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to make any number appear on a Caller ID system. And several Web sites have sprung up to provide Caller ID spoofing services, eliminating the need for any special hardware.

For instance, [Spooftcard.com](#) sells a virtual "calling card" for \$10 that provides 60 minutes of talk time. The user dials a toll-free number, then keys in the destination number and the Caller ID number to display. The service also provides optional voice scrambling, to make the caller sound like someone of the opposite sex.

Caller ID spoofing appears to be legal, though many of its uses are not. The Federal Communications Commission has never investigated the issue, spokeswoman Rosemary Kimball said.

Lance James, chief scientist at security company Secure Science Corp., said Caller ID spoofing Web sites are used by people who buy stolen credit card numbers. They will call a service such as Western Union, setting Caller ID to appear to originate from the card holder's home, and use the credit card number to order cash transfers that they then pick up.

Exposing a similar vulnerability, Caller ID is used by credit-card companies to authenticate newly issued cards. The recipients are generally asked to call from their home phones to activate their cards. Some card companies maintain, however, that they use additional means to confirm new cards. And caller ID spoofing may not work for calls to 1-800 numbers, where the hardware can identify calls using a separate technology.

Two spoofing services contacted by The Associated Press, [Spooftcard.com](#) and [Telespoof.com](#), did not return messages seeking comment about their business. However, some of the five or so Web sites in the business don't appear to be completely unscrupulous: James said he had been hired by a few of them, which he would not name, to help stop the Western Union scam.

Also, both [Spooftcard.com](#) and [Spooftel.com](#) say they will surrender call logs to authorities in response to subpoenas. [Spooftcard.com](#)'s site says the service is "intended for entertainment purposes only."

Telephone companies can trace calls to their origin regardless of the Caller ID information they carry, but the process is laborious, especially since a call may be carried by several companies before reaching its destination. The fragmented nature of the telephone network also makes it technically difficult for the carriers to prevent spoofing.

At [Verizon Communications Inc.](#), security manager John Lewandowski said the company often gets complaints about fake Caller ID after a telemarketer has spoofed his number to cover his tracks.

In a typical case, someone will be jarred in the middle of the night by repeated telemarketing calls. He checks Caller ID, calls the number -- which is false -- and starts "cussing out" the person at the other end of the line, Lewandowski said.

"And that poor guy was asleep. It wasn't him at all," Lewandowski said. The company investigates and tracks down the callers, he added.

Apart from fraud and telemarketing, Caller ID spoofing can be used

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for pranks and spying.

In one case, SWAT teams surrounded a building in New Brunswick, N.J., last year after police received a call from a woman who said she was being held hostage in an apartment. Caller ID was spoofed to appear to come from the apartment.

It's also easy to break into a cell phone voice mailbox using spoofing, because many systems are set to automatically grant entry to calls from the owner of the account. Stopping that requires setting a PIN code or password for the mailbox.

In a slightly more complicated fashion, spoofing was part of the technique used by a hacker who broke into Paris Hilton's cell-phone voicemail in 2004, according to security consultant Kevin Mitnick, who said he was citing hacking sources. The hacker apparently called the celebrity socialite posing as a technical-support person from the carrier, and lured the password from her.

That is known as a "pretext" call – someone poses on the phone as a customer, employee or even a regulator to obtain personal information from companies and individuals. And indeed, while [Spooftard.com](#) contends that its service is for "entertainment purposes," it also notes that "Private Investigators will find Caller ID spoofing valuable for pretext calls."

Robert Douglas, a privacy consultant in Colorado, testified before Congress last month that pretexters trade tips on finding the best spoofing services.

Pretexters generally claim their practices are legal, as long as they don't involve financial information. A bill introduced in the Senate would make it illegal to pose as someone else to obtain phone records, or to buy records from phone company insiders.

Douglas would like legislation against Caller ID spoofing as well, but there appears to be little interest in Washington.

"If I'm paying extra for Caller ID, which I do ... there should be some ability on my part to believe what I'm getting," Douglas said.

In Alaska, State Representative Bob Lynn has introduced a bill to make spoofing a misdemeanor. "False caller identification is more serious than pranks, or the annoyance of intrusive telemarketing," Lynn writes. "It facilitates fraud, and can be potentially deadly."

However, it is unclear what effect the bill would have. As Lynn notes, Caller ID is a federal issue. ■

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CONGRESSMAN

# Tim Murphy

Working For The 18th District Of Pennsylvania



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## Biography

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At a young age, Tim Murphy learned that hard work is the key to success. He was one of eleven children, born to working class parents who stressed the importance of family, education and self-reliance.

He worked his way through college and graduate school, eventually earning a PhD in psychology. He started a family of his own, opened a small business, went to work at hospitals across Western Pennsylvania, consulted for schools and Head Start, and taught at the University of Pittsburgh. He authored several publications, including two books: the award-winning "The Angry Child," and "Overcoming Passive-Aggression." During this time, he became widely known as "Dr. Tim" through regular appearances on local and national radio and television.

From 1997-2002 he served in the Pennsylvania State Senate. As an elected official, and one of very few with a health care background, he found that he could help more families. He penned the state's historic Patient Bill of Rights and increased funding for medical research, while consistently supporting responsible fiscal management government to promote job creation and reduce the tax burden on families.

He took this commitment to Congress when he began representing the people of the 18th district of Pennsylvania in 2003.

He got to work immediately in Washington. In just his second term, Congressman Murphy was named a member of the Energy and Commerce Committee. He has three subcommittee assignments: Commerce, Trade, and Consumer Protection; Energy and Air Quality; and Environment and Hazardous Materials. Tim quickly emerged as a leader among his peers and was elected by his colleagues to serve as President of the 2003 class. He also is recognized as a leader in Congress on mental health issues, and serves as Co-chair of both the Congressional Mental Health Caucus, and the 21<sup>st</sup> Century Healthcare Caucus.

During his tenure in the state Senate, he served as chair of the Pennsylvania Committee on Aging and Youth. He utilized this unique experience to ensure the recent Medicare Prescription Drug Act would work in conjunction with Pennsylvania's PACE program. As a result, it is estimated that PACE will save up to \$150 million over the next two years.

Tim Murphy makes it a priority to bring together business and community leaders to focus on new and innovative ways to retrain our job force to better position Western Pennsylvania to face the challenges of the new world economy. Representing a district with a large number of veterans – and a member of the Sons of American Legion himself, he firmly supports our armed services and shows commitment to our veterans by working to expand benefits and improve services to veterans' health care.

Nan and Tim Murphy reside in Upper St. Clair with their daughter, Bevin who is currently attending college. They attend St. Thomas More Catholic Church in Bethel Park.

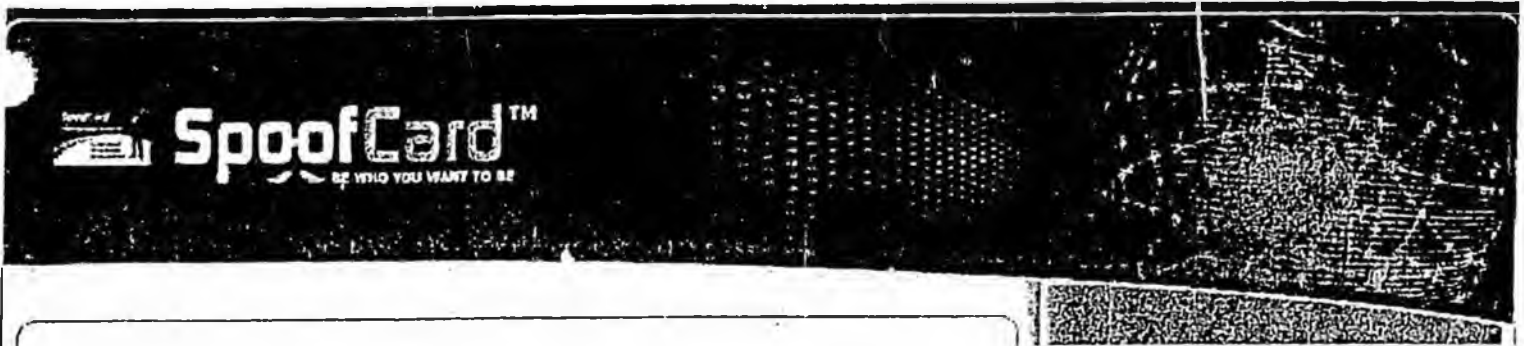
He earned a bachelors degree from Wheeling Jesuit University, a master's degree from Cleveland State University, and a his PhD from the University of Pittsburgh.

A fierce proponent of community involvement, he is a strong advocate of the Rails to Trails programs, an active participant in events for Habitat to Humanity and member of several Rotary Clubs and Chambers of Commerce.

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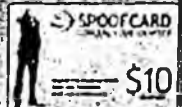
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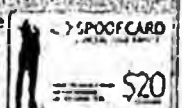
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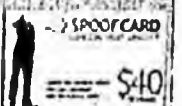
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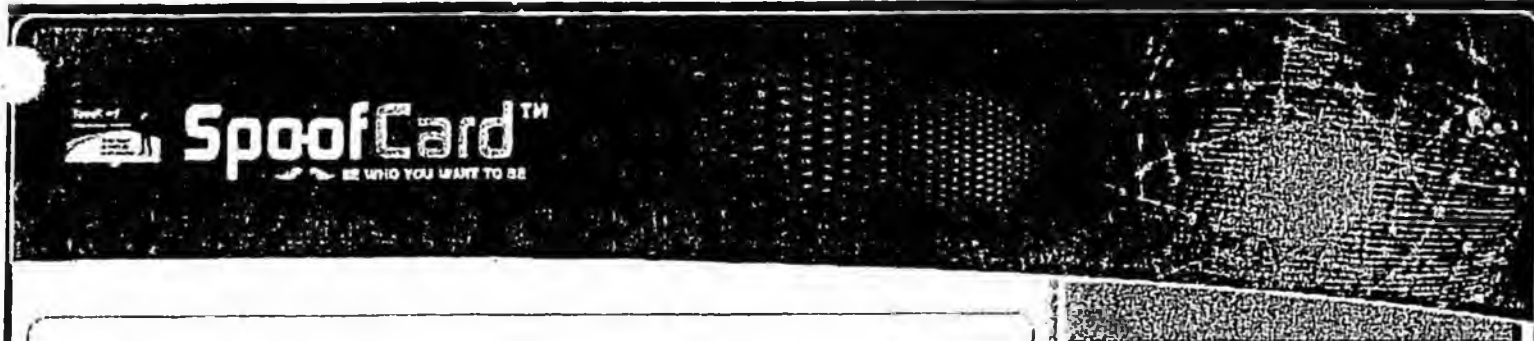
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### Frequently Asked Questions

#### How does SpoofCard work?

SpoofCard is a regular calling card. SpoofCard can be accessed through our dedicated toll free number where a user enters their pin number, desired Caller ID and the number they would like to call. The call is then placed instantly without the need to ever be online or at a computer.

#### Does SpoofCard offer call recording?

Yes, SpoofCard offers FREE call recording with instant access via your online control panel or by calling the toll free number.

#### How can I change my voice?

SpoofCard offers the ability to select a Male or Female voice when making a call. The feature works in real-time and allows the caller to speak in a normal tone while the person on the other end will hear the changed voice.

#### Are there any restrictions with using SpoofCard?

To ensure SpoofCard is used within our User Agreement, we have implemented several security measures which includes the inability to dial toll free numbers or 911. Federal Regulations prohibit the use of our technology by telemarketers or debt collectors to hide or falsify the telephone number from which they are calling. You must agree that you will not use the SpoofCard in violation of this or any other applicable law or regulation.

#### What are the advantages of Caller ID spoofing?

Caller ID spoofing gives business professionals the ability to manipulate their identity to their choosing and stay anonymous. Caller ID spoofing is also valuable in defeating popular telephone services such as "\*57 Call Trace", "\*69 Last Call Return", "Anonymous Call Rejection" and "Detailed Billing". Private Investigators will find Caller ID spoofing valuable for pretext calls.

#### Who may sign up for your service?

Our target market consists of, but is not limited to, businesses such as: Private Investigators, Law Enforcement, Skip Tracers, Insurance Agencies and Lawyers.

#### Does SpoofCard store my credit card information?

No, SpoofCard never receives your credit card information from our payment processors, keeping your information secure.

#### Can I call internationally?

Currently we only support the option to call within the United States and Canada

### Control Panel Login

Calling Card Pin:



Lost/Forgot PIN

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- ADD MONEY TO EXISTING CARD**
- FREQUENTLY ASKED QUESTIONS**
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- 60 Minutes USA Talk Time
- Caller ID Spoofing
- Free Call Recording
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**Purchase \$20 Calling Card**

- 120 Minutes USA Talk Time
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**Purchase \$40 Calling Card**

- 240 Minutes USA Talk Time
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**Can we send any number as the Caller ID and does it have to be 10 digits long?**

You may send any number as the Caller ID. Within the U.S. the number should be 10 digits long (NXX-XXX-XXXX) to guarantee proper delivery, but you may pass numbers of variable length such as "0", "411" or "12345". Results may vary based on location and the receiving end's telephone provider.



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## Caller-ID Spoofing: 'Appallingly Bad Idea'



By Erika Morphy  
September 2, 2004 1:26PM

A new software system that allows users to fool telephone caller-ID opens the door to a variety of abuses. "What an appallingly bad id security firm Sophos.

