2010 QUESTIONNAIRE FOR CANDIDATES FOR THE OFFICE OF COMPTROLLER

Citizens Union would appreciate your responses to the following questions related to policy issues facing the State of New York and our interest in reforming how state government operates. Responses to these questions will be one of several factors Citizens Union will use to evaluate candidates running for office in order to determine our "Preferred Candidates" for the Primary Election and "Endorsed Candidates" for the General Election.

We plan to make public your responses to this questionnaire in our Voters Directory and in other appropriate venues.

We thank you very much for your response.

Candidate Name: Harry J. Wilson Age: 38

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Education: Johnstown High School (Presidential Scholar, 1 of 141 in the nation), Class Valedictorian, Class President); Harvard University (AB, with honors); Harvard Business School (MBA). I was first in immediate family to go to college and worked my way through college and business school.

Occupation/Employer (or years in currently held elected office): I spent my career as an investor, primarily in distressed companies and working to fix them. After many successful years at four highly distinguished firms – Goldman Sachs, Clayton, Dubilier & Rice, The Blackstone Group, and Silver Point Capital – I was selected to serve on the President's Auto Task Force in 2009 - the group responsible for the overhaul of General Motors and Chrysler. I was the only Republican to serve in its leadership team.

Previous Offices and Campaigns: This is my first campaign for political office.

Are you willing to be interviewed by CU's Local Candidates Committee? YES __X__ NO _______
(Please note: Citizens Union can grant its "Preferred Candidate" and "Endorsed Candidate" rating only to candidates we have interviewed.)

Have you completed requisite campaign finance filings? YES__X__ NO______

Signature of Candidate: Date: 10/1/10

QUESTIONS

Please state your position on each of the following reform measures. Please feel free to explain in further detail your position on any one of these, by using the space available at the end.

POLICY ISSUES

1. What are your views regarding the fiscal health of our state government and the fiscal forecast for New York State, both in the private and public sectors?

New York has the highest combined state and local tax burden in the nation. Our debt burden is among the highest in the country. We have lost more people due to out-migration in the last 10 years than any other state, including post-Katrina Louisiana. We are facing an $8-plus billion budget deficit next year. Albany was 125 days late passing the budget this year, and the Legislature executed a Comptroller initiated pension raid to help close a budget gap. Even so, revenues are coming in short of Albany's initial unrealistic projections. And New York's Pension Fund is woefully underperforming, running a massive deficit that is billions larger than the Comptroller now admits to. Our state is a fiscal disaster.

As for forecasting New York's private sector future, the biggest challenge we face is that most companies find New York an unattractive place to do business. The fundamental reasons for this are our overwhelming tax burden and excessive regulations, which dramatically slow decision-making, deter business formation and expansion and increase the cost of transactions. In order to attract permanent, high-quality jobs, we need to reduce these barriers to job creation. If we do, then our private sector prospects are bright. After all, New York is the repository of a tremendously talented workforce as well as intellectual capital unmatched anywhere in the world. Once we unleash the full potential of our private sector, New York's fortunes will improve dramatically; this will afford New Yorkers of all backgrounds the opportunity to be financially secure and successful.

As for the State, we believe our government must go through the same operational restructuring that General Motors went through last year. This includes an honest budget process without fiscal gimmicks designed to kick the can down the road and put our State in greater financial peril sometime in the future. For instance, the current Comptroller's borrowing scheme against the Common Retirement Fund helped close this year's budget gap, but it will increase future pension contributions enough to cause dramatically higher State and local taxes in the near future. Similarly, the State's cash-basis accounting allows Albany leaders to defer required payments and maintain a structural budget deficit with impunity.

If New York continues along that path, our State's financial prospects will be bleak. The problem is that Albany has not gone through a pruning process (as every business and household has to do periodically) in decades, and the current level of mismanagement will spell catastrophe if left unreformed.

If elected, however, I will be the first businessperson to hold statewide office in decades, and probably the only restructuring expert to ever hold statewide office. As a result, I have the exact right skill set to implement a comprehensive restructuring of our State's broken operations. And at the end of a successful government restructuring, New York would be left with a truly balanced budget, an honest accounting of our financial position, an end to one-shot revenue gimmicks and a bright public sector future.

2. How would you use the power of the office to promote a fiscally sound future for the State of New York? How can audits be utilized by the office to not only effectively uncover waste and promote efficiencies, but realize actual savings?

The Office of the State Comptroller (OSC) comes equipped with significant and relevant powers to help promote fiscally sound practices for our State. For example, in theory and law the OSC's auditing authority is formidable; a tremendous amount of potential public good is connected to its effective use. Unfortunately, the current audit function is set up as a public process, and the incumbent Comptroller has both underutilized and misapplied his auditing capabilities by focusing on "gotcha" reports that are geared to capture headlines in the press, even though the amounts of achieved savings are relatively small and unverified.

Consider that the All Funds Medicaid Spending in the fiscal year 2011 State budget totals $45.3 billion, and that New York's Medicaid program is the most costly in the nation. In large part, this is true because our Medicaid program is administered in a manner that makes cost-containments almost impossible, and none of the OSC's State Department of Health audits have focused on the structural problems at issue. In addition, the Comptroller has conducted roughly 90 audits of the New York State Department of Health, the primary State agency for administering Medicaid. This is by far the largest number of audits of any single agency conducted by Comptroller DiNapoli, and roughly 40 of them focused specifically on Medicaid-related matters. But these audits focused on procedural operations and particular practices where there were inefficiencies, waste and small-scale fraud, such as individual doctors and dentists who overcharged for services, the qualifications of physical therapists and small scale recovery opportunities. In fact, 26 of the Comptroller's audits into Medicaid-related matters were for values under $5 million, while only 15 were for values of more than that. The Office of the Medicaid Inspector General (OMIG) generally deems matters amounting to less than $5,000,000 not sufficiently cost effective to pursue.

