4 Steps to Success

Protecting Your Pension
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A Message
From the General President

IN THE NEXT YEAR, YOUR STATE LEGISLATURE OR CITY OR COUNTY council will receive a study of its long-term financial obligations, including the status of pension obligations for public employees. As a result, state, city, and county officials will likely express great shock at the numbers and pursue an immediate plan to cut pension benefits (and possibly health care benefits) or implement a complete overhaul of the system to eliminate a defined benefit system—the very system that guarantees you a specified dollar amount upon retirement.

In fact, this is already happening in several states, sometimes with devastating results. In California, fire fighters won the first round in a very public battle that gained national media attention because of movie star-turned-Governor Arnold Schwarzenegger. The governor’s many legislative and political mistakes made this success easier, but don’t expect a repeat of those mistakes in the next round.

In Alaska, the IAFF was less successful. A campaign that started late resulted in a loss of pension benefits for newly hired public employees—including fire fighters—a loss that will take many years to reverse.

In New Jersey, after neglecting to put one dime into the pension program for years, the state legislature was “shocked” to learn of a $2.7 billion pension system deficit. A task force appointed by the governor is considering a number of cuts, including those affecting prescription drug benefits for retirees.

And in Colorado, a $12.8 billion pension shortfall has generated a number of reform plans, many of which could eliminate guaranteed retirement benefits and replace them with something similar to a 401(k) plan—ensuring big cuts in retirement benefits for most every public employee.

Whether or not proposed cuts become real cuts depends a great deal on you—the IAFF leadership. As we’ve seen in a number of states, success is most like-
ly to occur when IAFF local officers understand the pension threat and the reasons for it. Success also requires a well-planned response campaign that includes legislative and political tactics supported by a strong public relations component and—most importantly, the involvement of our rank and file members, as well as other stakeholders and public employee organizations from across the state.

This manual will help you prepare for what will be, in most states, an inevitable call for pension cuts, if not the outright privatization of your guaranteed benefits. This manual is the first step in preparing IAFF affiliates to defend against unjust calls for pension cuts. Throughout the next two years, we will send additional materials—including information on lessons learned from other states that are already engaged in battles to cut both pensions and health care benefits.

The most important lesson, however, is one we’ve already learned. In states where we’ve been prepared with an aggressive and comprehensive opposition plan, we’ve won. In cases where we were slow to respond and unprepared, we’ve lost.

The bottom line is that we are under attack. We cannot afford to be complacent or unprepared to fight off these challenges, or our members and future generations of professional fire fighters will pay the price.

We are entering an era that may well be remembered for the most serious pension assaults in the nation’s history. Failure will carry a heavy cost, because reversing pension cuts will be difficult, perhaps impossible. There won’t be many opportunities for second chances. Therefore, I encourage you to review this manual now, get organized, and get involved with other public employee pension organizations.

If you have any questions or encounter any attacks on your pension benefits, please contact my Assistant for Government and Public Affairs Kevin O’Connor by phone at 202-824-1541 or by email at koconnor@iaff.org

Sincerely and Fraternally,

[Signature]

Harold A. Schaitberger
General President
Introduction

Why the Fight for Pension Security Is Important

AT A TIME WHEN MANY OLDER AMERICANS IN THE PRIVATE SECTOR ARE seeing pension funds frozen, reduced, or eliminated, and when many younger workers are not even eligible for a traditional retirement plan, fire fighters in almost every state have a secure, guaranteed retirement plan. Fire fighters in general have the best retirement plans in the public sector. As important, fire fighters have essential death and disability benefits critical for individuals engaged in life-threatening work.

These retirement plans and disability benefits did not always exist. They are the result of years of negotiating and lobbying by our predecessors whose time and energy made it possible for us to have challenging and rewarding careers and financial security. Today, in almost every state, that security is under siege, and IAFF affiliates that fail to respond to proposed retirement cuts will lose these benefits.

What Happens When Pensions are Reduced or Privatized

Legislation, public referendums or take-backs at the bargaining table that reduce pension benefits or convert them into something less than a guaranteed benefit can be devastating—to the union, to the fire fighter, and to the families of fire fighters either killed or injured.

For the union, a separate or two-tiered retirement system for newly-hired fire fighters means two different—and unequal—systems, and a divided local. If the municipal or state government faces additional financial problems requiring more pension cuts, the battle will inevitably devolve into an “us vs. them” fight as each group seeks to protect their benefits at the expense of the other.

For the fire fighter, the loss of a guaranteed pension means a pension dependent exclusively on the self-discipline to contribute to a 401(k) type of plan, and the
good fortune to retire when the stock market is doing well. That’s hardly something a fire fighter can consider a guarantee, as they learned in Colorado.

Ray Rahne, Secretary-Treasurer, Colorado Professional Fire Fighters says, “Unfortunately, several jurisdictions in Colorado only have defined contribution programs. When the stock market tanked in 2000 and our portfolios dropped by 20 percent or more, many fire fighters, including me, had to re-think or postpone our retirement plans. I can tell you first hand that nothing compares to the security and guaranteed income of a traditional defined benefit program augmented by personal savings. Defined contribution plans simply don’t measure up.”

For fire fighter families, anything other than a traditional plan can be particularly devastating when there is an injury or death—whether related to a line-of-duty incident or not. Under traditional pension plans, most fire fighters who suffer any type of off-duty career-ending injury or illness after just a few years will typically receive 50 percent or more of his or her salary for life. Under these new pension plans, the fire fighter receives only what he or she puts into the plan—which, after four or five years would mean only a total of a few thousand dollars for life.

More importantly, when a fire fighter suffers a line-of-duty death, his or her family receives a guaranteed pension, usually two-thirds of the salary tax-free. Fire fighters and their families are protected, and their income remains secure. If proposals like the one offered in California in 2005 are adopted, that benefit would disappear completely.

At the end of the day, when your members ask if they really need to take pension threats seriously, ask this question: How important is it for you to know that you’ll have guaranteed benefits upon retirement, if injured, or if you suffer a line-of-duty death? Remind your members that if their pension benefits are cut, the one loss they can count on is the loss of their financial security—permanently.
Step 1
Assessing Your Pension Situation

HOW DID PENSION PROGRAMS FOR EMPLOYEES IN BOTH THE PRIVATE and public sectors become so endangered? Some private sector companies are experiencing complete pension system failures. The threat against pensions has been underway for many years and for many reasons.

In this section we discuss recent trends in pensions, noting in particular how trends in private sector pensions are affecting public employee pensions. This section includes a simple picture of current public employee pension problems, as well as a short quiz that provides a quick assessment of your own pension plan to help determine whether it will be the target of budget-cutting legislators in the near future.

Pension Trends: Private and Public Sectors

For decades, both public and private sector employees enjoyed employer-sponsored defined benefit retirement programs. A recent Bureau of Labor Statistics report, however, concluded that only 58 percent of private sector employees currently have any type of employer-sponsored program and only 20 percent enjoy a defined benefit model. Contrastingly, more than 90 percent of fire fighters have a defined benefit retirement program.

Over the last 25 years, corporate America has altered or reduced the retirement benefits of private sector workers. More recently, private sector pension problems have escalated dramatically. The mismanagement at Enron and Tyco made national headlines, and cost thousands of workers their jobs and their pensions. Many large companies, such as Bethlehem Steel and United Airlines, have used bankruptcy procedures to eliminate their pension liabilities, leaving millions of other retirees to cope with the loss of more than half their expected pension and health care benefits.
In 2005, well-known corporations IBM and Hewlett Packard announced they would freeze or discontinue their traditional, guaranteed pensions. Employees were offered the chance to join a new defined savings plan.

The move to privatize pension benefits has now been proposed for the world's largest defined benefit program: Social Security. In 2005, Congress and the White House began a major push to privatize Social Security. Under the guise of reform and personal empowerment, the government sought to revamp the most successful program of the New Deal. Proposals run the gamut, from instituting private accounts to forcing all fire fighters and other public safety employees into the Social Security system.

Now, public sector pensions are under attack. During the dot-com bubble when investment returns soared, many states either failed to fully fund their public employee pension programs, or did not contribute anything to them. Now, from coast to coast, politicians, think-tanks, and Wall Street have joined forces to attack defined benefit pension systems. Critics argue that these programs are outdated and unaffordable. Whether through public referendum, state legislation, or Enron-style actuarial processes, our opponents are fighting to undermine the progress and security we have achieved over the past half-century.

**Why Some Public Pension Plans Are in Trouble**

It is important to note that more than 90 percent of all public employee pension funds are well funded. Some states, however, face unique funding challenges when it comes to public employee pensions, and there are a number of problems common to most states.

**Pension Fund Raids**

During the last recession, many states found it impossible to balance their budgets—a task required in most states. The solution for many state legislatures was to choose between raising taxes and raiding pension funds. Knowing how voters would likely respond to a tax increase (especially in a recession), most legislatures found it easier to “borrow” from the state employee pension fund.

In just one year, this tactic saved Illinois $2.4 billion. Now the state now has the biggest pension under funding of any state in the nation. The deficit is $38 billion and growing. The situation was created with bipartisan support; both Republicans and Democrats approved the pension raid.

**Pension ‘Holidays’**

The current troubles for many public pension plans often boil down to too-low contributions or too-high benefit increases—or both. When the stock market
boomed, politicians became addicted to scant contributions, taking a “pension holiday.” In states like New York and California, employer contribution rates drifted down to near zero and, in some cases, zero.

In some states, pension holidays occurred at the same time that legislators approved increased pension benefits. Because of a booming stock market, such increases looked very inexpensive. Following are some examples of the results of such poor decisions. (More detailed information on these and other states are available in Appendix D.)

New Jersey

The $70 billion New Jersey Public Employees’ Retirement System (PERS) is in serious trouble. “The plan’s under funding is about $25 billion,” says New Jersey State Treasurer John McCormac. “It could be as high as $30 billion.”

According to Tom Canzanella, President of the Professional Fire Fighters of New Jersey, what happened “is similar to homeowners who skip their mortgage payments for six years, take out all the equity in their homes, and then face huge catch-up payments.”

The trouble began in 1997 when then-Governor Christie Todd Whitman decided to float $2.8 billion in 30-year bonds to pay off the state’s under funded pension liability. The idea was that the state could use the proceeds to earn more in the then-hot stock market than the 7.64 percent it had to pay out in interest on the bonds.

“The plan was to wipe out pension contributions for the foreseeable future,” says McCormac. “It is essentially a 30-year bet that the state can earn more on the pension investments than the yield on the bonds.”

That worked well for a few years, until the stock market tanked. Now, the state of New Jersey not only owes the principal and interest on the bonds, but also faces big funding payments into the pension system.

The state still owes $10 billion in principal and interest on those bonds. The actuary for the state’s six pension systems estimates that the state will have to contribute $1 billion to the plans in 2007.

