



# Awards for Excellence in Government Finance



## 2009 APPLICATION FORM

This application form must be completed and returned along with your entry in electronic form to [awardsforexcellence@gfoa.org](mailto:awardsforexcellence@gfoa.org) by **January 31, 2009**. If any supplemental supporting materials are not in electronic form, please send five (5) copies along with a copy of this application to GFOA, Awards for Excellence Program, 203 North LaSalle Street, Suite 2700, Chicago, IL, 60601.

Title of Entry: Master Trust and Investment Pool for OPEB and Pension Benefits

**Category** (Select only one):

- Accounting, Auditing, and Financial Reporting
- Budgeting and Financial Planning
- Cash Management and Investing
- Capital Financing and Debt Administration
- Economic Development
- E-Government and Technology
- Management and Service Delivery
- Pensions and Benefits

**Subcategory** (Select only one):

- Policies and Procedures
- Management and Policy Studies
- Communications and Reporting
- Training and Technical Guides
- Other

Name of government submitting entry: City of Winston-Salem

Population served Number of employees Population: 227,811 No. of Employees: 2710

Name of person submitting entry: Denise C. Bell \_\_\_\_\_

Title of person submitting entry: Chief Financial Officer

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If the person submitting the entry is *not* an active member of GFOA, an active member must sponsor the entry. If applicable, provide sponsor information below.

Name of sponsor: \_\_\_\_\_ Title: \_\_\_\_\_

Government: \_\_\_\_\_ Telephone: \_\_\_\_\_

Mailing address: \_\_\_\_\_

**Please provide simple and direct answers to each of the questions below. If necessary, use additional pages.**

A Local Significance and Value (Background)

1. Please give a brief general description of the project or program being submitted

The City of Winston-Salem has established a Master Trust and Custody arrangement with 3 irrevocable sub-trusts and one revocable trust that allows for the pooling for investment purposes of all long-term City assets in a widely diversified equity and fixed income portfolio. The City has 8 external equity managers and 4 external fixed income managers that provide wide diversification by investment style, type of assets, and risk profile. The master trust and investment pool functions like a unitized internal mutual fund managed by the City of Winston-Salem, but still qualifying under GASB 43 and 45 for higher actuarial return assumptions.

2. Describe the local events and/or problems that led to the undertaking of this project/program.

GASB 43 and GASB 45 required the establishment of irrevocable trusts for OPEB benefits if the governmental plan sponsor wants to use higher actual returns from long-term assets for its actuarial assumptions than the overall and generally lower returns on general governmental assets. This requirement means that governmental plan sponsors must either set the assets aside in an irrevocable trust or contribute much higher actuarially required contributions on an annual basis from operating revenues. The City of Winston-Salem had fully funded its pension and OPEB benefits in 1992 and thus had substantial assets that are affected by this ruling, but any governmental entity wishing to fully fund its ARC will eventually have to address this requirement as assets accumulate. The City of Winston-Salem has a well diversified investment program for long-term assets empowered by special legislation from the North Carolina General Assembly that allows the city to invest in equities and fixed incomes in a manner consistent with that of the NC State Treasurer's office. As a result, the City has long-term reserves, Police Pension assets, Police Separation Allowance assets, and OPEB assets invested with 8 external equity and 4 external fixed income managers. With the advent of the new GASB Statements each of these asset classes had to be placed into separate trusts and the investment programs would have to have been duplicated for each or the approach of combining assets for uniform returns, diversification and economies of scale would have had to be abandoned. Another complicating factor was the asset custody was spread out with three different custodians.

3. Describe the role of the finance officer/finance officers in this project/program.

The Chief Financial Officer, AFO/Controller, Investment Analyst and AFO/Treasurer operate as a team to manage these long-term assets serving as the Investment Committee under the City's Investment Policy. The team identified the problem of the GASB 43 and 45 irrevocable trust requirements would either cause the City to break up the assets into uneconomically small pools that would be very complex and costly to manage or would require the City to greatly increase its annual ARC, which would create a drag on City operating funds. The team discussed the issues with its bankers, actuaries, auditors and outside attorneys and decided to implement IRC Section 115 irrevocable trusts for each of the benefits programs and revocable trust for long-term City reserve assets all of which would be part of a general master trust agreement.

The AFO/Treasurer developed an RFP for a consolidated master trust agreement with consolidate custody of all of the assets under investment that specified the requirements for each trust and asked for specific pricing for all services to be rendered for both trust and custody services. The RFP was distributed to the current custodians and trust banks the City uses, published on the web and sent to several other trust banks that the City's research indicated performed trust and custody services. Four qualified proposals were received. The team reviewed the proposals, checked references and selected US Bank as providing the most robust, qualified services at the lowest price for both Trust and Custody work. Womble, Carlyle, Sandridge & Rice was retained to provide legal review of the trust documents. US Bank supplied trust agreements from other clients to serve as a starting point. The AFO/Treasurer

drafted Trust documents and City Council Actions which were then reviewed and refined by all of the team members. Those documents were then submitted for legal reviews by both the City Attorney and the outside legal firm. Custody Agreements with the bank were drafted and reviewed as well. The documents were then submitted to and approved by the City Manager and then the City Council. This established the trusts. Contracts were then reviewed, refined and executed to implement the council resolutions. The Investment Analyst then worked directly with US Bank to establish the accounting and trust structures, set up the business processes and ultimately move the assets held in the three existing custody providers into the master trust structure and custody at US Bank. The process was begun in January and all of the assets were in the master trust by the end of May. The Debt Manager setup a monthly reconciliation and settlement process for initiating and documenting cash flows into and out of the master trust for each benefit program. The settlement results in only one net payment or draw being performed each month. The master trust provides for unitized accounting for each trust in the pool, provides for centralized reporting of all holdings from the single custodian, and distributes flows into and out of the trust by investment manager or by sub-trust or on a consolidated basis. US Bank provides on-line, real-time access to reports at cost and market on all holdings as needed via the internet.

