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Texas Bill Aims to Strengthen Oversight Authority of Pension Review Board

Legislation introduced in the Texas Legislature aims to give the Texas State Pension Review Board (PRB) new authority to review the fiscal health and investment strategies of nearly 400 state and local pension systems across Texas, and set recommended standards for reporting their financial condition.

The legislation, Senate Bill 1548, introduced by Senate Finance Committee Chairman Steve Ogden (R-Bryan), also would extend the board's oversight authority to the investment funds that manage the endowments for Texas public schools and universities. It aims to establish policies on conflicts of interest, gifts and prohibited employment for the people who serve the systems.

It would also give the PRB and the state attorney general's office the au-

thority to investigate potential violations, including potential fraud, embezzlement, and breach of fiduciary duty. As proposed, the bill also would rename PRB the Pension and Investment Review Board.

The original drafting of SB 1548 worried many plan sponsors and trustees across the state due to its increased and possibly duplicative reporting requirements. They also expressed concern that the measure would diminish their ability to act as the sole fiduciaries for their pension trust funds, and could inhibit them from making decisions free of any political influence.

TEXPERS pointed out to lawmakers that there were serious constitutional problems with that aspect of the bill: it could possibly make the state a fiduciary, which in turn could subject the state to fiscal liability if a local pension plan were to become unsound.

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FASB Compromises on 'Mark-to-Market' Accounting

Under pressure from Congress to act quickly, the Financial Accounting Standards Board (FASB) has voted to approve substantial changes to "mark-to-market," or fair value, accounting.

Mark-to-market is a method of accounting that bases the value of an asset on the current market selling price, not what the asset might be worth in the future. Because of the financial crisis, many assets do not currently have a market in which to sell, and financial institutions have had to write down losses on these assets, exacerbating the financial crisis.

Defenders of "mark-to-market" rules say they protect bank investors, and changing them would allow institutions to hide future losses.

But detractors say they have helped drive down the value of bank stocks, made shorting the shares much easier and caused bank stockholders to lose hundreds of billions of dollars.

The five-member FASB voted unanimously to let banks exercise more judgment in using mark-to-market accounting. But the board split 3-2 on backing guidance that would let lenders take smaller losses on impaired assets such as mortgage-backed securities, a move critics said would let banks hide reality from investors.

According to testimony at a March 12 congressional hearing, witnesses said accountants have required many banks to calculate values based on distressed sale prices. That has meant large writedowns even on mortgage-backed securities that the institutions intend to hold to maturity.

"Mark-to-market is a rule that we should not end, but must amend," said Rep. Al Green (D-Texas). "The adverse impact in these circumstances exceeds the rule's positive effects, particularly since some products are going to be held until maturity. For these instruments, the most important time to assess their value will be at maturity as opposed to at random moments in time."

Banks began lobbying Congress last year to do away with mark-to-market, arguing that they couldn't lend because it had bled away so much capital. Congress in turn put the heat on the FASB. After months of pressure, including threats to take away its authority, the FASB voted to loosen the rule.


Banks can now use "significant judgment" to value assets. That means they can stop assigning doomsday

values to securities they think will have more value down the road. But some investors fear that this change will only help banks disguise their valueless assets, which was one of the contributing factors in the financial meltdown.

Despite the rushed schedule, the FASB board members insisted that they had conducted a thorough due diligence process. They also said that they met with investor groups, including pension funds, hedge funds and financial institutions.

The changes also include requirements for companies to add more disclosures to clarify the new value of the impaired assets. These disclosures also will be more frequent, coming in the quarterly financial statements, rather than only in the annual statements.

The International Accounting Standards Board, IASB, an independent body based in London and FASB's counterpart, has begun a public consultation on whether to change its rules to be in line with the FASB's.

On the Web at: <http://www.fasb.org/st/summary/stsum157.shtml>, and <http://www.fasb.org/action/sbd040209.shtml>. 

To Save Social Security, Baby Boomers Prefer Raising Revenue, not Cutting Benefits

America's baby boomers support protecting Social Security benefits for both current and future generations – but not by reducing benefits, according to a new survey.

When given a menu of options for funding Social Security, the most popular choice among the 45-63-year-old baby boomers was raising the wage base (currently \$106,800) on which Americans pay payroll taxes (36%) and the least popular was reducing benefits (6%). The survey was conducted by the National Committee to Preserve Social Security and Medicare.

Protecting Social Security benefits also crosses party lines: More than 30% of respondents (Democrats, Republicans, and Independents) supported raising the level of earnings on which payroll taxes are paid and just under 14% favored raising the retirement age. Among the small number of people supporting benefit cuts, there was a modest partisan gap on the issue, with 7.4% of Republicans, 5.4% of Independents and 4.7% of Democrats supporting benefit cuts.

