



NASRA

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Association
of State
Retirement
Administrators

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NEWS

F A L L 2 0 0 5

Riding the Wave of the Future

Perhaps the most interesting feature of public retirement system administration and policy is the many disciplines it encompasses: accounting and audit, retirement counseling, legal issues, investment management, employee benefits, information technology, politics, and federal policies make up just part of the vast public retirement system community. Remaining current on these and other areas is a continuous challenge for those who administer public retirement systems.

Because NASRA members have backgrounds in these and other areas, when they gather, the result is an environment rich in knowledge, experience, and interests. The diversity of disciplines and backgrounds poses a challenge: how to conceive, design, and orchestrate a conference that is relevant, informative and educational.

Following tradition, the 2005 NASRA Annual Conference opened with the Director's Workshop, an opportunity for NASRA members to gather behind closed doors to hear and discuss issues and events pertinent to their role as directors and administrators of statewide retirement systems. This year, the workshop focused on strategies for responding to challenges from legislators and the media.

Jeannine Markoe Raymond, NASRA Director of Federal Relations, discussed the results of the DB Coalition, whose members are various groups (including NASRA, NCTR, and NCPERS) with an interest in preserving defined benefit plans for public employees. Formed earlier this year and working with a media consultant, the coalition developed
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A New Day in America Stuart Varney

Noted cable television business reporter and author Stuart Varney gave an animated presentation on trends in the world economy energized the audience. He made three points – he called them premises – and a prediction.

First, he took us back fifteen years or so to the aftermath of the 1987 stock market crash. Conventional wisdom had it that the U.S. was in decline, and Japan was emerging as the new super-economy. The facts were there to prove it.

Between 1950 and 1990, Japan's GNP had gone from one-third that of Britain and one-twentieth of the U.S., to four times Britain's GNP and half that of the U.S. The Europeans were strengthening their union, building an egalitarian society that made American capitalism retrograde, mean, and in decline.

Fast forward to the present and how different it all looks. Japan is still wallowing in the results of

a real estate and stock market bubble that burst, Europe is still befuddled by 10% plus unemployment, and the U.S. has far outstripped the EU and Japan, having prospered, fumbled, and prospered once again in the interim. And no one – well, at least not Stuart Varney or anyone in the audience – has yet to buy a French-made computer!

The perception that a process of globalization is
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Ed Hennessee, Stuart Varney, Gilbert Gilman

Riding the Wave of the Future

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a packet of materials to assist coalition members in responding to inquiries from the media, legislators, and other external entities. This packet includes key messages, talking points, press kits, and related information. (NASRA will be distributing some of this coalition's products to NASRA members during the coming weeks.) Workshop attendees also discussed potential pitfalls, traps, and snares in working with the media and other outside groups and tactics for avoiding them; and received a reminder from NASRA counsel Bob Klausner on the importance of keeping ethics and other system governance policies up-to-date.

Television business analyst Stuart Varney kicked off the conference's general session with an optimistic assessment of the future of the U.S. and world economies. As a British native who has prospered in America, Mr. Varney expressed his deep gratitude to the United States and its citizens.

Subsequent speakers addressed a range of timely subjects, from system governance to corporate governance; from the state of DB plans to the future of So-

cial Security; from treasury inflation protected securities (TIPS) to hedge funds; from actual changes in public pension funding levels to pending federal tax code changes. Noted speaker Ken Dychtwald, of Age Wage, Inc., treated attendees to a memorable, outside-the-box perspective of how improvements in longevity are changing the way Americans think about aging, working, and living.

These varied and interesting presentations were interspersed with opportunities to take in the natural beauty and culture of Alaska, a place filled with stunning vistas and sunsets that approached midnight. Amid the work and fun, the notoriously family-friendly NASRA conference enabled all attendees, including spouses, partners, and children, to renew old friendships and make some new. NASRA conference attendees are an eclectic group formed around a single, overarching purpose: the pursuit of excellence in the management of public employee retirement systems. See you in San Diego!

By Keith Brainard, NASRA Research Director

A New Day in America

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underway, bringing with it a radical change in human affairs, is not new. In 1848, Karl Marx wrote about "constantly expanding markets ... establishing connections over the whole surface of the globe." Like Stuart Varney, Marx had no doubt he was witnessing the emergence of a global market with a worldwide system of production and consumption that paid no heed to national boundaries. But there is an inherent ambiguity to the idea of globalization.

Two very different concepts merge in the conventional wisdom – the belief that we are living in a period of rapid and continuous technological innovation, linking world events and activities more widely and quickly than before, and the belief that this process is leading to a single worldwide economic system. The first is an empirical proposition and plainly true. The second is a groundless ideological assertion.

Varney's third premise is the radical change in fertility rates, which have fallen sharply throughout the developed world. A decline of 25% in one generation, combined with increasing longevity, with implications for economic performance. How will we deal with this

new crisis? He did not say, but he did warn there will be changes in pension, health, and welfare policies.

Finally, Varney laid out a forecast for the next nine months of U.S. economic performance, predicting economic growth at 4% to 4.5%. He cited the housing boom, unemployment holding steady at just above 5%, strong job creation, and government spending. Wages are above historic averages, President Bush and the Republicans are now "spending money like drunken Democrats," and have that old-time Keynesian religion. "On the whole," he finished up, "I think the positives outweigh the negatives."

Conventional wisdom is a wonderful thing – explaining complex, multi-layered phenomena in a clear "no-spin" style – offending no one and pleasing everyone. After a decent interval, once today's unsettling events have faded in the rearview mirror of cable TV news, we can reassess.

And wonder at the radical shifts in public perception.

By Gilbert Gilman, Washington State Department of Retirement Systems

GASB and GASAC Update

Betty Ann Kane

Betty Ann Kane, executive director of the District of Columbia Retirement Board, is NASRA's representative to the Government Accounting Standards Advisory Council (GASAC). Kane presented an overview of GASAC and the Governmental Accounting Standards Board (GASB) and an update on their activities.

GASB is a nonprofit organization composed of seven members appointed by the Financial Accounting Foundation. The mission of GASB is to establish and improve standards of governmental accounting and financial reporting, to provide useful information for users of financial reports, and to guide and educate the public, including issuers, auditors, and users of financial reports.

