

TEXPERS OUTLOOK

ISSUES IMPACTING PUBLIC PENSION FUNDS

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Report Attempts to Put Dire Forecasts of State Government Finances in Perspective

A new report by the left-leaning Center on Budget and Policy Priorities finds that the current fiscal problems in the state and local government sector are not tied to longer-term issues related to debt, pension obligation, and retiree health costs.

The report, "Misunderstandings Regarding State Debt, Pensions, and Retiree Health Costs Create Unnecessary Alarm: Misconceptions Also Divert Attention from Needed Structural Reforms," attempts to counter recent articles that outline the dire fiscal status of states and localities.

The main problem with these doom-day articles, the report finds, is that they lump together states' current fiscal problems, which stem largely from the recession, with longer-term issues relating to debt, pension obligations, and retiree health costs.

This creates a misperception that immediate and drastic measures are needed to avoid an imminent fiscal meltdown.

The weak economy is to blame for the large operating deficits that most states are projecting for the 2012 fiscal year.

In fact, state revenues have stabilized after record losses but remain 12 percent below pre-recession levels, the report finds. In addition, localities are experiencing diminished revenues at a time when the need for public services has increased due to the rise in poverty and unemployment.

Since the economic meltdown began in late 2008, states and localities have used a combination of reserve funds and federal stimulus funds, along with budget cuts and tax increases, to close these "recession-induced deficits."

"While these deficits have caused severe problems and states and localities are struggling to maintain needed services, this is a cyclical problem that ultimately will ease as the economy recovers," the report states.

While projected operating deficits for fiscal year 2012 will need near-term solutions to meet

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states' and localities' balanced-budget requirements, longer-term issues related to bond indebtedness, pension obligations, and retiree health insurance can be addressed over the next several decades, the report says.

"It is not appropriate to add these longer-term costs to projected operating deficits. Nor should the size and implications of these longer-term costs be exaggerated, as some recent discussions have done," the report says. "Such mistakes can lead to inappropriate policy prescriptions."

On the Web at: <http://www.cbpp.org/cms/index.cfm?fa=view&id=3372>.

Government Watchdog Group Publishes Incriminating SEC Documents

The Project On Government Oversight (POGO), a nonpartisan independent watchdog that champions good government reforms, has released previously unpublished investigative reports exposing "a wide range of serious misconduct" at the Securities and Exchange Commission (SEC).

POGO obtained many of the investigative reports by the SEC Office of Inspector General (OIG) through the Freedom of Information Act (FOIA) and from other sources.

While some investigations were previously reported by the media and congressional offices, many were not made public and cannot be found on the SEC or OIG Web sites.

The previously unpublished reports include investigations into retaliation against SEC whistleblowers, the agency's failure to vigorously regulate Bear Stearns, conflicts of interest, and insider trading by SEC employees.

POGO previously raised concerns about the SEC ignoring recommendations made by its own Inspector General.

"The public has a great interest in knowing what is in these reports," said Michael Smallberg, a POGO investigator who compiled the database. "The SEC should hold itself accountable and that means embracing transparency, even when it might embarrass or bring negative attention to you."

On the Web at: <http://www.pogo.org/investigations/financial-oversight/sec-ig-investigative-reports.html>, <http://pogoblog.typepad.com/pogo/2011/01/un-posted-inspector-general-reports->

[showcase-sec-misconduct.html](http://www.pogo.org/pogo-files/letters/financial-oversight/er-fra-20091216.html) and <http://www.pogo.org/pogo-files/letters/financial-oversight/er-fra-20091216.html>.

New Legislation Opposes Bailout of State/Local Government Employee Pension Funds

In an action that mirrors efforts by some of his House colleagues, U.S. Rep. Jason Chaffetz (R-Utah) has introduced H.Res. 23, legislation that would declare Congress's opposition to federal bailouts of state and local government employee pension plans.

The legislation plays off of the Public Employee Pension Transparency Act (H.R. 6484), introduced last December by Reps. Devin Nunes (R-Calif.), Paul Ryan (R-Wis.) and Rep. Darrell Issa (R-Calif.). That bill, which did not pass the previous session, aimed to establish a clear federal prohibition on any future public pension bailouts by the federal government.

