PAPERS

Pennsylvania Association of Public Employee Retirement Systems
PO Box 61543, Harrisburg, PA 17106-1543
Website: *www.pa-pers.org*

Summer 2013
(Vol. 8, No. 2)

In This Issue

Looking Ahead at Upcoming Events

10th Annual PAPERS Forum

May 28-29, 2014
(Wednesday-Thursday)
Harrisburg Hilton Hotel

Don't Miss These Fall Workshop Deadlines

8/12/2013 - Hotel Reservations @ guaranteed conference rate

9/1/2013 - Conference Registration (including reservations for baseball outing)

You'll find more details inside.
You may also access Fall Workshop information and any updates on the PAPERS website **www.pa-pers.org**.

7th Annual PAPERS Fall Workshop

September 12-13, 2013 – Pittsburgh, PA

Who Should Attend the Fall Workshop

- **Pension Fund Staff and Board of Trustees**
- **Public Pension Investment Officers, Portfolio Managers**
- **Investment Consultants & Asset Managers, Service Providers**

Why You Should Attend the Fall Workshop

- **Learn how other pension fund executives are strategizing for the coming year to deal with the current economic turmoil.**
- **Enjoy a highly interactive and educational program specifically tailored for institutional investors in Pennsylvania.**
- **Meet your peers, hear their firsthand experiences and share your ideas.**
- **Network with asset managers, service providers, consultants and asset managers.**
- **Take advantage of the panelists' presentations provided in the conference hand-out materials.**
- **Analyze various potential innovative investment opportunities available to pension funds.**
- **Earns credits for *Continuing Professional Education* (CPE) and/or the PAPERS *Public Pension Certified Professional* (PPCP) program.**

From the PAPERS Executive Director

Will I SEE YOU IN PITTSBURGH?!?

Plan to attend the 7th annual PAPERS Fall Workshop to sharpen your pension management skills and meet with your peers and service providers to discuss the latest developments and issues about public pensions.

Trustees are facing ever increasing challenges in the current economic and political environment. The funding for Public Plans is under attack from many angles. It is critical that you work to understand the many factors involved in calculating and funding your Plans liabilities.

Being a pension board member and **trustee** brings with it a serious responsibility for public officials and others appointed to local pension boards. As a trustee you have a **fiduciary duty** to protect and nurture the funds that have been entrusted to your care. The employees you represent deserve the best possible management of their trust funds.

To that end, you as a trustee have an obligation to seek out the best education you can find in the subject areas related to your duties to manage the funds and control the liabilities of these pension plans. PAPERS' mission is to provide the most cost efficient high quality education possible for local trustees in Pennsylvania. We hope that you will give us a chance to show you what we have to offer by attending one of our Fall Workshops or our Spring Forums.

This summer PAPERS staff and Board are working hard on the production of our 7th annual Fall Workshop which will be held on September 12th and 13th at the Sheraton Station Square in Pittsburgh. We planned for two half days to provide an opportunity for participants to enjoy an evening at PNC Park to network with their peers.

The PAPERS Fall Workshop provides an opportunity for you to participate in an excellent series of educational workshops. **For details, see the agenda on Pages 5-6 of this newsletter**. In addition you will have the opportunity to meet with your plan sponsor peers and with professionals who provide consulting, investment, actuarial and legal services to the pension community. All PAPERS Participating Member pension systems **receive one complimentary registration to both the Spring Forum and the Fall Workshop**. To qualify you must submit a registration form so that we can plan for the proper number of attendees. Again, this year you can also earn credits for CPE or toward your Public Pension Certified Professional at the Fall Workshop.

We have put together an agenda that addresses some of the basic skills trustees must master to fulfill their fiduciary duty to the members of their Plan. The success of the Fall Workshop and of PAPERS as an organization is dependent on your participation and support. I look forward to seeing you at the PAPERS Fall Workshop on September 12th and 13th in Pittsburgh. You'll find the Workshop reservation form waiting for you to complete on Page 7.

Jim Perry

James A. Perry,
PAPERS Executive Director

Become a Member of PAPERS

A current year PAPERS membership is required for attendance at the Spring Forum and/or Fall Workshop and to receive credits in the CPE and/or PPCP programs.