GASAC serves as an advisor to GASB. The members of GASAC are appointed by GASB trustees and are broadly representative of preparers, attesters, and users of financial reports. An important function of GASAC is to assure that the views of its members are consistently and effectively communicated to GASB. GASAC provides individual comments to GASB and assists in assuring that GASB's views are communicated to the public.

Kane noted that prior GASB initiatives affecting public employee benefits include Statements 25, 27, 28, 31, 32. A recent GASB initiative affecting public pension benefits, Statement 40, Deposit and Investment Risk Disclosures, is effective in 2005 for larger governments. In addition, an amendment to Statement 3 requires disclosure, by asset type, of the interest rate risk on investments in debt instruments, the credit risk on investments in debt instruments, and foreign currency risk.

Other recent GASB projects include Statements 43 and 45. Statement 43 addresses financial reporting for post-employment benefits other than pension plans. It was issued in April 2004 with implementation to start for larger plans for fiscal years beginning in January 2006. Statement 45 addresses accounting and financial reporting by employers for these post-employment benefits.

The Other Post-Employment Benefits (OPEB) project establishes the financial reporting framework for measuring and reporting OPEB benefits sponsored by governmental entities. Kane reported that assets and liabilities of OPEB plans will be accounted for like pension fund assets and liabilities. According to Kane,

GASB's concern is that these benefits are similar to pension benefits and the costs should be recognized when the service is rendered.

Kane reported that potential impacts of the OPEB project on health care plan design, sponsorship, and funding include reevaluation of plan design because of likely increasing costs and the establishment of trusts for retiree health care plan assets. The project's



Tina Leiss and Betty Ann Kane

impact on employer financial statements will happen gradually and most employers will be in similar positions. However, all else being equal, an employer with fewer or less generous OPEB benefits will look better in the bond market.

Another recent initiative presented by Kane, Statement 47, was issued in June 2005. This statement covers both voluntary and involuntary benefits that encourage or require employees to terminate employment. Other current GASB projects of interest include hedge and derivative accounting, research on fiduciary responsibility, economic conditions reporting, fund balance reporting, real estate valuation for endowment funds, and international public sector accounting standards.

Kane concluded by noting that a plan's auditor and actuary are good resources regarding information on the activities of GASB in addition to GASB's website at www.gasb.org.

*By Tina Leiss, Operations Officer,
Public Employees' Retirement System of Nevada*

Update on DB/DC Initiatives

William Leighty & Fred Buenrostro

It is the news heard around the world in state retirement systems and the private sector. It is the debate of defined benefit plans versus defined contribution plans. With only four states offering a defined contribution plan, you may wonder why.

Bill Leighty, Chief of Staff to the Governor of the Commonwealth of Virginia, spoke from the perspective of employers.

The average expenses for defined benefit plans are approximately 0.3% of assets compared to over 0.5% for defined contribution plans. The debate includes the discussion of younger workers needing portability. According to Leighty, "Young people do not have a clue what they want; no concern about retirement planning." Instead of these issues, why isn't there discussion on seeking interest on the member refund of contributions at separation. Leighty commented that our workforce is not ready to handle their own accounts. He points out, "Yes, there are some people who can do well. However, we don't do a good job of educating people how to pay their bills." How can they possibly manage their investment account? Nonetheless, employers want lower cost.

The current environment shows several states' interest in defined contribution plans. Alaska – mandatory defined contribution plan for new employees effective July 1, 2006; California – Governor initiated end of defined benefit plan, but later withdrew; Florida – defined contribution plan since 2002 for new hires; Michigan – mandatory defined plan since 1997 for new hires; Nebraska – a 1960s defined contribution

plan was closed in 2003; Ohio – defined contribution plan since 2003; West Virginia – 1999 defined contribution plan for teachers closed in 2005.

Is opposition to defined benefit plans vendor driven? William Leighty thinks so. He noted that the American Legislative Exchange Council (ALEC) is the number one promoter of defined contribution plans. Most of us would all agree that much of the money behind the promotion to convert to DC plans comes from such organizations as ALEC, investment firms, insurance companies, and third-party administrators.

CalPERS Chief Executive Officer Fred Buenrostro continued the update on DB/DC initiatives. He concurred with Leighty that the fight against DB plans is political. CalPERS has approximately 25,000 new retirees each year averaging \$2,400/month in pensions and usually age 60 with 20 years of service. Buenrostro noted, "This discussion has been around a while. Ten years ago, defined contribution plans offered empowerment—that was when the market was good. This time it is being used to fix what's wrong with government; to correct fiscal problems."

The initiative of the governor of California to change CalPERS to a defined contribution plan failed to address the effect of death and disability benefits. The DC plan would eliminate death and disability benefits. No one talks about this devastation.

As fiduciaries, we have a voice. We must, as NASRA has stated, pool resources to craft messages and communicate to educate members, legislators, media and the public regarding the importance of defined benefit plans for public employees (<http://www.nasra.org/resources/dbdcissues.htm>). The debate will continue, but retirement systems must strategize to educate members regarding their need to fight for DB plans.

*By Phyllis Walker, Finance Manager,
Illinois Municipal Retirement Fund*



William Leighty, Fred Buenrostro, Phyllis Walker

Hedge Funds: Opportunities and Risks

Steve Holmes & Allan Emkin

Moderator Carol Wardlaw of Dimensional Fund Advisors introduced the topic of hedge funds as an investment for plans to consider. Steve Holmes, president of Summit Strategies Group, and Allan Emkin, managing director of Pension Consulting Alliance, two leading consulting firms in the public fund sector, discussed their views.

Though both Holmes and Emkin stated upfront that their firms are advocates for investments in hedge funds, if appropriate for the particular client, the discussion was intended to be a debate with Holmes and Emkin representing opposite sides of the argument.

Holmes spoke first and indicated that Summit recommends hedge funds for two reasons in an overall portfolio: the first is as an alternative to fixed income, the second is as the alpha engine in a portable alpha program. With an expected return of 6-7%, Holmes noted that the days of 18% returns in hedge funds are over.

