PAPERS
PENNSYLVANIA ASSOCIATION OF PUBLIC EMPLOYEES RETIREMENT SYSTEMS

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The mission of the Pennsylvania Association of Public Employee Retirement Systems (PAPERS) shall be to encourage and facilitate the education of its membership in all matters related to their duties as fiduciaries overseeing the assets of the pension funds with which they have been entrusted. It will be PAPERS' primary purpose to conduct an annual educational forum that provides the basis for improved financial and operational performance of the public employee retirement systems in the State. PAPERS will function as a central resource for educational purposes and act as a networking agent for all public plan staff and board members.

Spring 2008 (Vol. 3, No.2)

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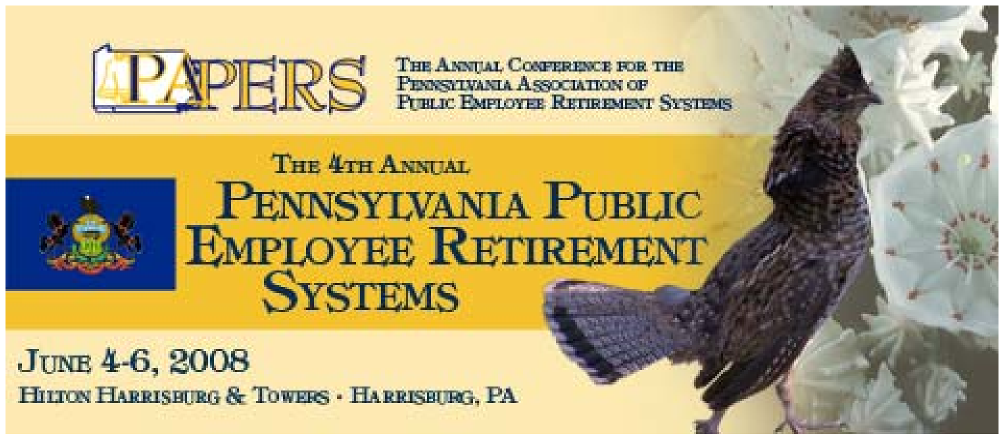
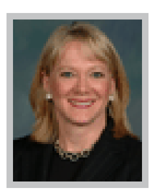


The Fourth Annual PAPERS Forum is the primary annual forum and networking event for members of the Pennsylvania Association for Public Employee Retirement Systems (PAPERS). This not-for-profit association was created for the purpose of providing ongoing education to public retirement systems within the state of Pennsylvania. The PAPERS Forum also serves as the annual meeting for the Association's membership and is designed to provide public pension plan administrators, staff and board members with a comprehensive program covering the essentials of pension fund operations and investment management. There will be input and representation from each of the retirement system segments in Pennsylvania, including municipal, township, borough, county, and state retirement systems along side investment consultants, asset managers, banks and academics that will provide exciting dialogue.



Featured Opening Keynote Speaker

Robin Wiessmann
State Treasurer, Commonwealth of PA

Featured Luncheon Speaker

Girard Miller
Strategic Consultant and Commentator
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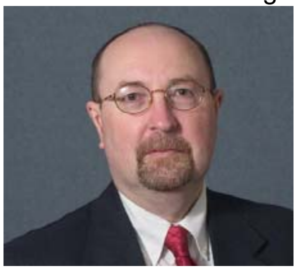
Your Fiduciary Duties: The Five W's *(Who, What, Where, When and What Happens If You Violate Them)*

By Jeffrey Clay, PAPERS Board Member and Executive Director of the Public School Employees' Retirement System (PSERS)

This is the third in a series of articles that are examining the fiduciary duties associated with the operation of public pension plans in the Commonwealth of Pennsylvania. In the last article we took a closer look at a pension trustee's duties of loyalty and prudence; the two cardinal principles that govern a trustee's actions. To briefly recap, the duty of loyalty requires a trustee to operate the pension plan for the exclusive benefit of its members. The duty of prudence requires the trustee to manage the pension plan in an economically rational and prudent manner. Another way to look at the duties is that the duty of loyalty governs the intentions of the trustee, while the duty of prudence governs his competence.



In today's article we will further explore each of these duties by seeing how they are applied in a real issue that faces many public pension funds, not only in Pennsylvania, but across the country; the issue of divestment for social or political reasons.