Public employee retirement systems (pension funds) can apply to become Participating Members; each Participating Membership includes one complimentary admission to both the Spring Forum and the Fall Workshop. Corporate providers of service to pension plans can apply to become Associate or Affiliate Members online at **www.pa-pers.org** or by contacting:

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James A. Perry, *Executive Director*
Phone: 717-545-3901
E-mail: perryja1@comcast.net

Douglas A. Bonsall, *Office Manager*
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E-mail: douglas.b@verizon.net

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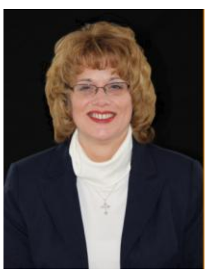
Certification Program Updated

It's been almost two years since PAPERS announced a certification program to encourage on-going education for pension plan trustees, staff and service providers. The program followed the model of the Florida Public Pension Trustees Association and PAPERS was very fortunate to receive consulting assistance from that group as we were getting started.

Two persons - ***Krista Rogers**, Controller of Lycoming County and a member of the PAPERS Board of Directors, and **Jonathan Davidson** of Associate Member Kessler Topaz Meltzer & Check, LLP in Radnor* – have completed the required 36 course credits and received their certification.

The PAPERS Board has recently updated the certification program and hired a part-time employee to coordinate it. There's a new name – ***Public Pension Certified Professional (PPCP)*** – designed to more clearly communicate the program's intent to certify a broad range of persons. The target audiences include:

- *public pension trustees*
- *pension administrators/staff, and*
- *industry professionals who work closely with pension systems*.



Krista Rogers (left) is the new coordinator of the PPCP Program and may be reached at: krista-rogers@comcast.net or 570-971-2528. You'll find an updated program description and application on the PAPERS website www.pa-pers.org and on Pages 17-19 of this newsletter.

The course requirements remain the same – 36 total course credits following a core curriculum and earned over a 3-year period of time. The credits are available for participation in three different educational offerings provided by PAPERS - *the Spring Forum, the Fall Workshop, and various Online Programs* - or a combination of the three venues. A certification exam must be successfully completed following each educational offering for credits to be awarded.

Similarly, the cost to enroll in PPCP remains the same. The enrollment fee, designed to cover the program's administrative costs, is $300 and may be paid in up to three annual installments. There is an annual $30 Post-Certification Fee for persons who have completed their credits.

Special Thanks to our 2013 Fall Workshop Sponsors

Sponsor Exhibitors

Bernstein Litowitz Berger & Grossman LLP
1285 Avenue of the Americas, 38th Floor
New York, NY 10019

Schroders Investment Management
875 Third Ave. 22nd Floor
New York, NY 10022

PAPERS' corporate sponsors provide financial support beyond regular conference registration fees and annual membership dues. Additional sponsorship opportunities for the 2013 PAPERS Fall Workshop are still available by contacting PAPERS Executive Director Jim Perry *(717-651-0792 or perryja1@comcast.net)* today for more details.

Sponsorship Levels

Sponsor Exhibitor..............................$3,000

- 2 complimentary registrations
- Recognition in program
- Complimentary exhibit space

Sponsor..$2,500

- 2 complimentary registrations
- Recognition in program

Sponsors

Bank of New York Mellon
One Mellon Center, 500 Grant St
Pittsburgh, PA 15258

Delaware Investments
2005 Market Street
37th Floor
Philadelphia, PA 19103

Kessler Topaz Meltzer Check, LLP
280 King of Prussia Rd
Radnor, PA 19087

Loomis Sayles
One Financial Center
Boston, MA 02111

Lord, Abbett & Co.
90 Hudson Street
Jersey City, NJ 07302

Neuberger Berman
605 Third Ave, 3rd Fl
New York, NY 10158

Ryan Labs Asset Management
500 Fifth Avenue,
Suite 2560
New York, NY 10110

TWIN Capital Management
3244 Washington Road
Suite 202
McMurray, PA 15317

PAPERS Pennsylvania Association of Public Employee Retirement Systems

7th Annual Fall Workshop

Thursday, September 12 – Friday, September 13, 2013

The Sheraton Station Square, Pittsburgh, Pennsylvania

Tentative Agenda

All PAPERS events at the Sheraton take place on the second floor

Thursday, September 12th

9:00 AM – 5:00 PM **Conference Registration/Exhibits ....Lobby area outside meeting rooms**

10:00 AM – 11:30 AM **PAPERS Board Meeting..Executive Board Room**

11:45 AM - 12:30 PM **Opening Luncheon ....Pointview Room**

All workshop sessions take place in the Haselton Room

12:45 PM - 1:00 PM **Opening Session**
Welcome .... Jim Perry, *PAPERS Executive Director*
Public Pension Certified Professional Program .... Krista Rogers, *Coordinator*

1:00 PM - 1:45 PM **Keynote Address**.. Rob McCord
Treasurer, Commonwealth of PA

1:45 PM - 2:30 PM **Economic Overview**
Speaker .... Rick Harrell, *Loomis Sayles*

2:30 PM - 2:45 PM **Beverage Break**

2:45 PM - 3:30 PM **The Changing Landscape of Fixed Income**
Speaker .... Tom Marthaler, *Neuberger Berman*

Declining rates and spread compression have left Global Fixed Income Investors with fewer options and more risks to navigate. What are the implications for the future?

