A hearty welcome to all of you at the 80th Annual Convention of the New Jersey Cemetery Association. I’d like to thank Judy and the NJCA for the opportunity to speak with all of you again this year.

My presentation this afternoon is expected to give you a sampling of promises and issues of entitlement reform in two principal areas:

-- Social Security

-- Public Pension Plans with particular emphasis on New Jersey

I will also touch on the political implications of changes to both which I believe are inevitable.

All this is a prelude to a discussion of whether there is a need to get out in front of any legislation from Trenton that could impact the funding and use of maintenance and preservation funds in our industry.

Today’s discussion is expected to be a kick off for continuation at the round table tomorrow morning at breakfast.

The information I intend to share with you today will be the view from 30,000 feet reflecting in important financial decisions in Washington and Trenton very soon that will impact all of us.
Since I expect to make some predictions, the words of John Galbraith are worth considering. Galbraith is reported to have said that: “the only function of economic forecasting is to make astrology look respectable”. One of the main predictions is that the world will not end on December 21, 2012.

Unlike Galbraith, we know that when you mix the best features of both you get predictions that are useful. Hopefully today will be no exception.

Here is another prediction. The economic world, as we have known it, is going to change in 2013, regardless of which party is elected in November. Fifty percent of the population will not be happy.

First, Social Security. Hardly a day goes by without some reference to the plight of people living on fixed income, mainly Social Security, many of whom live below the poverty line. This is hardly news. Media chooses to pay more attention to the feigned outrage expressed by politicians while ignoring the significance of the ever-growing gap between the haves and have-nots.

**Prediction**: As spring progresses, the Occupy Wall Street crowd will be even more vociferous and will attempt to influence the elections with a more focused strategy. Appearances of the protestors at the Presidential Conventions this summer are a certainty. It should not surprise us if they are joined by an older AARP generation, fearful that entitlement programs will be reformed with the idea of reducing their benefits. The occupiers seem to be personally concerned with their own plight as college-aged borrowers. They serve as an example of the breakdown of society that promised fulfillment of the American Dream, with education put on the credit card. For the first time last month, student loans topped
$1 trillion – so student-led protests become the “canary in the coal mine,” so to speak.

If you look closely at the demonstrators, interspersed in the crowd are older people who feel dissatisfaction. Many of them appear to be of Social Security age. For many of them, any changes to their monthly Social Security checks will have significant financial impact.

So what really is Social Security?

Social Security is nothing more than the national pension plan. In essence, workers and employers are obliged to pay into a system where recipients receive a defined benefit for life. In its simplest form it is nothing more than a deferred exchange - a deferred exchange of long duration.

Contrast that with a deferred exchange of short-term duration. There is a famous cartoon that portrays Popeye’s friend Wimpy, hamburger in hand, asking that you lend him money today to pay for his hamburger and he will pay you back on Tuesday. We can look to a short time when the second half of the promise fulfills the bargain.

Before we take measure of the financial implications of this, we need to understand the psychological nature of the pending transaction. Wimpy has made a promise, which is only as good as your belief in his integrity and his finances. Before we would consider his request, we would want to know if he is planning on additional borrowing to buy his next hamburger.
Here are other examples of other deferred exchanges.

What they have in common are promises to fulfill the other half of a transaction.

There is a wonderful book written by the Economist, Harry Scherman, many years ago. “The Promises Men Live By” defines a promise as a deferred exchange.

I can’t think of anyone who has described the current situation better.

Let me tell you what Sherman has to say about economic promises --particularly those made by Governments.

“A promise is of no more value than trust in the ability of the one who makes it to carry through, including a willingness to do so.

All in all, it seems there is a reasonable ground for suspicion of promises which governmental units, both supreme and subsidiary, make to their citizens. For if simple honesty will play no part in the completion of the promises; if there is no agent of eventual compulsion that can infallibly be relied upon; and if even the resources to complete the transactions, while theoretically ample in total, may be governed by the fitful wind of political circumstance, the degree of uncertainty about the completion of these deferred exchanges should be a high one. Yet, curiously, in the money market, they have, in the past, often been considered among the least speculative of all deferred exchanges. Why is this?