Pension Fund Divestment Movement:

Currently the chief divestment movements making the circuit of public pension plans are those who seek divestment from companies doing business in:

- **Sudan**, based on the on-going genocide in Darfur (see http://www.sudandivestment.org/home.asp);
- **Iran**, based on its efforts to seek nuclear weapons and its general threat to Middle East security (see both <http://www.aipac.org/Publications/AIPACAnalysesMemos/AIPAC_Memo_-_Divestment_-_An_Important_Tool_in_Preventing_Nuclear_Iran.pdf>, and <http://www.theisraelproject.org/site/c.hsJPK0PIJpH/b.2556231/k.2189/TerrorFree_Investing_Resources.htm>); and
- **Terrorist sponsoring countries**, including the preceding two countries, plus **Syria, North Korea and Cuba**, (see http://www.centerforsecuritypolicy.org/home.aspx?sid=56&categoryid=56&subcategoryid=57&newsid=11567)

Of these three, the most successful movement to date has been the Sudan divestment movement headed by the Sudan Divestment Taskforce (SDTF).

If and when one or all three of these divestment movements come knocking, how should a pension plan trustee respond to these very sympathetic causes? As with most other issues, by a careful examination of one's fiduciary duties, starting first with the duty of loyalty.

Divestment and the Duty of Loyalty:

Of the two fiduciary duties under consideration, the answer to the question of whether one can divest and still comply with one's duty of loyalty is the easiest to discern. It starts and ends with the question: Is the divestment for the exclusive benefit of the beneficiaries of the pension fund? The answer for most funds, both historically when facing social investment initiatives, and to date with modern divestment movements, has been an unqualified "no". Why? Because the well meaning divestment movements, by their very nature, are not motivated by the pension fund's beneficiaries' exclusive benefit. Instead, the various divestment movements are seeking to use/spend pension fund assets to accomplish their particular political and/or moral goals. These goals will detract from a pension fund's main goal of having sufficient assets to fund the promised pension benefits to its beneficiaries, by incurring, among other costs, unnecessary transaction costs to both sell the securities of the targeted companies and buy replacements for them, probable lost opportunity costs by failing to invest in profitable companies, increased risk by artificially limiting one's investment universe, and increased administrative and potential legal costs for complying with the divestment mandate.

These real costs, plus the prospect of becoming the moral arbitrators on a host of potential new divestment and/or other social investment issues, have resulted in most of the current public pension divestment mandates occurring through legislative fiat instead of unilateral plan action. In fact, currently the Pennsylvania General Assembly is considering divestment mandates responsive to all three of the current divestment movements. See House Bills 1140 (Sudan divestment directive specific to PSERS and SERS), 1085-1087 (terrorist sponsoring states divestment directive specific to SERS, State Treasurer and PSERS) and Senate Bill 1279 (Iran energy related divestment directive specific to SERS, State Treasurer and PSERS). Although these legislative directives are clearly within the authority of the General Assembly as the "supra-fiduciaries of the Commonwealth public pension plans/funds" and arbitrators of public policy, (subject to any federal constitutional limitations), it is incumbent for the plans facing such a legislative divestment mandate to ensure the General Assembly is aware of all the issues and potential costs involved with this volatile issue.

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Your Fiduciary Duties

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For an example of just such an effort see the Public Employee Retirement Commission's *Special Report: Divestment and Pennsylvania's Public Employee Retirement Systems* at: <http://www.perc.state.pa.us/perc/lib/perc/2007_divestment_complete_report.pdf>.

Divestment and the Duty of Prudence:

In contrast to the duty of loyalty, a pension trustee does have the authority to sell/divest from a particular company or class of investments, **provided** it is economically rational to do so. In fact, not to divest may be a violation of the trustee's duty of prudence. Like all other investment decisions made by a trustee, however, the result of the investment decision, i.e. a gain or loss, does not dictate whether the action was fiduciarily prudent. That determination depends on whether the decision was prudent, i.e. based on the facts (due diligence) at the time the decision was made. That does not mean, however, that the moral, political, or social issues that underlie most divestment requests cannot be considered. They can, but only as they impact the **economic analysis** of the proposed investment action. For example, a pension fund could potentially divest from a company that has made a substantial infrastructure investment in a country wracked by genocidal civil war, if the pension fund's trustees have evidence to believe the company's investment is at risk and the loss of the investment would seriously harm the value of the company's stock. To reach this conclusion, however, the trustees must believe that the market has not taken into account this risk exposure in the price of the security; a position that most institutional money managers reject. It also logically means that there is a price at which the security in question should be acquired, regardless of the moral concerns that surround it.