We view the audit function very differently. Rather than focus solely on small dollar, one-off items, we would seek to apply the audit power as one would conduct corporate restructurings – by reviewing every dollar of State spending, identifying the structural problems in a given program and proposing broad and specific reforms that would address those structural problems.

To implement these reforms, I plan to work collaboratively with the Governor and reform-minded members of the Legislature to include specific cuts and program changes in the budget, either through the Governor's proposed budget, through legislative modifications or through the Governor's use of the line-item veto.

3. What are the key areas in state government, local government, and in school districts that you have identified where New York State can realize significant fiscal savings? How would you use the Office of Comptroller to help achieve those savings?

The most savings to be found in New York State is in our Medicaid program. The All Funds Medicaid Spending in the fiscal year 2011 State budget totals $45.3 billion. That amounts to about a third of New York's State budget and about 23% more than California spends on its Medicaid program, even though California is substantially larger than New York and Medi-Cal covers 55% more people than New York's Medicaid program. As far as the magnitude of potential savings to be had, New York spends

$2,360 on Medicaid per capita – more than any other state in the country and more than twice the national average of $1,077. Closing that gap would result in billions of dollars in savings.

These potential savings come in a variety of forms. To be sure, our audits will uncover substantial fraud and waste. But larger savings will be found in an honest assessment of the cost/benefit of various programs and optional services and by reviewing and altering program design to achieve equivalent or better health outcomes at a lower cost.

To date, however, none of the OSC's State Department of Health audits have focused on structural problems. That needs to change, because our Medicaid program is currently administered in a manner that makes cost-containments very difficult. As Lieutenant Governor Richard Ravitch recently reported, long-term care accounts for almost half of the State's Medicaid spending and is purchased on a fee-for-service basis, but New York's Medicaid program has no coordinated cost management strategy for its fee-for-service expenses. Here, the OSC could help with solutions and implementation, while simultaneously calculating the potential savings from better managing New York's fee-for-service expenses. The Ravitch Report also points out that New York is virtually alone in its localization of Medicaid's administration. This makes coordinated cost controls difficult (although under new legislation, the Department of Health is required to develop a plan for the State's administrative takeover of Medicaid). Here again, the OSC could quantify the savings to be had while also helping to calculate what a complete State fiscal takeover would save for New York. This would help make the case to the Legislature, Governor and local stakeholders that, despite any political opposition, it is very much in the best interests of our financial future. Finally, State Senator Craig Johnson introduced legislation (S7821) that would cripple the State Office of Medicaid Inspector General (OMIG) and increase New York's liability for Medicaid recoveries owed to the Federal government. The bill has been championed by the "Home Care" industry, which has notoriously high error rates, meaning they are particularly subject to OMIG's scrutiny and recoveries, and Senator Johnson has received over $60,000 in campaign contributions from health care interests. But by conducting cost-benefit analysis on legislation that would interfere with the State's Medicaid recoveries, the OSC could help preserve New York's ability to achieve the $300 million a year budgeted for in future fiscal years. And because of the shared cost nature of our Medicaid program, this would also help local governments reduce their health care expenditures (and potentially property taxes).

There are also significant savings to be had in education spending. The State's fiscal year 2011 All-Funds Education spending totals $33 billion, and over the past ten years, State school aid has increased 45%, whereas the population of students remained flat. New York spends $15,546 per student, while the national average is $9,683. There are a number of significant cost-saving education ideas under discussion among budget watchdogs and fiscally responsible advocacy organizations. What the OSC can do, again through the auditing process, is conduct cost/benefit analyses of these proposals to determine which offer the best cost/benefit trade-offs and work in concert with the Governor and the Legislature to implement the most promising changes. Some of these proposals include: freezing teacher salaries for a period of time; developing a "best practices" template for non-classroom school district operations and work with school districts to improve their operations; repealing Taylor Law provisions that give teacher unions excessive financial leverage in negotiating with school boards; and enacting contracting reforms that can significantly reduce capital construction costs. All of these ideas would result in substantial savings for school districts.

Our work would not stop here. We would review every dollar of State spending; we highlight Medicaid and education simply because they are two of the biggest programs and likely to yield the most savings.

4. How do you see the role of the comptroller in reviewing government contracts? What are the criteria the comptroller can apply? Are there new criteria the comptroller should seek to use?

The Comptroller reviews and approves contracts that exceed $50,000 for all State agencies and for select public authorities, as well as contracts of over $1 million for public authorities. The OSC's role in contract review is intended to ensure compliance with relevant statutes and ensure open and competitive procurement of goods and services – absent political favoritism, overspending, bid-rigging, collusion or discrimination.

Despite recent reforms, it is still the case that much of the spending by public authorities falls outside the State's budget and accounting processes. This makes it difficult to keep track of, and it is in large part the reason why New York State's debt burden is disproportionately high. We believe the Comptroller's authority to review contracts comes with the right to review and reject bond purchasing agreements, which are the contracts required whenever authorities issue debt on a negotiated basis. By reviewing bond purchasing agreements, the Comptroller can prevent new debt that doesn't have a strong, dedicated and realistic revenue source and a payment schedule that corresponds with the life of the asset. In this way, the OSC could help prevent the State from increasing its debt load irresponsibly.

Furthermore, we will review every member item to ensure that it meets a code of ethics that we will establish that prevents member items from being used to benefit family members, business associates, donors or any other individuals with an inappropriate connection to the sponsoring legislator.

Finally, we will review the entire purchasing process. I myself have restructured the repurchasing operations of a number of corporations, including General Motors, in order to provide a more efficient process with appropriate checks and balances. For example, we have encountered a large number of small businesses across New York who are owed months of back-due payments from the State. The cost of that delay (essentially, a zero-interest loan from small businesses to the State) creates a higher cost of doing business that ultimately is priced into vendor contracts with the State – and either leads to higher taxes or diverts resources from essential services. We believe a more efficient process will result in reduced purchasing costs and benefits to taxpayers.

