



GAPPT

News and Reports

November 2015

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Import Dates to Note:

3rd Annual GAPPT Trustee School, March 21-23, 2016, Macon Marriott City Center Registration is Open!

City of Atlanta's 2011 Pension Reform Upheld by the Georgia Supreme Court

By Edmund Emerson III and Margaret C. Barker
Morris, Manning & Martin, LLP (Atlanta)

In a unanimous decision on November 2, 2015, the Georgia Supreme Court ruled in favor of the City of Atlanta (the "City") in a class action challenging the City's 2011 pension reforms. The Supreme Court, in *Borders v. City of Atlanta*, concluded that the City did not violate the Georgia Constitution or breach the employment contracts of its employees when it amended three defined benefit pension plans to increase the required employee contributions. The case sets an important precedent for Georgia public employers, as it affirms the authority of a local government to amend a retirement plan, including by increasing prospective employee contributions, so long as the plan unambiguously provides for subsequent modification or amendment.

Background

On June 29, 2011, in an effort to address the City's unfunded pension liabilities, the City enacted Atlanta Ordinance 11-O-0672 (the "Ordinance"). The Ordinance increased prospective annual employee contributions for three of the City's defined benefit pension plans: the General Employees' Pension Plan; the Police Officers' Pension Plan; and the Firefighters' Pension Plan (collectively, the "Plans"). The amendments to the Plans took effect on November 1, 2011. Prior to that date, participants in the three Plans were required to contribute 7% of their annual salary to their pension plan if they did not have a designated eligible beneficiary, and 8% of their annual salary if they did have a designated eligible beneficiary. After November 1, 2011, the amendments increased the mandatory employee contributions by an additional 5%, such that participants were required to contribute 12% of their annual salary (or 13% with a beneficiary). The Ordinance also provided that mandatory employee contri-

butions might be increased by an additional 5%, up to 17% or 18% of annual compensation, if the City's required contributions to the Plans exceed 35% of the City's total payroll. The Ordinance did not change a participant's benefit formula or the actual benefit amount payable at the time of the participant's retirement.

Litigation

In November of 2013, City employees who participated in the Plans prior to November 1, 2011, and who had not retired before that date (the "Plaintiffs"), brought suit against the City arguing that the City breached their employment contracts and violated the impairment clause of the Georgia Constitution by increasing the amounts that the Plaintiffs were required to contribute to the Plans, but providing Plaintiffs with the same retirement benefit to which they were already entitled prior to the passage of the Ordinance. The Superior Court of Fulton County heard the case and, in November of 2014, granted summary judgment to the City.

The Superior Court based its decision on the fact that the Plans contained enrollment provisions that stated that the receipt of an executed enrollment or application card would constitute the irrevocable consent of the applicant to participate under the provisions of the governing act, as amended, or as might thereafter be amended. The court noted, "Georgia courts have repeatedly held that government employees and their beneficiaries have no vested right in unchanged benefits where the pension or retirement plan at issue unambiguously provides for subsequent modification or amendment." The court found no ambiguity in the enrollment provisions at issue and determined that the provisions clearly au-

Message from the President

Charlotte Cagle

Hello! It is with great pleasure that I send greetings to each of you with this, my first letter as President of the Georgia Association of Public Pension Trustees.

It was a privilege to be sworn in as President along with other elected officers and directors, as part of the immensely successful 6th Annual GAPPT Conference in Savannah, in September of this year.

My thanks go to Jim Meynard for his efforts in leading this organization. I was excited to take the proverbial reins and now looking forward to building on the solid foundation he left us, and continuing to move this association forward.

For those that may not be familiar with me, here are a few details about my pension background: I started my journey as a new trustee in 2006: was named Board Chair in 2007, and continue to serve in that capacity for the City of East Point Employees Retirement Plan. I hold certifications in both Florida (2007) and Georgia (2014) as a Certified Public Pension Trustee.

Along with a group of colleagues, I co-founded the Georgia Association of Public Pension Trustees with a mission dedicated to promoting education for public pension trustees in Georgia.

You will hear a lot about education from me over the course of my term, because I am deeply committed to the belief that,

the best trustee is an educated trustee. It is important for all of us to understand that the most beneficial way to represent and assist our members is to educate ourselves firstly, and then carry that knowledge back to our constituents with the intent of sharing information widely and with thoughtful consideration. I have demonstrated that commitment personally, proving that obtaining an education works; and I would encourage all of you to do the same!

A great way to do that is to consider attending the upcoming 3rd Annual GAPPT School, which is scheduled for March 21-23, 2016 at the Marriott Macon City Center. Looking further into next year, our 7th Annual GAPPT Conference is scheduled for September 19-22, 2016 at Lake Lanier Islands Legacy Lodge & Conference Center.

Certainly it is important to attend these events, in conjunction with attendance at your regularly scheduled meetings – allowing for repeated exposure to all aspects of the pension business. Making these events a part of our routines will mean we have more chances to absorb knowledge and information, and also building and strengthening good relationships along the way.

Your work as a public pension trustee is important. With every meeting you attend and every vote you cast – make it count! You represent the participants in your Plan, utilize this association as a

resource to do so to the best of your ability.

I am excited to begin this new chapter, and I am thrilled to have each of you on this journey with me! Know that I will do my very best, not only for myself but for all of you as well as those dedicated retirees we all serve!

Until next time-
Charlotte Cagle CPPT
President, GAPPT

Your Current GAPPT Board members:

President and Chairperson	Charlotte Cagle, Chairperson, City of East Point Employees Retirement Plan Pension Board
Vice-President	Tom Harris, Finance Director, City of Alpharetta
Treasurer	Morgan Wurst, Executive Director Georgia Firefighters' Pension Fund
Secretary	Tracy Wells, Assistant Treasurer, Georgia Firefighters' Pension Fund
Director at Large 1	Michaela Thompson, Georgia Ports Authority
Director at Large 2	Tim Milligan, City of Marietta Pension Board, Georgia Firefighters' Pension Fund Board
Director at Large 3	Matthew Hamby, City of Gainesville Retirement Plan



7th Annual GAPPT Conference

Lanier Islands Legacy Lodge

September 19-22, 2016

www.lanierislands.com/accommodations/lodge

GAPPT Certified Public Pension Trustee (CPPT) Program Overview

What Will You Learn?

The CPPT Program has been set up to provide consistent, regimented training to Public Pension Trustees to ensure they are equipped with the knowledge necessary to confidently address the challenges they face. Throughout this program, you will gain an understanding of all disciplines in the field of public pension from fiduciary responsibility to alternative investments. Each workshop addresses a specific topic related to public retirement.

CPPT Certificate:

Upon successful completion of the CPPT Program, a participant will receive the designation of a Certified Public Pension Trustee. Certificates will be mailed within thirty (30) days of completion of the program.

CPPT Program (Basic/Advanced/Continuing Education):

The CPPT Program is comprised of a Basic, Advanced and Continuing Education course. To enroll in the Advanced course, the participant must have successfully completed and passed the Basic Course Exam (70% or greater) within the past two years. To enroll in the Continuing Education course, the participant must be a GAPPT Certified Public Pension Trustee.

Expert Faculty:

You will learn from a team of expert money managers, investment professionals, attorneys and financial consultants. These individuals are well respected in their fields and have extensive experience in educational seminars.

Certification Testing:

Proctored exams will be given for the Basic/Advanced programs on Wednesday morning during the GAPPT Trustee School. Program review workshops will also be offered on Tuesday afternoon to help prepare all certification candidates for the program exams. All individuals must attend the appropriate classes and in the proper sequence starting with Basic and finally Advanced. You must check in on Monday morning to receive your study material and to be eligible to take the

exam on Wednesday. You must check in on Wednesday to receive your exam. All individuals must pass all exams for certification.

CPPT Recognition:

Each fall at the GAPPT Annual Conference, the GAPPT will honor our members completing the CPPT certification process.

Post Certification Requirements:

After completing the CPPT Certification Program everyone must complete eight (8) GAPPT Continuing Education Units (CEU) annually to maintain your CPPT Certification. Units are available at the Annual GAPPT Conference and the Annual Trustee School only.

Re-Certification Fee and Affidavit of CPU completion:

Every year after initial certification, there will be a recertification fee of \$30. GAPPT will forward an invoice for your convenience. Upon payment and affidavit attesting to completion of continuing education requirement, the member will be recertified for a year beginning April 1 and ending the following March 31.

In-Active Status and Renewal Requirements:

Certification will lapse (in-active status) on March 31 if requirements are not met. If a participant's certification remains in-active for a period less than 1 year, recertification will be granted upon payment of \$30 and affidavit attesting to completion of 12 hours of GAPPT CEU during the period while in-active. Successful grade on Advanced exam in lieu of the required CEU will qualify. If the certification is in-active for more than 1 year, recertification will be granted upon payment of \$30 and obtainment of passing grade on the Advanced exam.

Registration Fee:

The present cost to participate in the CPPT Trustee School is as follows:

GAPPT Member: \$99;
GAPPT Non-Member: \$149
Affiliate: \$500

GAPPT Certified Public Pension Trustee School 2016 March 21—23, 2016, Macon Marriott City Center

Register early for the **GAPPT Trustee School** and start or continue your path towards becoming a GAPPT Certified Public Pension Trustee in Georgia! The school will get started on Monday morning, **March 21, 2016**, with Breakfast and Registration opening up at 8:00 a.m. and your first class beginning at 9:30 a.m. You will have another full day of classes on **Tuesday, March 22**. **Wednesday morning** starts with a continental breakfast and then your test for the course in which you enrolled (no test for Continuing Education course track). Classes for the Advanced and Basic tracks will run both days until 5:00, including daily review sessions at the end of each day. The Continuing Education classes are a single day only and will be held on Tuesday, March 22. In the evenings, we will have a social hour and then an evening Study Hall with a casual dinner provided, where you may review the day with your classmates while enjoying a light dinner and refreshments. Remember that your School registration fee includes all of your meals, two full days of course materials and a half day on Wednesday to take your test. The only other expense you will have is the cost of your room at the Macon Marriott City Center and we have secured a rate of \$110.00/night for a single room. Register on the web at www.gappt.org/2016-trustee-school.

