Part 3

Continued…..Tell us the Truth, the Whole Truth.

Let's take a look at one example of state retirement plans, the Public School Employees' Retirement Systems of Pennsylvania (PSERS). As presented at the West Chester School Board meeting in late summer, by the school district superintendent, it was explained to the citizens that funding obligations of the school district will be significantly increased over the next two to three years based upon Pa State guidelines to fund the plan. Let's first look at their projections.

As reported in the Public Employee Retirement Commission, regarding House Bill 2497, dated June 15, 2010, the proposed "employer' contributions, average split 55% from the state and 45% from the school district, was projected to increase to 8.22% for the fiscal year ending June 30, 2011, up from 4.79 and 4.78% in years ending 2009 and 2010. The participants, i.e. teachers and school administrators contribute as well with an average contribution rate of 7.34%.

From there, let's see their **projection** for the "employer" contributions: 2012-10.59%, 2013-29.22%, 2014-32.09% and 2015-33.60%. The state did adopt to limit the employer funding for 2010-2011 school year to 5.64% and then it increases for the following years. The question as to "why" reduce funding in the current year when the unfunded liability is so large is not only an obvious one to ask, but also an obvious one to answer: current state and local budgetary deficits.

On June 30, 2009, the PSERS reported in the actuarial valuation of the plan, that the plan was funded to the 79.2% level based up the accrued liabilities and the actuarial valuation of assets. Actuarial valuation of assets is the five-year moving average value and has been used by PSERS for many years, even before the recent downturn. Unfortunately, in a down market, it may not adequately identify the actual magnitude of the problem being faced, as it also underestimates the surplus in an up market.

If your savings account has been going down over the last five years, you would increase your savings account immediately by calculating the five year actuarial valuation of assets. For the PSERS, according to their valuations, in 2000 the actuarial valuation of assets was funded to over 120% of accrued liabilities. Now they are 79.2%. The ten year trend is down.

From the valuation report:

Accrued Liability:	$75,625,900,000	
Actuarial Value of Assets:	$59,886,700,000	
Unfunded accrued Liability	$15,739,200,000	Funded ratio of 79.2%
Market Value of Assets	$43,100,594,000	Funded Ratio of 57.0%
Unfunded (Real Dollars)	$32,525,306,000	

The Pension Protection act of 2006, which regulates private defined benefit plans, requires the use of Market Value of Assets. If the PSERS required "employer" funding contributions in two years were based upon the market asset numbers, which are about 25% less than reported actuarial values that would transition to a 25% increase in the amortized portion of the "employer" contribution (i.e. taxpayers). We will be going from a 5% contribution rate this year to a 30-40% rate in two years, if we want to adequately fund the plan. Is it economically feasible?

But wait, these funding projections utilize the average annualized rate of return of 8%. The states have averaged around 4-5% for last ten years. Do you think that counting on earning 12% for the next ten years is a good financial judgment, or 8% over the next five years? Do you want to plan on 12% returns in your IRA for the next ten years? If PSERS were to lower its assumed average return to 6%, that might increase the "employer" contribution rate by another 25% of the estimated 30-40% rate above. (8%-6%=2%, 2%divided by 8%=25%).

The annualized salaries of PSERS participants for 2009 were $12,524,593,000. Actuarially provided required employer funded contribution was $1,761,295,000. The actual contribution made was $503,227,000, or 29% of funding required. The year 2008 was funded at 41% of funding requirements, 2007-39%, 2006-34%, 2005-46%, and 2004-100%. Not a healthy track record of paying bills as they come due. Now we see from the state's own projections an increase of six-eight times current funding levels to get back on track to meet future liabilities. And this is with questionable assumptions about growth rates and the timing of cash flows completely neglected.

The question of the timing of the annual returns becomes relevant because there are withdraws being made. From the actuarial valuation, we see in 2009 an average annual benefit payout of $3,996,288,000. Employer contributions were $0.5 Billion, as noted above. A few negative or below expected return years out of the next 3-5 years, could increase the unfunded liabilities even more dramatically and raise the contribution rates higher yet. This article is not going to venture a guess on the size of those impacts, but the direction of the impact is clear, negative.

The Pennsylvania Municipal Retirement System (PMRS), similar to PSERS but for non-teachers, did look to review the effects of the timing of each of the annual rates of return, over a projected 19 year period and to their credit, based it upon a 6% average annualized rate of return. You will see on page 10 of their actuarial valuation as of January 1, 2009, produced March 2010, that they assumed four out of the first five years returns were over 10%, or what might be called "front end loading". You know from the analogy above in Part 2, that this will understate the funding requirements.

In the private sector, people with 401(k)'s, SEP's, IRA's, 403b"s, etc., would not look at their retirement today based upon an average value of the account over the last five years, or assume rates of return of 8% or higher over the next ten years as prudent expectations. Why? Because they understand the necessity to recognize their position and address it head on. Should we not expect the same of our elected officials?

The follow up question is always, “What do we do next, to remedy the problem?” The purpose of this article is the first step: **Recognize the Problem**. If not, either school property taxes will *“unexpectedly”* increase dramatically, or more unfortunately, our teachers of 20, 30, or 40 years of service will be left with reduced or no pensions. Will their constitutionally protected benefits be a stronger position than the citizen taxpayers simply running out of money to fund the plan under the weight of Federal, State and Local debt and taxes and finally saying, **NO MORE ?**

There are many alternatives solutions; one is to follow the private sector into more defined contribution plans where the employee has greater responsibility for their own retirement. Others are often harder and more difficult, such as reduced benefits, higher taxes, fewer teachers and administrators, or 12 month school years with rotating student attendance. It is recommended you visit the Commonwealth Foundation at www.PublicPensionReform.com to see the objective solutions they present in addressing this pressing issue.

We have just begun to discuss and address the “Mountains of Debt” facing our country and the world as a whole. **Recognize the Problem,** only then we can work together on the solutions.

Ernest Chisena ©

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Stay tuned for Part 4.