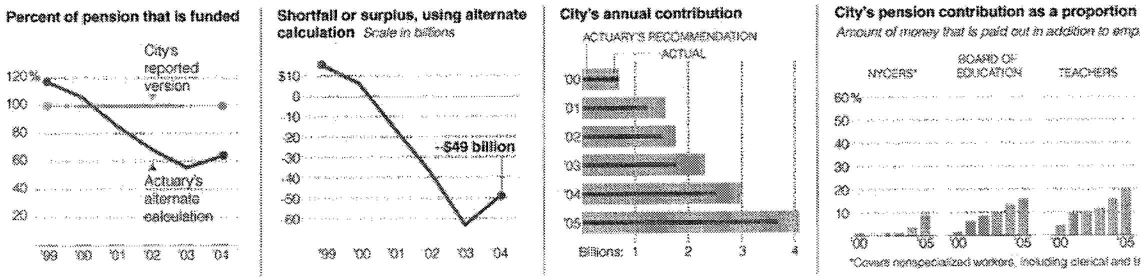
The New York Times

G112

Pension Gap

While New York City says in its annual reports that its five pension plans for city workers are fully funded, an alternate calculation by the city's chief actuary suggests that the city has a substantial shortfall. The state allowed the city to postpone a portion of the actuary's recommended increased contributions to pensions from 2001 to 2005.



Source: New York City Comptroller's Office

Close Window

The New York Times
nytimes.com

August 20, 2006

COSTLY PROMISES

New York Gets Sobering Look at Its Pensions

By MARY WILLIAMS WALSH and MICHAEL COOPER

Every year since 1999, New York City has reported that it has all the money it needs to pay for the pensions that have been promised to city workers.

With the retirement plans said to be financially sound, state politicians have happily showered city employees with generous pension enhancements — annual cost-of-living increases, holiday bonus payments, early retirement with full benefits — that are the envy of private-sector workers, whose pension benefits have eroded.

But a close inspection of city pension records shows that the funds committed to the plans may fall well short of the city's promises to hundreds of thousands of current and retired workers. They look fully funded chiefly because the city has been using an unusual pension calculation that does not comply with accepted government accounting rules. Even the city's chief actuary, who helps produce the annual reports, says the official numbers are "meaningless" when it comes to showing the plans' financial health.

The chief actuary, Robert C. North, has prepared a little-noticed set of alternative calculations showing that the gap in the pension funds could be as wide as $49 billion. That is nearly the size of the city's entire annual budget and the equivalent of the city's publicly disclosed outstanding debt.

The existence of a big gap between the city's future obligations and the resources committed to meet them does not mean the pension funds are about to run out of money. But it does mean that New York City is promising its current employees future benefits it might not be able to provide without big tax increases or major budget cuts. When such a reckoning might occur, if at all, is hard to predict.

Pensions are now one of the city's fastest-growing expenses. In recent years the city's required contributions to its pension funds have more than quadrupled, to $4.7 billion this year from $1.1 billion in 2001.

Two years from now, the city expects to spend one out of ten dollars in its budget on pension contributions.

Senior city officials vehemently dispute the suggestion that their pension funds are weaker than the official numbers claim and point out they are contributing more money to them every year. But a number of outside experts said the city's accounting method was flawed because it provides a misleading portrait of the plans' real condition.

In New York, public workers' pensions are guaranteed by the State Constitution, so once they are granted, they cannot be reduced, even if they cost more than expected.

Many economists say government pension accounting routinely understates the cost of benefits promised to state and local workers, because the rules allow the plans to take credit for investment gains not yet academic at this time."

Ms. Stark said that she was sure of the pension funds' health because the city was contributing responsibly to them every year, and because she was confident that the investments in the funds would meet their targets of 8 percent average annual returns over the long haul. Many other public plans have investments targets in this range.

She said that there were many ways to measure the health of the pension funds, and that while one method may show a large hidden shortfall, another would show that at least one of the plans had a slight surplus. She contended that no one method was better than another for all purposes.