City of Atlanta's 2011 Pension Reform Upheld by the Georgia Supreme Court

(continued from page 1)

By Edmund Emerson III and Margaret C. Barker
Morris, Manning & Martin, LLP (Atlanta)

thorized the City to amend the Plans without breaching Plaintiffs' employment contracts or violating the Impairment Clause.

The Supreme Court agreed with the lower court's analysis. The Court concluded, "Here, the language of the Enrollment Provisions is plain, unambiguous, and capable of only one reasonable construction in regard to the two points critical to the resolution of the challenge in this case: that the receipt of an applicant's executed enrollment or application card evidenced the applicant's irrevocable consent to participate in the applicable retirement plan, and that the

applicant would do so under the plan's governing laws as then amended, or as might be amended in the future. Thus, Plaintiffs did not acquire a vested contractual right in a retirement plan unaltered in the manner at issue." The Ordinance, according to the Supreme Court, "did not alter Plaintiffs' pension *benefits*, but rather modified their pension *obligations*, and in no manner divested Plaintiffs of their earned pension benefits, so as to implicate constitutional concerns." (emphasis added).

Impact of *Borders*

The serious problem of unfunded pen-

sion liability is by no means a challenge unique to the City. The *Borders* decision provides legal support to local governments in Georgia to address pension reform in the same manner as the City. Following *Borders*, so long as a public pension plan clearly provides for amendment, and the changes modify prospective employee *obligations* rather than earned employee *benefits*, then a local government in Georgia may amend a public plan without violating the constitutional and contractual rights of its employees.

Administrative Law Judge Orders Reduction in Retirement Benefits for County Commissioner Convicted Of Bribery

By: Avery Brown and David Will; Royal – Will Law Firms

Following a hearing before the Georgia Office of State Administrative Hearings (OSAH), Administrative Law Judge Amanda Baxter ordered that Charles Wyatt, a former county commissioner of Harris County, Georgia, would have his retirement benefits reduced by \$101,616.57 after his conviction of a "public employment related crime."

Under O.C.G.A § 47-1-22(b), if a public employee or official commits a "public employment related crime" and is convicted for the crime, upon final conviction such person's benefits under a public retirement or pension system, including any survivor's benefits if applicable, are reduced by an amount equal to three times the "economic impact" of the crime.

After an investigation by the Georgia Bureau of Investigation, Wyatt was convicted of bribery and violation of his oath of office after it was determined that he received \$22,414.69 from an insurance broker in exchange for his vote in favor of the broker's bid and proposal to contract with Harris County for

employee health insurance coverage. In calculating the "economic impact" of the crimes, the ALJ included the \$11,457.50 in legal fees billed to Harris County by the county attorney for legal advice arising from Wyatt's criminal activity.

In total, Wyatt's "economic impact" due to employment related crime was calculated to be \$33,872.19. As O.C.G.A § 47-1-22(b) requires that retirement benefits must be reduced by an amount that is three times the economic impact of the crime, Wyatt will lose a total of \$101,616.57 (\$33,872.19 x 3) in retirement benefits.

Wyatt did not appeal the decision and it is final. The case is Association County Commissioners of Georgia Defined Benefit Pension Plan Board of Trustees v. Wyatt, Case No. OSAH-PRS-ACCG-1542632-72-Baxter, Georgia Office of State Administrative Hearings. (A copy of the decision may be obtained from OSAH or the authors.)

What is the Cost of Transitioning from a DB Plan to a DC Plan?

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Will closing your Defined Benefit (DB) plan and moving some or all employees to a Defined Contribution (DC) plan be the promised panacea? If getting the most for each dollar going into the plan makes a difference in your decision-making, there is much to consider. If partnering with employees to create a secure retirement and to be active economic participants in your community after retirement is important, dig deeper. These outcomes are highly unlikely to occur with a DC plan being the primary retirement arrangement because research demonstrates that DC plans are at least 20% less efficient in delivering retirement benefits. Before making such a monumental change decide for yourself on the costs and merits of transitioning away from a primary DB Plan.

This paper examines the cost associated with transitioning from a defined benefit (DB) plan to a defined contribution (DC) plan. It also explores the cost difference of these two plan types in delivering retirement benefits.

A Key Equation

As Glenda, the Good Witch says in *the Wizard of Oz*, "It's always best to start at the beginning." The beginning analysis for any and all retirement plans (regardless of plan type) is that for any retirement plan, over time, the benefits provided will equal the contributions made plus the investment income earned minus the expenses required. The following equation summarizes this fact:

$$B \text{ (BENEFITS)} = C \text{ (CONTRIBUTIONS)} + I \text{ (INVESTMENT INCOME)} - E \text{ (EXPENSES)}$$

This formula is true regardless of the type of plan (DB, DC, hybrid, IRA, or any other design one can imagine). Therefore, if the "cost" of a plan is equal to the contributions made to the plan then any cost savings must come from one of the following:

- reduced benefits;
- increased investment returns; or
- lowered expenses.

So any "cost savings" due to transitioning from a DB plan to a DC plan must come from one of these sources. We will now examine each potential savings source in turn. Many hybrid plans include elements of a DB and a DC plan. In order to avoid complicating the discussion and cost analysis, this paper does not consider hybrid plans.

Let us examine the interaction among these elements of cost.

Initial Transition Costs

Most public sector employers offer both a traditional DB plan, funded with employer contributions and typically employee contributions, and a DC plan, typically a §457 deferred compensation plan or §403(b) defined contribution plan funded with employee contributions. The fact that the basic DC plan account structure is in place may help avoid some initial transition costs. However, these plans are often administered independently by a separate entity. In that case, much of the initial transition cost may still exist.

Regardless, there will be some extra initial expense in transitioning to a DC plan. Establishing the structure to accept and account for employer contributions will be required. In addition, employee communication material will be needed to describe the expanded DC plan offerings. If current employees are given the option (or are required) to transfer to the new DC plan, significant communication pieces would be needed to fully explain the options available. In addition, the proper forms and election materials will need to be developed in order for a smooth transition.

Another potential liability increase that may occur at implementation, which is often overlooked until it occurs, results from earlier-than-expected retirements from the DB plan. This can be especially true if the transition to the DC plan is mandatory and includes all active employees. Those employees eligible for retirement may decide now is the right time to retire. Even if the change does not include current active employees, just the general upheaval can result in some eligible employees retiring earlier than had been anticipated.

Two other sources of transition cost have engendered much controversy recently. These are selecting the appropriate amortization period and investment return assumption for valuing the legacy unfunded actuarial accrued liability (UAAL). We will consider each in turn.

Amortization periods vary greatly from system to system. However, many of the systems that are considering transitioning from a DB to a DC plan are doing so because of budget issues and are amortizing their UAAL over relatively long periods. A mature, ongoing DB plan is by nature always middle aged. When a DB plan is closed to new entrants, it loses this perpetual middle aged characteristic and begins to age. Furthermore, the covered payroll for the legacy UAAL will begin to reduce as the number of covered active employees declines. If a system does not shorten its amortization and modify the amortization method, from level percent of pay to level dollar, the legacy UAAL will continue beyond the active working life of the legacy covered employees meaning that future generations of taxpayers will be burdened with this continued payment. Current actuarial profession guidance encourages such modifications to the amortization policy.

Since a closed system is no longer perpetually middle aged, in fact, it is no longer a perpetual system, care should be taken in estimating the expected rate

Mutual Funds and Exchange Traded Funds Explored

Beth L. Baron, CFA, CFP® and Howard K. Bos, CFA
Richmond Capital Management

ETFs or exchange traded funds have recently grabbed the investment spotlight as a more nimble and tax efficient alternative to mutual funds. But before you write off mutual funds as an investment dinosaur, it is important to understand the strengths and weaknesses of each investment type.

The first open-end mutual funds were created in the early 1900's, and today there are over 10,000 different mutual funds offered to the investing public. This tremendous growth has come about for a reason. For many years, individual investors clamored for professional investment advice. Mutual funds fit this need by offering diversified portfolios of securities that are professionally managed and pool investors' assets together into one investment portfolio. The investing public can now track their actively managed mutual funds daily. Most mutual funds today are open-end investment companies that set a price or net asset value (NAV) at the end of each business day. Investors can sell or buy these investments at the closing NAV. Mutual funds tend to be classified by the asset class in which they invest, for example, bond or fixed income funds, money market funds, stock or equity funds. Today, you can find a mu-

tual fund that invests in almost any asset class. Mutual funds have expanded their options from actively managed funds to passively managed offerings as well. This incredible array of investment options with low investment minimums has propelled the mutual fund industry to over \$14 trillion in assets.

While ETFs do not have as long a history as mutual funds, their growth since their inception in 1992 has also been extraordinary. Today, there are over 1,500 different ETFs offered, targeting in some cases very specific investment niches. Unlike mutual funds where the price for trading is determined at the close of the business day, ETFs trade continuously throughout the trading day similar to a stock. The price is determined between the buyer and seller of the security and can trade at a premium or discount to the Net Asset Value (NAV). This is an important difference between a mutual fund and an ETF giving the investor the ability to buy into the market during the trading day as opposed to simply receiving the market's closing price. ETFs were originally designed to allow investors to passively invest in different sectors, mimicking the returns of a particular benchmark such as the S&P 500 Index. Newly launched ETFs, however, have since add-

ed active management to their palette of offerings.

