HB6611

GOVERNMENT AND MUNICIPAL SYSTEMS, LLC

Solving public problems with a private market solution

AMERICA'S PUBLIC EMPLOYEE BENEFIT CHALLENGE: After a difficult investment decade, America's public employee pension and health benefit plans are in crisis. From coast to coast, states and municipalities are confronting an increasing inability to keep up with the level of contributions required to meet promises to employees. New rule changes this year will dramatically complicate those efforts, and independent financial commentators predict that they will throw a number of large counties into bankruptcy.(1)

A number of municipalities have declared bankruptcy and over 100 are seriously considering it as an option to reduce their obligations under collective bargaining agreements.(2) Connecticut has been listed as #2 in the "First 11 State Pension funds That Will Run out of Money"(3), and January 20, 2012 Moody's Investor Service downgraded Connecticut's debt.(4) Illinois, as an example, has suffered several downgrades in recent years, with the last one adding an estimated $95MM in **additional** interest to $500MM bond issue (which was eventually withdrawn due to lack of interest on the part of investors).(5)

According to the most recently available public documents,(6) Connecticut currently has unfunded actuarially accrued liabilities (UAAL) in the state retirement plan of $11.7 Billion. The other post-employment benefits (OPEB), consisting primarily of health care, amount to $17.9Billion, for a total of $29.6 Billion. To put that in perspective, according to the US Census Data for 2011, there were $1.5 Million households in the State, which saddles each household with $19,722 of debt for these two employee benefit items in today's dollars. That's in addition to the estimated $136,260 per household of National Debt, according to a CBS News Money Watch report.(7)

THERE'S A NEW SHERIFF IN TOWN: The Government Accounting Standards Board (GASB) has been studying the events of the past decade and concluded that new accounting rules are warranted to put all assets and liabilities on "one page," **mark asset values to current market values**, and eliminate "smoothing" or averaging of gains and losses over time, which they feel has the ability to obscure the total amount of unfunded debt.(8) The independent Center for Retirement Studies at Boston College 2012 analysis of the effects of the new GASB rules shows CT SERS at 44.4% funded, with the new rules dropping that ratio to 37%; additionally, with the new recommended blended rate of assumed return, it would fall further to 34.5%; CT Teachers Plan shows currently funded at 61.4%, falling to 52.3% under the new rules.(9) Assuming those numbers are correct, the per household debt goes up accordingly.

ACTUALLY, TWO SHERIFFS: Moody's Investor Services has experienced frustration about the disparate ways governments calculate pension debts. Comparing one public agency's pension debt to another's is often apples to oranges. So, hence, in the Summer of 2012 Moody's announced plans to recalculate pension debt by applying the same accounting assumptions across the board.(10) This will be done with four adjustments, two of which are particularly significant and impactful. First, Pension Liabilities would be recalculated using high grade long term corporate bonds as the discount rate (5.5% for 2010-2011). Second, annual contributions would be adjusted to reflect this lower rate and a 17 year level-dollar amortization of unfunded liabilities. This will result in what is effectively a **cultural shift** in the way people think about their liabilities. This approach, Moody's estimates, would roughly **triple to $2.2 Trillion** the amount of unfunded pension debt across the US which is currently being reported at the state and municipal level. The new numbers would be used in calculating their credit ratings. A recent analysis of six large California counties shows that this analysis will push them into bankruptcy.(11)

WHAT CAN YOU DO ON A LOCAL LEVEL? The last Budget negotiation in Connecticut demonstrated well the extreme political challenges associated with addressing deficits through tax increases, spending cuts and concessions on the part of state employees. This bill is a "Permissive" bill to allow the consideration of innovative ideas in addressing the unfunded liability issue. **It does not** pass or approve any particular program or mandate the adoption of anything—rather, it **opens the door** to the consideration and **further study** of innovative ideas and alternatives which do **not** involve raising taxes, spending cuts and further employee concessions.

