiree health issues.

What are people doing about these issues? First, more employees are working longer because they can no longer depend on retiree medical benefits or are looking at reduced pension benefits. Many who are offered a full cash-out will take the lump sum to ensure they get their benefits – 97% of participants in private DB plans that have the option, do so.

The second thing is to do adequate planning. One fact that needs to be recognized is the older you are, the longer you are expected to live. For a couple both age 65 there is a 50% chance that one of you will be alive at 92 and a 25% chance that one of you is alive at age 97. This is much different than planning for an average life expectancy of 82 or 85. In the old days, the issue was about dying too soon, today it's living too long (if you haven't saved enough). The retiree medical benefit promise is far more valuable for longer life than pension benefits. Therefore, health is where most of the cost cuts are taking place.

Salisbury asked public plans to continue doing what they have been doing for so many years: help individuals deal with risk–the one most unknowable risk, when you will die–and help them with the retirement and health issues. Those are the objectives upon which EBRI was founded and is its mission today. Salisbury expressed a concern regarding the trend towards individual risk and away from pooled risks, all of this **without** much effort to educate individuals on what that means and what they will need to cope with this uncertainty and new responsibility.

Corporate Governance

Presentation: Richard Moore,
North Carolina State Treasurer

By: Rob Hamilton, Executive Director,
GE Asset Management

Richard Moore focused on various aspects of corporate governance that play an important role in buying good, solid, honest companies that become part of our retirement funds and try to create the type of corporate performance that will lead to an increase shareholder value.

Public pension plans need to play a bigger role in corporate governance. The public fund community has just recently awakened to the fact that they have a responsibility and power in regard to corporate governance with $2.6 trillion of assets under pension fund management. The public fund community holds a large percentage of every single publicly traded stock in America and has the responsibility to exercise shareholder rights on the behalf of 14 million public workers. Most workers had no idea what a proxy was, what it meant to own an equity, or what rights and responsibilities went along with this ownership. They found this out in a post-Enron, post-WorldCom world in an era where pension administrators are more worried and involved with a whole host of other issues.

Moore highlighted the fact that we can't always be totally absorbed in worrying about what kind of returns we need next year and what level of employer contribution we are going to get next year. We can't be totally caught up in the minutia of getting out checks, modernizing computer systems and the rights of employees vs. retirees. We have to spend some time worrying about the assets that we own. We have to push our money managers to exercise our rights on our behalf.

He initially formulated the *Investor Protection Principles* to assist with buying and owning the proper equity investments. Basically, three of the seven principles are most important. First, there must be a separation in the way research analysts and investment bankers are paid to absolve any conflict of interest. We want "independent" research to draw upon. North Carolina, California, and New York have been the driving force in this process. The SEC has not acted on this issue at all. Second in importance is transparency in accounting/ pay packages, etc., and third, good "corporate governance." These factors are paramount considerations when analyzing companies to buy for a portfolio.

Some corporations are trying to push back on the Sarbanes-Oxley Act, saying that it is too expensive to thoroughly and completely implement. Corporate compensation committees are supposed to be totally independent. Is this the reality? We find out after the fact

that pay packages are unrealistic and exorbitant. Moore believes that pay packages should be tied more to the company's stock market performance and financial performance hurdles to make corporate executives more accountable to the shareholder's stake. The whistle-blowing provision of Sarbanes-Oxley, if properly implemented, is very important and could have stopped the problems at Enron and WorldCom.

Rob Hamilton and Richard Moore

Moore used the Disney dissonance as an example of long-term horrendous performance by executive mismanagement. Institutional shareholders need access to the proxy to promote change, corporate efficiency, and fairness. He is on the New York Stock Exchange Board of Executives as a Public Fund representative and feels that John Reid really understands what needs to be accomplished. There is a need to help dampen price volatility by a clean and efficient auction system, which could be done more electronically and not by the whims of floor brokers.

Moore closed with some sage investment advice: "the best way to double your money is to take it out of your pocket, fold it in half, and put it back in your pocket."

The World of Doughnuts

Presentation: Scott Livengood, President and CEO, Krispy Kreme Doughnuts

By: Douglas S. Callantine, President, Legg Mason Real Estate Services, Inc.

The presentation by Scott Livengood, President and CEO of Krispy Kreme Doughnuts, was preceded by a sampling of the Krispy Kreme product by the standing-room-only audience. The Krispy Kreme doughnut was first baked in the 1930s and, for over 50 years, was largely a phenomenon of the South.

During the 1900s, the company decided to expand beyond their southern doughnut-shop base. The merchandising concept was changed from the coffee-bar setting to a dining experience with the doughnut processing in the center of the store. Customers were enticed to the stores during peak hours with the "Hot Doughnuts Now" neon sign. The growth has resulted in 370 stores in 44 states and 6 countries. The company has also enjoyed many successes: 32% compounded annual growth over the last 5 years, being featured on the cover of Fortune magazine, and induction into the Smithsonian Institute as an American icon.