5. Do you believe the state pension funds are adequately funded to meet their obligations? Do you think any other changes should be made to the rules used to determine whether funds can meet their obligations? How would you handle management and investment of the state pension funds to ensure obligations are met? What is your position on the state's pension funds borrowing from itself to meet current funding obligations?

The incumbent Comptroller has maintained for some time that New York State's Pension Fund is over funded. This isn't true – not by any stretch of the imagination, and the newest disclosure documents issued from the New York State Division of the Budget (DOB) dispute this plainly, specifically and outright. (We will discuss the DOB's report specifically, but later in this response.)

We have been arguing for months that the Pension Fund is, in fact, woefully underfunded. We first raised questions about the underlying assumptions in the Pension Fund in June. We asked simply for additional disclosure on the key assumptions. What we received was a personalized attack. So we took our case to the public, touring the state and raising these questions. Our opponent's responses were invariably: "We are fully funded" and "our target return of 8% is the industry standard and totally achievable" or words to that effect.

So in late August, we released a 53-page report, "Public Pensions: Averting New York's Looming Tax Catastrophe," showing the true size of New York's Pension deficit to be between $30 and $80 billion.

The report is available on our website at www.wilsonfornewyork.com. Mr. DiNapoli's response has been to say: "I don't know where he comes up with his numbers. We don't use the fuzzy math that Wall Street types use." ("Comptroller's Race Offers Candidates With Experience, but Starkly Different Kinds," by Sam Dolnick, *The New York Times*, September 28, 2010). Meanwhile, every economic authority on public pensions – including Professor Joshua Rauh, who told *The New York Times* our relevant analysis was "spot on" and finance professor Zvi Brodie, who called New York's numbers misleading – agrees with our analysis ("State Pension Fund Faces Shortfall, Candidate Says," by Mary Williams Walsh, *The New York Times*, September 1, 2010). Shortly afterward, Orin Kramer, the former Chairman of the New Jersey Pension Fund, a prominent investor and Democratic fundraiser and donor to Mr. DiNapoli, wrote an op-ed for *The New York Times* also supporting our analysis. Indeed, there is little disagreement on this point among outside economic experts, and New York State's Pension Fund is facing a serious shortfall.

The $30 to $80 billion range was based on just one key variable: the appropriate discount rate. We also highlighted several other key variables that were unknowable, given the limited transparency provided by the Comptroller, but which we suspected would increase the pension deficit gap. Shortly after our report was released, Mr. DiNapoli responded, perhaps inadvertently, on one of those variables, indicating that the market value of the Fund's assets were $13.4 billion lower than the actuarial value used to calculate funding levels – increasing the known gap to $43 to $93 billion (see the "Annual Report to the Comptroller on Actuarial Assumptions," by Michael Dutcher, August 2010, p 23).

There are a number of accounting rules that must be changed in order to properly determine the extent to which public pension funds genuinely meet their obligations. First and foremost, the Governmental Accounting Standards Board (GASB), the agency that sets accounting standards for public pension funds, is too lax and has allowed politicians to claim for their states and municipalities far better fiscal health than would otherwise be the case under any reasonable standards. GASB must change its guidelines to conform to stricter private sector standards as developed by FASB and which apply to every corporation and nonprofit in the United States. Second, the actuaries who support aggressive accounting policies must also be subject to stricter regulations. In an apt public sector example, a New York State actuary report in 2008 held that an early retirement bill carried no additional costs for municipalities. New York City officials protested the bill would cost the City $200 million each year, and it later came to light that the State actuary was paid for the report by public sector unions. On top of that, a later report found this same actuary had vetted more than 50 bills, and a survey of just 11 of them that passed showed they would result in $500 million in eventual costs. Finally, national politicians have enabled their counterparts at the state level. The Tower Amendment, a 1975 amendment to the Securities Exchange Act of 1934 that creates a carve-out from the disclosure requirement for municipal issuers, removed an important enforcement mechanism. With only the later creation of an insufficiently vigilant GASB, there is a void in oversight of public pension funds' financial practices that leave taxpayers unacceptably exposed. Good stewards of public pension fund assets would recognize this void and create disclosure to address this problem, which we will do.

Looking at a more specific example of a rule that must be amended, GASB advises that a discount rate "be based on an estimated long-term investment yield for the plan, with consideration given to the nature and mix of current and expected plan investments." This approach of basing the discount rate on an assumption of long-term investment returns is dramatically different from the standard followed by all corporations and nonprofits and every financial practitioner and economist of good standing. Consider the public pension fund manager who decides to substantially increase the risk profile of his or her investments. Normally this would lead to the assumption of higher returns (even though it also substantially increases the risk of loss). The use of a higher investment return assumption would then translate into the use of a higher discount rate, which reduces the present value of future liabilities. By taking on substantially more risk (and substantially increasing the risk of loss), then, the pension fund would actually be able to reduce its stated liabilities! This twisted practice has no grounding in basic economics or finance or even common sense, yet it is a fundamental foundation of public pension accounting.

Just as importantly, GASB provides very limited prescriptions around what might constitute an acceptable "estimated long-term investment yield for [pension plans]" and, as discussed above, does not offer any consideration for the appropriate risk profile and what that might mean for investment returns. But given the nature of the underlying liabilities, it is critical that GASB formulates investment return guidelines that take risk into account, lest it continue to provide an incentive for public pensions to wade into increasingly risky investments (as has been very much the case in recent years). In fact, the current Comptroller has sought to increase the Fund's exposure to alternative assets such as private equity firms and hedge funds while blaming those same firms for contributing to our nation's recent economic collapse.