CONSIDER A PUBLIC-PRIVATE PARTNERSHIP WHICH SOLVES THE PROBLEM AT NO COST TO THE STATE Government and Municipals Systems, LLC ("GAMS") has, over the past five years, created a Program to deal effectively with unfunded liabilities by bringing **brand new money** to the table which does **not** originate from tax increases, spending cuts or concessions on the part of state employees. Through the use of a unique patent-pending life insurance design which "finances itself," we can secure a **completely new asset** for the State which it has heretofore overlooked on its balance sheet. Each employee comes with **mounting obligations** to the taxpayers of Connecticut in the form of retirement and health benefits—each employee **also has an insurable capacity** which the state may use as an **offset** to the liabilities stemming from employee benefits, just as has been done in the corporate world for decades. Virtually 50% of the major banks in America use this approach to pay for employee benefits. In Connecticut, according to the FDIC, 70% of banks own corporate life insurance on their employees, primarily to pay for benefits.(12)

Instead of being an "expense," however, the GAMS program is completely unique in that it "**finances itself**" with an insurance policy on the life of each employee who **chooses** to participate (participation is **completely voluntary**, although there are **additional benefits** for those who elect to join). This is a policy which **grows on a guaranteed** basis by the premiums which go into it and a cost of money so, when **fully financed** by an outside lender (i.e., **not** using any of the current pension funds or State contributions), the policy "**pays its own acquisition and financing costs**" and the death benefits are **free and clear** to the State to use with the Retirement System, Health System, etc., as it sees fit. In any event, 100% of the benefits go **back to the employees**. For that reason, it has **nothing in common** with some abusive corporate plans of yesteryear (sometimes referred to as "janitor" plans or "peasant plans") where the employees (A) did not have a choice on participation, (B) did not know they were insured, and (C) did not participate at all in the benefits of the insurance. This Program is **entirely for the benefit of the public employees of the State of Connecticut—and the taxpayers**, to the degree that it mitigates against additional tax increases.

The Program is called "Public Employee Benefit Solvency" or PEBS, and **brings brand new money** to the table to address the current underfunding crisis and assist with the ratings agencies' changes about to dramatically change the credit-rating landscape. Additionally, to add another level of complexity for the states, it was announced Monday that Illinois had just settled securities fraud charges with the SEC in conjunction with inappropriate disclosures relating to their pension plan which the SEC said misled bond buyers.(13)

On the Union side, we have met with management at the highest levels, which is very interested in salvaging and preserving the gains they have made to date, and they want to grow their membership at a time when union membership is under assault and contracting. It is necessary to find new ideas which may forge a symbiotic relationship between the taxpayer and the state employee. The idea that "what's mine is mine and what's yours is mine," is outdated in this climate. This is a **Permissive bill to allow consideration** of innovative ideas not involving tax raises, benefit or spending cuts, and not just our approach but to allow consideration of **all** insurance-based innovative approaches, and we respectfully request that you give it every consideration. Thank you.

(1) "Moody's New Pension rules Would Bankrupt Six California Counties" Fox & Hounds 1-16-13

(2) Conversations with national law firm McKenna, Long & Aldridge Municipal Bankruptcy Specialists

(3) Business Insider, 10/18/10, Gus Lubin quoting Professor Joshua Rauh of Kellogg Business School

(4) Moodys.com January 20, 2012

(5) Capitolfax.com January 31, 2013

(6) Cavanaugh Macdonald Consulting, LLC Connecticut State Employees Retirement System Report of the Actuary on the Valuation as of June 30, 2010, Schedule A The Segal Group, Inc., Actuarial Valuation and Review of Other Post- Employment Benefits (OPEB), June 30, 2011, Section 1 United States Census 2011 Housing Units http://quickfacts.census.gov/qpd/states/09000.html

(7) CBS Money Watch 5-27-11

(8) www.GASB.org/

(9) How Would GASB Proposal Affect State and Local Pension Reporting?" Boston College Center for Retirement Studies Updated September 2012