So which investment vehicle is best for you? It depends. ETFs tend to have lower operating expenses compared to mutual funds, but like a stock, you will likely pay a commission on the number of shares that you purchase. So if you are buying or selling smaller dollar amounts, mutual fund total expenses could be lower. Secondly, if you are investing in a non-pension or non-retirement account, ETFs tend to be more tax efficient due to their typically more passive strategy. ETFs can target very specific market niches such as an India-only equity fund, but be aware of liquidity constraints which may arise from thinly traded ETFs or very small asset sizes which can materially affect the purchase or sell price. Of course, with any investment do your homework. Check past performance versus the fund's stated benchmark, compare operating expenses, and understand the risks involved with each investment. The reality is that once you look under the hood of different mutual funds and ETFs, both investment vehicles can offer excellent investment choices. Happy Investing!

"I am grateful for what I am and have. My thanksgiving is perpetual."

Henry David Thoreau

The GAPPT newsletter "News and Reports" is now accepting **advertising!** Our current electronic circulation is close to 400 recipients and growing every year. Included in our circulation are members of Public Pension Boards, State Legislators, and Affiliates from firms and organizations that support the work being done on our pension boards.

Our publication is quarterly and includes articles about issues pertinent to Georgia public pension boards. Every quarter we try and bring information forward to help our trustees stay abreast of any "hot" issues in the world of investing and fiduciary responsibility.

We will be accepting Full, Half, Quarter, and business card size advertising beginning with the First Quarter, 2015. Our deadlines for submission will be announced on the website and our advertising will be limited for each issue and accepted on a first-come basis.

Below are the initial rates for space:

Full Page	\$1,000	Quarter Page	\$250	For more information or if you have any questions, please contact either Charlotte Cagle (editor@gappt.org) or Margaret Bryant (execdirector@gappt.org)
Half Page	\$500	Business Card	\$125	

10 Years Removed from Cox & Thomas: A Survey of the Claims Filing Landscape for U.S. and Non-U.S. Securities Litigation Recoveries

Jonathan R. Davidson, Esquire; Emily Christiansen, Esquire; Kessler Topaz Meltzer & Check, LLP

According to NERA Economic Consulting, between 2010 and 2014 alone, \$26.8 billion dollars in securities class action settlement and judgment proceeds were made available to investors. In recent years, we have examined the claims administration process in securities class action settlements – the most important step of the process for institutional investors (when not actively litigating a case and serving as a fiduciary for the class) with regard to securities fraud class actions. This has included a review of the systems and best practices that institutional investors have implemented for recovering settlement proceeds, as well as the issues investors face in the complex claims administration process. As Q4 2015 approaches, we survey the current claims administration landscape, take a look at some recent, notable developments, and provide an overview of how the global institutional investor community is navigating this challenging and important area.

As has been widely cited for years within the shareholder litigation community, in 2005, Professors James D. Cox and Randall S. Thomas released a groundbreaking paper in the Stanford Law Review entitled, “Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements.” In their study, Professors Cox and Thomas compared the list of shareholders who traded stock in various companies during a class period with the list of institutions who filed claims in a securities fraud settlement concerning the same company and the same class period. The results were astounding – on average only twenty eight percent (28%) of eligible institutional investors filed claims in settlements.

Institutional investors owe a fiduciary duty to their plan participants to take reasonable steps to recover monies owed to their funds. Yet despite this fiduciary duty, the amounts of money at stake, and an ever-increasing array of options of services available to help institutional investors recover settlement dollars, claims filing participation rates remain low. A decade has passed and the claims filing participation rates are still not much better than they were in 2005. In fact, current estimates compiled from statistics from NERA Economic Consulting and Cornerstone Research suggest that only thirty five percent (35%) of eligible institutional investors file claims in U.S. settlements. The low U.S. claims filing rates and changes in the legal and regulatory landscape (including the U.S. Supreme Court’s 2010 decision in *Morrison v. National Australia Bank Ltd.*, which now requires investors to pursue a recovery outside the United States for securities fraud losses stemming from shares traded on non-U.S. markets) mean that

institutional investors are still leaving billions of dollars on the table. With numerous options available for claims filing services, why is so much money still going unclaimed?

There are essentially three options available to institutional investors seeking outside assistance with the claims filing process relating to U.S. securities class action settlements: 1) contracting with their custodial bank to file claims, 2) retaining a third-party claims filing service, or 3) retaining a law firm to assist with monitoring and claims filing. While all three are viable options to assist institutional investors with the claims administration process, they each present certain considerations.

Claims Filing by Custodian

Most U.S. based institutional investors utilize their custodial bank to file claims. Investors outside the U.S. appear less likely to utilize their custodial bank although it is unclear whether that is because their custodians are typically based outside the U.S. and do not offer the service, whether investors outside the U.S. are still unaware of how the U.S. class action system operates (and consequently are still unaware of their eligibility to file claims), or some other reason that may explain non-U.S. investors’ general reluctance to participate in securities class action settlements via their custodial bank. There are certainly many advantages to using a custodial bank for claims filing, including the custodian’s access to relevant transaction data. Utilizing custodians for claims filing, however, can also present certain challenges.

- Custodians process a large volume of claims and as a result, may miss key requirements on particular claim forms. For example, we have observed instances where a custodian did not realize that a particular securities class action settlement allowed investors to make claims for **both** purchases and holdings within a given class period. Accordingly, the custodian filed a claim only for the purchases and consequently the shareholder did not recover for their holdings that stemmed from pre-class period purchases. Further, in settlements related to particularly complicated cases that involve a number of companies and securities, there have been instances where custodians have missed filing claims for one or more eligible securities.
- When investors switch from one custodian to another and a class period in a case spans the time of the custodial transition, the custodians may not be aware of the inves-

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10 Years Removed from Cox & Thomas: A Survey of the Claims Filing Landscape for U.S. and Non-U.S. Securities Litigation Recoveries

(Continued from page 7)

Jonathan R. Davidson, Esquire; Emily Christiansen, Esquire; Kessler Topaz Meltzer & Check, LLP

tors' eligibility to file a claim or may each have insufficient data to file a complete claim.

- Some custodians are now outsourcing the claims filing service to third party administrators, which present other considerations (see *Claims Filing by Third Party* below for further discussion).
- Some custodians are unable to offer detailed or customized claims reporting that informs investors of what claims were filed (or when a claim was not filed, the reason(s) why).
- Inability of custodians to answer questions about a particular claim or to provide legal advice.
- Inability of custodians to provide assistance with recovering losses related to securities purchased on non-U.S. markets (see *Special Considerations for Seeking Recoveries Outside the U.S.* below for further discussion). In fact, many custodians will send notifications to investors alerting them to the fact that they purchased securities in the relevant non-U.S. company without regard to whether the investor has losses or is otherwise eligible to participate in the non-U.S. jurisdiction action.
- Other third-party claims filing services are a small part of a larger company that primarily offers services or goods unrelated to securities class actions or the legal field generally. A number of these servicers provide marketing or investment advisory services and may attempt to sell ancillary products or services.
- Although some third-party filers tout their ability to assist investors with non-U.S. recoveries, they are often unable to do more than provide investors with contact information for the attorneys in the local jurisdiction who are pursuing the case. Additionally, they are unable to inform investors about the shareholder litigation legal structure in a particular jurisdiction, or advise them as to the risks involved in the case, the costs they may incur in pursuing the action, and whether it ultimately makes sense for investors to participate (see *Special Considerations for Seeking Recoveries Outside the U.S.* below for further discussion).

Claims Filing by Law Firm

Unlike custodial banks and third-party filers, law firms have the ability to file accurate claims forms on behalf of institutional investors, as well as provide legal advice on securities cases worldwide (a particular benefit to institutional investors for cases that are unique or require more active participation, such as cases in non-U.S. jurisdictions that require investors to opt-in.) Engaging a law firm can also allow an investor the option to take a more active role, including seeking lead plaintiff appointment or choosing to opt-out of a particular case should the investor's losses merit doing so. Further, because law firms are involved in the prosecution of securities class action claims, they may be in a stronger position to understand what is required on a particular claim form and should be able to avoid making some of the mistakes sometimes seen in claims filed by custodians and third-party filers. Law firms are also better equipped to provide customized and more detailed reporting regarding claim recoveries.

As law firms in the securities litigation field provide portfolio monitoring services at no cost, an investor looking to engage a law firm for claims administration assistance should similarly expect their fund will not incur a cost for a law firm to file claims, nor concede any portion of their recovery in securities class action settlements as payment to the law firm. But while

Claims Filing by Third-Party

A number of third-party claims filing services have cropped up in recent years, presenting investors with an ever-increasing number of claims filing options. However, not all third-party filers are equal in terms of the depth and quality of services they provide.

- Third-party claims filing services tend to be the most expensive claims filing option available to investors – charging, on average, 20-30% of a claim recovery in exchange for their services.
- Some third-party servicers cater more to retail investors and are not as accustomed to handling institutional investor claims. This can be particularly problematic when an institutional investor manages more than one fund and would need to file multiple claims in one settlement.
- The third-party claims administrator market is rather fluid and companies frequently go out of business, merge, and either acquire or are acquired by other companies.
- Many third-party claims filing services have professional

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What is the Cost of Transitioning from a DB Plan to a DC Plan?

