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State Pension Funds' $865 Billion Loss Means New Hires Get Less

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By Adam L. Cataldo

Jan. 13 (Bloomberg) -- State governments from Rhode Island to California have run up estimated pension-fund losses of $865.1 billion, forcing some to cut benefits for new hires.

Assets for 109 state funds declined 37 percent to $1.46 trillion over the 14 months ended Dec. 16, according to the **Center for Retirement Research** at Boston College. The **Standard & Poor's 500 Index** of stocks fell 41 percent in the period.

"Not a whole lot of people get too excited about pension funds," Philadelphia Mayor **Michael Nutter** said in an interview. "But if you have to pay those costs, they do grab your attention."

After Philadelphia's fund lost $650 million in the first nine months of last year, Nutter joined the mayors of Atlanta and Phoenix in writing a letter to Treasury Secretary **Henry Paulson** seeking financial help for U.S. cities. Their November letter cited investment deficits and rising pension costs.

The $865 billion in losses, which exceed the $700 billion Troubled Asset Relief Program that Congress approved in October, comes as states face budget deficits totaling $42 billion.

The Boston College center analyzed holdings reported on financial statements from 2006, when the 109 funds had about 20.4 million members. It didn't specify which of the 218 U.S. state funds it studied.

To return to 2007 actuarial funding levels by 2010, the 109 funds would need annual returns of 52 percent on assets, the analysis found. Annual returns of 18 percent would achieve the goal by 2013, the center said. The projections are based on a 5.7 percent annual increase in liabilities and a $50 billion increase in assets from contributions above annual payouts.

'Accelerating Complications'

State funds have enough money on hand to pay benefits for the foreseeable future, said **Alicia Munnell**, the center's director. "Even if markets recover, this will be a one-time loss that will have to be made up in the future by taxpayers," she said.

"We can't make enough on investments to drive out of this hole if all you do is depend on investments," said Mike Burnside, executive director of the **Kentucky Retirement Systems** in Frankfort.

As of June 30, Kentucky's largest fund for state workers held about 52 percent of the assets needed to pay current and future benefits to its 117,000 members.

"When we are experiencing a negative cash flow and we are having to eat capital to make payroll, we are accelerating the complications," Burnside said.

Increasing taxes to fill the pension gap has little support, said Frank Karpinski, executive director of the **Employees' Retirement System of Rhode Island** in Providence.

No Easy Sell

"I don't think anybody wants to do that, likes to do that or would say it would be an easy sell anywhere, especially given the current economic situation," he said.

State and local governments contributed $64.5 billion to pension plans in fiscal 2005-06, according to data from the U.S. Census Bureau. That's about 57 percent of the $113.2 billion spent on police and fire services.

Attempts to reduce benefits also face opposition.

"I believe that our members will oppose such initiatives in collective bargaining or in state legislatures," said John Adler, a director with the Capital Stewardship Program in New York for the **Service Employees International Union**, which represents public workers. The union's 850,000 members were in retirement plans with more than $1.5 trillion in assets as of Jan. 1, 2008, Adler said.

Two-Tiered Plans

To cut pension costs, some states are creating two-tiered systems offering less to new hires.

Kentucky lawmakers this year set the state's first minimum retirement age, 57, for employees hired after Sept. 1, and required 30 years of service, up from 27, to receive full benefits. They capped cost-of-living adjustments, which had been tied to the Consumer Price Index, at 1.5 percent. The system had an unfunded liability of about $16 billion as of June 30, executive director Burnside said.

New York Governor **David Paterson**, trying to close a $15.4 billion budget gap over 15 months, wants to reduce new workers' benefits and raise the retirement age to 62 from 55. New York's pension system was over funded, with assets of $153.9 billion, as of March 30.

Of the 109 state funds, 43 were funded at 79 percent or less of estimated current and future costs. Those below 80 percent "constitute the weakest cases," said **Ted Hampton**, an analyst with Moody's Investors Service Inc. in New York. The average level is 85 percent, according to an analysis prepared for a Moody's report published in July 2008, Hampton said.

Public Costs Higher

Company pension funds have also lost assets in the stock- market decline. The value of so-called defined benefit plans fell to $1.1 trillion in October from $1.3 trillion at September's end, according to **Mercer LLC**, a New York-based pension consulting unit of Marsh & McLennan Cos.

Last month, after **Pfizer Inc.**, **International Business Machines Corp.**, **United Parcel Service Inc.** and dozens of other companies said losses could force them to make unexpectedly large contributions, Congress voted to delay provisions of the Pension Protection Act of 2006. The law would have penalized employers that didn't cover at least 94 percent of their liabilities this year.

For state plans, which weren't covered by that mandate, the funding issue is complicated by 12 percent growth in membership since 2002, with 23.1 million now participating, according to census data.

Excluding Social Security, public employers' pension costs are three times the retirement costs of their private counterparts, according to a June 2008 report by the Washington- based Employee Benefit Research Institute.

Missouri's Wager

Some state retirement systems have seen losses in derivatives as well as stocks. Public pension funds bought more than $500 million in so-called equity tranches of collateralized debt obligations, according to public records compiled by Bloomberg in 2007. CDOs are packages of securities that are backed by bonds, mortgages and other loans. Their equity tranches are considered their riskiest portions.

The **Missouri State Employees' Retirement System** invested $25 million in half the equity portion of the BlackRock Senior Income Series 2006 collateralized loan obligation, managed by New York- based **BlackRock Inc.** Moody's last month cut ratings on parts of the debt, saying a drop in value of the underlying collateral may cause "an event of default."

Chris Rackers, the manager of investment policy and communication for the Missouri fund, didn't return calls seeking comment.

In Rhode Island, state and local governments were scheduled to make contributions equaling 25 percent of their payroll expenses to retirement plans in 2010, said Karpinski, the executive director. Barring a recovery, the contributions may increase to as much as 30 percent in 2011, he said.

"That is kind of the elephant in the room," he said. "Where are the funds going to come from to make these kinds of required contributions?"

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