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.

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Details Coming!

Annual Forum

April 11-12, 2007

Holiday Inn

Grantville, PA

The Pension Protection Act of 2006:

The Times They Are A-Changin'

Andrew Abramowitz

When President Bush signed the Pension Protection Act into law on August 17, 2006, he enacted perhaps the broadest and most far-reaching pension legislation since ERISA became law in 1974. A stone's throw from a thousand pages in length, the Act changes the defined benefit world (in terms of funding and notice requirements), as well as defined contribution plans (in terms of investment advice, automatic enrollment, vesting, and diversification).

It was intended to address the numerous factors that have contributed to underfunding and, in some cases, plan termination, as well as the troubled condition of the Pension Benefit Guaranty Corporation. The upshot, as analysts almost uniformly agree, is greater responsibility on the employee to plan for retirement, and an increasing likelihood that employers will scale back or freeze traditional pension options – a result we have already begun to witness with such corporations as DuPont and IBM.

Changes to Defined Benefit Plans

One major area impacted by the new legislation is the funding of defined benefit plans. The Act requires contributions to underfunded plans so as to render them fully funded within seven years. That time frame is accelerated where the plan is considered "at risk" (which could mean 80% or 70% underfunded, depending on the actuarial assumptions). Requiring 100% funding represents an improvement over the previous 90% requirement mandated under ERISA and the Internal Revenue Code.

The Act has also beefed up notice and disclosure provisions. Beginning in 2008, employers must provide the plan's funding status to participants no later than 120 days prior to the end of each plan year. Such notices must also disclose details as to the allocation of assets.

Changes to Defined Contribution Plans

One of the most significant changes brought about by the new law relates to investment advice. Whereas investment fund fiduciaries were previously prohibited from offering investment advice to 401(k)

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From the Executive Director Jim Perry

This is my first attempt at writing an editorial for a newsletter. I'm not an English major and never really cared for writing. But I would like to provide you with information about the Public Pension world that will help keep you abreast of what is going on in our industry so you won't be blindsided by someone who wants to cause problems for your pension fund.

It's important that you be aware of the issues so you can formulate your own position on the various topics that are floating round. To that end I am including news clips that I receive because in my other life I am a member of NASRA, the National Association of State Retirement Administrators. Keith Branard is the Research Director for NASRA and spends his life developing information on topics that impact the Public Pension Community. Keith has given me permission to share his news clips with the members of PAPERS. I hope that it will help you to be aware of developing issues on the national level that can and will eventually impact you at the local level. If any of these articles spark your interest and you would like to know more about these subjects drop me an email and I will try to help you explore these issues more thoroughly.

Thank you for participating in PAPERS and I hope that you find the organization helpful in your efforts to be a better guardian for your member's pension benefits.

Jim Perry

PAPERS Executive Director

The Times They Are A-Changin'

(continued from page 1)

participants, now an advisor may do so if the fees generated by the transaction are the same regardless of the investment options available. Accordingly, a firm that administers a 401(k) may now give investment advice to employees about that firm's own financial products. However, potential conflicts are removed – or at least minimized – not only by the revamped fee structure, but by the fact that any advice given must come from a computer model certified and audited by an independent third party. Moreover, investment advice must be accompanied by full disclosure of certain information, including all fees that the advisor will earn from the transaction.

In addition, defined contribution plans will now be subject to diversification rules. An employer whose securities are publicly traded must allow participants to diversify the contributions that are invested in the employer's stock, and must notify participants not only that diversification is available but is indeed advisable. The dangers of not permitting diversification – and not publicizing this option to plan participants – have been brought to national attention through the sad story of Enron and other companies.

Another key feature of the Act is automatic enrollment in 401(k) and 403(b) plans. In an apparent reaction to low participation, employers are now permitted to automatically enroll their employees in retirement plans. This provision specifically preempts state wage and hour laws that prevented employers from doing so.

The New World: Out Here On Our Own

Although touted as a mechanism to stabilize and even rescue the pension world, most observers fear that the Pension Protection Act will hasten the phase-out of traditional pensions that employees looked to as guaranteed, reliable retirement money. The stricter funding requirements, experts say, will force corporations to throw up their hands and offer different options. Because today's workers are more likely to move from company to company, employers view the defined benefit plan as a dinosaur – and one that chokes the company's competitiveness.

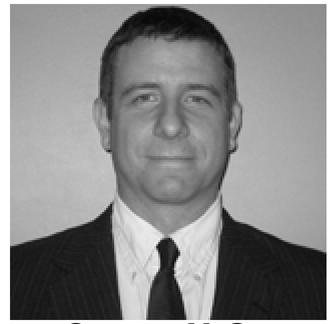
Simply put, the new law encourages a do-it-yourself approach to saving, particularly for younger workers. Before President Bush's signature was dry, DuPont & Co. announced a retreat from its traditional pension options. It was hardly alone – Illinois-based Tenneco, Inc. and Portland-based Blount International had also announced pension freezes shortly after the Act became law.