On the asset side of pension accounting, public pension funds are allowed to use a variety of accounting gimmicks to restate their asset values. New York's Pension Fund uses an "actuarial asset value" that incorporates two accounting devices that have little relation to the market value of assets. First, asset values are smoothed out over a five year horizon. So if the Fund owns stock in Microsoft, and Microsoft trades on the stock exchange at $25.00 per share, the actuarial value of Microsoft at that time could be $20, $30 or some other number that reflects a five-year smoothing. Second, a component of the actuarial asset value allowable by GASB includes the present value of future State and local government contributions (paid for through state and local taxes) and contributions by employees. These "assets" are not really there, but rather represent the expectation of future payments. Because of this allowance, as long as a state is willing to stipulate that it will ALWAYS pass through pension fund shortfalls to the taxpayers and has a robust mechanism to do so, IT WILL ALWAYS BE FULLY FUNDED. This present value tax account will increase to reflect higher future taxes. For example, in New York's 2004 Comprehensive Annual Financial Report (CAFR), these present values were negligible, less than $2 billion in aggregate. But in the most recent 2009 CAFR, the total exceeded $20 billion. This amounts to a more than ten-fold increase in the present value of future employer contributions (derived from state and local taxes) in order to fill the hole created over that period of time.

Fortunately, change is coming. GASB is currently conducting an extensive review of its policies, including a number of the key issues we have raised. If GASB does the right thing and adopts the fairer standards of its FASB cousin (though the Preliminary Views statement suggests they will only partially do so), we will have truth in public pension accounting for the first time, and our public officials will no longer be able to hide our pension crisis from wider view.

Not surprisingly, but embarrassingly nevertheless, many state pension fund officials, including the New York State Comptroller, have taken this opportunity to write to GASB officials and urge them not to make any material changes in its oversight practices and are opposing alterations to its rules. This is the equivalent of Enron writing to the FASB and requesting that they not change the accounting rules governing the special purpose entities that were a factor in its ultimate demise. Evidently, the New York Comptroller fears truth in accounting.

As for how to handle the management and investment of the State Pension Funds in order to ensure its obligations are met: recent stewardship of the State Pension Fund is a lesson on the perils of an overly aggressive return assumption. By shooting too high, the Fund took on too much risk, which led to more volatility and underperformance. Here, it's interesting to note that in the 1980s, before inflation and market bubbles enticed public pension funds into equities in far greater proportions, most were invested primarily in treasuries, corporate bonds and other less risky assets and had a correspondingly lower investment return assumption, generally around 4% to 5%. One way to think about that history is that public pension funds for decades were invested conservatively, had little volatility and delivered on their promises, even in adverse market environments. The long bull market from 1982 to 2000 allowed for pension funds to take on more risk, make richer promises and get away with it. It has taken the better part of a decade of mediocre market returns for the sins of the bull market period to catch up with us, but the overall trend among public pension fund returns has been clear enough. The corresponding costs have proven to be enormous. Interestingly, over the last three years, the most conservative part of the portfolio, the fixed income portfolio, was far and away the best performing portion of the Fund (a 6.8% compound annual return over the past three years, when overall performance was negative). Had the current Comptroller established a 6% investment return assumption at the beginning of his tenure and shifted more assets into fixed income, the Fund would have performed much better, with less risk, than it actually did, and taxpayers would be much better off.

It is therefore very likely the case that in allocating Fund assets, the result will be a meaningful shift from equities to fixed income. Still, within each asset class, there is a second layer of decisions to be made: what is the appropriate mix of active vs. passive (index fund) management? The vast majority of active managers underperform the index after fees over time. For example, the net rate of return over the last 1, 3, 5 and 10 years, for actively managed funds in New York's pension portfolio are meaningfully below the net rate of return for the S&P, even after adjusting for passive fund fees. This is not to say that active management should be abandoned – rather, that the Comptroller should select active managers in a manner different from current practice, namely: only select managers who can generate true alpha, or outperformance relative to the market, net of fees. This is highly likely to lead to a reduced number of active managers in the portfolio, increasing the percentage of equities currently under passive management (78%) while reducing the overall fees currently paid to equity fund managers ($98.8 million).

Just as in the case of more traditional equity and fixed income active money managers, most private equity funds and hedge funds do not outperform the market, net of fees and particularly on a risk-adjusted basis (i.e., adjusting for the fact that certain, but not all, firms employ leverage and thus have greater risk associated with their strategies and their returns). Similarly, then, the Comptroller must only invest in alternative managers who can generate true alpha. This approach is highly likely to lead to a reduced number of active managers in the portfolio, as well as reduced fees paid by the Fund. Presently, the New York State Pension System pays over $175 million annually in management fees to private equity and hedge funds.

Direct investments and real estate pose special challenges – they present all of the conflicts inherent in active manager selection, but also require greater in-house expertise in order to properly diligence the opportunity, assess the risks, etc. In one of the better practices of the current Comptroller, he utilizes a more active advisory committee for real estate investments as a partial recognition of this special case. However, in a much more professionalized investment process, there is an opportunity for a modest amount of direct investment in partnership with private investment funds that bear the same risk that the Fund would bear. These investments should be subject to strict limits and in all cases will constitute a small proportion of the portfolio.

Also, we are absolutely against any borrowing against the Pension Fund, including the Comptroller's so-called "amortization plan." The Comptroller's plan created a scheme to limit near-term contributions without being honest about the problem and kick the can down the road past the election so voters won't experience the problem for years. The initially reduced contributions will have to be paid back in the future with interest. This is a textbook definition of a borrowing – which is why virtually every major publication covering this story has characterized it as such – and the Comptroller's borrowing plan is nothing more than a disguised raid of the Pension Fund.

As stunning as this act of fiscal gimmickry may be, the approach was tried once before – and it failed. Comptroller DiNapoli's predecessor, Alan Hevesi, authored a similar plan several years ago. Of the $655 million he borrowed (a tiny fraction of what Comptroller DiNapoli now proposes to borrow), approximately $400 million remains outstanding, and to this day annual repayment costs exceed $75 million. It remains an open question as to how anyone looking out for the public welfare could seek to replicate and dramatically expand on such a failed program.