(cont'd from page 3)

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of investment return for future years. In the same manner that financial counselors recommend clients in private DC plans gradually move toward more fixed income investments as they age, a closed DB plan will also age and should consider moving to more income producing investment as the cash flow needs of the system increase. As a closed DB plan ages, it will no longer have the perpetual investment horizon that allows time for portfolios to ebb and flow with investment cycles. Significant market downturns near the end of the working career of the plan, or individual, will be difficult or impossible to overcome with the shortened investment horizon. Actuaries recommend reducing the investment return assumption to recognize this change in the underlying mechanics of the system.

Depending upon the amount of underfunding at the point of transition, shortening the amortization period and reducing the investment return assumption can greatly increase the near term cost of the legacy DB plan. If these changes are not recognized in advance, then any system shortfalls will have to be made up by future generations of taxpayers from the general operating income of the plan sponsor.

Investment Return

The distinct structures of the two types of plans result in significantly different investment characteristics. DB plans, by their very nature, pool investment risk across generations of taxpayers, as well as among current and former employees, with the investment risk predominately borne by the plan sponsor. As noted above, a mature, ongoing DB plan is, by nature always middle-aged. That is, the investment horizon remains relatively constant because group life expectancy is reasonably uniform. Even if the retiree population is gradually increasing faster than the active population (due to mortality improvements or employment reductions), the change in the investment horizon is significantly more stable than for an individual in a DC plan.

On the other hand, in DC plans, the investment risk is generally borne by the individual. As a plan participant ages, he or she faces an ever-shortening investment horizon. In practice, this means that participants in DC plans should be invested more conservatively during the years when their account balances are the largest (i.e., as one approaches and after retirement). Moreover, in contrast to DB plans that benefit from pooled, professional investing with large economies of scale, DC plan participants tend to have limited investment knowledge and options, which magnifies the difference in investment returns compared to returns in DB plans.

The combination of these characteristics results in a significant difference in the investment return for the two plan types. Recent estimates indicate that switching from a DB plan's pooled investment structure to the individual retirement account structure in most DC plans will reduce investment returns from 1% to 2% over the life of the participant. This difference may grow larger as DC plan demographics mature and DC retirees invest more conservatively in retirement. Past studies have compared the returns of mature DB plans to demographically younger DC plans – and the DB plans significantly outperformed even with less favorable demographics.

Therefore, the so-called "savings" from switching to a DC plan do not come from increased investment return. In fact, investment return will likely be reduced.

Plan Expenses

Recent studies have shown that the investment fees in a DB plan run from as low as 28 basis points to around 60 basis points depending on various factors. (A basis point is 1/100 of 1% used to briefly express differences in interest rates, i.e., 1% equals 100 basis points.) An April 2011 paper, "A Role for Defined Contribution Plans in the Public Sector," State and Local Pension Plans No. 16, Center for Retirement Research at Boston College, Chestnut Hill, MA., indicates administrative and investment expenses average 0.43% of assets for public sector DB plans and 0.95% for public and private DC plans.

The "savings" do not come from reduced expenses.

Pooled Mortality

A major strength of DB plans is that mortality experience is pooled. On average, each participant will receive roughly the same number of monthly payments. However, no one person knows precisely when he or she will die. In fact, some participants will live longer than their life expectancy and receive more payments and some participants will live shorter than their life expectancy and receive fewer payments. However, from the perspective of a DB plan, the participants on average will live to their life expectancy and, as a result, the expectation of payments is predictable and manageable. In a DC plan, converting the DC account balance to monthly payments is done on an individual basis, so that there is a pool of one participant. The participant must decide how long he or she wants the account balance to last. This is a daunting task to say the least. The participant can go to the market and purchase an annuity but the annuity will be priced to protect the annuity supplier from loss. This increases the cost of the annuity relative to a pooled arrangement.

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What is the Cost of Transitioning from a DB Plan to a DC Plan?

(cont'd from page 9)

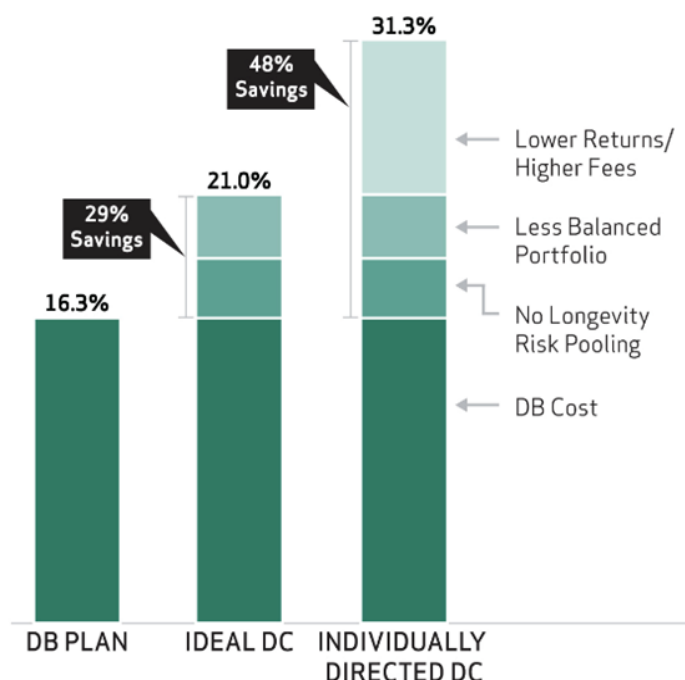
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ment such as in a DB plan. In addition, insurance company pricing will likely reflect potential adverse selection if only a subset of retirees are choosing to purchase annuities.

Comparison of DB and DC Delivery and Cost of Benefits

In 2008, the National Institute for Retirement Security (NIRS) prepared a paper, "A Better Bang for the Buck." The paper showed that a DC plan would require 46% more in contributions to generate a similar target benefit stream as a DB plan. Conversely, DC contributions deliver about 65% of the benefit dollars that DB contributions deliver. In December 2014, NIRS released an update to the original 2008 study. This paper took into account improvements in the DC delivery of benefits referenced in the report as an "ideal DC". The "ideal DC" plan has a pooled investment portfolio with mandatory annuitization at retirement. The paper found that the individual DC plan will cost 48% more than a comparable DB plan, which is very similar to the 2008 study. The ideal DC plan with all the improvements will still cost 21% more than a DB plan. The following chart comes from the NIRS paper, "Still a Better Bang for the Buck."

COST OF DB AND DC PLAN AS A PERCENTAGE OF PAYROLL



REPRINTED BY PERMISSION, "STILL A BETTER BANG FOR THE BUCK: UPDATE ON THE ECONOMIC EFFICIENCIES OF PENSIONS," ©2012, NATIONAL INSTITUTE ON RETIREMENT SECURITY, WWW.NIRSONLINE.ORG

On October 9, 2014, Robert L. Brown and Craig McInnes released a paper entitled, "Shifting Public Sector DB Plans to DC." This paper acknowledged the earlier NIRS paper and expanded the DB/DC comparison to reflect recent advances in model DC plans. The Brown/McInnes paper refers to these as pooled DC models. The pooled DC model is similar to the "ideal DC" plan mentioned earlier in that it has a pooled investment, professionally administered investment portfolio with mandatory annuitization. The pooled DC model is expected to improve DC efficiency but is still predicted to be about 20% less efficient than a comparative DB plan in providing retirement income. The chart below illustrates these results. The first chart shows the contri-

Continued on page 11

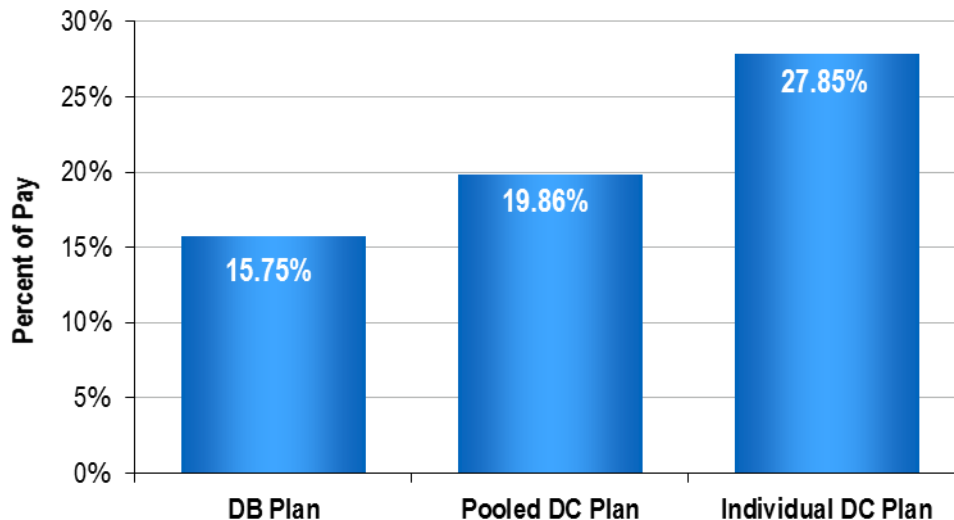
What is the Cost of Transitioning from a DB Plan to a DC Plan?