If approved, H.R. 6484 would have denied states and municipalities the ability to sell tax-exempt bonds unless they followed new rules on reporting their pension fund liabilities to the U.S. Treasury. Since that bill failed to pass, it was fully expected that a similar effort would be relaunched in the new Congress when Republicans took control of the House.

While Chaffetz' bill covers Congress's opposition to federal bailouts of state and local government employee pension plans, Rep. Nunes planned to introduce legislation that would require state and local governments to be more transparent in disclosing their pension liabilities to taxpayers.

Chaffetz said his legislation was aimed at stemming a "looming fiscal crisis."

"Another wave of debt problems is coming our way," he said. "State and local government employee pension funds have unfunded liabilities of more than \$3 trillion, and many states will not be able to deliver on promised benefits to government employees. Many of these states will undoubtedly be coming to the federal government for bailouts."

Chaffetz lauded Utah's efforts to address the matter, saying it has been "adequately managing and reforming their government employee pensions, but too many states have been reckless and overly generous with their state and local government employee pension plans."

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He added that, “These unfunded liabilities demonstrate an inherent flaw in defined benefit pension plans and justify increased reliance on defined contribution plans, which Utah is doing.”

Chaffetz claims a federal bailout of state and local government employee pension funds is “unjustifiable” for several reasons:

- States are already heavily dependent on federal funding.
- The recent economic downturn is not a reason to bail out state and local governments because their employment has grown 9 percent since 2000 while private-sector employment has decreased nearly 2 percent.
- The federal government is already in dire fiscal straits and is no position to bail out state and local governments.
- Many states have been “fiscally responsible” with their government employee pension plans and a bailout would reward states that have been “fiscally irresponsible.”

The bill was referred to the House Committee on Education and the Workforce on Jan. 6. It had 25 Republican cosponsors as of press time.

On the Web at: <http://www.govtrack.us/congress/bill.xpd?bill=hr112-23> and <http://chaffetz.house.gov/statebailoutinfo.pdf>. 

SEC Launches Inquiry into Illinois Pension Fund’s Statements about its Funding Methods

The Securities and Exchange Commission has launched an inquiry into public statements by Illinois officials about the state’s unorthodox pension funding method, trying to determine whether the state misled bond investors about the risks.

The inquiry was disclosed in a prospectus for the state’s \$3.7 billion bond offering planned for February. The state wants to use the proceeds from the sale to make its annual contribution to its pension funds, which are among the most poorly funded in the country. Illinois must sell bonds to come up with the cash because the state is low on money.

The prospectus said that the SEC contacted the state last September and that Illinois was cooperating with the inquiry.

At issue is an unusual actuarial technique the state


adopted in March 2010 to save money by shrinking its annual pension contributions.

The technique, variations of which are in use by Arkansas, Ohio, Rhode Island and Texas, is based on sharp cuts in benefits for future state workers. Although the cuts will not produce an appreciable savings today, Illinois is taking future savings and treating them as current reductions in the cost of the pension fund.

While the SEC has no direct jurisdiction over public pension funds and cannot order a government to follow any particular funding method, it is responsible for protecting investors, and making sure they have enough information to make well-informed decisions. The agency appears to be trying to determine whether Illinois adequately explained its funding method to bond buyers, giving them an understanding of how the reduced contributions may ultimately affect the state’s finances.

The SEC has a special team devoted to investigating public pensions, and last August it brought its first case ever against a state, accusing New Jersey of securities fraud for claiming to have pension assets that did not really exist. New Jersey authorities settled the SEC case without admitting or denying wrongdoing.

In October, the commission said that four former San Diego officials agreed to pay penalties for allegedly misleading investors in \$262 million of the city’s municipal bonds. The agency said the civil settlement marked the first time it had secured financial penalties against city officials in a muni-bond fraud case.

If the SEC decides at some point to bring a case against Illinois, it would send another warning to public pension funds nationwide that the agency is willing to exercise its anti-fraud authority and its authority over the professionals that deal in the marketplace. 