3:30 PM - 4:15 PM **Pension Obligation Bonds: Friend or Foe?**
Speaker ....Sean McShea, *Ryan Labs Asset Management*

A lively debate of the pros and cons of these financing solutions

4:15 PM - 5:00 PM **Challenging Conventional Wisdoms:**
A Fresh Perspective on the Global Equity Landscape
Speaker .... Stephen Kwa, *Schroders*

6:00 PM - ??? **Baseball Outing at PNC Park:** *Pittsburgh Pirates vs. Chicago Cubs*
Transportation from the hotel to ballpark via the Gateway Clipper River Taxi
The World Series Suite opens at 6:00 PM; game time is 7:05 PM

PAPERS and its corporate sponsors invite you to an evening of baseball, banter, food and spirits

Friday, September 13th

7:30 AM – 12:00 PM **Conference Registration/Exhibits .... Lobby area outside meeting rooms**

7:45 AM - 8:15 AM **Breakfast .... Pointview Room**

All workshop sessions take place in the Haselton Room

8:30 AM - 9:15 AM **GASB from a Portfolio's Manager's Perspective**
Speaker .... Andrew Wozniak, *BNY Mellon*

This presentation has three main themes: "Expect change" in accounting, funding and governance; "Get in front of …" 2014 changes, potential implications and sponsor considerations; and "Challenging return environment over the next five years".

9:15 AM - 10:00 AM **You Should Be Concerned about Risk**
Speaker .... Geoffrey Gerber, *TWIN Capital Management*

Mr. Gerber will discuss a range of related topics including: Understanding Risk and Market Variability, Risk Matters, and Reducing Risk.

10:00 AM- 10:15 AM **Beverage Break**

10:15 AM- 11:00 AM **Fiduciary Duty 201**
Speaker .... Jeanna Cullins, *AON Hewitt*

The next step in understanding your fiduciary duty

11:00 AM- 12:00 PM **Trustee Panel: Fiduciary Duty, Funding Challenges, State of Pensions in PA**
Panelists .... Tim Johnson, *Allegheny County Retirement Office*
.. Others to be announced

The panel members will discuss what they see as their duty to the Plan, the participants and the political body that appointed or requires them to service in their capacity as Trustee to their Pension Plan. They will also discuss funding challenges and the state of things at their respective plans. Questions from the audience will be welcomed to cover as many topics as time permits.

12:15 pm - 1:00 pm **Closing Luncheon .... Pointview Room**

As of 7/17/2012

Registration for 7th Annual PAPERS Fall Workshop

Sept. 12-13, 2013 at The Sheraton Station Square Hotel
300 West Station Square Drive, Pittsburgh, PA 15219-1122

Conference Registration Deadline – September 1, 2013*

Each individual attending must submit a separate registration form. Please check appropriate category:

- ❑ **Pension Plan Representatives** – Current (2013) PAPERS Participating Membership required
  - First individual from pension plan – complimentary
  - Each additional individual - $50 conference registration

  All Pension Plan Representatives please answer this question: Do you plan to attend the 9/12/2013 evening ballpark outing (no additional charge to do so for Participating Members)? ___ Yes ___ NO

- ❑ **Corporate Sponsors** - Current (2013) PAPERS Associate or Affiliate Membership + sponsorship required
  - Two complimentary registrations (includes tickets to Ballpark Outing)

- ❑ **Service Provider Representatives** - *Firms providing investment management and legal services*
  Current (2013) PAPERS Associate Membership required
  - Conference only: Each individual from organization - $400
  - Conference + Ballpark Outing: Each individual from organization - $550

- ❑ **Service Provider Representatives** - *Firms providing consulting services, exclusive of investment/legal*
  Current (2013) PAPERS Affiliate Membership required
  - Conference only: Each individual from organization - $200
  - Conference + Ballpark Outing: Each individual from organization - $350

Individual's name ____

Preferred name for name tag ____

Representing (name of pension plan or company) ______________________________

Mailing address ____

City, State, Zip ____

Telephone number (______) _____-________ E-mail address ______________________

Please indicate all Fall Workshop events that you plan to attend. This information is needed so arrangements for adequate seating & meals can be made.