Of the baby boomers who responded, more than 80% do not believe Social Security is in crisis. However, most do believe there are problems.

Boomers continued on next page

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“This survey shows that in spite of long-running and well-financed campaigns to convince the American people that Social Security is in ‘crisis,’ they’re just not buying it,” said Barbara B. Kennelly, president and CEO of the National Committee to Preserve Social Security and Medicare. “Social Security is not bankrupting the nation and is in fact keeping millions from poverty; especially as retirees’ have seen their healthcare costs skyrocket, savings evaporate, home values plummet during this recession. The long-term challenges facing Social Security are modest and manageable.”

Edward F. Coyle, the executive director of the Alliance for Retired Americans, echoed the sentiment that Social Security is not in crisis. He responded sharply to news reports that the economic recession has hurt the Social Security Trust Fund.

“Current and future retirees should be suspicious of those who react to today’s news with ‘sky is falling’ predictions of doom,” he said. “These warnings mask an ongoing ideological agenda to cut Social Security benefits and increase the retirement age, and are brought to you by the same people who have been badly discredited after years of advocating for a privatized Social Security tied to the roulette wheel of the stock market.”

According to economist Henry J. Aaron of the Brookings Institution, the recent decrease in Trust Fund revenue will account for less than a few one-hundredths of one percent decrease in the 75 year projection for the Social Security Trust Fund, Coyle said.

The answer lies in comprehensive health care reform and a long-term economic recovery plan that puts Americans back to work. If more Americans are working, then more money will flow into local, state, and federal coffers, including the Social Security Trust Fund, he said.

The survey by the National Committee to Preserve Social Security and Medicare is available at: http://www.ncpssm.org/pdf/poll_results_33109.pdf. Edward Coyle’s statement is available at: <http://www.retiredamericans.org/ht/display/ReleaseDetails/i/12212/pid/179>. 

Big U.S. Pension Fund May Divest Stakes in Sudan

TIAA-CREF, the leading provider of retirement services in the academic, research, medical and cultural fields, plans to intensify pressure on companies that maintain business relations with the Sudanese government, divest from those that fail to take meaningful steps to respect human rights within a reasonable time, and call upon other U.S. financial companies to follow its lead.

Two U.S. lawmakers, Reps. Joseph Crowley (D-N.Y.) and Melvin L. Watt (D-N.C.), applauded the decision to endorse the UN-sponsored Principles for Responsible Investment and for divesting from Sudan.

“As the situation in Darfur grows more desperate, investors everywhere have a moral obligation to stop their support of a criminal regime,” Crowley said. “By accepting these principles, TIAA-CREF can help lead the way for others to join them in putting pressure on the Sudanese government to respect human rights and stop the genocide in Darfur.”

“I am hopeful that TIAA-CREF’s decision to divest from companies that do business with the government of Sudan will inspire other companies to follow suit,” Watt said. “In the wake of Sudan’s recent expulsion of refugee relief organizations, it is more important than ever that nations, businesses and individuals exert whatever pressure they can upon Sudan to respect the human rights of their people.”

Roger W. Ferguson, Jr., TIAA-CREF’s president and CEO, said: “We very much appreciate the support from Representatives Crowley and Watt for TIAA-CREF’s decision to ask companies that maintain relations with the government of Sudan to cease those relations or take steps to alleviate suffering in Darfur, and our calls upon other financial companies to do the same. Together we can add to pressure on companies to improve their stances and help bring an end to this humanitarian tragedy.”

On the Web at: http://www.tiaa-cref.org/about/press/about_us/releases/pressrelease269.html. 

www.texpers.org

GAO: Conflicts of Interest Can Reduce Returns of Defined Benefit and Defined Contribution Plans

A study by the Government Accountability Office (GAO) has revealed a correlation between the existence of conflicts of interest among pension fund consultants/advisers and lower rates of return on investments.

The GAO's analysis used econometric data of ongoing defined benefit (DB) plans and Securities and Exchange Commission (SEC) study data on pension consultants registered as investment advisers, both those who adequately disclosed their conflicts of interest and those who did not. The agency detected lower annual rates of return for those ongoing plans associated with consultants that had failed to disclose significant conflicts of interest.

The lower rates of return generally ranged from a statistically significant 1.2 to 1.3 percentage points over the 2000 to 2004 period, according to the study.

The average return for the ongoing plans that used consultants who did not have significant conflict disclosure violations was about 4.5 percent, GAO said. Based on this model, the average returns for ongoing plans that used consultants who failed to disclose significant conflicts was 3.2 to 3.3 percent for the period, GAO said.