For the average New Yorker this year – the 2010 election year – rates will stay the same as in 2009, when total employer contributions were $2.5 billion or so. That comes to just over $500 for every household outside of New York City (the City has its own separate pension system but bears some of the state cost through state taxes). Due to the underperformance of the Fund, government employer contributions are expected to increase dramatically and, when combined with interest costs, will cause total contributions to increase by 2017 to over $1,800 per household. The net effect of the underperformance and borrowing costs is a $1,300 per household increase in pension costs.

Unfortunately for New York taxpayers, the costs of this scheme beyond that could be even more devastating, as the borrowing plan that ultimately passed the State Legislature on August 3, 2010 allows for this to go on each and every year forever. So significant increases would not come in 2017, as called for under the original plan incorporated in the proposed budget, but the borrowings would be much larger over time, the interest costs would grow accordingly, and the bill would not come due for even longer. It is a Ponzi scheme that, like Bernie Madoff's, would eventually collapse on itself.

Indeed, the plan's true costs depend upon the performance of the State's Pension Fund. And according to previous reports the Comptroller has not disputed, his office is assuming – fantastically – a repeat of market conditions after the 1987 crash, including the halcyon years between 1988 and 1998 when returns averaged nearly 14%. If the market underperforms that rate – what amounts to the best ten-year span in the Fund's history – then this borrowing plan's reported costs could be even higher. To put this expectation into perspective, assuming the same asset mix as the current Pension Fund portfolio while making reasonable predictions for returns on fixed income and alternative investments, equities would have to skyrocket, with the Dow needing to reach 80,000 (versus a current level slightly above 10,000) by 2022 for the Comptroller's market assumptions to hold up.

Should the Fund return anywhere less than an astounding 14% average over the next ten years, it would mean even greater financial pressure on the State and municipalities and a mountain of new debt – both of which could lead to even more substantial underfunding.

Finally, as promised in the beginning of our response to this question, we offer one more unequivocal and empirical point related to the funded status of New York State's Pension Fund. *The New York Times* just reported that, "When he lists his accomplishments, Mr. DiNapoli points to the health of the pension fund, one of only four in the country that were fully funded…" ("Comptroller's Race Offers Candidates with Experience, but Starkly Different Kinds," by Sam Dolnick, *The New York Times*, September 28, 2010.) The story went on to quote DiNapoli directly: "That's why we continue to have the best-funded pension plan of any pension plan in the nation."

Yet earlier that month, DOB released the Annual Information Statement (AIS) for fiscal year 2010, where it states outright that our Pension Fund is only 94% funded <u>and that funding level dates back to</u>

April 1 of this year. (You can look up the disclosure – on page 128 – here: www.budget.state.ny.us/investor/ais/2010AISFinal-Reissued.pdf)

Therefore, anytime the Comptroller has claimed fully funded status since April 1, he has been mistaken or been deliberately deceiving. Incidentally, the Pew Study that DiNapoli cites as proof New York is fully funded is a mere regurgitation from the OSC's own misleading and outdated numbers. (*The Governing Magazine* article he also cites took its findings directly from Pew and was compiled by their Events & Program Manager.) In any event, both Pew and *Governing Magazine* have stated they would revise their analysis in light of this new information, and New York State's AIS should clear up how disingenuous the OSC has been.

6. Is it appropriate for the comptroller to use his or her pension authority to advance a policy agenda? If so, what are the appropriate parameters on this type of action?

It is possible to earn attractive risk adjusted returns for New York State's Pension Fund while always taking into account incontrovertible national security issues when deciding how to invest New York's pension assets. There are clear cases when we should never invest in certain regimes, such as those that sponsor terror, and we are committed to establishing a state-of-the-art system of checks to assure that pension dollars are not invested in companies doing business in states that sponsor terror.

By contrast, it is not acceptable for the Comptroller to use the Pension Fund to advance his or her own political career. Unfortunately, the incumbent has not abided by this self-evident principle. In one recent example where the Comptroller leveraged public assets for his political benefit, Mr. DiNapoli referred menacingly to the OSC's ownership stake in a publicly-held corporation while attempting to influence a contract negotiation between the corporation and a close labor ally. The Retail, Wholesale and Department Store Union (RWDSU) endorsed Mr. DiNapoli in February 2010. Less than two months later, in the middle of a labor dispute between the RWDSU and Dr. Pepper Snapple Group, Inc., Mr. DiNapoli wrote to Dr. Pepper's Chief Executive Officer on April 9, 2010:

> "…I am informed that ongoing contract negotiations…have grown contentious largely because…the workers are being asked to take a significant pay cut….As Comptroller of the State of New York, I am the Trustee of the New York State Common Retirement Fund currently valued at approximately $126 billion. The Fund's portfolio includes 938,270 shares of the Dr. Pepper's stock with a market value of approximately $33.2 million. The Fund is a long-term investor and in my fiduciary capacity I monitor issues that have the potential to impact the value of its investments. I am troubled by the…allegations and the opportunity they create for the Company to be perceived as 'anti-labor'. Public perception aside, such unresolved labor issues can negatively affect the morale and productivity of the Company's dedicated employees. A disenfranchised workforce and the associated negative publicity ultimately may impact profitability."

If Mr. DiNapoli genuinely feared that Dr. Pepper's labor policies might harm the value of his stake, then he had a fiduciary duty to divest of his interest to protect the value of the Fund. Note that his letter does not address the merits of the dispute. Ironically, it does make the point that the Fund exists for the benefit of its members' retirement plans, not to fulfill the political goals of the Comptroller.

This is not to say that the Comptroller should not weigh in with corporations in which the Fund has an investment. On the contrary, he or she absolutely should in situations where doing so will enhance the value of the Fund's holdings. This is, of course, very different from a naked attempt to influence a corporation for one's own political ends.

7. What reforms do you think are necessary to promote a timelier, transparent and more accountable budget process? What is your view of applying GAAP (Generally Accepted Accounting Principles) to the state's budget? What is your position on the creation of an independent budget office?