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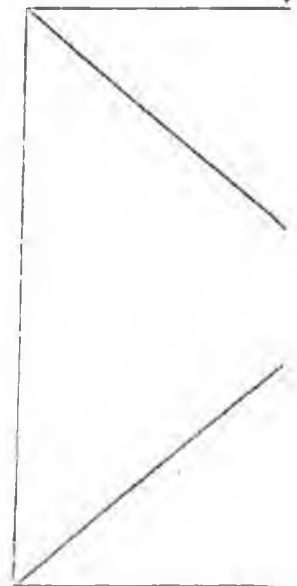
>> A startup company has developed a software system that allows users to spoof a caller-ID number in order to trick the telephone-call recipient into answering the phone.

Developed by Star38, the service will be marketed solely to collection agencies, private investigators and the police, according to statements made by the company.

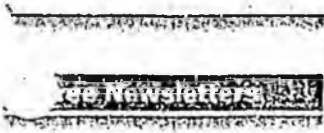
The system itself is said to be easy to use, with the user typing in the recipient's number and the number he or she would like to appear on the caller ID.

#### Appallingly Bad

Critics of the system -- and there are many, even outside the usual privacy/consumer-advocacy brigade -- find the technology frightening. "What an appallingly bad idea," says Graham Cluley, managing consultant for security and antivirus firm Sophos. "It reminds me of the hacker-driven spam and phishing scams that have taken over the Internet," he told NewsFactor.



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In fact, it is a much worse form of deception than Internet fraud, says John Morris, staff counsel for the Center for Democracy & Technology, a Washington-based public-policy organization with a focus on technology.

**Reasonable Expectation**

"On the Internet, most people understand that the identity of someone who is sending an e-mail may easily be spoofed," Morris told NewsFactor. "But the phone, historically, has had a different set of expectations or assumptions. Most people that have Caller ID assume the number listed is accurate."

In news accounts, Star38 has emphasized its intent to limit the technology to the police, collection agencies and private investigators.

However, "there really isn't anything that will prevent this kind of technology from being used by other firms, such as telemarketers, now that it has been developed," Morris says, adding, "In this age of identity theft, we are skeptical that spoofing other phone numbers on Caller ID is a desirable development."

One scenario, Morris suggests, might be someone purporting to call from a distant relative's house, claiming the person had an accident.

**Potential for Abuse**

But even assuming that Star38 keeps the technology in the hands of collection agencies, private investigators and the police, there still would be cause for worry.

While the police may well have a legitimate need for the technology in criminal investigations, the potential for abuse by collection agencies and PIs is huge.

For example, there have been cases of stalkers retaining private investigators to find victims who went into hiding.

As for collection agencies, the potential for abuse is even wider. "We don't understand what purpose a legitimate collections agency would have in hiding its identity," Morris says.

The typical example, of course, is an agency that uses the system to get a phone-shy debtor to answer the call and coax him or her into paying the debt.

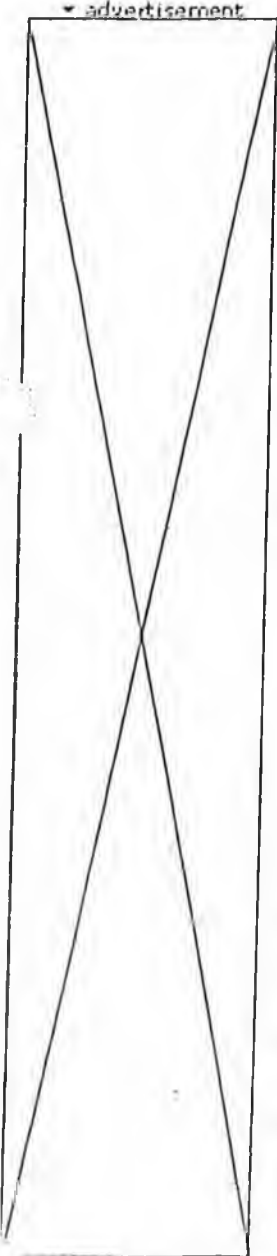
Collection agencies, though, have not entirely shed their less-than-upstanding practices since the passage of the Fair Debt Collection Practices Act. Recently, one firm was fined for continually contacting and harassing a debtor's neighbors -- a

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practice clearly illegal under FDCP.

#### Over the Line

More often, though, when these agencies go over the line, it is a little more discreet.

Recently, a legal journal reported that a court found a collection agency had made false statements as to the time limit of a debt-discount offer; reportedly, the firm told the debtor she had 30 days to make a payment if she wanted to get a percentage taken off her debt. In truth there was no time limit of 30 days -- a deception prohibited by the law.

Which brings us back to Star38's latest contribution to the Internet age. In his first take on the system, Morris says he does not believe the system itself violates the tenets of FDCP. When it gets in the hands of the agencies, though, that may be a different story.

"I do believe we will see some deceptive practices on the part of the agencies that will violate the spirit of FDCP," he says.

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## March 2005 Archive

March 08, 2005

### "Caller ID spoofing" an emerging VoIP security threat

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*If you have caller ID, you might want to think twice about trusting the information displayed on your telephone. As more people place phone calls over the Internet instead of the wired telephone network, identifying the person on the other end of the line is getting more difficult.*

Starting late last summer, people all over the U.S. and Canada got phone calls from a Twin Cities phone number -- a recorded voice offering a deal on wireless phone services. When they called the number to complain, they were patched through to a small Minneapolis company that definitely was not selling Nokias or Blackberries. It was a company that provides janitorial services to area businesses.

Building Resources Corporation office manager Rhiannon Fisk fielded the complaints.

"Around Christmastime, the call volume started to pick up, and we got dozens and dozens every day," she said. "It got to the point where we just had to start ignoring them because it was affecting how we did business."

Understandably, the callers complained angrily about the unwanted telemarketing calls.

"I'll pick up the phone, they immediately say you called my house and I want you to stop calling, and take me off the list, and they usually just hang up," Fisk said.

Fisk sought answers from the company's telephone provider, Integra, but received none. She then complained to the Minnesota Attorney General. The AG's office told Fisk that, while nothing could be done, it knew the likely source of the problem: caller ID spoofing. The shady telemarketers, wanting to avoid detection, made it look like it was someone else. It's a mystery why they chose the Minneapolis company.

Scammers have long known how to fake the source of e-mail. Since Voice over IP, or VOIP, sends voices as packets of data, it was perhaps predictable that telephone customers would start seeing a

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problem like e-mail spoofing.

"If you pick up your standard phone today, and you have caller ID, you can see which number is actually calling you, and you have a very high level of assurance that it really is that telephone number," said Stuart McIrvine, security researcher at IBM. Now, when you start to get into Voice over IP, it's very easy for someone to fake that number, so you think the call is coming from somewhere else."

Consumer advocacy groups are just beginning to field complaints about the problem. Jordana Beebe with the Privacy Rights Clearinghouse says she's not sure how many people are being burned by caller ID spoofing, but calls it a deceptive practice that should be stopped.

"Caller ID is there so that you know who is calling and you can make a determination about whether you want to take that call or not," she said. "And if for instance that technology is being abused so that you are duped into taking a call that otherwise you wouldn't take, we feel that consumers shouldn't be in that type of situation."

You don't have to be a skilled, devious hacker to trick called ID displays. In the past year, about a half dozen services have cropped up that use VoIP technology to sell caller ID spoofing, at five to ten cents a minute, to consumers. They go by names like "Telespoof," and "Camophone." They're marketed to people who want to hide their true identities, like bill collectors and private investigators. Only one caller ID spoofing service, responded to inquiries from MPR, but the owner wouldn't reveal his name, saying only that he believes his service is ethical and lawful.

Beebe of the Privacy Rights Clearinghouse says new regulations and laws are needed to fight caller ID spoofing. But VoIP is largely unregulated. A spokeswoman at the agency that would most likely have jurisdiction, the Federal Communications Commission, did not respond to numerous requests for comment.

In the meantime, caller ID spoofing could get worse as more consumers and businesses switch to Internet telephone calls.

"What we're going to see is more people devote more time and energy into breaking it, because it's going to become more popular," said David Endler of the Voice Over IP Security Alliance.

Back at the janitorial services firm, office manager Rhannon Fisk says that mercifully, her phone stopped ringing off the hook about a month ago. The calls ended as mysteriously as they appeared.

It's not clear if Murphy's criticism figured in Barton's introduction of a new FCC-focused bill explicitly outlawing spoofing; Murphy couldn't be reached for comment. Engel is the Barton bill's lead Democratic sponsor. A cosponsor of the original bill with Engel, Rep. Wilson (R-N.M.), isn't listed as a Barton bill cosponsor; her office couldn't be reached for comment. Barton's spokesman said that for "some reasons of technicality, [spoofing] really needs to be addressed by the FCC" instead of the FTC.

The FCC is a better agency to handle spoofing rules, Electronic Privacy Information Center Dir.-West Coast Chris Hoofnagle told us. With FTC jurisdiction, "it would have suffered from all sorts of blind spots -- common carriers... are generally exempt from FTC rules," Hoofnagle said. But the Barton bill's lack of an intent requirement "will create major problems for many," he said: "Many businesses and government do not transmit their direct line -- they 'spooft' the institutional number. Are they on the hook under this law?" The bill should make clear that intent to deceive is the clincher, Hoofnagle said. -- *Greg Piper*

### 'Percolates Up'

## **WildBlue Jumps Digital Gap without U.S. Funds; State Interest Up**

GREENWOOD VILLAGE, Colo. -- Since setting up its first customer in Strasburg, Colo. nearly a year ago, NRTC-backed satellite broadband provider WildBlue has been bridging the digital divide in rural communities across the U.S. without govt. aid. The firm's main market lies beyond the reach of terrestrial broadband - particularly in farming and ranching communities targeted by WildBlue advertising the past year in agriculture magazines and local radio spots.

WildBlue's service might seem a natural means of meeting the President's broadband pledge and FCC rural connectivity goals. But the firm doesn't qualify for federal USDA grants, and state support has been stirred only by word of mouth, WildBlue Sr. Vp & Gen. Counsel David Brown told us in an interview. Faster than dial-up but slower than wired options, the least expensive WildBlue access is \$49.95 a month.

The U.S. has about \$2 billion in USDA Rural Utilities Services loans to spend on rural broadband deployment through 2007 (CD Sept 20 p6). Satellite broadband is touted as an ideal rural broadband solution, but "it doesn't really fit the rules around the Department of Agriculture money," said Brown. The USDA funds are "really meant for small local telcos as opposed to somebody that can distribute nationally," Brown said.

The USDA rules, written in the early 1990s, "didn't have satellite in mind," Brown said. If a broadband provider can distribute service nationally, including regions already wired with DSL or cable, "then you don't qualify for the money," he said. WildBlue relies on the NRTC for political maneuvering, and the cooperative "has been leading the charge for the USDA RUS rules to be written in a more technologically neutral way," Brown said.

If WildBlue is looking for govt. support in bridging the digital divide, it might have more luck at the state level. Several states are "very interested in the service," thanks to WildBlue's ability to get broadband to rural residents, WildBlue Pres. & COO Kenneth Carroll said: "They're very interested in working with us to develop programs for rural constituents to provide the service where cable, DSL or fixed wireless isn't available."

So far state interest is from the bottom up, he said: "Somebody in the state government got the service, or their parents got the service out on their farm or ranch, and it percolates up. Then the state gets interested and says they're going to look at using you to complete the blueprint for service to all constituents."

Tribal connectivity should be included in that vision, Carroll said. "It's an important area," but one that WildBlue hasn't "specifically engaged in," he said. NRTC members and retailers WildBlue works with serve tribal lands, he said: "I don't have specifics, but we are very interested in being able to service those communities."

Angelos proposed to merge MASN with Comcast's regional sports network (RSN). "We're prepared to talk about a potential amalgamation of the 2 systems under an appropriate arrangement," said Angelos: "We're prepared to work at it, and come back and report to your committee our progress." Earlier in the hearing, McCollum said Cox would rather carry one RSN. Cohen echoed that sentiment, telling reporters: "Everyone who is in this business realizes that the best result is to have a single sports network in the same market." Several hurdles stand in the way of a deal with Angelos, including price and MASN's ownership structure, he told the panel.

Comcast wouldn't agree to compulsory arbitration, proposed by Committee Chmn. Tom Davis (R-Va.). That tactic helped resolve a similar dispute in N.Y. between Cablevision and the YES Network, said Davis. Cohen balked: "Compulsory arbitration is not something we would be interested in... We have to run our business and we really can't turn it over to a 3rd party." -- *Josh Wein*

### Action Soon After April Break

## **Barton Bill Would Ban Deceptive Caller ID, Give FCC Jurisdiction**

"Spoofing" caller ID information would be outlawed under a bill introduced by House Commerce Committee Chmn. Barton (R-Tex.) Thurs. The bill would give the FCC power to enforce the bill's provisions within 6 months of enactment. Spoofing refers to services, mostly by Web-based firms, that let a user create phony phone numbers or other data displayed by a call recipient's caller ID. Phone numbers for Republican House offices were used on calls criticizing the members to their constituents. The same was also done with Democratic Party office numbers.

Barton is making the issue a high priority, a Commerce Committee spokesman told us: "I understand we're going to get to this in short order" after the Easter recess.

The bill would apply to traditional and VoIP calls in which the caller causes "any caller identification service to transmit misleading or inaccurate caller identification information." There's an exception for law enforcement. Not all VoIP services are covered; the bill defines VoIP service as that provided "for a fee," excluding free services like Skype's PC-to-PC calling and similar services through instant-messaging programs that don't touch the PSTN. But paid VoIP with "capability" to interconnect with the PSTN -- regardless of whether a particular call made through VoIP actually interconnects -- is covered.

The feds aren't the first to study spoofing services. Fla. Attorney Gen. Charlie Crist (R) in March pursued several sites through their hosting service, GoDaddy.com. Crist asked GoDaddy to provide business record data on Spoofer.com, SpooferTech.com, SpooferTel.com, SpooferCard.com and TrickTel.