Now, New Jersey has to try to dig out. Solutions include diversifying its investments more. PERS has not met its annual assumed return—8.75 percent before it was lowered to 8.25 percent earlier this year.

The retirement system invests two-thirds of its money in stocks and one-third in bonds, while every other major plan in the country has alternative investments.

New Jersey has been criticized in the past for some archaic policies, such as not hiring any outside managers and only trading on Tuesdays. The Tuesday mandate is now history. The investment diversification project began in June 2005, and
the Investment Council approved the first three investments in private equity. These investments cannot be managed in-house by the Division of Investment staff.

In May, acting New Jersey Governor Richard Codey named an eight-member Benefits Review Task Force to make recommendations for dealing with the escalating cost of the state’s benefit programs. Options could include converting new employees to a defined contribution plan.

“Cities, taxpayers, and pensioners alike are paying the price for elected officials who were patently negligent in their decision to skip or take a pension holiday with their pension contributions, never saving for the day they might have to resume or make up those payments,” says Canzanella.

Alaska

In Alaska, legislators—not the voters—made a change to the system because of a pension cash crunch. In May 2005, the state voted to put all new state and local government hires as of July 2006 into a defined contribution plan. The reason: a $5.7 billion funding shortfall in the Alaska Public Employees’ Retirement System (PERS) and the Teachers’ Retirement System (TRS).

“The financial crunch stems from two factors,” says Joseph Esuchanko, who was hired by a state legislative committee to study the situation. “First, the state’s pension funds had poor investment returns when the stock market turned unpredictable. Second, Alaska takes the unusual step of pre-funding its post-employment health care through the pension plan. That policy cannot be changed because a state law prohibits taking away any future benefits promised to state workers. With the rising cost of health care, the liability has grown astronomically.”

Lawmakers used the shortfall as an excuse to privatize the system. In spite of a valiant effort by Alaska’s public employees, the legislature passed a measure which was signed into law by the governor to force new hires into a strictly defined contribution system.

Consequently, in July 2006, Alaska’s new defined contribution retirement system will take effect. This change will be a significant blow to Alaska’s public employees, including fire fighters. All new employees will be placed into a defined contribution system that provides no guaranteed retirement benefit. “The Republican majority in both houses with the strong support of the Republican Governor and even the White House eviscerated the traditional retirement system that was in place for over 30 years,” said Michael Davidson of the Alaska Professional Fire Fighters. (See Appendix E for a copy of the letter from The White House.) “Make sure that you support people (elected officials) who believe in a guaranteed retirement, a living wage and meaningful health care for their employ-
ees and retirees. Learn from our lesson. Those are all benefits we lost in the legislature last year," cautioned Davidson.

**National Numbers**

The result of these budget-balancing tricks and pension holidays is clear. Public pension funds had an aggregate funding ratio of 101 percent in fiscal year 2001, according to the National Association of State Retirement Administrators. In fiscal 2004 that funding ratio has dropped dramatically, to 88.2 percent.

**Assessing Your Plan’s Financial Condition**

Is your pension fund well managed? Well funded? Or is it the victim of pension raids and holidays?

Defending against pension cuts requires a plan for protecting long-term financial stability of the retirement system, and an understanding of the variety of solutions available to correct pension problems. First, it’s important to understand the current state of your pension plan.

The International can be helpful in this area, but you must begin the process. Review the questions below. Write the appropriate score in the left-hand column based on your answer to each question, and then total your score.

**Your Score**

**Administrative/Legal**

_____ Do all trustees have copies of appropriate statutes, attorney opinions and other governing laws?

*Score 1 for Yes, 0 for No*

_____ How frequently does the board review, with counsel, its legal authority and the fiduciary responsibilities of trustees?

*Score 1 for Every Year or Two, 0 for Never*

_____ Does your plan operate under a “prudent person” investment statute?

*Score 2 for Yes, 0 for No or Outdated*

_____ Have investment policies been written and adopted?

*Score 2 for Yes, 0 for No*

_____ Does the board maintain accurate minutes regarding the rationale for major investment decisions?

*Score 2 for Yes, 0 for No*
Your Score | Professional Coordination

_____ | Are annual meetings held with each of the major advisors (attorneys, accountants, actuaries, consultants, portfolio managers, etc.) to discuss the investment program?
Score 2 for Yes, 0 for No

_____ | Have actuaries and investment advisors met to analyze the plan’s demands for cash in relation to investment planning?
Score 1 for Yes, 0 for No

_____ | If multiple money managers are used, has the board determined how their responsibilities fit together and how they might duplicate or cancel each other out?
Score 1 for Yes, 0 for No

_____ | Has the retirement board provided for investment training for an internal staff person and for trustees (plan administrator, finance director, etc.)?
Score 2 for Yes for Both Internal Staff and Trustees, Score 1 for Yes for Training Staff, 0 for No

Asset Allocation

_____ | Has the board of trustees developed a formal asset allocation plan?
Score 2 for Yes, 0 for No

_____ | Have pension officials determined the financial impact (on contribution rates) of different long-term rates of return?
Score 1 for Yes, 0 for No

Portfolio Management

_____ | Are portfolio managers assigned specific portfolio responsibilities on the basis of a formal plan?
Score 1 for Yes, 0 for No

_____ | Have portfolio performance measures (indices or benchmarks) been established as a basis for evaluating portfolio manager performance?
Score 1 for Yes, 0 for No
Your Score  Portfolio Management (continued)

_____ Has the board formally evaluated the advantages and disadvantages of index funds as an alternative to active portfolio management?
*Score 1 for Yes, 0 for No*

_____ Has the board evaluated the relative net (after fees) investment returns of its portfolio managers over the past two or three years, on a collective as well as individual basis?
*Score 1 for Yes, 0 for No*

_____ Has the board established a procedure for systematically monitoring money manager activities and for controlling their actions?
*Score 1 for Yes, 0 for No*

Reporting

_____ Does the board annually report its investment results to the sponsoring jurisdictions and employees?
*Score 2 for Yes/Comprehensive, 0 for Incomplete or No Reporting*

_____ TOTAL SCORE

Now determine the diagnosis for your pension plan based on your total score.

**TOTAL SCORE**  **DIAGNOSIS**

21 - 24  You are in a complete investment program.

16 - 20  You are in a generally well-designed investment program that can be improved.

12 - 15  Although basic decision-making is sound, you must correct several weaknesses.

11 or less  You must promptly and decisively improve the investment program. Sponsors or beneficiaries could challenge serious deficiencies.
Understanding the Score

Although getting a good score on our ratings test is an important objective, it’s also important that you be able to answer questions about the management and financial stability of your plan:

- Can you explain your plan’s approach to asset allocation?
- Are you familiar with the “prudent person” investment statute?
- Do you know about your state’s laws regarding pensions?
- Have you read your annual report and, if yes, are you able to identify any problem areas?

Knowing the answers to these questions is important in order to effectively lobby members of the state legislature, county, or city councils who want to alter your pension programs, or to effectively communicate with reporters who are covering these often complex issues.

The next section is a quick course in public employee pensions so that you can understand them, can defend them, and can answer general questions about them from legislators, reporters, and your own members.
Step 2

Learning about Pensions, Typical Funding Problems, and Options for Addressing Them

TALKING ABOUT PENSION PLANS IS EASY FOR MOST PLAN TRUSTEES, harder for IAFF affiliate officers. But learning the basic vocabulary, the history of pensions, and the value they offer public employees and taxpayers is essential to developing and implementing a plan to protect public employee pensions.

This chapter offers a crash course in pension basics, including a brief history of pensions, and a comparison of the two predominant types of pension plans.

You'll find more detailed information in the appendices, including a glossary of terms and a longer discussion about asset allocation. Contact the IAFF for additional information or visit the National Conference on Public Employee Retirement Systems web site at www.NCPERS.org. NCPERS members include many IAFF active and retired members.

Public Pension Plan Origins

In the 1800s, local governments were the first public sector entities to establish pensions. That’s because the first groups to be covered worked at the local level: police, fire fighters, and teachers. The states followed in the early 1900s. It wasn’t until the 1920s that the federal government created the first universal pension plan for federal civilian employees. The majority of today’s public pension plans trace their beginnings to the first half of the 20th century.

Many state legislators want to cut what they consider overly generous public employees pensions but fail to understand why pensions were first offered. From the 1900s to the present, public employees typically have made less than their private sector counterparts. To improve total compensation, governments have offered public employee pensions.

The concept was simple and sound. Employees earned less during their working days, but received good retirement benefits—retirement benefits that were
guaranteed. This guarantee protected employees and family members in their retirement years.

As one example, a New York state law passed in 1857 covered New York City police injured in the line of duty. A lump-sum payment and later a pension were provided. This same coverage was afforded New York City’s fire fighters in 1866. In 1878, city police and fire fighters were able to retire without proof of incapacity at half final pay. The earliest municipal plan for teachers was established in New York’s borough of Manhattan in 1894. Six state teacher retirement systems date back to the beginning of the 20th century.

When the Social Security Act was passed in the 1930s, it expressly excluded public sector employees (this is another important historical fact most legislators and reporters are unaware of). Although Congress has since amended the law to allow public employees to participate in Social Security, most fire fighters remain outside of the system and dependent upon state and local retirement systems.

Consequently, in lieu of Social Security, progressive state and local governments began instituting or improving pension benefits for public employees. The IAFF took a leading role in the expansion of retirement benefits and has been a major advocate on this issue for more than 50 years.

Congress has chosen not to exert oversight on public retirement programs. The best example of this posture is the Employment Retirement Income and Security Act of 1974 (commonly referred to as ERISA), which governs private sector pension plans and does not apply to the public sector.

As a result, the public sector developed its own history with respect to pension benefits and fund management. Most public pension systems are governed by a Board of Trustees, charged with the fiduciary responsibility of the system. The trustees are obligated to make investment and other decisions based solely on what is in the best interest of the system and plan participants. In some cases, state and local legislative bodies retain ultimate authority over the plans.

In aggregate, the fiscal health of public pension systems remains strong. As a group, public plans are 90 percent funded. Unlike Social Security, public pension systems build long-term assets to cover their liabilities. These pension funds have quantifiable assets that produce dividends, interest income, and other sources of revenue. Contrastingly, Social Security is funded through government debt and IOUs.

Consequently, the burden on the taxpayer is relatively modest. In almost every retirement system, employees contribute a percentage of their annual earnings towards retirement benefits. For most fire fighters, the share ranges from 5 percent to 9 percent of payroll. More than three-fourths of all funds in the pension system were contributed either by the employees or earned through wise investments. The employer (taxpayer) contributes less than 25 percent of the total cost of funding retirement benefits.
Defined benefit programs are the appropriate model for the public sector—especially public safety employees. Fire fighters have frequently forfeited pay raises to improve and protect retirement benefits. As important, the accidental disability provisions unique to defined benefit programs are essential for public safety employees. Most employers recognize that a defined benefit retirement plan is vital in retaining well-trained, quality workers.