Some companies are converting to cash balance plans, which are essentially hybrids of the traditional pension and the 401(k): they are portable, they are insured by the PBGC, they provide periodic statements to participants and are easier to understand, and the employer bears all the responsibility. Older workers should be wary, though, because in some cases the conversion to cash balance plans ends up substantially cutting benefits that an employee has spent a lifetime earning.

Meet the PAPERS Advisory Committee

PAPERS is very fortunate to have the expertise of an Advisory Committee of pension and investment professionals providing guidance to the organization. In this and coming issues of the newsletter, we'll meet the committee members in more detail and learn from the articles that some of them will contribute (see Andrew's article on pages 1-2).

***Andrew Abramowitz** – Spector, Roseman, Kodroff*
***Tom Dattilo** – Emerald Advisors*
***Ronnee Ades** – Dow Jones Indexes*
***Rosemay Kelly** – ADP*
***Matthew Butterfield** – Nomura Asset Management*
***Suzanne Schechter** – Capital Guardian*
***Greg Stump** – EFI Actuaries*



Gregory M. Stump,
***Vice President* EFI ACTUARIES**

Rosemary Kelly is Vice President, Institutional Relations, at ADP Investor Communications Services with responsibility for developing and maintaining client and non-client executive level relationships. Rosemary's primary focus is the dissemination of information regarding corporate governance and proxy vote processing to the investment management and pension fund community. Rosemary joined ADP in 1992, with the acquisition of the Independent Election Corporation of America, where since 1984; she held various management positions in the Client Service and Sales Groups.

Suzanne L. Schechter is a vice president and relationship manager for Capital Guardian Trust Company with client relations and marketing responsibilities. She joined our organization in 1995, working for Capital International Research, Inc., and in 1997 transferred to Capital International, Inc. as a marketing associate. Prior to joining Capital International, she worked as an assistant with Ernst & Young, LLP, and before that, she spent a year as a member of a consulting team for LTV Aerospace & Defense Company, based in Spain. Ms. Schechter received her BA in international relations with a minor in Spanish from the University of Southern California. She also attended a semester at the Universidad de Cantabria in Santander, Spain. She is based in New York.

The following articles reprinted with permission from the National Association of State Retirement Administrators **www.nasra.org**

Boston Globe September 6, 2006

Private 401(k) retirement-savings plans have underperformed traditional company **pension** plans by one percentage point a year, according to a Boston College report released yesterday that found individual retirement accounts fared even worse.

The findings of the review, which studied about 5,000 companies that sponsored both kinds of plans from 1988 to 2004, underscore the risks facing many workers as companies shed traditional **pension** plans in favor of vehicles such as 401(k)s. In theory these plans offer more flexibility for modern workers who change jobs often, but some traditional financial advisers have argued that most people aren't as good at investing their money as **pension** plan professionals.

Those worries were supported by yesterday's report from Boston College's Center for Retirement Research. Its director, Alicia H. Munnell, acknowledged a one percentage point difference isn't significant in any particular year. "But this is every single year, and if that were true over a person's 40-year worklife, they would end up with 20 percent less at retirement," she said.

Munnell and three co-authors also found that the individual retirement accounts, or IRAs, have turned in even worse performances than 401(k)s. Also there aren't enough tools to properly analyze their performance even though IRAs now account for a larger share of retirement savings than either of the other two vehicles. If proven correct, the lower return for IRAs "implies trouble ahead given the massive amount of money that is being rolled over into these accounts," wrote the authors.

Dallas L. Salisbury, chief executive of the Employee Benefit Research Institute, a Washington, D.C., group funded by plan providers, labor unions, and other organizations, said the findings were in line with other research in the area but not directly relevant to individual investors. Salisbury also said the IRA figures weren't alarming since the biggest accounts tend to be held by older workers who want more conservative investments anyway.

Some managers are already addressing some of the issues raised in the report, such as a lack of diversity in the portfolios of many 401(k) participants. Jamie Cornell, senior vice president at Fidelity Investments, the Boston mutual-fund giant, said the company offers plans with features like funds tailored to a worker's age.

For their paper, the BC researchers compared returns of private retirement plans that hold a combined $8.4 trillion dollars $3.67 trillion in IRAs, $2.87 trillion in 401(k)s and similar "defined-contribution" plans, and $1.92 trillion held by traditional **pension** systems known as "defined-benefit" plans.