More specifically, Holmes said that as a fixed income alternative, the expected return from a nondirectional hedge fund investment will help at the margin, as it should provide consistent positive absolute returns and have low correlation to interest rate changes. He gave a specific client example of how an investment in a hedge fund worked as a fixed income diversifier due to its higher return, low volatility, and low interest rate correlation.

Holmes also gave an example of a client who successfully used hedge funds as part of a portable alpha program. Portable alpha combines the returns from a pool of hedge funds with the returns from traditional asset classes by synthetically creating the beta exposure. A reasonable goal of a plan should be to achieve the market + 4%. Holmes showed how the portable alpha program had a positive impact on the client's overall portfolio.

Holmes summarized by noting that innovation in the markets has given us these opportunities, and that is appealing. The markets are continually evolving and a "new breed" of active management that looks much different from traditional approaches is emerging from the creativity. This should provide both sensible fee structures and greater transparency for investors, both of which will be positively influenced by large institutional investors such as public pension funds.

Emkin humorously countered with a simple expression to start his presentation: "the horrors." He cautioned with the old adage that these strategies often "sound too good to be true because they are too good to be true." Yet he warned that plans are still investigating them in order to nudge up returns with the hopes of limiting contributions. Emkin noted their cost, not only in fees but also in terms of business risk, and cited the disastrous example of Long Term Capital in 1998. Emkin warned that hedge funds fail at a large rate.



Tim Jannetta, Allan Emkin, Steve Holmes

Emkin stressed that though the market is moving to becoming institution-friendly, it is not there yet and many of the best performing hedge funds do not want institutions as clients. These hedge funds are discouraging institutional clients from investing because they do not want to have to reduce their fees, offer transparency, and open themselves up to the attention and scrutiny that comes with this client type.

Emkin concluded by cautioning investors to know what they are doing if they choose to go ahead with an investment in hedge funds. The information on the funds is often limited, so careful homework in the due diligence stage is very important.

During the question-and-answer period that concluded the presentation, both Emkin and Holmes had the opportunity to state their positions. Emkin responded to a few questions by suggesting that investors find a way to off load as much of their fiduciary responsibility as they can if they invest in hedge

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Roll Call of the States

Plan design studies and plan changes

Most systems faced some type of major plan study or design change (some voluntary, some involuntary) this past year with the defined benefit (DB) vs. defined contribution (DC) plan design debate being front and center on both the local and national stages.

Indicative of this current climate was separate legislation introduced in Alaska and California to convert future public employees from defined benefit plans to defined contribution plans – but with very different outcomes.

Melanie Millhorn, executive director of our host state Alaska, described their plan design study, begun in January 2004, resulting in passage of legislation that replaced the current defined benefit plan with a single, new defined contribution plan for members of both the Alaska Public Employees' Retirement System and Teachers' Retirement System hired on or after July 1, 2006. The driving force behind this legislation was the decline in their funding status from 101% in 2002 to 75% in 2004. The actuarial employer contribution was projected to increase from 6.8% in 2002 to 24.9% in 2005.

Fred Buenrostro, executive director of the California Public Employees Retirement System (CalPERS), described the legislative process in California relating to

pension reform proposals. After much work and national exposure on both sides of the issue, Governor Schwarzenegger announced he would delay the pension initiative until at least June 2006. Meanwhile, pension reform proposals were introduced in a special session to reduce the volatility of employer contributions (aka rate stabilization or rate smoothing), to reduce benefit manipulation (aka pension spiking), and to reduce fraud and abuses in industrial disability retirement benefits.

Karen Copeland, membership manager representing West Virginia Consolidated Public Retirement Board, reported that they reopened a defined benefit plan and closed their existing defined contribution plan this past year to best meet the needs of their membership.

Joe San Agustin, chairman of the Government of Guam Retirement Fund Board of Trustees, indicated that they discontinued their DB plan in 1995 in favor of a DC plan. He expressed concern about the high level of member loans which could leave some members with insufficient retirement funds at time of anticipated retirement.

In summary, the majority of comments strongly favor a defined benefit retirement plan structure with additional voluntary supplemental defined contribution plan(s). Most executive directors reported defined benefit plan costs are very reasonable and provide the best benefits for members. Mark Reynolds, deputy director of the Retirement System of Alabama, indicated that 80% of their funding is derived from investment returns, 10% from employee contributions, and 10% from employer contributions.

Most plans are concentrating on additional ways to reduce costs, stabilize contributions, and eliminate unfunded and/or under-funded benefit enhancements by working more closely with their legislatures. The state of New Mexico strongly supports the current DB structure. Fixed, reasonable member and employer contribution rates, few unfunded and/or under-funded benefit enhancements, and excellent investment returns enabled the New Mexico plans to weather the recent market decline and remain strong.

Some retirement systems give members a choice between DB or DC structures. Other systems have existing tiered defined benefits/costs or are considering

Hedge Funds

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funds. He concluded by raising questions about the accuracy of the data that surround the funds. Holmes stated that human capital is a key to the hedge fund's success, so be aware of the risk of turnover. He also reinforced Emkin's comments by encouraging plan sponsors to understand the strategies and invest in them if it is sensible and logical.

*By Tim Jannetta,
Morgan Stanley Investment Management*

creating new tiers. All agreed this issue must be carefully studied and every retirement system must be proactive.

Another major design issue faced by many systems was return-to-work programs after retirement. Many different designs and funding mechanisms were described with varying degrees of support or lack thereof. During one of the other conference sessions we also heard from Ken Dychwald regarding re-visioning retirement and the aging of the population, which also has implications for the future. The pros and cons of this particular issue depend on the political, economic, and employment climate in each geographical area as well as unique design and funding issues for each retirement system. This would be an excellent session topic for a future NASRA conference.



Terry Slattery, Michael Williamson, Kurt Weber

Funding status

Investment returns for the year were generally good – above actuarial assumptions. However funding status results were mixed as many retirement systems use a multi-year (typically three to five years) “smoothing” methodology to spread investment gains and losses in determining their actuarial asset value. Many are still “carrying forward” investment losses from previous years, which contributed to decreases in funding status. Fred Buenrostro, executive director of CalPERS, indicated their board recently adopted a policy to spread investment gains and losses over fifteen years to reduce employer contribution volatility.

