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Revisions Considered for Valuations Of Public Pension Fund Payouts

By David Cho
Washington Post Staff Writer
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The leading U.S. association of actuaries is considering a change to the way state and local officials value the cost of their pension promises, which could force governments to dramatically raise their contributions to their retirement plans.

The American Academy of Actuaries heard testimony yesterday on whether to revise accounting methods used by public pension funds that determine how much money they must invest now to meet their payments to workers in the future. Some economists said the current practices, which use optimistic assumptions that are not permitted in the private sector, allow public pensions to understate the cost of the future payouts.

The debate is being described by pension actuaries as a "family fight" within their close-knit community. But it has also sparked an uproar among pension fund managers and public officials around the country.

Several leading pension managers say the change could confuse governments and their constituents. And they accused the academy of being unduly influenced by big Wall Street firms, which stand to make money from offering services to pension funds if they change their accounting methods. William Bluhm, the academy's president, denied the charge.

Bluhm said an Academy board could issue new standards directing pension funds to modify their accounting methods, but municipalities could pass their own measures trumping the requirement. A second Academy board could make recommendations on the matter as soon as next month to the Governmental Accounting Standards Board, a federal body that sets voluntary standards that most public pension funds follow. GASB officials have been considering this issue since July.

Even with current accounting methods, state and local governments are increasingly struggling to keep up with the soaring cost of retirement promises, some pension analysts say. The number of public plans that are underfunded -- defined by the industry as not having enough money to meet 80 percent of future payouts -- soared to 40 percent in 2006, a five-fold increase from 2000, according to the Government Accountability Office.

The trend has presented taxpayers with a bill that is eating up a vast portion of government budgets at the cost of other services. In Montgomery County, pension and retiree health-care costs are already higher than the combined budgets for the departments of transportation and health and human services.

In May, the city of Vallejo, a suburb of San Francisco, became the largest city in California's history to declare bankruptcy after it was swamped by salary and pension costs. The city had agreed to pay rank-and-file police officers an average of $122,000 before overtime while firefighters made an average of $130,000. They also could retire at age 50, walking away with an annual pension equal to 90 percent of the pay in their final year.

Public pension funds generate money from worker contributions, government payments and the returns from investing that money. These funds pay an annual pension salary and health benefits to retirees and often their spouses for as long as they live. As state and local entities, pension funds are not subject to federal oversight and have wide latitude in how they estimate the cost of their future obligations.

One of the most important assumptions they use in their calculations concerns the rate at which a fund makes money on its investments. The better these investments fare, the more flush the fund. If a government projects a high rate of return, there is less need to tap taxpayer money to finance a shortfall. Most assume their investments will earn 8 percent interest.

That is about twice the market-based rate that private firms are allowed to use under federal regulations. Economists and some actuaries say public pension funds should use these market rates, which they argue are more realistic gauges of long-term returns from risk-free investments such as 30-year Treasury bonds. The rate on the 30-year Treasury was a little higher than 4 percent yesterday.

Using such a risk-free market rate is a widely accepted practice that is "drilled into the head" of "every first-year MBA student," said David Wilcox, deputy director of the division of research and statistics at the Federal Reserve, who testified before the Academy yesterday and who advocates the accounting change. "A market-based estimate provides the truest measure of the burden on taxpayers of providing the pension benefit in question."

Some Academy leaders say pension funds should disclose their future payouts using the two different interest rate assumptions. "I lean in the direction that if you give out information, that can't be a bad thing," said Bruce Schobel, an Academy board member.

But Christian Weller, a senior fellow at the Center for American Progress, told the Academy panel that disclosing the two numbers would confuse workers. He said politicians who oppose government pensions might also try to exploit the difference in the numbers.

"I'm not sure why you should confuse things by even implying that you should be using a different system than the one you are using," added Nancy Kopp, Maryland's treasurer. "We are trying to be as straightforward and transparent as we can, and we also are trying to have a diversified portfolio to ensure we will be well funded so that taxpayers don't have to pay any more than they should."

Other pension managers noted that fund returns have historically averaged about 8 percent per year for the past two decades. And because they do not face the possibility of going out of business, unlike firms in the private sector, they should be allowed more leeway in their rate of return assumptions.

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