An alternative path to divestment under the duty of prudence exists even when a targeted company is not materially at risk by its activities in a specific country, e.g. a multi-billion dollar company that receives no revenue from the country in question and only has a limited investment of under $15 million. In this case, if an alternative investment is available that is better or equal to the investment burdened by the particular moral concerns, a pension fund can divest even if that decision is motivated by moral and/or social concerns. While this appears to open the door to divestment initiatives, in practice it only really works if the divestment initiative involves only a very small number of companies and the fund considering divestment is small. Why? The greater number of companies involved makes it harder to find acceptable alternative investments. Further, in the case of large highly diversified public pension funds such as PSERS and SERS, they usually already have an investment in the acceptable alternative security. To require them to enlarge their investment in the alternative security will expose the funds to increased risk by reducing their diversification. This problem is again exacerbated if the divestment mandated targets a large number of companies, e.g. the 400 plus that allegedly have some business activities in the five states that have been labeled as sponsors of terrorism.

As a consequence and notwithstanding these two paths, most public pension plans have not unilaterally divested under the auspices of their duty of prudence, being constrained by that very duty to stay the course. Instead, as already noted, it has been done by legislative action.

Conclusion:

Although there are many more issues involved with divestment initiatives than just those that involve a trustee's fiduciary duty of loyalty and prudence, the divestment case study does illustrate both the meaning and complexity of these two key parameters on a trustee's conduct. It also shows that at times a trustee may be required to take an unpopular position; one that might not be politically expedient. In the next article in this continuing series, we will explore the both potential consequences if one strays from his or her fiduciary duties and the wide array of temptations to do so.

Free Service Available to PAPERS Members

PAPERS Participating Members (retirement systems and fund administrators) can get one-year free access to *Public Pensions Online*. This is yet another important reason to become a PAPERS member. Go to www.publicpensionsonline.com/member/papers.html and fill out the requested information (name, email, retirement board, etc.). Once the application is submitted, an account will be activated and you will receive an email with your personal login information.

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From the PAPERS Executive Director

There is an issue representing yet another attack on the defined benefit pension structure that should be watched carefully by public pension plan administrators and trustees. The issue revolves around the reporting of the market value of plan liabilities. Plans currently report actuarially projected values that represent the present value of future benefits based on the returns of assets currently invested. The method being proposed by the proponents of financial economics would use a risk-free bond rate of return that would grossly overstate the liabilities of public pension plans.

The following article on this issue was written by Leigh Snell, Government Relations Representative for the National Council on Teacher Retirement (NCTR) and is reprinted here with permission. This is an important issue that PAPERS will continue to monitor and definitely one of which you should be aware.

Jim Perry,
PAPERS Executive Director

Actuaries Hold NYC Roundtable on Public Pension Plan Disclosure of Market Value of Liabilities

The American Academy of Actuaries (the Academy) and the Society of Actuaries (SOA) held a roundtable meeting in New York City on February 6, 2008; the topic was "Public Pension Plan Disclosure: Who Needs to Know What – and Why." While several NCTR members were present, the event was "by invitation only," with approximately50 actual participants and another 60 or so audience members. The nominal topic was disclosure in general, but the focus was actually on whether or not public plans should be required to report the market value of their liabilities (MVL), sometimes referred to as a plan's termination liability. Proponents of this view, an outgrowth of "Financial Economics" theory, argue that such disclosure is necessary to prevent the transfer of plan costs to future generations. However, NCTR believes that the reporting of liabilities in this manner is inappropriate for governmental plans that will not go out of business, and would only serve to undercut the traditional defined benefit structure by drastically and unrealistically increasing current and projected plan costs. GASB is expected to formally undertake a reassessment of current governmental accounting standards in April, and proponents of MVL for public plans would undoubtedly like to have the Academy support their position and urge GASB to adopt this additional disclosure. However, a recent PBGC decision to abandon its current investment strategy of using bonds to match assets with liabilities because it was financially unsustainable and failed to take advantage of the agency's long-term investment horizon is a positive sign for MVL opponents.

According to the invitations, the purpose of the Academy/SOA roundtable was to consider (1) how financial disclosures drive the funding, investment, and governance of current pension plans; (2) whether current financial disclosures create any biases that may influence how public plans are funded, invested, or governed; (3) if current financial disclosures serve the needs of all stakeholders in the system, including employees, taxpayers, lenders; and (4) how might changes in financial disclosure change the funding, investment, or governance of public plans.