This finding should not be considered as proof of causality between conflicts and lower rates of return – because many factors can affect returns – although it shows how important it is to detect the presence of conflicts among pension plan consultants.

Conflicts of interest can have adverse effects on both defined benefit (DB) and defined contribution (DC) plans. The GAO study focused exclusively on DB plans because less information exists on the extent or nature of conflicts of interest in the DC plan environment.

But because the risk of investment is largely borne by the individual participant in DC plans, participants are vulnerable to any decision, including those involving conflicts of interest, that could result in higher fees or other outcomes that can lower investment returns for participants, GAO said.

Many opportunities exist for conflicting business arrangements to go undisclosed. Problems may occur when pension consultants or other companies providing services to a plan also receive compensation from other service providers.

Without disclosing these arrangements, service providers may be steering plan sponsors toward invest-

ment products or services that may not be in the best interest of participants.

The U.S. Department of Labor has published proposed regulations to improve the information disclosed about the various business arrangements among service providers. But these regulations are awaiting review and approval by the new Secretary of Labor.

More information is available at: <http://www.gao.gov/products/GAO-09-503T>. 


Senators Call for Independent Commission to Investigate Near Collapse of Banking System

U.S. Sens. Johnny Isakson (R-Ga.) and Kent Conrad (D-N.D.) have introduced legislation to create a seven-member, bipartisan Financial Markets Commission. The commission would be modeled after the 9-11 Commission, which investigated the failures leading up to the September 11, 2001, terrorist attacks and made recommendations on improvements to prevent another attack in the future.

The Financial Markets Commission would have one year to investigate all the circumstances that led to this financial crisis. The panel would have the authority to refer to the U.S. Attorney General and state attorneys general any evidence that institutions or individuals may have violated existing laws. At the end of its investigation, the Commission would report to the President and to the Congress its recommendations for statutory or regulatory changes necessary to protect our country from a repeat of this financial collapse.

The Commission would include two appointees by the President and one appointee each from the Speaker of the House, the House Republican Leader, the Senate Democratic Leader, the Senate Republican Leader and the Chairman of the Board of Governors of the Federal Reserve System.

Co-sponsors of the legislation include Sens. Saxby Chambliss (R-Ga.), John Cornyn (R-Texas), Bill Nelson (D-Fla.), James Risch (R-Idaho), Jeff Sessions (R-Ala.), Olympia Snowe (R-Maine), and Sheldon Whitehouse (D-R.I.).

Separately, Rep. Michael Burgess, M.D. (R-Texas), a member of the bicameral Joint Economic Committee, sent a letter to President Obama March 19 asking him to appoint an independent Special Prosecutor to investigate and prosecute those responsible for this financial crisis. The text of his letter: <http://burgess.house.gov/News/DocumentSingle.aspx?DocumentID=115294>. 

Credit Rating Agencies Under Attack for Role in Financial Crisis

Credit rating agencies such as Moody's Investors Service and Standard & Poor's Ratings Services are facing mounting criticism – and possible new regulation – as a result of their questionable performance leading up to the financial industry meltdown.

Experts are in near unanimous agreement that their performance – or lack thereof – was a major contributing factor in the crisis. But because they're such an integral part of the financial system, mitigating their influence might prove to be a tough regulatory challenge.

Ratings agencies are entrenched in the financial system. For example, the Securities and Exchange Commission (SEC) bans money market funds from investing in paper below a certain rating. And institutional investors such as pension funds are often barred from buying bonds below a certain grade.

As a result, a rating firm's view can determine whether the market for a bond is huge or minuscule. For corporate issuers, a top credit rating is money in the bank because it means lower borrowing costs.

Yet the rating process is full of conflicts of interest. The agencies get almost all of their income from fees for rating securities, and those fees are paid by the issuers of those securities. As a result, the raters are wary of giving low grades, fearing customers will get mad and take their business to a competitor that might be more obliging.

As mortgage products were packaged and sold as securities during the boom in the housing market, the credit rating industry consistently gave undeservedly high ratings to many of these securities, said Rep. Patrick McHenry (R-N.C.). Now, there is wide agreement that the credit rating agencies need to institute reforms to their business practices.


"The housing market meltdown exposed dangerous weaknesses in the credit rating industry," said McHenry, who has introduced the Credit Rating Agency Transparency and Disclosure Act.

Mary Schapiro, chairwoman of the SEC, has also addressed the need for reform in the credit rating market, but has not advocated support for any specific legislation.

"Bringing greater transparency to the credit rating market is a good first step that we can all agree on," said McHenry, a member of the House Financial Services Committee. "I certainly hope that Chairwoman Schapiro will lend her support to this important legislation."

