
Rep. Ryan's Express Could Save—or Derail—Public Pensions

By Kerry Pechter *Wed, Dec 15, 2010*

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A bill recently introduced by Reps. Paul Ryan (R-Wisc), Darrell Issa (D-Calif) and Devin Nunes (R-Calif) would punish states that fail to transparently disclose their public pension funding status each year by revoking their right to issue bonds that are exempt from federal income tax.

If the bill were passed—perhaps by the incoming Republican-controlled House of Representatives—it would be hard for a non-compliant state to sell bonds for any purpose, not merely to finance pension benefits for their retired teachers, snowplow drivers, policemen and other public sector workers.

“In the case of a failure... of State or local government employee pension benefit plans to meet reporting requirements,” the proposed bill says, “no specified Federal tax benefit shall be allowed or made with respect to any specified bond issued by any such State or political subdivision.”

Perhaps the most pointed aspect of the bill, H.R. 6484, is its requirement that states use Treasury rates, which are historically low, to discount pension obligations and calculate funding requirements. Since Treasury rates are far below the rates (as high as 8%) that states now use to project the growth of their pension funds, the switch could instantly double a state's reported funding gap—and send shock waves through the electorate.

Why use Treasury rates when states don't invest pension fund assets primarily in Treasuries? “The argument being made by the congressmen is that because the pensions are risk-free”—that is, the states are obligated to pay them—“you should use a risk-free rate to discount them,” said Ethan Kra, vice president of pensions at the American Academy of Actuaries vice president of pensions. “This bill addresses reporting and disclosure. It does not address funding or required investment risk,” he added.

The bill, which state pension administrators consider politically partisan, reflects the nation's broad climate of fiscal anxiety in general and about public pensions in particular, Kra said. The Security and Exchange Commissions is worried that states with overwhelming pension costs might end up defaulting on their bonds. Taxpayers nationwide fret that states may plead for pension fund bailouts from Uncle Sam.

Two of the three sponsors of the bill, Darrell Issa and Devin Nunes, represent districts in California, whose state public pension funding has fallen behind since the dot-com crash of 2001. According to the Pew Center on the States, the California State Teachers Retirement System paid less than two-thirds of its \$4.3 billion contribution obligation in 2008.

But overall the state's projected pension liability of \$454 billion is 87% funded. Between 1999 and 2008, the state pension's liabilities grew 125% while assets grew only 65%. The big hole is in health care, where virtually none of the state's \$62 billion in retiree health care and other benefit promises are funded.

The other sponsor, Paul Ryan, was described in a recent *New Yorker* article as “the GOP’s designated thinker on the big issues, like entitlement reform.” Ryan, who turns just 41 in January but has represented Wisconsin since 1999, drew attention in early 2009, when he introduced a bill that would have eliminated the Obama stimulus package, replaced Medicare, reduced the top individual income tax rate to 25% and introduced a value-added consumption tax of 8.5%.

A stick, not a carrot

As for the bill’s blunt threat to withdraw a state’s tax-exempt bonding privileges unless it improves its pension accounting practices, Kra noted that Congress has a limited array of levers for influencing the states. “They have to do it this way, because under separation of powers, [the federal government] can’t force the states to do anything,” Kra noted.

The bill’s sponsors assert that some states are purposely hiding the impact of past promises to public employees.

“As we speak, lucrative pension promises are being made to public employees that taxpayers simply cannot afford. The plans themselves admit to more than a \$1 trillion in unfunded liabilities,” said Rep. Devin Nunes in release. “Unfortunately, the true level of unfunded liabilities associated with these plans—perhaps more than \$3 trillion—is being hidden thanks to unrealistic accounting standards.”

Not surprisingly, state pension fund managers resent this characterization, and have denounced the bill’s implied accusation that they are hiding their pension obligations. A coalition of state organizations led by NASRA, the National Association of State Retirement Administrators, in a December 8 press release, said:

“Inaccurate and inflammatory descriptions of the state of public pensions and unnecessary calls for federal intervention are unwarranted and only serve to confuse the public and unduly alarm state and local government retirees.”