Many retirement systems reported increased contribution rates. Gail Stone, Executive Director of the Arkansas PERS, and David Shimabukuro, Executive Director of the Hawaii ERS, both reported plan changes from noncontributory to contributory. Robert Schultze, new executive director state of Virginia, reported that con-

tribution rates had to be raised as a result of prior contribution “holidays” during periods of strong investment market returns.

Other post-employment benefits

Many executive directors indicated that health insurance will present more challenging issues in the future than the current pension funding issues. This is due to the rapid rise in current and future health care costs and the unfunded and/or under-funded status of these benefits.

Technology and membership communication

Most retirement systems were somewhere in the process of replacing their old legacy information systems, implementing or upgrading imaging technology, managing back file conversions, and/or reviewing business information processes. Many systems were also creating or updating their member call centers and providing access to member data via the web. A few lucky ones were at the tail end of the projects while many were just starting. Information technology must be viewed and funded as an ongoing continuous process to avoid getting too far behind the curve.

In summary, I feel fortunate that my executive director, Terry Slattery, allows me to attend the NASRA conference. The conference is focused and encourages the free exchange of ideas in an important and complex profession. One of my favorite sessions is the Roll Call of the States, where I always pick-up new ideas. The “rumor central” concept described by Gary Findlay, executive director Missouri State Employees’ Retirement System, was very interesting. This is an attempt to provide positive, accurate information to members and other interested parties to head off potential negative rumors. A few executive directors talked briefly about succession planning. This is becoming more and more critical in our current retirement environment.

*By Kurt D. Weber, Deputy Executive Director
New Mexico Public Employees Retirement System*

The Fall 2005 newsletter is also available on NASRA's website at www.nasra.org.

Road to the Iditarod

Martin Buser

Racing sled dogs might not seem to have much to do with managing public employee retirement systems, but many of Martin Buser's (four-time Iditarod Champion and four-time Humanitarian Award Winner) comments about perseverance, team work, discipline, diversification, focus, and developing a strong game plan sounded a lot like many of our jobs.

Each year, on the first Saturday of March, Buser and his team begin traversing 1150 miles through jagged mountain ranges, frozen rivers, dense forests, desolate tundra, and miles of windswept Alaskan coast, in what's been referred to as "The Last Great Race." It's the Iditarod – a race that goes from Anchorage to Nome and has been run each year since 1925. Buser directs a team of 12–16 world-class athletes (sled dogs) through extreme conditions with temperatures as cold as –63 degrees Fahrenheit. A tremendous amount of training and planning go into winning a competition as difficult as the Iditarod. Putting together a winning game plan and training are year-round pursuits that start with breeding better and better genetics into a "45-pound dog with 100-pounds of heart," as Buser put it. Like each of us in our own organizations, Buser focuses on team building. His concern isn't the strongest member of the team, it's the relative weakest. By raising the performance of the relative weakest, he raises the performance of the team. There's no magic to being the best. It comes from a great team, strong desire, great planning, and the ability to make key adjustments on the fly.



Martin Buser and Joel Whidden

One example Buser gave drives home lessons that can help everyone in their careers, whether pension administrators, investment staff, or money managers.



Camp NASRA participants also got to see the Iditarod pups.

Buser spoke of learning to win in the 1991 race. Approximately 15 teams started the race that year. During the race, conditions were unforgiving. Late in the race, a bad storm hit. Visibility was zero – a total whiteout. All the racers could see was a wall of white from the snow. All but two teams stopped. Buser and his competitor, Rick Swenson, walked in the blizzard for 27 straight hours without rest. Buser came in second that year, minutes behind Swenson, but the experience gave him the confidence to win. Since 1991, he has won the Iditarod four times (1992, 1994, 1997, and 2002) and in 1998 was voted into the Iditarod Hall of Fame.

We all want to be the best at what we do. Not all of us have Buser's extreme desire, drive, and perseverance, but we can all learn from him. We can all set high standards and hold our teams accountable. We can think about the game in more detail. We can plan better. We can challenge ourselves to think outside the box, and we can strive to perform at our best. At the end of the day, each of us has a choice, "we can wake-up and mush or let our competitors pass us by." How hard we work and how smart we work will have a big influence on the outcome of the game, and a lot of public fund retirees and active members have entrusted their future to us.

By Joel Whidden, Director, Public Fund Marketing at Bridgewater Associates

System Governance

Nancy Williams

Nancy Williams, a principal with Ennis Knupp, received nods of agreement when she opened her presentation by stating, "Public pension trustees and administrators are an endangered species. It's a tough time to be in business with record-high attacks focusing in this group." There are some public retirement boards not doing their job or not operating properly.

Williams went on to provide a thorough presentation on board governance: what it is, why it is important, how to develop good governance practices, and the consequences of poor governance.

What is board governance?

Board governance is the manner in which a board operates, how a board accomplishes its work, and the methods for complying with statutes while meeting the expectations of its members. The "Rules of the Game" are the way a board fulfills its fiduciary responsibilities.

Fiduciary responsibility of the board

The fiduciary responsibility of the board is steadfast compliance with the "exclusive benefit" of all beneficiaries of the fund. The board must use prudent processes at the expert level. The board must have awareness and understanding of the importance of issues with long-term impacts to the fund. Conferences like NASRA are a forum to discuss important topics like hedge funds and DB/DC to trustees and administrators.

Avoiding fiduciary liability

Williams distributed a template to establish a Board Governance Manual. Each board should create and maintain comprehensive written policies and ensure that trustees fully understand these policies. Clearly identify the parties responsible for monitoring compliance, early detection of noncompliance, and implement self-enforcement mechanisms. Williams cited the new trustee orientation requirements by Ohio law as the model.

The bottom line is to create policy, monitor the policy, and take action when needed.

Following good business models

Good governance means good business models. Board chairs are being asked to step up and carry more responsibilities. Don't punish the consultant or staff who communicate potential threats to the board. Use the talent of the board and staff appropriately, and employ outside experts when necessary. Practicing good governance will protect the system's reputation.

Developing good governance practices



Kim Chan and Nancy Williams

Create a governance diagnostic (checklist). Analyze policies by doing a self-assessment or hire an outside party to make an independent assessment. Do the policies make sense? Create an action plan to deal with the results – whatever they may be. Reach a consensus about priorities and assign responsibility for policy development – set time limits. Most importantly, learn from the mistakes of others. Some examples of poor governance: faulty investment policies with Ohio BWC, poor process used for the cost of the DROP plan in Milwaukee, and confusion over the role of the San Diego board.