(cont'd from page 10)

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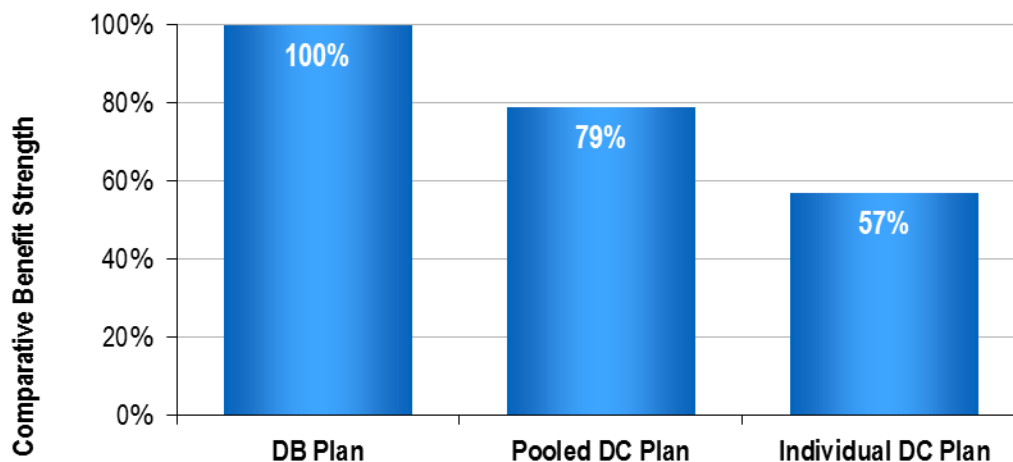
tribution rate necessary to provide the same benefit. The second chart shows the percentage of benefit provided by the same contribution rate.

CONTRIBUTION RATE REQUIRED TO PROVIDE EQUIVALENT RETIREMENT INCOME



Note: Amounts shown are from the Brown/McInnes Paper.

COMPARATIVE BENEFIT PROVIDED BY PLANS



Note: Amounts extrapolated from Brown/McInnes paper. Brown, Robert L. PhD, FCIA, FSA, ACAS and McInnes, Craig. "Shifting Public Sector DB Plans to DC: The experience so far and implications for Canada." (Canadian Public Pension Leadership Council) (October 2014).

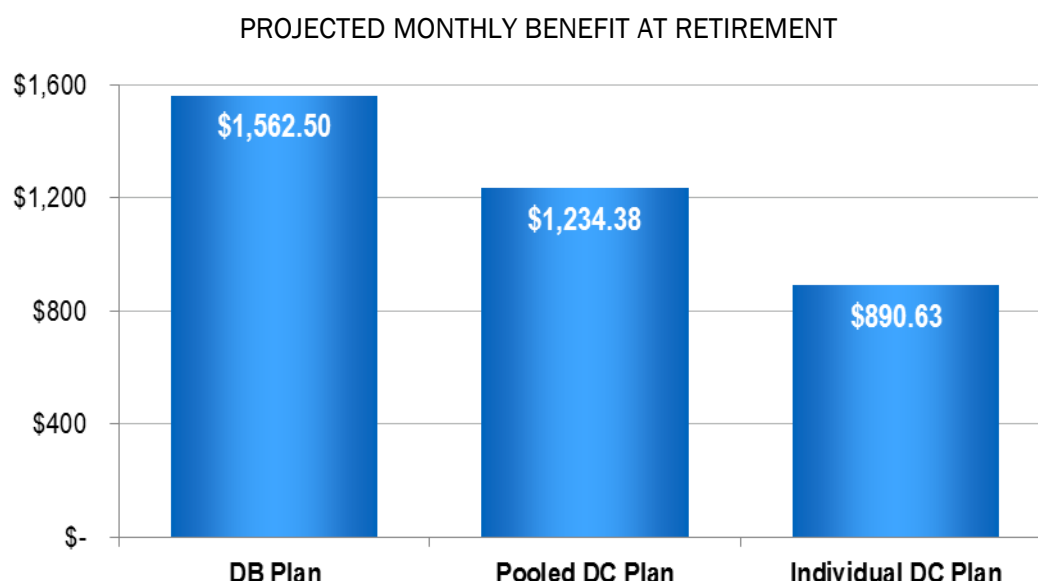
Another way to view the chart above is to compare the projected monthly benefit at retirement in a DB plan, a Pooled DC plan and an Individual DC plan. For illustration purposes, presume a DB plan with a 1.5% per year accrual rate, 25 years of service at retirement, and a final average salary of \$50,000. Further, presume that the DC plans each have the same contribution rate as the normal cost rate for the DB plan. This results in the following projected monthly benefits at retirement.

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What is the Cost of Transitioning from a DB Plan to a DC Plan?

(cont'd from page 11)

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Other Cost Impacts

If the legacy DB plan is "frozen" either to new entrants or for future service, additional costs may develop as the DB plan ages along with the plan population. This aging results in a shorter investment horizon. As cash flow needs rise, long-term stability vanishes and the plan needs investments with greater liquidity features. Without the addition of new employees, any fluctuations in the plan's emerging demographic characteristics or economic results will be more acutely felt on a diminishing participant population.

Another cost consideration is the fact that DC plans are very inefficient vehicles for providing ancillary benefits, such as death and disability. Early in an employee's career, DC accumulations are too small to provide meaningful benefits. Therefore, making a DC plan the only retirement plan will trigger a need to purchase long-term disability coverage and spousal death coverage outside of the retirement plan. That coverage is often more expensive than pooled coverage offered as part of a DB plan.

In summary, any "cost savings" for plan sponsors associated with switching from a DB design to a DC design are due to reductions in employee benefits and shifting of risk to plan participants. There are hybrid design options that may more equitably share plan risk that discussion is beyond the scope of this paper.

Human Capital Issues

Reducing contributions results in diminished participant benefits. As shown earlier, over time, Benefits equal Contribution plus Investment Return less Expenses. Since investment income is lower and expenses are higher in a DC plan, the benefits will be lower for the same amount of contributions. Thus, for an entity whose sole purpose is to supply services to its constituent base, reductions in retirement benefits can lead to changes in employee behavior, such as employees working longer than originally planned if DC benefits are not expected to support a desired standard of living in retirement. Alternatively, employees could cease employment earlier than desired since the DC balance would be available to them at an earlier age. Such changes in behavior will alter career expectations and staffing needs, including potential increases in training costs.

DB plans are often designed with specific career targets. One example is public safety with retirement ages that are often geared to specific age and service levels. In contrast, it is very difficult (and expensive) for DC plan designs to influence employee behavior.

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What is the Cost of Transitioning from a DB Plan to a DC Plan?

(cont'd from page 12)

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Given the Transition Costs, Why Switch?

DC plans have one very significant and distinct advantage over DB plans: contribution stability. Whereas DB plans are prone to contribution volatility due to changing market and demographic conditions, DC plans have no such sensitivity to market changes. The reason DC plans are immune from contribution volatility is in the nature of the promise.

Returning to the formula mentioned at the beginning of this paper, $B = C + I - E$.

$$B = C + I - E$$

If C is constant and I goes down, B must go down. That is the DC plan model.

$$B = C + I - E$$

If B is constant and I goes down, C must go up. That is the DB plan model.

$$B = C + I - E$$

As a reminder, the promise in a DB plan is for a fixed benefit amount. In a DC plan, the promise is a fixed contribution rate.

In the DB model, if I goes up then C goes down. That is what happened in the long-ago 1990s. In the DC model, if I goes up, then B also increases.

To Transition or Not to Transition? Guidelines for Making a Decision

The American Academy of Actuaries has established a set of principles to guide plan sponsors and participants in understanding the retirement promise and to assist in setting priorities. (Retirement for the Ages, January 2014)

These principles called AGES are from the above document. The acronym stands for the following::

- **Alignment** – A retirement system should align stakeholder roles with their skills.
- **Governance** – Good governance provides a balanced framework for making and implementing good decisions.
- **Efficiency** – Systems should maximize retirement income while avoiding excessive risk.
- **Sustainability** – The system should be designed to support retirement income over all generations of participants while being able to withstand financial shocks, such as recession or prolonged inflation.

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What is the Cost of Transitioning from a DB Plan to a DC Plan?

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Alignment involves evaluating risk and determining which stakeholder is best able to deal with that risk. Governance should be transparent and understandable. Efficiency determines which plan (or combination of plans) best balances the retirement income target with risk that can be tolerated. Projections can be used to model how a system of benefits will perform under various economic conditions allowing the sponsor to incorporate features that improve plan sustainability.

Summary

DC contribution dollars provide lower benefits than do DB contribution dollars. This is primarily due to the pooled nature of DB plans, particularly with regard to investment return and longevity.

Thus, transitioning from a DB to a DC plan for some or all employees does not by itself reduce contribution dollars. Any reduction in contribution dollars is due to reductions in employee benefits.

DC plan contribution rates by design are insulated from investment market volatility and participant longevity. However, market fluctuations will directly influence employee benefits and retirement behavior.

Transitioning to a DC plan is not the panacea that some tout them to be. In considering such a move, an entity should take into account all facets that will affect the purpose and mission of the entity.

The Brown/McInnes paper includes three major points:

1. "If the motivation for a conversion to DC is to reduce costs, then it should be noted that shifting to DC actually increases the cost of delivering a comparable retirement benefit."
2. "If the motivation for a conversion to DC is to reduce government's exposure to the financial risks associated with sponsorship of the pension plan, then it should be noted that other plan design options are available for reducing or transferring risk that do not require sacrificing the plan's investment efficiency."
3. "If the motivation for a conversion to DC is to address an existing unfunded liability, then it should be noted that converting to DC does nothing to address past-service unfunded liability that a plan may have accumulated."

This paper was published by NCPERS April 2015 and GAPPT has been granted permission from NCPERS to re-print. NCPERS wishes to thank Leon "Rocky" Joyner, ASA, FCA, MAAA, EA the primary author, as well as Cathie Eitelberg and Kim Nicholl FSA, FCA, MAAA, EA, of Segal Consulting for their research and assistance in drafting this paper.

National Institute on Retirement Security: State Financial Security Scorecards are released

NIRS' new State Financial Security Scorecards summarize the economic outlook for retirement security in every state. The two-page downloadable State Scorecards are designed to serve as a tool for policymakers to help identify potential areas of focus for state-based policy interventions to improve Americans' retirement prospects.