Thursday, Sept. 12, 2013
- ❑ Opening Luncheon
- ❑ Afternoon sessions
- ❑ Evening PNC Park baseball outing

Friday, Sept. 13, 2013
- ❑ Breakfast
- ❑ Morning sessions
- ❑ Closing Luncheon

___ **Check if interested in PPCP (*Public Pension Certified Professional*) Program**

Full payment of any fees due must be included with this registration.

You may pay the registration fee either by check or electronically through PayPal.

1. ***To pay by check.*** Please make check payable to: **PAPERS** and return with this application to: **PAPERS, P.O. Box 61543, Harrisburg, PA 17106-1543**
2. ***To use PayPal.*** Please access the PAPERS website (www.pa-pers.org) and click on "Fall Workshop". Select the appropriate type of registration from the drop down box and follow the directions to have PayPal transfer the applicable fees automatically from your bank account to PAPERS. In addition to PayPal payment, you must also submit this registration form. Your completed conference registration form may either be mailed to: ***PAPERS, PO Box 61543, Harrisburg, PA 17106-1543*** or scanned, saved and e-mailed to: ***douglas.b@verizon.net.***

*** The PAPERS Fall Workshop group rate for overnight lodging of $135 double or king plus 14% tax at The Sheraton Station Square is guaranteed only for reservations made on or before 8/12/2013. To make hotel reservations, call 1-888-627-7029 OR reserve on-line at:** https://www.starwoodmeeting.com/Book/papers2013.

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Pennsylvania Association of Public Employee Retirement Systems

Pittsburgh Pirates vs. Chicago Cubs

PAPERS invites you to an evening of baseball, banter, food and spirits.

September 12, 2013

6:00 Suite Opens
7:05 Game

World Series Suite
PNC Ballpark

Casual Attire.

RSVP:
Space is limited.

Please respond by September 1, 2013 by indicating acceptance on your Fall Workshop registration.

7th Annual PAPERS Fall Workshop

Downtown Pittsburgh, PA - September 12-13, 2013

In addition to outstanding educational sessions and the opportunity to network with those involved in public pension work, we've also planned an evening outing to a Pirates professional baseball game at PNC Park. Firms that are interested in corporate sponsorships and speaking opportunities on the agenda should contact PAPERS Executive Director Jim Perry (perryja1@comcast.net) immediately.

If you're interested in overnight lodging for the Fall Workshop

The Sheraton Station Square

300 West Station Square Drive, Pittsburgh, PA

Conference Rate: $135/double or king + tax

Conference Rate Guaranteed only through August 12, 2013

For Reservations:

CALL 1-888-627-7029 and mention you're attending PAPERS' Fall Workshop

OR reserve on-line at: https://www.starwoodmeeting.com/Book/papers2013

Driving Directions to The Sheraton Station Square, Pittsburgh

From Pittsburgh International Airport

Take 60 South (Pittsburgh) to Interstate 279 North to Exit 5-C. Bear right and continue for approximately one mile. At the second light, turn right onto Carson Street (837). The Pittsburgh riverfront hotel is approximately 1.5 miles on the left.

From East

Take Interstate 376 West to the Grant Street Exit (1C). Turn left at the first light onto Fort Pitt Boulevard. Stay in the left lane and go one block to Smithfield Street. Turn left at the light onto the Smithfield Street Bridge, and the Station Square entrance is at the end of the bridge.

From North

Take Interstate 79 South to I-279 South to Fort Pitt Bridge. Stay in the far right lane and exit 5-C (just before the tunnel). This will put you on Carson Street. (Route 837). Turn right at the first light and follow the access road to the hotel.

From South

Take Route 79 North to I-279 North (Pittsburgh). Take Exit 5-C (West End) and bear to the right. Continue for approximately one mile and at the second light, turn right onto Carson Street (837). The Pittsburgh riverfront hotel is approximately 1.5 miles on the left.

The following re-printed with permission of National Council on Teacher Retirement (NCTR).

Understanding New Public Pension Funding Guidelines and Calculations

The importance of properly financing state and local government retirement systems has never been greater. Sound pension funding policies not only help ensure costs and benefits remain sustainable, but also strengthen the financial position and credit rating of the sponsoring governments.

State and local governments soon will need to distinguish several separate pension calculations that will be derived in different manners for distinct purposes:

- *Books – computing an annual position regarding pensions for financial statements*
- *Bonds – calculating how pension obligations affect a government's creditworthiness*
- *Budgets – determining the appropriate annual contribution to the retirement system for sound funding*

The Governmental Accounting Standards Board (GASB) has released new standards for how governments should report pensions on their books or income statements. Some credit ratings agencies have announced that they will make new adjustments to governmental pension data for bond ratings. However, none of these computations is intended to determine the appropriate annual pension contribution a government should appropriate to ensure sound funding.