The presentation included a series of video clips highlighting the Krispy Kreme "doughnut experience." The video demonstrated the euphoria of recent store openings in the U.S. and overseas with huge lines of customers, headlines for TV news, and customer quotes that included a description of the doughnuts as "warm and really, really good."

Livengood shared some of the corporate philosophy of Krispy Kreme. The key values that have been adopted include integrity, authenticity, passion, learning, sharing, and positive expectation. The company's future strategy includes solidifying and expanding its customer base; developing new products, e.g. doughnut holes and miniature doughnuts; smaller retail stores; and probably a sugar-free doughnut!

The presentation concluded with some entertaining video clips from television shows that clearly demonstrated the cult following that Krispy Kreme has generated. Actors ranging from Rosie O'Donnell to Jay Leno to John Travolta have sung the praises of "KKs."

Scott Livengood and Doug Callantine

An Overview of the U.S. Economy and its Financial Markets

Presentation: Anthony Chan, Economist

By: Ronan J. Burke, Director of Institutional Sales, Hartford Investment Management

The U.S. economy has made good progress overall but has been struggling a little lately. Chan predicted 2004 economic growth to come in at 4%, in comparison to 2001, a recession year where growth was a mere 0.7%. One of the most promising components of the current economic growth is "inventories." Chan's research showed that inventories have not supported economic growth recently, but will not disappoint in 2004. He estimates a 1.1% contribution this year, with the first half of 2004 data coming in at 1.1%, which is well above estimates of 0.4%. This growth is needed as other parts of the economy are slowing.

Consumer spending during the second quarter decreased from 3.8% to 1%. Positive stimulus is dwindling; tax refunds are behind us and refinancing has slowed, having added over $100 billion to consumer spending in each of the last two years. Refinancing is estimated to add $75 billion this year, with most of this accounted for in the first quarter. Low interest rates have helped fuel spending such as in auto sales. Capital spending should also slow next year. The current tax program, which expires at the end of 2004, allows companies to depreciate 50% of capital equipment purchased and utilized in 2004, with the remaining 50% over nine years.

So why did Chan feel confident the economy would grow 4% this year? The economy typically grows faster in a presidential election year as the incumbent makes every effort to get reelected. Economic consensus is for 4.4% growth this year. However, Chan was a little more cautious with his 4% estimate because he recently researched real purchasing power, defined as retail sales less growth in wages. Retail sales, in nominal terms, are growing in excess of growth in earnings. Therefore, he was concerned that spending will slow. Any time the number has gone above 5%, consumer spending slows down. So we need to see wages picking up to help spur consumer spending.

But how does this impact the markets? Unlike economic growth, equities don't do as well in an election year. They do better in the third year, which intuitively makes sense, as the markets are predictors of future growth. Last year (2003), was no exception with stellar returns across the equity markets. This year won't be nearly as strong, but Chan predicted a 7-8% return for 2004. Earnings were very strong in 2003 at 25%, leading to good returns. Earnings this year are at 20%+, so why is this not converting into strong market returns? Chan saw a deceleration in earnings to a 14-15% level because in the early stages of an economic expansion earnings shoot up, but this simply is not sustainable over a longer period and as earnings remain strong year after year comparisons become very difficult. Productivity is also slowing as economic expansion (now in its third year) matures, historically at 1.5% but a little higher this year at 2%. If productivity slows and wages rise, then corporate profits will be squeezed and impact company share prices.

Anthony Chan

Can employment movements predict an election winner? If 1.9 million jobs are added in an election year, then the incumbent usually wins. We are well on track for that level this year. However, this predictor has only a 60% accuracy. But the second part of Chan's employment research gave him more confidence. He looked at the household survey to compute the unemployment rate and found that when you gain 2.2 million jobs the president was elected 85% of the time. The third year of the presidential cycle is typically the best year for job creation as CEO's know the fourth year is usually strong and staff up accordingly to meet the economic growth in the fourth year.

So what will the Fed do for the rest of the year? Chan expects them to continue to gradually raise short-term rates. He expects the Fed Funds rate to be at 2% at year-end and expects tightening to be done by mid 2006 leaving the Fed Funds rate at 3.5-4% with the prime rate at 6.5 to 7%. One of the key determinants to Fed Funds rate being changed is rising employment. But we have not done well during the recent economic expansion. Only 401,000 jobs created during a period where 5.7 million should have been generated but, because we are moving in the right direction, the Fed will continue to increase rates. But is the Fed behind the curve? With the economy recovering, why have rates been at near 46-year lows? Chan didn't believe they were behind the curve as the CPI historical average is 2.9%, currently at 3.3% so a little higher but not a

concern. Core CPI excluding food and energy has averaged 3.3% but is currently only ay 1.9% so we are in good shape. Chan expects this to increase to an absolute high of 2.5%.