When adjusted for the size of their holdings, the defined-benefit plans returned 10.7 percent a year on average, compared with 9.7 percent a year on average for the defined-contribution plans. Also, using data from the Investment Company Institute, they estimated IRAs' average performance from 1998 to 2003 was 3.8 percent, compared with 6.6 percent for defined-benefit plans and 5.6 percent for 401(k) plans. The authors speculate one reason the 401(k)s lag may be that fees tend to be higher for the plans, which typically put their money into mutual funds.

The paper also highlights other research that that found nearly half of all participants in 401(k) plans have either none of their money in equity stocks, or more than 90 percent of their money in stocks, rather than more balanced strategies most advisers suggest.

Unions quietly develop models for hybrid plans

Pensions & Investments September 4, 2006

WASHINGTON - Faced with a declining defined benefit system and half the working population not covered by any employer-provided retirement plan, officials at the AFL-CIO and the Service Employees International Union have been developing separate foundations for new hybrid pension plan models. A hybrid plan typically combines what its designers consider the best of defined benefit and defined contribution plans. One example is a cash balance plan, although sources say the AFL-CIO's and SEIU's concepts are not modeled after cash balance plans.

On Aug. 8, the AFL-CIO, Washington, issued five principles for retirement income policy:

- Financing and risk should be allocated equitably among government, employers and workers.
- Every worker should have the opportunity to retire at 65 with at least 70% of pre-retirement income.
- Retirement benefits should be portable.
- Defined contribution plans should be structured to serve the interest of workers.
- Participants should be represented in the governance of their plans.

Damon Silvers, associate general counsel for the AFL-CIO, said in an interview: "Our current system is failing. It functioned well for the work force 25 years ago. By the time it becomes apparent to the majority of employees, it will be too late."
Neither Stephen Abrecht, director, benefits and capital stewardship program at the SEIU, nor Andrew Stern, president of the SEIU, would return numerous calls requesting comment for this story. But sources said the SEIU proposes a hybrid plan model that:

- covers the 50% of the work force not now covered by traditional plans;
- offers portable accounts;
- pools investment risk;
- pays benefits primarily in annuity form;
- requires employer contributions;
- minimizes costs; and
- is simple to communicate.

In perhaps the most controversial principle, the SEIU would give participants or their union representatives the power to name fiduciaries that decide investment policies, select service providers and monitor investment performance. The SEIU - which represents 1.8 million health-care workers in the U.S., Canada and Puerto Rico - broke away from the AFL-CIO in July 2005. Mr. Silvers said the retirement policy documents of the two union groups were created separately.

Of the SEIU's principles, Mr. Silvers said, "Their principles relate to the same set of problems. We understand that they would have their own document ... but that doesn't preclude that we wouldn't team up with them. It wouldn't surprise me at all. On the Hill we could work together; it's likely that we will. But as of today, we haven't signed off on theirs and they haven't signed off on ours.

'First Step'

"We view this document as a first step in a public policy discussion. The next step is to talk to Congress, to put this out there. The final step is actual framed legislation," said Mr. Silvers, adding the AFL-CIO has no timeframe for presenting its principles to Congress.

"Yes, it a new plan design, but we're not going to propose our own branded plan. We're going to look into the public policy and hopefully work with Congress," he said. Sources say the SEIU leadership has been circulating the principles to its various local unions, and plans to present its hybrid plan concept to Congress by the end of the year.

Industry experts think it's a significant move for unions to contemplate moving away from a pure defined benefit system. Unions typically are foursquare behind traditional pension plans; in debating a set of principles aimed at establishing a new hybrid model, the unions could be setting a precedent.

James Klein, president of the American Benefits Council, Washington, said, "The (unions) certainly have been a strong supporter of DB plans. That everybody - union and management alike - is seeing the reality of the troubled DB system and is searching for ways to make DC or hybrid plans more successful, is a huge step."

"... Simpler and portable are certainly themes and features that may help smaller employers and unions adopt such plans, whether it's a cash balance or hybrid type of plan," said Mr. Klein.

Of the AFL-CIO's principles, Mr. Klein said, "Undoubtedly these are principles that the business community would embrace. Expanding the retirement system is a goal shared by all and it seems that's what (the AFL-CIO) is looking to do."

It does not strike Mr. Klein as odd that two union organizations are working on separate principles, especially since the SEIU and AFF-CIO have a history together. "The SEIU broke away from the AFL-CIO about a year ago. Their interests are very similar and it makes sense that they would have similar principles," he said.

James Delaplane, a partner at Davis and Harman LLP, Washington and a well-known pension attorney, said these principles are "very aggressive on the organizing front." "They are proposing getting employer dollars contributed, but recognizing that there may be significant restraints to offer a traditional DB in today's environment, whether it's financial, legislative or regulatory," Mr. Delaplane said.