We support and will fight for the following budget reforms:

- An honest accounting of our State pension problems, beginning with applying private sector standards, as maintained by FASB, to our Pension Fund.
  - Put an end to borrowing schemes that raid the Pension Fund in order to help balance the State's budget (i.e., the Comptroller's "pension amortization plan.")
- Create a multi-year financial planning process where the budget must include a five-year forecast of revenues and expenses and require that the approved budget be balanced for the first two years of the forecast.
  - Identify present and future structural budget gaps, require proposed action to close the gaps and adjust periodically, but at least every year, to take into account changed conditions.
  - Explicitly identify every assumption in budget forecasting.
- Require that New York State releases more frequent updates to the Financial Plan.
- Balance the budget not just for the General Fund, but for all non-federally funded State spending.
- Ban the use of one-shots to balance the budget or fund recurring spending.
- Create a full balance sheet for New York State that incorporates State authorized debt, all authority debt, underfunded pension obligations and unfunded retiree health care obligations.
  - Require all future debt issuances to be issued by the State Comptroller and to be accounted for in this comprehensive balance sheet.
  - Have this comprehensive balance sheet subject to a debt cap that is frozen for five years and thereafter can only rise by the lesser of inflation or 2%.
- Change the beginning of the fiscal year to July 1 to allow policymakers to have a more complete picture of tax revenues and allow incoming administrations adequate time to reorder budget priorities.
- Require that all mandates have a full, multi-year accounting of their costs as part of their legislative description before the Legislature votes to approve the mandate; this multi-year accounting must be subject to the independent review of the Comptroller.
- Apply a spending cap for New York State of the lesser of inflation or 2%.
- Institute a property tax cap of the lesser of inflation or 2%.
- The State should be required to balance the budget according to Generally Accepted Accounting Principles (GAAP).

We believe that, if the Comptroller is performing his job in the proper way, an independent budget office would not be necessary. In the absence of an active Comptroller, an independent budget office would create a helpful, independent voice in budget debates.

8. Is the current balance of power between the governor and the legislature appropriate to ensure a transparent, timely and accountable budget process? What is your view on the recent use of budget extenders accompanied by actual budget appropriations for state operations by the governor as it relates to the appropriate balance of power?

New York State's budget process is horribly broken. Our State's Executive Budget law is 80 years old and is both outdated and unsound. Budgets are routinely late and they often rely on accounting gimmicks and one-shots to balance out expenditures using non-recurring revenue actions. The State therefore maintains a nagging structural imbalance, and this flaw was on full display during New York's cash-flow crisis in the second half of fiscal year 2010.

Given the current power balance, the use of budget extenders was an effective resource for seeking responsible cuts when the Albany Legislature proved incapable of coming up with a sound resolution on time. An even better solution would have been more significant cuts within those budget extenders to truly balance the budget without tax increases or borrowing from the Pension Fund. Generally, however, fundamental changes in the budget processes are long overdue, starting with shifts in power between the Governor and the Legislature.

Specifically, we would require that, if the Governor and the Legislature cannot agree on a revenue forecast, an average of the Governor's, Legislature's and Comptroller's forecast be utilized. Also, we would require that the Governor's budget take effect if the Legislature has not passed a balanced budget by the start of the fiscal year, as it happens in a number of counties in New York.

Furthermore, we believe the Comptroller has the constitutional authority to refuse certification, and we would use that authority when appropriate. Budget gimmicks over the past two decades have put state taxpayers in an unsustainable position. The current Comptroller has certified dishonest budgets that went out of balance almost immediately. The result was mid-year school cuts, hospital cuts, park closures, and other serious disruptions to the taxpaying public. We believe the Comptroller must fight for honest and fiscally responsible governance. And we will use the OSC's certification powers to do just that.

9. What is your position regarding measures to limit the role of money in elections and politics, such as substantially reducing contribution limits and/or instituting a public campaign financing system at the state level?

We support restricting outside influence in political campaigns and believe New York State's campaign contribution limits are too high and should be substantially reduced.

We think the greatest abuses develop within those groups who do business with those to whom they donate. A textbook example is the series of scandals around the Comptroller's office due to the role of politically-connected placement agents and campaign donations from money managers. We think the restrictions introduced to address these issues need to be extended substantially as they address only one pocket of potential corruption in the Comptroller's office. In addition to money managers, these common-sense restrictions must include class action securities plaintiffs' attorneys and public sector labor unions.

Our campaign released a white paper on ethics reform titled, "The Office of the State Comptroller – It's a Question of Ethics," that addresses these specific reforms, which should be voluntarily adopted right away and legislated as soon as possible. This report is available on our website. But we currently oppose public financing at the state level because we believe it would reduce the resources challengers could realistically amass and therefore have the unintended consequence of affording incumbents added protections. This is not as significant a problem for New York City's public financing system, since it exists within term-limited election cycles. At the state level, however, there is rarely any political turnover outside of resignations or death. And we oppose reforms that, however well-intentioned, would add another barrier to entry for fresh faces and the innovative thinking that comes with the injection into politics of new blood.

10. What is your view on continuing the office's current practice to eliminate campaign contributions to the comptroller for those who do business with the pension fund, like investment advisors, which is more restrictive than the SEC's rule on this matter?

Presently, there are SEC regulations preventing select professional classes that do business with New York State from contributing to the Comptroller or a candidate for Comptroller. Any contribution above *de minimis* exemptions triggers a two-year ban on receiving an investment from the State. On June 30, 2010, the SEC voted unanimously to extend these restrictions to money managers who solicit business from public pensions. This is a step in the right direction. But other professional classes conducting business with New York's State Comptroller receive millions of dollars in compensation and remain free to donate to the Comptroller up to New York's legal limit – among the highest in the nation at $37,800 per cycle for statewide office in the general election. Just who are these professionals who reap millions from their dealings with the OSC? Most obviously they are securities class action plaintiffs' attorneys and public sector labor unions.

