

PTSCPTSC BOARD OF DIRECTORS
OCTOBER 2, 2007Public
Transportation
Services
CorporationOne Gateway Plaza
Los Angeles, CA
90012

213-922-4611

SUBJECT: CREATION OF A LIABILITY TRUST FOR INVESTMENT PURPOSES**ACTION: ADOPT A RESOLUTION CREATING AN IRREVOCABLE WORKERS' COMPENSATION AND GENERAL LIABILITY TRUST****RECOMMENDATION**

- A. Adopt a resolution authorizing the creation of an irrevocable trust with Metro for the investment of Workers' Compensation and General Liability reserves, Attachment A.
- B. Authorize the deposit of monetary assets equal to the General Liability and Workers' Compensation booked liabilities into the Workers' Compensation and General Liabilities Trust.

ISSUE

The Government Accounting Standards Board (GASB) sets accounting rules for governmental entities. Those rules require Metro/PTSC to estimate outstanding liabilities for workers' compensation and general liability losses and report them on Metro's/PTSC's balance sheet. Metro currently sets aside cash to cover these liabilities, much like a pension plan. Metro and PTSC are currently constrained, however, by the Government Code and Metro/PTSC policies from investing in portfolios that, in the long run, should yield significantly higher returns. The establishment of a Metro/PTSC trust will ensure that Metro and PTSC meet their obligations to employees and third parties for accidental losses resulting primarily from bus and rail operations. Further, creation of a trust will afford Metro and PTSC the opportunity to achieve higher investment returns on outstanding reserves, thereby reducing future appropriations needed to fund Metro's and PTSC's workers' compensation and general liabilities.

POLICY IMPLICATIONS

In February 2007, the Metro Board of Directors adopted a resolution creating an Other Post Employment Benefits (“OPEB”) Trust to achieve a higher investment return on funds set aside for retiree medical benefits. Creating a second trust of this type, the Metro Board of Directors adopted a resolution on September 27, 2007 authorizing the creation of an irrevocable trust for the investment of workers’ compensation and general liability reserves.

The funding strategy to minimize future workers’ compensation and general liability expenses would rely upon the PTSC-MTA Risk Management Authority (“PRMA”), a joint powers authority composed of Metro and PTSC established in 1998 for the purpose of operating a program of cooperative self insurance, insurance and risk management in order to reduce the cost of transportation services to the public. Cash in the amount of the currently restricted cash balances for the workers’ compensation and general liabilities (approximately \$300M) would be set aside into a Metro/PTSC irrevocable trust. Annually, the estimated workers’ compensation and general liability expenses (approximately \$100M) would also be added to the trust. Monies in the trust would then be used to satisfy obligations of Metro/PTSC set forth in the joint powers agreement to make contributions, pay premiums, and deposit funds with PRMA. Monies in the trust would be irrevocably dedicated to pay all costs and expenses in connection with Metro/PTSC workers’ compensation and general liabilities, including insurance premiums, third-party settlements and judgments, statutory workers’ compensation indemnity benefits, medical costs and allocated loss adjustment expenses (primarily legal fees). The trust assets would have to be legally protected from creditors and the Board would have no further discretion over the use of those assets.

Adopting the resolution creating the trust allows the trust fund assets to be invested in a broader range of securities than is permitted under the Metro/PTSC Investment Policy that is constrained by State law. Like Metro’s pension fund assets, the monies will be invested in equity securities and longer term fixed income bonds and, accordingly, will be expected to generate greater investment income that can be used to reduce PTSC’s annual workers’ compensation and general liability expenses.

PTSC will determine future years’ funding of the trust consistent with discussions and commitment to recommendations by Metro’s auditor to maintain reserves sufficient to ensure that the trust will maintain assets to cover 50% to 80% confidence of periodic actuarial estimates of outstanding workers’ compensation and general liabilities.

ALTERNATIVES CONSIDERED

Continue the existing practice of investing conservatively in accordance with the Investment Policy and Government Code 53607. This alternative is not recommended since it does not provide the best opportunity for increasing returns.

The segregation of funds will allow monies to be invested in a diversified portfolio of stocks and bonds that will yield a higher return. Those returns will support FY08 agency goals and exercise fiscal responsibility by reducing the costs of Metro/PTSC operations.

FINANCIAL IMPACT

Approval of the funding strategy, Attachment B, and the expected higher investment returns through the workers' compensation and general liability trust will reduce the deficit projected in Metro's 10-Year Forecast by approximately \$5 million annually for FY09 and FY10. Trust set up and ongoing administrative costs such as investment advisor fees, investment management fees, legal fees and similar expenses should be more than covered by the higher investment earnings.

BACKGROUND

Metro engages the professional services of an actuary (Milliman) to perform quarterly analyses based on claims and financial data for both workers' compensation and general liabilities. These analyses provide estimates of outstanding reserves needed to fund the losses and allocated loss adjusted expense liabilities of the self-insured programs related to the bus and rail operations.

