1 CITY OF JACKSONVILLE

2 SPECIAL COMMITTEE ON CITY PENSION SUSTAINABILITY

3 MEETING

4

5

6 Proceedings held on Tuesday, June 16, 2009,

7 commencing at 3:10 p.m., City Hall, Council Chambers,

8 1st Floor, Jacksonville, Florida, before Diane M.

9 Tropia, a Notary Public in and for the State of

10 Florida at Large.

11

12 PRESENT:

13 MICHAEL CORRIGAN, Chair.
WARREN JONES, Vice Chair.
14 REGINALD BROWN, Committee Member.
KEVIN HYDE, Committee Member.
15 STEPHEN JOOST, Committee Member.

16
SUBJECT MATTER EXPERTS:
17
HENRY COOK, Jax Retirement System Trustee.
18 JOHN KEANE, Police/Fire Pension Administrator.
ALAN MOSLEY, Chief Administrative Officer, COJ.
19 SHEILA SHARP-CAULKINS, Retired Employees Assoc.
DAVID E. KILCREASE, Corrections Advisory Comm.
20

21 ALSO PRESENT:

22 KIRK SHERMAN, Council Auditor.
THOMAS CARTER, Council Auditor.
23 DERREL CHATMON, Office of General Counsel.
JEFF CLEMENTS, Chief of Research.
24 JESSICA STEPHENS, Legislative Assistant.

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1 P R O C E E D I N G S
2 June 16, 2009 3:10 p.m.
3 - - -
4 THE CHAIRMAN: Good afternoon, everyone.
5 We'll call together -- call to order --
6 excuse me -- the special committee on -- the
7 City's Pension Sustainability Committee.
8 Welcome back to my colleagues and to my
9 subject matter experts that have joined us
10 today.
11 Let the record reflect that -- I think
12 everybody is here except -- Mr. Mosley is the
13 only one -- I don't see him in the room, so
14 welcome back to everybody.
15 We really have an interesting topic today.
16 We have a special speaker. I know we have a
17 little video difficulties, but you have a
18 handout in front of you. If we have to, we'll
19 go strictly with that, and I'm going to let
20 Mr. Miller introduce our guest when we get to
21 that point.
22 A couple of housekeeping notes before we
23 get too started -- too far started this morning.
24 Technically, technically, this is our final
25 meeting of this committee because we were

1 appointed by Council President Fussell and would
2 sunset on June 30th under the normal conditions.
3 I've already spoken to Council President
4 Fussell and to President-Elect Clark about our
5 work, and they both understand that we are not
6 finished yet, and have asked us to continue to
7 serve, but we have not been officially
8 reappointed yet, so we will -- we'll be kind of
9 in a lame duck state for a couple of days, and
10 Council President-Elect Clark can't really
11 authorize us, again, until he becomes council
12 president, but I will tell you that most
13 likely -- and "most likely" is pretty darn
14 likely we will meet again on -- July 21st will
15 be our next meeting.
16 So if you could have your aides put it on
17 your calendar for July 21st, and I will let you
18 know if that date does not come to fruition. So
19 most likely we will meet again on July 21st
20 because the council takes a two-week break the
21 first two weeks in July.
22 So I appreciate your patience, appreciate
23 your understanding, and most of all appreciate
24 your willingness to work on this very important
25 subject.

1 Having said that, we will -- we're still
2 trying to get the audio working.
3 Mr. Keane, you do have a memorandum you
4 passed out. If you want to take just a minute
5 to explain what that is.
6 MR. KEANE: Yes, sir.
7 You want the big one or the little one?
8 THE CHAIRMAN: The little one is the one
9 I'd like to start with, if you don't mind.
10 Since it just got here, if you could start
11 with the little one, I would appreciate that.
12 Actually, I think it's a little bit of good
13 news, so I'll let you talk about it.
14 Yeah, it's the one dated June 16th, today.
15 MR. KEANE: Is that the one that's -- the
16 recovery?
17 THE CHAIRMAN: The recovery.
18 MR. KEANE: Yes, sir, Mr. Chairman, and
19 members of the committee.
20 We have prepared an analysis of the impact
21 of the stock market over the last 98 days.
22 Since March the 9th, when the market reached its
23 low point, all of the market indices have
24 recovered handsomely. The police and fire
25 pension fund has recovered $122 and a half

1 million in market value, which translates into a
2 17.66 percent return over the last 98 days.
3 And if my arm was a little bit longer, I'd
4 reach around there and pat myself on the back,
5 but I'm length-challenged.
6 Thank you, Sheila.
7 MR. KEANE: So the recovery is --
8 THE CHAIRMAN: I've seen you do that a
9 number of times.
10 MR. KEANE: It's usually late at night.
11 THE CHAIRMAN: I have not seen that.
12 MR. KEANE: But we are well -- we're well
13 happy with the activities of our professional
14 investment staff in the last 100 days. We were
15 just a little bit behind President Obama taking
16 office. He got there in January. We started
17 taking off in March, but our 100-day period has
18 been quite nice to us.
19 And thank you for the opportunity to point
20 that out.
21 THE CHAIRMAN: Sure. Thank you.
22 Appreciate it.
23 I'm trying to get an update on my -- are we
24 having success or not?
25 (Discussion held off the record.)

1 MR. KEANE: We have another one if you want
2 to do another one while we're filibustering.
3 THE CHAIRMAN: Do I have a choice on that
4 or not?
5 Well, since we -- since we are trying to
6 reboot that system, I think everyone on the
7 committee has a copy of a letter from John Keane
8 to me with some questions to the General
9 Counsel's Office. Mr. Chatmon is here today.
10 Derrel, if you'd like to address that
11 letter at this time, I welcome you to do that.
12 MR. CHATMON: Yes, sir.
13 Good afternoon, everyone.
14 Referencing the letter dated June 8, 2009,
15 to Chairman Corrigan, I believe it was actually
16 executed by Mr. Keane. There are two questions
17 addressed to the chairman:
18 Number one, is the agreement enacted by the
19 City Council in ordinance 2000-1164, which
20 amended the agreement originally approved by
21 ordinance 91-1017, in full force?
22 Question number two, may either of the
23 parties to the agreement enacted by the City
24 Council in ordinance 2000-1164, which amended
25 the agreement originally approved by ordinance

1 91-1017, unilaterally void any section,
2 provision, or the entire agreement?
3 In addressing question number one, I will
4 go back over the last time I addressed this
5 committee in identifying two issues. Again,
6 ordinance 2000-1164 and the agreement attached
7 thereto was not a reiteration of a prior
8 ordinance, 91-1017. As such, it doesn't follow
9 the original ordinance.
10 However, specifically dealing with the
11 question itself, regarding the -- 2000-1164,
12 that is, is it in full force, pursuant to the
13 objective of this subcommittee, we're dealing
14 specifically with the ability of this committee
15 to pass -- or that I should say of City Council,
16 to actually pass pension benefits.
17 To the extent that I addressed that before,
18 again, we were dealing with the sections that
19 reiterated the benefits which were passed by
20 this council the various years, including
21 specifically in 2000, specifically the point of
22 collective bargaining was identified by myself
23 as being the sole basis for the inability to
24 identify any benefits and any agreement and
25 maintain those benefits.

1 Translation: To the extent that collective
2 bargaining exists in this state where the
3 parties want to -- be it the unions or executive
4 branch -- negotiate benefits, no agreement may
5 hold those two parties from negotiating those
6 benefits, as I indicated the last time this
7 committee referenced in -- the previously-stated
8 agreements, past practice of the City Council
9 for identifying and establishing benefits for
10 police and fire unions themselves as well as
11 others.
12 That having been said, it is the past
13 practice because neither the unions nor the
14 executive branch objected to those benefits
15 being established. The point ultimately is,
16 however, as -- not only do we anticipate in the
17 future, but if the benefits themselves are going
18 to be objected to by either Local 122 or the FOP
19 or the executive branch, then this council and
20 no one else can establish benefits upon those
21 units. It is their supreme right.
22 And as that is said, in the agreement,
23 specifically 2000 [sic] and its iterations
24 thereafter, to the extent we're talking about
25 the benefits themselves, that document is

1 voidable. And, again, voidable because
2 collective bargaining mandates that the parties
3 either object to it or they waive their ability
4 to object.
5 Question number two. May either party to
6 the agreement enacted by the City Council --
7 again relating to 2000-1164 -- unilaterally void
8 any section, provision, or the entire
9 agreement?
10 Well, again, the focus here was dealing
11 with the pension benefits. I think I'd be a
12 little remiss if I were to say I completely
13 analyzed the entire agreement to look at all
14 sections. I'm specifically dealing with the
15 idea of benefits.
16 As I said, collective bargaining is supreme
17 to any agreement. And, as such, that process
18 which is outlined in this state surpasses any
19 ability for that document to restrict either the
20 unions themselves or the executive branch of
21 City government.
22 As far as the rest of the agreement is
23 concerned, I'm sure it speaks for itself, and
24 announced, as appropriate, could address that
25 point. But for this committee, again, pension

1 benefits in and of themselves are subject to
2 collective bargaining, which makes the agreement
3 as it identifies the benefits also subject to
4 collective bargaining.
5 Does that address the questions
6 specifically or does anyone need further
7 clarification?
8 THE CHAIRMAN: I don't have any questions.
9 Does anyone else have a question?
10 MR. JOOST: (Inaudible.)
11 THE CHAIRMAN: Mr. Joost, I'm sorry. I
12 didn't see you.
13 MR. JOOST: Thank you.
14 Just let me try to break down what you
15 said, how I understand it.
16 So what you're saying is that -- at least
17 to me -- pension benefits for current retirees,
18 can they be taken away in collective bargaining
19 or added to? That is a possibility; that's what
20 you're saying?
21 MR. CHATMON: I'm saying the identification
22 of benefits as they are stated in that agreement
23 are subject to collective bargaining. To the
24 extent that collective bargaining may affect any
25 benefit, it's those negotiations, that process

1 which is outlined in the state can also affect
2 those benefits.
3 So to the extent -- again, if a benefit is
4 subject to collective bargaining, however it may
5 be subject to collective bargaining, then those
6 benefits may be affected.
7 MR. JOOST: Okay. Let me ask you this:
8 Say I'm a retired firefighter for, say, ten
9 years now. Can my benefits be affected by a
10 collective bargaining agreement that's being
11 negotiated right now?
12 MR. CHATMON: My inclination, to answer
13 that question, would be that I would like to
14 look at that a little bit further because I'm
15 not sure, as I sit here, whether a retired
16 firefighter's benefits, who is currently
17 collecting, would necessarily be affected by
18 collective bargaining.
19 I am not sure I can state the answer to you
20 directly on that because we're not talking about
21 current employees; we're talking about employees
22 that have already retired and they have -- I'm
23 assuming, since they have retired, they're
24 already engaging in the benefits that they had
25 worked for through their entire life.