The real reason can be found in what we have already pointed out: that these economic promises, unlike others, tend to be perpetual.

Full completion is never asked for.”

This was written in 1938.
Social Security is an example of a deferred exchange with a long duration. I have an expectation that, whenever I retire, I will get a return on my investment for the balance of my lifetime. After all I paid in; I am entitled to completion of the bargain.

Until the last decade, few gave any thought to whether this promise might not be honored.

Confidence in the ability to complete the deferred part of the transaction has been shaken by events. I can tell you from counseling clients for over forty years, older people are anxious, if not outright scared and the younger generation is getting angrier.

The aftermath of the debt binge created over the past thirty years is the realization that new promises can’t be honored if old economic promises are unfulfilled, but that doesn’t stop politicians from making them.

**Trust in the ability to honor them starts with the honesty and integrity of the maker, the financial ability to deliver on the promise and reliance on others to carry it out.**

The public has observed that the banking system has been saved on the back of savers of the United States by Federal Reserve suppression of interest rates. Many see this as outright theft. They see GM bond-holder’s rights trampled, bankers rewarded instead of jailed and fraud unpunished. They also feel that markets are manipulated and that there is less transparency in financial dealings.

Jed Graham in *Investor’s Business Daily* recently pointed out a sharp deterioration in the solvency of the system.
These are two estimates of Social Security Trust Fund’s depletion rate. What we are concerned with here is the government’s ability to afford benefits where the assets (which are special U.S. Treasuries) supposedly are sufficient to match ongoing and future liabilities. The assumption is that legally the promised benefits can be paid until all these special treasuries are spent.

Let me tell you a little secret: There are some of us who believe that a portion of these supposed assets have already been spent by Congress. The question Ron Paul and others in Congress should be asking is: “What has happened to the Social Security Trust Fund?” Please don’t expect an answer any time soon.

When completion of the second half of the bargain is in doubt, reformation is essential or like Greece, default or insolvency is inevitable. What has so far been ignored is the demographic time bomb of a huge generation retiring and living longer. In short, the amount expected to be paid out is growing faster than the new workers’ ability to pay in to perpetuate the system.

In the 2012 report that just issued, for the first time Social Security is cash flow negative. It takes in less revenue than it pays out in benefits. The annual cash gap is $48 billion in 2011 and is expected to rise above $100 billion annually by the end of the decade.

Because treasury rates are at historic lows, smaller interest payments are earned on the Trust Fund’s balances and mathematically can’t add much to make up the cash shortage.

Under certain assumptions, if left untouched, by 2018, cash flow deficits would exceed interest payments. Thanks to Mr. Bernanke, this is one of the indirect consequences of the Fed’s sustained zero interest rate policy.
You may be sitting there thinking this is not today’s problem and there is plenty of
time to reform Social Security, but unfortunately procrastination only makes
confronting this problem worse.

**Prediction**: Both parties will promise that a Commission will be formed to study
the problem. (Please don’t laugh.)

Whatever the reform, it seems obvious that the retirement age will be extended, the
threshold for FICA payments raised substantially, if not eliminated altogether, and
benefits means tested and taxed at higher rates.

This issue is easy to sidestep because there is enough blame to go around
independent of party affiliation.

On the other hand, dealing with the issues of underfunding in the private and
public pension fund arena are far more complex.

In the words of Tip O’Neill, remember, “All politics are local.”

I’ll let you in on a dirty little secret. Defined benefit pension plans only work if
they earn a compound rate of return of at least 8% annually forever, if today’s
workers pay in nearly triple the amount from their compensation, (roughly 15%
annually) and the employer contributions are sustainable and uninterrupted.

