

COMMENTARY

Covering Up the Pension Crisis

States and actuaries are trying to stifle debate about the growing shortfall in fund assets.

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Plunging investment returns have sent debt soaring in state and local pension funds and prompted new financial concerns. Meanwhile, a debate has broken out about whether these pension funds are accurately measuring their obligations. Though the issues might seem arcane, the stakes are high for taxpayers who might have to bail out these funds and for public employees who rely on them for retirement.

On Aug. 1, the American Academy of Actuaries and the Society of Actuaries shut down a 14-year-old task force on pension financing when several members were about to publish a paper that found many state and local retirement systems calculate their obligations using overly optimistic future rates of return. The authors want states and municipalities to adopt new valuation standards that would make projecting the cost of future benefits more predictable.

The problem is that this change would also make many public pension funds seem far more indebted than they are under current standards. Such a change would produce more pressure on politicians to boost funding and cut benefits.

One of the task-force members, Edward Bartholomew, blasted the AAA and the SOA in an interview with the trade publication *Pensions & Investments*. “This paper [is] being censored,” he said. “They didn’t want it to get out.” In a memo about the controversy, the AAA and SOA said they intended to block any attempt by task-force members to publish their work independently because that would be “inappropriate.”



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The spat is part of a growing fight over how governments measure the value of pension assets. Private-sector retirement funds follow guidelines set by the Financial Accounting Standards Board. But states and municipalities follow voluntary rules from the Government Accounting Standards Board.

One crucial difference is that private pension systems must project the future growth of their assets using a conservative “risk-free” rate of return based on U.S. Treasuries, but public pension funds can adopt a higher rate. The difference, compounded over time, can account for enormous variations in pension asset calculations.

Government pension funds on average estimate they will

earn 7.6% a year on their portfolios, according to a survey by the National Association of State Retirement Administrators. Using that number, the funds say they are currently about \$1 trillion short of the money they will need to fund pension credits that workers have already earned. But if pension systems were required to use a riskless rate, currently below 3%, the shortfall would soar to more than \$3 trillion.

Government officials have long argued that they should be allowed to employ the higher number because governments don't go out of business the way private companies do. That gives states and municipalities a much longer window to recover from bad investments.

The problem is that the arbitrary nature of the valuation standards allows elected officials to pressure pension systems to adopt overly optimistic assumptions, which can make offering new benefits to public workers seem more affordable and more attractive.

As Jeremy Gold, one author of the task-force paper, said in a September speech: "Consistent lowballing of pension costs over the past two decades has made it easy for elected officials and union representatives to agree on very valuable benefits, for very much smaller current pay concessions."

But when pension funds fail to deliver on these lofty projections—as many across the country have in the past decade—pension debt soars. According to a July 2015 report by the Pew Charitable Trusts, since 2005 the unfunded liabilities reported by state pension systems have risen by nearly threefold from \$339 billion to nearly \$1 trillion thanks in part to investment shortfalls.

Some actuaries say they've been reluctant to speak up about optimistic valuations because they could lose their jobs. When the Montana state pension system sought to hire new actuaries in 2009, it issued guidelines stating that any firm arguing that government pension funds should adopt more conservative valuation standards "may be disqualified from further consideration." A May 2009 editorial in *Pensions & Investments* noted that there had been rumors for years of similar "threats" by other pension systems to prevent firms "from expressing their reasoned positions on unsettled issues."

Yet as the government pension crisis widens, more voices like those on the task force are calling for reform. Meanwhile, firms working for government pension systems now face a different kind of pressure—in the courts. In 2014 retirees of bankrupt Detroit sued Gabriel, Roeder, Smith & Co., the actuary for the city's pension, contending that the firm's accounting helped the city's pension trustees cover up problems in the plan's finances that resulted in benefit cuts to workers. The litigation is pending.

The public dispute over accounting standards is a signal to taxpayers, retirees and political reformers that fundamental flaws remain in how pensions measure their finances. The beginning of the end of this crisis won't arrive until more reasonable, less risky standards are in place.

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