To guide lawmakers in reviewing the effectiveness of existing funding policies and practices, national organizations representing the nation's governors, state legislatures, state and local officials, and public finance professionals jointly formed a Pension Funding Task Force and released *Pension Funding: A Guide for Elected Officials*.

These guidelines urge policymakers to ensure pension contributions are actuarially determined within sound parameters. Doing so ensures that pension promises can be paid, employer costs can be managed, and the policy to finance pensions is clear to all stakeholders.

Separate Pension Numbers for Books, Bonds, and Budgets

	Books	Bonds	Budgets
Purpose	Standardized financial reporting of pensions for accounting	Stress testing the degree to which pension obligations may affect a government's ability to repay bonded debt	Determining an annual pension contribution to properly fund benefits
Primary audience	Users of government financial statements	Ratings analysts	State/local policymakers
Source of calculation	Accounting standards set by the Governmental Accounting Standards Board (GASB)	Practices established by individual credit rating agencies	State/local statutory, administrative and procedural rules
Methodology	Pensions are accounted for through the computation of a Net Pension Liability, i.e., the difference between the market value of pension fund assets and benefit obligations as of a specific date	Varies by rating agency, as pensions are just one of many metrics used to determine a bond rating	Most governments make actuarially determined contributions, calculated within established parameters as a level percentage of payroll to fully fund benefits earned each year and to amortize unfunded liabilities
What's changing	The Net Pension Liability is a new figure that will be placed on basic government financial statements and is expected to create unprecedented volatility and, in some cases, could dwarf other items on the financial statement	Some ratings agencies have announced that in their credit analytics, they will adjust pension data using uniform, generally more conservative assumptions regarding amortization periods and investment returns	New GASB standards will no longer include parameters for calculating an annual required contribution. Although this does not necessitate a change to existing funding policies or statutes, governments are urged to follow recommended guidelines established by the Pension Funding Task Force

(Continued on Page 11)

Understanding New Public Pension Funding Guidelines…

(Continued from Page 10)

For More Information

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The Council of State Governments
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June 2013

Protect Pennsylvania Pensions!

By: Diane Oakley, National Institute on Retirement Security (NIRS)

Diane Oakley is Executive Director of NIRS. This article was first published on April 18, 2013 and is re-printed here with NIRS permission.

Pennsylvania taxpayers want reliable public services delivered at a reasonable cost. These public services are provided by trained and experienced Pennsylvanians such as teachers, nurses, paramedics and park foresters. But it's an ongoing challenge for public employers to recruit and retain highly qualified workers to deliver these services.

Government employers have significant disadvantages when recruiting employees. They cannot offer higher salaries typically offered to professionals and managers in the private sector. For example, more than half of public employees in Pennsylvania have a college education, yet data indicate that these highly qualified public employees earn 21 percent less on average than comparably educated private sector employees. In similar comparisons across all workers, public sector pay trails private sector pay by 11 percent to 12 percent.

One management tool that helps public employers stabilize a large workforce is the ability to offer good retirement benefits. Pensions that pay a monthly benefit check based on employee's years of service enable the state of Pennsylvania, for instance, to recruit and retain high quality workers. Because pension contributions are a shared responsibility among employees and employers over the long term, investment earnings pay most of the cost of the benefits. As Eli Leher of the conservative Heartland Institute indicates, public employers "have a strong comparative advantage relative to private industry in offering pension benefits."

The Pennsylvania Legislature is considering a proposal to dismantle the pension system provided to public employees in Pennsylvania in favor of individual 401(k)-type accounts. Not only would this change undermine the ability of middle-class Pennsylvanians to be self-sufficient in retirement, it would threaten the quality of education and public services in the state by making it even harder to keep qualified and experienced employees.

Towers Watson research finds the percentage of workers under age 40 who agree that a pension plan is important in their job choices has soared -- to 63 percent in 2011 from 28 percent in 2009. Pensions also land near the top of workers' "top ten" list of benefits, while 401(k)-type savings plans rank near the bottom. More than three-fourths of new hires say their defined-benefit pension gives them a compelling reason to stay at a job, reducing employee turnover that undercuts productivity.

The financial crisis provided a key lesson about the economic value of pensions. Spending by retirees with predictable pension checks stabilized the struggling U.S. and commonwealth economies. In 2009, retired public employees in Pennsylvania continued to spend their monthly incomes at grocery stores, pharmacies and local restaurants. This cash flowing to private businesses from Philadelphia to Pittsburgh supported nearly 100,000 jobs and $14 billion in economic output. In contrast, retirees with plummeting 401(k) accounts scaled back spending when the economy most needed it.