Allow me to share another dirty little secret. Virtually all defined benefit plans in
the public sector are massively underfunded.
In every case of underfunding, in my opinion, the following are present:

1) An intent to hide the financial imbalances by using faulty backward looking analysis with imprecise data;
2) Liberal assumptions about asset returns while understating current and future liabilities;
3) Empty promises made by people in positions of power who knew or should have known could not be honored without intervention, that is, a bail out to correct imbalances.

*Remember, a promise is of no more value than trust in the ability of the one who makes it to carry through, including a willingness to do so.*

When I first began to study the plight of public pension funds in early fall of 2011 at the urging of some of my clients in New Jersey who were considering retiring, I was actually surprised to find the number of scholarly studies that were sounding an alarm largely ignored by government policy makers at all levels.

“The Tragedy of the Commons” authored by Meredith Whitney was devoted to the role State Pension Funds play in measuring the solvency of states. In her controversial study she compared the plight of the states and municipalities with the problems of countries in the Euro zone.

She felt, and indeed predicted, that overvalued housing and reduced property taxes in local economies were the seeds of the next financial crises.
According to *Fortune Magazine*, Whitney claimed that the study was the most comprehensive in-depth analysis of the states’ murky patterns of spending, revenues and benefit programs ever assembled by government foundations or another research firm.

What Whitney found reminded her of the poor disclosure and arcane accounting rules that hid the fragile condition of the banks and mono-line insurers that she had unmasked.

She concluded that: “The states represent the new systemic risk to financial markets.” She stated that, “I see a lack of transparency and an abundance of complacency on the part of investors and politicians, just as we saw before the banks imploded. I was shocked by what I was seeing that I couldn’t stop. Any long-term strategic plan needs to take account of the dangerous, mostly overlooked problems in state finances.”

It was with the same calling that I began to undertake the study of the underfunded nature of state pension plans, particularly those of New Jersey, my home state, where many of our firm’s clients reside.

Since our firm prides itself on conducting unbiased research and analysis, we felt that the underfunding of pension plans was far too important an issue to be ignored any longer. Sadly, after much study, I cannot assure my clients that their pensions are safe, that future benefits will not be cut, or that the plans they are in are any more meaningfully solvent in spite of recent political responses to deal with the issue in the short term. Unlike most complex problems however there are common sense solutions but only after recognition that there is a problem.
Like Meredith Whitney, I found in my research some shocking data. I will try to condense the definition of the problem: Just try to envision a financial system that strives for equilibrium. Call that one where cash inflows go into a reservoir (assets), where the cash outflows match the inflows. Then let’s imagine that the system needs cash contributions from employees who are still working and increased cash generation from predictable portfolio returns. When the cash outflows are equal to the inflows and the assets remain stable the system is in balance.

But because the system is dynamic, a number of variables enter the equation, none the least of which is time. For you see, the rate of contributions change based on the number of employees paying into the system, the amount each is paying based on a percentage of their wage compensation and the time until they expect to receive pension payments.

In a defined benefit plan there is an expectation that the employer will also help fund an amount sufficient to insure that the system remain solvent and liquid to insure future payments to all participants.

In the defined benefit space a fund is established, usually a trust, whose trustees invest for all participants, normally with the help of outside experts. Policy is established by a board of trustees, supposedly independent of the political process. Don’t believe it isn’t influenced by politicians. If you think governance could be better in publicly traded companies you have not seen anything until you observe the behavior of policy setters in pension plans.
In its simplest form, a defined benefit plan is nothing more than a promise to pay an employee a defined amount during retirement determined by formula by an employer, whose motive is to pay the least into the plan to keep it solvent.

If this were a Broadway play, the title might be “Who Has Skin in the Game?”

The answer, in the public sector, is nearly everyone.

This very industry exists because society at large has concluded that it is humane to take care of its elders and the downtrodden. The issue of whether society can any longer afford to prolong life and extend economic benefits is at the heart of any meaningful entitlement reform. I realize how controversial and super charged this is and bound to evoke a wide range of emotional responses.