Each State Scorecard gauges the relative performance of the fifty states and the District of Columbia in three key areas: anticipated retirement income; major retirement costs like housing and healthcare; and labor market conditions for older workers.

[A copy of the full report may be found at this link.](#)

The National Institute on Retirement Security is a non-profit research and education organization established to contribute to informed policymaking by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole. www.nirsonline.org

10 Years Removed from Cox & Thomas: A Survey of the Claims Filing Landscape for U.S. and Non-U.S. Securities Litigation Recoveries

(Continued from page 8)

Jonathan R. Davidson, Esquire; Emily Christiansen, Esquire; Kessler Topaz Meltzer & Check, LLP

retaining a law firm to file claims and monitor can be beneficial to an investor, using a law firm for these services may also present a unique set of challenges.

- Some institutional investors may have policies that require them to generally only seek to recover money from securities class action settlements as a passive class member rather than by serving as the lead plaintiff or assuming a more active role. Engaging a law firm that prosecutes securities fraud cases may be seen to be somewhat at odds with such a policy.
- Not all law firms are created equal and some may offer greater depth and quality of services than others – both in terms of claims filing accuracy as well as substantive reporting to the investor.

Special Considerations for Seeking Recoveries Outside the U.S.

As has been discussed widely within the shareholder community, in recent years the legal and regulatory landscape related to shareholder rights has changed drastically. In 2010, the U.S. Supreme Court issued a landmark opinion in *Morrison v. National Australia Bank Ltd.*, which foreclosed the ability of shareholders to litigate in the U.S. in order to recover for losses stemming from securities purchased on non-U.S. markets. In the aftermath of *Morrison*, there has been a pronounced increase in securities fraud-related litigation in jurisdictions around the world – with over 100 cases now pending in 13 countries outside the United States. As a result, investors must now evaluate their options for recovery of losses related to securities purchased on non-U.S. markets.

Recovering funds outside the United States can be much more challenging because investors often need to take proactive steps to “opt-in” and actively participate in a case in order to have a chance at any recovery. Each non-U.S. jurisdiction operates differently and for investors, there may be risks associated in joining litigation. For example, many jurisdictions outside the U.S. are “loser pays” jurisdictions and investors who pursue litigation in that jurisdiction could end up being held responsible for paying the defendants’ attorney fees and court costs if the litigation is unsuccessful. Evaluating shareholder litigation outside the U.S. and adequately weighing all the options can be time consuming for investors.

When it comes to seeking assistance with the often arduous process of recovering money outside the U.S., there are fewer

service provider options available to institutional investors. Many custodians are unwilling and/or unable to handle non-U.S. claims and will instead merely notify an investor of a case, that may or may not impact them, exists. Like custodians, some third-party claims filing services are also unable to assist investors with non-U.S. claims. Other third-parties purport to offer services related to non-U.S. litigation, however, their services may be limited to informing investors about the case and providing the contact information for the litigation funder or local counsel pursuing the claim in that jurisdiction. With the exception of claims in Canada (which is an opt-out jurisdiction that operates much like the U.S.) and some cases in Australia (when the action proceeds as an opt-out), third-party filers are not able to act on an investor’s behalf and register the investor to participate in a given claim because doing so would impact shareholders’ substantive rights and require a power of attorney. Further, neither third-party filers nor custodians are equipped to advise investors of alternative options available to them or help them choose the best course of action for a particular case. For example, there have been several recent instances of parallel litigation – that is, litigation concerning the same company and the same legal and factual issues proceeding in two or more jurisdictions. Neither a third-party filer nor a custodial bank is able to provide legal guidance to investors in determining which of two or more parallel actions may be their best option.

By any objective standard, law firms actively engaged in the global shareholder litigation field offer the most comprehensive services to investors when it comes to pursuing claims outside the U.S. A law firm that is experienced in prosecuting shareholder litigation in non-U.S. jurisdictions and that devotes resources to researching and following legal developments around the globe can assist shareholders in evaluating the merits of a non-U.S. case, help investors understand their avenues to potential recovery, advise them of the risks and benefits, and can ultimately assist an investor in joining any litigation as well as help with the claims administration process should there be a positive result in the action.

Conclusion

Without question, it has been a roller-coaster ride in the shareholder litigation world since Professors Cox and Thomas released their initial research on claims administration. Shareholders have achieved landmark settlements in cases stemming from the tech bubble and the financial crisis. A number of challenges to investor rights were contested before the U.S.

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Move The Markets To A Price-Customer Order Priority System

Eric Noll, Convergenx

As US stocks ride the third-longest uninterrupted bull run in history, the question of whether equity markets are rigged continues to pervade the industry.

Fingers remain pointed at high-frequency traders (HFT) and their use of high-speed trading, with complaints it has put other market participants at a disadvantage. It is no surprise that there is widespread support for an immediate change in market structure to neutralize the advantages given to HFTs.

While HFT proponents say high-speed trading adds liquidity to the market, unfortunately that advantage is often outweighed by the market volatility high-frequency trading may cause as well as the considerable mistrust in their activities.

In their defense, they are just taking advantage of a market structure that allows them to buy and sell stocks ahead of retail and institutional customers who cannot compete on speed. That is the crux of the issue: speed should not be the most important criteria in determining how orders are handled unless we want markets that do not focus on what the real investor needs in the market.

If Wall Street and the Securities and Exchange Commission are serious about wanting “better” markets over “faster” markets and protecting investors, as I believe both are, then they need to support a change in market structure that will adopt new pricing reforms that take away the speed advantage and mandates retail and institutional customer orders above orders from all others.

While best price should take precedence, the current price/time priority order handling rule for stock executions is a pricing system that is detrimental to investors, susceptible to abuse and contributing to the deterioration of market quality.

This year the SEC created the Equity Market Structure Advisory Committee, which I was appointed to alongside other industry veterans, to provide recommendations to ensure that markets operate openly, fairly and efficiently to benefit investors. For the committee to make an impact, however, it and the SEC need to take actionable steps. Reforming a rule that is little understood but would have a huge impact on the industry and how we treat the investing community is a dramatic step in the right direction.

We cannot continue to give some an advantage and then cry foul when market mishaps occur. It is most important to enshrine both retail and institutional investors above all market participants. Elevate customer orders in all markets ahead of brokers, market makers and high-frequency traders and move the markets to a price-customer order priority system.

To understand how much market deterioration has occurred, take a look at the numbers. We now operate in an environment where liquidity is confined to approximately 100 names accounting for over 80 per cent of US trading activity, and the average trade size is as small as 200 shares.

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10 Years Removed from Cox & Thomas: A Survey of the Claims Filing Landscape for U.S. and Non-U.S. Securities Litigation Recoveries

(Continued from page 15)

Jonathan R. Davidson, Esquire; Emily Christiansen, Esquire; Kessler Topaz Meltzer & Check, LLP

Supreme Court – some, like *Morrison*, which have significantly altered the shareholder litigation landscape, and others, such as *Halliburton Co. v. Erica P. John Fund, Inc.*, where shareholders were fortunate to prevail and their rights with respect to securities class actions were left largely intact. Despite all the challenges and modifications to shareholder rights and securities fraud litigation, shareholder claims filing rates remain largely unchanged.

We have observed the global institutional investor community take significant strides in the wake of *Morrison* to put proper systems in place to track and manage the non-U.S. jurisdiction

shareholder litigation impacting their portfolios. Similarly, we have seen institutional investors, particularly U.S. investors, take steps to shore-up their claims filing practice for U.S. actions. Our hope is for this trend to continue, and that institutional investors will continue to lean on their service providers for more detailed reporting in this area to help them verify their members' money is not being left on the table. And ultimately, that the next ten years will reveal a marked increase in participation rates for the institutional investor community in securities class action recoveries.

Move The Markets To A Price-Customer Order Priority System

Eric Noll, Convergenx

(Cont'd from page 16)

We need to attract more investors to trade at the exchanges instead of dark pools — but what is the incentive for investors to trade on exchanges if they believe that the current system puts them at a disadvantage?

Since Regulation NMS was introduced in 2007, our market structure has been in constant flux, with high-frequency trading, dark pools and complex order priorities each adding challenges for institutional investors.

I propose that exchanges and other market venues create a simple tiered system for order executions, with customer orders at the top, followed by orders from market makers, and lastly orders from high frequency and professional traders. This sends a clear message that quality of execution is more important than speed.

Detractors will claim this change will be disruptive to markets, hurt liquidity and negatively impact the business models of many market participants. I contend that this change would be a welcome benefit to lit markets, driving traffic back from dark pools which, according to Rosenblatt Securities, account for 16 per cent of US daily trading volume (while total off-exchange volume exceeds 30 per cent).

If done correctly, prioritizing customer orders would have the

potential to drive institutional investor flow back to exchanges and reduce or eliminate latency arbitrage, potentially increase order execution size, increase liquidity and certainty of execution for customer orders, and most importantly, allow these customer orders to be executed first at the marketplace at the best price.

Moreover, adopting a new order execution priority would only require changes to the language of Regulation NMS and not an overhaul of wider financial regulations. In addition, exchanges already have mechanisms to put this change in place using their customized technology.

While this proposal may have its critics and may require adjustments from the sellside and other market participants, changing order execution prioritization will be an absolute positive for markets and for investors.

I urge regulators and our industry to begin structuring a process to implement this change in the order priority system, to rank customers at the top, thus restoring investor confidence and ensuring a more robust and fair market structure.