1 To give you the answer off the top of my
2 head, I don't believe so if they have retired.
3 But as I stated before, I was dealing with the
4 idea of looking at current employees and current
5 collective bargaining agreements, and that was
6 the focus of my answer.
7 To address the specific questions you were
8 asking for, I would like a few more -- well, at
9 least till the next meeting to address it if
10 necessary.
11 MR. JOOST: Okay. Because just, to me, off
12 the top of my head, it almost sounds like you
13 could affect -- when you said you could, I
14 guess, affect pension benefits, that would
15 include people who are also retired as of
16 today. So off the top of my head, it almost
17 sounded like you could affect somebody's
18 benefits that is currently retired --
19 MR. CHATMON: The rationale --
20 MR. JOOST: -- if it was agreed to in
21 collective bargaining.
22 MR. CHATMON: Well, again, the limitation
23 is collective bargaining. And let me point out
24 to the committee and subject matter experts,
25 collective bargaining is a matter of addressing

1 current benefits as they were addressed at that
2 point in time.
3 Typically, the bargaining itself doesn't go
4 retroactively back, but that depends. And,
5 again, I think it depends upon the specific
6 issue and what we're looking at. That's why I
7 would like to look at the overall context
8 because as I was addressing it, I was dealing
9 specifically with the agreement in 2000 and how
10 those benefits were identified at that point.
11 And, of course, we're also talking about 2009
12 and 2010 and subsequent agreements along the
13 way.
14 Specifically, again, I think I need some
15 time to look at that to see what we're dealing
16 with. But as I was answering that question
17 today, here, I was looking specifically at the
18 agreement in 2000, not considering necessarily
19 retirement.
20 MR. JOOST: Okay. And then one last
21 question. Say I'm getting ready to retire in a
22 year from now and collective bargaining comes
23 up, my pension benefits, if I was getting ready
24 to retire in a year from now, just to be clear,
25 could be affected in the new collective

1 bargaining agreement?
2 MR. CHATMON: It depends, and I say it
3 depends because there are certain stages where
4 you might be in the pension system. You could
5 have already done disability, retirement may
6 have not been effectuated. You may be in DROP.
7 There are certain things which are identified
8 points where you have rights on top of merely
9 collective bargaining agreement rights.
10 It's because of those -- that culmination
11 of rights which might allow for your benefits to
12 be changed or it could actually say that you
13 can't. It just depends upon where the
14 individual is. But those are issues
15 specifically dealing with a person, not as a
16 matter of just an overall glossary consideration
17 of we'll change everything.
18 MR. JOOST: Because I just -- what I'm
19 trying to say is -- I'm trying to make clear --
20 so all -- at least all parties know where the
21 baseline is because, to me, there's an
22 impression, if we change, say, like any pension
23 benefits going forward, it would only affect the
24 new employees coming in and you would have a
25 two-tiered system. And so that assumption is

1 not necessarily true?
2 MR. CHATMON: That is correct. That is not
3 necessarily true.
4 MR. JOOST: Okay. Thank you.
5 THE CHAIRMAN: Thank you, Mr. Joost.
6 I don't see anybody else on my queue.
7 Let me -- I do have a question, I guess,
8 Derrel, or maybe it goes back to the council
9 auditor and Kirk Sherman.
10 When we increase, for instance, a health
11 insurance benefit for retired employees, is that
12 done in collective bargaining, typically done as
13 a bill before the council? How is that --
14 MR. CHATMON: It's my understanding -- and
15 I say that dealing with the situations I looked
16 at in the past. Typically, that has not been an
17 issue for the vast majority of bargaining units
18 in the City of Jacksonville.
19 I think it has come into play with one or
20 two -- and I would hesitate to state to this
21 particular body which ones those involved, but
22 typically that has been like pension benefits in
23 the past. The unions have left it up to council
24 to establish what the health benefits have been
25 as well as what the pension benefits have been,

1 but I -- again, my memory seems to goes back to
2 the past, that we have had a couple of
3 bargaining units that have engaged in
4 negotiations dealing with health benefits.
5 THE CHAIRMAN: Okay. Thank you.
6 Kirk, do you concur with that?
7 MR. SHERMAN: I would agree with that.
8 The only collective bargaining units that
9 dealt with this at all would be corrections, has
10 dealt with pensions.
11 THE CHAIRMAN: Okay. Thank you. I
12 appreciate that.
13 All right. Good. Any other questions on
14 that subject?
15 COMMITTEE MEMBERS: (No response.)
16 THE CHAIRMAN: Okay. Well, good.
17 We have tried and tried on technology. I
18 think we're going to give up on it. Unless
19 you're right at it, we're going to -- we're
20 going to punt on technology. There's a color
21 copy for all the committee members up here.
22 We apologize to the public for not being
23 able to get that working.
24 We can kind of -- if you want to keep on
25 working on it off-side, we can do that. Let's

1 go ahead and -- in respect for everybody's time,
2 let's go ahead and get to our special guest this
3 afternoon.
4 At this point, I'd like to call up Mickey
5 Miller to introduce our special guest.
6 As Mickey comes up, I'll tell you, I had an
7 opportunity to sit down with Mr. Miller -- both
8 Mr. Millers this afternoon, prior to this
9 meeting, and we are in for a real treat.
10 I had a great visit with Mr. Miller and
11 look forward to hearing his presentation. He
12 welcomes questions. If you can hold them to the
13 end, that would be preferable. If there's
14 something you don't understand as he's saying
15 it, I'm sure he wouldn't mind giving a further
16 explanation. But I've been looking forward to
17 this. And after my previous meeting today, I'm
18 really looking forward to it.
19 So, Mickey, if you could introduce him.
20 (Mr. Miller approaches the podium.)
21 MR. MILLER: Mr. Chairman, thank you very
22 much for the honor to introduce an old friend.
23 We're both named Miller. We are not
24 related. I go by G. Michael Miller, as I think
25 you all know. And it's Girard Miller, so we --

1 we've checked into each other's hotel rooms,
2 we've received each other's e-mail and voicemail
3 and various other things in the same hotel over
4 the last period of time.
5 But I believe this is one of the leading
6 experts on pension or active investment in the
7 entire country, and I'm very happy to introduce
8 him to you here.
9 He came to work in the GFOA -- or what was
10 the MFOA, Municipal Finance Officers
11 Association -- of the United States and Canada
12 in about 1980, was where I met him. He had been
13 in local government and finance for ten years
14 preceding that point. He wrote several --
15 there's a copy of the resume there -- Bio-Sketch
16 before you.
17 In his time at GFOA, he started and wrote a
18 number of articles, and he has continued to
19 update and rewrite articles on behalf of GFOA
20 after he left that employ.
21 He left there to go to Fidelity where he
22 was seven to eight years at Fidelity and ended
23 up being responsible for all local government
24 business, both active and pension portfolio
25 business for Fidelity with regard to local

1 governments.
2 He was hired away from there for ICMARC,
3 the International City Managers Association
4 Retirement Corporation. They, historically, had
5 one or two employees in the city and not really
6 had gone after the city business for either 457
7 or 401(a) business.
8 He was there about a decade and moved,
9 then, from not really being a competitive player
10 in that industry to being one of the leaders in
11 that industry and with foresight and early
12 implementation of some of the models with regard
13 to active investment to help people understand
14 how better to invest money within a 457 or a
15 401(a) product.
16 He was hired away from there to Janus. If
17 you remember, Janus is Denver based, very large
18 money management firm. He did arrive just a few
19 days before they had a bit of a hiccup because
20 there had been some after-hours trading in that
21 particular market. So he spent the next couple
22 of years teaching classes on prudence and
23 fiduciary duty and other things while being the
24 chief operating officer at Janus for that period
25 of time.

1 He then left there at an opportunity, went
2 to Malibu, where he still lives as Girard at
3 Malibu, was going to retire. That lasted a very
4 short period of time.
5 He was then nominated for and elected to
6 the Government Accounting Standards Board, one
7 of seven members, one representing the buy side
8 or the community side of that particular
9 industry.
10 There are two local government people, two
11 state people, one academician, and one retired
12 big 6 -- big 8 partner, and then there's one
13 citizen type. He had that position, which he
14 held until he was provided an opportunity to
15 join his current employer, PFM, Public Financial
16 Management, which is far and away the largest
17 financial advisory firm in the country, where he
18 joined their investment group to help, being a
19 special counsel to that.
20 He's one of the leading authorities. He's
21 often called to speak on economic issues. I've
22 asked him here to make a presentation I've seen
23 before and I think you'll find quite educational
24 and helpful.
25 At our last meeting I spoke about meeting

1 with him and others in upstate Pennsylvania to
2 talk about how this program might be designed,
3 what the mechanics of it might look like.
4 I'd like, at this point, and with great --
5 my personal privilege to introduce Girard Miller
6 to you for your presentation this afternoon.
7 THE CHAIRMAN: Thank you, Mickey.
8 (Mr. G. Miller approaches the podium.)
9 THE CHAIRMAN: Good afternoon, Girard.
10 Good to see you.
11 MR. G. MILLER: Good afternoon.
12 And I apologize for the glitches we're
13 having with the technology, mostly to the
14 audience. At least you have a paper copy in
15 front of you.
16 I wanted to change four words. The price
17 of trying to undo that on the PowerPoint is that
18 we've lost the whole thing, so --
19 If you can walk through the paper copy with
20 me, we'll continue to try to restore things for
21 the benefit of the audience.
22 Mainly what I'm here to talk about today
23 are what we call pension obligation bonds, or I
24 will sometimes refer to benefit bonds, which
25 include a close cousin of OPEB obligations.