How much does the Fed typically increase short-term rates? Over the last 50 years it has been 5.5% but this time Chan didn't think the Fed needed to be as aggressive. Equity markets have tended to lag in periods of rate tightening but still post positive return of 6% per annum approximately. Equities typically do poorly in the early stage of rate increases but rally as the cycle continues. On the other hand, the 10-year bond is usually the worst place to be as rates go up but this time the market was very pessimistic in advance so the market incurred less pain. Chan also expects the housing market to take a little breather with new homes, which sell at a 15-20% premium feeling the most effect. Chan was also closely following the impact of rising oil prices and estimated that every $10 sustained increase in oil subtracts $50-70 billion from GDP as this impacts retails sales, etc.

In summary Chan expects the equity markets to finish the year up 7-8%, the economy to grow by 4% and the inflation rate to hit about 3%.

Glad to the Bone

Presentation: Dr. Dale Henry, author

By: Virginia Burton, trustee of the Louisiana State Employees' Retirement System

Dale Henry, author of *The Proverbial Cracker Jack How to Get Out of the Box and Become the Prize*, was entertaining and educational. In his opinion, an upbeat, happy person gets a lot more accomplished and, at the end of the day, feels good about themselves. He stated that if you hold in laughter it goes straight to your colon. It will get out somehow and in the end your hips will get larger. Five minutes of belly laughter is equal to walking a mile.

He talked about the turning point in his life. He joined the military at age 17 because he was tired of having his parents control his life. This turned out to be one of the best decisions he made in his life. After 6 months of boot camp, he realized a lot about his parents and when he returned home suddenly his father was one of the smartest men he knew. He realized that his parents weren't telling him what to do but were guiding him. They were teaching him the wisdom he would need to make decisions in his life.

Virginia Burton and Dr. Dale Henry

He talked about the importance of teaching our children about respect and honor. At a young age he was taught by his grandfather and dad to pull over when a funeral procession goes by and put your hat over your heart to show respect. His daughter does this now. It is important to take time in your life to love others and provide guidance.

He sees a lot of parallel between a box of Cracker Jacks popcorn and the organizations we work for. Everyone is looking for the prize. In every organization there are people who are all puffed up with importance, and the candy-coated people tell you how important they are. Of course, we can all pick out the nuts. Then there is the prize. The one taking care of the organization and helping everyone. This is the person that lives their life like a proverb and is showing us the way to be.

Henry's five steps to improve your life are:

1. Prioritize your knowledge, your values, your responsiveness, and your integrity.
2. Recognize your understanding, your control, and your family involvement.
3. Individualize your self-talk, your influence, and your worth.
4. Zing others with your ability to plan, your level of commitment to service, and your ability to lead and follow.

continued on page 25

Portable Pensions: The Inevitable Reform

Presentation: Daniel Clifton,
Chief Economist, Americans for Tax Reform

By: Bill Butler, consultant,
Spector Roseman & Kodroff

In one of the most eagerly awaited presentations of the 2004 conference, Americans for Tax Reform (ATR) brought their case for defined contribution plans to a clearly skeptical audience of defined benefit plan administrators. ATR, a major player on the "conservative/anti-tax" side of the ideological divide in Washington, is headed by Grover Norquist who, in a 2001 article in *The Nation*, made no bones about his desire to "dismantle and privatize" state pension plans. The chief tool in this assault on the traditional defined benefit plan is the expansion of defined contribution plans in both the private and public sectors. ATR sees the DC plan as the "better" vehicle to carry the retirement promise for the growing number of retired employees in this country.

Filling in at the last minute for Norquist, who was called away unexpectedly, Daniel Clifton, chief economist of ATR, took the podium to give his firm's view of the reasons why the retirement policy of this country, especially within the public pension plan sector, should replace the traditional defined benefit plan (DB) with the more controversial defined contribution plan (DC). In perhaps the understatement of the day, he opened his comments with the observation that "I probably hold a different view than most of you in the room on the issue of defined benefit and defined contribution plans."

Four Factors

Clifton set the stage by reviewing demographic phenomena all too familiar to pension administrators: longer life expectancy, decreasing fertility rates, and a burgeoning retirement segment. With this as a backdrop, he listed four factors that are shaping the DB/DC debate.

■ Economic Uncertainty

By virtue of their exposure to the volatility of the stock market, DB plans bring the potential for the need to increase taxes to make up shortfalls in their funding. Because of the legal obligation to make benefit payments, governments are pressured to look to tax revenue to close the gap between the benefit need and investment performance. Currently many DB plans require additional funding to cover losses suffered in the recent decline of the capital markets, a situation only made worse by benefit expansions put in place during recent up-market years. While this money must come from additional taxes, this is the worst time to seek more tax revenue, when governmental income is declining.

■ Demographic Pressures

The retirement of large numbers of "baby boomers" coupled with the expectation that there will be fewer workers to replace them constitutes a demographic trend that will make it all the more difficult for sponsoring governments to close the funding gap. Without some correction, this gap may never be closed.