**Defined Benefit vs. Defined Contribution: Public and Private Sector Pension Differences**

Today, most public employees have a defined benefit retirement plan, while in the private sector, most employees have a defined contribution plan.

- A defined benefit, or traditional retirement plan, offers a guaranteed benefit after a required number of years of service.
- A defined contribution plan, which is often a 401(k) plan, requires employees to contribute a defined amount and bear the entire risk of opportunity of investment results. Employees do NOT receive a guaranteed benefit.

In the last several decades, many private sector companies discontinued their traditional retirement plans and began offering defined contribution plans. And while the stock market was soaring during the dot-com bubble, those plans were very attractive. However, once that bubble burst, many employees were left with pensions that would offer very little in retirement.

The IAFF supports defined benefit models for all professional fire fighters. Retirement security is best attained through a defined benefit retirement program augmented through personal savings in deferred compensation investment vehicles. The table on page 17 shows the differences between the two types of programs and why the IAFF advocates the defined benefit model as the only appropriate.

Many public sector employees participate in a defined benefit, or traditional pension plan that is supplemented by some type of defined contribution plan. The IAFF supports defined contribution plans as a supplement—not as a replacement for a traditional retirement plan.

In fact, the IAFF has a separate wholly-owned subsidiary, the IAFF Financial Corporation, which can establish and manage a deferred compensation program for fire fighters. The IAFF Financial Corporation Frontline Deferred Compensation Plan is administered by Nationwide Retirement Solutions. Nationwide fully supports the idea that public sector employees should have a defined benefit plan along with a 457 plan as a supplement to maximize retirement security. During the
battle to save the defined benefit plan in California, Nationwide provided IAFF leaders with a letter stating this support (as shown in Appendix E). For more information on the IAFF Financial Corporation visit www.iaff-fc.com.

Choosing One Plan over Another

For governments, defined contribution systems are much less expensive to operate and sustain. A local government recognizes that it is only responsible for making an annual contribution to an employee’s retirement account (if it even chooses to do so) and providing management, usually through outsourcing, of the accounts. Once the employee retires, the local government shoulders no long-term responsibility.

Traditional defined benefit models require the jurisdiction to fund a retirement system over a period of years, a concept known as amortization. Further, the jurisdiction must show the assets and liabilities of the retirement system on its balance sheet, which can impact its bond ratings and ability to borrow money. Most importantly, they maintain responsibility for the retiree and, in many cases, dependents for many years after the individual leaves employment or dies.

Defined contribution systems are more profitable. The table below illustrates how much more profitable a defined contribution system can be. In this example, the retirement plan has $100 million to invest. As you can see, investment firms prefer a defined contribution plan simply because they earn more fees on multiple accounts, rather than on a single defined contribution account—the brokers make more money on your investments, and you earn less in retirement.

<table>
<thead>
<tr>
<th>Feature</th>
<th>Anytown, USA Defined Benefit Retirement System</th>
<th>Mytown, USA Defined Contribution Retirement System</th>
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<tbody>
<tr>
<td>Total system value</td>
<td>$100 million</td>
<td>$100 million</td>
</tr>
<tr>
<td>Account</td>
<td>One single account</td>
<td>Multiple accounts, one for each of the 5,000 employees and retirees</td>
</tr>
<tr>
<td>Fees earned</td>
<td>.5 percent or 1 percent, creating annual revenue for the investment firm of $500,000</td>
<td>2 percent, plus a $25 annual fee, creating $2,125,000 in fees</td>
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<td><strong>Feature</strong></td>
<td><strong>Defined Benefit</strong></td>
<td><strong>Defined Contribution</strong></td>
</tr>
<tr>
<td>---------------------</td>
<td>--------------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
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<tr>
<td>Contributions</td>
<td>Employer and employee pay a percentage of salary each month.</td>
<td>Employee pays (sometimes with matching employer contributions).</td>
</tr>
<tr>
<td>Payment Formula</td>
<td>Retirees receive a guaranteed amount determined by two factors:</td>
<td>Retirees receive an unknown amount determined by two factors:</td>
</tr>
<tr>
<td></td>
<td>1. years of service</td>
<td>1. the amount contributed</td>
</tr>
<tr>
<td></td>
<td>2. final average salary over a set period of time.</td>
<td>2. the dividends and interest earned.</td>
</tr>
<tr>
<td>Investment Process</td>
<td>Contributions go to a regulated trust fund managed by professionals who are hired by the retirement system.</td>
<td>Contributions go to a predetermined number of investment options, such as stocks and bonds, selected by the employee.</td>
</tr>
<tr>
<td>Benefits</td>
<td>A guaranteed benefit based on years of service. For example, fire fighters might be assured a retirement of 50 percent of their annual salary after 25 years of service. Traditionally, these programs include disability benefits to members injured in the line of duty.</td>
<td>Defined contribution systems do not guarantee any specific benefit. There is no ongoing benefit. If the assets are exhausted due to bad investment decisions or a down market, the retiree is left with little or no income. These plans do not include disability benefits to injured fire fighters.</td>
</tr>
<tr>
<td>Payout</td>
<td>Guaranteed for life, and may increase through cost of living adjustments.</td>
<td>Uncertain and dependent on several factors:</td>
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<tr>
<td></td>
<td></td>
<td>■ how wisely the employee invested</td>
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<td></td>
<td></td>
<td>■ the state of the stock market, which may produce substantially lower returns than expected.</td>
</tr>
</tbody>
</table>
Defined Benefit + Defined Contribution

Today, many local and state governments offer a traditional pension plan augmented by a defined contribution option. The IAFF supports such combinations because defined contribution plans have a value. They are an important tool to enhance retirement income. Most fire fighters have access to defined contribution plans in the form of deferred compensation (457) plans.

However, these plans exist as a supplement to traditional defined benefit programs. Opponents are attempting to replace defined benefits with defined contribution models. The next section offers a more detailed explanation of why this approach is bad policy.

Reviewing Existing Laws Governing Pension Plans

It’s impossible to adequately defend a pension system without understanding the laws that govern it. Most states have laws that place requirements and restrictions on the operation of public pension plans. It is important to become familiar with the provisions of these laws. In some cases, a pension attorney can explain exactly how the law is administered and interpreted.

Pension laws often have detailed reporting and disclosure requirements. Make sure your pension plan is fully compliant with these requirements and that you can access information regarding the health of your pension plan. For example, make sure that the actuarial assumptions regarding rate of return and expected benefits are prudent. Sometimes states and localities seek to hide shortfalls in pensions by assuming an unrealistic rate of return on investments, or by assuming that fire fighters will work longer or live fewer years after retirement than they actually do.

Some states have more progressive pension laws that contain various requirements that assure pension plan funds are managed wisely. For example, some states require “full funding” to assure that plans can meet their obligations. Others require employee representation on pension boards.

Whatever your state law, make sure you are familiar with its provisions and that you are taking full advantage of all its protections.

In addition to state laws, public sector pension plans also must adhere to certain provisions of the federal tax code to maintain tax exempt status. For example, the tax code requires that all pension plans be administered for the “exclusive benefit” of plan participants. This means that plan administrators cannot make investment decisions based on anything other than maximizing the rate of return. Investments designed to meet political or social objectives might run afoul of the exclusive benefit rule.
Using the tax code to change the behavior of plan administrators is a very high-stakes gamble, used as a last resort. The danger is that if a plan is found to violate the tax code, the IRS could disqualify the plan and take away its tax exemption. This would have serious consequences for fire fighters and other plan participants who currently do not pay tax on employer contributions or plan earnings because of the plan’s tax exempt status.
Step 3

Mobilizing Your Campaign Coalition

As you know from other IAFF publications on grassroots lobbying, some of the most effective campaigns occur when fire fighters work with other public employee organizations as part of a coordinated coalition. This approach has already proven enormously successful in the fight to protect fire fighter pensions.

In this section is information on how to get your campaign organized, develop talking points for defending against pension attacks, and identify the organizations to include in your coalition.

Campaign Preparation

As has been learned in several states, the key to defending your pension is to be prepared before the threat becomes apparent and then to respond quickly and decisively.

If your state has yet to seriously consider pension cuts, consider yourself lucky and take advantage of the additional lead time you have. Form a standing committee to address this single issue. Use your existing political and public relations committees to help you connect with legislators, community groups, and the media. Then establish a mechanism for communicating with these individuals—such as an email distribution list or a page on your local’s web site.

Campaign Materials

Educational materials for legislators, community leaders, and reporters are an essential part of any campaign to protect pensions. The key element is simplicity. Many in the private sector, and some fire fighters, find it difficult to understand the differences between a traditional retirement plan and a defined contribution plan (which they may call a 401(k) plan, even though there are many other types of defined contribution plans).
Below is a list of some of the basic documents you’ll need to develop and distribute.

- A formal resolution approved by your local pledging to fight the attack.
- A news release announcing passage of the resolution and the local’s plan for protecting the pension benefits fire fighters deserve and have earned.
- A one-page fact sheet explaining in simple language the threat and the outcome if the proposal is approved by the municipal or state government.
- A web site explaining why the proposal is a bad idea and the consequences of passage. (You can use much of the same language put into your one-page fact sheet.)

**Message Points**

When meeting with legislators, community leaders, and the media, it’s important to offer several key reasons why traditional pension plans are worth defending. The IAFF can help in this area. For example, if you need expert testimony for a hearing, the IAFF can provide proponents of traditional pension plan design to testify.

As a starting point, following are some examples of the types of background information and statistics you can use. These examples explain the value of traditional pension plans, and the problems that could result from pension cuts or the elimination of traditional plans. Remember, you must customize these message points to respond to the specific proposal in your situation.

- **Eliminating traditional plans means eliminating disability coverage for public safety officers who put their lives on the line every day.** Almost all state and local traditional plans provide disability and survivor benefits, as well as retirement income. Switching to a defined contribution plan would eliminate those benefits or require employers to obtain them from another source, probably at a higher cost. Many employers would simply allow public safety officers to fend for themselves in terms of disability coverage. Others may be forced to purchase insurance to deal with potential disabilities. In defined benefit programs, the cost of disabilities is determined actuarially and factored into the overall costs.

- **Traditional plans provide a guaranteed and secure retirement benefits based on a person’s salary and period of service.** Retirees covered under defined benefit plans are guaranteed an income regardless of market performance. There is NO risk. The unfortunate reality is that most defined contribution plans fail to generate enough accumulation to provide members and beneficiaries with a lifetime income. In many cases, faulty
investment decisions or bad market performance create scenarios in which the defined contribution plan is unable to sustain a secure retirement. This is a more acute concern because of increasing life expectancies among Americans. Switching to a defined contribution plan is likely to result in lower and less secure retirement benefits for many long-term government employees, including teachers, police officers, and fire fighters, who constitute over half of all state and local government workers.