The bill would require credit rating agencies to provide additional disclosures with respect to the rating of structured securities, and it would also:


- Ensure that issuers and originators are providing credit rating agencies with adequate information on the assets underlying a structured security.
- Require credit rating agencies to institute procedures for getting data from issuers and originators concerning the procedures employed to attest to the data's veracity and the fraud detection capabilities surrounding the process.
- Require credit rating agencies to disclose in a central database the historical default rates of all classes of financial products they have rated.

Introduced March 11, the legislation (H.R.1445) has not garnered any cosponsors. For more information, visit: <http://mchenry.house.gov/News/DocumentSingle.aspx?DocumentID=114239>. 

South Carolina Claims It Can Use Federal Stimulus Cash to Bolster State Pension Fund

The Obama administration has given South Carolina Gov. Mark Sanford permission to use a portion of the state's expected \$2.8 billion in federal stimulus money to help reduce the liabilities of the \$27 billion South Carolina Retirement System, Joel Sawyer, Sanford's spokesman, told Pensions & Investments.

The administration initially rejected Sanford's request to use the stimulus money to pay down state debt, including debt related to retirees, but relented after he wrote a letter to Obama on March 18 seeking to use the money to reduce pension liabilities.

Sanford has said he will accept the stimulus funds – expected to total \$740 million – only as long as the state assembly uses equal amounts of the money received for programs and to pay down debt, Sawyer told P&I. Sanford has not yet announced whether he has formally accepted them yet. 

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Commodities Regulator Boosts Oversight of Previously Exempt Markets

The Commodity Futures Trading Commission (CFTC) has approved final rules and rule amendments that increase the government's oversight of exempt commercial markets (ECMs) – electronic trading facilities where institutional investors buy and sell commodities.


The policy change will allow the CFTC to track trading in certain contracts on exempt electronic platforms like the Atlanta-based IntercontinentalExchange, which trades a host of energy contracts with little government oversight, unlike the regulated New York Mercantile Exchange that is owned by CME Group.

Under the rules, the CFTC will monitor trading on exempt commercial markets in oil, natural gas and other commodities that are similar to contracts listed on regulated exchanges and that play an important role in setting prices for the underlying commodities.

By increasing monitoring of these contacts, the CFTC has said it will be able to deter price manipulation and other disruptions to markets.

“This is a step in the right direction to increase transparency and accountability in these markets so we can better protect market participants and the public at large,” said CFTC Acting Chairman Michael V. Dunn. “The final rules put in place the framework in which we will exercise our new authority to police these important contracts.”


The final rules will take effect on April 22.

Based on public comments on the agency's initial rules, the CFTC said it would wait to decide how “position limits,” or accountability, should be applied to uncleared trades, after it completes an additional review of the matter in the coming months. These and related comments with respect to uncleared trades raise complex issues which, in the CFTC's view, warrant further consideration. 

GASB Seeks Comments on Pension Accounting and Financial Reporting

The Governmental Accounting Standards Board (GASB) is accepting comments on its reexamination of its pension accounting and financial reporting standards.

The board is considering the focus of pension accounting and financial reporting; recognition of liabilities and expenses; measurement of unfunded pension obligations; the use of actuarial methods; and reporting by government employers in cost-sharing multiple-employer pension plans and reporting by pension plans themselves.

The board is still determining if it should modify current pension standards “in order to better meet the financial reporting objectives of accountability and decision usefulness, including enabling users of financial reports to assess the extent to which interperiod equity has been achieved,” according to GASB. More information about the proposal is available at www.gasb.org. 

New Fraud Case Hits Public Pension Fund Clients

Another investment fraud scheme has engulfed institutional investors, including many public pension funds. The Securities and Exchange Commission (SEC) has frozen the assets of two New York residents and their three affiliated entities on the grounds that they orchestrated the misappropriation of as much as \$554 million in investor assets.


The SEC claims that Paul Greenwood and Stephen Walsh promised investors that their money would be invested in a stock index arbitrage strategy. Instead, they “essentially treated their clients' investments as their personal piggy bank to purchase multi-million dollar homes, a horse farm and horses, luxury cars, and rare collectibles such as Steiff teddy bears,” the SEC said.

SEC froze the assets of Greenwood and Walsh and their companies: WG Trading Investors, L.P.), which is an unregistered investment vehicle; WG Trading Co., Limited Partnership, a registered broker-dealer located in Greenwich, Conn.; and Westridge Capital Management, Inc., a registered investment adviser located in Santa Barbara, Calif.