■ Wider Ownership of Securities Among the Middle Class

In a nod to libertarian thinking, ATR's third factor claims that the expansion of ownership of publicly traded securities by families over the past several decades will fuel the desire among DB plan participants to take control of their own financial destiny by investing directly in these assets, in the same way a 401(k) account owner can. Clifton and ATR believe public employees will want the same control over their retirement assets as their brethren in the private sector and that the DC plan is the best way to accommodate the demand.

■ Need For Portability

The final factor is the increasingly transient work force in the U.S. For this segment of the population, portability becomes an important feature in the overall scheme of retirement security. The rigidity of the DB plan simply does not lend itself to the solution of this issue.

One Leg of the Stool

Clifton spoke next of the three-legged stool of retirement security–Social Security, personal savings and an employer pension–arguing that all three need to be strengthened.

It is, of course, not news to anyone that savings in this country is quite low and by any measure ought to be increased. It is ATR's view that the federal tax code, in its present form, favors consumption over savings since the paycheck is taxed only once if it is spent but the saver pays twice, not only upon receipt, i.e. income tax, but again when his savings are subjected to capital gains tax and the tax on dividends. Thus, they argue, the tax system creates a perverse incentive to spend and not save.

As far as Social Security goes, it is to no one's surprise that ATR thinks the system is broken and beyond repair.

continued on page 24

The Case for Defined Benefit Plans

Panel: Tom Lussier, Anna Sullivan, Meredith Williams

By: Cathie Eitelberg, Sr. Vice Presdient and National Director of the Public Sector Market at The Segal Company

Former U.S. Speaker of the House Tip O'Neill recounted learning the lesson that all politics are local, following an early unsuccessful run for Congress. Who taught it to him? A longtime neighbor who, when telling her about how he just did not understand how he could lose, she replied, "I didn't vote for you." "Why?" he asked. "Because you didn't ask me to," she replied. What does this have to do with preserving defined benefit plans? After listening to *The Case for Defined Benefit Plans* panelists, the answer is everything. Nebraska and Colorado had very different political experiences because of their local politics. Moreover, as the national debate continues on the appropriate role of government in the financial security of its citizens, if defined benefit plans are to survive, much less thrive, the future of defined benefit (DB) plans will depend on local support.

First to Nebraska

Anna Sullivan, Director of the Nebraska Retirement System, took the audience through a journey that resulted in conversion of the state's 30-year-old defined contribution (DC) plan that covered state and country employees, to a cash-balance defined benefit plan. Policymakers and the retirement system were curious if their pension contributions were buying the best benefit in terms of the ultimate goal of the plan–to provide adequate retirement income to career employees. Studies revealed that the returns in the DB plans covering teachers and school employees were historically up to 2% above those the state and county employees were generating in their DC plan. Despite years of educational programs, competing with professional money managers was still a challenge for most individuals in the DC plan. Sullivan points out, "Money is emotional for people." Whether it was the inability to take on enough risk or the tendency to take on too much risk, such as the few participants who were market timers, the result was lower returns.

Working with policymakers, the system moved to a cash-balance plan, which is a form of DB plan that guarantees a set rate of return typically tied to a recognized index and accepts both employer and employee contributions. Nebraska finds this a more flexible arrangement in that the plan:

- Can offer a benefit that is assured for life
- Can provide cost-of-living adjustments
- Can provide better long-term returns on investments

Getting back to local politics

Sullivan's advice is to work with your policymakers, make the case based on economic arguments, face your detractors head on, and educate your supporters and participants as to the value of DB plans. Nebraska's advantage, which significantly influenced the outcome, was that policymakers not only were part of the solution, but also were involved throughout and had the goal of getting the most for their pension contributions. This was not the case in Colorado.

Anna Sullivan (standing), Tom Lussier, and Meredith Williams (both seated.)

Colorado's story is more like taking the rapids on one of the state's Rocky Mountain rivers. Hold on, feet first, and rely on your partners for survival. Colorado PERA is often considered one of the nation's most innovative systems. In previous years, PERA had developed a

continued on page 25

Portable

(continued from page 22)

Focusing on the third leg, the employer pension, Clifton began from his hypothesis that DB plans don't have what it takes to meet the trends outlined in his opening comments. He discussed the merits of the DC plan as the way to strengthen the third leg of the stool.

Using "government" as a proxy for the taxpayer, he pointed to the reduction of financial risk and uncertainty, especially in the budgeting process, when government escapes the obligation to fund traditional DB plans. As recent history has taught us, changes in the markets and the sudden decline in asset values can push an "overfunded" pension system back to "underfunded" status in a very short time. The obligation to close that gap then rests on the sponsoring government and becomes a liability of equivalent proportion.

In a DC environment, the sponsoring government would no longer be subjected to the market risk and volatility attached to a portfolio. Government would simply be out of the investment business and would have only a predetermined percentage of payroll to contribute to the plan. Governments could expect further savings from a reduction in administrative costs, not to mention the benefits it would reap from its ability to recruit higher quality workers. Clifton described, for example, President Clinton's ability to attract highly qualified staff, many of whom came from the private sector and who would certainly want to be able to take their DC accounts with them when they returned rather than leave retirement benefits behind in a DB plan. As for the worker, the positive aspects of portability is the ability to move from job to job without losing any of the benefit built up in the DC plan.