Spoofing services emphasize their utility especially for inquiries into illegal activity. As other sites do, SpooferCard.com says its services are aimed at law enforcement, private investigators, lawyers and insurance agents but aren't limited to their use. The website says private investigators will "find spoofing valuable for pretext calls" -- a loaded term given approval of bills criminalizing pretexting -- impersonation of another's identity to acquire personal records -- in the House and Senate Commerce and Judiciary committees (CD March 31 p2, March 9 p2).

Barton's bill follows one introduced a day earlier by Rep. Engel (D-N.Y.), which simply gave the FTC jurisdiction to classify spoofing as an "unfair or deceptive act." Engel's bill didn't mention the FCC. The FTC provision irked Rep. Murphy (R-Pa.), whose office phone number was among those appropriated by a spoofer in calls to constituents that made critical comments, *Wired News* and *National Review* reported. Murphy, who initially worked with Engel on the bill, came to see the FTC enforcement as too weak, investigation too slow, and likely penalties for violation too small.

FTC = Federal Trade Commission.



 Print this article

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## Scam Artists Dial for Dollars on Internet Phones

Sun Mar 20, 2005 09:40 AM ET

By Andy Sullivan

WASHINGTON (Reuters) - Internet phone services have drawn millions of users looking for rock-bottom rates. Now they're also attracting identity thieves looking to turn stolen credit cards into cash.

Some Internet phone services allow scam artists to make it appear that they are calling from another phone number -- a useful trick that enables them to drain credit accounts and pose as banks or other trusted authorities, online fraud experts say.

"It's like you've handed people an entire phone network," said Lance James, who as chief technology officer of Secure Science Corp. sees such scams on a daily basis.

The emerging scams underline the lower level of security protecting Voice Over Internet Protocol, or VOIP, the Internet-calling standard that has upended the telecommunications industry over the past several years.

Traditional phone networks operate over dedicated equipment that is difficult for outsiders to penetrate. Because VOIP calls travel over the Internet, they cost much less but are vulnerable to the same security problems that plague e-mail and the Web.

Internet worms that snarl online networks can render VOIP lines unusable, and experts at AT&T say VOIP conversations can be monitored or altered by outsiders.

Federal Trade Commission Chairman Deborah Platt Majoras recently warned that unscrupulous telemarketers could use VOIP to blast huge numbers of voice messages to consumers, a technique known as SPIT, for "spam over Internet telephony."

All of these threats remain largely in the realm of theory. Caller ID spoofing, on the other hand, has emerged over the past six months as a useful tool for identity thieves and other scam artists, according to fraud experts.

### PRESIDENT BUSH ON THE LINE

Any reporter would scramble for a ringing phone that reads "White House media line" on its caller ID display.

But it's not the Bush administration on the line -- it's security instructor Ralph Echemendia, calling from a mobile phone on a remote Georgia highway.

"You can see how this sort of thing could be used in a very malicious way," said Echemendia, a security instructor at the Intense School, a technology training company.

Caller ID spoofing is not prohibited by law, but the Federal Communications Commission requires telemarketers to identify themselves accurately, a spokeswoman said.

Echemendia built his own system to spoof calls, but several free or low-cost services allow even technical novices to falsify caller ID information as well.

Debt collectors and private investigators use Camophone.com's 5-cents-per-call service to trick people into answering the

phone, according to messages posted on a discussion board.

Traveling salesmen say the service comes in handy when they want clients to return calls to the main office, rather than their motel room.

James said criminal uses of caller-ID spoofing have become common over the last six months.

Wire-transfer services like Western Union (FDC.N: Quote, Profile, Research) require customers to call from their home phone when they want to transfer money in an effort to deter fraud -- a barrier easily sidestepped by any identity thief using a caller-ID spoofing service.

Fraud rings can now transfer money directly out of stolen credit-card accounts, rather than buying merchandise and reselling it, he said.

Western Union spokeswoman Danielle Periera said the company has no other way to verify that transfer requests are valid.

"We try hard to stay one step ahead of them and recognize that scam artists are sophisticated and often change their schemes," she said.

Criminals can use caller-ID spoofing to listen to other people's voice mail, James said, especially when those accounts are not protected by passwords.

They also have begun to use the technology to make it appear that they are calling from a bank or other financial institution, said Dave Jevans, who chairs the Anti-Phishing Working Group, a banking-industry task force.

That helps them convince consumers to divulge account numbers, passwords and other sensitive information in a scam that echoes the "phishing" e-mails that have become common, he said.

VOIP industry pioneer Jeff Pulver, whose Free World Dialup service can be used to spoof calls, said he couldn't prevent abuse of his system.

The problem will likely recede as companies like VeriSign Inc. (VRSN.O: Quote, Profile, Research) and NeuStar Inc. develop ways to verify online identities, he said: "We're not there yet, but we're going to get there."

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February 23, 2007

The Honorable Mike Chenault, Co-Chair  
House Finance Committee  
Alaska State Capitol, Room 505  
Juneau, AK 99801-1182

The Honorable Kevin Meyer, Co-Chair  
House Finance Committee  
Alaska State Capitol, Room 515  
Juneau, AK 99801-1182

RE: HB 7 (Lynn)—Support

Dear Co-Chairs Chenault and Meyer:

On the behalf of the members of AARP in Alaska, we strongly encourage you and your colleagues of the House Judiciary Committee to support HB 7, authored by Representatives Bob Lynn and Berta Gardner, Buch, and Doogan.

**Well over half of the number of people targeted by telemarketers each day are over the age 50 and over — and many of them are your own constituents.**

AARP's survey of older telemarketing fraud victims revealed they find it almost impossible to tell the difference between fraudulent and legitimate sales calls, underscoring the importance of allowing the consumer to stop calls in the first place.

Even though baby boomers have been called the most savvy and informed consumers of any generation of Americans, many of them, like their parents and their children, have been victims of unrelenting deluge of unwanted telemarketing sales calls.

The FTC does not regulate false caller ID (spoofing). The FTC only regulates telemarketers who use phony caller ID to contact people whose numbers are listed on the National Do Not Call Registry. Therefore, state law is crucial to cover any Alaska false caller ID calls.

The FTC has no jurisdiction over common carriers (such as long-distance companies or airlines), banks, credit unions, insurance companies, or private calls. There are no limitations on the states to regulate these calls and state law is needed to address the exemption to the FTC rule.

Why should caller ID spoofing be a key issue for legislators?

The number of unsolicited telemarketing calls that residents of Alaska receive is staggering. These calls present a significant privacy concern for individuals who believed Caller IDs would protect them from multiple, daily intrusions into their privacy.

In today's information technology age, constituents value their privacy more than ever. AARP believes that, as consumers, they have the right to be free from unsolicited calls into their homes, and they shouldn't have to worry about false caller identification on their Caller IDs.

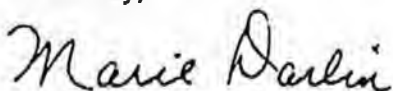
In the last few years caller ID spoofing had made it easier for telemarketers and predators to prey on Alaska's most vulnerable -- children and the elderly. The elderly and children are most vulnerable because they are home during the time telemarketers like to call.

We look forward to your support of this bill in the House Judiciary Committee and we sincerely thank you in anticipation of that support.

Should you have any questions about our position, please feel free to contact me (586-3637) or Patrick Luby, AARP Advocacy Director (907-762-3314).

Thank you for your consideration.

Sincerely,



Marie Darlin, Coordinator  
AARP Capital City Task Force  
415 Willoughby Avenue, Apt. 506  
Juneau, AK 99801  
586-3637 (voice)  
463-3580 (fax)

CC: Vice-Chair Bill Stoltze  
Representative Richard Foster  
Representative Mike Hawker  
Representative Bill Thomas  
Representative Harry Crawford  
Representative Les Gara  
Representative Reggie Joule  
Representative Mike Kelly  
Representative Mary Nelson  
Representative Bob Lynn  
Representative Berta Gardner

**HB**

**13**

**HFIN**

**FILE**

**HOUSE COMMITTEE REPORT**

(11)

Date Referred to Committee: March 26, 2007

FURTHER REFERRALS:

Date of Committee Action: 4-20-07

The FINANCE Committee considered:

HB 13

**HOUSE BILL NO. 13**

**RETIREMENT SYSTEM LIABILITY/BONDS/CORP.**

"An Act relating to prepayments of accrued actuarial liabilities of government retirement systems; relating to the Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority to assist state and municipal governmental employers by issuing bonds, notes, commercial paper, or other obligations to enable the governmental employers to prepay all or a portion of the governmental employers' shares of the unfunded accrued actuarial liabilities of retirement systems; authorizing a governmental employer to issue obligations to prepay all or a portion of the governmental employer's shares of the unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or other contractual agreement with a trustee or the Alaska Municipal Bond Bank Authority or a subsidiary of the authority in connection with the issuance of obligations for that purpose, and relating to those obligations; and providing for an effective date."

Recommends it be replaced with  HCS or  CS for HB 13 (FIN)  
 For Senate Bills with new title:  Technical Title  New Title: HCR \_\_\_\_\_  Same Title  New Title

- attach amendments
- add new referral to \_\_\_\_\_ Committee
- Letter of Intent \_\_\_\_\_ Committee

List of Abbrev for Depts.:  
 ADM  
 CED  
 COR  
 CRT  
 EED  
 DEC  
 DFG  
 GOV  
 HSS  
 LWF  
 LAW  
 LEG  
 MVA  
 DNR  
 DPS  
 REV  
 DOT  
 UA

HE

<u>NEW FISCAL NOTES</u>				
*Assigned by Chief Clerk's Office				
List by Dept(s):	*FN#	Fiscal	Indet.	Zero
ADM			✓	

<u>PREVIOUS FISCAL NOTES</u>				
List by Dept(s):	FN#	Fiscal	Indet.	Zero
RCU	1			✓

<u>Signing with recommendations</u>	Printed Last Name	DP	DNP	NR	AM
<i>[Signature]</i>	Gara			✓	
Harry Crawford Jr	CRAWFORD	✓			
Will Bell	Thomas	✓			
Michael Kelly	KELLY	X			
Michael Kelly	Hawker	X			
Chair: K. Meyer	Meyer	✓			
Chair: Mike Chew	Chew			X	

# FISCAL NOTE

**STATE OF ALASKA**  
**2007 LEGISLATIVE SESSION**

Fiscal Note Number: 1  
 Bill Version: CSHB 13(W&M)  
 (H) Publish Date: 3/7/07

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: Revenue  
 Title Pension Obligation Bonds RDU Taxation and Treasury  
 Component Treasury  
 Sponsor Representative Hawker  
 Requester House Ways and Means Component No. 121

**Expenditures/Revenues (Thousands of Dollars)**

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>						
-----------------------------	--	--	--	--	--	--

<b>CHANGE IN REVENUES ( )</b>						
-------------------------------	--	--	--	--	--	--

**FUND SOURCE (Thousands of Dollars)**

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
Bond Proceeds						
Bond Bank Operating Budget						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2007) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal:

**POSITIONS**

Full-time						
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)

The bill expands the powers of the Alaska Municipal Bond Bank Authority (Bond Bank) and the State Bond Committee (SBC) and creates the Pension Obligation Bond Corporation (POBC) for the purpose of issuing obligations to provide funds to prepay unfunded accrued actuarial liabilities of the retirement systems. The premise of undertaking this type of transaction is borrowing at rates that are at least 1.5% lower than the actuarial assumed rate of return on the pension funds (8.25%).

The fiscal note is indeterminate in cost as it is uncertain how or if a transaction will develop if the legislation is passed. If a transaction is undertaken it is likely that it will be of considerable size, up to several billion dollars, and occur in FY 2008. Contractual costs include rating agency fees, financial advisor, bond counsel, printing, cusip service, underwriting, & other miscellaneous costs would need to be funded in the year of issuance as well as ongoing costs for administrative monitoring and cost of contractors over the life of the bonds.

Prepared by: Deven Mitchell  
 Division: Treasury  
 Approved by: Jerry Burnett  
 Agency: Department of Revenue

Phone 465-3750  
 Date/Time 3/6/07 12:00 AM  
 Date 3/6/2007

# FISCAL NOTE

STATE OF ALASKA  
2007 LEGISLATIVE SESSION

Fiscal Note Number: \_\_\_\_\_  
Bill Version: CS HB 13 (FIN)  
( ) Publish Date: \_\_\_\_\_

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: Administration  
Title Retirement System Liability/Bonds/Corp. RDU Centralized Administrative Services  
Component Retirement and Benefits  
Sponsor Representative Hawker  
Requester House Finance Committee Component No. 64

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	*	*	*	*	*	*

<b>CAPITAL EXPENDITURES</b>						
-----------------------------	--	--	--	--	--	--

<b>CHANGE IN REVENUES ( )</b>						
-------------------------------	--	--	--	--	--	--

**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (specify type)						
<b>TOTAL</b>	*	*	*	*	*	*

Estimate of any current year (FY2007) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal:

**POSITIONS**

Full-time						
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)

This bill will require that the division develop an accounting structure within both PERS and TRS to keep track of lump sum payments and the related disposition of such balances separately from all other employer contributions. Staff will allocate operating costs and investment earnings to these lump sum balances and provide an accounting of activity to employers at least annually. The division will work with the Department of Law to develop regulations to govern the accounting for such accounts.

The House Finance Committee finds the cost of implementing the provisions of HB 13 should be recognized as indeterminate at this time.