SEC Adopts ‘Say-on-Pay’ and Golden Parachute Rules for Shareholders

Shareholder votes on executive compensation (so-called “say-on-pay”) and “golden parachute” compensation arrangements must occur at least once every three years beginning with the first annual shareholders’ meeting taking place on or after Jan. 21, 2011, according to the Securities and Exchange Commission (SEC).

In addition, companies also are required to hold a “frequency” vote at least once every six years in order to allow shareholders to decide how often they would like to

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be presented with the say-on-pay vote. Following the frequency vote, a company must disclose on an SEC Form 8-K how often it will hold the say-on-pay vote.

The new rules were required under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The rules also require companies to provide additional disclosure regarding “golden parachute” compensation arrangements with certain executive officers in connection with merger transactions.

Smaller companies with a public float of less than \$75 million are not required to conduct say-on-pay and frequency votes until annual meetings occurring on or after Jan. 21, 2013.

On the Web at: <http://www.sec.gov/news/press/2011/2011-25.htm> and <http://www.sec.gov/news/speech/2011/spch012511mls-3.htm>. 

SEC Seeks Uniform Fiduciary Standard for Broker-Dealers and Investment Advisors

A new Securities and Exchange Commission (SEC) report to Congress indicates the agency will create a new uniform fiduciary standard of care for broker-dealers and investment advisors when providing advice to retail customers.

This single fiduciary standard should be applied to both advisors and brokers instead of the separate codes of conduct to which each group is currently held, the agency said in its report, “Study on Investment Advisors and Broker-Dealers.”

The report recommends rulemakings that would apply “expressly and uniformly to both broker-dealers and investment advisors, when providing personalized investment advice about securities to retail customers, a fiduciary standard no less stringent than currently applied to investment advisers” under the Investment Adviser Act of 1940.

“Retail investors generally are not aware of these differences or their legal implications,” the report states. “Many investors are also confused by the different standards of care that apply to investment advisers and broker-dealers. That investor confusion has been a source of concern for regulators and Congress.”

Stockbrokers and their companies are only held to a “suitability standard” – a lesser legal standard requir-

ing only that the brokers ensure the products they sell are suitable for their clients. Investment advisors, on the other hand, have a fiduciary duty to put their clients’ best interests first.

The SEC report says subjecting both groups to the higher standard will “increase investor protection and decrease investor confusion in the most practicable, least burdensome way for investors, broker-dealers and investment advisers.”


But the two Republican SEC Commissioners, Kathleen L. Casey and Troy A. Paredes, issued a joint dissent, saying the report’s “pervasive shortcoming is that it fails to adequately justify its recommendation that the Commission embark on fundamentally changing the regulatory regime for broker-dealers and investment advisers providing personalized investment advice to retail investors.”

The report does not adequately articulate or substantiate the problems that “would purportedly be addressed via that regulation. The Study also does not adequately recognize the risk that its recommendations could adversely impact investors.”

They call for a “stronger analytical and empirical foundation” before new regulations are put in place for broker-dealers and investment advisors.

The recommendations are finding support across Wall Street associations and investor advocates. The Securities Industry and Financial Markets Association says it also supports reworking examinations of advisors, bringing them closer in line with the oversight of brokerage firms.

But there were also questions raised about the SEC’s ability to enforce the recommended changes. The SEC delivered a separate report to Congress in which it said there is inadequate funding and staff resources to carry out timely and effective oversight and examinations of registered investment advisors.

On the Web at: <http://www.sec.gov/news/studies/2011/913studyfinal.pdf> and <http://www.sec.gov/news/speech/2011/spch012211klctap.htm>. 

REGISTRATION NOW OPEN!

Where Do We go From Here?

TEXPERS 22nd Annual Conference
March 27-30, 2011 (CTT Course - March 26)
Sheraton Austin Hotel at the Capitol
Austin, Texas

register: **www.texpers.org**

New Systemic Risk Reporting Rule Proposed for Larger Private Fund Advisers

Advisers to hedge funds and other private funds must report information that the new Financial Stability Oversight Council (FSOC) would use to monitor risk to the U.S. financial system, under a new rule proposed by the Securities and Exchange Commission (SEC).

The FSOC, established under the Dodd-Frank Act, will provide, for the first time, comprehensive monitoring to ensure the stability of the U.S. financial system.