Under the DC scenario, a further advantage is the curtailment of government's ability to use the pension system for its own political advantage. Clifton spoke of governors pushing benefit increases to curry favor with government workers or supporting provisions to direct the investments of the system in the name of state economic development. In another example, he described the efforts of one governor to use the state's pension system's ownership of pharmaceutical company shares to call for a shareholder resolution supporting price controls. While this was intended to gain favor with the older segment of the state's citizens, Clifton viewed it as "playing politics" with the system and a potential breach of fiduciary duty. By his thinking, such an action would hamper the company's ability to recoup its investment and, therefore, drive down the value of the stock which would be contrary to the interests of the systems' members.

Questions from the Audience

Hands shot up as soon as Clifton finished his comments, and moderator Steve Yoakum wasted no time in recognizing Gary Findlay, Executive Director of the Missouri State Employees' Retirement System, who opened with a question about the costs of DC plans and a concern about DB plans being vilified for their involvement in shareholder activism. Clifton denied knowledge of the cost issues related to DC plans. His view of corporate governance activity by shareholders was that much of it was good but that he stopped short of endorsing anything that amounted to grandstanding.

NASRA President Ed Hennessee, Director of the Tennessee Consolidated Retirement System, asked about the issue of lump-sum payments and whether employees would be disciplined enough to save the money. Clifton sidestepped the question, claiming that since families have other assets for retirement besides their DC plans, we have to look at the whole picture to understand the effects of spending a cash-out. Anna J. Sullivan, Executive Director of the Nebraska PERS, asked if ATR really wanted to know "how we feel or do you just think we're *only* government employees?" Clifton denied any disdain for government employees and mentioned that he, himself, had been a government employee early in his career. As an illustration of the power of public employees, he went on to say that he felt the creation of the DC plan in Florida was made possible with the support of the state's employees and their unions who favored its creation.

Conclusion

Clifton's presentation on behalf of the Americans for Tax Reform and the responses it drew from the audience illustrated the wide gulf between the DB and DC communities. Neither "side" would argue with the fact there are trends and forces afoot in the country that will certainly bring change to the business of retirement security. The task is to determine what is best for the active members as well as those who have retired. Although it is a core NASRA belief that a DB plan should serve as the primary retirement benefit for public employees, NASRA is committed to hearing all side of the issue.

Steve Yoakum, Daniel Clifton, and Bill Butler

DB Plans

(continued from page 23)

hybrid approach that embraced portability of both employee and employer contributions, enacted gain-sharing with participants, retirees, and employers, permitted lump-sum distributions at retirement or a lifetime benefit, and offered a 401(k) plan. But changes in statehouse political power and the governor's mansion, term limits, and volatile financial markets combined to fuel a push for a pure defined contribution alternative. PERA Director Meredith Williams made the case eloquently for the existing plan structure, pointing out that it already gave a great deal of flexibility to the participants in terms of benefit distributions and plan choice.

A freestanding DC plan would be a choice without distinction for snowplow drivers like PERA participant Harvey. As Williams points out, "if he screws up by about six inches, it's a thousand feet down," his only thanks comes in the form of a darn good and secure pension. These arguments did not prevail, nor did they counterbalance the support private-sector companies were providing to those supporting DC choice. PERA legislation necessary in response to financial market swings was being held hostage to the governor's desire to enact a defined contribution plan.

After protracted negotiations with the governor, it was agreed that DC choice would be made available to new state hires beginning in 2006. New employees will be allowed to choose to participate in a state-sponsored DC plan or to join PERA. Harvey still has his PERA choice; however, there is concern that the DC advocates are not done. As term limits begin to reduce the ranks of legislators who have been PERA supporters and participants, the concern is that additional efforts will be taken to further restrict participation in PERA. Again, the future of local politics will be about teaching Harvey how to have a voice and have it heard. Williams' advice is to go to work each day with Harvey as your guide, find your friends, continue to learn all you can about industry innovations, and be vigilant about what is going on around you.

No good deed goes unpunished

This was the message of Tom Lussier. Public sector employers have been doing the right thing. Ninety percent of full-time workers are covered by a DB plan, and the vast majority have access to a supplemental retirement savings plan. Compare this to the private sector which covers just half of its workers under any type of retirement plan. One would think that governments would be praised for this record—deferring part of current earnings for retirement, providing a stream of payments that has positive economic effects, and reducing pressure on government income support programs. However, Americans for Tax Reform and its president, Grover Norquist, disagree. They are supporters of the "Ownership Society" where collective responsibility for societal needs is nonexistent. Each person is responsible for his or her financial well-being. Norquist is particularly bothered by government DB plans in their role as institutional investors. Norquist has a stated goal to launch a state-by-state campaign to dismantle governmental pension plans. As Lussier indicated, the desire is to "destroy" public sector DB plans by dismantling boards and turning the investment of assets over to individuals. This goal of privatization is part of the Ownership Society doctrine. And political influence is being used to push this agenda at the national level through the conservative coalition known as the "K Street Project" headed up by Grover Norquist. In response to a question, Tom's advice becomes crystal clear. Public sector plans need to tell their story and not leave it to others to frame the debate. The threat is clear and present.