Prepared by: House Finance Committee  
Division: \_\_\_\_\_  
Approved by: Representative Moyer  
Representative Chonault

Phone 465-4945  
Date/Time 04/23/07 10:50 a.m.  
Date 4/23/2007

4-20-07

**State of Alaska**  
***POB Issuance Illustrations***

March 20, 2007

**Prepared by:**  
**Jason Ellement FSA, CFA**  
**Investment Consultant**  
**Michael J. O'Leary CFA**  
**Executive Vice President**  
**Callan Associates Inc.**



# Overview & Description

---

- Callan was asked to illustrate the range of possible outcomes associated with issuing \$2 billion in Pension Obligation Bonds (POBs) using the following assumptions:
  - ✓ POB interest rate of 5.7%
  - ✓ Mortgage like level repayment pattern over a 25 year period
  - ✓ Callan's standard capital market projections
  - ✓ Multiple asset allocation policies starting with 100% stocks
- We also were asked to stress test the results by presuming that the initial year produced a negative return.
- The results presented on the following pages simply illustrate the order of magnitude and range of possibilities for investing the POB proceeds. The results do not consider the effects on annual pension contribution levels or funded status.

# Asset Mixes

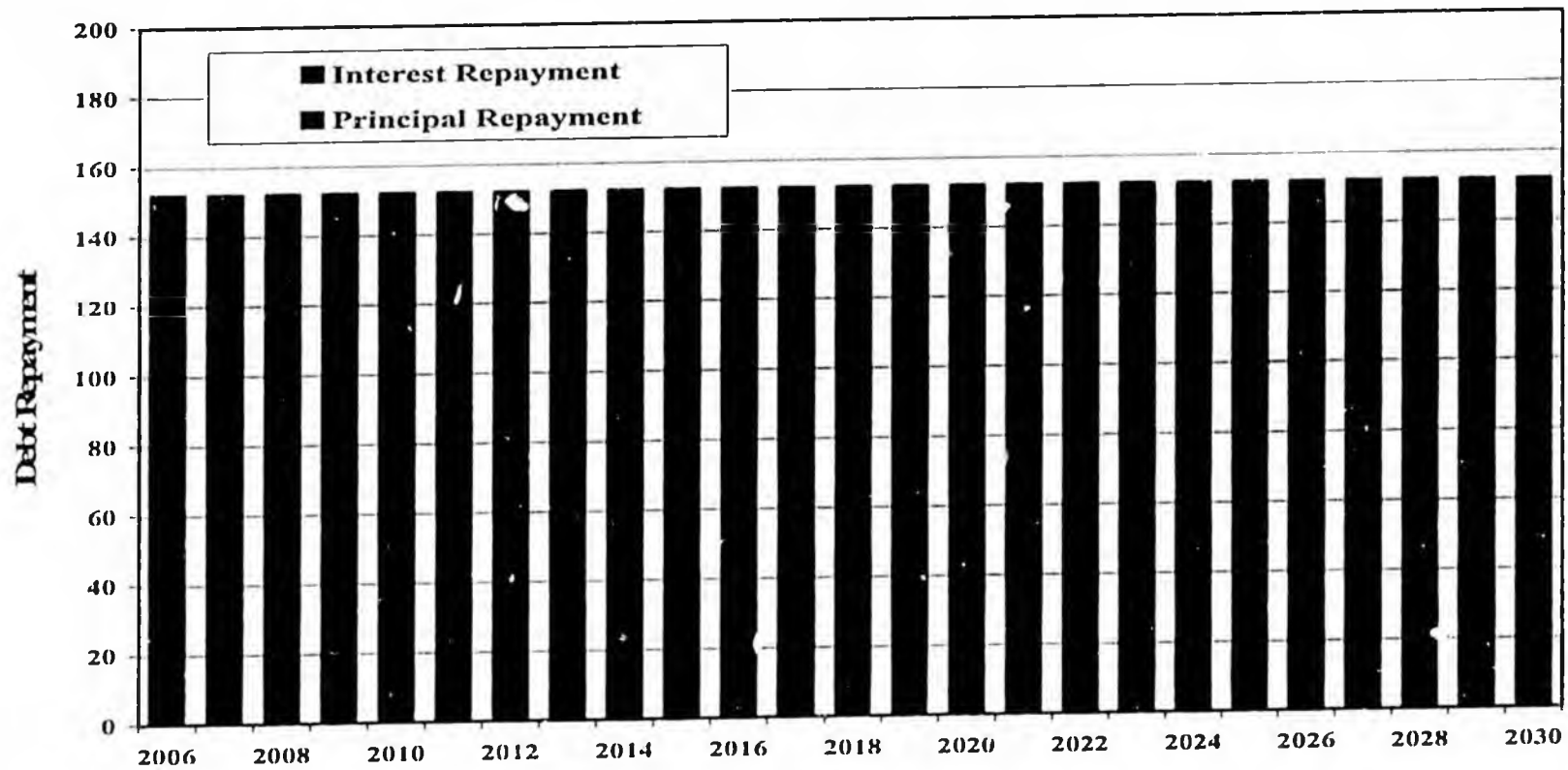
	45/55 Mix	65/35 Mix	85/15 Mix	100% SP500
Large Cap U.S. Equity	34%	49%	64%	100%
Non-U.S. Equity	11%	16%	21%	0%
U.S. Fixed Income	55%	35%	15%	0%
Total	100%	100%	100%	100%

Equity	45%	65%	85%	100%
Bonds	55%	35%	15%	0%

Expected Return	6.9%	7.7%	8.4%	8.9%
Standard Deviation (Risk)	8.2%	11.0%	13.9%	16.4%

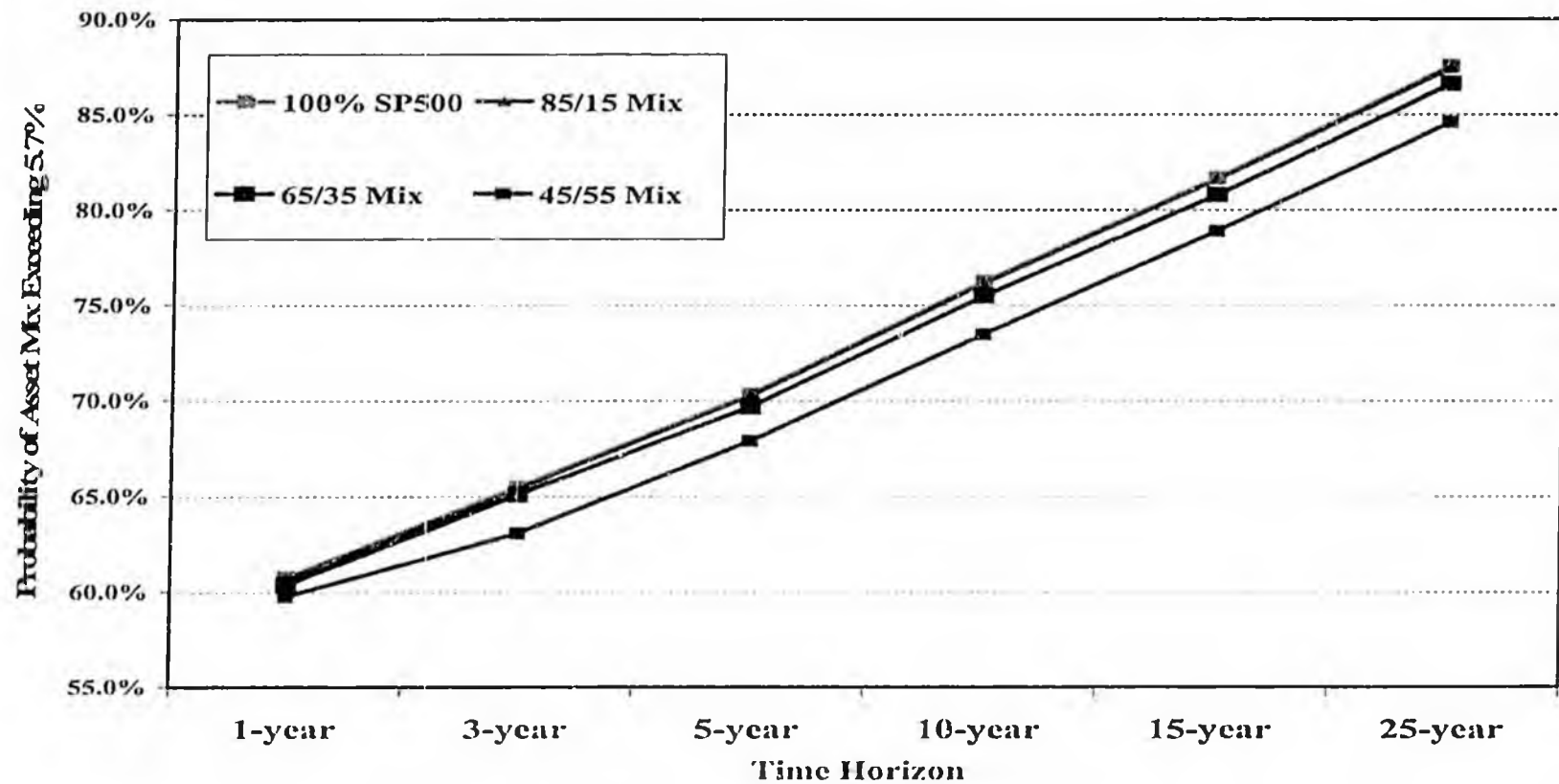
- A simplified range of asset mixes are examined in this study.
- The 65/35 mix is similar to traditional diversified pension fund portfolios.

# Assumed Debt Schedule



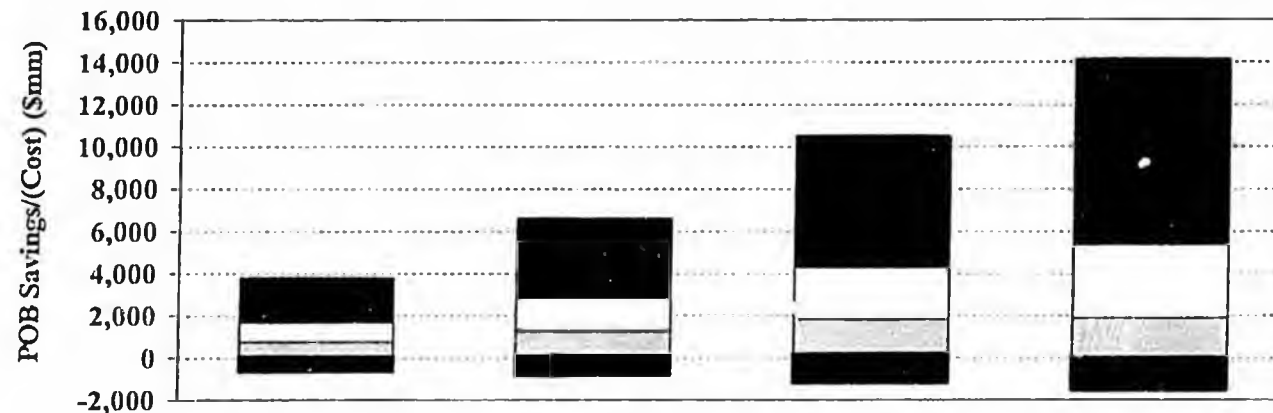
- Level annual payments = \$152 mm.
- Total principal repayment = \$2.0 bn.
- Total interest payments = \$1.8 bn

# Probability of Exceeding 5.70%



- There is a 13% probability that the 65/35 Mix will not exceed 5.7% over 25 years.

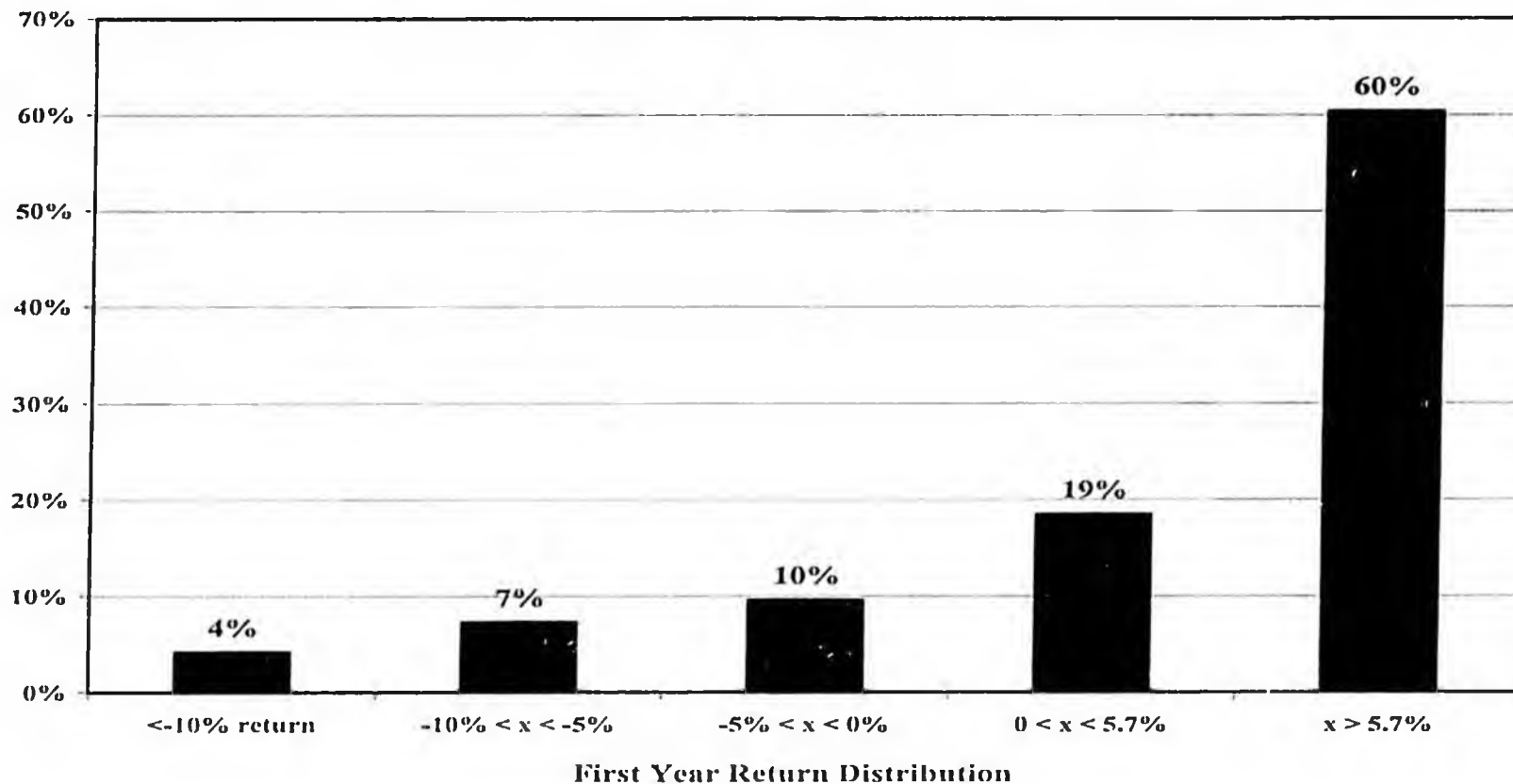
# POB Savings/(Cost)