1 There are some municipalities that are
2 selling bonds in the taxable municipal bond
3 market to fund their retiree medical plans.
4 That's not relevant to your immediate
5 discussions.
6 Mainly we're going to focus today on
7 pension obligation bonds as a financing tool and
8 to share with you research that we have done at
9 PFM that I think has been done nowhere else, and
10 to share with you, I think, special thoughts
11 that I've collected over the past 12 months
12 concerning the feasibility, the timing, and the
13 use of these strategies.
14 So if you'll flip to the first inside page,
15 the topics today -- I'm going to try to talk
16 about the typical drivers of pension obligation
17 bond decisions, how those relate to the business
18 cycle, which happen to have been a part of
19 people's thinking for the past 25 years.
20 We have gone back now to the
21 Great Depression partly in part because before
22 the afternoon is over at least one of you, I
23 suspect, will ask what is similar about the
24 current market environment that we're in now to
25 perhaps some time like 1932 and what did we

1 learn from all of that that might be relevant to
2 the issuance of pension obligation bonds.
3 I'll talk briefly about trusts, to hold
4 those as we often see them constructed or
5 thinking about constructing them, in association
6 with bond issues, and, then, finally, strategy.
7 The five words I wanted to take out were "a
8 need for new legislation," which is actually
9 part of a separate presentation I did
10 elsewhere. You don't have a particular
11 statutory problem in Florida. And particularly
12 as a home rule city, there's really not a
13 statutory impediment to you, and so really part
14 of my prior presentation elsewhere isn't
15 applicable here.
16 If you flip to page 3, this is the basic
17 so-called POB model. And there are two lines,
18 the upper and lower, that really define what was
19 originally the concept.
20 The first pension obligation bonds were
21 sold in Oakland, California, back in about 1984,
22 '85, right around then, and they were issued as
23 tax-exempt bonds. This was back before the 1986
24 federal arbitrage regulations, which clamped
25 down on these things and essentially held that

1 you can't sell a tax-exempt municipal security
2 to turn around and invest the money in a
3 portfolio. They kind of figured out that was
4 making it too easy for people and we'd end up
5 with bonds all over America being sold in the
6 tax-exempt market. So the IRS came out and said
7 you have to sell these on a taxable basis.
8 (Mr. Miller confers with Mr. G. Miller.)
9 MR. G. MILLER: So we at least have -- if
10 you'll follow to page 3, at least now folks
11 can -- if we can move back to -- there we go.
12 All right. These folks back here now have
13 some help, and I -- are you able to see the
14 screen from where you --
15 THE CHAIRMAN: We're good. Thank you.
16 MR. G. MILLER: Okay. Good.
17 Well, then, I'm the only one who doesn't
18 have the visual, but I've got paper, so that's
19 good.
20 Basically, the pension obligation bond
21 concept is a simple yet extremely complex
22 transaction, as we'll see, but its basic concept
23 is that if a municipality, like Warren Buffett
24 or a hedge fund manager, can borrow money in a
25 taxable market for 30 years at an interest rate

1 less than what you can turn around and invest
2 the money, there's a profit opportunity that
3 should make it less expensive to finance the
4 pension fund than if you just use normal
5 actuarial funding. That's the basic concept.
6 (Mr. Jones exits the proceedings.)
7 MR. G. MILLER: So in this example, which
8 is sort of typical of a lot of transactions over
9 the past 10 or 20 years, you'll have a borrowing
10 cost in the taxable market of maybe 5-and-a-half
11 percent, the lower line, and the actuarial
12 assumption for the pension fund is some higher
13 number. We're going to use 8-and-a-half
14 percent, which is sort of close to yours, not
15 necessarily indicative, but just one that's out
16 there with some of the plans that we see.
17 Now, three things can happen:
18 We can earn less than what our borrowing
19 cost is, in which case the entire transaction
20 loses money. And guess who pays for that? The
21 taxpayers. Okay?
22 We can earn more than the borrowing cost
23 but less than the actuarial rate of return. And
24 if that happens, it still is a good thing. We
25 have done better than if we had done nothing,

1 but we won't make the goal of the original bond
2 issue. So all of the savings that have been
3 presented in all of the models to the governing
4 bodies along the way won't have been realized.
5 Now, again, the pension fund also will be
6 falling short of its expectations, so it's going
7 to have a separate problem in addition to the
8 problem that the bonds didn't do everything that
9 we might have wanted them to do, but we won't
10 regret the fact that we've sold the bond issue.
11 And then the third area of possibility is
12 the white space above the top line, which is
13 when the actual returns in the pension fund
14 exceed the actuarial rate, and then we've hit a
15 home run. We've actually produced surplus
16 earnings. And then the question is, what are we
17 going to do with that money? We'll come back to
18 that later on.
19 So let's go, then, to the next page, 4,
20 which is the traditional pension obligation bond
21 model. And, again, to reiterate what I've
22 already told you, it was to borrow at a taxable
23 rate below the pension fund's assumed actuarial
24 rate of return assumption, and the business
25 cycle we really didn't care about.

1 All the people focused on for the last
2 25 years of POB history has been two numbers,
3 what does it cost us to borrow in the taxable
4 number, what is the pension fund's actuarial
5 rate of return? If there's a positive spread,
6 go. That was essentially the way most financial
7 advisors, bond attorneys, investment bankers,
8 and anybody else who had money to make in the
9 transaction would approach their clients.
10 The second premise of the traditional model
11 was borrow as much as possible, get yourself up
12 to full funding, and basically eliminate this
13 problem for once and for all. It was
14 essentially the silver bullet, the panacea, the
15 great solution, the great salvation for
16 underfunded pension plans was bring them up to
17 100 percent funding, borrow, and we'll be done
18 with this once and for all. It didn't
19 necessarily work.
20 And, thirdly, part of the model was to
21 basically turn the money over to the pension
22 fund; i.e., invest the money just the way all
23 other assets that have been accumulated might be
24 invested. We'll come back to that and realize
25 that that model had an inherent technical flaw

1 and fallacy that nobody thought about until I
2 started writing about this subject a year ago
3 today.
4 So what went wrong with the POB model?
5 There are very, very few pension obligation
6 bonds in existence today except for the ones
7 done back before 1993. And, obviously, the ones
8 in the '80s are still above water, but one of
9 the things you can see here is -- this is the
10 chart of the Standard & Poor's 500 -- or excuse
11 me -- I guess in this case we're at the -- yeah,
12 this is the S&P.
13 And, as you can see, it didn't take a
14 genius to figure out, you know, if you sold
15 pension obligation bonds at the peak of the
16 Internet bubble, which would have been in
17 2000/2001 -- the red line over there which
18 corresponds with an issue done by the City of
19 New Orleans in this instance -- you haven't been
20 above water very long.
21 And, likewise, those who sold pension
22 obligation bonds or, in this case, an OPEB bond
23 issued at the 2007 peak of the stock market --
24 in that period of time, again, market timing not
25 so favorable -- suddenly we have a portfolio

1 that's worth two-thirds of what we borrowed and
2 suddenly we're under water.
3 On the other hand, issuers who sell bonds
4 at the trough of the stock market in recessions
5 have typically looked a little bit better, and
6 so we've seen successful issues.
7 Historically, again, those who sold most
8 recently in the 2003 era -- the state of
9 Wisconsin, Contra Costa County -- have had
10 relatively successful issues even though they
11 have had some suffering points along the way in
12 February and March of this year.
13 So basically the moral of the story from
14 this chart is timing matters. And although
15 nobody in public finance wants to be accused of
16 being a market timer, the raw fact of life is
17 that this is a leveraged transaction and just as
18 you would not go out and borrow money on a refi
19 on your house in order to fund your IRA at the
20 peak of the stock market cycle, you would want
21 to think twice about that and you would want to
22 think three times about it if you are a
23 fiduciary charged with prudence.
24 So now let's take a look at the next slide
25 and realize that it gets even more complicated

1 than the linear model that I just showed you in
2 the previous slide because now we have to cover
3 the interest costs of our borrowing, which means
4 that we're very much like that leveraged,
5 long-term hedge fund, that we have a cost of
6 capital and we have to clear that as well. And,
7 therefore, in the current market you can see
8 that even some of the successful 2003 bond
9 issues at this point are still under water even
10 though we've had market recovery in recent
11 periods.
12 So the notion that this is simply free
13 money needs to be disavowed, and clearly the
14 painful experience of the past year -- or the
15 past decade, excuse me, which has been basically
16 a dearth, sort of a silent decade, as they had
17 in Japan, is something that gives us cause.
18 I'm not here to paint doom and gloom. I'm
19 just here to say, these are the risks that we
20 face. And one of the benefits of our research
21 at PFM is that we've basically been able to
22 establish that part of the risk of stock
23 investments and leveraged stock investments is a
24 function of time.
25 Risks that exist in one week, one month,

1 one year are not the same risks as risks of
2 30 years. And, in fact, if we're making
3 long-term investments, which pension funds have
4 the capability of undertaking, then we can look
5 at things in a different way or at least have
6 that opportunity, and I'll come back to that
7 notion as well.
8 This, then, gets us to the next page, 7,
9 which is what we call the new benefits bond
10 paradigm. And the first aspect of the new way
11 of thinking about these pension obligation bonds
12 and OPEB bonds is that, in fact, business cycle
13 analysis is helpful.
14 There will come some point in a business
15 cycle -- which I will illustrate in a following
16 slide -- beyond which your odds of success
17 diminish below 50/50. And, again, if you are a
18 prudent fiduciary, a steward of taxpayers'
19 money, and responsible for the risks that are
20 inherent in this transaction, you have to be
21 thinking about declining margin of opportunity
22 as the business cycle advances and stocks become
23 more expensive with a greater likelihood of
24 being under water in the next recession.
25 The second thing that we started thinking