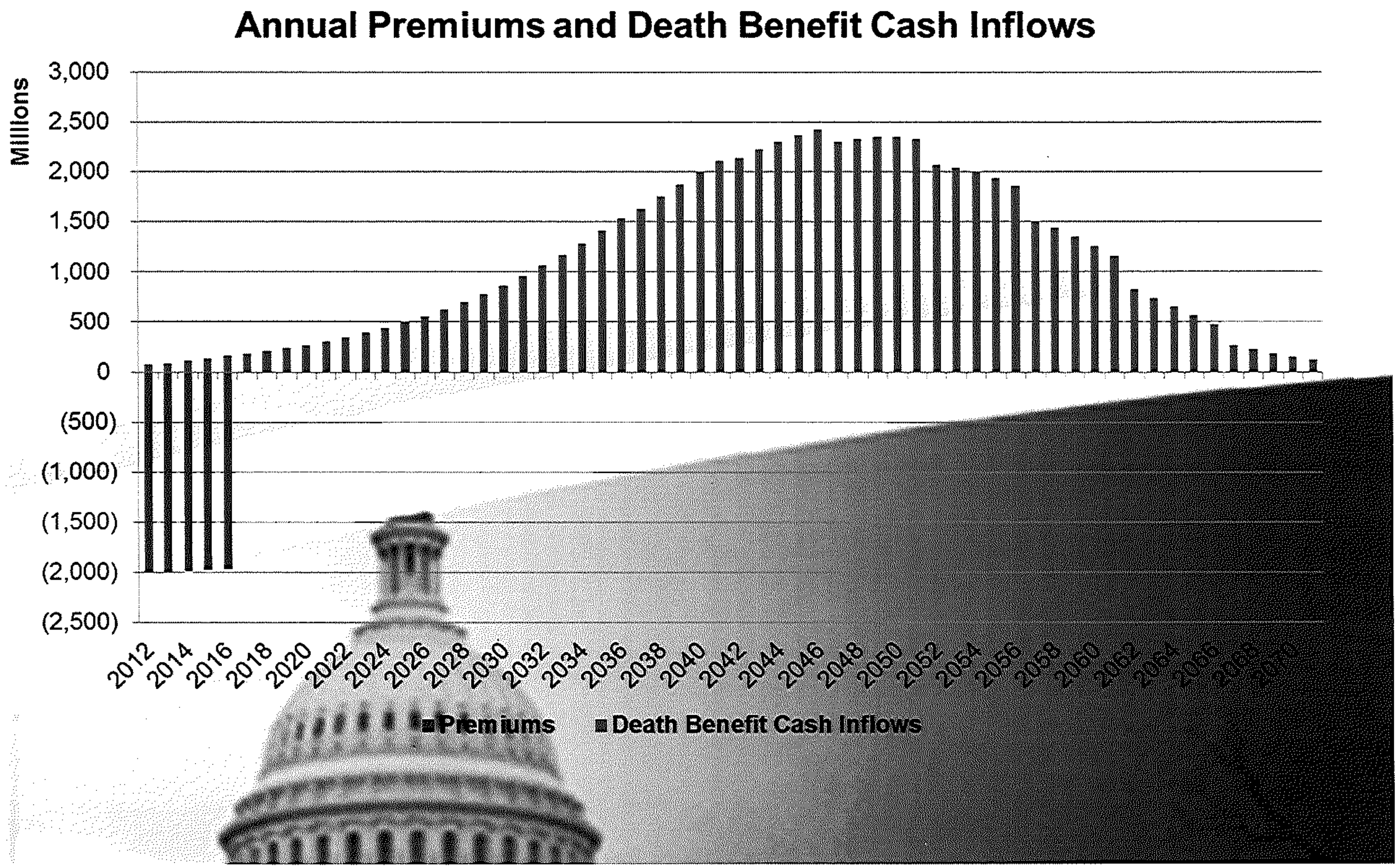
(10) Moody's Investor Services Proposed Changes in Analyzing Government Pension Data (1/1/13)

(11) FDIC Call/TFR Report (website: www.fdic.gov) as of 06/30/12

(12) See #1 above

(13) New York Times, Monday March 11, 2013 "Illinois is Accused of Fraud by SEC"

Premiums and Death Benefit Cash Flows



The New York Times

March 11, 2013

Illinois Is Accused of Fraud by S.E.C.

By MARY WILLIAMS WALSH

For the second time in history, federal regulators have accused an American state of securities fraud, finding that Illinois misled investors about the condition of its public pension system from 2005 to 2009.

In announcing a settlement with the state on Monday, the Securities and Exchange Commission accused Illinois of claiming that it had been properly funding public workers' retirement plans when it had not. In particular, it cited the period from 2005 to 2009, when Illinois also issued $2.2 billion in bonds.

The growing hole in the state pension system put increasing pressure on Illinois' own finances during that time, raising the risk that at some point the state would not be able to pay for everything, and retirees and bond buyers would be competing for the same limited money. The risk grew greater every year, the S.E.C. said, but investors could not see it by looking at Illinois' disclosures.