	45/55 Mix	65/35 Mix	85/15 Mix	100% SP500
5th Percentile	3,809	6,632	10,530	14,156
25th Percentile	1,667	2,797	4,284	5,361
50th Percentile	758	1,272	1,837	1,889
75th Percentile	99	190	244	36
95th Percentile	-642	-847	-1,189	-1,554

- POB savings/(cost) = POB proceeds and investment earnings less debt payments over the entire 25-year period.
- POB savings/(cost) are in today's dollars (discounted for simulated inflation).

# Distribution of One-Year Return

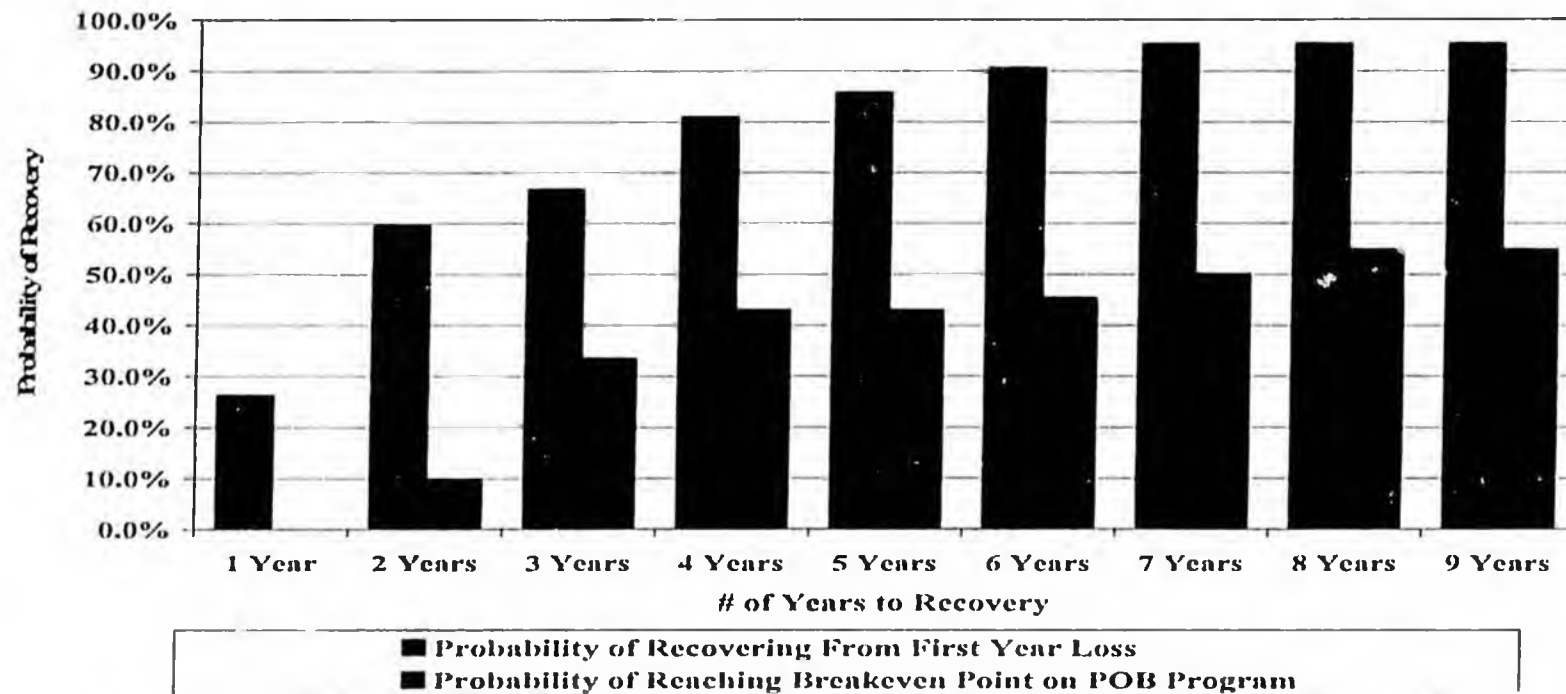


- Probability that one-year return is less than -5.0% = 11%.
- Probability that one-year return is less than 5.7% = 40%.

# Years to Recovery

## First Year Return < -10%

Years to Recovery over 10-Year Horizon  
First Year Return < -10%

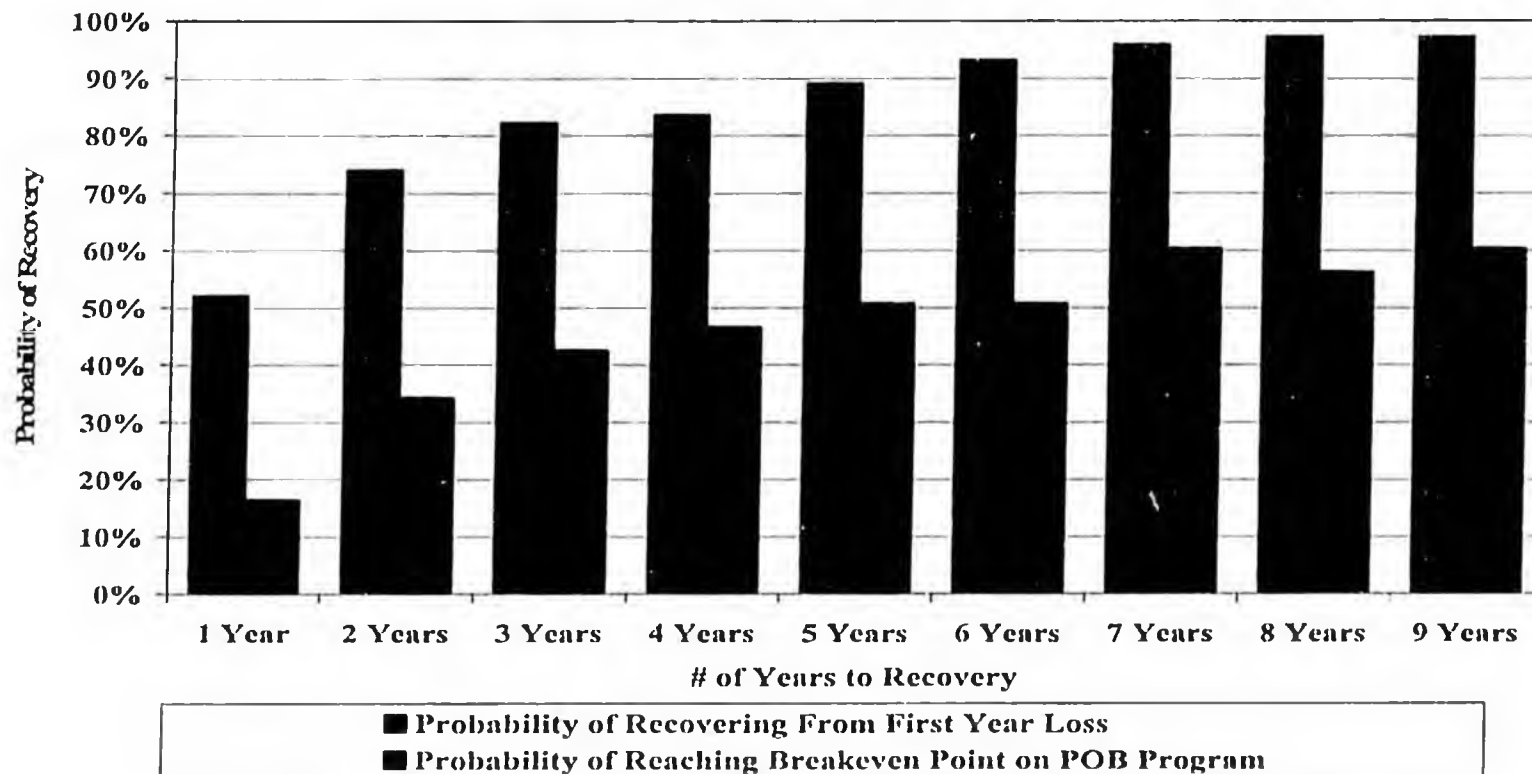


- Probability of recovering from first year loss is equivalent to the probability of POB assets exceeding \$2 bn.
- Probability of reaching breakeven point is equivalent to probability of POB assets exceeding  $\$2 \text{ bn} \times 1.057^{(\# \text{ of years to recovery})}$ .

# Years to Recovery

## -10% < First Year Return < -5%

Years to Recovery over 10-Year Horizon  
-10% < First Year Return < -5%



- As expected, probability of recovery is higher if first year loss is smaller.

# Conclusion

---

- Issuing POBS and investing the proceeds in higher yielding securities is a leveraged investment strategy.
  - ✓ Does not guarantee savings via earnings arbitrage or refinancing of debt at a lower rate.
  - ✓ The success of a POB program will depend on whether the investment of the POB proceeds earns a higher return than the cost of borrowing.
- Over the long run, a POB program that is prudently implemented has a high probability of success. Some factors that constitute a prudent POB program:
  - ✓ Cost of borrowing is low. Issuing POBS at high interest rates and back-loading debt repayment increase the return hurdle.

# Conclusion

---

- ✓ Amount of debt issuance is reasonable. If POB proceeds are large relative to size of pension fund, a Plan Sponsor may be unable to simultaneously make large pension contributions (due to investment losses) and service debt schedule.
  - ✓ Asset allocation of POB proceeds is appropriate given the cost of borrowing, and financial ability of the sponsor to manage pension contributions in a worse-case scenario.
  - ✓ 100% of POB proceeds are invested in Plan to reduce the pension deficit. POB proceeds are not used to cover future contributions.
- POB programs that have been unsuccessful in the past have used too much leverage and/or issued when interest rates were high.

4-20-07



# Pension Obligation Bonds

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April 20, 2007

Department of Revenue



---

# **Overview of Pension Obligation Bonds (POBs)**

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# Pension Obligation Bonds (POBs)

---

- Pension Obligation Bonds are bonds issued by a state or local government to pay its obligation to the pension system in which its employees are members.
- POBs have been an increasingly popular and successful way for state and local governments to accomplish financial objectives.
- According to Thomson Financial, during the past decade there have been 340 POB issues by state and local government issuers in at least 26 states.

# Why Should We Consider Issuing POBs?

---

- Interest rate savings – the interest rate of POBs issued in the near future will be lower than 8.25% charged by the pension system.
- Arbitrage – the actual investment return of pension asset exceeds the POB cost.
- POBs are not generally viewed as adding to the debt burden of the state or local government issuer because they replace existing pension obligations.