1 about -- and this occurred to me as I began
2 focusing my work a year ago on OPEB, the retiree
3 medical plans, which are essentially starting
4 from zero. And for them to work their way out,
5 bonds look like an attractive transaction.
6 I said, you know, somebody never thought
7 about this very much because if we sell bonds
8 for a municipality and invest in a pension
9 portfolio, we need to think about what we're
10 really doing here. The goal is an arbitrage.
11 The goal is to earn a higher return from the
12 financial markets than our cost of money.
13 So if I sell a hundred thousand or a
14 hundred million of bonds in the taxable market
15 and I invest in the pension fund, what am I
16 doing? And so we turn over to the pension fund,
17 which actually was never consulted by the bond
18 advisors or the financial advisors -- there's
19 two separate worlds here -- they just looked at
20 the actuarial rate of return assumptions.
21 But, in reality, what the pension fund is
22 doing is they're investing the money according
23 to an asset allocation plan, so much in stocks,
24 so much in bonds, so much in real estate, so
25 much in hedge funds, whatever. But ordinarily,

1 to cut through the chase, the typical public
2 pension fund asset allocation for the last
3 40 years has been originally 60/40. Today's
4 world, it's probably 65/35, 65 percent stocks,
5 35 percent bonds.
6 So I said to myself, self, why are we
7 selling taxable bonds to invest 35 percent of
8 the money in taxable bonds? Where's the profit
9 in that? Where's the profit in that after we've
10 paid the financial advisor, after we've paid the
11 bond attorney, after we've paid the money
12 managers, and after we've let the underwriter
13 take their spread?
14 And the answer is there ain't any, or if
15 there are, it's usually because of credit risk
16 that's being taken inside the pension fund in
17 securities that probably have a lower credit
18 rating than the issuer's cost, but that's a
19 marginal opportunity and it has zero value on a
20 risk-adjusted basis because it is strictly a
21 reflection of risk because, again, we're taking
22 all these fees out of whatever spread might have
23 been there in the first place.
24 So that really means that we probably are
25 selling too much of these when we do them. So

1 that, then, got me thinking even deeper, and I
2 said, the other thing is if, in fact, there is a
3 business cycle, we need to think about when
4 we're doing it and what are the implications of
5 doing it right.
6 If we sell these bonds and invest in -- now
7 we're only going to invest in stocks. We're
8 probably not going to invest 100 percent of the
9 gap. We're going to invest some ratio that gets
10 us in. What if we're successful? And what if
11 we buy stocks at the absolute bottom of the
12 business cycle and market cycle -- we're that
13 smart to get the timing correct -- what's going
14 to happen at the peak of that next business
15 cycle?
16 If we've done better than the borrowing
17 cost, we're going to generate a surplus, and all
18 of a sudden our pension fund is going to be
19 overfunded, and then what happens?
20 Well, you're probably going to reduce
21 contributions. The labor groups will be before
22 you to ask for more increases. You can be sure
23 that the retirees are going to say, "Time for a
24 COLA." And nobody steps up to the governing
25 body to say, who's here to protect the investors

1 who bought these bonds in the first place and
2 took the risk if this thing didn't work? But,
3 moreover, who's here to protect the interests of
4 the taxpayers who took the entire risk of the
5 transaction in the first place because we know
6 that if we went south on this, that we wouldn't
7 be making employee benefit cuts because those
8 are constitutionally protected and subject to
9 labor negotiations, and you just went through
10 that whole discussion.
11 So this is an asymmetrical transaction.
12 And that being the case, we need to have special
13 thought about sizing the pension obligation
14 bonds so that if, in fact, we're going to take
15 all these risks, and if, in fact, we're
16 successful, we really either have to have a
17 solution for the, quote, overfunding that comes
18 from market cyclicality or we better be sure
19 that it never happens in the first place. That
20 gets us to design issues and the financing.
21 And then -- I have this note here about
22 obviously trying to deal with the issues of the
23 taxpayers who are the sole risk-takers in this
24 transaction. You may think of yourselves as the
25 agents in that transaction, but at the end of

1 the day the people who bear all risk of a
2 pension obligation bond issue ultimately are the
3 plan sponsor, a/k/a the taxpayers.
4 So then we get down to the final issue. In
5 addition to all of that, I'm not smart enough,
6 nobody in this room is smart enough -- any of us
7 who are that good would be off running a hedge
8 fund of our own -- to pick market bottoms or to
9 know when is the next recession or to know
10 whether in today's world we're going to have a
11 double dip, all of those issues along the way
12 that give us great uncertainty.
13 And so part of the paradigm of the benefits
14 bond model that we're now working with is we've
15 got to mitigate risk, we've got to be risk
16 managers because this is an inherently risky
17 transaction, which then gets me to page 8.
18 The drivers -- again, to provide contrast,
19 deal sizing, under the traditional POB, was
20 fully fund a pension. The financial analysis
21 was based upon current taxable bond rates; i.e.,
22 how much below the actuarial rate of return are
23 we, and then we'll use whatever statistical
24 tools we have.
25 There's a product called Monte Carlo that

1 enables us to go through and take an evaluation
2 of the likely outcomes based upon everything we
3 know from history. And that stochastic model,
4 which looks -- bell curves and all that stuff --
5 is essentially static. It ignores the idea of a
6 business cycle. It doesn't exist in the world
7 of Monte Carlo. You don't program in business
8 cycles. They happen because we get variations
9 of data, but basically it's assumed to be
10 Brownian motion. It's assumed to be random
11 effects. And the investment model -- again,
12 60/40 stock/bonds and no risk mitigation.
13 If you compare that with page 9, the new
14 benefits bond model, would basically say, well,
15 first thing is we're going to take into account
16 where we are in the business cycle.
17 The optimal sizing for a bond issue is
18 probably -- to get you in a recession -- to no
19 better than 80 to 85 percent. We tend to be
20 more conservative at these points in time, for a
21 pension fund, to bring it above 80 percent
22 funding after the market has fallen from 14,000
23 to today. Even after the bounce back, we are
24 substantially below the previous peak. And if
25 we were to get back to 14,000, you only need to

1 run the numbers through and say, gee, what would
2 happen to our funding? We'd probably be in a
3 surplus if we did more than 80 percent. You can
4 work through the math on your own.
5 For OPEB plans -- again, retiree medical
6 plans -- we basically say there's no sense in a
7 zero balance start-up to ever fund more than
8 65 percent with equities because if -- if I'm
9 going to invest it all in equities, you can see
10 that a 50 percent market gain, which is not
11 unusual in most businesses cycles and stock
12 market cycles, would rapidly move us to an
13 overfunded situation.
14 So we're going to take a look at risk
15 management, we're going to take a look at all of
16 this, we're going to take a look now at dynamic
17 reinvestment as the way to evaluate it.
18 So moving on to page 10, the investment
19 management model in our new way of thinking
20 about pension obligation bonds is that the
21 proceeds initially ought best be invested only
22 in equities and you only sell bonds sufficient
23 to make up the equity chunk of the underfunded.
24 The bond portion of the portfolio will be
25 funded through normal actuarial analysis. Every

1 year we're still going to have an unfunded
2 liability that needs to be amortized, and that
3 will wash through the actuarials and there will
4 be employer contributions made to the pension
5 funds, which will be invested in bonds. And any
6 surplus earnings that we receive from this new
7 subportfolio -- if you want to think of it that
8 way -- in stocks, we can then move that money
9 over into bonds. And over a 30-year period, I'm
10 going to migrate myself so that at the end of
11 time we'll end up right back where the pension
12 fund wanted to be, with 100 percent funding and
13 with a stock/bond portfolio that's going to look
14 like the normal strategic objective.
15 In order to mitigate the risks of
16 overfunding, a couple of tools -- and I know a
17 few of them have been kicked around here a
18 little bit in the vernacular. The first
19 recommendation, in any event, no matter how you
20 do this -- inside, outside the pension fund and
21 all of the rest -- is to have a market
22 stabilization reserve that basically realizes
23 that over market cycles stocks go up and stocks
24 go down. They don't go in a linear path.
25 If we could guarantee that stocks would

1 earn 10 or 11 percent for the next 30 years in a
2 straight line, I wouldn't need to be here
3 today. That would be a no-brainer. Our problem
4 is markets fluctuate. Average bear market,
5 down 25 percent. Average bull market, up
6 50 percent -- excuse me -- 100 percent over the
7 last 13 cycles going back to the Great
8 Depression.
9 So with that sort of variation, we have to
10 kind of think through, how do we deal with the
11 numbers? Well, it turns out that if the average
12 bear market is down 25 percent -- and actually
13 in print, in Governing Magazine, on this issue,
14 with plans that were approaching this issue back
15 in 2007 -- if your plan is 60/40 stocks/bonds
16 and you are at a 117 percent funding ratio,
17 you're going to end up back at 100, which means
18 anything above 117 percent may be overfunded in
19 the classic sense.
20 But a plan which is statistically funded
21 with assets at 105 percent of its actuarial
22 liability is not overfunded if you're in the
23 advanced stages of a business cycle because the
24 next recession is going to take you down to 82
25 or 85 or whatever the number is going to be. So

1 we have to at least conduct that assessment of
2 funding ratios as a product of business cycles
3 as part of our assessment.
4 The other things that can be done as part
5 of the design -- and this is where I put my
6 financial advisor hat on from a firm that works
7 with bond issues in addition to the investment
8 work -- is that you can use excess reserves, if
9 properly structured in a proper trust, to pay
10 down the debt.
11 And let me just take you to the scenario of
12 2003. If you go back to slide number 5 or 6,
13 whatever we were back there. If you turn back
14 to slide 5 for just a moment.
15 If I had sold pension obligation bonds in
16 2003 at 80 percent or whatever of the total
17 liabilities and invested in stocks from 2003 to
18 2007, what would have been my funding
19 condition? I would have been, quote,
20 overfunded.
21 Now, would that have been a time to grant
22 benefit increases or a time to pay off the
23 pension bonds?
24 If I increase benefits, I increase
25 liabilities permanently because they're