The Wall Street Journal, citing court records and other public statements, reported that the alleged victims include the Iowa Public Employees Retirement System, which said it had about \$339 million, or 2% of its funds, invested with one of the entities; the Sacramento County Employees' Retirement System in California, which said it had invested \$89.9 million, or 1.6% of its portfolio; the University of Pittsburgh, which invested more than \$65 million; and Carnegie Mellon University, also in Pittsburgh, which had put in more than \$49 million.

Bloomberg reported that Greenwood and Walsh were released on \$7 million bonds each.

The University of Pittsburgh and Carnegie Mellon sued the men on Feb. 20, alleging they misrepresented their trading in commodity futures contracts, resulting in \$114 million in investment losses.

More information is available at: <http://www.sec.gov/news/press/2009/2009-35.htm>. 

Lawmakers Seek to Reinstate Uptick Rule to Combat Abusive Short-Selling

Efforts are under way in Congress to reinstate the “uptick rule,” which requires short sellers faced with falling stock prices to wait for a price increase before continuing to sell shares short.

Many experts believe the rule, repealed in July 2007, aided market stability for 70 years. Its repeal ushered in an era of abuse of “naked” short-selling – or selling stock that the trader does not own, they say. This exacerbated the stress on stocks and markets during the financial meltdown.

“Abusive short selling is tantamount to fraud and market manipulation and must be stopped – now,” Sen. Ted Kaufman (D-Del.) said on the Senate floor March 16. “The uptick rule should have never been repealed. To permit people to sell shares they don’t have and won’t be able to deliver turns investment into pure speculation. The time has come for this practice to stop.”


Under current SEC rules, short sellers are allowed to sell stocks they haven’t actually borrowed in advance of their short sale. If the settlement day arrives and the seller does not have the necessary shares, the failure to deliver the shares harms investor and market confidence, particularly when the failure persists for substantial periods of time, as statistics show they clearly have.

Kaufman was joined by Sen. Johnny Isakson (R-Ga.) in introducing new legislation that would direct the SEC to write regulations within 60 days that accomplishes five things to end abusive short selling:

- (1) Reinstate the substance of the uptick rule that prohibited short sales that are not made on an increase in the price of the stock; this prevents short sellers from piling on a declining stock, driving prices down.
- (2) Require exchanges and other trading venues to execute the trades of long sellers ahead of short sellers, all other things being equal.
- (3) With the concurrence of the Secretary of the Treasury and the Chairman of the Board of Governors of the Federal Reserve System, prohibit short sales of the securities of any financial institution unless that trade is affected at a price (in minimum lots specified by the Commission) at least 5¢ higher than the immediately preceding transaction in such securities. This would allow the Treasury and Fed to better protect taxpayer investments in institutions during the financial crisis.
- (4) Prohibit any person from selling securities short unless that person has at the time of the short sale a demon-

strable legally enforceable right to deliver the securities at the required delivery date. Under current law, many short sellers fail to deliver.

(5) Require that all short sales settle on the same time frame employed for long sales of the same securities. The senators said there is no reason short sellers should have 13 days to deliver shares when long sellers have only three days.


“This is bigger than just one rule, however influential that rule is,” Kaufman said. “Markets all over the world continue to tumble because average investors have lost confidence that the markets work for them. Piece by piece, we must restore that faith. One important step is instituting sensible regulations. In this case – enacting a proven, time-tested rule – it’s an easy call.” 

White House Readies \$250 Recovery Payments for Social Security and SSI Beneficiaries

The American Recovery and Reinvestment Act of 2009 provides for a one-time payment of \$250 to adults who receive Social Security and Supplemental Security Income (SSI), except those receiving Medicaid in care facilities. To receive the payments, which will be issued in May, the individuals must have been eligible for Social Security or SSI during the months of November 2008, December 2008 or January 2009.

No action is required to get the payment, which will be sent separately from the person’s regular monthly payment. The payments are estimated to inject more than \$13 billion into the economy and are designed to assist older Americans and people with disabilities – many of whom have been hit hard by the economic crisis.

The legislation also provides for a one-time payment to Veterans Affairs (VA) and Railroad Retirement Board (RRB) beneficiaries. The VA and RRB will be responsible for paying individuals under their respective programs. However, if someone receives Social Security and SSI, VA or RRB benefits, he or she will receive only one \$250 payment. People getting Social Security or SSI should not contact the agency unless a payment is not received by June 4, 2009.

For more detailed information about the \$250 one-time economic recovery payments, go to www.socialsecurity.gov/payment. 

Madoff Auditors Charged with Securities Fraud

The Securities and Exchange Commission (SEC) on March 18 charged the auditors of Bernard Madoff's broker-dealer firm with committing securities fraud by representing that they had conducted legitimate audits, when in fact they had not.