Asking pension plan participants to contribute a share of their wages earned from their current labor to provide for the well being of others no longer able to work is one thing, selling it is as fulfilling a promise of a better life for them in the future is another.

Better than half of all employees worldwide no longer trust the government promises that their savings contributed by them will be managed in a way sufficient to support them in retirement.

More and more parents are coming to rely on their children to provide for them in retirement, hurting their generation’s capacity to save for their old age and forcing the next generation of children to support them in turn.

The pension industry and the government know that younger generations are being set up for disappointment. As long as contributors are willing to pay into such a system retirees can expect to receive their pensions. What pensioners are not
likely to get for sure are future payments that increase with inflation and the cost of living. If the young perceive that paying into a system that has a high probability of default, we could have *intergenerational strife*.

When you get involved in this type of study you learn quickly that all these characters with their supporting casts create a highly charged atmosphere. Among the thorniest of issues is who sets the discount rate and how are pension plan liabilities measured and determined? Who determines the expected annual rate of return on plan assets? The decision over what to do when underfunding is determined really boils down to what constituency is affected most when promises made to teachers, fireman, policeman, judges and other public employees can’t be honored.

What becomes painfully obvious is that, in spite of recent reforms, the unfunded liabilities are growing faster than the contributed assets and the expected return on investment in the plans. The strategic gap results from assumptions about a growth in assets from increased contributions from the state and/or employees coupled with substantial significant outpaced investment returns. For decades, the pension assets could be invested in such a way that a portfolio could be concentrated in bonds of various issuers, including sovereign debt with predictable yields and equity investments representative of underlying growth of the US and global economy.

The growth in assets historically was sufficient to match or exceed the increase in actuarial liabilities. The assumption was that assets could be allocated in such a way that a low risk strategy could be pursued and sufficient predictable income coupled with normal capital appreciation would at least match gross distributions from the plan.
Fast forward to today’s low interest rate environment. It seems clear that the growth rate of capital deployed would have to be accelerated to just match the annual gross distributions. It would appear that this mathematical reality is, in part the impetus for the NJ Investment Council’s policy shift to greater reliance on annual returns from a portfolio, which depends heavily on equities and alternative investments.

This policy can best be described as the pursuit of higher reward with greater risk. This pursuit is explainable only partially because of the low interest environment. In spite of the recent triumph in getting the legislation passed requiring most government workers to pay more toward their pension and health care insurance, as well as raising the retirement age for many from 62 to 65 and suspending the cost-of-living adjustments for those workers already collecting a pension, the amount of inflows to the plan do not appear to sufficiently match the annual gross outflows.

I have found that pension fund recipients for the most part, are largely uninformed. They have been misguided by governments at all levels, the Federal Reserve and financial advisors in general. They know, however, that the plans have been underfunded and that reformation is necessary.

In return for grudging acceptance, they have been promised and indeed are expecting that their pensions are assured, constitutionally mandated and court protected. Those that are better informed know that the basis for their expectations remains uncertain. To eliminate the unfunded liabilities near term is nearly mathematically impossible. Politicians know it. Legislators know it. The informed public feels it. This year’s reform appears to be just the beginning of a much needed trend, a politically necessary first step.
Those who don’t know it are the citizens of each state where the degree of underfunding will necessitate higher taxes. In New Jersey - the 90% in the private sector likely will be called upon to pay significantly higher taxes in the future for the benefit of the roughly 770,000 members covered by the state’s pension and benefit plans, 280,000 of whom are already retired.

Additionally, what part does the expectation of the need for future contributions by state and pension participants and likely taxpayers play in determining the need for a higher risk investment policy?

One can pose that question, but don’t expect an answer. I am not even sure that New Jersey has conducted studies that give confidence in the assumption that an 8.25% compound annual investment return is achievable for the foreseeable future.