More than 70 percent of Americans agree that the public sector employees who protect and shape our future should receive a pension. So it is not a surprise that, after the financial crisis, Pennsylvania and nearly every state enacted changes to their public pensions to ensure long-term sustainability and maintain this vital human-resource tool.

Pennsylvania's 2010 Pension Reform Act cut pension benefits for new employees by over 20 percent, reducing employer cost of future pensions to only 3 percent of salaries. Meanwhile, school and state employees contribute more -- 7 percent on average from every paycheck -- to fund their pensions. The Legislature in 2010 also committed to restoring proper funding, correcting for the diversion of pension contributions to other purposes over the last decade. Over time, the 2010 changes will restore Pennsylvania's public pensions to full funding.

(Continued on Page 13)

Protect Pennsylvania Pensions!

(continued from Page 12)

Now, lawmakers are considering replacing the pension plan for new employees with a 401(k)-type plan. In addition to making it more difficult to hire and retain first-rate employees, such a path, according to a wide body of research and employer experience, is ill-advised because:

- *Closing an existing pension plan to new employees means fewer employees share the cost of existing pension commitments, leaving taxpayers on the hook to make up any difference.*
- *Switching to 401(k)-type individual accounts would cut retirement income beyond the 2010 reform, leaving Pennsylvania's public servants less able to support themselves in retirement after a career working for the public good.*
- *Taxpayers would lose the significant cost efficiencies of lower fees and better investment returns achieved by defined-benefit pensions in a switch to 401(k)-type individual retirement accounts.*

The workforce and economic benefits of pensions are key factors to consider while examining pension proposals that would undo the 2010 reforms. Experts agree that the 2010 changes will work over time -- if everyone does their fair share.

Given the anxiety 85 percent of Americans feel about retirement, it's no wonder that a similar percentage agree that all workers should have a pension so they can be independent and self-reliant. Real pension reform for Americans should start with better retirement security for all.

Read more: http://www.post-gazette.com/stories/opinion/perspectives/protect-pennsylvania-pensions-683937/#ixzz2UckhWajJ

Check Out the PAPERS e-Library

From time to time PAPERS Associate & Affiliate (corporate) members provide research papers on timely topics related to public pension fund administration that are too long to be included in the PAPERS newsletter. We are pleased to share these important documents with our readers by posting them in the PAPERS e-library on our website. Access the library at: http://www.pa-pers.org/newweb/library.html.

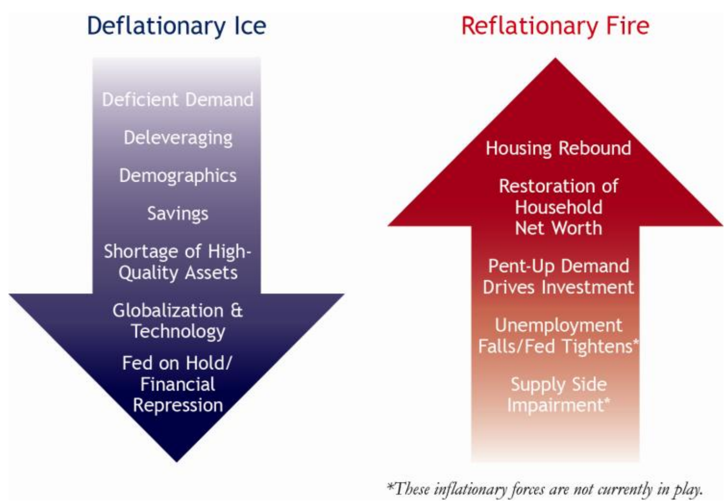
Bond Realities:

The Changing Landscape for Fixed Income and the 'Death of the Agg'

By: Andrew A. Johnson, Neuberger Berman

The following is a summary of a longer research paper that can be found in the PAPERS e-library at http://www.pa-pers.org/newweb/library.html.

In my 20-plus years as a portfolio manager, I've seen the death of the Barclays U.S. Aggregate Bond Index, affectionately known as the "Agg," forecast no fewer than three times. This reminds me of a quote from Mark Twain, who said, "The reports of my death have been greatly exaggerated." The same could be said of the Agg, a market-weighted amalgam of fixed income assets which reflects the strengths, weaknesses—and distortions—of the overall U.S. bond market.



