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Supervisor Dianne Jacob
County Administration Center
1600 Pacific Highway
San Diego, CA 92101

Dear Supervisor Jacob

In the Information Age we are bombarded with data, some more accurate than others. This past week I happened to notice two items that are, at best, partially correct. Both of them appear to concern you.

The first of these is a transcript of a conference call from Mr. Nick Maounis to Amaranth Group investors in which I presume the County of San Diego participated. A copy is enclosed. In particular, I direct your attention to the top of page five:

> "We viewed the probability of market movements such as those that took place in September as highly remote."

This view was mistaken. Had your fund managers been using the most sophisticated risk measurement tools available they would have known that the probability of losing 75% of capital at some time during the year was a predictable 5.3%. Something that happens one time in twenty is not a rare event by any standard. Next, Mr. Maounis tells his investors:

> "...our energy-risk models correspondingly discount the Funds' exposures to the losses associated with such scenarios."

It would have been more accurate to say

> "...our energy-risk models incorrectly discount[ed] the Funds' exposures to the losses associated with such scenarios."

While it is not trivial to make the correct calculations, neither is it impossible. For nearly five years anyone could correctly calculate these risks on a web-based calculator. Simply stated, there is little excuse for this sort of error.

The second item is the editorial in yesterday's San Diego Union exhorting you to "attend refresher courses on Investing 101". Not to make too much of the metaphor, but elementary courses – as the "101" suggests – typically are descriptive in nature and end with recommending advanced courses if you plan to pursue the profession of financial management. For those not so inclined, such basic courses refer you to the advice of a qualified professional before you invest. My hope is that you did the latter and if so it is to those professionals you need look to learn why millions of dollars of County Pension funds were lost last week.

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Unfortunately, many who hold themselves out to be professionals did not progress far beyond Investing 101 and are unable to properly quantify the risks involved in this sort of venture. The County may have a valid claim of professional liability or negligence associated with the advice or actions of their advisors with respect to County funds.

If the County would like to improve its risk management techniques I will be happy to meet with you and explain where the problem lies. This is a simple gesture of a concerned taxpayer, merely offering assistance in an area where I happen to have some expertise.

Sincerely

Roger J. Brown

/rjb
Encl.

Risky business

Pension giveaways catch up to taxpayers

Taxpayers were surprised to learn last week that their elected officials have been gambling their money in one of the riskiest investments known to Wall Street — a hedge fund that lost billions betting on the future price of energy.

Any car owner knows that nobody can reliably predict the direction of energy prices. But that didn't stop Supervisor Dianne Jacob, Treasurer Dan McAllister and the rest of the county's pension board from putting $175 million into the fund. In all, $1.5 billion in public assets, representing an astonishing 20 percent of the nest egg for county workers, is in the hands of hedge fund managers.

It's a risky strategy, particularly as hedge funds are almost completely unregulated. Clients often don't know where their cash is invested. The plight of San Diego County, which may have lost $45 million in a single week, has prompted nervous looks at financial statements by the nation's public pension managers.

We heartily encourage all elected officials, particularly Jacob and McAllister, to attend refresher courses on Investing 101. But this sudden interest in portfolio management only serves to obscure the real threat posed by government retirement plans: In California, taxpayers must pay for public pensions, period. Officials gamble, but taxpayers bear the risk.

What's worse, elected officials have been working overtime to increase this risk. In 2002 the five elected supervisors of San Diego County voted to raise pension benefits by 50 percent. Politicians promised public employees lifetime checks that rose with inflation, far better than the private-sector retirements of the taxpayers who must pay for public pensions.

The supervisors' giveaway immediately plunged the county $1.1 billion into debt, without a countywide vote. Then supervisors, fearing political blow-back from budget cuts or a tax hike, failed to put enough cash into the higher pensions — much as the city of San Diego failed to adequately invest in its retirement program. That's why, just four years later, the county's overall pension debt has grown to nearly $2.7 billion (about $1.3 billion in bond debt and $1.4 billion in unfunded pension liability).

This story would be shocking if only San Diego's city and county governments had decided to boost benefits beyond reason and then failed to invest enough. But an estimated 80 percent of all government retirement accounts are similarly underfunded.

That's why officials everywhere are shoveling tax dollars into risky investments in hopes of higher returns. Profits enable officials to get by with lower payments to retirement funds. The beauty of it, for the officials, is that any losses flow to taxpayers.

County officials must immediately shift to safer investments, reduce profit assumptions and boost payments to the pension fund. But taxpayers will remain in danger until they demand private, 401(k) plans for new public workers, thus gradually weaning government from its pension risk.

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