In its complaint filed in federal court in Manhattan, the SEC alleges that from 1991 through 2008, certified public accountant David G. Friehling and his firm, Friehling & Horowitz, CPAs, P.C. (F&H), purported to audit financial statements and disclosures of Bernard L. Madoff Investment Securities LLC (BMIS). The SEC previously charged Madoff and BMIS with committing securities fraud through a multi-billion dollar Ponzi scheme perpetrated on advisory and brokerage customers of his firm.


James Clarkson, acting director of the SEC's New York Regional Office, said, "As we allege in our complaint, Friehling's and F&H's misconduct is egregious. Friehling essentially sold his license to Madoff for more than 17 years while Madoff's Ponzi scheme went undetected. For all those years, Friehling deceived investors and regulators by declaring that Madoff's enterprise had a clean audit record."

The SEC's complaint claims Friehling enabled Madoff's Ponzi scheme by falsely stating, in annual audit reports, that F&H audited BMIS financial statements pursuant to Generally Accepted Auditing Standards (GAAS), including the requirements to maintain auditor independence and perform audit procedures regarding custody of securities.

F&H also made representations that BMIS financial statements were presented in conformity with Generally Accepted Accounting Principles (GAAP) and that Friehling reviewed internal controls at BMIS, including controls over the custody of assets, and found no material inadequacies. Friehling knew that BMIS regularly distributed the annual audit reports to Madoff customers and that the reports were filed with the SEC and other regulators, the complaint alleges.

All of these statements were materially false because Friehling and F&H did not perform a meaningful audit of BMIS, and did not perform procedures to confirm that the securities BMIS purportedly held on behalf of its customers even existed, the complaint states.

Instead, the SEC says Friehling merely pretended to conduct minimal audit procedures of certain accounts to make it seem like he was conducting an audit, and then

failed to document his purported findings and conclusions as required under GAAS. If properly stated, those financial statements, along with BMIS related disclosures regarding reserve requirements, would have shown that BMIS owed tens of billions of dollars in additional liabilities to its customers and was therefore insolvent. 

Chicago Mercantile Exchange to Operate as Clearinghouse for Credit Default Swaps


The Chicago Mercantile Exchange, the world's largest financial exchange, will temporarily operate as a central clearinghouse for transactions involving credit default swaps. The Securities and Exchange Commission (SEC) has approved exemptions from agency rules to allow the action.

The SEC, having granted three similar approvals in December, aims to create a new system of central clearinghouses for the swaps, which are complex investments that have been partly blamed for the global financial crisis.

The SEC believes that well-regulated central clearinghouses should help promote stability in the financial markets by reducing the risks from the default or financial distress of a major market player.

The Chicago Mercantile Exchange is part of Chicago-based CME Group Inc., along with the Chicago Board of Trade and the New York Mercantile Exchange. The Chicago Merc, as it is known, joined with Citadel Investment Group LLC, one of the biggest hedge funds, to apply to operate the new clearinghouse.

Credit default swaps have come under scrutiny by Congress and federal regulators in the wake of the financial and credit crises that have plunged economies around the world into recession. The \$60 trillion swaps market, unregulated and secretive, is commonly used to insure against the default of financial instruments such as bonds and corporate debt. But they also are bought and sold as bets against bond defaults.

More information is available at: <http://www.sec.gov/news/press/2009/2009-58.htm>. 

Two N.Y. State Officials Face Charges of Extorting Kickbacks for Investments in Public Pension Fund

The Securities and Exchange Commission (SEC) has charged New York's former Deputy Comptroller and a top political advisor for extracting millions of dollars in kickbacks from investment management firms seeking to manage the assets of New York's largest public pension fund, the New York State Common Retirement Fund.

The SEC's complaint alleges that Henry "Hank" Morris, the top political advisor and chief fundraiser for former New York State Comptroller Alan Hevesi, and David Loglisci, former Deputy Comptroller and Chief Investment Officer of the New York State Common Retirement Fund, orchestrated the fraudulent scheme from 2003 through late 2006 in order to enrich Morris as well as others with close ties to Morris and Loglisci.

The SEC alleges that Loglisci caused the fund to invest billions of dollars with private equity firms and hedge fund managers who together paid millions of dollars in the form of sham "finder" or "placement agent" fees to obtain investments from the fund. As asserted in the SEC's complaint, Morris made more than \$15 million in such purported placement and finder fees.

"Investments should be based on sound decisions not shady deals," said SEC Chairman Mary Schapiro. "We will continue this investigation and will pursue anyone who unlawfully profited from their privileged access to the hard-earned contributions of public employees."