In today's market, U.S. federal budget deficits are fueling expectations that the Agg will become dominated by Treasuries—making it an index devoid of significant yield, the victim of multiple interest rate cuts and quantitative easing. The constant "remaking" of the Agg reflects the changing nature of issuance patterns. The Agg is often critiqued as reflecting the most indebted issuers. I will not join the debate concerning its stature as the default benchmark. Rather, I argue in favor of benchmark-agnostic (or unaware) opportunistic investing. The prevailing low yields and more normalized spreads make the current environment especially ripe for opportunistic portfolio management.

(Continued on Page 14)

Bond Realities

(Continued from Page 13)

Multiple tactics are needed today to succeed in managing fixed income portfolios. Beyond smart sector allocations and timely duration decisions, this market in particular requires an expanded toolkit that should provide the resources to expand the duration band (potentially to allow negative duration), introduce pure alpha strategies and allocate to non-traditional fixed income asset classes. Based upon where we are in the current market cycle, you must think creatively and draw from more areas of the markets to capitalize on the opportunities that do exist.

In my view, truly unconstrained opportunistic investing implies no benchmark. Mandates are better designed by establishing clear return goals with a specific risk budget. That said, an investor in opportunistic fixed income might desire a benchmark that establishes the neutral duration of the portfolio based on specific needs.

For example, let's suggest a scenario where an opportunistic fixed income manager has no opinion on the direction of interest rates or holds a very uncertain or weak view. With cash as a benchmark, investors would expect the manager to maintain portfolio duration at or close to zero. On the other hand, if the same manager is given the Barclays U.S. Aggregate Bond Index as the benchmark, one would expect a portfolio reflecting no opinion or a weak view on the direction of interest rates to have duration within shooting distance of the benchmark. Even if the mandate allows for significant tracking error, the benchmark choice will likely anchor the manager wrestling with what a neutral duration position should look like. A truly unconstrained manager will arrive at a portfolio duration that is entirely driven by an assessment of the risk and return tradeoffs across the yield curve.

Given the unconstrained nature of true opportunistic mandates, it's critical for investors to set return objectives and a risk budget with managers. One fairly basic principle is that risk and return must be consistent and reasonable in relation to one another. In that context, aspiring to an *ex-ante* information ratio (IR) of between 0.6 and 0.8 is reasonable. To achieve this, you either need to set risk or return. The natural inclination is to start with a return bogie, and, once that is established, the level of risk falls out as a function of the assumed IR.

NEW ENVIRONMENT, NEW APPROACHES

The prevailing low yields and more normalized spreads make the current environment especially ripe for moving beyond the Agg to opportunistic portfolio management. We must think creatively and draw from more areas of the markets to capitalize on the opportunities that do exist. To effectively execute opportunistic portfolios, investors and managers must maintain a clear focus on both the risk and return tradeoff. Finally, it's vital that investors understand the means by which opportunistic managers establish and implement their investment views, ensuring they employ consistent and disciplined portfolio construction processes.

Andrew A. Johnson, Managing Director, joined Neuberger Berman in 1989. Andy is the Head of Investment Grade Fixed Income and lead Portfolio Manager for multiple Core Bond portfolios. He is the Chief Investment Officer for Investment Grade strategies with responsibility for the overall direction of the investment process and research. Andy leads the senior investment team that sets overall portfolio strategy, and serves on numerous investment grade sector specialty teams. He is also a member of Neuberger Berman's Fixed Income LLC's Board of Directors. Prior to joining the firm, Andy was a manager of financial planning and analysis at Illinois Bell. Previously, he had been an R&D engineer at Northrop Defense Systems Division. Andy earned his BS and MS degrees in Electrical Engineering at the Illinois Institute of Technology and his MBA from the University of Chicago.