State and local employees who are without Social Security coverage would be put at even greater risk. A Congressional Research Service report concludes that defined contribution-type plans will provide less than $5,000 in annual income for over one-half of participants; in contrast, traditional pensions will pay an average of more than $18,000 annually. The disparity is further exacerbated for employees (more than 75 percent of all fire fighters) who do not participate in the Social Security system.

Defined contribution plans are portable, but that feature is of little value to public safety workers. In the private sector, workers expect to change jobs several times before retirement. However, when it comes to public safety employees such as fire fighters and police, experience is valued. Longevity on the job ensures the presence of qualified, experienced individuals, especially in management positions—and that enhances public safety.

Switching to a defined contribution plan would likely cost state and local governments more over the short term. The cost of administering defined contribution plans is expensive. These costs must be borne by either the plan sponsor (the employer) or passed on to plan participants in the form of higher fees.

Traditional plans enhance the ability of state and local governments to attract qualified employees and retain them throughout their careers. Switching to a defined contribution plan would limit this ability, possibly producing or exacerbating labor shortages in key service areas by increasing employee turnover rates. Higher turnover rates result in increased training costs and lower levels of productivity that can, in turn, result in the need for a larger total workforce. One survey shows that 58 percent of employers believe that a defined benefit retirement plan helps in employee retention. The prospect of a guaranteed retirement encourages employees to remain with their respective employers and not search for greener pastures. Especially for public safety positions, maintaining a well-trained, consistent workforce is good public policy.

Traditional pension plans help state and local governments manage their labor force by providing flexible incentives that encour-
age employees to work longer or retire earlier, depending on the circumstances. Switching to a defined contribution plan would limit this flexibility and make these incentives more expensive for the employer. Traditional plans are sufficiently flexible that they can be tailored to provide benefits to either retain or encourage early retirement. For example, deferred retirement option plans (DROPs) may be used to plan for orderly retirements and subsequent hiring needs.

Traditional plans lower overall retirement benefit costs by pooling the risks of the entire workforce and smoothing investment performance (both gains and losses) over a long period of time. Switching to a defined contribution plan would require each individual to bear these risks alone, resulting in higher contributions than if the risks were pooled. Traditional plans earn higher investment returns and pay lower investment management fees, on average, than defined contribution plans because of the economies of scale. Return statistics show the investment management fees of defined contribution plans are often several times more than traditional models, which further erode ultimate asset accumulation, so at the end of the day, participants lose. Traditional plans are managed by professionals. Investment decisions are made in a fashion that balances risk and return. Too frequently, individual investors lack the time and skill needed to determine the best investments. An actuarial study by Michael Carter demonstrates that non-professional investors underperform in the market by approximately two percent annually. Over a 25-year or more investment horizon, those results are catastrophic. Finally, studies indicate that when individuals change jobs, more than 50 percent withdraw all or part of their contributions from defined contribution plans.

Traditional plans help sustain state and local economies by providing adequate retirement benefits for a significant portion of the workforce. Switching to a defined contribution plan may slow state and local economies, because a large number of retirees would likely receive lower retirement benefits. The estimated economic value of income derived through defined benefit pension plans over what would have been earned in defined contribution plans is two percent of the U.S. Gross Domestic Product, or $200 billion a year.

The IAFF is developing additional materials and participating in several research projects that will provide additional information to use in defending your pensions. Look for details in the International Fire Fighter magazine and the IAFF Leader newsletter.
Coalition Partners

In most state and municipalities, pension attacks affect many other public sector workers. Building a working coalition with these individuals is essential to defeating these attacks. Forming an informal coalition with these organizations' leaders begins when you and your fellow IAFF leaders contact your counterparts in organizations such as these:

- **AFL-CIO**: On the national level, the AFL-CIO has established a quick response system to address attacks on public pension systems and maintains a division dedicated to pension and investment issues.

- **Local Chamber of Commerce**: This business league has often been supportive of the IAFF, especially where the locals are members. Local chamber leaders do not always share the same positions as the national organization. The support of business leaders can be enormously beneficial.

- **National Conference on Public Employee Retirement Systems (NCPERS)**: NCPERS is the largest national nonprofit public pension advocate, representing more than 500 public pension funds.

- **National Association of State Retirement Administrators (NASRA)**: NASRA represents the directors of the nation's state, territorial, and largest statewide public retirement systems.

- **National Council on Teacher Retirement (NCTR)**: NCTR's membership includes 77 state, territorial, local, and university pension systems.

Other associations and unions that represent public employees and have a vested interest in protecting traditional retirement programs include but are not limited to the following:

- **American Federation of State, County and Municipal Employees (www.afscme.org)**

- **American Federation of Teachers (www.aft.org)**

- **Communication Workers of America (www.cwa-union.org)**

- **Fraternal Order of Police (www.grandlodgefop.org)**

- **International Brotherhood of Teamsters (www.teamsters.org)**

- **International Union of Police Associations (www.iupa.org)**

- **National Association of Police Officers (www.napo.org)**

- **National Education Association (www.nea.org)**

- **United Food and Commercial Workers International Union, CLC (www.ufcw.org)**

If you have not formed a coalition and you come under attack, immediately bring all stakeholders together. Meeting on a regular basis draws everyone togeth-
er and creates a commonality of interest. Engage in frank and candid discussions on what resources each group brings to the table. Draw upon each other's strengths and weaknesses.

For example, fire fighters may have the best relationships with elected officials. The police association may have better media contacts. A member of the teachers union may be a trustee of the retirement system.

**Lessons Learned in California and Other States**

The success in defeating the 2005 ballot initiatives in California offers several lessons regarding political and public relations tactics—and especially the value of a coordinated campaign. Led by fire fighters, teachers, and school employees, public employee organizations came together to form a coalition in response to several anti-worker ballot initiatives supported by the governor, including the defined contribution pension measure.

The California Professional Fire Fighters levied an $8-a-month assessment on their membership. The campaign used several tactics:

- Television commercials featuring the spouses and widows of fire fighters proved that Governor Schwarzenegger is not the governor he promised voters he would be.
- At rallies held across the state and at the state capitol, coalition members captured the attention of local voters, explaining why the proposed cuts were unfair.
- The coalition sent a steady stream of information to the media, explaining the true financial situation of the pension plan and of the proposed cuts. The coalition also wrote dozens of letters to the editors that were published in numerous newspapers.

The result? Governor Schwarzenegger lost—for now. “When we started this battle, we were down almost two to one in the polls,” says Lou Paulson, President of the California Professional Fire Fighters. “We faced well-funded and committed adversaries, as well as a popular celebrity governor. Even though our backs were against the wall, we had to fight because IAFF affiliates and more than 60,000 CPF members’ and retirees’ pensions were in jeopardy. In the end, we prevailed because we worked hard and we worked smart. Fire fighters built effective coalitions, educated and mobilized our membership and conducted a coordinated and effective political and public relations campaign which carried the day.”

Additional ballot initiatives are likely, but face a now experienced coalition that continues to meet regularly, share information on possible legislative maneuvers and develop better materials that reveal the truth about public employee pensions.
In California, as in many states, legislators unfriendly to public employees perpetuate a number of myths, a tactic IAFF locals should be prepared to counter. Some examples:

- Is your pension plan truly under-funded? Many are not, or are not in as bad financial shape as claimed. In many states, problems of under-funding can be corrected over time; they do not need to be resolved by huge cash infusions over the next year or two.

- If your plan is under-funded, what happened? Is it because of excessive pensions? In many states, the problem is the legislature’s failure to contribute sufficient funds—and in some cases any funds—into the system.

- Are your pensions excessive? In California, the comparatively high pensions of a few state employees were presented as typical by Governor Schwarzenegger. In fact, the typical public employee receives only $19,200 a year—including those who live in some of the most expensive cost-of-living areas in the country.

Collecting this type of information is faster and easier when many groups work together. Get together with your public employee colleagues to analyze the statements—or misstatements—of political leaders and the often incorrect or distorted media reports, and then prepare simple, easy-to-understand responses that make your case.

For More Information

IAFF affiliate presidents may request these and other materials referred to under the “For More Information” headings by calling their district vice presidents or the appropriate department at IAFF (indicated in parenthesis at the end of each item listed).


- The IAFF booklet, *Guidelines for Public Relations/Marketing a Fire-Based System*, contained in the *IAFF Privatization Deterrent Kit*, suggests ideas for community involvement programs and includes leave-behind materials for meetings with government and media officials (IAFF Technical Assistance and Information Resources Department).

- The IAFF CD, *Survey of Pensions*, provides the results of a recent survey of state and local government retirement systems. The survey provides representational data that affiliates can use to compare components of their own retirement system with information compiled on other public sector plans (IAFF Governmental and Political Affairs Department).
Step 4

Responding to Proposed Cuts

A FAST, ORGANIZED CAMPAIGN IS ESSENTIAL TO DEFEATING PROPOSED pension cuts. Delay, and you risk losing benefits that may take years to restore.

An effective campaign, one designed to protect pensions, will have three major strategies:

- Legislative
- Political
- Communications

Legislative Strategy

A legislative campaign will test the effectiveness of your existing Legislative Committee. Having an informed activist as chair is essential.

Your legislative strategy begins by making a careful and detailed analysis of the proposed measure that would reduce your pension benefits. Such a review may yield extremely important information. In California, for example, such a review revealed an unknown—and perhaps unintended consequence: the elimination of disability coverage for line-of-duty deaths. This single fact was responsible for lining up numerous individuals and organizations who publicly opposed the governor's proposal, leading to its defeat.

The next step is to identify the individuals in the state legislature or municipal government who propose the pension cuts. Then identify elected officials, community leaders, business and trade organizations, and newspaper and media outlets that support your opponent's position.

Once you have analyzed the proposed cuts and learned everything you can about those supporting them, it's time to meet with them—in private and in public. Preparation is essential, as is a well-rehearsed, professional presentation of your position.
Behind-the-scenes, private negotiations with these proponents of pension cuts and their supporters often present the best opportunity to discuss your arguments. A face-to-face meeting gives you the best means for establishing a relationship with appointed and elected officials, who often will speak more openly in private than they will during a public meeting.

Eventually you will need to confront your opponents in public meetings and hearings. An advantage of public meetings is that they present an even better opportunity to get an elected official to state a position on your issue. An elected official is also more likely to keep a commitment made at a state government committee or city council meeting in front of a public audience that includes reporters.

In the few minutes immediately before a public meeting, you typically have an opportunity to speak briefly with elected officials. If you’re meeting someone for the first time or someone who may have forgotten you or your position in an IAFF local, always introduce yourself by name, indicating your position both as a fire fighter and an IAFF local representative.

During the meeting, if an official says something with which you disagree or that you believe is incorrect, and you don’t have the chance to address the comment publicly, try to get the attention of the official afterward. If unsuccessful, follow up with a meeting, a phone call, or a letter, stating your position or supplying information to refute the comments.