Of the "invitation-only" participants actually at the table, approximately half had some link to the public sector, and included NCTR members Laurie Hacking (Minnesota Teachers); Ronnie Jung (Texas Teachers); Gary Findlay (Missouri State Employees); Dana Bilyeu (Nevada PERS); and Mel Aaronson (UFT). Pat Robertson (Mississippi PERS) was also in the audience. Other roundtable participants representing the public sector included, among others, Leigh Snell (NCTR); Keith Brainard (NASRA); William Leighty (formerly with the Virginia Retirement System); Robert North (NYC Chief Actuary); Donald Steuer (San Diego County CFO); Michael Musuraca (NYC Employees Retirement); Richard Stensrud (Sacramento County ERS); Timothy Barrett (San Bernadino Employees Retirement Association); Beth Almeida (NIRS); and Nancy Kopp (Maryland State Treasurer).

"Financial economics" refers to a financial theory that essentially argues that traditional actuarial science, as it is applied to defined benefit (DB) plans, both public and private, is outdated and no longer appropriate. Proponents of financial economics believe that actuarial training and practices therefore need to be "modernized" to reflect the new tools and techniques of this theory, the main change being to require disclosure of the "market value of liabilities." That is, the calculation of liabilities would be based on a risk-free investment return assumption and not on that of a diversified portfolio – in short, instead of the traditional actuarial approach of using the expected return of the assets being invested as the discount rate for the liabilities, bonds would be used as matching assets for plan liabilities and their interest rate term structure as the liability discount rate.

In most cases, the results would be to significantly increase a plan's unfunded liability. And we all know what the political consequences of that can be.

Private sector DB plans are already required to calculate and disclose the MVL, but this makes some sense since this valuation would be important to know should the corporate sponsor go bankrupt or be sold. However, governmental plans are permanent, independent entities, and actuarial methodologies and accounting standards that reflect realistic outcomes -- based on a range of variables using past experience and reasonable expectations for future returns for capital markets and typical public fund portfolios -- are therefore appropriate for them to use.

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Liabilities' Market Value

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Clearly, the results of this struggle by proponents of financial economics to change the approach used by public pension actuaries and to require the disclosure of MVL could be of the utmost significance to the future of governmental DB plans. Therefore, there was much concern that this New York roundtable was being organized more as a show to legitimize a foregone conclusion on the part of the Academy and the SOA, rather than a legitimate exercise in information-gathering. This was particularly true given the short notice, the limited time allotted for discussion at the event itself, and the restricted nature of attendance.

However, on balance, the event went much better than expected in the opinion of many public sector attendees. First, Laurie Hacking did a superb job with her "table-setter" comments at the outset on behalf of public plans. She certainly put MVL proponents on notice that this attempt to apply their approach to public plans was not going to be without controversy; that many plans were very unhappy with the Academy's process; and that potential conflicts of interest among proponents were not going unnoticed. In fact, Laurie disclosed her employer and all her professional affiliations, and invited all of the other speakers/participants to do the same.

While there was a lot of discussion about the need for better-informed boards and more responsible employer/sponsor behavior, what was missing was the link between this behavior and the disclosure of MVL. Enhanced educational efforts undertaken by actuaries, accountants and other consultants to improve the understanding by boards, plan sponsors and other stakeholders of *existing* disclosures may be very desirable, but proponents failed to make a good case that MVL was the particular item of necessary *additional* information that would somehow improve the overall situation, whether it be in the areas of funding, investments or governance. For example, would the disclosure of MVL make it more likely that some plan sponsors would begin to fully fund their annual required contributions when they haven't in the past? In fact, such additional disclosures would probably only serve to create further confusion and misunderstandings in this regard.

By the end of the day, the Academy's Pension Practice Council was attempting to reassure people that any further steps would be part of a more deliberate process, and that opportunities for additional input would be considered. From this attendee's perspective, the public sector representatives certainly held their own, and proponents of MVL definitely know now that it is going to be very controversial issue. However, whether this will serve to slow down the supporters of MVL in the Academy remains to be seen. NCTR will be sending a letter to the Academy and the SOA concerning this issue in the near future, urging that meaningful public accountability, and not a desire for uniformity with either private sector accounting and financial reporting rules or those of the international community, should be the standard by which all governmental financial reporting objectives are measured.