The proposal would create a new reporting form (Form PF) to be filed periodically by SEC-registered investment advisers who manage one or more private funds. The SEC says information reported on Form PF would remain confidential.

The focus of the proposed rule is on larger private fund advisers managing hedge funds, “liquidity funds” (i.e., unregistered money market funds), and private equity funds. The heightened reporting requirements would apply to large private fund advisers – any adviser with \$1 billion or more in hedge fund, liquidity fund or private equity fund assets under management.

All other private fund advisers would be regarded as smaller private fund advisers and would not be subject to the heightened reporting requirements.

This heightened reporting threshold would apply to only about 200 U.S.-based hedge fund advisers, but these advisers manage more than 80 percent of the assets under management.

The SEC’s public comment period on the proposed rule will last 60 days from the time the rule was introduced in late January.

On the Web at: <http://www.sec.gov/news/press/2011/2011-23.htm> and <http://www.sec.gov/news/speech/2011/spch012511mls-1.htm>. 


Social Security Makes it Easier for Public to Comment on its Regulations

The Social Security Administration has launched new electronic methods for members of the public to provide direct feedback on its rules and regulations. Ideas and comments may be emailed to RegsReview@ssa.gov.

In addition, Social Security’s program rules are available online and may be accessed at www.socialsecurity.gov/regulations. This Web page provides information

on Social Security’s laws, regulations, rulings, and employee operating instructions.

The changes stem from President Obama’s executive order directing federal agencies to create a more open and transparent government.

For information about Social Security’s efforts to improve its regulations and how the agency will implement the President’s executive order, visit its Open Government Web page at: www.socialsecurity.gov/open/regsreview/. 

Coalition of Latino Groups Unveil Plan to Protect Social Security

A new coalition, Latinos for a Secure Retirement, was launched in January to serve as a voice for the Latino American community in the fight to defend Social Security as new threats emerge against the 75 year-old program.

The coalition unveiled its policy recommendations in a report entitled “Protecting Social Security: A Blueprint for Strengthening Social Security for All Americans.”

The plan features recommendations to ensure the sustainability and solvency of Social Security for the next 75 years and beyond without any cuts to benefits or increase in the retirement age.

The need for the coalition grew in response to recent attacks from Social Security adversaries who have attributed the nation’s rising deficit problems with the program. The most recent threat to Social Security has come from the deficit reduction proposal from Alan Simpson and Erskine Bowles, known as the Simpson-Bowles plan.

Instead of cutting benefits or increasing the retirement age, the coalition’s plan proposes to raise additional revenue to make Social Security fully solvent, increase the independence and fairness of Social Security, and strengthen benefits for those most in need.


While the plan rejects privatization, it also features several innovative suggestions for the federal government, including raising the earnings cap to 90 percent of all earnings, diversifying the trust fund, extending Social Security coverage to newly hired state and local employees to ensure that all Americans can benefit from Social Security, and automatic triggers to raise additional revenue if the trust fund should come close to exhaustion.

The coalition brings together some of the most prominent advocates for Latinos in the country, including the League of United Latin American Citizens (LU-LAC), the Labor Council for Latin American Advance-

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ment (LCLAA), The Hispanic Federation, the National Hispanic Council on Aging, MANA- A National Latina Organization, SER- Jobs for Progress National, Inc., the Institute for the Puerto Rican/Hispanic Elderly, the American GI Forum and the National Association for Hispanic Elderly.

The full report is available at www.lulac.org/socialsecurity. 

Merrill Lynch Settles SEC Charges it Misused Customer Order Information and Charged Undisclosed Trading Fees

Merrill Lynch, Pierce, Fenner & Smith Inc. in January agreed to pay a \$10 million penalty and agree to a cease-and-desist order to settle SEC charges that it committed securities fraud by misusing customer order information to place proprietary trades for the firm and by charging customers undisclosed trading fees.

The Securities and Exchange Commission (SEC) charged that Merrill operated a proprietary trading desk between 2003 and 2005 that was known as the Equity Strategy Desk (ESD), which traded securities solely for the firm's own benefit and had no role in executing customer orders.