Asked why the pension funds appeared to be fully funded back in 1999, when they were swollen with gains from the stock market boom, and still appear to be almost fully funded now — after losing billions of dollars in the stock market and granting billions of dollars worth of new benefits — she said that the numbers were "smoothed" to avoid short-term fluctuations. She also noted that the city had been increasing its annual contributions in recent years.

The independent governmental accounting board, which sets standards for state and local jurisdictions across the country, is not allowed to comment publicly on New York City's financial statements.

"But I can tell you that our standard is very clear on this issue," said Gerard Carney, a spokesman for the board, "and we fully expect it to be followed accurately. Moreover, history has shown that bad things can happen when accounting standards are not accurately followed."

Unlike the accounting board for companies, however, the governmental accounting board has no enforcement agency backing it up. A company that breaks an accounting rule may hear from the Securities and Exchange Commission; a government will not. The rules board relies on each local government's outside auditor to police violations.

New York City's outside auditors defended its unusual accounting approach.

Robert Rooney, an audit director at Deloitte & Touche who worked on New York City's audit, said he was not permitted to discuss the details of New York City's financial reports because of confidentiality rules. But in general, he said, it was possible to modify accounting standards without violating them.

When Deloitte's auditors see such a modification in a city's financial report, he said, they discuss it with the city's officials to make sure they understand it. If the modification is not material or misleading, he said, then the city can use it and still get a clean audit.

New York City's comptroller, William C. Thompson Jr., who has ultimate responsibility for the city's financial statements, said through his spokeswoman that he believed New York was compliant with the accounting rules. He also said that pension calculations were "the subject of much debate."

"We will continue to work with the boards of our pension funds and the actuary to assess the funded status of the plans, while ensuring that we remain in compliance with mandated standards," Mr. Thompson said.

Although the city pays the bills for its workers' pensions, all increases in public employees' pensions must be according to any single actuarial methodology, as company plans do.

Government pension plans also have much greater latitude to fiddle with such critical assumptions as how long they expect their workers to live after retirement. And because they are not monitored by a federal guarantor or outside investors, they have not received the kind of scrutiny corporations have.

The magnitude of the potential discrepancy in New York City alone, which has often been held out as an exemplar in funding its pensions, suggests how poorly understood the looming public pension debt may be nationwide. New York State's pension fund uses another reporting method, but it also tends to make the plan look fully funded at all times.

Uncertainty about the city's pension numbers has attracted the New York State Insurance Department's attention, which has regulatory authority over public pension plans. The department has been auditing the city's pension plans and asking pointed questions about their financial health.

City officials who have been interviewed by the state regulators said they seemed interested in Mr. North's alternative method and asked whether the other public plans in New York State should be using it as well. A spokesman for the insurance department declined to discuss the audits.

Mr. North said New York City took on its unusual calculation for the purpose of determining the city's annual pension contribution, not as a financial status report.

But it does not show the volatility of the city's pension fund investments or the long-term soundness of the plans. Some of the other six approved models do, to some degree.

Other actuaries confirmed that the method was sound when used to speed up the financing of pensions. But they agreed with Mr. North that it gives a misleading picture of whether a plan is healthy or not.

Lost in the Fine Print

In 2003, when the pension funds were under severe financial strain — and their annual reports were still showing perfect health — Mr. North decided to start providing his alternative numbers.

He said he had wanted to publish them prominently, in the front of the plans' annual reports, but the city's outside auditors stopped him, because the accounting board had not approved the method he wanted to use. So the numbers ended up in the fine print, where few have noticed them.

Instead of basing his calculations on the investment returns the pension fund might earn in the future, Mr. North used very conservative investment returns — the type of returns now being paid by risk-free investments, such as Treasury bonds. He said he thought this was appropriate because the benefits are themselves risk-free, being guaranteed by the state constitution.

More analysts are beginning to question the rule that allows governments to base their pension values on anticipated investment returns. Doing so risks seriously understating the pensions' costs, they say.

"This is a really, really serious problem," said Andrew L. Turner, a former managing director at the Frank Russell Company, a pension consulting concern in Tacoma, Wash. "The taxpayers think they're paying a lot less than what they're ultimately going to pay."