Economic Climate Change & the Long-Term View on Yields

By: Rick Harrell, Loomis, Sayles & Company

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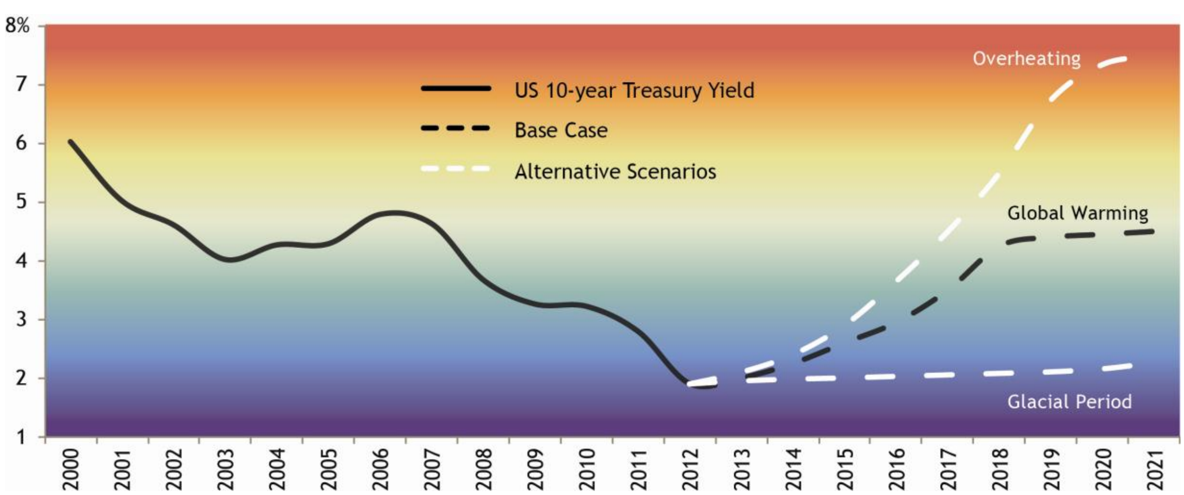
Fire vs. Ice: Our View of the Secular Drivers of Interest Rates

Will rates rise? It's a logical question. US Treasury yields have been in a secular downward trend since the 1980s and almost frozen at historic lows for the last several months. While recent cyclical improvements suggest the US economy is heating up, we do not expect interest rates to start soaring to record highs. The interest rate environment will eventually undergo climate change, but the process will be gradual. In the chart at right and in full text of this article available here, we name the secular deflationary and inflationary drivers that we think will simultaneously cool and heat interest rates in the near term.

Changing Climate Zones for Yields

The balance between deflationary ice and reflationary fire will change over time, creating different climates for yields. We set forth three potential scenarios—"Glacial Period," "Global Warming" and "Overheating"—to illustrate how the 10-year Treasury yield might evolve over the next five years and beyond.

US TREASURY YIELD SCENARIOS



Source: Loomis Sayles estimates as of May 2013. For illustrative purposes only.

Base Case: Arrive at Global Warming

We believe deflationary ice conditions will keep interest rates depressed until 2016. Fiscal policy will be tight, acting as a drag on growth and tempering reflationary fires, and slow profit growth will lumber along with subpar global demand. We expect the 10-year Treasury yield to remain below 3% until about 2016 when reflationary conditions should cause yields to enter Global Warming. During the transition to this phase, the

(Continued on Page 16)

Economic Climate Change

(Continued from Page 15)

economy can grow very quickly without alarming the Federal Reserve (the Fed) because of the large output gap. We believe once excess slack in the economy is removed and unemployment falls below 6.5%, a more typical interest rate setting should be in place, allowing for tighter Fed policy. At this stage, we believe the 10-year yield will begin to normalize toward 4%.

Alternative Scenarios: Glacial Period and Overheating

The first alternative is a Glacial Period in which deflationary forces persist beyond 2016 and the 10-year Treasury yield stays extremely low, potentially falling closer to 1%. If the private sector maintains an aversion to debt and delevers further, the "borrow-and-spend" recovery should stay on ice. Additionally, fiscal austerity could ramp up too quickly and short-circuit a recovery in private demand.

The second alternative, Overheating, could result from policy error—fiscal, monetary or both. On the fiscal policy side, "crowding out" is a key risk. If the government fails to address entitlements and ramps up deficit spending in the face of strong private sector demand, the increased competition for capital will promote higher inflation and interest rates. In terms of monetary policy risk, the Fed may underestimate the extent of supply side impairment and continue to ease as the economy hits capacity constraints. Under such a scenario, we see the 10-year Treasury yielding above 6%.

In our view, Overheating is the most distant and least probable of the three scenarios. By definition, Overheating can only occur after the output gap has closed and Global Warming is in full swing. And, crowding out and supply constraints—the inflationary forces we see as necessary to ignite Overheating—are not likely to be considerations until 2018 at the earliest.

To read the full text of this article, please visit http://www.loomissayles.com/.

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then email or mail the completed form to Krista Rogers.

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Participant Information:

Name: ____

(Please print your name the way you would like it on your final certification)

Organization: ____

Address: ____

____

City: ______________________ **State:** __________ **Zip:** ______________

Telephone: ______________________ **Fax:** ______________________

E-Mail: ____

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Billing Name: ____

Billing Address: ____

City: ______________________ **State:** __________ **Zip:** ______________

Please submit PPCP application to:

Krista Rogers
234 Gordon St.
Duboistown, PA 17702
Or:
krista-rogers@comcast.net