

# Will Pension Plans Run Out of Money?

***A new research report using GASB proposed metrics reveals risks of "depletion."***

[Girard Miller](#) | December 8, 2011

With Christmas just around the corner, here's a column that will surely win me the Pension Grinch of the Year award for 2011. Don't blame me, however, because I'm just the scribe here. This column merely highlights the worrisome implications of a [new research report](#) by the prolific scholars at Boston College's Center for Retirement Research, headed by the insightful professor Alicia Munnell.

Munnell's Boston College (BC) team has studied the implications of proposed governmental accounting standards on the reported financial condition and funding status of 126 public pension plans. On the face of it, you'd think this stuff would be about as exciting as a typical actuarial report's demographic assumptions or the accounting-basis footnotes to a municipal financial statement. But it contains an appendix that I predict will have tongues wagging in more than a dozen state capitols. That's because of an innocuous and easily overlooked column called the *Run-Out Date*. That is the calendar year when the pension trust fund would be projected to literally run out of money under the proposed governmental accounting standards methodology for evaluating the funding condition of public pension plans. GASB kibitzers call it the "depletion date."

Now do I have your attention? Running out of money -- completely -- is a pretty big deal where I come from. That's the pension equivalent of the collapse of a Ponzi scheme. This is far worse than Social Security which can at least pay 75 cents on the dollar to the next generation under its current design.

The BC research study was mostly focused on the implications of the Governmental Accounting Standards Board's (GASB) proposed standards for financial reporting, and especially on the funded ratios (assets/liabilities) of these plans. Their narrative makes it clear they don't really like GASB's proposed method on philosophical grounds. The BC academic researchers apparently don't like the blended discount rate concept, or at least its current form. That said, the BC report's primary focus was the ratio of assets to liabilities -- using what GASB has proposed for a lower discount rate to be used in valuing the underfunded plans' actuarial funding status.

But what caught my eye was the unprecedented column of data showing when the plans are each projected (by the BC researchers, using their interpretation of the GASB method\* but not anything sanctioned specifically by GASB or the pension plans) to run out of money if something doesn't promptly change for the better. Now, that's the kind of information that a whole lot of taxpayer watchdog groups, wary municipal bond investors, bond ratings agencies, bond counsel, the Securities and Exchange Commission, the plaintiffs' bar and a host of pension plan critics would find insightful information.

Don't mistake my reporting for an endorsement. I'm not sure that the BC researchers' methodologies and calculations are entirely correct at this point. Some of my actuarial friends tell me that the depletion test is very hard to flunk if the pension funding policy is properly designed. I don't have the BC researchers' database -- and the formulas described in their footnotes outflank my freshman college math and grad-school statistics, quant methods and econometrics training. But I do know what GASB meant when it published the term "depletion" in its exposure draft for the proposed accounting rules -- and I do know what the words "run out" mean. We're now focusing on the projected (not just potential or possible) consumption of plan assets to pay promised benefits for services already performed.

Before highlighting the bad news, it is important to note that a good number -- at least one-third of the public plans in this study -- will clearly not run out of money under the BC researchers' model and show strong financial capacity beyond the year 2100. So it's very, very important to avoid over-generalization here. To my mind, the level of variation in results is really quite remarkable.

It would be simple to just refer my readers to the report and call it a day. That would be a cop-out, however. Too many readers will quickly become lost in the statistics and miss the point. So I think this column will be more likely to encourage a healthy debate about the need for timely and effective remedies if we list here the major public

pension plans cited in this study **as having the potential to run out of assets to pay their bills within 25 years**. That's about one-fifth of the total group reported. If I were a 45-year-old public employee in one of these plans, an investor in that state's bonds or a taxpayer likely to be handed the bill for these deficits, I would want to know now whether this depletion risk is accurately portrayed by this study. And I would sure want to know what the public officials responsible for funding and running these plans are doing to fix them before "D-day" arrives. Absent a defect in the BC researcher's methods, the burden of proof now empirically resides with the elected officials and these plans' officials to show that they have a strategy in place (or at least underway) to put their house in order. These plans are:

California Teachers; Chicago Teachers; Illinois Teachers; Illinois SERS; Indiana Teachers; Kentucky County; Kentucky ERS; Kentucky Teachers; Louisiana Teachers; Minnesota Teachers; Mississippi PERS; Missouri Local; Montana PERS; Montana Teachers; New Jersey PERS; New Jersey Police and Fire; New Jersey Teachers; New Mexico PERF; New Mexico Teachers; New York City Employees; New York City Teachers; North Carolina Teachers and State Employees; Pennsylvania SERS; Pennsylvania School Employees; South Carolina Police; Texas LECOS; Washington PERS I; Washington Teachers I; Wyoming Public Employees

Without causing a panic, it's clear that the time has come for stakeholders, trustees and plan sponsors in these systems to ask penetrating questions and get to work on solutions -- pronto. That includes the unions whose members must contribute to the solutions and stop playing the "not me" entitlement game. This report should be a giant red flag in those states: This abyss is the result of a decade or more of benign neglect by all parties at the table. Now, I have no doubt that if capital markets resume their historical returns, a dozen or more of the plans listed above can eventually work themselves out of their problems with carefully structured incremental strategies and shared sacrifices to defease their unfunded liabilities. But until they make public their definitive plans and secure the necessary stabilizing legislation, employer and employee contribution commitments, and benefits adjustments where inevitably required, that's "all talk and no cattle" as we say out West.

And please don't get me started about retiree medical benefits plan (aka OPEB) funding levels. Most OPEB plans have no reserves put aside whatsoever, and no funding plans. I would estimate that about three-quarters of those with above-average benefits would clearly flunk the GASB's proposed depletion tests and any sensible financial analyst's sustainability analysis -- and will take even less time to flunk these tests than the pension funds. If this report is not a wake-up call for retirement plan reform, then I don't know what it will take.

*\*The original version of this column stated that the BC methodology was "their own," and was corrected herein on Dec. 20 to clarify that the researchers made their best efforts to follow the GASB method using limited data available to them, in an effort to depict the potential outcome of the GASB methodology.*

This article was printed from: <http://www.governing.com/pension-plans-run-out-money.html>