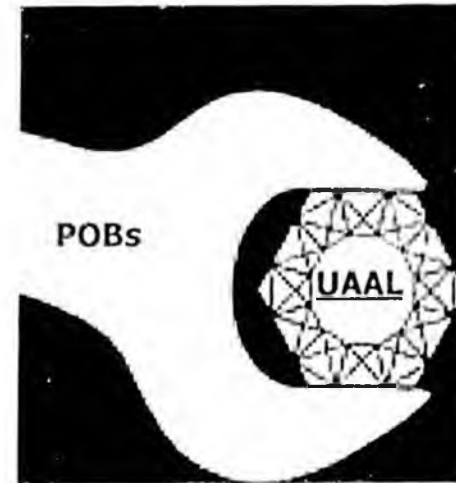
# POBs Are:

**Not ...**



Golden Bullet

**But ...**



Financial Tool

# Alaska Pension Bill/Unfunded Actuarial Accrued Liability (UAAL) in 2006

Total \$8.6 Billion:

\$5.5 Billion PERS

\$3.1 Billion TRS



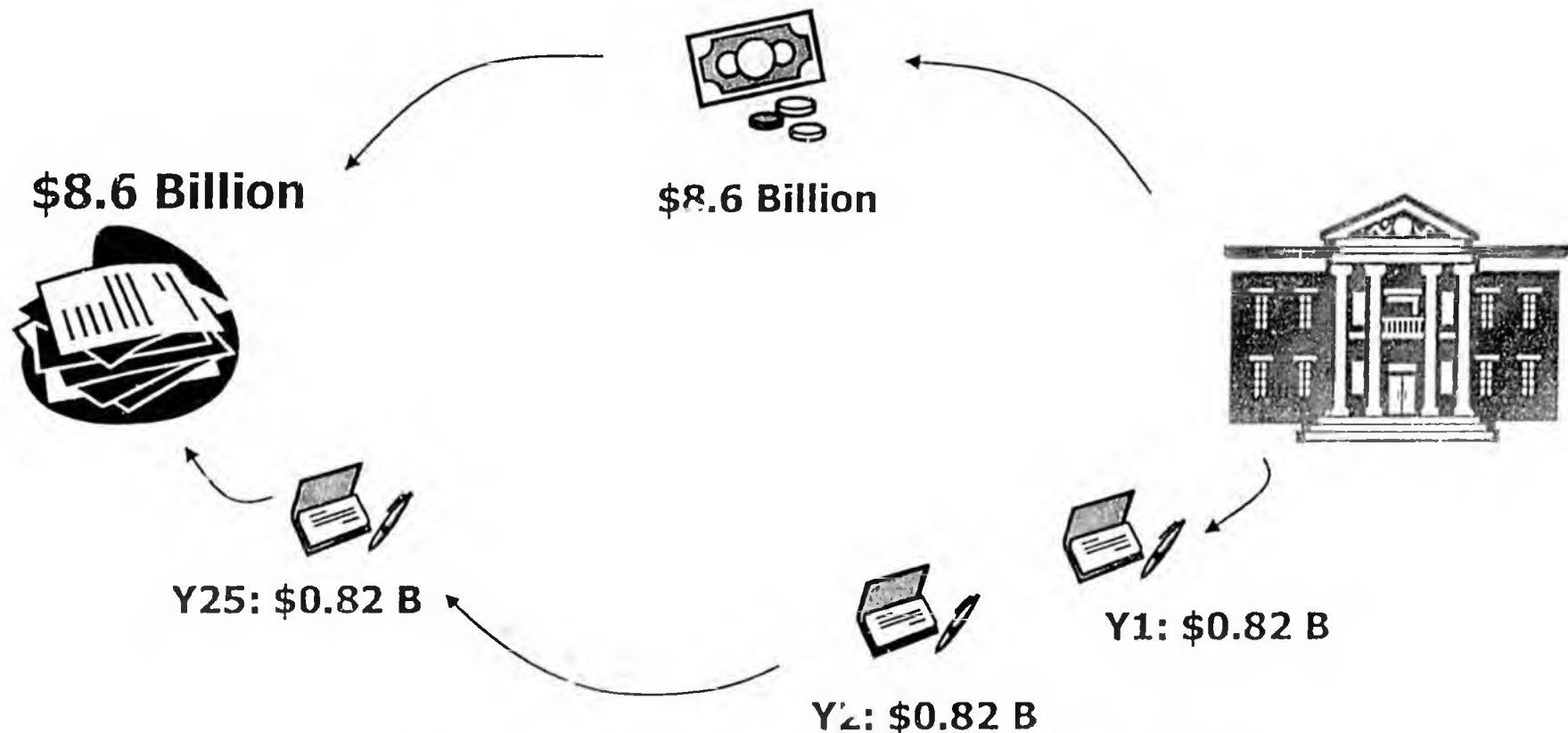
**AK Pension System**



**State & Local  
Governments**

# Paying the Bill/UAAL

## Option A: Pay the total with Cash



## Option B: A "loan" of 25 years at 8.25% cost



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# **Interest Rate Savings**

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# Interest Rate Savings

Comparing the amortization of \$1 billion debt at 8.25% cost to \$1 billion debt at 5.75% over 25 years:

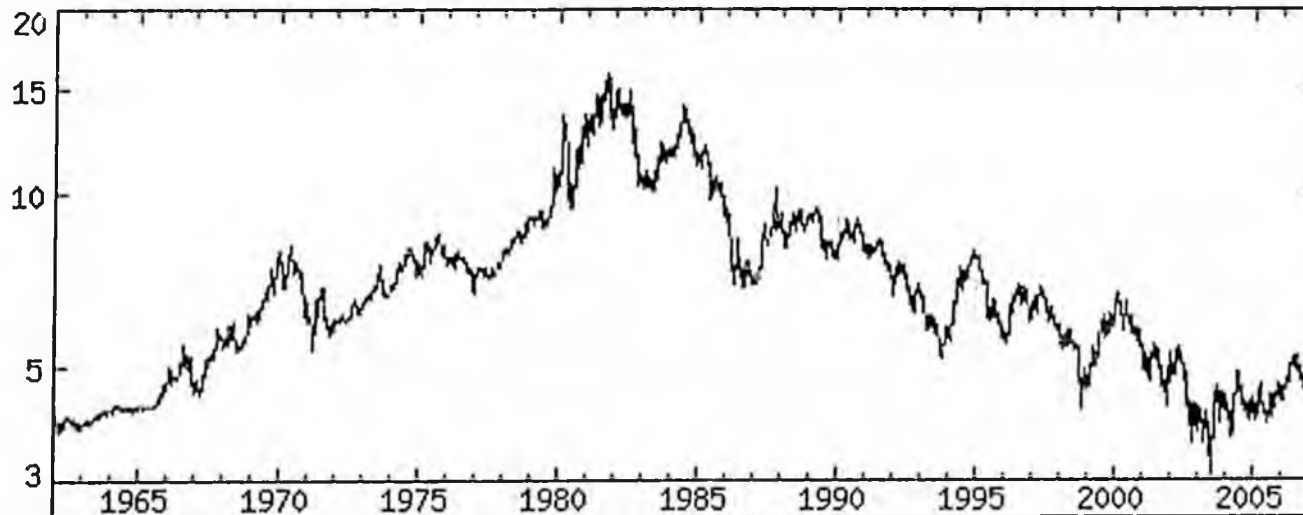
- Saving on interest cost is 2.5%;
- Saving on annual debt payment is \$19 million;
- NPV of savings on annual debt payment over 25 years is \$272 million discounted at 5%.

	<b>Amount (\$MM)</b>	<b>Interest Cost</b>	<b>Annual P&amp;I Payment</b>
<b>Old Debt</b>	\$ 1,000	8.25%	\$ 96
<b>New Debt</b>	\$ 1,000	5.75%	\$ 76
<b>Savings</b>		2.50%	\$ 19
<b>NPV of Cumulative Savings @ 5%</b>			\$ 272

# Interest Rate History

- 10-Year Treasury yield is 4.52% as of March 14, 2007. This rate is extraordinarily attractive when viewed in a historical context.

## 10-Year Treasury Yields





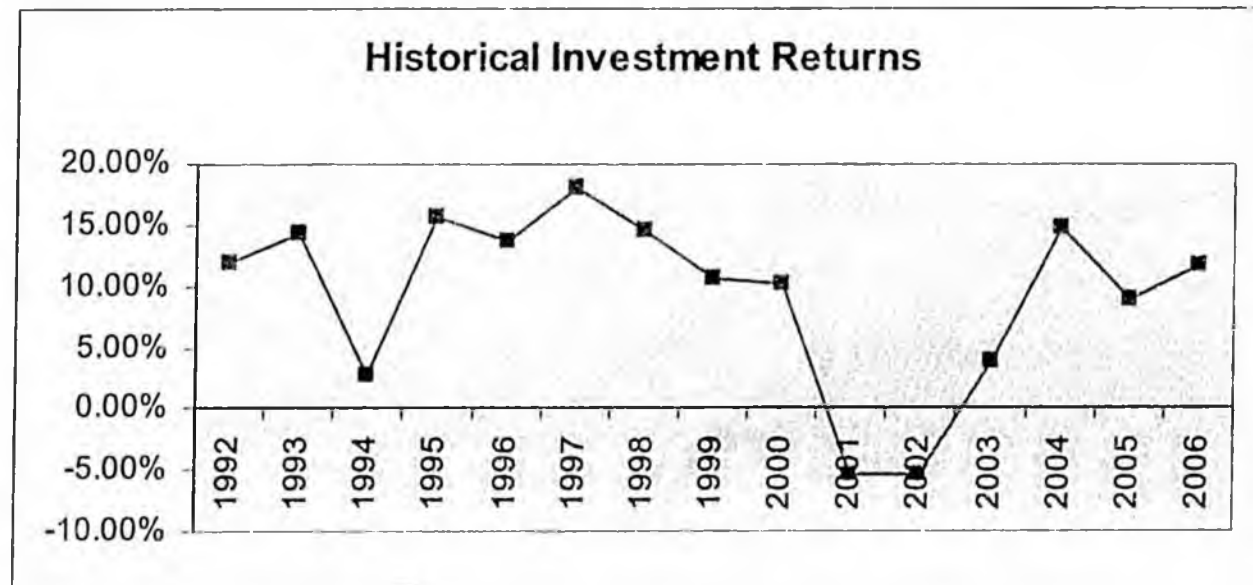
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# Arbitrage

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# Historical Investment Returns of State Pension Plans (PERS)

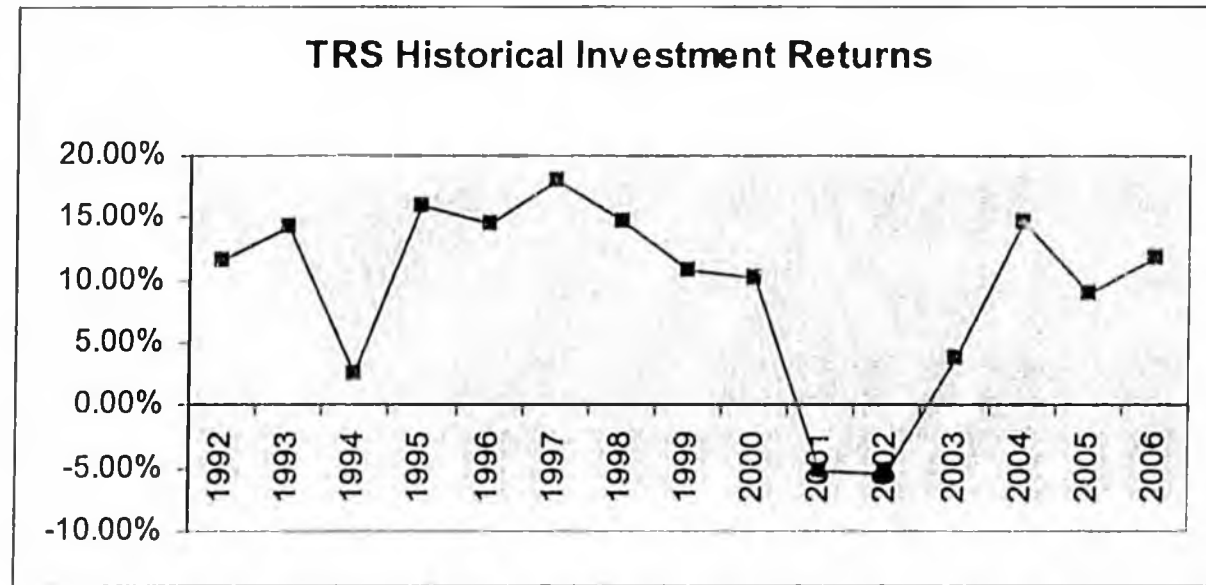
FY	ROR
2006	11.69%
2005	8.86%
2004	14.73%
2003	3.82%
2002	-5.40%
2001	-5.30%
2000	10.12%
1999	10.65%
1998	14.62%
1997	18.07%
1996	13.70%
1995	15.56%
1994	2.66%
1993	14.25%
1992	11.80%



- The average return from 1992 to 2006 is 9.09%.
- Standard Deviation is 7.25%.

# Historical Investment Returns of State Pension Plans (TRS)

FY	ROR
2006	11.72%
2005	8.90%
2004	14.75%
2003	3.81%
2002	-5.41%
2001	-5.36%
2000	10.19%
1999	10.73%
1998	14.73%
1997	18.00%
1996	14.35%
1995	15.89%
1994	2.61%
1993	14.16%
1992	11.58%



- The average return from 1992 to 2006 is 9.14%.
- Standard Deviation is 7.31%.

# Long Term Target Asset Allocation

<b>Asset Class</b>	<b>Allocation</b>	<b>Range</b>
Domestic Large Capitalization	30%	± 3%
Domestic Small Capitalization	6%	± 3%
International Equity	14%	± 3%
Emerging Markets Equity	2%	± 2%
Private Equity	7%	± 5%
Domestic Fixed-Income	20%	± 3%
High Yield	2%	± 2%
International Fixed-Income	2%	± 2%
Real Estate	10%	± 4%
Absolute Return	4%	± 4%
Other	3%	± 3%
Cash	0%	± 3%

**Median Return**            **8.05%**  
**Standard Deviation**    **12.27%**



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# **Credit Neutrality**

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# Credit Rating Consideration

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- Credit Neutral – debt obligation is already recognized and POBs are not considered new debt.
- “Moody’s believes the issuance of POBs is one effective way of addressing an unfunded liability.”
- “Standard & Poor’s has viewed POBs as a strategy for savings on carrying charges as long as the transaction are structured conservatively and the assumptions were reasonable and attainable.”

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# Risks

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# Risks Overview

- Investment Risk – POB financing is successful as long as the return of investment of proceeds exceed POB cost.
- Political Risk – Overfunded pension system can lead to political pressure to increase pension benefits, which can cause further increased pension liability in the future.
- Market Risk – Prudent investment of POB proceeds in early years is important.
- Debt Service Risk – With the issuance of POBs, the state and local governments are obligated to make annual debt service payments while POBs are outstanding.