Whether in a public or private meeting, remember these basic rules for lobbying appointed or elected officials:

- When discussing an issue, be polite and courteous. Don’t argue or threaten.
- When seeking a commitment for support, be clear and to the point. Don’t be evasive.
- Know the reasons why the official should support or oppose the issue in question, and anticipate objections to and questions about the local’s position.
- Schedule meetings in advance. Don’t show up unannounced and expect a meeting on the spot.
- Never resort to name calling. Remember that you may need to meet with this individual again on the same or some other issue.
- Never threaten political retaliation if the elected official disagrees with your position.
**State Legislation**

Another way to protect the security of your pension plan is to amend your state law by adding provisions designed to improve the operation of pension plan administration and expand participant involvement.

Carefully review your state laws to detect problem areas, and explore the possibility of advancing state legislation to correct any deficiencies. The IAFF can provide model legislative language, but the onus of crafting specific legislation appropriate for your state falls on the IAFF state association and affiliates.

In 1991, the National Conference of Commissioners on Uniform State Laws (NCCUSL) drafted a model state pension law. Although the model law contains a number of helpful provisions, it falls far short of what is necessary to adequately protect the interest of plan participants. At a minimum, every state should be fully compliant with the NCCUSL model law, and most states should go beyond these bare minimum requirements.

**Florida 2000: Another Controversial Election**

Beginning in the late 1990s, a cadre of well-paid, out-of state lobbyists tried to influence the Florida legislature. These influence peddlers wanted to convert the nation’s fourth largest retirement system into an exclusively defined contribution-style program. The Florida Public Employees Retirement System covers 660,000 active members and 240,000 retirees. If successful, the conversion would have been a windfall for Wall Street.

Recognizing the very real threat, a coalition of stakeholders launched a counterattack and mobilized a massive grassroots lobbying campaign to protect retirement security for Florida’s public employees. “When the legion of Wall Street lobbyists descended on Tallahassee, we knew the score. They wanted to convert our pension system into a defined contribution program, which is little more than a glorified savings plan. But through grassroots lobbying and a little backroom deal making, Florida fire fighters and our allies from other public sector unions thwarted their scheme. Today, our members still enjoy traditional pension benefits,” says Bob Carver, President of the Florida Professional Firefighters.

When the dust settled, the traditional defined benefit program was preserved and an “optional” defined contribution plan was instituted. After a comprehensive educational campaign was waged by various public sector unions, more than 95 percent of plan participants elected to remain in the traditional retirement program.
Political Strategy

Other IAFF documents address at length ways to support politicians who support fire fighters and to defeat those who do not. It’s important to get candidates for elected office on the record regarding this issue.

The easiest way to identify candidate positions is through a candidate survey. A sample is available on the IAFF web site. For surveys focusing exclusively on retirement issues, include direct questions such as these:

- Would you maintain defined benefit retirement systems and disability benefits for public safety employees?
- Would you commit to supporting legislation stating that money designated for retirement system purposes cannot be diverted for other purposes, including reducing the annual employer or employee contributions to the system?

You will, of course, have supporters in government. Encourage them to support your campaign. They can write editorials, submit testimony, and lobby their colleagues.

For those politicians who are undecided or refuse to state a position, demand answers. Many politicians choose to travel the path of least resistance. On this issue, you must force a choice.

Fire Fighter Candidates

The best way to advance IAFF legislative issues is to ensure that fire fighters and emergency medical personnel are among those officials managing public employee pensions.

Just as the IAFF has been able to help elect more than 350 IAFF members and spouses to elective office across the United States, we believe fire fighters must pursue one of two positions that are typically available with most pension plans:

- pension plan trustee
- pension plan administrator

In some states, these positions are elected, while in others they are appointed by politicians. Find out what positions are available in your system and when the positions next become available. Your participation in the day-to-day management of these plans can help ensure timely, accurate information. As important, it can help prevent the type of actuarial and accounting data manipulation described in Appendix C.
Communications Strategy

An effective communications strategy can be the most important tool in a fight to preserve your pension. That’s because it can help address the lack of information that exists among many key audiences who will determine whether the proposed cuts are approved.

- Most voters oppose taking disability benefits away from fire fighters and police officers. Defined contribution plans do not protect fire fighters injured in the line of duty. And many legislators and reporters are unable to distinguish the difference between traditional and defined contribution pension plans.

- Most Americans are unaware that public employee pensions were offered in lieu of the higher salaries typically found in the private sector.

- Most legislators are unaware that many fire fighters must retire at a certain age and of the importance of disability benefits because of the potential for career ending injuries.

- Most Americans are unaware that public sector employees were legally prohibited from participating in Social Security at the time it was created.

Whether using paid media (advertising) and earned media (news stories on television and in newspapers), the key is to use every possible tactic to reach as many different audiences as possible and to attain several goals:

- explain the value of government-run public services
- shift public opinion to support your position on the pending legislation
- create public pressure on political leaders
- produce the votes needed to defeat the pension proposal

A successful communications strategy begins by formulating the essential message, which must be customized in every situation, based on the proposed cuts. Your coalition members can help develop your message, as can the staff at the IAFF.

Undertaking a media campaign is an enormous expense, and in most cases, paid media may be unnecessary. There are, however, statewide referendum campaigns when a media campaign is imperative. These costs are another incentive for organizing a diverse coalition of organizations and individuals to support your campaign.

The key to a successful campaign is to evoke public support for your position and make the issue relevant. To help achieve this goal, be sure to recruit retirees, dependents, and members receiving disability benefits who would be most likely
negatively impacted by the proposed pension cuts. In several states, these individuals have consistently proven to be the most effective spokespersons at press conferences and community meetings, and as authors of editorials.

Of course, getting your message out requires a current media list. Remember that the reporters covering pension cuts are most likely different than those who cover the fire service. So you’ll need a new list of the appropriate reporters and assignment editors, and a strategy for educating these individuals on the value of traditional pension plans. Assign a committee member the task of developing a media list that includes names, addresses, and phone numbers—and especially email addresses. Learn their deadlines and, for television and radio, the number of broadcasts per day. Remember to track the editorial writers who publish editorials on government services and fiscal responsibility.

Meeting with local editorial boards to explain the issue is an essential step. Even if a paper is predisposed to support privatizing a pension fund or converting to a defined contribution model, it is important to articulate your position and why the issue is important to fire fighters.
### Appendix A

#### Pension Terms

<table>
<thead>
<tr>
<th><strong>401(k) Plan</strong></th>
<th>A defined-contribution pension plan offered by many corporations.</th>
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<tr>
<td><strong>403(b) Plan</strong></td>
<td>A retirement plan that is provided by nonprofit entities, such as public school systems, hospitals and 501(c)(3) entities. These plans are also called Tax-Sheltered Annuities (TSA).</td>
</tr>
<tr>
<td><strong>Actuarial Assumptions</strong></td>
<td>A group of assumptions set about future inflation, rates of return, salary growth, probable death rates, and probable disability. As a whole, these form a basis for the actuary to determine the liability of the pension fund and the amount of money that needs to be paid into the plan.</td>
</tr>
<tr>
<td><strong>Actuarial Valuation</strong></td>
<td>The actual cost of the municipality’s pension plan based on the plan’s demographics. The cost study is based on the plan’s determined retirement age, benefit level, years of credited service, and the individual demographics of the employees. The actuary calculates how much money is needed to fund the pension.</td>
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<tr>
<td><strong>Actuary</strong></td>
<td>A qualified independent professional who determines the amount of money that needs to be deposited in a defined benefit plan to ensure adequate assets accumulate to pay the promised benefit.</td>
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<tr>
<td><strong>Aggregate Volatility</strong></td>
<td>The volatility of a total portfolio, as opposed to the volatility of individual securities, individual managers, or individual asset classes.</td>
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<td>Term</td>
<td>Definition</td>
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<tr>
<td>Agreement</td>
<td>The document or contract between the employing municipality and employee that details the retirement benefits and eligibility requirements for plan members.</td>
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<td>Alternate Payee</td>
<td>A spouse, former spouse, child, or other dependent having a right to receive a portion of the participant’s benefits under a Qualified Domestic Relations Order (QDRO).</td>
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<tr>
<td>Alternative Asset Classes</td>
<td>Asset classes other than traditional asset classes such as stocks and bonds.</td>
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<tr>
<td>Annuitant</td>
<td>A retiree or a survivor or beneficiary of a retiree who receives a monthly periodic payment.</td>
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<tr>
<td>Annuity</td>
<td>A series of periodic payments that typically continues for the lifetime of the participant. Optional forms include a joint and survivor annuity and a term-certain annuity that pay a beneficiary a predetermined amount if the participant dies first.</td>
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<tr>
<td>Asset Class</td>
<td>A category of assets, such as large U.S. stocks or high-yield bonds, or venture capital.</td>
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<tr>
<td>Asset/Liability Studies</td>
<td>Studies based on (a) assumptions about the future performance of specific asset classes, and (b) projected liabilities of a pension fund, to determine an optimal asset allocation.</td>
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<tr>
<td>Back-Loaded Mutual Funds</td>
<td>Mutual funds that charge a fee when an investor sells the mutual fund.</td>
</tr>
<tr>
<td>Benchmark</td>
<td>A basis of comparison for the investment return of an investment manager or for an overall portfolio.</td>
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<tr>
<td>Beneficiary</td>
<td>The joint annuitant or any other person, estate, or trust fund you last designated in writing to receive any benefits which may be payable upon your death.</td>
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<tr>
<td>Benefit Payment Forms</td>
<td>Payment options, such as Single-life, 50 Percent Joint and Survivor, 100 Percent Joint and Survivor, Period Certain, or Certain and Life.</td>
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<tr>
<td>Term</td>
<td>Definition</td>
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<tr>
<td>Book Value</td>
<td>The price that was paid for an investment.</td>
</tr>
<tr>
<td>Capitalization of a Stock</td>
<td>The number of a company shares outstanding (or available for trading), times the price of its stock.</td>
</tr>
<tr>
<td>Cash Balance Plan</td>
<td>A defined benefit plan that looks like a defined contribution plan. Participants have hypothetical account balances that earn a guaranteed rate of interest.</td>
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<tr>
<td>Certificate of Deposit</td>
<td>A deposit with a bank of a specific amount of money for a specific time at a specific rate of interest.</td>
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<tr>
<td>Commingled Fund</td>
<td>A fund in which two or more clients invest. Mutual funds, group tests, and most limited partnerships are common examples.</td>
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<tr>
<td>Compensation</td>
<td>The salary, wages, and other earnings paid to a member for employment which is used in calculated the pension benefit.</td>
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<tr>
<td>Consumer Price Index (CPI)</td>
<td>The index of inflation for the previous year as released each January by the U.S. Bureau of Labor Statistics.</td>
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<tr>
<td>Correlation</td>
<td>A statistical term measuring the amount of similarity between the volatilities of any two indices, individual securities, or investment portfolios.</td>
</tr>
<tr>
<td>Cost of Living Adjustment (COLA)</td>
<td>An annual adjustment in wages to offset a change (usually a loss) in purchasing power most often derived by the CPI.</td>
</tr>
<tr>
<td>Custodian</td>
<td>The organization that holds and reports on the assets of an investment fund.</td>
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<tr>
<td>Derivative</td>
<td>A security such as a convertible bond or futures contract where the market value is derived all or partially from a different security.</td>
</tr>
<tr>
<td>Diversifiable Risk</td>
<td>Volatility that can be eliminated through diversification.</td>
</tr>
<tr>
<td><strong>Diversification</strong></td>
<td>Assembling a portfolio of securities that fluctuates in value differently from one another.</td>
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<tr>
<td><strong>Diversification Benefit</strong></td>
<td>The reduction in volatility or increase on return that can be gained through the diversification of a portfolio.</td>
</tr>
<tr>
<td><strong>Dividend Yield</strong></td>
<td>A stock’s dividend as a percent of its market value.</td>
</tr>
<tr>
<td><strong>Dollar-Weighted Return</strong></td>
<td>Internal rate of return, the average percent return on every dollar that was invested over an interval of time.</td>
</tr>
<tr>
<td><strong>Duration</strong></td>
<td>A measure of the average amount of time before returns on an investment are realized, including both interest and principal payments.</td>
</tr>
<tr>
<td><strong>Early IRA Withdrawal Penalty</strong></td>
<td>A 10 percent penalty on money withdrawn from an IRA retirement plan before age 59 1/2. There are some exceptions to the penalty, such as payments on account of death, disability, termination of employment after age 55, and payments to an ex-spouse due to a qualified domestic relations order.</td>
</tr>
<tr>
<td><strong>Efficient Frontier</strong></td>
<td>Given assumptions for the return, volatility, and correlation of each asset class, the Efficient Frontier is a graph showing the highest return that can be achieved at every level of portfolio volatility.</td>
</tr>
<tr>
<td><strong>Elective Deferral</strong></td>
<td>A contribution that an employee makes to a 401(k) plan.</td>
</tr>
<tr>
<td><strong>Emerging Markets</strong></td>
<td>Stock and bond markets of the less developed countries of the world.</td>
</tr>
<tr>
<td><strong>EPS (Earnings Per Share)</strong></td>
<td>The net earnings of a company divided by the number of its outstanding shares.</td>
</tr>
<tr>
<td><strong>ERISA (Employee Retirement Income Security Act)</strong></td>
<td>A law passed in 1974 covering qualified retirement plans that include the Internal Revenue Service pension laws, Department of Labor provisions, and the Pension Benefit Guaranty Corporation (PBGC).</td>
</tr>
</tbody>
</table>
**Fiduciary**