As Williams does, keep Harvey as your focus. As Sullivan did, find your allies and hold on to them. And, as the industry has done and is set to do more of, tell the positive story of DB plans and how they are economic engines that support local economies and provide a long-term investment in the future. Public sector employees have long had the opportunity to enhance their retirement through voluntary participation in DC and deferred compensation plans. The debate should not pit plan against plan as those that want to divide and destroy the public sector retirement community are attempting to do. Rather, this debate should continue to utilize the best of each approach for government employers, employees and the citizens they serve. The case for DB plans is best made by those who plow snowy mountain passes, teach our children, and defend our cities ... not those who will increase their power and purses through the demise of these plans.

Glad to the bone

(continued from page 21)

5. Energize yourself with your ability to work with others, your witness, and your standards.

If you always do what you always did, you will always get what you always got. Problems get solved better if you smile than if you whine. You need to be glad to the bone and have a life that is fulfilling and joyous. You can't play the banjo and sing the blues at the same time. As long as you have a happy face you will get some of it back.

Current Events Panel

Presentation: Cynthia Webster (moderator), Maureen Westguard, Michael Williamson, and Alan Winkle

By: Kathie Vaugh, Assistant Executive Officer, California Public Employees' Retirement System

Cynthia Webster, Director of the Vermont State Retirement System, moderated the Current Events Panel. She remarked that one of the best features of NASRA is the opportunity to network, share experiences, and learn from each other. She introduced a panel of current directors to do just that.

Strategic Planning at Washington DRS

Pitch-hitting for John Charles, Director of the Washington State Retirement, Maureen Westgard (Deputy Director) presented their experience with a "Balanced Scorecard" approach to implementing their strategic plan. Responding to a governor's initiative to implement performance measurement systems, the state of Washington participated in a Harvard Team project to adapt the Scorecard to the state's strategic planning program. Westgard shared Washington's vision "Delighted Customers/Proud Staff" and showed how they have taken a holistic approach by focusing on: Customer, Value & Benefit, Financial, Internal Processes, and Learning & Growth. The Scorecard allows management to track goals, measure progress against milestones, and identify issues needing critical attention.

Surviving an HHS Audit at the North Carolina Retirement Systems

Michael Williamson, Director of the North Carolina Retirement Systems, discussed how his system survived a Health & Human Services (HHS) audit. He described how the state withheld contributions to the retirement system in the amount of $212 million in order to balance the budget. These funds were placed in escrow and included federal contributions. The lack of a state match triggered an HHS audit that resulted in HHS telling North Carolina that they owed the federal government $7 million. North Carolina continues to work with them on a payment schedule. According to the HHS website, other states that have been audited include Tennessee, California, and Florida.

A collateral issue that arose in the course of the audit could have been detrimental to North Carolina and all other systems. The federal auditors reasoned that since the system had been overfunded (114%) for four years, North Carolina actually owed them $315 million. This attempt was met with an effective counteroffensive, showing that North Carolina had been underfunded for 55 years and never asked for additional funds from the federal government.

Michael Williamson, Maureen Westgard, Alan Winkle, and Cynthia Webster

PPCC Standards Program

Alan Winkle, Director of the Idaho Public Employees Retirement System, distributed the revised Public Pension Coordinating Council Standards for 2004. PPCC members are NASRA, NCTR, and NCPERS. Of the 80 systems that participated in 2003, 53 systems were approved and 27 were denied, mostly because of funding adequacy. Thirty-six (36) of 74 NASRA systems applied last year; Winkle announced that they are hoping for a 50% increase in NASRA system applications in 2004.

The survey will be conducted electronically between October 1 and October 31, 2004 (the Internet browser must be set to accept "cookies" in order to access the survey). Certification results will be available by the end of November.

The Case for Long-Term Care

Presentation: Frederick H. Nesbitt and William F. Robinson, Jr.

By: Frederick H. Nesbitt

Many of us have grown up believing in the venerable "three- legged stool" as the key to retirement security. The three legs of the stool – individual savings, employer pension plans, and Social Security – should get us through our golden years in reasonable financial shape.

Two developments have challenged the sanctity of the three-legged-stool theory. First, the combination of relentlessly growing health care costs and the pressure on employers to continue to fund retiree healthcare has caused people facing retirement to rethink their future retirement needs. Providing access to affordable retiree healthcare is a national issue, and one not easily addressed at the retirement system nor individual level. Secondly, the potential of a long term chronic physical or mental illness or injury also undermines traditional thinking about retirement funding. The dramatic increase in recent years in the cost of nursing home services can potentially devastate one's retirement savings in a relatively short period of time. However, the good news is that, unlike retiree healthcare issues, the threat of long term illness can be addressed by a retirement system.