Eric Noll is chief executive of Convergenx, a US brokerage

Interesting Facts about Thanksgiving As published on KickassFacts.com

1. Up until 1933 Macy's Thanksgiving Day Parade balloons were released into the air at the conclusion of the parade and would stay airborne above the city for as long as a week. A return address was stitched in and people who returned them received \$100 reward.
2. It is against the law for supermarkets, department stores, and other big box stores in Rhode Island, Maine, and Massachusetts to be open on Thanksgiving.
3. Lincoln declared Thanksgiving a National Holiday in 1863 during the Civil War to keep the country together.
4. When Abe Lincoln declared Thanksgiving a national holiday, it was thanks to the tireless efforts of a magazine editor named Sarah Josepha Hale. She also wrote the nursery rhyme, "Mary had a Little Lamb."
5. In 1939, President Roosevelt proclaimed that Thanksgiving would take place on November 23rd, not November 30th, as a way to spur economic growth and extend the Christmas shopping season.
6. Since 1947, the National Turkey Federation has presented a live turkey and two dressed turkeys to the President. The President does not eat the live turkey. He "pardons" it and allows it to live out its days on a historical farm.
7. TV dinners have Thanksgiving to thank. In 1953, someone at Swanson misjudged the number of frozen turkeys it would sell that Thanksgiving, by 26 tons. Some industrious soul came up with a brilliant plan: Why not slice up the meat and repackage with some trimmings on the side? Thus, the first TV dinner was born!
8. The average person consumes 3,000 calories during Thanksgiving dinner. With other meals and snacking included a day can come to between 4,000 and 6,000 calories. It could take 8 hours of moderate exercise to burn that off. The original celebrants of Thanksgiving consumed around 550 calories at their celebration thanks to the lack of pies and alcohol.

The Realization: The growing role of real assets in investment portfolios

By Bernie McNamara, Pulkit Sharma, and Ryan Holgan of J.P. Morgan Asset Management – Global Real Assets

Investors are embracing real assets – which include investments in real estate, infrastructure, shipping/transport, and other large-scale, productive, hard assets – as an expanding, distinct asset class within their overall portfolio due to the spectrum of potential benefits that they can provide. In the Global Real Assets group at J.P. Morgan Asset Management, we believe that the investment world has come to *The Realization* – an inflection point, in which investors are coming to realize that real assets may be needed to help meet their investment needs and objectives.

Over the last several years, more and more investors have incorporated substantially larger allocations to “real assets”, with certain investors devoting up to 25% or more of the overall portfolio to real assets. The rationale? With higher income potential than bonds and strong risk-adjusted return potential relative to equities, real assets can provide unique solutions to the issues facing investors searching for income, growth, inflation sensitivity, and portfolio diversification.

The Inflection Point: Low Yielding Bonds, Volatile and Highly Correlated Equities, Low Growth Prospects, Inflation Concerns

A convergence of long-developing trends and rapidly changing realities has given rise to concern over the ability of equities and bonds to deliver the absolute and/or risk-adjusted investment requirements of institutional investors. Fixed income sectors are generally offering yields that are at or close to historic lows. Equity market volatility has been elevated, with investors having trouble diversifying away that volatility due to high correlations across geographies and sectors. Over the most recent decade (2005-2014) the correlation coefficient between the S&P 500 and the MSCI World indices was 0.961. During that same period, U.S. real GDP growth averaged just 1.6% per year, and most forecasts are not much more optimistic for the U.S. or other developed markets². At the same time, inflation remains a concern on the horizon, which requires advance planning for when it does arrive.

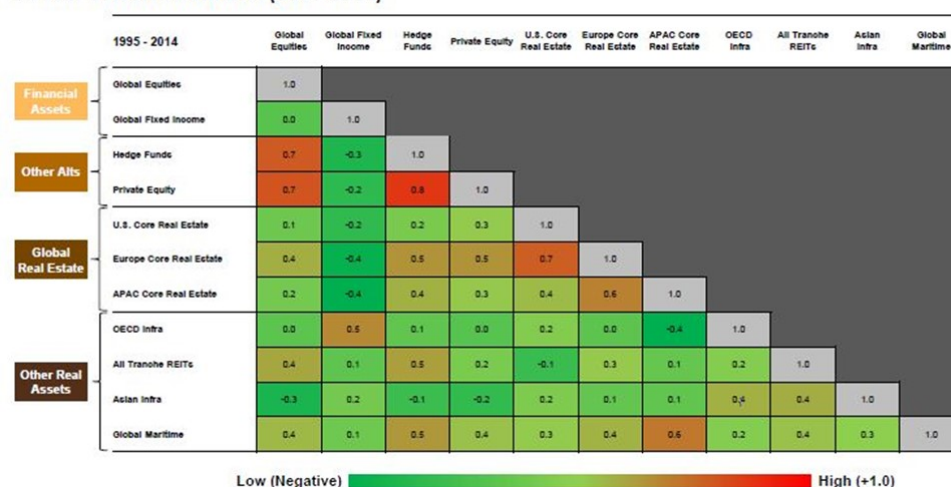
Real Assets to the Rescue?

Investors are beginning to search out new opportunities that can deliver when the Big Two Traditionals (i.e., equities and fixed income) cannot. Real assets encompass a wide variety of tangible investments that give investors optionality in this world of uncertainty – the ability, that is, to serve as a stable source of income in weak markets and to participate in the capital appreciation associated with strong markets.

More is Better ... and Broader is Better

A key point of *The Realization* is not simply that a higher allocation to real assets is worth exploring but that a more diversified execution can make sense too. The exhibit below shows a color-coded correlation matrix, which demonstrates 20-year annual correlations for equities, fixed-income, alternatives, and various real asset categories. As the heat map shows, not only do most real assets exhibit low correlations with financial assets and other alternatives, but there are meaningful degrees of non-correlation among different real asset categories.

Diversification Benefits within Diversification Benefits
20 Year Correlation Matrix (1995-2014)



Continued on page 19

The Realization: The growing role of real assets in investment portfolios

(cont'd from page 18)

By Bernie McNamara, Pulkit Sharma, and Ryan Holgan of J.P. Morgan Asset Management – Global Real Assets

Sources: Bloomberg, MSCI, Barclays Capital, HFRI, Burgiss Private Equity, NCREIF, IPD, CBRE, Jones Lang LaSalle, Wilshire, Wells Fargo, UBS, Clarksons Shipping Research, and JPMAM-Global Real Assets. Europe and Asia real estate, as well as OECD infrastructure data is denominated in local currency, all other data is denominated in USD. Annual data as of December 2014. Note: Unlevered real estate series were levered to reflect how institutional investors typically access the representative asset classes. Past performance is not indicative of future results. Diversification does not guarantee investment returns and does not eliminate the risk of loss. The above table is for illustrative and discussion purposes only.

This “double layer” of diversification, due to the local and private market nature of the real assets, delivers risk-adjusted return enhancement, which is a key rationale for considering a more diversified global real assets allocation. A well-diversified, global portfolio of these assets can increase the risk-adjusted returns of the overall real assets allocation by lowering overall portfolio volatility, as well as reducing the tail risks associated with more concentrated exposures – such as domestic-only real estate. In diversifying the real assets allocation globally, investors may be well-served by taking a strategic approach that is flexible and evolves over time, based on changing objectives, tactical considerations and the expanding global real assets opportunity set.

Our expectation is that over the coming years, more and more investors will have *The Realization*. As investors face considerable challenges in their portfolios, particularly within their public market allocations, real assets present attractive alternatives to the Big Two. Real assets deserve to be considered as a foundational asset class (i.e., a third traditional), offering an attractive mix of options for yield, growth, diversification, lower volatility, emerging market exposure, and inflation sensitivity. And early movers should continue to be rewarded in the midst of this (r)evolution in asset allocation.

¹ Bloomberg, S&P 500, MSCI, and J.P. Morgan Asset Management. Correlation coefficient calculated using 10 years of annual returns in USD terms; data as of December 2014.

² IMF and J.P. Morgan Asset Management. Average U.S. real GDP rates calculated using 10 years of annual growth rates; data as of December 2014.

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Real estate and infrastructure investing may be subject to a higher degree of market risk because of concentration in a specific industry, sector or geographical sector. Real estate and infrastructure investing may be subject to risks including, but not limited to, declines in the value of real estate, risks related to general and economic conditions, changes in the value of the underlying property owned by the trust and defaults by borrower.

International investing involves a greater degree of risk and increased volatility. Changes in currency exchange rates and differences in accounting and taxation policies outside the U.S. can raise or lower returns. Also, some overseas markets may not be as politically and economically stable as the United States and other nations. The Fund's investments in emerging markets could lead to more volatility in the value of the Fund. As mentioned above, the normal risks of investing in foreign countries are heightened when investing in emerging markets. In addition, the small size of securities markets and the low trading volume may lead to a lack of liquidity, which leads to increased volatility. Also, emerging markets may not provide adequate legal protection for private or foreign investment or private property.

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Allocation of the Net Pension Liability to Proprietary Funds

By: Joel Black

There has been much talk lately about one of the more significant implementation issues related to GASB Statement 68, *Accounting and Financial Reporting for Pensions* – whether or not to allocate the new Net Pension Liability to proprietary funds. Prior pension standards required allocation of the old net pension obligation if practical, however the new standard was silent on the issue. The GASB Implementation Guide addressed this issue with the below question (#36 of the Implementation Guide) and answer:

Q—What guidance does **Statement 68** provide regarding recognizing a portion of the net pension liability in fund financial statements if a portion of the net pension liability of a single or agent employer will be paid from an enterprise, internal service, or fiduciary fund?

A—Except for blended component units, which are discussed in **Questions 34 and 35**, Statement 68 does not establish specific requirements for allocation of the net pension liability or other pension-related measures to individual funds. However, for proprietary and fiduciary funds, consideration should be given to **National Council on Governmental Accounting (NCGA) Statement 1, Governmental Accounting and Financial Reporting Principles**, paragraph 42, as amended, which requires that long-term liabilities that are “directly related to and expected to be paid from” those funds be reported in the statement of net position or statement of fiduciary net position, respectively.