# Investment Risk Analysis

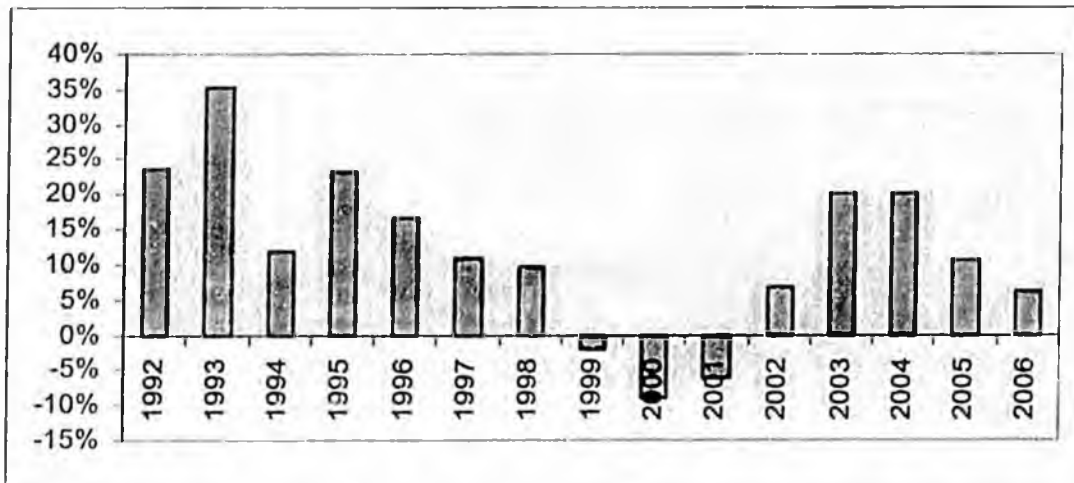
As long as those bond-funded assets earn more than 5.75%, we are better off for having borrowed.

- With the current low interest rate environment, POF issuance with cost around 5.75% is achievable.
- Historical investment returns of PERS and TRS indicate that we can outperform 5.75% most of the time.
- Simulations of future investment returns show that there are high possibility that we are going to outperform 5.75%.

# Investment Risk (PERS)

FY	PF ROR	PERS ROR	Estimated Cost of Borrowing	Estimated Cumulative PERS Net Return to 2006
2006	8.66%	11.69%	5.55%	6.14%
2005	6.30%	8.86%	5.04%	10.47%
2004	5.95%	14.73%	5.02%	20.22%
2003	1.51%	3.82%	4.76%	20.06%
2002	1.17%	-5.40%	5.36%	6.90%
2001	5.20%	-5.30%	5.77%	-6.22%
2000	10.15%	10.12%	6.78%	-8.94%
1999	8.95%	10.65%	6.40%	-2.03%
1998	14.02%	14.62%	6.01%	9.70%
1997	12.14%	18.07%	7.10%	10.86%
1996	11.73%	13.70%	7.19%	16.47%
1995	6.99%	15.56%	7.32%	23.28%
1994	7.97%	2.66%	7.84%	11.86%
1993	9.55%	14.25%	6.62%	35.35%
1992	8.73%	11.80%	7.76%	23.43%

Estimated Cumulative Net Return to 2006 (PERS)

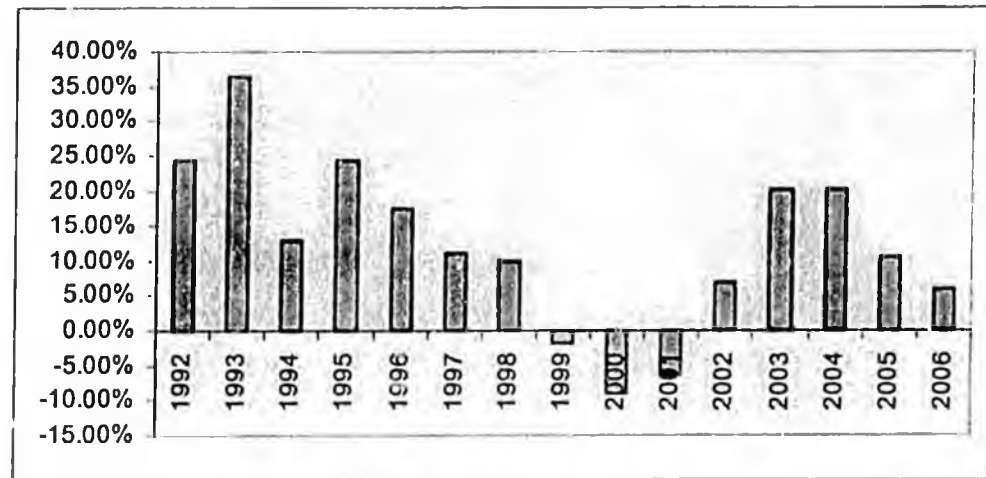


- Based on PERS actual investment history, we can see what the cumulative net return to 2006 might have been if POBs had been issued in any given year.
- For 12 out of 15 years the issuance of POBs would have resulted in a gain to the pension system.

# Investment Risk (TRS)

FY	PF ROR	TRS ROR	Estimated Cost of Borrowing	Estimated Cumulative TRS Net Return to
2006	8.66%	11.72%	5.55%	6.17%
2005	6.30%	8.90%	5.04%	10.54%
2004	5.95%	14.75%	5.02%	20.31%
2003	1.51%	3.81%	4.76%	20.14%
2002	1.17%	-5.41%	5.36%	6.97%
2001	5.20%	-5.36%	5.77%	-6.21%
2000	10.15%	10.19%	6.78%	-8.86%
1999	8.95%	10.73%	6.40%	-1.87%
1998	14.02%	14.73%	6.01%	9.97%
1997	12.14%	18.00%	7.10%	11.06%
1996	11.73%	14.35%	7.19%	17.32%
1995	6.99%	15.89%	7.32%	24.46%
1994	7.97%	2.61%	7.84%	12.99%
1993	9.55%	14.16%	6.62%	36.39%
1992	8.73%	11.58%	7.76%	24.25%

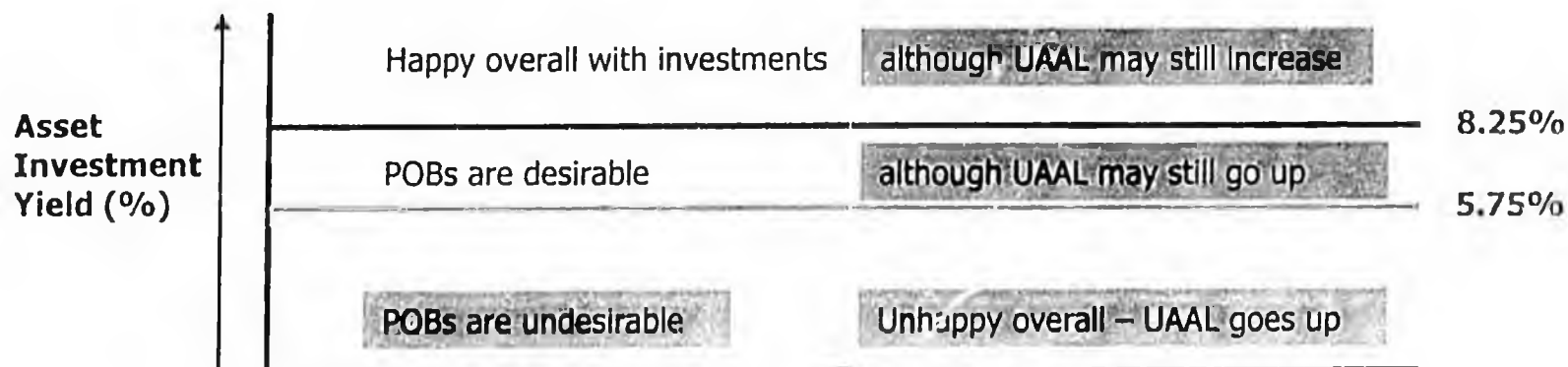
Estimated Cumulative Net Return to 2006 (TRS)



- Based on TRS actual investment history, we can see what the cumulative net return to 2006 might have been if POBs had been issued in any given year.
- For 12 out of 15 years the issuance of POBs would have resulted in a gain to the pension system.

# UAAL vs. POB Financial Success

- POB financing:
  - As long as those bond-funded assets earn  $> 5.75\%$ , we are better off for having borrowed.
  - However, even if the bond funded assets earn greater than their cost, the UAAL may still increase.
  - POB financing is undesirable if assets earn  $< 5.75\%$ .
- All other things equal, when PERS and TRS assets earn  $< 8.25\%$ , the UAAL goes up.
- Further, even if those assets earn  $> 8.25\%$ , the UAAL can increase due to actuarial and / or accounting changes.

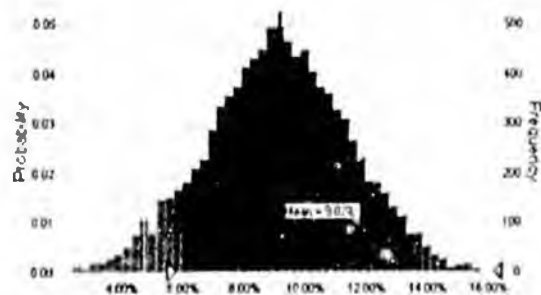
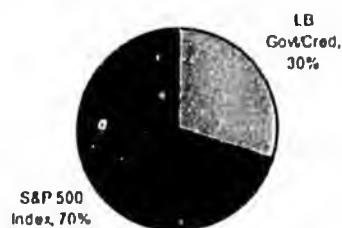


# Investment Return Forecast

Monte Carlo simulation with 10,000 iterations for each scenario.

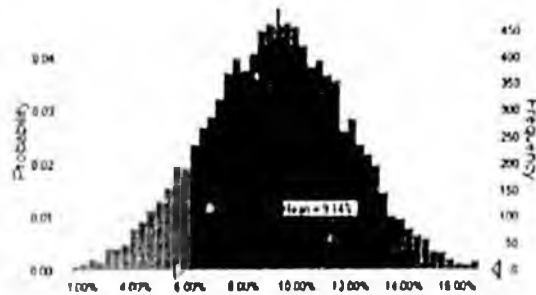
## Conservative – 70/30

Annualized Average Return	9.02%
Stand Deviation of Returns	2.36%
Probability of outperforming 5.75%	91.3%



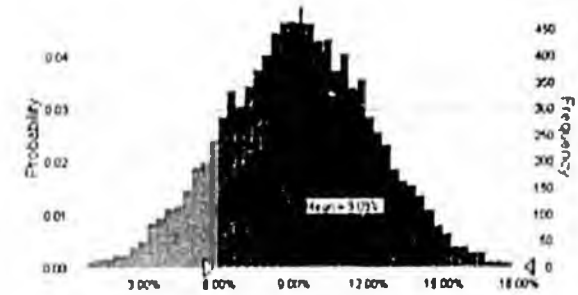
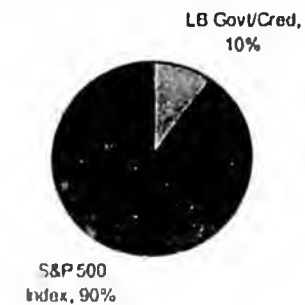
## Moderate – 80/20

Annualized Average Return	9.14%
Stand Deviation of Returns	2.7%
Probability of outperforming 5.75%	89.3%



## Aggressive – 90/10

Annualized Average Return	9.09%
Stand Deviation of Returns	3.01%
Probability of outperforming 5.75%	86.45%



# Political Risk – Key Driver of UAAL

Between 1992 and 2003, increasing liabilities – not poor investment performance – caused the most damage to the PERS/TRS system.

- Presented by State Actuary to ARM Board in 2005

## Changes in Assets Include:

- Investment performance (i.e. investment risk)

## Changes in Liabilities Include:

- Health benefits cost experience
- Health assumption changes
- Plan changes
- Demographic experience
- Non-health changes

## Drivers of PERS/TRS Funding Ratio Changes ( 1992-2003)

	PERS Change in Funded Status	TRS Change in Funded Status
Change Due to Assets	-3.8%	-2.7%
Change Due to Liabilities	-18.5%	-26.6%
<b>Total Change in Funded Status</b>	<b>-22.3%</b>	<b>-29.3%</b>

# Political Risk

High amount of FOBs proceeds may cause the pension system to be over-funded, which could lead to political pressure calling for benefit increases that incur new liabilities in the future.

## Risk Control:

- POBs are not issued for the full UAAL; a funded ratio of 70-80% is an industry standard.
- Manage pension benefits and UAAL with discipline.

# Market Risk

POBs proceeds cause a large amount of capital infusion into the pension system at once. Prudent investment of the proceeds in early years is critical.

## Risk Control:

- Thorough market assessment before POB issuance;
- Considering whether to have a special investment allocation strategy for the proceeds, or stick with the traditional allocations.



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# **Types of POBs**

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# Security

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- **General obligation bonds**

Bonds that satisfy any constitutional debt limitation and are backed by the full faith and credit and taxing power of the issuing state and local government.

- **Obligations imposed by law**

Obligations imposed by the state or local government by the constitution or by statute or by court judgment as distinguished from a voluntary exercise of the borrowing power by the state or local government.

- **Annual appropriation bonds**

Bonds that are not considered debt subject to a constitutional debt limitation because the state and local government issuer has no legal obligation to pay them and payment is therefore subject to annual appropriation of funds for that purpose at the discretion of the legislature or governing body of the state or local government issuer.

- **HB13 Restriction**

Please note that HB13 Sec. 37.15.900(b) indicates that "The bonds do not constitute a general obligation of the state."



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# Potential Savings

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# POBs and Cash Infusion

Pay partial UAAL off with cash and borrow partial at 5.75% by issuance of Pension Obligation Bonds (POBs).