In effect, that meant investors overpaid for bonds of a lower value than they were made out to have, although the S.E.C. did not measure any loss in dollars, and it did not impose fines or penalties in Monday's settlement. Illinois agreed to a cease-and-desist order without admitting or denying the accusations.

The charges put the state's pension system, generally thought to be the weakest of any state, back in the national spotlight. In his budget address last week, Gov. Pat Quinn, a Democrat, issued a clear warning that the system had to be fixed.

"Without pension reform, within two years, Illinois will be spending more on public pensions than on education," said Mr. Quinn. "As I said to you a year ago, our state cannot continue on this path."

Many states, counties and cities are struggling with shortfalls in their pension systems, and because large numbers of people now qualify to draw benefits, the expense is wreaking havoc with budgets. Still, securities lawyers are not predicting a wave of S.E.C. pension enforcement actions. The states are legal sovereigns, and federal securities regulators have much more power to police corporate wrongdoing than potential violations by the states and municipalities.

The S.E.C. does have the power to step in when it believes that there has been a fraud, but that means meeting a tough standard of proof. Many of today's troubled public pension funds got that way through missteps that, while harmful, do not necessarily constitute fraud: overly rosy investment assumptions, failure to take into account that Americans are living longer, and bad calls about how much benefits actually cost.

The agency did send a signal that Monday's enforcement action would probably not be the last, however.

"Public pension disclosure by municipal issuers continues to be a top priority," said Elaine C. Greenberg, chief of the S.E.C.'s Municipal Securities and Public Pensions Unit, which was formed in 2010.

Its first action against a state accused New Jersey of fraud that year in connection with pension disclosures that said a special reserve had been set up to pay for pension increases. The reserve was an accounting illusion, The New York Times had previously reported.

In that case, as with Illinois, the S.E.C. has cited the harm done to the investors who bought the governments' bonds — not the retirees whose pensions were at risk, or the taxpayers who found themselves expected to make outlays they never agreed to. The S.E.C.'s mission is to uphold the integrity of the capital markets, not to protect retirees or promote balanced budgets.

"Municipal investors are no less entitled to truthful risk disclosures than other investors," George S. Canellos, acting director of the S.E.C.'s Division of Enforcement, said in a statement. "Time after time, Illinois failed to inform its bond investors about the risk to its financial condition posed by the structural underfunding of its pension system."

The S.E.C. noted that Illinois had passed a law in 1994 allowing itself to put less than the required amount into its pension system each year. It is not the only state to have done so. For the next 15 years, Illinois issued annual reports showing that it was on track with its lawful schedule, even as it fell further behind the real-world amount needed to pay all current and retired public employees.

By 2003, the state was so far behind that it issued $10 billion of bonds and put the proceeds into its pension funds to make them look flush. The main underwriter of those bonds, Bear

Stearns, was later found to have made an improper payment to win the business, figuring in the corruption trial of a former governor, Rod R. Blagojevich.

In 2005, the state passed another law, giving itself a holiday from making even the inadequate annual pension contributions called for by its 1994 schedule. It said it would offset the missing money with bigger contributions from 2008 to 2010, but then did not do so. By 2010, the reported shortfall of the pension system was $57 billion, and senior officials were warning that the system was at risk of breaking down completely.

Illinois is one of a number of states where the teachers, state police and certain other public workers do not participate in the Social Security program, so they have no federal backstop in case the state system should fail. Republican members of Congress have issued a warning that they expect Illinois to seek a federal bailout for its pension system, and said they would oppose such assistance.

In reaching its settlement, the S.E.C. said it had considered "remedial acts" by the state, including that Illinois had hired disclosure counsel in 2009 and made extensive corrections and amplifications in its financial reports. These steps clarified the state's financial position, but the legislature has yet to enact significant pension reform.