Consequences of poor governance

Many board members leave out of frustration, not lack of pay. Administrators leave because of dysfunction.

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Anchorage Memories

Past NASRA presidents (from left): Alan Winkle, Glen Pond, David Bergstrom, Gary Findlay, Sparb Collins



Alaska Native Heritage Center



Conference attendees

Portage Glacier Tour



System Governance

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tional boards. When accountability is not clearly defined, there is a useless expenditure of time and energy. Confusion about the roles and responsibilities of the board and staff lead to spending time blaming each other instead of taking ownership and focusing on meaningful issues to the fund. This situation can result in scandals and harsh criticism from the press. Once the press becomes involved, the membership loses confidence and, even worse, the members or retirees may file lawsuits. By far, the largest consequence of poor governance is when board members or staff face criminal indictments, convictions, and personal financial hardship, which may lead to ill health. Once the fund's reputation is damaged it is very hard to recover. A bad reputation can haunt a fund for decades.

Good governance

Prepare for good governance! Board members must think about how they want to operate and what they want to accomplish. What is the best way to handle the work in front of them, and what happens if they don't change anything.

Williams concluded her presentation by summarizing that the trustees are responsible for the way the board manages its work. Spending time to discuss and develop good governance policies and practices will pay off, and trusteeship can be enjoyable and rewarding or it can be a miserable and costly experience. The choice belongs to the trustees!

By Kim Chan, State Street Corporation

Re-visioning Retirement

Ken Dychtwald, Ph.D.

Dr. Ken Dychtwald, president and CEO of Age Wave, began by explaining that we are in the throes of a longevity revolution, one that began in 1900. Life expectancy was fairly flat for most of recorded time, increasing from 38 years in 1800 to 47 years in 1900. During the 20th century, life expectancy increased dramatically, reaching 76.5 years in 2000.

Significant improvements in public health and the development of antibiotics has led to a large jump in the share of the population at older ages. For example, Dychtwald noted that two-thirds of all the people who have ever lived past age 65 are still alive today. This phenomenon is raising issues for which we have no historic precedent. In fact, the concept of “old” and the arbitrary use of age 65 as a “normal” retirement age are coming into question. The future holds even more change as the 76 million baby boomers born between 1946 and 1964 approach retirement age, thereby creating their own age wave as they move through their retirement years.

Dychtwald argued that demography is our destiny. For example, between the years 2000 and 2020, the size of the U.S. population between ages 55 and 64 will grow by 73% and those 65 and over will grow 54%. This is due not only to the baby boom generation, but also to the significant drop in fertility rates in the U.S. and around the world. Estimates are that between now and 2050, working age populations in almost all major developed countries will shrink. The U.S. and Canada are the only exceptions, but even in these countries a labor shortage is expected to develop.

As a result, Dychtwald argues we need to revisit work and retirement. Historically, humans have lived a linear life moving from education to work to leisure. In the future, based on many surveys he has conducted, Dychtwald expects the linear life to change to a multi-cycle life as people want to be productive and valued during their ever-increasing lifetimes. In fact, working in retirement to keep mentally active was cited as twice as important by retirees as working in retirement to earn money.

During his research, Dychtwald identified four groups to which retirees can be assigned:

- Ageless Explorers (27% of all retirees) have the highest net worth and never feel elderly

- Comfortable Contents (19%) want to relax and play but expect to feel old soon
- Live for Todays (22%) are financially unprepared and get no fun out of retirement
- Sick and Tireds (32%) have a low net worth and are inactive and worried.



Tom Cavanaugh and Ken Dychtwald

His survey results have important implications for retirement systems. Among individuals throughout the world, there is universal opposition to mandatory retirement but great support for choice in retirement. Those in the developed world look at retirement as an opportunity for something new and want to be able to cycle between work and leisure. This would suggest that phased retirement and return-to-work issues will continue to grow in the public sector. The current stumbling block is the legal impediment to changing the existing structure of retirement systems to accommodate this likely growing demand (and need if the labor shortage materializes) for flexibility in cycling between work and leisure.

Dychtwald concluded with four questions for further thought:

- Have you envisioned your power years (between ages 50 and 70)?
- Does your funding match your dream?
- What might sidetrack your plan?
- What type of legacy do you want to leave?

*By Thomas Cavanaugh,
Cavanaugh McDonald Consulting*

Investing in the New Age Wave

Charles Baird

The Alaskan summer morning was sunny and warm as the conference's fourth general session got underway. The "age wave," as described by Dr. Ken Dychtwald in the first hour and a half, proved to be the perfect segue into Charles Baird's portion of the program, *Investing in the New Age Wave: The Power of Focused Funds*. After Dr. Dychtwald pointed out the financial, healthcare, and workforce implications of the "age wave," Baird, founder of North Castle Partners, showed us why we should be paying close attention to the fact that baby boomers are now approaching their sixties and will continue to fuel the markets that serve them. Investors, take heed.

In an effort to get higher returns, retirement funds have been seeking alpha with many investment products, especially private equity funds. What's happening today in the private equity market? Baird reported that competitive intensity among managers has been accelerating, and private equity funds are getting bigger and bigger. With funds so big, where will future returns come from? Who will be the likely winners? Baird said that private equity funds, which specialize in active value addition, will generate higher returns and that "focused" funds are gaining momentum. Which brings us to his focus – healthy living and aging.

Baird has been no stranger to private equity investing and he has been studying the healthy living and aging market for the last decade. He concluded that by concentrating on this one market investors could significantly improve operating performance and increase investment returns.

In his humorous and sometimes self-deprecating pictorial presentation, Baird showed conferees what has been happening to baby boomers, the single largest group of consumers in the history of our country. They're getting old and they're fighting it every step of the way. They're fighting hair-loss with Rogaine; they're gaining weight but buying memberships to health clubs; they're buying glasses and hearing aids; they're taking pain-killers and vitamins. The list goes on and yet the wheels still seem to be falling off. The

impacts of aging are unavoidable. And yet, it's not all bad news. The older population is living a lot longer, and they're living better. They're more active. They travel more, play more golf, and have more money to spend. And spend it they do!