Where do things go from here? Can opponents delay if not defer any formal actions on the part of the Academy in support of MVL disclosure for public plans? The real firewall is GASB, which is expected at their upcoming April meeting to formally add a new project to their current agenda "to address issues related to pension accounting and financial reporting standards and to consider whether standards should be amended in order to improve their effectiveness." This is where the public sector could really run into trouble if this project results in a requirement to disclose MVL, either in lieu of or in addition to current disclosures.

However, it will in all likelihood be a long process before there is any GASB Exposure Draft on this topic. GASB might issue an "Invitation to Comment," followed by more research by their staff and the Board itself. There could then be a "Preliminary Views" document released. GASB has a history of taking its time digesting issues and typically considers all viewpoints prior to taking next steps. Thus, according to some observers, an actual draft proposal addressing MVL disclosure could take several years to produce.

So there may well be time for the public sector to craft a well-thought out strategy to deal with this issue. Some suggest that the governmental plan community might consider approaching GASB with our own proposal to modify current reporting and disclosure standards that address assessments of benefit security, intergenerational equity, transparency, and provide perhaps even some degree of plan-to-plan comparisons.

Of course, proponents of MVL will certainly mount an intense campaign focused on GASB as well. And in the middle of all this, the Congress and the SEC – perhaps under new management – may want to make major changes in GASB's role and independence. (See December 2007 NCTR Federal e-News)

However, there are a few bright spots on the horizon. For example, recently the Pension Benefit Guarantee Corporation (PBGC) announced that it is dropping its liability-driven investment (LDI) policy, which it has used for the last four years, and is reallocating almost $15 billion to equities and alternative investments.

The new investment policy, approved February 12, 2008, would change the old asset allocation, which was 75 percent to 85 percent fixed income and 15 percent to 25 percent equities, to one with 45 percent targeted to equities, 45 percent to fixed income and 10 percent to alternative investments, including private equity and real estate.

This decision is not good news for supporters of MVL. For example, both the PBGC and public plans are fundamentally different from private sector, for-profit employers in terms of goals and purposes, stakeholders,

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revenue streams, budgetary demands, and longevity. These differences are some of the primary reasons why public plans argue that the premises and conclusions of financial economics do not work when applied to them. The PBGC's actions help to confirm this argument.

In short, the PBGC's decision directly contradicts one of the key principles of financial economics, which is that pension plans cannot be financially managed on a time horizon that differs from that of their shareholder, or, in the case of public plans, the taxpayer. Statements like "a pension plan is a long-term enterprise" or "pension plans can take a long-term view of risk and reward" are not supported by financial economics, according to its proponents. However, the PBGC's experience has repudiated the investment policy promoted by financial economics of matching assets with liabilities. As its press release announcing the decision states, "Because the PBGC's obligations are paid over many years, the new investment policy is designed to take advantage of a long-term investment horizon. The strategy of increased diversification—including use of alternative investments—aims at generating returns, while providing superior protection against ultimate downside risks over time."

According to the PBGC, their new policy was adopted after an extensive review process that began in mid-2007. This review evaluated current and alternative investment policies over 5-, 10- and 20-year periods, and showed that the new diversified portfolio would have outperformed the LDI asset mix 98 percent of the time over rolling 20-year periods.

Clearly, this is a debate that is far from settled. Stay tuned – and stay informed on this complex but critically important issue.

Growing Concern Over The Need To Monitor Fees Paid To Plan Service Providers

By Andrew D. Abramowitz of Spector, Roseman & Kodroff and PAPERS Advisory Committee Member

As demonstrated by the Pension Protection Act of 2006 ("PPA"), as well as its interpretation through guidance issued by federal agencies such as the Department of Labor, the IRS, and the Treasury, the pension world continues to experience heavy scrutiny and change. Indeed, this summer will mark the two-year anniversary of the enactment of the PPA, which brought considerable changes to the requirements of funding, notice, diversification, and many others in the realm of defined benefit and defined contribution plans.

As we observe how pension participants and administrators react to the new landscape, it is hard not to notice one area that has received a great deal of attention: the fees paid to service providers hired by those responsible for plan assets. Over the past few years, there have been a large number of lawsuits alleging that the fees paid to third-parties were either excessive or otherwise inappropriate such that the compensation constituted a breach of fiduciary duty on the part of the plan sponsors.