1 constitutionally protected, irrevocable. If I
2 pay down the pension bonds, I reduce the
3 liabilities, at least temporarily, because the
4 next market cycle can take me to be underfunded
5 again, but at least I have rewarded the
6 taxpayers by selling at a market peak.
7 So part of what needs to be thought about
8 in the overall management of the pension
9 obligation bond issue is the management of
10 excess returns during market cycle peaks.
11 From the range of 100 percent funding to
12 some higher ratio, we probably just set aside a
13 reserve that says don't touch that money and
14 don't act like you actually have it because it's
15 all going to go away in the next recession.
16 Once we get above some level, we have an
17 opportunity at that point to do something with
18 it and at least -- the bondholders would like to
19 be thinking, gee, maybe we get paid back first,
20 maybe the taxpayers are relieved of the
21 liability, and if the market goes down, we can
22 either repeat the exercise or we can amortize
23 the cost.
24 This gets us to the concept of a protective
25 pension obligation trust, which has been used by

1 some governmental employers to essentially say
2 we're going to put a shell around that.
3 Now, a POB trust can be held and created by
4 the municipality, it can be turned over to the
5 pension fund, and you'll have all of those
6 discussions. I am not an attorney, I'm not
7 going to try to play trust attorney, I'm just
8 going to give you the notion there that you
9 probably need to be thinking along those lines
10 as part of your deliberations.
11 Slide 11 now, to jump back to where I was
12 in the presentation, gets us to this first
13 question I raised with respect to the timing of
14 these transactions.
15 The old model said sell pension obligation
16 bonds anytime, anyplace where you could have a
17 lower cost of borrowing than the actuarial
18 return on the pension fund. The new model says
19 that's not going to work for you because there
20 will be another recession. And when the next
21 recession occurs, statistically we know, from
22 13 past cycles, that the average down market is
23 25 percent. We certainly know from the last one
24 it can be deeper than that.
25 So your odds -- after you get beyond the

1 stage of the economy where it shifts from being
2 what we call recovery up to the peak of prior
3 industrial capacity into the expansion stage,
4 there's some magical, mythical point out there
5 that I'm not going to try to quantify. This is
6 just pure theory here, but we do know -- and I'm
7 actually conducting empirical data on this now
8 for the last 15 cycles, going all the way back
9 to 1926, which is the earliest stock market
10 data, so we can actually provide to you, if the
11 question comes up, you know, how far from the
12 bottom to the top can you go before the odds
13 diminish and you begin to run a greater than
14 50/50 risk that the next recession you're going
15 to be under water. That's the question you're
16 all going to ask me whenever you get down the
17 road in this -- this issue.
18 What we do know is that there's some point
19 in the trough of a business cycle and a market
20 cycle in which two things happen. Interest
21 rates, typically, are the lowest of the cycle.
22 The Fed is flooding the market with capital,
23 rates are low. And, typically, historically,
24 taxable municipal bonds have been at their
25 lowest levels. Not happening this time because

1 we have a credit crisis. Municipal bonds are
2 actually trading at higher rates than treasury.
3 We have an aberration because this is not a
4 garden variety recession. So half of our model,
5 from all 13 past business cycles, doesn't apply
6 quite as neatly as we might want in the --
7 thinking about a pension obligation bond.
8 What we do know is that in recessions
9 stocks always plummet. The fear factor in the
10 stock market drives down prices and they are
11 relatively cheap, and so the one part that we do
12 have is the -- the best bargains to be found in
13 a typical business cycle are at the worst points
14 in the recession.
15 Now, is the bottom in now? You know, a lot
16 of people at this point are beginning to guess
17 that may have happened. So the second question
18 you're going to ask me today is, okay, if we're
19 up 30, 35 percent from March 9th, have we
20 already missed the window? Has the window
21 closed before it even opened? And I don't have
22 a definitive answer.
23 My instincts are telling me no, that some
24 of this is a function not just of stock market
25 levels, but of where you were relative to the

1 prior peak, but more importantly, where are you
2 in terms of the business cycle?
3 In other words, when the economy is
4 operating only at 80 percent of its capacity --
5 and capacity utilization numbers are even lower
6 than that; they're 69 percent -- the odds are
7 that there's plenty of overhead opportunity for
8 upside appreciation in the equity markets before
9 we're going to run into another business cycle,
10 but that's -- that's a story for a later time.
11 What I now want to do is talk about what's
12 outside of 13 business cycles of research and
13 take you into some proprietary studies that we
14 have done, that I have presented at the bond
15 buyers annual OPEB and POB conference, so this
16 is now public information. There's nothing that
17 I'm showing here today that is secret
18 information.
19 But what we did do is, we at PFM said, you
20 know, this isn't a garden variety recession.
21 There's a huge credit overhang in the global
22 markets. We're exercising emergency measures
23 for stimulus and fiscal policy on a global basis
24 unlike anything since the Great Depression and
25 hopefully learning lessons from the Great

1 Depression. And that being the case, what would
2 have happened if we had sold pension obligation
3 bonds during the Great Depression? What would
4 that period have told us? Can we learn any
5 lesson from it?
6 And so what I'm going to do is to share
7 with you about a two-and-a-half-month research
8 project of a small army of people inside PFM,
9 because we have a lot of people asking us this
10 question because they're scared to death that
11 they could issue a pension obligation bond and
12 find out that we're in the analogue of 1937.
13 And for those of you who don't know the
14 history, the market bottomed in '32. I'll show
15 you a chart of that shortly. We had a
16 substantial rally up to 1937 where stock prices
17 tripled and then they fell right back down, not
18 to the absolute lows of 1930, but there were
19 horrific losses in '37/'38, and so this issue of
20 getting it wrong is a frightening thought to
21 fiduciaries.
22 What we did find, first and foremost, is
23 that stock prices revert to the mean. There is
24 a general tendency in a capitalist society for
25 equities to return 10 to 11 percent. There's no

1 magical formula that says that that has to
2 happen. But if you think about it in common
3 sense, if -- if there's a cost of borrowing
4 through bonds, which is just a guaranteed rate
5 of return of 5 or 6 percent, 4 percent for
6 treasuries, whatever number you want to have, it
7 makes absolutely no sense for investors in the
8 stock market to be earning some number less than
9 that.
10 There's got to be a premium, a so-called
11 equity premium, for putting capital at risk and
12 taking all of that volatility, uncertainty, and
13 the horrors that we've all experienced in the
14 past 18 months. And the market, in fact, will
15 price in the future stream of earnings
16 expectations at some level that ensures that
17 investors have every reason to believe that
18 they're going to capture that kind of 10 percent
19 or 11 percent long-term return, and what changes
20 is our expectation of what those future earnings
21 and business prospects will be.
22 Well, what happens with all of this is it
23 turns out that the best opportunities for
24 stocks, because of this mean reversion, are, in
25 fact, during the periods when people are

1 terrified of being in the stock market. And, of
2 course, recessions and depressions happen to be
3 most likely periods.
4 Even during that, however, the risks are
5 greater over five- and ten-year periods during
6 those time periods. So even though the
7 opportunities are better, the risks worsen
8 during these kinds of severe recessionary
9 periods. And, in fact, what we're going to do
10 is we're going to see the worst case in
11 depression history was the 20-year period from
12 before the crash of '29 to '49, and I've got a
13 chart that will go through that.
14 What is relevant here is that out of all of
15 the research -- I started writing about this
16 stuff last October -- last October and September
17 of last year. And up until that point we had
18 never in the recorded history of the United
19 States -- and this is using, again, data that
20 goes back to '26 -- ever had a period in which
21 30 years went by that stocks didn't outperform
22 bonds. Research from 1926 all the way up until
23 2008, a 62-year period -- 82-year period, no
24 problems.
25 Well, we actually entered one as we went

1 into this recession. In fact, when we came out
2 the other side of the March crevice in this
3 market, there had been a six-month window, six
4 months out of 83 years in which stocks failed to
5 outperform bonds over 30 years.
6 Now, what I'm going to do is I'm going to
7 give you vivid living proof of sort of how this
8 all plays through, so we'll skip through
9 page 13, which is just sort of the introduction,
10 and walk you through the performance of stocks
11 versus bonds. We use corporate bonds because
12 taxable municipal bonds did not exist in the
13 '20s and the '30s and the '40s, so the best
14 proxy we have is corporate bonds. And they --
15 you know, in today's market they trade at levels
16 reasonably similar to a taxable municipal.
17 The upper chart, the blue line shows you
18 what the rates of returns were on stocks if you
19 had invested in that year. So if I go to 1931
20 and I look up there, I see a line that crosses
21 about 10 percent. Okay? And that's telling me
22 that if I bought stocks in 1931, two years into
23 the Great Depression, the next 30 years I earned
24 30 percent on my money. If I waited until 1932,
25 when stocks hit their absolute low point, I

1 earned a 13 percent compound return over the
2 following 30 years. So these are rolling
3 30-year periods at each point along the way in
4 the blue line.
5 Down below is what my cost of money would
6 have been. In other words, if I were selling
7 pension obligation bonds, selling taxable
8 municipals, and investing for 30 years, what was
9 my profit spread? And you'll see that
10 throughout all of history, up until just 1978,
11 which was the beginning of a 30-year period that
12 ended during this recession, during this market
13 correction stocks always outperformed bonds.
14 So that's given us a lot of confidence.
15 And, in fact, all of the historical Monte Carlo
16 studies that have ever been presented by
17 financial advisors to municipal clients have
18 always said, hold them for 30 years, you always
19 win.
20 What we want to do now is to say, what's
21 great for 30 years doesn't feel so good in five
22 or six. And, as I like to tell all of my
23 clients who are practicing municipal finance
24 officers, 30 years we can be right, but you have
25 to hold on to your job for at least seven.

1 And so what I'm going to do is talk about
2 how things can go sour in the shorter period, so
3 now we're going to work back through time and go
4 to slide 15. Slide 15 shortens that time window
5 from 30 years to 20, and already we begin to see
6 some cracks in the wall.
7 If you had sold 20-year bonds in 1926, it
8 doesn't take a genius to figure out that there
9 is this little thing called the stock market
10 crash in '29. So if you sold bonds in '29 and
11 '28 and held them for 30 years, guess what?
12 You didn't make a profit.
13 And, likewise, you'll see over on the
14 right-hand side, some of you remember the high
15 interest rate periods -- Paul Volcker tightening
16 money, runaway inflation -- before we kind of
17 got things under control.
18 Likewise, we were in that high interest
19 rate period back in 1980/'81, there was a period
20 back then when the problem wasn't the stock
21 returns, which it was back in the depression,
22 the problem was the bond yields were so high
23 that you couldn't clear that rate of return.
24 So if we sold 20-year paper in 1981 and we
25 held it till 2001, guess what happened in 2001?