Any person or entity that exercises discretionary authority or control over a plan or its assets and any person who gives investment advice to the plan for a fee. Generally, the employer, the trustee, and the investment advisor are fiduciaries.

**Fixed Income**

Bonds and cash equivalents where principal and interest payments are fixed.

**Forfeitures**

The portion of an account that a participant loses if he/she terminates employment before becoming 100 percent vested.

**Front-Loaded Mutual Fund**

A mutual fund that deducts a sales charge from a purchase of that fund.

**Frozen Plan**

A plan that continues to exist even though employer contributions have been discontinued or future accruals have ceased.

**Funding Deficiency**

For defined benefit or money purchase plans, the amount of the minimum required contributions that were not funded by the minimum funding deadline (eight-and-a-half months after plan year-end).

**Funding Ratio**

The ratio of (a) the market value of a pension fund to (b) the present value of the liabilities of that pension fund.

**GDP/GNP**

Gross Domestic Product and Gross National Product are two measures of the size of a nation’s economy.

**Growth Stocks**

Stocks with higher growth rates in earnings per share.

**Hardship Withdrawal**

An in-service withdrawal from a 401(k) or 403(b) plan because of the immediate and heavy financial need of a participant.

**Hedge**

An investment that reduces the risk of another investment.

**Hedge Funds**

A term designated for a broad range of funds that make both long and short investments, sometimes using a variety of derivatives.
<table>
<thead>
<tr>
<th><strong>High-Grade Bonds</strong></th>
<th>Bonds with high quality ratings.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>High-Yield Bonds</strong></td>
<td>Bonds with lower quality ratings, once known as “junk bonds.”</td>
</tr>
<tr>
<td><strong>Illiquid Assets</strong></td>
<td>Assets that cannot be rapidly sold or otherwise converted to cash, usually for at least a year and perhaps for many years.</td>
</tr>
<tr>
<td><strong>Index</strong></td>
<td>A measure of the investment return on an asset class.</td>
</tr>
<tr>
<td><strong>(a Securities Index)</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Index Funds</strong></td>
<td>An investment fund that is designed to replicate as closely as possible the return on a particular index; for example, an S&amp;P 500 index fund.</td>
</tr>
<tr>
<td><strong>Individual Retirement</strong></td>
<td>A qualified retirement plan into which an individual may contribute pretax dollars and keep the money tax-free until retirement age. The individual may withdraw the money without penalty anytime between ages 59-1/2 and 70-1/2.</td>
</tr>
<tr>
<td><strong>Account (IRA)</strong></td>
<td></td>
</tr>
<tr>
<td><strong>In-House Management</strong></td>
<td>Management of all or a portion of a fund’s investments by its internal staff.</td>
</tr>
<tr>
<td><strong>Integration</strong></td>
<td>A feature of the plan whereby benefits are integrated with Social Security. An integrated plan generally provides larger benefits for employees who earn more than the Social Security taxable wage base. After 1986 integration was renamed “permitted disparity.”</td>
</tr>
<tr>
<td><strong>Leverage</strong></td>
<td>Investing with the use of borrowed money or credit.</td>
</tr>
<tr>
<td><strong>Liabilities of a</strong></td>
<td>The value of promises made to the participants in a pension plan, usually the present value of those promises.</td>
</tr>
<tr>
<td><strong>Pension Fund</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Liquid Assets</strong></td>
<td>Assets that can be sold or otherwise converted to cash in less than a year.</td>
</tr>
</tbody>
</table>
**Long/Short Investments** Investments that are both long and short, such as buying security A (long) and borrowing and selling security B (short), so that results depend entirely on the difference in return between securities A and B.

**Market-Neutral Investments** Investments where volatility has a very low correlation with the volatility of the stock and bond markets.

**Market Value** The price at which an investment could be sold at any given time.

**Median** The midpoint of a distribution, with half above and half below.

**Micro Stocks** Midsize stocks, such as (in the United States) stocks smaller than those included in the Russell 2000 index.

**Mid-Cap Stocks** Midsize stocks, such as (in the United States) stocks larger than those included in the Russell 2000 index, but excluding the larger stocks.

**Money Market Mutual Funds** Mutual funds that invest in fixed income securities shorter than one year in maturity, funds whose price is not expected to fluctuate.

**Multiemployer Plan** A retirement plan sponsored by more than one employer that is established pursuant to a collective bargaining agreement (union).

**Net Returns** Investment returns that are net of all fees and expenses.

**Normal Retirement Age** An assumed retirement age that is specified in the plan document. Participants are not required to retire when they reach retirement age. Participants generally continue to earn benefits if they work past retirement age. Participants are 100 percent vested at normal retirement age.

**Operating Policies** An organization’s written policies relative to the operation of its investment committee.
<table>
<thead>
<tr>
<th><strong>Options</strong></th>
<th>The right, but not the obligation, to buy a security from (or sell a security to) a particular party at a given price by a given date.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PBGC (Pension Benefit Guaranty Corporation)</strong></td>
<td>A U.S. government agency that insures the payment of pension benefits up to a certain benefit level in the event that a private pension plan is terminated and can’t come up with the money to meet its promises.</td>
</tr>
<tr>
<td><strong>Plan Administrator</strong></td>
<td>The entity that has responsibility to administer the plan (i.e., collect data, calculate contributions, and pay benefits). Generally, the company is the Plan Administrator. Oftentimes, a company will appoint a committee to act as its agent to administer the plan. In addition, the Plan Administrator or committee can hire a company (third-party administrator or record keeper) to help it administer the plan. The Plan Administrator has legal responsibility for the plan and can be sued.</td>
</tr>
<tr>
<td><strong>Plan Sponsor</strong></td>
<td>The business entity that sponsors the plan and has responsibility for the plan.</td>
</tr>
<tr>
<td><strong>Policy Asset Allocation</strong></td>
<td>The target asset allocation that an organization has established in its Investment Policies.</td>
</tr>
<tr>
<td><strong>Portfolio</strong></td>
<td>All of the securities held by an investment fund.</td>
</tr>
<tr>
<td><strong>Predictive Value</strong></td>
<td>The extent a manager's past performance may provide some indication of that manager's future performance.</td>
</tr>
<tr>
<td><strong>Price/Earnings Ratio</strong></td>
<td>The ratio of a stock's price to its earnings per share.</td>
</tr>
<tr>
<td><strong>Private Investments</strong></td>
<td>Investments that are not sold publicly.</td>
</tr>
<tr>
<td><strong>Proxy</strong></td>
<td>The voting on issues to be decided at a stockholder's meeting.</td>
</tr>
<tr>
<td><strong>Quantitative Managers</strong></td>
<td>Managers who develop and rely on mathematical algorithms to determine the transaction to be made in managing an investment portfolio.</td>
</tr>
</tbody>
</table>
Quartile  
One-quarter of a distribution, for example the top 25 percent or the bottom 25 percent.

Real Return  
Investment return in excess of inflation.

Rebalancing  
Transactions that bring a portfolio's asset allocation closer to the investment fund's Policy Asset Allocation.

Reinvested Dividends  
Dividends paid by a stock that are used to buy more shares of that stock. For example, a total return index assumes that all dividends are reinvested.

REITs (Real Estate Investment Trusts)  
Common stocks of companies that invest in real estate, but instead of paying corporate income tax pass their income tax liability on to their stakeholders.

Required Minimum Distributions  
The minimum amount that must be paid to a participant each year after attaining age 70 1/2.

Retirement Eligibility  
Meeting the age and service requirements to be eligible for retirement.

Risk  
The probability of losing money, or that the value of an investment will go down. For a portfolio of investments, risk is often defined as volatility, which over long intervals tends to encompass most individual risks.

Risk-Adjusted Return  
Return-on-investment adjusted for its volatility over time, with a volatile investment requiring a higher return and vice versa.

Rollover  
A tax-free transfer of cash or other assets from one retirement plan to another retirement plan or to an IRA.

Rollover IRA  
An individual retirement account that is established for the sole purpose of receiving a distribution from a qualified plan. Oftentimes distributions in rollover IRAs can be rolled back into a qualified plan.
Roth IRA  
An IRA in which the contributions are non-deductible and the distributions are non-taxable.