Nor am I sure what actions would be considered if the investment returns do not match or exceed the 8.25% expectation. Will the state make up the difference out of tax receipts from the annual budget? If the answer is “yes, the state, hence the taxpayers, will come to the rescue.” Is there any intention to share this belief with the citizenry?

To quote from the working paper “The Crisis in Public Sector Pension Plans: A Blueprint for Reform in New Jersey” co-authored by Eileen Norcross and Andrew Biggs, “The ability of governments to pay for the retirement benefits promised to the public sector workers runs up against the reality of limited resources.”

In New Jersey’s case, it appears that, in spite of recent reforms, New Jersey has, for now, sidestepped the issue. Using 2008 data, the state reported that the pension system was underfunded by $44.7 billion when the liabilities are discounted at the 8.25% annualized rate that New Jersey predicts it can achieve on the investment
portfolio. However, since the enactment of quantitative easing measures by the Federal Reserve including the more recent adoption of a zero interest rate policy until at least mid 2014, the amount of underfunding, using the 2.5% current yield on 15 year Treasury obligations, rises to over $200 billion, roughly 500% of New Jersey’s total debt and over 35% of the Annual Gross State Product. At that rate, the plans could run out of assets by 2019. If the returns are less than 8%, the plans will be insolvent sooner. If, as has been the case in 2011, the net assets of the pension fund decline, the day of reckoning will be sooner yet.

You need not go any farther than New York City and State to believe that this is a hot political issue for 2012.

Governor Cuomo, Mayor Bloomberg and other politicians recently marched up to Albany faced with a near term economic calamity. Cities and Counties were borrowing funds from the Pension Plans to fund operating budgets. Essential services were threatened with deep cuts and curtailments. The trustees and legislators were faced with a dilemma. Coming down the tracks real soon are changes in accounting standards that spell disaster: they need to get ahead of these changes.

Will knowledge of the precarious financial situation lead to more economic and political strife as citizen taxpayers learn more about the financial predicament of unfunded liabilities in virtually all entitlement programs in state, municipal and local pension plans? That remains to be seen.

So what is the significance of all this to us as cemeterians?

For one, we operate our cemeteries in a State with the following metrics:
1. Highest property taxes in the nation
2. Unfunded liabilities that dwarf all but three other states:
   · Rhode Island
   · Illinois
   · California
3. Annual family income of $60,400 that has not grown in a decade
4. Among the three worst states for corporate tax rates
5. Rating downgrades of the state’s debt
6. Massive underfunding of municipal & state entitlement plans

The effect of all this is a rising cost of living squeezing the middle class and a mass egress from the state by retirees.

Turning the cemetery industry for a moment – it too faces a similar dilemma because it must fund future obligations, and serves a population base that is not growing. Because of the aging of the baby boomers, we can expect that morbidity statistics will produce an increase in burials for a while longer. What we can’t predict is the trend toward cremations over burials because they are less costly.

Unfortunately, I don’t think we can spend the necessary time this afternoon to dive into the assumptions that go with a long range planning process for each of your cemeteries, although I believe it is absolutely essential that you do so.

What you can do is to look at the maintenance and preservation funds and cost of operations to see if the promises of perpetual care of your cemeteries can be met from the current funds on hand or those projected.
How many people here believe that in light of today’s uncertain future that you can meet your mandate to care for our buried population in perpetuity?

How many people think we will see a day when there are more distressed cemeteries than there are viable ones?

With New Jersey’s preoccupation with its own financial predicament, does anyone here have an opinion of how the state views the cemetery industry and the responsibility of its trustees to deal with impending costs of fulfilling promises made to lot owners? In short, is there a point in time when the industry comes under state control with taxpayer citizens called on to bail out the distressed cemeteries?

I will attempt to answer these and other questions and offer a range of solutions during tomorrow’s roundtable discussion. Thank you for your kind attention.

Any information contained in this presentation should not be considered a complete analysis of every material fact with respect to matters discussed. Although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed. The presentation has been modified from the original to, among other things, include a few changes and remove references to the slides.