1 We had the Internet collapse, and so stocks were
2 down at the end of the 20-year period, but I had
3 this very high carrying cost of double-digit
4 interest rates that I had to beat through the
5 stock market, which it failed to do during those
6 two periods.
7 So, okay, those are extremes. We're still
8 in a period we can say, okay, 20 years, two
9 cases out of 20, you know, that doesn't feel so
10 bad.
11 Now, however, we're going to keep
12 shortening the time window to show you how risk
13 on these transactions increases as we reduce the
14 investment horizon.
15 So now we're going to go down to ten
16 years. And, as you can see, we have a fair
17 number of instances. In fact, almost 30 percent
18 of all time periods now we have cases where
19 stocks failed to outperform bonds over a
20 ten-year holding period.
21 And so what we now know is that a
22 transaction that has the potential and all good
23 investment reasons and rationale to work over
24 long, long time periods, once we hold them less
25 than ten years, we begin to get levels of risk

1 that are going to make people nervous while
2 they're watching the flowers come up and some of
3 them dying as they come through the ground.
4 And that now takes us to the five-year
5 horizon where, here, we've actually marked
6 everything below zero, so you can see there were
7 periods in which not only did we underperform
8 the bonds, but we actually lost money. So now
9 you've got to be sweating bullets about having
10 negative returns and paying the interest costs
11 on your debt, which are even higher.
12 So what this will tell all of us who pay
13 attention to this is over five-year holding
14 periods, market cycle risk is really something
15 important we have to deal with. And even though
16 we don't want to be market timers, we really
17 have to manage and mitigate risk.
18 Now, I'm going to move to slide 18, which
19 kind of shows you the composite. This puts all
20 of that data all into one place. And, again,
21 the conclusion is that in short time periods,
22 one business cycle, stocks will underperform
23 bonds about a third of the time. So anything we
24 can do to improve our odds by not just doing
25 this blindly and paying attention to where we

1 are in the business cycle will improve that
2 statistic.
3 All right. Now, page 19 takes us into the
4 depression. And what I did was, instead of
5 using absolute numbers, I said, let's take the
6 absolute low point in the market -- and if you
7 think that was 6,500 in the Dow last March,
8 that's great. What I can tell you is that in
9 1932 the stock market bottomed. It took three
10 years to get there from '29. It kept going down
11 and down and down. It finally got down to the
12 bottom at 100, normalizing this. And then
13 stocks went up even during the depression. In
14 fact, there was a -- as I said, a substantial
15 rally in '37/'36, and then we went back down.
16 And then at the end of the depression, as
17 the United States began to gear up toward the
18 rearmament and there was more demand for
19 agricultural products and other things as Europe
20 had begun to engage in war, stocks, you know,
21 were 500 percent above.
22 You've got to remember, however, that
23 500 percent is from a market that had fallen 83
24 or 87 percent. I think it's 83 percent. Maybe
25 it's 87 percent. At any rate -- so we would be,

1 with the Dow in today's market, somewhere in the
2 neighborhood of 2,000 to be at the level of
3 severity that it was back in the '30s.
4 But what I wanted to do is to superimpose
5 this data and say, okay, if I sold pension
6 obligation bonds during this horrific period of
7 decade-long economic malaise, what would have
8 happened?
9 And, interestingly enough, page 20 gives us
10 the first glimmer of good hope, which is that
11 because things were so bad, the 30-year returns
12 from the stock market were substantial even
13 during the depression. If you bought for
14 five-year holding periods, as we showed you
15 before, that didn't look so good. But excess
16 returns during the period of the Great
17 Depression for holding stocks over and above
18 bonds were the best, in fact, in the history of
19 the United States.
20 So that's a powerful realization, and it's
21 the same idea of pension holidays. The one
22 thing you don't want to do is stop contributions
23 in a recession even though you don't have any
24 money to pay for them because that's the period
25 you want to be investing in equities, the same

1 rationale here.
2 And so, in fact, slide 21 shows us that if
3 you compare the average surplus return of stocks
4 versus bonds, that that number is about
5 6 percent, stock returns over corporate bond
6 yields, over, again, the 83 period of our
7 study. And, as you see, the Great Depression
8 significantly exceeded that, which at least
9 gives us some confidence that periods of great
10 economic malaise are not a bad time to be
11 considering this strategy. However, it's not
12 all that easy.
13 What we need to now look at is there are
14 times in the middle of these long periods in
15 which issuance is better than others. And, in
16 fact, you'll see the ellipsis on page 22 make it
17 pretty clear that in '37, '36, as well as by the
18 time we climb back up in the early '40s, the
19 relative investment value of the strategy began
20 to drop once stock prices got higher.
21 So, again, it's the same idea of the
22 business cycle. Once we start getting up to the
23 point that values in that period had tripled or
24 if they had recovered half of what they had lost
25 before, you know, the excess returns begin to

1 melt away a little bit.
2 So there's something there that we want to
3 look at. And so I said, okay, let's -- turn to
4 page 23 -- let's superimpose that dashed line of
5 where the stocks were during the '30s with the
6 excess returns and see what we learned. And one
7 of the interesting things was that, again, the
8 shorter horizon, the five and ten years, was the
9 worst. So being early into a period, such as
10 the one we're in now, such as the early '30s,
11 was, in fact, something that even though you got
12 better long-term returns, you took greater
13 risks.
14 And that's the -- if I have one simple
15 message from this it is that, in fact, even
16 though the argument could be made that having
17 fallen from 14,000 to 6,500 and climbing our way
18 back out, that there may be better long-term
19 returns if you want to look 30 years out. Over
20 the next five years we probably have higher risk
21 now than we might later on, after all of this
22 clutter in the financial markets and the credit
23 problems have all been washed through the
24 system.
25 Now, the next slide, page 24, is going to

1 come back to something Mickey will talk to you
2 about on another occasion, but I just want to
3 plant the seed here that simply says if you do
4 variable rate bonds -- which are something most
5 folks aren't crazy about looking at, but we can
6 use medium term notes, there's other instruments
7 as well -- that actually the arbitrage from the
8 pension obligation bond does better than just
9 using fixed-rate, 30-year stuff. And so that's
10 the moral of the story here, is that there's
11 a -- there's actually a better strategy than
12 just simply selling 100 percent fixed-rate debt
13 even though that's the simplest answer.
14 I'm not going to go into a lot of the
15 technical detail. We can go through that in the
16 Q and A, but I do want to at least let you know
17 that the data suggests that what we call a
18 multimodal issue, a bond issue that includes
19 some fixed-rate, long-term, some shorter,
20 intermediate -- may be the best design structure
21 for you in the long run if you go this way.
22 And now we get to page 25, which is sort of
23 the bottom line of the depression research.
24 Record spreads are feasible during periods
25 of gross economic malaise, such as what we are

1 probably in now, something similar to the Great
2 Depression, but not with the same problems
3 because of all of the Band-Aids that we are
4 capable of putting in place through national
5 policy, the lessons we learned, the FDIC
6 insurance to prevent bank runs, and all of the
7 rest, but we still have to deal with
8 double-digit risk. We have to deal with the
9 possibility that this economy could stall back
10 out.
11 We have nothing yet to tell us that --
12 although China is pulling the world along and
13 things look a lot better now than they did in
14 March, we still have weak fundamentals. And if
15 you look at the housing market and some other
16 areas along the way, just a report this morning
17 from Europe that there's about a $283 billion
18 problem in their bank system that still hasn't
19 been fixed, there are still enough reasons to
20 have suspicion that we may get, you know, a weak
21 and moderate recovery and then something that
22 could stall out. I'm not predicting that, I'm
23 just saying for a pension fund to make all of
24 its bets all at one time, probably not the most
25 prudent approach.

1 So the risk of a false positive, on the
2 other hand -- here's where things cut across
3 you -- every month that goes by into the
4 economic recovery, we're going to get closer and
5 closer over time towards stocks being fairly
6 valued, at which point they're no longer a
7 bargain. So we have to kind of think through
8 the timing concerns.
9 Now, I'm going to jump ahead to things that
10 are not market data and just talk quickly about
11 the pension obligation bond trust, not as a
12 matter of advocacy, but really simply to explain
13 the instrument and how it can work or why it
14 might work or why it might be considered along
15 the way. I'm not here as an advocate as much as
16 an explainer.
17 Page 27 goes into the fundamentals. As I
18 have indicated, an alternative to the money
19 going to the pension fund is that it be placed
20 in a separate trust. Whether the pension fund
21 exercises control over the trust or not is,
22 again, something that is your local issue.
23 The main important concept is that the
24 money should be invested in equities. If the
25 pension fund agrees to invest in equities, you

1 know, the first reason for having a trust is
2 obviated. You can accomplish that through
3 intergovernmental cooperation. I understand a
4 tiny bit about your structure here. I don't
5 purport to be an expert with respect to the
6 authority here.
7 But the important part, again, is, why sell
8 bonds to buy bonds? So if what you're going to
9 do is go out and sell a couple hundred-million-
10 dollar pension obligation bonds, turn it over to
11 the pension fund, the pension fund is going to
12 act like business as usual, then I'm going to
13 tell you that you've sold one-third too many
14 bonds and that you're incurring fees that are
15 probably not in your taxpayers best interest.
16 But, you know, that's your decision to make.
17 And then you do have to go through these
18 issues of what can we do to assure that the
19 interest of the taxpayers who are bearing the
20 risk of the transaction have some reasonable
21 promise that if all works out well and if we are
22 successful and if stock yields do better than
23 expected, that there should be some return to
24 them that is commensurate with the absolute and
25 100 percent risk that they take on the