## Implications

- Immediate reduction of the UAAL;
- Increase in the Funded Ratio;
- Reduction of employer past service contribution rate.

# Case Study (PERS)

**Employer Contribution Rates**  
POBs (in billions)

Cash (in billions)	POBs (in billions)							
	\$ -	\$ 0.5	\$ 1.5	\$ 2.5	\$ 3.5	\$ 4.5	\$ 5.5	
	0%	9%	27%	45%	64%	82%	100%	
\$ -	44.49%	43.91%	42.76%	41.61%	40.46%	39.31%	38.15%	
\$ 0.5	41.64%	41.06%	39.91%	38.76%	37.60%	36.45%		
\$ 1.5	35.93%	35.35%	34.20%	33.05%	31.90%			
\$ 2.5	30.22%	29.64%	28.49%	27.34%				
\$ 3.5	24.51%	23.94%	22.78%					
\$ 4.5	18.80%	18.23%						
\$ 5.5	13.09%							

**Savings on Annual Contribution Amount (in millions)**  
POBs (in billions)

Cash (in billions)	POBs (in billions)							
	\$ -	\$ 0.5	\$ 1.5	\$ 2.5	\$ 3.5	\$ 4.5	\$ 5.5	
	0%	9%	27%	45%	64%	82%	100%	
\$ -	\$0.00	\$9.65	\$28.96	\$48.27	\$67.58	\$86.89	\$106.20	
\$ 0.5	\$47.84	\$57.50	\$76.81	\$96.12	\$115.43	\$134.73		
\$ 1.5	\$143.53	\$153.19	\$172.49	\$191.80	\$211.11			
\$ 2.5	\$239.22	\$248.87	\$268.18	\$287.49				
\$ 3.5	\$334.91	\$344.56	\$363.87					
\$ 4.5	\$430.59	\$440.25						
\$ 5.5	\$526.28							

**Savings on Employer Contribution Rates**  
POBs (in billions)

Cash (in billions)	POBs (in billions)							
	\$ -	\$ 0.5	\$ 1.5	\$ 2.5	\$ 3.5	\$ 4.5	\$ 5.5	
	0%	9%	27%	45%	64%	82%	100%	
\$ -	0.00%	0.58%	1.73%	2.88%	4.03%	5.18%	6.34%	
\$ 0.5	2.85%	3.43%	4.58%	5.73%	6.88%	8.04%		
\$ 1.5	8.56%	9.14%	10.29%	11.44%	12.59%			
\$ 2.5	14.27%	14.85%	16.00%	17.15%				
\$ 3.5	19.98%	20.55%	21.71%					
\$ 4.5	25.69%	26.26%						
\$ 5.5	31.40%							

**NPV of Savings on 25-year Contribution Amount (in millions)**  
POBs (in billions)

Cash (in billions)	POBs (in billions)							
	\$ -	\$ 0.5	\$ 1.5	\$ 2.5	\$ 3.5	\$ 4.5	\$ 5.5	
	0%	9%	27%	45%	64%	82%	100%	
\$ -	\$0.00	\$136.07	\$408.21	\$680.36	\$952.50	\$1,224.64	\$1,496.78	
\$ 0.5	\$674.31	\$810.38	\$1,082.52	\$1,354.66	\$1,626.80	\$1,898.95		
\$ 1.5	\$2,022.92	\$2,158.99	\$2,431.13	\$2,703.27	\$2,975.42			
\$ 2.5	\$3,371.53	\$3,507.60	\$3,779.74	\$4,051.89				
\$ 3.5	\$4,720.14	\$4,856.21	\$5,128.35					
\$ 4.5	\$6,068.75	\$6,204.82						
\$ 5.5	\$7,417.37							

1. \$1.5 billion POBs issued in 2007
2. Assumed \$5.5 billion PERS UAAL in 2007
3. Annual employer contribution amount for Tiers I, II, and III would be \$745.79 million without POBs starting in 2007
4. Funding ratio will be improved from 65.12% to 74.64% (based on preliminary \$10.27 billion PERS asset as of Dec 31, 2006)

# Case Study (TRS)

**Employer Contribution Rates**  
POBs (in billions)

Cash (in billions)	POBs (in billions)					
	\$ -	\$ 1.0	\$ 2.0	\$ 3.0	\$ 3.1	
	0%	32%	65%	97%	100%	
\$ -	57.65%	54.45%	51.25%	48.04%	47.72%	
\$ 0.5	49.72%	46.51%	43.31%	40.11%		
\$ 1.0	41.78%	38.58%	35.38%			
\$ 1.5	33.85%	30.65%	27.44%			
\$ 2.0	25.91%	22.71%				
\$ 2.5	17.98%	14.78%				
\$ 3.1	8.46%					

**Savings on Annual Contribution Amount (in millions)**  
POBs (in billions)

Cash (in billions)	POBs (in billions)					
	\$ -	\$ 1.0	\$ 2.0	\$ 3.0	\$ 3.1	
	0%	32%	65%	97%	100%	
\$ -	\$0.00	\$19.31	\$38.62	\$57.93	\$59.86	
\$ 0.5	\$47.84	\$67.15	\$86.46	\$105.77		
\$ 1.0	\$95.69	\$115.00	\$134.31			
\$ 1.5	\$143.53	\$162.84	\$182.15			
\$ 2.0	\$191.37	\$210.68				
\$ 2.5	\$239.22	\$258.53				
\$ 3.1	\$296.63					

**Savings on Employer Contribution Rates**  
POBs (in billions)

Cash (in billions)	POBs (in billions)					
	\$ -	\$ 1.0	\$ 2.0	\$ 3.0	\$ 3.1	
	0%	32%	65%	97%	100%	
\$ -	0.00%	3.20%	6.40%	9.61%	9.93%	
\$ 0.5	7.93%	11.14%	14.34%	17.54%		
\$ 1.0	15.87%	19.07%	22.27%			
\$ 1.5	23.80%	27.00%	30.21%			
\$ 2.0	31.74%	34.94%				
\$ 2.5	39.67%	42.87%				
\$ 3.1	49.19%					

**NPV of Savings on 25-year Contribution Amount (in millions)**  
POBs (in billions)

Cash (in billions)	POBs (in billions)					
	\$ -	\$ 1.0	\$ 2.0	\$ 3.0	\$ 3.1	
	0%	32%	65%	97%	100%	
\$ -	\$0.00	\$272.14	\$544.28	\$816.43	\$843.64	
\$ 0.5	\$674.31	\$946.45	\$1,218.59	\$1,490.73		
\$ 1.0	\$1,348.61	\$1,620.75	\$1,892.90			
\$ 1.5	\$2,022.92	\$2,295.06	\$2,567.20			
\$ 2.0	\$2,697.22	\$2,969.37				
\$ 2.5	\$3,371.53	\$3,643.67				
\$ 3.1	\$4,180.70					

1. \$0.5 billion cash infusion and \$2.0 billion POBs issued in 2007
2. Assumed \$3.1 billion TRS UAAL in 2007
3. Annual employer contribution amount for Tiers I, II, and III would be \$347.65 million without cash infusion and POBs starting in 2007
4. Funding ratio will be improved from 59.9% to 92.24% (based on preliminary \$4.63 billion TRS asset as of Dec 31, 2006)



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# **Tax Issues**

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# Taxable Bonds vs. Tax Exempt Bonds

- Taxable Bonds
  - Can be issued for any purpose
  - Complete flexibility with use of proceeds
  - Interest rate about 1% higher than tax exempt in current market
  
- Tax Exempt Bonds
  - Can only be issued for public capital projects
  - Earnings on proceeds are restricted to yield paid on bonds
  - 1% lower interest rate than taxable bonds in current market

# The Difficulty with Tax Exempt

- Very difficult to identify appropriate GF funded capital projects to issue bonds for.
- Certificates of Participation issuance is the most viable option.
  - However the existing, yet unexpended GF funded capital projects are small, for private purposes, short lived acquisitions, operational grants, or federal match.
  - Fiscal Year 2008 capital budget is only \$100 million, all of which could not be funded with tax exempt bonds.
- Any use of tax exempt bonds to fund capital projects would have to be coincidental, rather than integrated, to any use of on hand cash to fund PERS/TRS contributions.



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# Take-aways

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## Take-aways

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1. If we can earn more than the cost of POB, we are better off for issuing it.
2. We are in a very favorable interest rate environment – take advantage of it!
3. Risks associated with POB issuance are quantifiable and statistically justified by the rewards.
4. Doing nothing is not a viable option.

Q & A



Change to \* 11-20-07

# FISCAL NOTE

STATE OF ALASKA  
2007 LEGISLATIVE SESSION

Fiscal Note Number: HB013-DOA-R&B-3-12-07(1)  
 Bill Version: CSHB013(W&M)  
 () Publish Date: \_\_\_\_\_

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected: Administration  
 Title An Act relating to prepayments of accrued actuarial RDU Centralized Administrative Services  
liabilities of government retirement systems. Component Retirement and Benefits  
 Sponsor Representative Hawker  
 Requester House Special Committee on Ways and Means, Component No. 64

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Personal Services	38.7	38.7	38.7	38.7	38.7	38.7
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>38.7</b>	<b>38.7</b>	<b>38.7</b>	<b>38.7</b>	<b>38.7</b>	<b>38.7</b>

CAPITAL EXPENDITURES						
----------------------	--	--	--	--	--	--

CHANGE IN REVENUES ( )						
------------------------	--	--	--	--	--	--

**FUND SOURCE** (Thousands of Dollars)

1029 PERS	27.9	27.9	27.9	27.9	27.9	27.9
1034 TRS	10.8	10.8	10.8	10.8	10.8	10.8
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
<b>TOTAL</b>	<b>38.7</b>	<b>38.7</b>	<b>38.7</b>	<b>38.7</b>	<b>38.7</b>	<b>38.7</b>

Estimate of any current year (FY2007) cost: 0.0  
 Mark this box (X) if funding for this bill is included in the Governor's FY 2008 budget proposal:

**POSITIONS**

Full-time						
Part-time	1	1	1	1	1	1
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)  
 This bill will require that the Division develop an accounting structure within both PERS and TRS to keep track of lump-sum payments and the related disposition of such balances separately from all other employer contributions. Staff will allocate operating costs and investment earnings to these lump-sum balances and provide an accounting of activity to employers at least annually. The Division will work with the Department of Law to develop regulations to govern the accounting for such accounts. The additional work that will need to be performed by the Division is estimated to require the addition of one part-time position.

Prepared by: Melanie Millhorn, Division Phone: 465-2200  
 Division: Retirement and Benefits Date/Time: 3/12/2007 Rev 3/21/07  
 Approved by: Rachael Petro, Deputy Commissioner Date: 3/21/07 3:00pm  
 Agency: Department of Administration

*adopted 4-20-07*

25-LS0084M  
Cook  
4/17/07

**CS FOR HOUSE BILL NO. 13( )**

**IN THE LEGISLATURE OF THE STATE OF ALASKA**

**TWENTY-FIFTH LEGISLATURE - FIRST SESSION**

**BY**

**Offered:  
Referred:**

**Sponsor(s): REPRESENTATIVES HAWKER, Fairclough, Kelly**

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act relating to prepayments of accrued actuarial liabilities of government  
2 retirement systems; relating to the Alaska Municipal Bond Bank Authority, the Alaska  
3 Housing Finance Corporation, and the state bond committee; establishing the Alaska  
4 Pension Obligation Bond Corporation; permitting the Alaska Municipal Bond Bank  
5 Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance  
6 Corporation, the state bond committee, and the Alaska Pension Obligation Bond  
7 Corporation to assist state and municipal governmental employers by issuing bonds,  
8 notes, commercial paper, or other obligations to enable the governmental employers to  
9 prepay all or a portion of the governmental employers' shares of the unfunded accrued  
10 actuarial liabilities of retirement systems; authorizing a governmental employer to issue  
11 obligations to prepay all or a portion of the governmental employer's shares of the  
12 unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or

1 other contractual agreement with a trustee, the Alaska Municipal Bond Bank Authority  
2 or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance  
3 Corporation, the state bond committee, or the Alaska Pension Obligation Bond  
4 Corporation in connection with the issuance of obligations for that purpose, and relating  
5 to those obligations; relating to revision of the employer contribution rate in connection  
6 with financed prepayment of unfunded accrued actuarial liabilities of government  
7 retirement systems; and providing for an effective date."

8 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

9 \* Section 1. AS 14.25.070 is amended by adding new subsections to read:

10 (d) All or a portion of the employer's share of any accrued actuarial liability to  
11 the plan any be prepaid in a lump sum. The commissioner of administration may, by  
12 regulation, establish a minimum amount for the lump sum payment of a portion. The  
13 administrator shall charge to the employer appropriate and reasonable administrative  
14 costs to the plan attributable to a lump sum payment that are not greater than  
15 administrative costs applied to other employer contributions. If an employer is  
16 grouped with any other employer in accounting for contributions, the lump sum  
17 payment for the employer shall be accounted for separately in accordance with  
18 regulations adopted by the commissioner. The regulations must provide for crediting  
19 to each lump sum payment account all earnings and losses received from investment  
20 of that payment. The lump sum payment shall be used solely to offset contributions  
21 under this section required of the employer for which the payment was made, taking  
22 into account earnings and losses from its investment. A lump sum payment made by or  
23 on behalf of an employer under this subsection, together with all earnings and losses  
24 from investment of that payment, may not be considered in calculating that employer's  
25 share of any discretionary payment authorized by the state that benefits multiple  
26 employers.

27 (e) If all or a portion of an employer's share of any accrued actuarial liability  
28 to the plan is prepaid in a lump sum under (d) of this section, the administrator shall