Kickback schemes corrupt the integrity of the investment decision-making process and enable well-placed yet unscrupulous officials to enrich themselves and their associates at the expense of the fund, said James Clarkson, acting regional director of the SEC's New York Regional Office.

As laid out in the SEC's complaint, filed in federal district court in Manhattan, Loglisci ensured that investment managers who made the requisite payments to Morris — and other recipients designated by Morris and Loglisci — were rewarded with lucrative investment management contracts, while investment managers who declined to make such payments were denied fund business.

The SEC alleges that Loglisci repeatedly directed investment managers, who solicited him for investment business, to Morris or certain other individuals and signaled to the investment managers that they first needed to "hire" Morris as a finder or placement agent. Neither Morris nor anyone else who received the payments at is-

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sue allegedly performed legitimate placement or finder services for the investment management firms who made the payments.


The investment managers in some instances had already allegedly hired a finder or placement agent of their own and were already negotiating an investment with Loglisci when they were told that they also needed to "hire" Morris or another individual, according to the SEC's complaint. Once the sham finder fee was agreed upon, Loglisci approved the proposed deal with the investment management firm.

The SEC further asserts that Loglisci and Morris took steps to conceal these improper payments and quid pro quo arrangements from relevant members of the Comptroller's investment staff and the fund's Investment Advisory Committee. In some instances, the two men even arranged for investment managers to make payments to another individual who would then covertly funnel a portion of these sham fees to Morris, sometimes even without the knowledge of the investment managers, the complaint alleges. In addition, Morris allegedly paid the girlfriend of a high-ranking member of the Comptroller's staff nearly \$100,000 in cash to ensure that the staff member would not ask questions or otherwise reveal the scheme to others.

According to the evidence, Loglisci also personally benefited from his role in the scheme. In addition to receiving Morris's support for promotion to Deputy Comptroller, Loglisci obtained funding from Morris and the principal of a private equity firm for a low-budget film that Loglisci and his brothers produced.

The SEC's complaint seeks permanent injunctions against future violations of the federal securities laws, disgorgement of ill-gotten gains with prejudgment interest, and financial penalties.

In a parallel criminal action, the Office of the Attorney General of the State of New York indicted Morris and Loglisci.

On the Web at: <http://www.sec.gov/litigation/complaints/2009/comp20963.pdf> and <http://www.sec.gov/news/speech/2009/spch031909mls.htm>. 

Indiana Considers Merging Public Funds under One Board

The public pension funds for Indiana's state employees and teachers could soon merge into a single entity as they struggle with a nearly one-third decline in their assets – a combined \$8 billion – over a little more than a year.

Legislation that would merge the funds — giving them a single executive director and board, but managing them as separate pools of money — cleared the state Senate in February on a 50-0 vote and is pending in the Indiana House.

By the close of January, assets of the Public Employees' Retirement Fund (PERF) had fallen \$5.5 billion, or about one-third, from a peak of \$16.7 billion in October 2007, the Indianapolis Business Journal reported.

The Indiana State Teachers' Retirement Fund, meanwhile, has fared a bit better, closing 2008 with assets of \$6.9 billion, down 26.5 percent from its fall 2007 peak.

Combining the funds would yield \$8.9 million in one-time administrative cuts, plus \$1.2 million in annual savings, according to Legislative Services Agency estimates.

Due to losses from the recession, PERF officials have considered whether to require increased contributions from the more than 1,200 public employers — state agencies, city and county governments, etc. — that participate in the fund.


State Sen. Dennis Kruse, who sponsored the merger bill, said he had been concerned about the proposal by the public employees fund to raise the employer-contribution rates from 6.3 to 6.5 percent, and that was one of the motivations behind the bill.

The Indiana State Teachers Association said it supports the merger because educators covered by the pension would have greater board representation than they do on the current board.

For several years, both funds have been moving hundreds of millions into private-equity investments, such as venture capital and leveraged buyouts.

The public employees fund has placed 12.9 percent of its assets in private equity investments, and is aiming eventually to have 30 percent in that class.

But the full extent of recent private-equity losses hasn't yet shown up in PERF's formal accounting, since its fiscal year closes on June 30.

The pension fund's actuarial consultant has recommended that it warn employers that it could need a larger hike – to 7.5 percent of each employee's wages – in 2010. 

GAO Takes the Pulse of DB Pension Plan Sponsors

In a survey of the nation's largest private defined benefit (DB) plan sponsors, the Government Accountability Office (GAO) has found that the number of DB plans has declined substantially over the past two decades. It also found that large DB plans covering many participants have modified, reduced, or otherwise frozen plan benefits in recent years.

About 92,000 single-employer DB plans existed in 1990, compared to fewer than 29,000 today.