As a multi-billion dollar institutional investor, the Fund often has meaningful holdings in public companies. Consequently, the Fund sometimes serves as a lead plaintiff representing shareholders in lawsuits filed against corporations accused of improper financial activities. The OSC maintains discretion to choose legal counsel on behalf of all shareholders in these cases, where success can lead to judgments that run into the tens of millions, and occasionally hundreds of millions, of dollars. Lawyers can claim a meaningful percentage of the recovery in legal fees. At the same time, and perhaps in turn, New York State Comptrollers have collected hundreds of thousands of dollars in campaign contributions from these litigators.

Accusations of impropriety have been a troubling and recurring theme. One former New York State Comptroller advocated for the selection of two law firms that had contributed $100,000 to his campaign around the time the firms were retained to represent investors in a securities case. Other plaintiffs in the case accused the Comptroller of choosing the firms as political payback. The courts found that there was insufficient evidence, but noted that selecting counsel based on political favoritism would be injurious to the class as a whole and that public pensions should 1) disclose campaign contributions that could be linked to an attorney's selection, 2) submit a sworn declaration recounting the selection process and 3) verify that it was free of influence from elected officials. The law firms in this case received $55 million in contingency fees and, in the months that followed, raised almost $200,000 in campaign donations for the Comptroller.

In total, lawyers representing the New York State Pension Fund in class-action suits have raked in $518.7 million in fees over the past 10 years. This exposes an obvious and lingering conflict and is precisely the kind of pay to play culture that has scandalized the Comptroller's office and so must be prohibited. Yet, as of January 2010, Tom DiNapoli has taken at least $129,000 in contributions from the same securities plaintiffs' attorneys he chose to represent the Fund in class action cases. He has shown no intention of reform and refuses to discontinue exploiting the OSC's leverage for his political benefit at the expense of New York pensioners. Just recently, he accepted $14,000 in campaign donations from a law firm that he proceeded to hire the next week (to help litigate a case against Bank of America, where he had formerly been part of a class action suit but dropped out for some reason and retained his own counsel).

In an effort to eliminate this vexing pay to play practice – and in the absence of SEC enforcement – the OSC should stipulate that any time the Fund serves as lead plaintiff in a class action case, its attorneys will be barred from making political contributions to the New York State Comptroller or a candidate for that office for two years after the date of their selection. In addition, the Fund should apply the same contribution restrictions to these attorneys that the SEC instituted for bond underwriters and more recently investment firms, so that plaintiffs' attorneys cannot win business from the OSC for two years after donating to the Comptroller or a candidate for that office.

Another professional class with interests closely linked to the Fund that generates large campaign contributions – and also provides in-kind campaign services – is public sector labor. The conflict for the OSC in this case is its discretion in accounting for the Fund's obligations. Financial analysts are increasingly in uniform agreement that the methods the OSC now uses, while currently accepted under GASB, nevertheless substantially overstate the degree to which the Fund's long-term liabilities are covered by its current assets.

This distorted financial analysis obscures the true costs of the Fund's liabilities and thus misrepresents the economic cost of the State's contractual commitments to its employees. That is of serious benefit to these public sector unions, who in turn find it easier to negotiate for additional wage increases and pension sweeteners when existing member benefits appear more affordable than they actually are. The injured parties in this are all New Yorkers, since the actual math is irrefutable, and – despite temporary accounting gimmicks – pension shortfalls would be borne by unsuspecting taxpayers.

This is another case where a professional class can reap large financial gain from the OSC's authority at the expense of the public fisc. Not surprisingly, but no less problematically, public sector labor unions have been aggressive campaign contributors to New York Comptrollers. Labor groups representing public sector employees have donated at least $283,200 to Tom DiNapoli just since he was appointed Comptroller.

Since the Comptroller's responsibilities with regard to pension obligations are ongoing and continual (as opposed to episodic, as it is when awarding business to investment management firms or plaintiffs' attorneys), a two year ban on donations is insufficient. To achieve the salutary effect of a "pay to play" ban, Comptrollers or candidates for Comptroller should be prohibited from receiving monetary contributions from public sector labor unions, with only a *de minimis* exception.

11. What is your view of placement agents, be they third party or directly employed who are licensed professionals by the firms selling their securities and investments? Should they be banned or should there be different treatment depending upon whether they are third party or work directly for the firm?

We would maintain the ban on placement agents. While there are certainly some legitimate placement agents who were barred from working with the Pension Fund as a result of the illicit activity of politically connected placement agents, we don't see a workable proposal that would fairly make a distinction. Second, the public trust that was so greatly abused through this process needs to be restored. As a result, we would maintain the current ban on placement agents.

12. What is your position regarding stricter limits on gifts and other benefits, such as honoraria, that public officials can receive from lobbyists, investment managers, contractors and others attempting to influence the political process?

We support a total ban on gifts and other benefits from lobbyists, contractors and those with interests before the OSC. The restriction should cover gifts of any value to employees – including meals – from anyone connected to business originating from the OSC. Only then can we expect to end the pay to play culture that continues to envelope this office.

13. What is your view regarding the establishment of an independent board to help the comptroller oversee investments rather than maintaining the status quo in which the comptroller is the sole trustee?

We believe the best approach is a hybrid approach that seeks to blend the best aspects of the sole trustee system and a more common board, while addressing the shortcomings of both.

The virtues of the sole trustee are that there is clear accountability to the voters, and we need more accountability in Albany, not less; and the sole trustee has historically been a great bulwark against politically-driven raids (until the current Comptroller initiated his borrowing scheme, which has the equivalent economic impact of a raid).

However, the sole trustee can preclude the input of a broader group and has obviously created enormous breaches of trust through the selection of active managers.

So how do we blend the best of both?