4. How much time did each participant devote to this program/project? Were outside consultants engaged?

Approximately 120 hours of the AFO/Treasurer's time was spent developing the documentation and routing it for reviews. About 120 hours of the Investment Analyst's time was spent working with the various custodians, trustee and investment manager to set up, move and reconcile the trust accounts. The CFO, City Attorney, AFO/Controller, and Debt Manager each spent approximately 20 hours reviewing documents, attending meetings and performing other related tasks related to the project.

#### Technical Significance

5. What financial concepts, standards, or techniques are displayed or advanced by this entry? Why is this important to the public finance profession?

The primary concept is to allow for fiduciary trusts to be setup for multiple benefit programs (Pension, Separation, and post-employment health and life insurance), while still allowing for centralized investment management, cash flow management and accounting for the benefit programs. It incorporates the proper separation of duties of outside providers between investment managers and custodians while still allowing for centralized reporting for management and control. It also provides for GASB compliance while allowing higher assumptions to be used for actuarial valuations and minimizes the cost of providing the benefits to employees.

6. Transferability

Any medium to large city that chooses to fund its post-employment benefit programs could use this approach. There is nothing in this approach that is specific to city vs county or state government and nothing that is specific to North Carolina.

7. How can this project/program be adapted for use by other organizations? Who else might benefit by its adoption? Would significant modifications be required for implementation?

Any medium to large city that chooses to fund its post-employment benefit programs could use this approach. It is especially beneficial to any entity that must manage multiple benefit programs such as pensions, retiree health, and early retirement separation allowances. Generally, the trust documents used in this program could be readily copied and used with only entity specific things such as entity name, state of organization and specific benefit program names needing to be changed. The same is true for council action documents. The investment management program could be setup with the help of any of the better known investment consulting firms (Winston-Salem uses Deutsche Bank Alex Brown

and Citigroup SmithBarney), but the investment program is an independent consideration from the master trust structure described here.

#### Documentation

8. What documentation describes the entry (e.g., reports, forms, memoranda, software, audio-visual materials, etc.)? All materials must be provided, preferably in electronic format.

See the attached trust documents, agreements, city council resolutions, RFP and contracts.

#### B. Cost/Benefit

- I. Quantify the total resources (money and time) devoted to this project/program and identify the value added (tangible and/or intangible) as a result of its undertaking.

The RFP was entirely internally developed. Bidding and consolidating the custodial services reduced the annual cost of custody to \$78,900 per year saving about \$64,500 annually or about \$193,500 over the three year initial contract period, while adding master trustee services at no additional charge. Outside legal counsel required 20 hours at a cost of \$7,920. The entire master trust value on consolidation date was \$318,252,542. The benefit plan portion of these assets was \$123,216,088. The five-year weighted average return on the portfolio has been 5.92% while the return on fixed income only investments for general governmental assets has been 3.59%. The additional 2.33% return allowable under the GASB 45 assumptions for the calculation for actuarially required contribution for these plans is worth a savings of approximately \$2,870,935 in additional annual operating revenues that otherwise would have to be contributed as part of the ARC.

#### C. Complexity

- I. Describe the complexity of the project/program. How much training and technical skill is required for employees to make use of this solution?

Development of the RFP, trust documents and draft agreements was performed by internal Financial Management Services management and professional staff. Excellent technical and legal writing skills are required to originate the documents, but less skill is required if existing model documents are used and just modified to the individual entity's needs. Highly skilled and competent legal review of all documents is absolutely essential.

#### D. Originality, Creativity, and Innovation

- I. To your knowledge, is this the first time this type of project/program has been implemented by a government entity? If not, identify previous work in this area and explain the uniqueness of your approach.

We are unaware of anyone in government who has done this, however we do know of an endowment that is seeking to follow the model the City has used.

#### E. Other Distinguishing Features (Optional)

- I. Highlight any other noteworthy features about your project/program.

One key advantage of this program is that it consolidated reporting for multiple benefit plans while cutting the cost of custody and trust services. These were hard cash savings that are in addition to the actuarial contribution savings. It provided a lot of internal accounting and reconciliation effort to

set up, but has resulted in reduced reconciliation effort on an on-going basis while providing better centralized reporting and streamlining the business process.

Investment income from all investment managers is automatically recorded with the Trustee/Custodian and shows up in the centralized pool and is easy to track either on a consolidated or on a by manager basis. Investment income is unitized like a mutual fund so the ownership by benefit trust is also automatically distributed and easy to report upon by holding or by trust benefit program. A change in managers is automatically reflected in the unitized holdings but does not have to be divided up and recorded manually. In effect, the investment pool is a mutual fund owned by each trust proportionately to the assets contributed on a net basis. Contributions to and withdrawals from each trust are made on one monthly net transaction with a single settlement and unitized ownerships in the pool are adjusted accordingly. The City has online access to all trust holdings on a real-time basis and can run reports as needed directly from US Bank's web page.