SAR (Summary Annual Report)  
A summary of the Form 5500 (annual report) that is required to be distributed to plan participants.

Securities  
Evidence of ownership or debt, such as stocks or bonds.

Separate Accounts  
A portfolio that is held for only one investor. (Insurance companies, however, use “separate accounts” to denote a portfolio held for one or more investors that is valued for those investors at market value.)

Short Selling  
Borrowing a security and then selling it.

Short-Term Investment Fund (STIF)  
A money market fund provided by a bank for investment clients for whom the bank serves as custodian.

Small Stocks  
Stocks with relatively low capitalization, sometimes measured by the Russell 2000 index.

Social Investing  
Overlaying a fund’s investment objectives with a set of social goals that constrain the fund from investing in certain kinds of companies or that encourage it to invest in certain other kinds of companies.

Social Security Retirement Age  
The age, used as the normal retirement age under the Social Security Act to pay unreduced benefits, that depends on the calendar year of birth.

SPD (Summary Plan Description)  
A detailed, but easily understood, summary of the plan that must be provided to participants and beneficiaries.

Standard Deviation  
A measure of volatility of the return on a security or a portfolio.

Style  
The manner in which a manager invests, such as in small, medium, or large stocks, or in growth stocks or value stocks.
<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Systemic Risk</td>
<td>The portion of a security’s volatility that is highly correlated with all or a portion of the market; for example, the portion of a stock’s volatility that is highly correlated with the overall stock market or with other stocks in its own industry.</td>
</tr>
<tr>
<td>Tactical Asset Allocation</td>
<td>A strategy of moving investments between different asset classes (such as between stocks and bonds), depending on which seems more attractive at time. Such strategies are typically driven by quantitative models.</td>
</tr>
<tr>
<td>Target Asset Allocation</td>
<td>See Policy Asset Allocation</td>
</tr>
<tr>
<td>Time Diversification</td>
<td>Purchasing investments in an asset class in multiple different years.</td>
</tr>
<tr>
<td>Time Horizon</td>
<td>The time between when one makes an investment and when one will need to use the money for other purposes.</td>
</tr>
<tr>
<td>Time-Weighted Return</td>
<td>The compound annual growth rate of a dollar that was in a portfolio from the beginning of an interval to the end of that interval. The portfolio’s performance in each unit of time is given equal weight.</td>
</tr>
<tr>
<td>TIPS (Treasury Inflation-Protected Securities)</td>
<td>Inflation-linked bonds are issued by the U.S. government.</td>
</tr>
<tr>
<td>Total Return</td>
<td>The investment return on a security or a portfolio that includes income (such as dividends and interest) and capital gains (whether realized or not), net of all fees and expenses.</td>
</tr>
<tr>
<td>Total Return Index</td>
<td>A securities index that assumes that all dividends are reinvested in the issuing company’s stock.</td>
</tr>
<tr>
<td>TPA (Third Party Administrator)</td>
<td>An outside company hired by the Plan Administrator to assist in administering the plan.</td>
</tr>
<tr>
<td>Track Record</td>
<td>The historical investment performance of a manager.</td>
</tr>
<tr>
<td><strong>Transaction Costs</strong></td>
<td>The total costs involved in buying or selling a security, including both brokerage commissions and market impact costs.</td>
</tr>
<tr>
<td>-----------------------</td>
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</tr>
<tr>
<td><strong>Treasury Bill (T-Bill)</strong></td>
<td>A short-term loan to the U.S. government.</td>
</tr>
<tr>
<td><strong>Trust</strong></td>
<td>A legal entity established under state law to hold and administer plan assets. Federal law allows the trust to be tax-exempt.</td>
</tr>
<tr>
<td><strong>Trustees</strong></td>
<td>The parties responsible for managing the trust. The trustees can manage the plan’s assets or can appoint an investment manager.</td>
</tr>
<tr>
<td><strong>TSA (Tax Sheltered Annuity)</strong></td>
<td>A type of retirement plan provided by non-profit entities such as public school systems, hospitals and 501(c)(3) entities. These plans are also called 403(b) plans.</td>
</tr>
<tr>
<td><strong>Unfunded Liability</strong></td>
<td>The amount of funds or time (commonly measured in years) needed to pay for improvements over the years for present members and retirees who formerly contributed at a lower contribution rate for a lesser program.</td>
</tr>
<tr>
<td><strong>USERRA</strong></td>
<td>The Uniformed Services Employment and Reemployment Rights Act of 1994, which prohibits discrimination against employees because of membership in the uniformed services.</td>
</tr>
<tr>
<td><strong>Value Stocks</strong></td>
<td>Stocks with lower price-to-book-value ratios.</td>
</tr>
<tr>
<td><strong>Venture Capital</strong></td>
<td>Private corporate investments, especially in start-up companies.</td>
</tr>
<tr>
<td><strong>Vested</strong></td>
<td>The rights members of a retirement plan acquire by length of service needed to receive benefits.</td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
<td>The percentage of a participant's account or benefit that he or she owns and is entitled to when he or she terminates employment.</td>
</tr>
<tr>
<td><strong>Volatility</strong></td>
<td>Fluctuation in the market value of a security or a portfolio.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Voluntary Contributions</td>
<td>After-tax amounts that a participant voluntarily contributes to a retirement plan.</td>
</tr>
<tr>
<td>Wealth</td>
<td>The total market value of a portfolio at any given time.</td>
</tr>
<tr>
<td>Wilshire 5000 Index</td>
<td>A capitalization-weighted index of virtually all stocks traded in the United States, including foreign stocks listed on U.S. exchanges.</td>
</tr>
<tr>
<td>Withdrawal from a Fund</td>
<td>The cash payment by an investment fund to its sponsor or to its plan participants.</td>
</tr>
<tr>
<td>Workers Compensation</td>
<td>A state government system designed to address work-related injuries.</td>
</tr>
</tbody>
</table>
IN ANALYZING THE CONDITION OF YOUR PENSION SYSTEM, AND DETER-
mining whether you will likely be the target of pension cut propos-
als, the most important issue to understand is funding—knowing
where the pension fund contributions originate. Employer and
employee contributions are essential, but the return on the fund’s
investments can be even more important.

Pension funds with the most consistently high returns use the process of allo-
cating investments into different asset classes—a process known as asset alloca-
tion.

Well-managed pension plans have a number of policies, notably an investment
policy, that state the plan’s investment goals and the authority for achieving them.
The policy indicates the plan’s approach toward risk, and the amount of risk per-
mitted. Ensuring a good return on investment requires taking some investment
risks. That approach to risk is reflected in the degree to which the plan uses asset
allocation.

Asset Allocation Options

To reduce risk, good investment managers use asset allocation to diversify
their investments. For example, instead of putting an entire pension fund into one
single stock, you could buy a variety of stocks. A more sound approach, of course,
would be to put only some funds in stocks and some in other types of investments.

Asset allocation decisions include which asset classes to allow, as well as the
amount to be invested in each asset class. Following are a few examples of asset
classes and some of the choices within them:

- equities (stocks) vs. bonds vs. cash
- domestic vs. international stocks
growth vs. value stocks
large cap stocks vs. small cap stocks

Asset subclasses vary greatly. Within domestic stock mutual funds, for example, there are many options based on the size of the companies in the fund:

- **Mega Cap:** More than $200 billion
- **Big/Large Cap:** $10 billion up to $200 billion
- **Mid Cap:** $2 billion up to $10 billion
- **Small Cap:** $300 million up to $2 billion
- **Micro Cap:** $50 million up to $300 million
- **Nano Cap:** Less than $50 million

The size of a pension plan may determine the type and level of investment diversification. Smaller plans are less likely to diversify than larger plans. Also, smaller public employee pension plans typically invest more in domestic stocks and bonds than larger plans.

**Policy Reviews**

Because asset allocation is so important to ensuring a sound pension plan, pension fund trustee boards must continually review their investment policy to ensure that it offers clear direction on asset allocation. As important, the success of the allocation “model,” as it is must also be reviewed. This is one area where IAFF local officers who are not pension experts can play a big role in ensuring the financial stability of their pension plan by asking the pension plan board members these questions:

- Does the pension board have a written investment plan with clearly stated objectives?
- Is the plan meeting its allocation targets?
- When was the last time the board revised its allocation (a process known as asset rebalancing)?
- Are investment returns published in an annual report available?

Asset allocation is a very complicated issue requiring more time than most IAFF officers have. To ensure that the pension plan is well managed, fire fighters and other public employees must rely on their pension trustees, who are expected to understand asset allocation and ensure that this approach is being pursued responsibly. The IAFF encourages its locals to get involved in the selection of their pension plan trustee and nominate individuals whenever vacancies occur. Retired fire fighters in many states serve in these positions.
Appendix C

Undermining Public Pension Plans to Encourage Privatization

MOST UNION LEADERS ARE ADEPT AT DEALING WITH FRONTAL ASSAULTS—legislation, initiatives, or public referendums. But there is an equally effective method for undermining public pension systems and influencing pension policy that is, in many instances, shielded from public view or scrutiny.

By manipulating actuarial and accounting data (both legally and illegally), policy makers can influence the balance sheets of public pension systems. That step can create an environment in which changes are required to protect the integrity of the system.

Influencing Actuarial Assumptions

Every pension system is governed by a set of financial/actuarial assumptions. Actuaries, plan administrators, and trustees set these assumptions to evaluate the financial health, or funding status, of the retirement system.

Most pension plans rely on a three-pronged funding system:

- employer contributions
- employee contributions
- interest income

Actuaries determine how much money is needed from each category to keep the system funded or solvent.

For example, assume that the Smithville Retirement System has $100 million in assets and the jurisdiction has an annual payroll of $200 million. System actuaries determine that to stay fully funded, the system requires $30 million a year. Through contracts with the unions, the employees each pay 5 percent of payroll as their contribution to the system:

\[ 0.05 \times 200,000,000 = $10 \text{ million} \]
The retirement system assumes that its assets will earn 6 percent in returns. This is called the actuarial assumption:

\[ .06 \times 100,000,000 = 6 \text{ million} \]

Combined, the employee contributions ($10 million) and the actuarial assumption ($6 million) produce a total of $16 million in revenue. The trustees set the employer contribution at 7 percent of payroll. Because $30 million is required, the employer must contribute $14 million or 7 percent of payroll:

\[ .07 \times 200,000,000 = 14 \text{ million} \]

In today’s climate, 6 percent is a reasonable assumption on investment performance. If the actuary/plan administrator/trustees decide to base returns on an actuarial assumption of 9 percent, the mathematics changes. The employee portion remains $10 million. But interest income projections rise from $6 million to $9 million. As a result, the employer is now able to reduce their contributions from $14 million to $11 million or from 7 percent to 5.5 percent.