We would create an investment committee of retired, world-class investors that would serve two functions:

1) Advise the Comptroller on asset allocation, broad strategic questions and other fund management questions

2) Serve as a first screen for all active manager selections. If the investment committee approves, the proposal is made to the Comptroller, who can support or deny the recommendation. If the investment committee rejects the manager, the Comptroller has no recourse or ability to inject him/herself into the decision-making process.

This may be a novel approach in the world of public pension funds, but it is routine in the world of money management, as virtually all investment funds and endowments are managed in this way.

We have more retired investment talent here in New York than anywhere else in the world. We are highly confident we could build a team of 7-9 world-class investors who would serve, conflict-free, as a public service. The Pension Fund and the Comptroller would benefit from their wise counsel, and they would serve as a good ethical barrier for the Fund.

Finally, in the world we envision where we manage the Pension Fund with a more conservative asset allocation, there is also less active management and more passive (index fund) management. As a result, there is less opportunity for corrupt decision-making and a manageable workload for the investment committee.

14. What steps, if any, should be taken to promote greater transparency and accountability of our state's public authorities? Which additional measures are needed, if any, beyond the recently passed Public Authorities Reform Act of 2009?

Despite positive reforms included in the Public Authorities Reform Act (PARA) of 2009, there remain fundamental shortcomings when it comes to the level of transparency with which our State issues debt. For instance, the only State debt that is subject to public referendum is New York's General Obligation bonds. But the last time the State sought authority to issue General Obligation (GO) bonds was in 2005. And only $3.4 billion of New York's outstanding bonds are GO, whereas New York's total state-related debt outstanding is $55.1 billion (as of 3/31/10, according to the Annual Information Statement of the State of New York Fiscal Year 2010, p. 106). Therefore, almost 95% of the State's outstanding bonds originate through so-called "back-door" borrowing. These bonds are issued by one of the State's many authorities, which are much less transparent than the State's General Obligation credit. Authorities aren't required to seek voter approval when issuing debt, and not even legislators get a vote when authorities decide to borrow. Instead, back-door borrowings are usually only discussed at authority board meetings. While these meetings are open to the public, the attention paid to them is significantly less than the attention paid to any public referendum.

Furthermore, the State Legislature's role in issuing back-door debt is generally limited to making debt service appropriations once the bonds have already been issued. At that point, blocking the appropriations would result in a fiscal calamity, which is to say that that not even our elected officials get a meaningful say in back-door debt.

Ultimately, the only way to truly manage the State's outstanding debt obligations (including underfunded pension obligations and unfunded retiree health care obligations) is to create a consolidated balance sheet for the State, complete with contingent liabilities, and pair that with a long-term forecast in order to truly assess the State's finances and create a debt cap to better manage our outstanding State debt.

Beyond the question of debt issuance is the operations of these authorities. The Comptroller should aggressively audit these authorities to root out mismanagement and the patronage that dominates too many of them. As a starting point, a proper, constructive audit of the MTA should seek to address their massive operating deficits forecast by cutting costs to close the deficit and repeal the MTA tax.

15. What is your position on requiring state legislators to submit receipts to the comptroller for per diems they receive for travel, lodging, and food expenses while in session in Albany?

We favor this policy and, as Comptroller, will seek whatever action is required to institutionalize it.

Please provide any additional information about your positions as well as actions that you have taken or plan to take to advance your positions on the above issues either below or on a separate sheet of paper.

I am not a politician, but a businessperson with an expertise in restructuring broken companies, and I decided to run for New York State Comptroller because I believe I have the skills the State desperately needs to address its broken fiscal condition. The State's financial problems hurt all New Yorkers, but they disproportionately hurt the working men and women who can least afford the high taxes and borrowing costs that support our inefficient State and local governments.

I know all too well what happens to families when businesses are economically motivated to move elsewhere and New York factories shut down. My hometown of Johnstown, NY had sky-high unemployment when I was growing up in the 1970s because the factories employing a largely immigrant workforce, including my mother, moved away. I saw our community and my family suffer from the results. It instilled in me a deep, firsthand understanding of what economic dislocation can do to New Yorkers, and I believe my business experience gives me a unique perspective on how to help avoid this calamity.

As you may know, I played a critical role in saving General Motors, in particular, and the U.S. auto industry in general, and I was the only Republican on the senior leadership team of the President's Auto Task Force. I know we all appreciate the catastrophic impact that the liquidation of General Motors would have had on the American economy. Obviously, President Obama deserves the credit, but my role in leading the day-to-day restructuring of General Motors was critical to its success. I offered to serve in this capacity for a number of reasons, including the fact that our country was in a crisis and I thought my restructuring skill set could be of significant benefit. Since I know the pain communities feel when factories shut down, and I thought the problems at GM were fixable, I wanted to play whatever role I could in fixing those problems and avoiding that pain, as long as it could be done at a cost acceptable to taxpayers.

Just one year after the bankruptcy filing, the success of our work is showing up in GM's results. GM, which once had the highest cost structure in the auto industry, now has the lowest. The Company is profitable, gaining market share and adding jobs, including here in New York State. I recently toured the Tonawanda plant, the sight of up to 1100 new announced jobs, because it gives me great pride to see the benefits brought to working people and their communities from the work we did last year.

I believe New York State government has to go through the same operational restructuring that GM went through last year. Our government has not been pruned and made more efficient (as every business and household has to do periodically) in decades, and that accumulated waste and mismanagement drives higher taxes that hurt people and businesses across this state. I will be the first businessperson to hold statewide office in decades, and I will probably be the only restructuring expert to ever hold statewide office.

As even Democrat Andrew Cuomo has said, our State needs a wholesale restructuring. Well, I have the exact right skill set at the exact right time for the exact right office. And when we get through that process, New York State will be dramatically more efficient, less wasteful and more job-friendly than it is today.

I have a very different approach than most political candidates because I have a very different background. I care passionately about creating opportunities for working people across New York to partake in the same American Dream I have been able to live in my own life. I believe I have a unique angle on how to do this, and it is coming at a critical time in our history.

Thank you for your time and consideration.

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