It went to say that “Pension fund asset values have been growing since March 2009, and the most recent data show current assets are approximately \$2.9 trillion. The Government Accountability Office has found that public pensions on the whole are financially secure and positioned to meet their long-term pension obligations, and even after the market decline, aggregate public pension funding levels are around 80 percent.”

A pension official in one state told *RIJ* that the bill is seen more as part of an attempt to undermine public support for state pension plans and hasten their conversion to defined contribution plans, rather than as an attempt to force pension administrators to put the plans on a firmer financial footing.

“What they’re doing is mean, heavy-handed and punitive,” said the official, who asked not to be identified. “As soon as [the bill] came out, the associations were just deadily opposed to it. There’s a negative reaction everywhere because it’s as though someone’s trying to come in and run your business. It’s also a way to

produce the most conservative view of a state's pension liabilities. But it's the wrong punishment for the behavior.

"If I understand it correctly, the bill doesn't refer to the tax benefits of the pension itself, but about the tax treatment of the state's bonding authority. The state's ability to issue tax-exempt bonds is related to a lot of things other than pensions. There's no direct relationship.

"I don't see the connection between the bonding authority and the pension disclosures. They're looking for a way to get this information disclosed in the way they want it disclosed. That's not necessarily wrong, but they're using the wrong punishment to get us there. It's too draconian. There's probably better ways to evaluate the pension liability than with the Treasury rate.

"It would approximately double the pension liability. That would shock people and I think that's the effect that they're aiming for. I don't know where the assumption came from that the federal government has to bail out the state pensions. Anybody's who is responsible in this area understands the wisdom of easing toward a more realistic assumed earnings rates. But this bill could create a disaster."

The pension official said that the push for more conservative public pension accounting practices could have been handled in a less sensational manner through negotiations with the Government Accounting Standards Board, which "has been moving in that direction already." But Kra said that the GASB has been very slow to act, and that is plagued by conflicts of interest, because some of its members are actively employed as public pension administrators.

Objective analysis

The Pew Center on the States recently produced a study of the public pension crisis, "The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform." It criticized state pension administrators for:

- Failing to make annual payments for pension systems at the levels recommended by their own actuaries;
- Expanding benefits and offering cost-of-living increases without fully considering their long-term price tag or determining how to pay for them; and
- Providing retiree health care without adequately funding it.

In their own defense, state pension fund managers describe themselves as whipsawed by the markets. They felt pressure to abandon conservatism and seek higher returns in the equities markets during the 1990s boom, only to pay for it in the busts of the 2000s. The Pew study noted that:

- In 2000, just over half the states had fully funded pension systems. By 2006, that number had shrunk to six states. By 2008, only four—**Florida, New York, Washington** and **Wisconsin**—could make that claim.
- In eight states—**Connecticut, Illinois, Kansas, Kentucky, Massachusetts, Oklahoma, Rhode Island** and **West Virginia**—more than one-third of the total pension liability was unfunded. Two

states—**Illinois** and **Kansas**—had less than 60 percent of the necessary assets on hand.

- Nine states were deemed solid performers, having enough assets to cover at least 7.1 percent—the 50-state average—of their non-pension liabilities. Only two states—**Alaska** and **Arizona**—had 50 percent or more of the assets needed.
- Forty states were classified as needing improvement, having set aside less than 7.1 percent of the funds required. Twenty of these have no assets on hand to cover their obligations.

A report issued in October by the American Academy of Actuaries, “Risk Management and Public Plan Retirement Systems,” provided some background and perspective on the plight of public pensions. It said:

“State and local workers were excluded from Social Security, at its inception, and thus, subsequently, many states and local governments endeavored to establish plans. Over half of the large public retirement systems that exist today were established between 1931 and 1950, and by 1961, 45 states had established defined benefit plans.

“U.S. Census Bureau data showed that, in 2008, public plans covered almost 26 million active workers and retirees. Size and coverage of public plans vary widely; Table 1 shows that, in general, the very large state systems, which only comprise 9% of the total number of systems, cover 88% of the membership of public employee systems.

“For fiscal year 2008, public sector plans reported holding \$3.2 trillion in assets, with \$180 billion in payments to plan participants (mostly in payments to retirees and beneficiaries), and \$119 billion in contributions (\$37 billion from employees and \$82 billion from state and local governments).”