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U.S. Public Pension Funding Gaps to Widen Under New Rules.

Some U.S. public pensions, which lack savings for $1.4 trillion of promises to retired government workers, will record wider gaps in fiscal years starting after July 1 because of changes in accounting rules.

Pensions in Illinois, Kentucky, Pennsylvania and other states will see funded levels decline, in some cases by more than half, as they comply with new Governmental Accounting Standards Board rules that for the first time will require future pension costs to be included on balance sheets and change how they must calculate their underfunding.

The new rules won't affect the amount that states and municipalities actually owe, though they could prompt them to address their underfunding, said Dean Mead, research manager at the Norwalk, Connecticut-based board known as GASB, which makes accounting rules used by most governments. The changes may force some states to cut borrowing or spending.

"It could affect their policy decisions," Mead said in a telephone interview. "It's their choice how to react to the new numbers."

Under the new rules, governments will have to calculate an estimate of how much they owe for future pension liabilities and put that on their balance sheets. Under current rules they put estimates in footnotes on financial statements. Some plans predicted to run out of money will have to lower investment return assumptions used in calculating their future costs, making their liability seem larger.

Funding Adjustments

"They may not want to discuss these numbers," said Keith Brainard, the Georgetown, Texas-based research director with the National Association of State Retirement Administrators in Washington. "Because of these new numbers, some policy makers will make funding adjustments so they won't look so bad."

Teachers Retirement System of the State of Illinois could see its funded level decline to 17.5 percent from 48.4 percent under the changes, according to 2012 estimates from the Center for Retirement Research at Boston College.

Illinois Teachers doesn't agree with the estimates, said spokesman Dave Urbanek. The only effect of the new GASB rules will be that the fund will have to report a new number. Though the pension has earned 9 percent on average in the past 30 years, the state has never fully funded the plan since it was created in 1939, he said.

"We will have a full range of unfunded liabilities that people can pick from," said Urbanek. "The bottom line is that we have a problem."

Fixes Made

Funding for the Kentucky Employee Retirement System would decline to 23.7 percent from 40.3 percent, according to the Boston College estimates.

Executive Director William Thielen said by e-mail that he wasn't aware that the changes would affect the funding ratio. The rules will require the fund to use new reporting terms and "include significantly more information" in financial reports, he said.

Some municipalities have taken action to try to increase funding ahead of the new rules taking effect: Alaska moved $3 billion from its rainy day fund to shore up pensions. California passed legislation to close a $74 billion gap in the California State Teachers' Retirement System.

The new numbers may not affect debt costs in the $3.7 trillion municipal bond market because of limited supply and small differences in yields between issuers, said Richard Ciccarone, president of Merritt Research Services in Chicago. Still, borrowers that don't address shortfalls may eventually be penalized, he said.

"Over time, as the pension crisis continues, you're going to see spreads widening," Ciccarone said.

By Darrell Preston Jun 26, 2014 9:00 PM PT

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