Charles "Chip" Baird and James "Doc" Savage

In the private equity context, demographics and the "age wave" are both indications of a great place to put your money, says Baird. That place consists of companies that focus on and serve that special market. He continued by pointing out that the signs of "healthy living and aging" are everywhere. "Healthy foods are growing at a healthy pace and we're gobbling up the greens," he said. Sales of enriched drinks and nutrition bars are soaring. Health clubs and spas, vitamin shops, and fitness equipment are just some examples of spending in an effort to put off the impacts of aging.

Statistics suggest that baby boomers will spend 25 years in retirement and the "50 plus" demographic controls 77% of the country's wealth. With that in mind, Baird said that investors should "Get out in front and dig a big hole."

Is "healthy living and aging" a 21st century alchemy for investors? According to Chip Baird, "Only if you do it right."

By: James Savage, Lord Abbett

Washington Watch

Jeannine Markoe Raymond, Cathie Eitelberg & Ron Gebhardtsbauer

Washington Update

Retirement issues are moving in many different reforms, primarily in the areas of Social Security, private pensions, and the federal tax code. Many of these reforms are being addressed as a response to the crisis in private pension systems. As Washington considers pension reform, there are public pension concerns that need to be considered. Among these issues is the assumption that defined benefit plans are assumed to be in the same peril as the private pensions of the airline, auto, and steel industries. There is also the assumption by many in Congress that public pension system financing works in the same way as the "pay-as-you-go" Social Security system. A third issue is that of significant legacy costs (retirement and health), where there is an overall feeling by some economists that these costs cripple our economy and the free market. It is imperative that state public pension plans cultivate a relationship with their congressional delegation (federal and state level), educating them on the key fact of the system and current issues, as well as offering to be a resource to the delegation when dealing with pension issues.

Retirement legislation being considered this fall include:

- (i) In the House, a broad Ways and Means Committee retirement bill to include pension and Social Security reform. The contents of this package are unknown, but we can expect pension proposals on funding PBGC, auto enrollment (automatic enrollment unless individual opts out), and individual Social Security Account - GROW Accounts (Growing Real Ownership for Workers Act of 2005). Social Security solvency is not expected to be addressed in this session.
- (ii) The Senate will consider the National Employee Savings and Trust Fund Equity Guarantee (NESTEG) Act of 2005, passed by the Finance committee, which included helpful technical clarifications for public sector pensions but did not address Social Security individual ac-

counts or solvency. There could also be a Health Education Labor and Pensions Committee pension bill in the Senate.

- (iii) The Federal Tax Reform Panel is expected to release its report at the end of September.
- (iv) We can expect a House Democratic "AmeriSave" package which is a likely alternative to Social Security Individual Accounts and Republican Retirement Legislation.
- (v) The Joint Committee on Taxation has issued a staff report, *Options to Improve Tax Compliance and Reform Tax Expenditures* (JCS-02-05), which includes options affecting both state and local government plans. This report is not currently in any legislation, but could be eyed as a "pay-for" for future legislation.

Again, public pension advocates are encouraged to take this message to Congress: **DO NO HARM!** As a whole, public pension funds, a large component of national retirement savings, are in good financial condition with nearly 90% funded. The annual \$130 billion in benefits distributed by public pension funds exceeds the gross product of 23 states and the District of Columbia. Taxpayers do not shoulder the bulk of public pension benefit funding. In fact, 62% of benefit funding is obtained via investment income.

(continued on page 14)



Cathie Eitelberg, Teresa Webb, Jeannine Markoe Raymond, and Ron Gebhardtsbauer

Washington

(continued from page 13)

Other issues discussed in the Washington update include 415 Proposed Regulations (treatment of DB Plan COLAS, multiple annuity starting dates, benefit limit after age 65), and investment in sanctioned nations. Legislative representatives from NASRA, NCTR, NCPERS, NCSL, NASACT, and CII continue to seek federal guidance on this issue. A resolution was approved by NASRA membership on this issue stating, "NASRA supports efforts by the U.S. Departments of State, Treasury, and Commerce, in coordination with each other and the U.S. Securities and Exchange Commission, to identify domestic and international companies violating U.S. national security and humanitarian policies, and provide proper guidance to U.S. investors so that such companies may be denied access to the U.S. capital marketplace."

Social Security

Social Security reform may not be the hottest current news topic, but it continues to be a topic of conversation in Washington. There is general agreement that historically Social Security has been a successful program. For example, statistics show that in 1959, approximately 35% of the population over 65 was in poverty. In 2004, that rate had been reduced to 10%. Turning our attention to the current financial status of Social Security, actuaries forecast, under their best estimate assumptions, that the program will be exhausted in the year 2041. This means that the trust fund will be \$0, but there will still be FICA taxes coming in to fund approximately 74% of benefits to be payable. Almost everyone agrees that some type of Social Security reform is needed. Social Security has proven to be an extremely flexible and resilient program that adapts to change. Social Security is projected to have a deficit, but that deficit can be eliminated if the right steps are taken. Of course, it would be in the best interest of the program if the right steps were taken sooner rather than later.

There are essentially two ways to fix Social Security. One is to move more money into the system and the other is to take less money out of the system. A combination of these two will eventually get Social Security back on its feet.

Reforms to move more money into the system include raising the retirement age, expanding the wage base, and raising payroll taxes. In benefit reduction, the following actions should be considered: a one-time across-the-board benefit cut, a price indexation of initial benefit, progressive price indexation, and reduction of cost-of-living increases. An additional reform consideration for Social Security is mandated universal coverage or mandatory participation for new hires. It should be noted that the projected cost for the first five years for mandatory coverage for new hires is \$44 billion. Also, every state has localities or a retirement system that would be impacted by this universal coverage.

Finally, any change to the retirement aspect of Social Security system should be sensitive to how that change will affect the social policy of Social Security. For example, currently 1.9 million children and 7.2 million disabled individuals receive an average Social Security benefit of \$585 and \$834, respectively. Any reform in the current Social Security program can make a huge difference in the social "security" of an individual's life.