The DB plan sponsors surveyed have made a number of revisions to their retirement benefit offerings over the last 10 years or so. They have changed benefit formulas, converted to hybrid plans, or frozen some of their plans. Eighty-one percent of responding sponsors reported that they modified the formula for computing benefits for one or more of their DB plans. Among all plans reported by respondents, 28 percent of these (or 47 of 169) plans were under a plan freeze – an amendment to the plan to limit some or all future pension accruals for some or all plan participants.

Most sponsors reported no immediate plans to revise plan formulas, freeze or terminate plans, or convert to hybrid plans before 2012. When asked about the influence of recent legislation or changes to the rules for pension accounting and reporting, responding firms generally indicated these were not significant factors in their benefit decisions. Finally, a minority of sponsors said they would consider forming a new DB plan.

For details, visit: <http://www.gao.gov/highlights/d09291high.pdf>. 

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Congressman Proposes New Tax to Save Social Security

Rep. Robert Wexler (D-Fla.) is putting a new twist on saving Social Security. He has introduced legislation to close the Social Security funding gap – without cutting benefits or raising the retirement age – by imposing a 3 percent hike on payroll taxes for incomes above \$102,000 a year. Currently, individuals do not pay any taxes for Social Security purposes on earnings above \$102,000.

“Social Security’s future solvency is threatened by the fact that not all wages and salaries are subject to Social Security taxes,” Wexler said in introducing the bill April 1. As of April 5, the Social Security Forever Act of 2009 (H.R.1863) had no cosponsors.

In addition, Wexler also introduced legislation designed to help seniors reduce their Medicare premiums. The Medicare Prescription Drug Affordability Act addresses the fact that seniors are facing ever-dwindling purchasing power of their Social Security benefits.

In 2009, when seniors received the highest cost-of-living-adjustment (COLA) since 1982, the amount was a mere 5.8 percent, whereas the national level Medicare part D’s weighted average premiums increased by 25 percent. The legislation would limit Medicare Part D increases by matching them with the same consumer price index that determines annual COLA adjustments to Social Security payments. 

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Texas Bill continued from front page

In response to the concerns, Ogden offered a substitute bill that modifies many aspects of the original. While the substitute is a much improved bill, it still has some problems, according to Randy Stalnaker, chairman of TEXPERS Legislative Committee, who testified April 9 before the Senate Committee on State Affairs.

First, the bill would require plans to produce duplicative audits and evaluations for the PRB and Governmental Accounting Standards Board (GASB). Local retirement systems are currently required under Texas law and GASB rules to prepare an actuarial report every two years and an additional audit of their plan every five years, Stalnaker said.

These multiple reports would cost plans a lot of money, would not be used by the local municipalities in assessing the status of their retirement systems, and could be potentially misleading to stakeholders and the general public because they could be taken out of context, Stalnaker said.

Another problem with the bill is that it would force all plans to use the same set of actuarial assumptions, both economic and demographic.

“Demographic assumptions are incontrovertibly tied to the makeup of the workforce and therefore will vary from system to system,” Stalnaker said. “It is simply inappropriate to have one set of demographic actuarial assumptions determined centrally that are forced into different workforces. In essence, you’d be putting a square peg into a round hole. Furthermore, each retirement system must choose an actuarial method for its valuation. Each system chooses the method that is most appropriate for its workforce, economy and projections of growth.”

In later testimony to the committee, Christopher Hanson, interim executive director of the PRB, agreed

with Stalnaker that using the same actuarial assumptions for all plans would be a mistake. “That would not make sense,” he said. “The previous testimony is correct in that regard.”

“You can’t just assign one assumption to all plans. That would be unfortunate and it would create a lot of problems.”

Hanson also agreed that the law should not force pension systems to prepare duplicative actuarial evaluations.

“If this were to pass and this is the will of the legislature, we obviously would work with the [pension] plans to ensure that this wouldn’t be the case – that they wouldn’t have to do two evaluations, that demographic assumptions weren’t just picked for all plans,” Hanson said. “It would require a lot of work on behalf of the board to make sure that we have standards that are reasonable, that make sense and that serve the best interests of our public retirement systems.”

While the bill has its detractors, it also has its supporters. Former PRB Chairman Frederick “Shad” Rowe has praised the bill while Paul Brown, president of the Texas Association of Public Employee Retirement Systems, has denounced it as unnecessary, according to a report in the Austin American-Statesman.

Rowe told the paper the bill is a “big step in the right direction” to ensure that the state’s retirement systems are honest and forthcoming about their financial condition. But Brown told the paper that the bill aims to fix problems that do not exist because the funds are generally in good shape. 🇺🇸

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