Background

The threat of long term debilitation is not new. In the past, families have often taken care of members in times of need. Today, however, due to changing American demographics, reliance on relatives may not be practical or even possible. This is because:

- Families tend to be more geographically dispersed, making care of elders more difficult.
- Families are smaller, so fewer members are available to care for others.
- Nontraditional family units make determining responsibility for care unclear.
- Migration to suburbs makes access to urban care givers and services more difficult.
- Because people are having children later, they often are faced with caring for parents and children (the "sandwich generation").

Long Term Care Facts

- The current average length of stay in a nursing home is almost 2.5 years (and increasing).
- The average national nursing home daily room charge is $144/day (and increasing at 5.8% per year).
- At current daily rates, an average nursing home stay would cost over $130,000. In five years, the cost grows to almost $175,000; in ten years, to over $230,000.
- People age 65 face at least a 40% lifetime risk of entering a nursing home; 10% will stay 5 years or longer.

Who Pays for Long Term Care?

If family members are not able to provide long term care, who will pay?

- Group Health Insurance? Group health insurance does not pay for custodial services such as most nursing home confinements
- Medicare? Medicare offers limited nursing home benefits. Nationally, Medicare provides only about 14% of all nursing home payments.
- Medicaid? Medicaid does pay for long term care expenses. In fact, it currently pays almost 44% of all nursing home costs. However, Medicaid comes at a steep price. To be eligible, one has to spend down personal assets, to less than $5,000 in order to meet Medicare's stringent eligibility requirements.
- Long term care (LTC) insurance? Yes, LTC insurance can pay for all or most of nursing home expenses, even if for custodial purposes. LTC insurance pays benefits regardless of personal savings, retirement benefits, or Social Security income.

(continued on page 28)

David Bergstrom, Fred Nesbitt, and Bill Robinson

Long-Term Care

(continued from page 27)

What to Look for in a Long Term Care Plan

If your retirement system determines that it can best serve its members by offering a voluntary long term care insurance plan, what are the key issues to consider when selecting a carrier?

Group or Individual Coverage—Perhaps the most important decision is whether to sponsor a group or individual LTC plan. This decision will shape the program for years to come. If the decision is to offer an individual plan, your system will not be able to later offer a group plan. Once an individual plan (under which every applicant must pass medical underwriting) skims off the good risks, a group carrier will not be willing to offer voluntary coverage to the remaining members. In aggregate, a group LTC plan for a larger retirement system will provide lower average costs for more members than an individual plan.

Financial Stability of the Carrier—Because long term care benefits may not be paid out for 20 or more years, you want to make sure that the carrier will still be solvent when future claims occur. Financial ratings of major carriers are readily available from several national organizations. Additionally, you can contact your division of insurance to check the solvency and financial ratings of LTC carriers licensed in your state.

Guaranteed Issue—Individual LTC policies rarely offer guaranteed issue (coverage offered without medical underwriting). Another advantage of group LTC coverage is that this is an option if your system's demographics are favorable. Always attempt to negotiate some guaranteed issue provisions into your LTC plan to guarantee the optimal benefit for your members.

Inflation Protection—With nursing home costs increasing at almost 6% a year, the daily cost of care will almost double in 12 years. Benefits experts recommend that you purchase a LTC plan that offers some type of optional inflation protection to prevent erosion of benefits.

Adequate Coverage Levels—Nursing home costs vary greatly by geographic location. When purchasing LTC coverage, be sure to offer daily rates and lifetime maximums that are adequate for a majority your members. Keep in mind that many retirees move to other areas of the country, where daily rates may be different higher.

Covered Services—Make sure that you consider LTC plans that reimburse services other than just those for nursing homes. Home and assisted living care reimbursements may be acceptable and at lower costs, extending your member's lifetime benefits.

Optional Features—Evaluate the available optional features—nonforfeiture, refund of premium, paid-up options, etc.—to determine if they would be valuable to your members and worth any additional costs.

Conclusion

The traditional retirement planning concept based on the three-legged stool as the foundation for financial security is being challenged by the demands of retiree healthcare and long term medical conditions. Medicare and Medicaid are not solutions for most people who want to maintain their financial independence. Long term care insurance can assure that a retiree will have the resources to pay the costs of chronic illness and disease, while at the same time continuing to benefit from individual savings, retirement benefits, and Social Security. To help your members help preserve benefits, retirement systems should consider offering LTC as part of the total retirement package for its members.

New System Directors Attend Conference

Rob Wylie (South Dakota Retirement), Ronnie Jung (Texas Teachers' Retirement), Mary Most Vanek (Minnesota PERA), Jim Winfree (Ohio School Employees), Dana Bilyeu (Nevada PERS), and Gary Austin (Minnesota Teachers Retirement Association)

NASRA in Asheville

Past Presidents: Frank Ready (2003), Gary Findlay (2002), Sparb Collins (1999), Jim Sims (2000), Richard Schumacher (1997), Glen Pond (1981), and Alan Winkle (1996).