The specific facts of such cases cover the spectrum of relationships entered into between plan fiduciaries and those retained to perform some type of service on behalf of the plan. For instance, a recent case challenged an arrangement whereby a company hired to provide investment options was compensated based on the percentage of plan assets invested in certain mutual funds. The plaintiff asserted that the third-party became a plan fiduciary when hired to provide investment options, and that it breached its fiduciary duty in the manner in which it compensated itself with plan assets.

In another suit, the plaintiffs alleged that plan sponsor and administrator breached their fiduciary duty to the participants by purchasing various services – administrative, investment management, consulting, among others – from a company that was a direct subsidiary of the plan sponsor.

In yet another case, plan participants complained that the investment advisors paid excessive fees to service providers and failed to realize an appropriate return on investment when it held a significant amount of plan assets in cash. As these cases demonstrate, in today's environment, plan participants clearly have a heightened awareness of what plan fiduciaries should be doing for the plan – and how much those fiduciaries should be paying for such services.

In addition to the recent burst of litigation, Congress is moving forward with a bill addressing this very concern. In April, the House Education and Labor Committee approved the 401(k) Fair Disclosure for Retirement Security Act, which would require, among other things, plan administrators and service providers to disclose all fees – administrative, management, transaction, as well as other types – paid to service providers in connection with plan administration. Moreover, the statute would allow the Department of Labor to enforce the law through the assessment of fines.

It deserves mention that while much of the litigation and the proposed law working its way through Congress address issues pertinent to 401(k) and defined contribution plans, it is relevant to the defined benefit world, as well: the PPA seems to encourage greater control over retirement investments on the part of the participants, which means that how a sponsor or administrator exercises its discretion over plan assets is vital to all enrollees in all types of retirement plans.

The Gazbees are Here!

Part II of a series by Greg Stump, EFI Actuaries & PAPERS Advisory Committee Member

This is a follow up to my article "The Gazbees are Coming!" featured in a 2007 PAPERS newsletter. So where are you now? Is your OPEB actuarial valuation done? Surprised at the results? Join the club.

Last time, we reviewed the basics of OPEB. So what do we know so far?

1. **It's expensive.** If you provide retiree healthcare benefits in some way, shape or form to your retirees, the cost can be very expensive, largely because healthcare is very expensive. Accounting on an accrual basis is a good thing, even though it may be initially shocking and perhaps even painful.
2. **The future is uncertain.** Actuarial costs and liabilities are based on what are believed to be reasonable expectations of the future, and are consequently uncertain. On behalf of all actuaries, I apologize. Your actual costs will be different from what has been estimated. One of the greatest uncertainties in the world of actuarial assumptions is the estimate of future medical inflation, usually the most important assumption in an OPEB valuation.

Now we will go a little more in depth. First let's talk about those "hidden" costs.

Implicit Subsidies

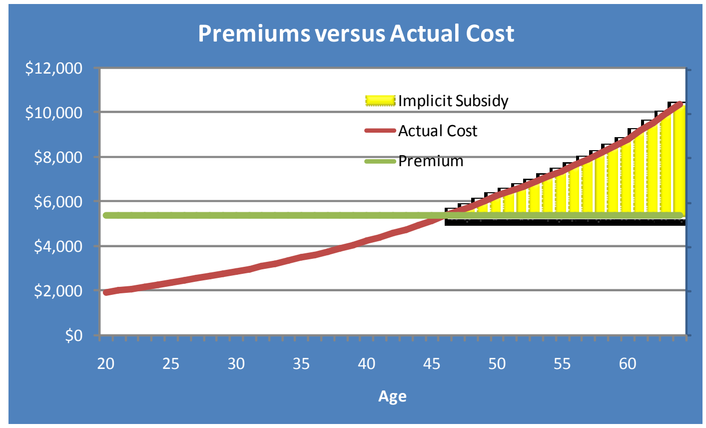
If my retirees pay the full premium for their medical coverage, I have no GASB liability, right?

Not necessarily. Most, but not all, plan sponsors in this situation do have a liability due to implicit (or "implied") subsidies.

What is this implicit subsidy?

It is the additional benefit that is paid to retirees when the premiums for them are based on a pool of active and retired plan participants. These benefits are indirectly, but veritably paid to retirees.

It has been well established that people generally incur higher medical costs as they grow older. For example, the average annual medical cost for someone age 59 may be $8,500 while the cost for someone ten years younger may be closer to $6,000. If these two participants pay the same premium, which is very often the case when the employer sponsors the healthcare program, then the older participant is receiving a more valuable benefit for the same "price", thus the implicit subsidy (about $2,500 per year in this case). This graph shows a simple illustration of the concept.