EMPLOYER:

REPORT: Analysis of BOLI Holdings: All States

SOURCE: FDIC Call/TFR Report (website: www.fdic.gov) as of 06/30/2012

State	Banks with BOLI Number	Banks with BOLI Rank	Percent of Banks with BOLI Percent	Percent of Banks with BOLI Rank	Average BOLI Holdings Number	Average BOLI Holdings Rank	Average BOLI Relative to Tier 1 Capital Percent	Average BOLI Relative to Tier 1 Capital Rank
Alabama	77	22	57.04%	21	47,752,558	10	18.01%	6
Alaska	3	50	42.86%	41	1,921,667	50	2.71%	50
Arizona	10	44	32.26%	48	8,248,400	32	14.76%	30
Arkansas	78	21	60.47%	15	6,418,423	35	13.21%	40
California	131	10	51.78%	29	27,837,061	12	13.27%	39
Colorado	39	33	36.79%	46	5,006,667	40	14.01%	35
Connecticut	35	36	70.00%	7	32,751,543	11	16.43%	15
Delaware	9	46	37.50%	45	228,775,333	4	12.49%	44
Florida	81	19	37.50%	44	10,271,481	27	15.77%	19
Georgia	117	14	48.95%	33	13,817,521	21	17.50%	8
Hawaii	7	47	77.78%	1	118,072,714	5	19.39%	1
Idaho	9	45	56.25%	22	5,622,222	39	13.42%	38
Illinois	265	1	46.33%	36	16,272,309	18	15.69%	20
Indiana	91	15	64.54%	10	13,334,154	22	18.61%	3
Iowa	172	5	50.29%	31	3,159,674	45	13.09%	42
Kansas	143	6	45.69%	39	3,563,140	44	13.46%	37
Kentucky	82	18	42.05%	42	4,880,439	41	13.12%	41
Louisiana	84	17	57.53%	19	8,158,548	33	11.26%	47
Maine	20	39	66.67%	9	87,397,850	7	11.89%	46
Maryland	49	28	59.76%	17	8,774,306	28	18.20%	5
Massachusetts	122	12	75.78%	3	12,854,549	23	18.37%	4
Michigan	74	23	56.06%	23	25,037,378	15	16.80%	13
Minnesota	183	3	47.16%	35	2,293,361	48	14.35%	34
Mississippi	69	24	76.67%	2	14,154,203	20	17.21%	12
Missouri	136	8	41.09%	43	4,854,993	42	14.73%	32
Montana	37	35	55.22%	25	5,779,135	38	15.03%	26
Nebraska	79	20	36.57%	47	1,998,203	49	11.07%	48
Nevada	5	49	20.83%	50	15,803,800	19	10.75%	49
New Hampshire	16	41	72.73%	4	8,336,875	31	15.07%	25
New Jersey	62	27	54.87%	26	26,241,177	13	17.70%	7
New Mexico	25	37	51.02%	30	4,645,120	43	12.48%	45
New York	88	16	47.31%	34	274,463,261	3	15.91%	18
North Carolina	66	25	70.97%	6	351,328,803	2	17.28%	10
North Dakota	45	31	50.00%	32	2,382,756	47	12.98%	43
Ohio	126	11	52.94%	27	104,581,643	6	18.91%	2
Oklahoma	133	9	55.65%	24	6,653,624	34	14.81%	29
Oregon	21	38	60.00%	16	11,775,857	24	15.24%	22
Pennsylvania	142	7	67.94%	8	83,037,556	8	17.42%	9
Rhode Island	6	48	46.15%	37	19,888,000	16	15.27%	21
South Carolina	45	30	64.29%	11	6,299,867	36	15.99%	17
South Dakota	46	29	57.50%	20	424,131,326	1	16.21%	16
Tennessee	119	13	63.98%	12	10,702,261	26	16.60%	14
Texas	261	2	44.54%	40	8,597,161	29	13.77%	36
Utah	14	42	25.93%	49	49,915,500	9	14.98%	28
Vermont	10	43	71.43%	5	6,188,600	37	14.74%	31

EMPLOYER:

REPORT: Analysis of BOLI Holdings: All States

SOURCE: FDIC Call/TFR Report (website: www.fdic.gov) as of 06/30/2012

State	Banks with BOLI		Percent of Banks with BOLI		Average BOLI Holdings		Average BOLI Relative to Tier 1 Capital	
	Number	Rank	Percent	Rank	Number	Rank	Percent	Rank
Virginia	63	26	58.33%	18	25,868,317	14	14.70%	33
Washington	37	34	52.86%	28	17,893,324	17	15.18%	23
West Virginia	40	32	63.49%	13	11,154,800	25	17.24%	11
Wisconsin	172	4	63.24%	14	8,591,285	30	15.10%	24
Wyoming	16	40	45.71%	38	3,140,188	46	15.00%	27
Total:	**3,760**		**51.72%**		**35,715,686**		**15.30%**	