By Teresa Webb, Pomerantz Haudek



NASRA welcomes new system directors: Robert Schultz, Virginia Retirement System; Melanie Millhorn, Alaska Public Employees' Retirement System; Gene Glass, Texas County & District Retirement System; Ann Fuelberg, Employees' Retirement System of Texas; Michael Nehf, Employees' Retirement System of Georgia; Sandra Metheson, Washington State Department of Retirement Systems

Alaskan Maritime Protection

Rear Admiral Jim Olson

The pristine landscape and vast expanse of Alaska offers a raw view of the natural world rare in much of United States. Alaska's natural beauty is thrilling to observe, but it can be perilous for those who traverse the surrounding seas. Rear Admiral Jim Olson of the United States Coast Guard leads the effort to keep vessels from harm in Alaska's wild waters. Olson shared his experiences with NASRA annual conference attendees in Anchorage.

Stationed in Juneau, Olson directs the 17th Coast Guard District operations that cover 3.8 million square miles of ocean and 36,000 miles of coastline. Coast Guard Long Range Navigation stations (LORAN), marine safety offices, and air stations throughout Alaska are staging areas for approximately 20 Coast Guard cutters. Those resources saved 184 lives in 2004 and, as of August, had saved 137 lives during 2005. The Coast Guard is part of the U.S. Department of Homeland Security, which was created in 2002.

Past missions in the 17th District include one of the country's most infamous environmental disasters. The *Exxon Valdez* oil spill, which took place in 1989, inflicted major environmental damage to approximately 460 miles of the Alaskan coast. Lessons learned from this disaster have led to periodic oil response exercises for the Guard and the pre-positioning of oil response equipment throughout Alaska.

Commercial barges carrying crude oil and other commodities keep the Guard busy, as do the many cruise ships that travel the seas around Alaska. Recently, Olson's forces helped to return the *Semester at Sea* cruise ship to port after an unusually fierce wave caused damage to the ship in the Pacific Ocean.

While search and rescue missions are a top priority, policing ocean fisheries is another critical duty for the 17th District. The Coast Guard maintains a full-time

watch on the Maritime Boundary Line, located just outside the Bering Sea, which separates United States fishing waters from those in Russia. Foreign fishing vessels frequently attempt to breach the international fishing boundary in violation of industry regulations.



Kirsten Weeks and Rear Admiral Jim Olson

Fisheries enforcement is essential to maintaining Alaska's economy. A one billion dollar industry, Alaska's fishing businesses produce 50% of the fish products sold in the United States and 20% of the ocean protein sold in the world.

The Coast Guard became part of the U.S. Department of Homeland Security in 2002, when it transferred from its previous home in the U.S. Department of Transportation. The new Department is an excellent fit for the Coast Guard's duties, said Olson. The change has resulted in expanded budgets, along with vastly increased security responsibilities.

Olson, a native of Minnesota, addressed the NASRA conference on its last full day, August 9.

By Kirsten Weeks, North Carolina Retirement System

The Public Fund Survey

and Other Observations of the Public Pension Community

Keith Brainard

Keith Brainard, NASRA Research Director, began his presentation by discussing recent changes in the public pension landscape. He reported Alaska is closing its defined benefit (DB) plans for state employees and teachers, requiring employees hired after June 2006, to join a new defined contribution (DC) plan. He also reported Colorado will offer state employees a choice between DB and DC plans starting January 2006. He noted that governmental employees in both states are not covered by Social Security and expressed concern that the changes could make it more difficult for them to secure an adequate retirement.

On a brighter note, Brainard reported that California retained its DB plans and that West Virginia switched back to a DB plan for teachers hired after June 30, 2005. Brainard observed that, even with the pressure



Keith Brainard and Paul Zorn

on governments to switch to DC plans, DB plans have demonstrated “remarkable resilience.” Approximately 90% of state and local government employees still have a DB plan as their primary retirement benefit.

He noted that DB plans go “beyond altruism” and, in fact, are good public policy. State and local governments (and taxpayers) have a compelling interest in hiring and retaining qualified educators, police officers, firefighters, and many other skilled personnel. DB plans contribute to the reliable functioning of government, the retention of qualified staff, and the orderly turnover of employees.

Brainard then summarized the results of the 2004 Public Fund Survey. While funding levels slipped from 91% in FY 2003 to 88% in FY 2004, 85% of the surveyed plans still had funding levels above 80%. Moreover, Brainard’s analysis of the most recent actuarial valuations (those done since July 1, 2004), show funding levels improving substantially.

Investment returns in 2004 were also good. As reported by Wilshire Associates, the median public fund investment returns for (annualized) periods ending December 31, 2004, were 11.6% for 2004, 7.3% for the past three years, and 10.2% for the past ten years.

Brainard also found that asset allocations have shifted away from fixed-income securities and toward equities over the past few years. Between FY 2001 and FY 2004, the percentage of plan assets invested in equity securities increased from 56.5% to 60.4% while the percentage in domestic fixed-income securities fell from 32.6% to 27.4%.

While employer contribution rates increased somewhat in FY 2004, the increase was relatively small on average. For plans whose members are covered by Social Security, Brainard reported that median employer contribution rates increased from 6.5% of covered payroll in FY 2003 to 7.1% in FY 2004, and that member contributions remained unchanged at 5.0%. For plans whose members are not covered under Social Security, the median employer and member contribution rates were 10.3% and 8.0%, respectively, and remained unchanged between FY 2003 and FY 2004.

Overall, Brainard’s data show that the vast majority of state and local DB plans are in good financial condition and that 2004 helped to further secure their financial health.

By Paul Zorn, Director of Governmental Research, Gabriel, Roeder, Smith & Company

NASRA Welcomes New System Directors

Mississippi

Pat Robertson of Madison has been appointed executive director of the Public Employees' Retirement System of Mississippi (PERS) effective November 1, 2005. She was the unanimous choice of the PERS Board of Trustees following a nationwide search to fill the vacancy created by the June 30, 2005, retirement of Frank Ready.

"Being selected as executive director of the Public Employees' Retirement System of Mississippi is the pinnacle of my career," Robertson said. "After spending more than 25 years here, it is going to be an honor to serve the membership and lead one of the nation's best retirement plans."