Does this mean that everyone is providing this implicit subsidy?

No. There are cases where the implicit subsidy either does not exist or does not need to be accounted for. Plans with either separate premiums for retirees or age based premiums are examples. Another example is a "community rated" plan in which all employers in a (typically large) pool are charged the same premiums regardless of whether or not they have active employees in the pool.

Does the subsidy vary from year to year?

Yes. Claims experience, and thus the subsidy, can vary quite a bit from year to year; however, the actuarial aging assumption (much like the assumed return and other actuarial assumptions) is designed to capture the long-term expected cost.

Funding the Benefits

As cities, counties, states, and municipalities receive the results of their actuarial OPEB valuations, one of the first issues that they need to address is whether they should set aside funds for future benefit payments. GASB does not require pre-funding, but has made pay-as-you-go funding very unattractive. Here's why.

The rationale is based on a simple actuarial concept – the actuary develops reasonable expectations of future experience (when people will retire, how long they will live, how the assets in the fund will grow in the long term). So if no separate trust fund exists, then the expected return (which is used to discount expected future benefits) is based on the sponsor's general fund (since benefit payments will come from it), which is typically invested in short-term fixed income, and earns about 4% on an annualized basis.

If you are pre-funding OPEB the same way you would a pension plan (e.g. a fund with a 60% equity allocation), 7.5% is probably a reasonable discount rate. If you have ever financed a house with a 30 year mortgage, then you have some idea how much of a difference this rate can make. In other words, the more you set aside now, the less you will be expected to pay in the long run,

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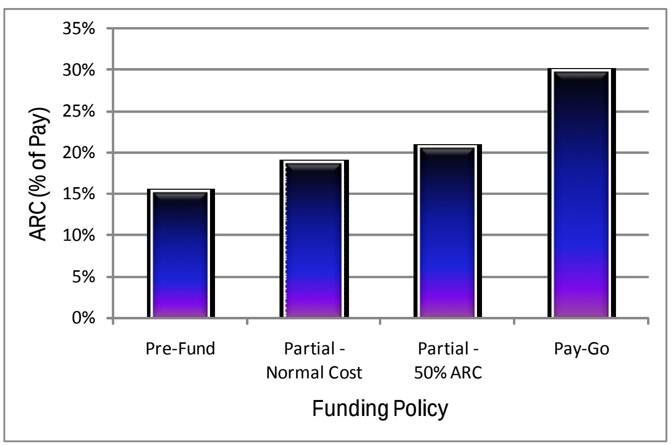
because investment returns will pay for a portion of the benefits.

Note: Some proponents of "financial economics" prefer to take a short-term outlook, insisting that the measurement of liabilities should change annually in step with changes in bond yields, thereby ignoring the expected return concept altogether. These folks will insist that your OPEB (or pension) liability is exactly the same whether you pre-fund or not. GASB and most public pension actuaries disagree.

There has been a great deal of discussion throughout the country concerning funding of OPEB. A California commission (Public Employee Post-Employment Benefits Commission) recently published a report which recommended (among other things) that sponsors pre-fund OPEB in some fashion. Pundits have also suggested that states should offer a fund to local governments as an option to pre-fund. However, pre-funding is easier said than done.

It is possible to partially pre-fund OPEB. If a funding policy calls for a contribution that is higher than the pay-as-you-go amount but lower than the full pre-funding amount, the GASB 45 Annual Required Contribution (ARC) will reflect this.

The chart below represents the percentage of pay ARC under various funding policies for a valuation I recently completed. In this case, the pay-as-you-go ARC was about twice the pre-funding ARC.



At the very least, your actuarial OPEB valuation should give you a better idea of <u>what</u> you are paying (and will be paying) for retiree healthcare, and help you address <u>how</u> to pay for the benefits. There are many additional considerations regarding OPEB, such as benefit policy and accounting policy, but I'll save them for next time. Look for Part III ("The Gazbees Won't Leave"?) later this year.

Looking Ahead...Details to Follow!

The 2nd annual PAPERS fall workshop will be held Tuesday, September 23, 2008, at the Desmond Hotel & Conference Center in Malvern, PA.

The 5th annual PAPERS Forum will be held April 15-17, 2009, at the Hilton Hotel in downtown Harrisburg.