The ESD was located on Merrill's main equity trading floor in New York City, where traders on Merrill's market making desk received and executed customer orders.

While Merrill represented to customers that their order information would be maintained on a strict need-to-know basis, the firm's ESD traders obtained information about institutional customer orders from traders on the market making desk. They then used it to place trades on Merrill's behalf after executing the customers' trades. In doing so, Merrill misused this information and acted contrary to its representations to customers.

The SEC also found that, between 2002 and 2007, Merrill had agreements with certain institutional and high-net-worth customers that Merrill would only charge a commission equivalent for executing riskless principal trades. However, in some instances, Merrill also charged customers undisclosed mark-ups and mark-downs by filling customer orders at prices less favorable to the customer than the prices at which Merrill purchased or sold the securities in the market.

Merrill settled the charges without admitting or denying the SEC's findings.

On the Web at: <http://www.sec.gov/litigation/admin/2011/34-63760.pdf>. 

Recession Made More Households 'At-Risk' of Running Short of Money in Retirement


The housing and financial crisis of 2008-2009 caused between 4 percent and 14 percent of Americans to become "at risk" of running short on income to cover basic expenses in retirement – people who otherwise would have had adequate income.

Those are the results of a new report by the non-partisan Employee Benefit Research Institute (EBRI): "A Post-Crisis Assessment of Retirement Income Adequacy for Baby Boomers and Generation Xers."

The likelihood of becoming "at risk" due to the economic crisis depended to a large extent on the size of the retirement account balances that the household had in 401(k)-type plans and/or individual retirement accounts, as well as their relative exposure to fluctuations in the housing market, the report found.

The resulting percentages of households that would not have been "at risk" without the 2008-2009 crisis that ended up "at risk" vary from a low of 3.8 percent to a high of 14.3 percent, the report found.

The report finds that baby boomer households would generally need to save between 1 percent and 4 percent more of their compensation each year between now and retirement age to make up their losses from the crisis. But these estimates depend on several key factors, such as the size of account balances and exposure to the equity market; proximity of the household to retirement age; the relative level of preretirement income; and the desired probability of adequate retirement income.

The full report is available on the Web at: http://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=4742. 

New Rules Regulate Asset-Backed Securities

The Securities and Exchange Commission (SEC) has voted to adopt two sets of new rules designed to help revitalize the asset-backed securities (ABS) market by encouraging better disclosure for investors.

ABS are created by buying and bundling loans — such as residential mortgage loans, commercial loans or student loans — and creating securities backed by those assets that are then sold to investors.


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The SEC approved one set of rules that requires ABS issuers to disclose the history of the requests they received and repurchases they made related to their outstanding asset-backed securities.

The second set of rules would require ABS issuers to conduct a review of the assets underlying those securities.

“At one time, the securitization market provided trillions of dollars of liquidity to virtually every sector of the economy. However, during the financial crisis, ABS investors suffered significant losses, causing the market for securitization to rapidly decline,” said SEC Chairman Mary L. Schapiro. “These rational measures are designed to help revitalize the important asset-backed securities market by encouraging better disclosure for investors.”

On the Web at: <http://www.sec.gov/rules/final/2011/33-9175.pdf>, <http://www.sec.gov/rules/final/2011/33-9176.pdf> and <http://www.sec.gov/news/speech/2011/spch012011mls.htm>. 

GAO Studies GASB's Role in the Municipal Securities Markets and its Past Funding

The Government Accountability Office (GAO) has completed a study of the role and importance of the Governmental Accounting Standards Board (GASB) in the municipal securities markets while also analyzing the manner and level at which GASB has been funded.

In conducting the study, GAO consulted with organizations representing state governors, legislators, local elected officials, and state and local finance officers.

Its objectives were to answer the questions: 1) What are key stakeholder views on the role and relevance of GASB in the municipal securities markets? and 2) What is the manner and the level at which GASB has been funded?

GAO conducted research from September 2010 to January 2011 and has sent copies of the report to the appropriate congressional committees, the chairman of the Board of Trustees of the Financial Accounting Foundation, the president and CEO of the Financial Accounting Foundation, the chairman of GASB, and the chairman of the Securities and Exchange Commission.