1 downside. So that's the fundamental question.
2 Now, in any event, the City and its pension
3 authority have to have cooperation. Nothing on
4 all of these deals work unless everybody is on
5 the same scene, and that's the -- the good news
6 here and certainly something we want to help to
7 try to promote as well, and that is, to begin
8 with, no matter how you structure these
9 transactions, the actuaries have got to be able
10 to treat the pension obligation bond proceeds as
11 a valuation asset. Otherwise, we have defeated
12 our purpose.
13 The City of New Orleans went through this
14 whole craziness and they set up a separate trust
15 and they have this whole convoluted structure,
16 which I would never recommend in a million
17 years, in which every year the trust then makes
18 a contribution over to the pension fund, which
19 means they've got to invest that year's
20 contribution in short-term securities, which are
21 inherently inefficient, and they're paying this
22 huge frictional cost for this design thing
23 because they were so concerned about trying to
24 maintain integrity of their bond issue, that
25 they kind of lost sight of what was the big

1 picture that we're trying to do this for.
2 So, again, all of your deliberations in
3 this area need to go toward how do we put
4 everybody on the same team along the way in
5 terms of accomplishing a common good here and
6 what are the terms and structures that
7 accomplish that.
8 A couple of things for you to then think
9 about on the next slide that can be or would be
10 things that we certainly would encourage you to
11 think about. One is the concept of a market
12 stabilization reserve or policy. Again, whether
13 done through a trust, whether done through your
14 pension funds, the point here is that the
15 essential concept is that if, in fact, we have
16 superior stock market returns, if everything
17 works out right, there does need to be some
18 agreement that at the peak of a business cycle a
19 funding ratio in excess of 100 percent is not
20 overfunded, that we need to be looking ahead to
21 the next recession and understanding that if the
22 typical historical recession of minus 25 percent
23 valuation in stocks is going to take us below
24 100 percent, then we're not overfunded.
25 And there needs to be kind of a

1 constitutional agreement to that concept before
2 you start, either that or definitely don't sell
3 any more pension obligation bonds than about
4 75 percent funding because that's the only other
5 way that the City could achieve its objective of
6 trying to assure that the taxpayer risk reward
7 here is optimized.
8 Finally, bond redemption ought to be a
9 first priority at some point along the way.
10 And, again, these are balance issues, but,
11 again, I go back to, again, the -- the
12 phenomenon we saw in this country in 2000/2001
13 was we had a large number of public plans that
14 became 100 percent or more funded in the
15 Internet bubble. A large number of them went
16 out and granted irreversible,
17 constitutionally-protected benefit increases,
18 only to watch the value of their portfolios fall
19 dramatically in 2001 and again in 2008.
20 And the net result of all of that is that
21 employer pension costs nationally will double
22 from 2002 to 2012 simply because of the
23 simultaneous effect of benefit increases at the
24 peak followed by subsequent market losses.
25 And if you think about what would have

1 happened if we went back to 2000 and said, you
2 know, if we -- again, in a hypothetical world of
3 having sold pension obligation bonds -- had
4 actually redeemed the bonds and reduced the
5 liability rather than increase the liability,
6 what a completely different scenario we would
7 have today with respect to the funding of
8 Americans' public pension plans.
9 So those are some things to think about.
10 The policy questions that I posed to you on
11 the next slide are, when would it be too late to
12 issue POBs? And I'm not here to have a magic
13 formula. In fact, this is something that we're
14 now conducting active research on because, as
15 I've indicated, we need to think about this in
16 the context of prior business cycles and just
17 simply looking at stock market metrics is not by
18 and of itself the only way to attempt to solve
19 this. So we're doing studies that take into
20 account factors such as gross domestic product
21 and industrial capacity utilization, all of the
22 other measures of the real economy as opposed to
23 the financial markets, to help provide some
24 bearings for our clients, not just here in
25 Jacksonville but in other places in America,

1 with respect to at what point do we begin to
2 believe that the use of a leveraged strategy
3 such as this has an increasing risk of losing
4 money in the next recession. I'm not here to
5 present that data now. It's still being ground
6 out by researchers back along the way.
7 Secondly, if you're going to have a POB
8 trust or any version of protective measures,
9 what form would that take? Again, a question I
10 pose to you. Not here with answers, but
11 certainly issues for you to contemplate along
12 the way.
13 And then the third element is there's -- as
14 I've indicated here before, there's got to be
15 cooperation between the City and the pension
16 fund in order for these transactions to work
17 because if we do them the way they've been done
18 for the last 25 years, you're not doing your
19 taxpayers a service because you will either be
20 wastefully consuming borrowing capacity that
21 could be used for other purposes, you're
22 incurring fees for managing money and executing
23 transactions to sell bonds to buy bonds, and you
24 may be approaching the whole transaction at the
25 wrong point in the cycle. So those are the

1 things to think about.
2 With that, the final thing -- it's not a
3 sales pitch. It's so that you know what we
4 actually do at PFM. I'm not the financial
5 advisor, there's a separate team of people who
6 do that, but they certainly have the capacity
7 and have in the past provided guidance with
8 respect to deal structure sizes, variable versus
9 fixed rate, all of that stuff that is the rare
10 province of municipal financial advisors. And,
11 of course, we track the municipal taxable market
12 closely as well in terms of timing
13 considerations.
14 The one thing that we do provide along the
15 way there is the guidance to the issuer, in this
16 case, the City, with respect to when does it
17 make sense -- if, in fact, we were to see stocks
18 advancing, what strategies might be out there
19 10 or 15 years from now. The one advantage that
20 PFM has is, with its longevity, it will be here
21 in order to help with that.
22 We also do have the capacity to provide
23 investment advisory services, whether inside or
24 outside the trust and all that stuff, but
25 clearly we have a focus that enables us, through

1 any part of an engagement, whether through the
2 bond issue side or the other side, to help with
3 the asset allocation issues that are peculiar to
4 the issuance of a pension obligation bond.
5 That concludes my formal presentation. I'm
6 happy to take questions. I'm sure that many of
7 you have aspects of this that you would like to
8 either hear less or more of. I'm sure there's
9 some subjects you never want to hear again.
10 And I, first of all, want to thank you for
11 your forbearance in listening through a very
12 complex presentation of a not simple topic. I
13 hope I've been able to reduce it to its core
14 elements in order to facilitate a discussion.
15 THE CHAIRMAN: Well, Girard, thank you very
16 much. You definitely shed a lot of light on all
17 of us. I do have -- Mr. Keane has a question
18 for you if you don't mind.
19 MR. G. MILLER: Sure.
20 THE CHAIRMAN: John.
21 (Mr. Hyde exits the proceedings.)
22 MR. KEANE: Thank you very much for being
23 here with us today.
24 I want to get to the cost. Assume for
25 discussion purposes the City wishes to issue a

1 $500 million pension obligation bond in the
2 market -- and you mentioned some of those costs
3 a while ago, the approving lawyers, the check-in
4 lawyers, the bond underwriters, this one, that
5 one. Of that 500 million, how much is going to
6 be eaten up at the front end before they show
7 back up here with a sack of cash to be handed
8 over to the pension trustees, about, just about
9 how much?
10 MR. G. MILLER: Well, you're dealing in
11 hundreds of thousands, you're not dealing in
12 millions, but the order magnitude is going to
13 fall into that.
14 By the time you deal with -- and I think if
15 you take into account, Mr. Keane, the actual
16 underwriter's spread, that's another factor, but
17 the City won't look at the underwriter's
18 spread. They're just going to look at what's my
19 cost of capital. But, obviously, whoever buys
20 your bonds has got money in that part of the
21 transaction.
22 We know we can quantify bond attorneys'
23 fees, financial advisors' fees, those parts will
24 be there. And then, as I understand with -- in
25 your role, obviously, there are going to be

1 money managers' fees on the other side of it.
2 But it's not going to be tens and twenties
3 of thousands. It will be several hundred,
4 undoubtedly, in the total cost of issuance by
5 the time you're done, but not -- not half a
6 million, but you'll be dealing with numbers that
7 are in the hundreds of thousands.
8 MR. KEANE: Thank you.
9 THE CHAIRMAN: Let me ask, then -- Girard,
10 it could be you, it could be John -- if the
11 pension fund was just to go out and buy a
12 $500 million investment, what's the cost on
13 that? I mean, I need some comparison. I
14 don't --
15 MR. KEANE: Well, what I was going to get
16 at is, rather than go to New York and sell a
17 bond up there, sell a bond directly to the
18 pension fund. We would take it in and escape
19 those underwriting costs and the bankers' costs
20 and the trading costs and the printing costs and
21 legal fee costs and -- cost, cost, cost.
22 MR. G. MILLER: Well, the -- it's a novel
23 concept. I will say that we've seen some of
24 this happening up in Minnesota with school
25 districts buying each other's OPEB bonds. And

1 generally we've been discouraging people from
2 that from the standpoint of, as trustees, we
3 question whether or not they should be making
4 such a large, undiversified investment.
5 And it's -- again, nobody here is concerned
6 about the solvency of the City of Jacksonville,
7 we're not California here, and I happen to live
8 in that state.
9 MR. KEANE: Fortunately.
10 MR. G. MILLER: Fortunately, that's right
11 very fortunately for you.
12 But, nonetheless, there would be -- the
13 first question that you really should be
14 thinking about there is whether, in fact, the
15 pension fund buying its own obligations in order
16 to conduct this transaction, whether that all is
17 effectively prudent.
18 The second part is, you do need to ask also
19 whether the pension fund's best investment in a
20 fixed-income portfolio is really the City's
21 bonds or whether you would end up with a better
22 diversified portfolio of corporate and other
23 securities.
24 So those things can all be considered.
25 You are in a unique position, because of

1 your scale and because of the relative
2 magnitude, to engage in a little bit of that as
3 part of the strategy. I wouldn't think that
4 funding the entire piece, just in terms of sort
5 of the overall magnitude, has sort of the right
6 feel to it, but it's -- it certainly is a
7 strategy that's worth considering. It will --
8 that would diminish, but obviously not eliminate
9 those issuance costs.
10 THE CHAIRMAN: Thank you. Appreciate it.
11 I had a couple of questions. One is, how
12 many communities -- I know you mentioned four or
13 five in your presentation. How many communities
14 are taking advantage of this or is there an
15 upswing of communities that are looking at this?
16 MR. G. MILLER: Now, I would say that
17 actually there was probably more interest in the
18 concept of pension obligation and OPEB bonds six
19 months ago than there is today, and the main
20 reason is that the economy has clobbered many
21 municipalities.
22 For example, in California there is not
23 unlimited taxing authority to sell pension
24 obligation bonds. And so although here, if you
25 properly structure your issue, you have the