Mr. Delaplane said the SEIU's principles make sense. "Given where SEIU is focused - hotel, entertainment and health care, industries that have not had universal DB coverage historically - (the principles) seem realistic to me. There has been a good deal of interest in systems that blend DB and DC structures," said Mr. Delaplane.

He added that defined benefit plans "have provided critical retirement income guarantee features. It seems that the SEIU want to see how we can retain those features." Mr. Delaplane did not comment on the AFL-CIO's principles.

Kyle Brown, an actuary with Watson Wyatt Worldwide, Washington, said, "This is the first time I've heard that a union has initiated this kind of step, so that is pretty significant.

"Cash balance and hybrid designs have features that unions in growing industries would find appealing. It provides a faster accrual of benefits for newer and younger employees."

Said Jack Marco, chairman of the SEIU's consultant, Marco Consulting Group, Chicago: "SEIU is debating whether a (hybrid) plan makes sense. They're addressing the shortcomings of DB plans. In SEIU's view, when it comes down to it, there needs to be more plan design. When they get down to talking about it, they may look to incorporate lifestyle or lifecycle options. But it's very, very early. There is no concrete plan design today." He declined to elaborate.

In a speech given at the July Conference of Major Superannuation Funds in Chicago, the SEIU's Mr. Abrecht said the U.S. retirement income system is headed for a "train wreck," according to a report in the Australian publication, Investment & Technology. "If you rely on just Social Security, you are going to be poor. Fifty percent of the work force is headed for a retirement disaster in our country," he said.

During his presentation at the conference, Investment & Technology reported, Mr. Abrecht said an ideal system would result in retirement being funded at a level of 70% of pre-retirement income, including Social Security, and would involve a significant employer contribution.

'A Turning Point'

Dallas Salisbury, president and chief executive officer of the Employee Benefit Research Institute, Washington, said, "Many of the union people over the last five years have acknowledged a turning point away from pure, pure, pure traditional DB. We're seeing sort of this wave movement slowly taking place. (SEIU President) Andy Stern is a tremendous leader, well known, well connected; if SEIU decides to move forward, it would be very significant." Mr. Salisbury was not interviewed about the AFL-CIO principles.

If these principles are presented to Congress, the AFL-CIO and SEIU approaches have a chance to gain support, said experts. "Congress is not close-minded to the notion of hybrid concepts. Congress enacted the DB(k), promoted annuities in DC plans and clarified cash balance plans," said Mr. Delaplane.

"Now that the clarity is there for cash balance plans ... it's possible Congress would be open to this. A next logical step would be a universal DB(k) where you could put aside a portion of retirement income," said Mr. Salisbury.

A DB(k) plan, which became law under the Pension Protection Act, is a hybrid pension plan for employers with 500 or fewer employees that provides an employer-paid guaranteed lifetime monthly retirement benefit that could be supplemented by voluntary tax-deferred contributions by employees.

The minimum benefit, payable to employees who work three or more years, would be equal to the greater of 1% of average pay during the last three years of work multiplied by the number of years worked under the plan, up to 20 years, or 20% of final average pay. The 401(k) component requires the employer to match at least 50% of an employee's contributions up to 4% of the employee's salary.

Mark Iwry, senior adviser, retirement security project, and non-resident senior fellow at The Brookings Institution in Washington, said, "I think it's constructive and appropriate for this kind of thinking to be going on. The key is in the specifics ... who's covered, who's contributing, how much, how the funds are invested, distributed, how ample are the benefits, if it's cost efficient. It's a good thing that a major organization would take an open-minded look at a different plan design from the one they traditionally had. "It would be widely supported provided that the benefits are meaningful and secure and that they're being distributed widely for the people who need it the most. A key is to have the most vulnerable covered; that's what you would expect from the (unions)."

Alternatives Capture More of Pension Funds

09/01/06 DailyII.com

More than four out of 10 pension funds are hiring alternative investment managers to handle more of their assets, according to **Eager, Davis Holmes**. In its midyear report of institutional mandate hiring activity, the investment management consultant found that a record 42% of the managers that pension funds (note: the study is limited to those that disclose hiring information) work in alternative investments, up from 38% of awarded mandates in 2005 and 26% in 2004.

Further, alternative investments are now grabbing nearly one-third of all placed asserts, compared with 26% last year and 15% in 2004. The 2006 midyear assets figure is nearly five times the slice of that just three years ago, according to EDH. As a result of the upward trend, those pension consultants that have strong alternative research teams have seen their share of the pension advisory market share, most notably **Callan Associates, Wilshire Associates, Ennis Kupp, New England Pension Consultants** and **Pension Consulting Alliance.**

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