Conference attendees

The "Calling of the Cows" at the Taylor Ranch Party

Cloggers at the Taylor Ranch Party

Color Guard

2005 Committee Assignments

Audit and Budget Committee

William Hanes, Chairman
Michael Williamson
Jack Gastler
Teresa Webb

Code of Conduct Committee

Steve Yoakum, Chairman
Michael Carter
Sandy Dzinski
Teresa Webb

Constitution and Bylaws Committee

Terry Slattery, Chairman
Eric Stanchfield
Robert Newman
Sandy Dzinski
Cathie Eitelberg

Education Committee

Thomas Lee, Chairman
Michael Williamson
Cathie Eitelberg

Nominations Committee

David Bergstrom, Chairman
Ed Hennessee
Carol Wardlaw

Program Committee

Laurie Hacking, Chairman
Eric Stanchfield
Eddie Vandiver

Legislative & Resolutions Committee

William Hanes, Chairman
Robert Newman
Carol Wardlaw

Special Programs Committee

Steve Yoakum, Chairman
Thomas Lee
Jennifer Hunt

Membership Development Committee

Gary Findlay, Chairman
David Bergstrom
Michael Carter
Jeff Gallahue
Jack Gastler
Jennifer Hunt
Eddie Vandiver

Performance,Compensation, and Benefits Committee

Ed Hennessee, Chairman
David Bergstrom
Terry Slattery
Jeff Gallahue

Committee on Accounting Standards

Representative: Betty Ann Kane (DC)

Conference attendees' children enjoy the return of Camp NASRA.

Officers

Ed Hennessee (TN), President
Laurie Fiori Hacking (OH), President Elect
M. Steve Yoakum (MO), First Vice President
William P. Hanes (KY), Second Vice President
David Bergstrom (MN), Immediate Past President

Regional Vice Presidents

Thomas K. Lee (MD) - Region I
Michael Williamson (NC) - Region II
Eric Stanchfield (WI) - Region III
Terry Slattery (NM) - Region IV
Robert Newman (UT) - Region V

Staff

Administrative Office
Glenda Chambers, Executive Director
P.O. Box 14117
Baton Rouge, LA 70898
Tel: 225-757-9558
Fax: 225-757-9765
E-mail: glendac@nasra.org

Liz Antin, Administrative Assistant
Tel: 985-307-0342
Fax: 985-307-0412
E-mail: liza@nasra.org

Washington Office
Jeannine Markoe Raymond
Director of Federal Relations
444 North Capitol Street, NW, Suite 234
Washington, DC 20001
Tel: 202-624-1417
Fax: 202-624-1419
E-mail: jeannine@nasra.org

Research Office
Keith Brainard
P.O. Box 980
Georgetown, TX 78627-0980
Tel: 512-868-2774
E-mail: keithb@nasra.org

Associate Advisory Committee

W. Michael Carter
(Gabriel, Roeder, Smith & Company)
Chair - 2005*

Sandy Dzinski
(GE Asset Management) - 2007*

Cathie Eitelberg
(The Segal Company) - 2006*

Jeff Gallahue
(KBC Asset Management International Limited) - 2006*

Jack Gastler
(Nicholas Applegate) - 2007*

Jennifer Hunt
(Voyageur Asset Management) - 2005*

Eddie Vandiver
(AIG Global Investment Group, Inc.) - 2007*

Carol Wardlaw
(Dimensional Fund Advisors) - 2005*

Teresa Webb
(Pomerantz Haudek Block Grossman Gross) - 2006*

** Year Term Expires*

Save the Dates

51st Annual Conference
August 5-10, 2005
Hilton Anchorage
Anchorage, Alaska

52nd Annual Conference
August 4-9, 2006
Loews Coronado Bay Resort
Coronado, California

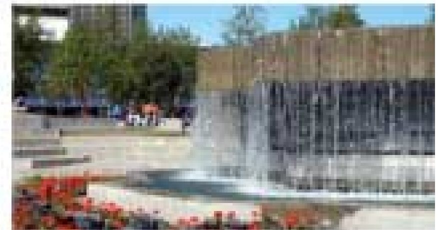
53rd Annual Conference
August 3-8, 2007
Fairmont Turnberry Isle Resort & Club
Aventura, Florida

See you in Anchorage

Mark your calendar for the 51st Annual NASRA Conference to be held August 5-10, 2005, at the Hilton in Anchorage, Alaska.

Located on the shores of Cook Inlet and at the foot of the Chugach Mountains, Anchorage is a unique urban environment set in the heart of great wilderness. Breathtaking scenery, Alaska wildlife, culture, recreation and adventure – it's all here, plus first class dining, lodging, shopping, entertainment, and attractions.

We hope you'll join us as we continue our traditions and innovations with a mix of education, networking, and fun. Check the NASRA website at www.nasra.org for convention details as they become available.



NASRA

National Association of State Retirement Administrators

P.O. Box 14117
Baton Rouge, LA 70898