Additionally, question 122 of that implementation guide brings the same guidance to the allocation of the employer’s proportionate share of the Net Pension Liability when participating in a cost-sharing plan so this issue impacts anyone implementing GASB 68.

We are left to look at NCGA 1 and whether the proprietary fund is “expected to pay” the Net Pension Liability. There has been much discussion about this within our firm as well as among other firms and the AICPA. In the end, we called the GASB and after speaking with them, the answer came back that, essentially, if a fund is paying contributions to the Plan, then that fund should be allocated a portion of the Net Pension Liability related to that Plan.

Technically, the answer is that if the fund is paying contributions that exceed an amount for that year’s service cost and interest on the Total Pension Liability, then that fund is paying on the Net Pension Liability (“NPL”) and should be allocated a share of the NPL. In our experience the actuary always includes some component of amortization of the unfunded pension liability in the recommended contribution rate (this would be above service cost and interest for the year). Thus, you would have to have your actuary calculate a special contribution rate that only included the service cost and interest on

the total pension liability for that year and apply that special rate to only the proprietary funds for them to not be considered as paying on the NPL. As we do not usually see this occurring, then the result is the conclusion in the paragraph above that the NPL should be allocated to any fund that is paying contributions.

Do I have any options?

Yes. If you do **not** want to allocate the NPL to proprietary funds then you have the following options:

1. As discussed above, have the actuary prepare a special contribution rate which would only include that year’s service cost and interest on the total pension liability and then apply that special rate only to the pensionable payroll of the proprietary funds. The actuary would then have to have a higher contribution rate for the governmental funds to include all of the amortization of the unfunded liability in that rate – which you would then apply to the pensionable payroll of the governmental funds.

OR

2. For the fund(s) that you do not want to have to allocate a portion of the NPL to - don’t require the fund(s) to make any pension contributions. That would then increase the contributions required in the remaining funds so that you continue to meet your recommended actuarial contributions entity-wide. Under this option, it is acceptable to increase transfers out in the fund that is no longer paying the pension contributions – with the corresponding transfer in going to the fund(s) that are making the pension contributions.

We recently discussed this option / concept with GASB, and unless the transfer is specifically tied to the funding of pension contributions, the transfer does not prompt the need for allocation. In this scenario, only the specific fund (s) actually making the pension contribution would be allocated their portion of the NPL.

For example: Assume an enterprise fund annually made \$1 million worth of transfers to the General Fund and was also annually making \$400,000 in pension contributions. If that fund decided to no longer make any pension contributions, but increased the transfer to the General Fund by the amount they had typically made in pension contributions (thus making a \$1,400,000 transfer to the General Fund), and the General Fund increased its pension contributions by \$400,000 (so that total pension contributions were still what they needed to be entity-wide), then the result of this scenario would be that the enterprise fund is not making any pension contribu-

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tions and would not be allocated any of the pension liability. The General Fund would be making all the pension contributions and would be allocated all of the NPL.

Please keep in mind that the accrual of the NPL is a full accrual concept so when we say a governmental fund is making the contribution and thus allocated a portion of the NPL – this NPL is only being reported at the government-wide level, not at the governmental fund level. However, for proprietary funds, which report on a full accrual basis at the fund level, their allocated portion of the NPL will be recorded at the fund level.

What funds does this apply to?

Theoretically – all funds. Since governmental funds do not record the liability at the fund level and are aggregated as the governmental activities in the government-wide statements, then we aren't concerned with which governmental funds make pension contributions and which ones don't. When considering proprietary funds – enterprise and internal service – this concept applies to each of those funds. Thus each enterprise fund or internal service fund that makes pension contributions should be allocated their portion of the NPL.

If you consider option 2 above, it could be applied to some (or all) of these funds. If you had a couple of small enterprise funds or internal service funds to which you didn't want to deal with allocating the NPL, then you could use the concepts discussed in option 2 for those funds – even if you kept making pension contributions out of larger enterprise funds. In that case the NPL would only be allocated to the large enterprise funds that continue to make contributions, but no allocation would need to be made to the smaller enterprise funds which no longer make pension contributions.

Internal Service Funds? Really?

The same theory does apply to the internal service funds if they are making pension contributions, even though when aggregated in the government-wide statements, they will most often be combined with the governmental activities. In the fund statements, internal service funds are full accrual and thus would need to be considered for allocation of the NPL at the fund level if they are making contributions.

Theoretically, internal service funds should break even and not report deficits of any significance. With the implementation of this standard – if they are allocated a portion of the NPL and this creates a significant fund deficit, then we would **not** look to make the internal service fund “whole” by creating a due to/from the other funds. The idea behind this is that the internal service fund is making the annual required contributions (think annual debt service) and if its revenue is supporting its annual operating expenses (plus the pension contributions), then it is recovering its costs for that year.

Okay, so I have to allocate the NPL. How do I do that?

GASB 68 (and the implementation guide) are silent on how this allocation should take place. When the standards are silent on an accounting transaction then we are to look to similar transactions that are covered by GAAP to determine accounting treatment. GASB 68 does address a very similar concept in paragraphs 48-71 when considering the allocation of the collective NPL to the participating employers in a cost-sharing multi-employer plan.

To summarize, the net pension liability and all its related components (deferred inflows, deferred outflows, and pension expense) are allocated based on a proportionate share. The proportionate share should be determined consistent with the manner in which contributions to the Plan are determined. GASB prefers that the long-term contribution efforts be considered

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“Before you speak, listen. Before you write, think. Before you spend, earn. Before you invest, investigate. Before you criticize, wait. Before you pray, forgive. Before you quit, try. Before you retire, save. Before you die, give.”

- William A. Ward

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when determining this percentage, however many large cost-sharing plans in the southeast are basing the proportionate allocation on actual contributions for the year. So, if you used actual contributions as your allocation percentage then your allocation may look something like this:

	2015	Allocation		
ARC Allocation	Contributions	Percentage		
Governmental Activities	200,000	67%		
Water & Sewer Fund	90,000	30%		
Motor Pool Fund	10,000	3%		
Total	300,000	100%		

	Total	Governmental Activities (67%)	Water & Sewer (30%)	Motor Pool (3%)
Recording of the NPL				
Deferred Outflows	80,000	53,600	24,000	2,400
Deferred Inflows	(40,000)	(26,800)	(12,000)	(1,200)
Net Pension Liability	(1,500,000)	(1,005,000)	(450,000)	(45,000)
Restatement in Year 1	1,300,000	871,000	390,000	39,000

Components of Pension Expense:				
Full accrual pension expense	500,000	335,000	150,000	15,000
Less amount paid in contributions	(300,000)	(200,000)	(90,000)	(10,000)
Adjustment to pension expense	200,000	135,000	60,000	5,000

Going forward, each year would look similar except that if the percentage of contribution (allocation) changes – then the NPL (and all related deferred inflows and outflows) automatically change by offsetting amounts (still same amounts in total only the allocation changes). The resulting changes would be run through pension expense for that year – or if the difference is material, then these changes can create a new deferred inflow or outflow (depending on which way it goes), and be amortized over the remaining service life of all plan members. These deferred inflows and outflows should net to zero entity wide.

What else should I consider?

Materiality. The implementation of any accounting standard should take into account materiality. If a fund's contributions and related allocation of the NPL would be clearly immaterial then that can be considered and allocation of the NPL would not necessarily be required to that fund.

More is on the way?

GASB 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, is effective for periods beginning after June 15, 2017 (i.e. 2018 fiscal years). This standard brings the same accounting now effective for pensions to OPEB amounts (post-employment healthcare), and these same allocation methods will need to be considered and implemented upon the adoption of GASB 75.

"My cooking is so bad my kids thought Thanksgiving was to commemorate Pearl Harbor."

- Phyllis Diller

Notes from the Executive Director

Margaret Bryant

Another successful conference is in the books with record attendance in Savannah! I believe the resounding theme I heard from all in attendance was “when are we going to come back here?”. Well, it won't be in 2016 because we are now gearing up for our **7th Annual Conference at Legacy Lodge at Lake Lanier Islands—September 20-22, with another golf outing planned for Monday, September 19th.** We are in the planning stages now and will keep all posted as things move along and we open up registration. The venue is beautiful and our plan is for another successful and informative Annual Conference!

As we start preparations for the 3rd Annual Trustee School in March and crystallize the Annual Conference program, it will be a bittersweet year for me. I will be officially retiring in 2016 and **the GAPPT will be looking for a new Executive Director!** If you are interested, or know anyone who might be a

good fit for the Association, please contact me or one of our GAPPT Board members. It's been a wonderful experience and you'll still see me around, but in a different role as just a retiree!

One final note from me – **the GAPPT will be holding elections again in 2016 for several Board positions.** The position of **Treasurer** (currently held by Morgan Wurst, Executive Director for Georgia Firefighters Pension Fund), **Vice-President** (currently held by Tom Harris, City of Alpharetta Finance Director), and **Director at Large 2** (currently held by Tim Milligan, City of Marietta and Georgia Firefighters Pension Fund Board member) will all be on your ballot this year. If you are interested in running for one of these positions or would like to nominate someone, keep your eyes out in January for email notices about the nominations process!

**2016 GAPPT Conference at Legacy Lodge, Lake Lanier Islands!
September 20-22, 2016; Golf Outing on Monday, September 19th.**

If you would like to submit an article for the quarterly newsletter, please contact Charlotte Cagle, our GAPPT newsletter editor, by email: editor@gappt.org , or by phone: (770)780-1117.

We're on the Web
www.gappt.org



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