Robertson has been a state employee for 28 years. She received a B.S. degree in Accounting from Mississippi State University in 1975 and joined PERS as an investment accountant in 1980. She was promoted to director of finance in 1992 and to her current position of deputy director for administrative services in 1995. As deputy director, she has been responsible for the retirement systems' financial reporting, budgeting and accounting functions, information technology, human resources, and facilities management. She managed the two-year project to renovate and expand the PERS building on Capitol Square.

Robertson received the Certificate in Supervisory Management and the Certified Public Manager Certificate from the State Personnel Board. She is a Certified Public Accountant, a Certified Governmental Financial Manager, a Certified Retirement Counselor, and a Certified Retirement Administrator. She is a 2002 graduate of the State Executive Development Institute, John C. Stennis Institute of Government at Mississippi State University and currently serves on the executive board of the Government Finance Officers' Association of the United States and Canada (GFOA).

Louisiana

The Teachers' Retirement System of Louisiana (TRSL) Board of Trustees appointed Maureen H. Westgard director of the retirement system, effective August 29, 2005, according to Sheryl R. Abshire, board chair.

"We welcome the outstanding leadership experience Maureen is bringing to TRSL. Her breadth of knowledge of the retirement industry and issues will help us move forward to meet the challenges of the future and the growing needs of the members and retirees we serve," said Abshire.

Westgard most recently served as deputy director of the State of Washington Department of Retirement Systems, where she managed the customer service, administrative, financial, technology, and communication divisions. She has over 30 years of work experience in the fields of retirement system administration, management consulting, and banking. Relocating to Baton Rouge from Olympia, Washington, Westgard earned her bachelor's degree in management from The Evergreen State College. She also completed the executive management program of The Cascade Center of Public Affairs and Research at the University of Washington.

As TRSL director, Westgard will oversee the administration of Louisiana's largest public retirement system, which manages approximately \$12.4 billion in assets (as of June 30, 2005) and provides services to more than 153,000 active and retired members. The system's sole purpose is to safeguard and manage the money it holds in trust to provide retirement income for its members.

Westgard succeeds Bonita B. Brown, CPA, who is retiring after more than 32 years of state service.

Maine

The Board of Trustees of the Maine State Retirement System is happy to announce that it has voted to appoint Gail Drake Wright, current acting executive director, as the executive director of the system at its regular meeting today. The trustees undertook a nationwide search and received 70 qualified applications for the position. Catherine Sullivan, Chair of the Search Committee, reported: "Gail was clearly the best candidate for this position, and the Search Committee unanimously recommended that she be hired for the position." Wright has been chief deputy executive director for nine years and has served as acting executive director since October 2004.

NASRA Annual Business Meeting

NASRA members attended the annual business meeting on Wednesday, August 10, to discuss important business items.

The NASRA Constitution was amended to change the criteria for membership. Under the old provisions, administrators of statewide retirement systems that included general public employees, K-12 public school teachers, and/or public school employees were eligible to join NASRA. If general state employees were not covered by the system, the fund was required to have at least \$2 billion in assets to join. The amendment changed the criteria to allow the administrator of any public employee retirement system with a statewide membership constituency to become a member. If employees of the state government are not covered, the fund must have at least \$3 billion in assets. For future years, the asset requirement increases at the rate of 5% per year.

Two resolutions were considered and approved by the members, "Ethics Standards and Disclosures Required of Service Providers" and "Ensuring Public Retirement System Investment Positions Do Not Conflict with U.S. Foreign Policy and Humanitarian Goals." These resolutions can be read in their entirety on the NASRA website at www.nasra.org/resolutions.htm.

Members were informed that an educational DVD covering fiduciary duties is in the final stages of production. Each member will receive a copy as soon as it's completed. Other educational DVDs are under consideration.

A report on membership and conference attendance was presented by the executive director. NASRA has 77 members and 153 associate members for 2005. A total of 496 people attended the conference including members, associates, and guests. Attending the Anchorage conference were 154 members, trustees, and staff representing 54 member systems, and 154 associate members representing 95 associate firms.

The executive director reported that the annual audit for the year ending September 30, 2004, was completed timely and that there were no findings to report. NASRA expects to end the current fiscal year within budget. The expected equity balance for the year ending September 30, 2005, is expected to be

approximately \$531,000.

The slate of officers for 2005/2006 recommended by the Nominations Committee were elected by unanimous vote of the membership as follows:

President:	Laurie Fiori Hacking
President Elect:	M. Steve Yoakum
First Vice President:	William P. Hanes
Second Vice President:	Eric Stanchfield
Immediate Past President:	Ed Hennessee



Ed Hennessee, outgoing NASRA president, hands over the gavel to new president, Laurie Hacking.

Regional vice presidents are elected for a two-year term. Elections were held on Monday, August 8, for Regions One, Two, and Three. The regional vice presidents are:

Region One:	James R. Winfree
Region Two:	Michael Williamson
Region Three:	J. Sparb Collins
Region Four:	Terry Slattery
Region Five:	Robert Newman

Ed Hennessee, outgoing president, thanked NASRA members for the honor of serving as president. He advised the members that two major issues – the defined benefit/defined contribution debate and the interest in investments in terrorist supported countries – will continue to dominate much time and effort. His final official act was to present incoming President Laurie Hacking with the president's gavel.

By Glenda Chambers, NASRA Executive Director

Officers

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

Regional Vice Presidents

James Winfree (OH) - Region I
Michael Williamson (NC) - Region II
Sparb Collins (ND) - Region III
Terry Slattery (NM) - Region IV
Robert Newman (UT) - Region V

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(KBC Asset Management International Limited) - 2006*

Sandy Dzinski, Vice Chair
(GE Asset Management) - 2007*

Cathie Eitelberg
(The Segal Company) - 2006*

Jack Gastler
(Acadian Asset Management) - 2007*

Norm Jones
(Gabriel, Roeder, Smith & Company) - 2008*

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

Carol Wardlaw
(Dimensional Fund Advisors) - 2005*

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

Nancy Williams
(Ennis Knupp) - 2008*

* Year Term Expires

Save the Dates

Winter Administrators' Meeting
February 5-7, 2006
Washington, D.C.

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

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

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*NASRA's mission is to engage in activities that position
its members to better pursue excellence
in the management of public employee retirement systems.*



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