The report is available at: <http://www.gao.gov/new.items/d11267r.pdf>. 

www.texpers.org

Census Bureau's Statistical Abstract Covers Social Security, Retirement Plans

The U.S. Census Bureau has released an online version of the 2011 edition of the Statistical Abstract of the United States, a vast compilation of data and statistics.

The 1,407 tables describe the state of the nation's social, political and economic condition.


One section, on Social Insurance & Human Services: Social Security, Retirement Plans, details facts and figures on the nation's retirement plans.

On the Web at: <http://www.census.gov/newsroom/releases/archives/miscellaneous/cb11-07.html>, <http://www.census.gov/compendia/statab/> and http://www.census.gov/compendia/statab/cats/social_insurance_human_services/social_security_retirement_plans.html.

The Census Bureau also has released “Finances of Selected State and Local Government Employee Retirement Systems: 3rd Quarter 2010.” It is a quarterly survey that provides national summary data on the revenues, expenditures and composition of assets of the 100 largest state and local public employee retirement systems in the United States.

These 100 systems comprise 89.4 percent of financial activity among such entities, based on the 2007 Census of Governments. This survey presents the most current data about investment decisions by state and local public employee retirement systems, which are among the largest types of institutional investors in the U.S. financial markets.

These data tables are published three months after each calendar quarter and show national financial transactions and trends for the past five years.

On the Web at: <http://www.census.gov/govs/qpr/>. 

Federal Reserve: Economic Recovery Continues, Although Slowly

The Federal Reserve's Federal Open Market Committee (FOMC) released a statement Jan. 26 indicating that the economic recovery is continuing, though “at a rate that has been insufficient to bring about a significant improvement in labor market conditions.”

While household spending picked up late last year, it remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit.

At the same time, business spending on equipment and software is rising, while investment in nonresidential structures is still weak.


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“Employers remain reluctant to add to payrolls,” the FOMC said. “The housing sector continues to be depressed. Although commodity prices have risen, longer-term inflation expectations have remained stable, and measures of underlying inflation have been trending downward.”

At its December meeting, the FOMC agreed to continue expanding its holdings of securities as announced in November 2010. The Federal Reserve hopes to promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate.

The committee intends to purchase \$600 billion of longer-term Treasury securities by the end of the second quarter of 2011, and plans to continue to reinvest principal payments from its securities holdings.

On the Web at: <http://www.federalreserve.gov/newsevents/press/monetary/2011monetary.htm>. 

Important Dates

- **82nd Texas Legislative Session**
January 11-May 30, 2011
- **Certified Trustees Training Module C**
Saturday, March 26, 2011
- **TEXPERS 22nd Annual Conference**
March 27-30, 2011
- **NYSE Symposium**
May 16-17, 2011
- **Summer Educational Forum**
August 7-9, 2011

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March 27-30, 2011 (CTT Course - March 26)
Sheraton Austin Hotel at the Capitol
Austin, Texas

register: **www.texpers.org**

NYSE Symposium May 16-17, 2011

Open to: TEXPERS Pension Fund Members only

When: May 16-17, 2011

Where: NYC

Cost: Airfare & Hotel (no conference registration fee; meals provided)

Topics: Tour NYSE plus interactive sessions relating to the execution of stock transactions on the NYSE trading floor and other related investment subjects

Check your emails for more information on the NYSE Symposium.

PENSIONS UNDER ATTACK!

There have been ads placed in the TEXPERS Outlook, messages in emails and TEXPERS Board Members have spoken to you about joining the Legislative Focus Group. Your active participation in the Legislative Focus Group is extremely important, and it really can't be stressed enough that having you as part of the Legislative Focus Group will help to ensure the sound retirement of hundreds of thousands of Texas public employees.

Public plans have been under attack lately and the attacks have been relentless. With the start of the 82nd Legislative session on January 11, TEXPERS wants to make sure that we are all thoroughly prepared to defend your pensions if needed, and we need your help to do this.

Many of you have signed up and yet there are still some of you who haven't. And if you're one of those not already in the Legislative Focus Group, the time to get active is NOW. Join the Legislative Focus Group today. There's just too much at stake to risk your retirement.

Sign up: www.texpers.org