1 borrowing capacity, you go out and do it. In
2 states like California, where they have tax
3 limitations, they don't have the available
4 revenue stream to pay the debt service even.
5 And so the economy has actually shut down some
6 parts of the economy along the way. There are a
7 lot of jurisdictions that are simply waiting
8 until yet perhaps a later time.
9 I would say that, again, out of the PFM
10 client base there's probably less than a dozen
11 jurisdictions of anywhere close to this
12 magnitude. We obviously have a little small fry
13 here and there, but in my meetings with people
14 with municipal bond rating agencies and others,
15 clearly there's -- there is a growing backlog.
16 Alaska has a $4 billion authorization that
17 they will probably pull the trigger on this
18 year, and so there are some hefty players out
19 there that are looking.
20 What has also impeded things is that the
21 taxable municipal market has not been
22 cooperative. We would have expected by now -- I
23 wrote a big, long white paper for internal
24 purposes at PFM about how we expected taxable
25 interest rates to come down along with the

1 recession, and they've been stubbornly high, and
2 now we have the Build America Bonds that were
3 authorized under the infrastructure package.
4 Now, the Build America Bonds allow a
5 municipality to sell taxable bonds and get a
6 35 percent interest rebate for an infrastructure
7 project. You can't use them for a bond -- or
8 pension bonds. We'd be all over you if we could
9 use them that way.
10 But what's happened now is California and
11 other large issuers have sold -- the last number
12 I saw was about 81 billion of taxable bonds, and
13 so the taxable bond market has been preempted,
14 at least temporarily, by the APPA, the
15 infrastructure bill.
16 All of that said, you have this combination
17 of taxable rates still remaining relatively
18 high, not attractive to many jurisdictions, and
19 stocks having come up from 6,500 to 8,000,
20 8,800, you know, people are saying, "Well, you
21 know, that doesn't feel as good as it did when
22 we were lower, but I couldn't sell bonds there."
23 So the long answer and -- to short-term is
24 that it is -- there will still be substantial
25 volume, if and when that window opens up, and

1 there are -- Milwaukee County, other
2 jurisdictions out there planning sizes of this
3 and larger in other jurisdictions.
4 You won't have, in my opinion, a huge
5 competition if you're in the first three
6 months. There will -- if the floodgates open,
7 there will come some point where you will be
8 well advised to have done your homework in
9 advance.
10 THE CHAIRMAN: The other question I had for
11 you -- and you touched on earlier the unfunded
12 liability level, it's artificially raised with
13 the issuance. What level do you think is a
14 comfortable level? Do you have a --
15 MR. G. MILLER: Well, we -- as a national
16 practice, we tend to like 80 to 85 percent for
17 pension funds. And the reason for that is,
18 again, if I mark from sort of where we are at
19 this point in a recession and look at
20 historically how much stocks have appreciated in
21 the next upside -- if you have a 60/40 balance
22 of stocks versus bonds, you can start at
23 80 percent and not get yourself into this
24 overfunding issue in a demonstrable way.
25 If you funded up to 90 percent, you would

1 probably be finding yourself with this, quote,
2 overfunding problem if the business cycle were
3 to return.
4 And, again, you just do simple math. If we
5 were to get to 11 or 12,000 on the stock market
6 and you run that through the numbers, if you
7 started with anything north of 85 percent
8 funding, you'll end up above 100 very quickly if
9 this cycle were to turn positive.
10 So 80 percent is probably the best center
11 point along the way.
12 THE CHAIRMAN: Okay. Perfect.
13 John, you had another question?
14 MR. KEANE: We met with some congressional
15 staff members last week and asked them to
16 consider supporting legislation to amend
17 Section 103 of the Internal Revenue Code so that
18 municipalities issuing bonds for pension
19 obligations -- just change those four or five
20 words there in 103 and make them tax exempt.
21 Would you support that type of concept?
22 MR. G. MILLER: Well, obviously, I work for
23 a firm that makes a good living on tax-exempt
24 bond issues and, therefore, I will never say no
25 to that question.

1 As a public policy analyst, I would say
2 that the flaw with that suggestion is that the
3 creation of a tax-exempt pension obligation bond
4 window puts us right back where we were with
5 Oakland County in 19- -- or Oakland City of
6 California in 1984, which is then you can sell
7 tax-exempt bonds and do nothing more than go out
8 and buy taxable bonds at a pure profit, and the
9 U.S. Treasury hates that. They absolutely hate
10 bond arbitrage, and this would open the biggest
11 window. So from a public policy standpoint, I
12 would be highly skeptical that that will have
13 any chance of working its way through
14 Washington.
15 I think that the better solution is the
16 Connolly bond guarantee bill, which would enable
17 the U.S. government to provide guarantees to
18 taxable bonds. And if you could sell a
19 guaranteed taxable bond at a rate closer to the
20 U.S. Treasury borrowing rate, we would have open
21 season for pension obligations.
22 I think that's the better solution.
23 MR. KEANE: Okay. Better solution?
24 MR. G. MILLER: Yes.
25 MR. KEANE: Thank you.

1 THE CHAIRMAN: Councilmember Joost.
2 MR. JOOST: Yeah, but even if you did that,
3 wouldn't you have the same problem where you're
4 bond swapping?
5 MR. G. MILLER: No, because -- basically,
6 you could still engage in a profitable
7 transaction with a taxable guaranteed municipal,
8 but you would probably be more inclined under
9 that scenario to invest in the traditional
10 pension fund because I can buy bonds and stocks
11 at that point with reasonable rates of return.
12 I wouldn't simply focus on the tax-exempt
13 feature.
14 MR. JOOST: Okay. And then just go back
15 and explain to me -- if I had a tax-exempt bond,
16 obviously I can sell at a lower interest
17 rate --
18 MR. G. MILLER: Right.
19 MR. JOOST: -- the pension fund can swap it
20 out for Triple A bonds at a higher rate, what's
21 wrong with that?
22 MR. G. MILLER: Oh, there's -- from your
23 standpoint, nothing. From the IRS's standpoint,
24 it is a direct subsidy to municipalities to
25 commit that arbitrage transaction, because

1 they're losing the revenue on the taxable bond
2 and -- simply so that you can go become a hedge
3 fund.
4 MR. JOOST: I understand.
5 Thank you.
6 MR. G. MILLER: It's too good to be true is
7 the better way to put it.
8 MR. JOOST: It's always Washington's
9 problem.
10 MR. G. MILLER: That's right.
11 Now, had South Carolina not lost the
12 constitutional law case in 1986, we could have
13 that discussion, but that sort of did away with
14 the idea that you have constitutional rights to
15 issue tax exempt for whatever you want.
16 THE CHAIRMAN: Got it?
17 MR. G. MILLER: Other questions on the
18 strategy, the research?
19 THE CHAIRMAN: Well, I mean -- Girard, I
20 mean, I guess my appreciation is -- you see the
21 struggle we have up here. We're looking at
22 something so complex, and we really -- we're
23 really issuing our suggestions or
24 recommendations on this side of it to the mayor
25 and the council president, so I think it was

1 actually very beneficial.
2 I can't tell you how much I appreciate you
3 coming in town today and spending your time with
4 us. I know between this presentation and our
5 previous conversation, I have a much better
6 understanding of it, so I appreciate that.
7 Mr. Mosley.
8 MR. MOSLEY: You did ensure us that the --
9 there will not be a double dip?
10 MR. G. MILLER: No, I didn't. I didn't
11 ensure you that.
12 In fact, actually, our recommendation for
13 OPEB bonds is only half of the issues you sold
14 because what we do know is that there will be
15 another recession some time. Whether it's in
16 twelve months, twelve weeks, or eight years,
17 there will be another opportunity.
18 And so although we might regret that we
19 didn't get everything done all at one time, one
20 of the important parts of our concept here is
21 that you shouldn't think about this being the
22 great -- you know, the silver bullet, the
23 panacea, the onetime fix-all.
24 If we've learned anything about pension
25 finance and retiree and medical benefits, it's

1 the liabilities will come back at you and you're
2 never done, even when you think you're done.
3 THE CHAIRMAN: Translation, you still lose
4 sleep, Alan.
5 Thank you very much. I appreciate it.
6 MR. G. MILLER: It was my pleasure to be
7 here. Thanks for having me.
8 And I do want to applaud you. I mean,
9 speaking as a technical professional, there
10 aren't very many places in America where people
11 have taken it as seriously and as studiously as
12 you have, and you should be -- as much as this
13 may look very complicated and confusing, you are
14 well ahead of the curve versus most of the rest
15 of the country.
16 THE CHAIRMAN: I just hope our investments
17 do the same thing.
18 MR. G. MILLER: Don't we all.
19 Take care. Thanks for having me.
20 THE CHAIRMAN: Thank you very much for
21 being here.
22 Committee, I don't have anything else on my
23 agenda today. I think we've had a pretty good
24 learning lesson today. I think my knowledge is
25 tremendously better than it was.

1 As I stated earlier, I think that we'll
2 most likely have another meeting on July 21st at
3 3 o'clock, so I would encourage you to please
4 put that on your calendar.
5 I think we probably are getting to a point
6 of finishing our research on the unfunded
7 liability and -- really start looking at other
8 things that we want to look at.
9 So I appreciate it. I appreciate --
10 Mickey, I appreciate you setting up the speaker
11 today. I appreciate everybody's time and
12 commitment, especially to my colleagues on the
13 council; I know most of them have another
14 meeting today, so I appreciate your attention.
15 Look forward to seeing all of you again.
16 And, with that, we are adjourned.
17 (The above proceedings were adjourned at
18 4:37 p.m.)
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1 C E R T I F I C A T E
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3 STATE OF FLORIDA:
4 COUNTY OF DUVAL :
5
6 I, Diane M. Tropia, certify that I was
7 authorized to and did stenographically report the
8 foregoing proceedings and that the transcript is a
9 true and complete record of my stenographic notes.
10 Dated this 12th day of July, 2009.
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14 Diane M. Tropia
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