There is nothing wrong with this, provided the system actually earns 9 percent. However, if the projection is off and the system fails to meet the assumption, the jurisdiction will have to contribute more money or run a deficit and become under-funded.

The reality is that a 9 percent assumption is too high in today’s market, and jurisdictions rarely agree to incur additional costs.

As the deficits rise and the under-funded status grows, political pressure mounts to address the situation by cutting or eliminating benefits.

There are literally hundreds of actuarial assumptions in which subtle changes can greatly impact the bottom line and threaten your security. Examples include the following:

- projected age at which employees retire (projecting younger retirements increases the burden on the system because benefits are paid for a longer period of time, and vice versa)
- projected age at which participants die (projecting earlier ages of death reduces the cost because benefits are paid over a shorter period of time, and vice versa)
- projected number of employees retiring with disabilities (projecting fewer disabilities decreases the cost of the system, and vice versa)
- projecting the average age at which employees are hired (projecting a younger hire date strengthens the systems because people will be contributing longer)
These are only a few possible nuances. Suffice it say, there are many different assumptions that can play havoc on your pension system. Your job is not to become a “kitchen actuary,” but to be aware of the potential pitfalls and traps.

Other strategies used to undermine a pension system’s financial integrity include payment holidays. Essentially, in periods of strong performance (such as during bull stock markets in which investment returns exceed actuarial assumptions), many jurisdictions take a “pension holiday” and fail to contribute the employer share of pension costs.

Using the Smithville Retirement System again as an example, operating on the same assumptions as previously listed, the employee share is $10 million. Although the actuarial assumption remains 6 percent, the system actually earned 20 percent, which can occur in good markets. So, 20 percent of $100 million is $20 million:

\[ .20 \times 100,000,000 = 20 \text{ million} \]

So, although the employer is supposed to contribute 7 percent of payroll, it reasons that investment return produced sufficient income, so that the employer contribution is not required, and grants itself a pension holiday.

Many systems, including New Jersey, took “pension holidays” for years and are now stuck with growing unfunded liabilities.

So, what’s wrong with that? Nothing, if the jurisdiction is willing to make up the difference in off years. Invariably, that doesn’t occur.

Because retirement systems are seemingly perpetual institutions, pension holidays are problematic. Prudence would dictate that both employer and employee contributions should be made regardless of performance. The excess earnings should be invested to compensate for periods of poor performance. Essentially, excesses from bull markets should be saved to make up for deficits in bear markets.

It is impossible to completely cover actuarial science in this document, and the examples listed in this section are very basic. But even if you are not an actuary, you can keep an eye on those who would seek to undermine a pension system by taking the steps outlined in the following checklist.

- Obtain and save a copy of the annual actuarial statement of your retirement system. These documents are normally several hundred pages and outline all system assumptions. Should an issue ever arise, a library of these documents would be useful in demonstrating questionable practices and tracing the financial history of your system.

- Obtain and save a copy of your system’s annual financial report. This document includes summaries of pertinent assumptions, demographical data, and investment performance analysis.
- Obtain and save a copy of your system’s investment performance data and analysis.
- Learn who the trustees are of your retirement system and build a relationship with as many trustees as you possibly can.
- Determine if your system has dedicated spots for active and retired employees to run for trustee. If so, partner with other employee organizations to elect union/employee-friendly trustees.
- Ask questions! If you feel your system may come under attack, ask the IAFF for assistance. Encourage other employee associations to do the same.
- Attend retirement system meetings. Many “sunshine laws” allow plan participants to attend these meetings. Letting management know that you are constantly watching is a powerful tool.

To summarize, it is important to prevent Enron-style accounting practices and actuarial slight-of-hand tricks to jeopardize the security of your retirement system or benefit structure. You must work to ensure that your system is operating and continues to operate on sound, reasonable actuarial assumptions.

**The Bargaining Table**

In many jurisdictions, pension benefits are the subject of collective bargaining agreements. Management frequently uses real or perceived actuarial or census data to demand benefit cuts or retractions. Consequently, it is imperative that local union leaders understand the intricacies of pension system management, investment and accounting procedures. If you are confronted with a challenge to your pension benefits as part of contractual negotiations, contact the IAFF Department of Labor Issues and Collective Bargaining.

To be successful in combating these challenges, your local must be educated and prepared. Unfortunately, much like political and public relations campaigns, negotiations and dispute mechanism procedures, such as fact finding or arbitration, may prove expensive. Your local may need to hire consultants, actuaries and pension experts to buttress your arguments. It is important to budget for those contingencies.

“Any benefits worth achieving or protecting are worth fighting for,” says Joe King, President of the Pittsburgh Professional Fire Fighters, Local 1. “That’s why many years ago our members voted to create a special legal assessment in addition to the regular monthly dues to fight off attacks at the bargaining table. Believe me; this fund has been used to help us stave off attempts to lower our benefits contract after contract. The city knows that we are well funded and ready to spend what it takes to win the battle.” Today, Pittsburgh Fire Fighters pay $40 a month for their assessment.
Appendix D

Abbreviated Case Histories

EACH DAY NEW THREATS EMERGE TO UNDERMINE PUBLIC PENSION systems. We encourage you to stay abreast of these challenges. Track what’s occurring in your state by visiting this website for the most current and comprehensive information available.

www.cwapublicandhealthcare.org/pensions/st-pension-threat-levels.html

This site, with information from the AFL-CIO and managed by the Communication Workers of America, offers the most current information on states that are facing everything from specific pension privatization proposals to the possibility of pension cuts.

Check the site frequently for new information about all states—including yours.
Appendix E

White House Letter on Alaska Public Employee Pensions and Nationwide Letter on Defined Benefit Plans

THE WHITE HOUSE
WASHINGTON
May 7, 2005

Dear Senator Stevens,

On behalf of the President, thank you for your letter regarding your efforts to improve the Public Employee Retirement System for future public employees in Alaska. As you are aware, the President is also working to strengthen the nation’s retirement system—Social Security—for future generations of Americans.

According to recent reports, Alaska’s retirement system could be more than $5 billion short of meeting its long-term obligations. Like with the current Alaska state plan, the federal government has made promises it cannot afford to pay with the current system.

I understand that your proposal would provide individual savings accounts for now state employees. Likewise, the President believes that a strengthened Social Security system should include personal savings accounts.

As a former governor, the President understands the challenges facing state government. Just as you are finding with your state system, if we do not act to fix Social Security now, the only solutions will be dramatically higher taxes, massive new borrowing or sudden and severe cuts in benefits or other government programs.

The President continues to meet with state and local officials to highlight the need for reform. Last month the President addressed a joint session of the South
Carolina legislature and he also met with public employees in Galveston County, Texas. All full-time public employees of Galveston County, including elected officials, pay into personal accounts. And, Galveston public employees enjoy higher rates of return than they would under Social Security.

Just like the challenges you are facing with your state system, President Bush understands that reforms will not be easy. But he believes that if we approach these debates with courage and honesty, we will succeed. As you understand, our children’s and future workers' retirement security is more important than politics.

Sincerely,

(signed)

Ruben Barrales
Deputy Assistant to the President
Director of Intergovernmental Affairs

Ben Stevens
Senate President
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182
January 28, 2005

Mr. Will Pryor
LA County Fire Fighters Local 1014
3460 Fletcher Avenue
El Monte, CA 91731

RE: Nationwide Position on Defined Benefit Plans

Dear Mr. Pryor:

Retirement income has often been described as a three-legged stool composed of Social Security, employer-sponsored retirement plan assets, and personal savings. Nationwide Retirement Solutions (NRS) believes that each of these three legs is essential to the integrity of the whole. In the public sector in particular, employer-sponsored plans have been a critical part of workers’ retirement income.

Nationwide Retirement Solutions is deeply committed to the health of employer-sponsored plans in the public sector. Historically, the public retirement system has been dominated by traditional defined benefit plans, in which the employer bears the investment risk and the plan pays lifelong benefits to workers. Such plans protect workers from investment risk, and guarantee that they will not outlive their retirement assets. NRS strongly supports defined benefit plans and the role they play in maintaining quality of life in retirement.

In recent years, defined contribution plans have emerged as another source of retirement income in the public sector. While individuals bear more risk in such arrangements, 457 plans have proven popular with some public employees because they are easy to understand, and employees like having control over some portion of their retirement assets.

Nationwide Retirement Solutions believes that 457 plans should be used to supplement, not supplant, public defined benefit programs. The ideal arrangement in terms of retirement security is one in which both types of retirement plans thrive, and all public sector employees have access to both arrangements. Therefore, Nationwide Retirement Solutions strongly supports both defined benefit and defined contribution plans.

Best Regards,

Brian McCleave
Vice President, Business Development
Nationwide Retirement Solutions
IN 2007, PUBLIC EMPLOYEE PENSION FUNDS FACE A NEW THREAT WITH publication of a new accounting rule published by the Governmental Accounting Standards Board. GASB’s mission is “to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports and guide and educate the public, including issuers, auditors, and users of those financial reports.”

Next year, the GASB will introduce a new accounting rule, GASB 45, requiring governments and agencies to account in the present for their future liabilities for the first time—including both pension and health care costs. These reports will show that many states have substantial liabilities that they are unprepared to address. Inevitably, some state legislatures and governors will propose cutting pension benefits and retiree health care to reduce the size of the liabilities.

This appendix includes a very preliminary introduction to the GASB and the new rule. Look for an updated Appendix F later this year, with additional information on how to prepare for this important new rule.

GASB 45 Overview

The GASB established standards in 1994 for how public employee pension plans and governmental employers participating in pension plans should account for and report on pension benefits, but similar provisions did not exist for other post employment benefits (OPEB). The GASB believes that pension benefits and OPEB are a part of the compensation that employees earn each year, even though these benefits are not received until after employment has ended.

Therefore, according to the GASB, the cost of these future benefits is a part of the cost of providing public services today. However, most governments report their cash outlays for OPEB in a given year, rather than the cost to the employer of
OPEB earned by employees in that year. These two amounts may be vastly different. In the absence of standards similar to those the GASB enacted for pensions, most governments do not report the full cost of the OPEB earned by their employees each year.

Furthermore, most governments do not report information about the nature and size of their long-term financial obligations and commitments related to OPEB. Consequently, the readers of financial statements, including the public, have incomplete information with which to assess the cost of public services and to analyze the financial position and long-term financial health of a government.

The purpose of the new standards—GASB Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, and GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions—is to address these shortcomings.

**Preparing for GASB 45**

To learn more about the GASB and the new standard, visit [www.gasb.gov](http://www.gasb.gov). Detailed information on the new standard—in plain language—is also available online at [http://www.gasb.org/project_pages/opeb_summary.pdf](http://www.gasb.org/project_pages/opeb_summary.pdf).

During 2006, the IAFF will publish additional information on Standard 45 and how states are approaching the recommended reporting requirements. Additional information and training will be offered during the IAFF Legislative Conference, March 19–22 in Washington, DC.