ATTACHMENTS

- A. Resolution Authorizing a Workers' Compensation and General Liability Trust
- B. Funding Strategy

Prepared by: Gregory Kildare, Executive Officer, Risk Management
Tracy Dixon, Risk Analyst, Risk Management

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

Gregory Kildare
Executive Officer, Risk Management

RESOLUTION AUTHORIZING A WORKERS' COMPENSATION AND GENERAL LIABILITY TRUST

WHEREAS, pursuant to current practice, the Public Transportation Services Corporation ("PTSC") makes monthly contributions for self-insured workers' compensation and general liabilities; and

WHEREAS, the PTSC-MTA Risk Management Authority is a joint powers authority established by the Board in 1998 to operate a program of cooperative self insurance, insurance, and risk management on behalf of Metro and PTSC; and

WHEREAS, PTSC wishes to utilize PRMA to effect cost savings in the administration of self-insurance, insurance and risk management programs for PTSC workers' compensation and general liabilities by increasing investment returns; and

WHEREAS, PTSC is obligated through the agreement establishing PRMA to make contributions, pay premiums, and deposit funds with PRMA, in accordance with programs established and adopted by PRMA; and

WHEREAS, PTSC's current practice has been to budget and set aside cash for the present value of future payments for workers' compensation and general liability obligations; and

WHEREAS, under this funding practice, PTSC will have accumulated substantial funds by September 30, 2007 for workers' compensation obligations; and

WHEREAS, the investment options for PTSC are restricted by state law and PTSC's Investment Policy, but without these restrictions, investment earnings should be at least 2% greater by investing in equities and longer term fixed income bonds; and

WHEREAS, a 2% difference in expected investment returns will make a significant difference in reducing the annual self-insured expense for workers' compensation and general liabilities required under the Governmental Accounting Standards Board rules; and

WHEREAS, PTSC wants to create a workers' compensation and general liability trust with Metro pursuant to Internal Revenue Code ("IRC") section 115 so that a higher investment return assumption may be used in calculating annual required contributions for workers' compensation and general liability obligations, and actually to earn a higher rate of return; and

WHEREAS, the Metro Board of Directors adopted a similar resolution on September 27, 2007, authorizing the creation of an irrevocable trust for the investment of its workers' compensation and general liability reserves, and further authorizing the deposit of monetary assets equal to its general liability and workers' compensation booked liabilities into the trust;

NOW, THEREFORE, the PTSC Board of Directors hereby authorizes the Chief Executive Officer or his designee to take all necessary and appropriate steps to create and properly administer an IRC sec. 115 trust with Metro, including but not limited to executing a trust agreement, retaining an Actuary, selecting an institutional custodian to hold trust fund assets, utilizing an independent investment advisor to monitor fund performance, and appointing one or more trustees to manage the trust and select appropriate investment options. Monies in the trust would then be used to satisfy obligations of Metro/PTSC set forth in the joint powers agreement to make contributions, pay premiums, and deposit funds with PRMA. Monies in the trust would be irrevocably dedicated to pay all costs and expenses of PRMA in connection with Metro/PTSC workers' compensation and general liabilities, including insurance premiums, third-party settlements and judgments, statutory workers' compensation indemnity benefits, medical costs and allocated loss adjustment expenses (primarily legal fees). At a minimum, the workers' compensation and general liability trust must satisfy the following three requirements:

1. *Exemption from federal income tax.* Contributions to the trust and income on investment of trust assets shall not be treated as income to the trust beneficiaries in each case under federal and state income tax laws.
2. *Qualified trust for investment purposes.* Contributions to the trust shall be irrevocable, protected from PTSC creditors and dedicated solely to paying for general liability losses and workers' compensation costs.
3. *Broad investment powers, including equities.* The trust shall be able to invest in a broader range of investments than those to which general, governmental funds are restricted in California, including equities and longer term fixed income bonds.

Adopted this _____ day of _____, 2007.

ATTACHMENT B

FUNDING STRATEGY

Cash Flow as of April 30, 2007	Workers' Compensation & General Liability Reserves (000s)	PIMCO Historical Investment Returns - 10 years	Dollar Amount (000s)	80/20 mix of Equities to Bonds (in percentages)	Projected New Returns (Dollar Amt)	Incremental Annual Returns Expected
WC & GL Funded Liabilities	\$300,553	5.98%	\$17,973	7.84%	\$23,563	\$5,590

The initial deposit of assets into the workers' compensation and general liability trust fund, based on the April 30, 2007 balances, will be treated like an endowment. Since these monies may be invested like pension funds, investment earnings should be 2% greater than these monies now earn as Enterprise Fund assets restricted by the Metro Investment Policy. Trust fund administrative expenses will be paid from the higher earnings. Until the trust has actual performance data, it is premature to estimate how much the deficit will be reduced in the short-term with this endowment strategy.