Chapter 5
Analysis of Information in The Council of State Governments' (CSG) Southern Office Survey

Along with the data extracted from the federal government, another important source of information for the trends assessed in this report was obtained by a survey forwarded to 190 state and local government retirement plans in the 50 states and the District of Columbia. The survey (see Appendix A for a copy) comprised five questions that sought the latest information on the market value of the individual plan, the number of actives and annuitants in the plan and the extent of each plan's actuarial assets and liabilities. In the analysis of the survey information, the tables in this section present the top and bottom five plans for each category while the complete listing of plan information is contained in the report's appendices.

Analysis of Information in CSG Survey

As indicated in the methodology section, the survey elicited responses from 105 of the 190 plans contacted (55 percent), with at least one plan in 46 of the 50 states providing responses to the questionnaire. In breaking down the responses, four major issue areas were identified: the market value of the plan's assets; annuitants as a percentage of actives; actuarial funding ratio; and the specific unfunded liability or surplus. This information is provided in the following four tables.

Market Value of Assets

In describing the market value of the plans' assets, a number of important points must be specified at the outset. For instance, there is a great deal of variation among public pension systems and market value asset comparisons remain meaningless unless accompanied by more detailed information. Such factors as payment benefits, contribution rates, number of actives, number of annuitants, asset allocation strategies and fiscal year-end dates all contribute toward this tremendous degree of variety; consequently, no two systems are alike. Even a simple statistic like the date on which a plan's annual audited financial statement is based has huge implications for the market value of a plan's assets. In this connection, information from the Pennsylvania Public School Employees' Retirement System (PSERS) illustrates how "no two systems are alike."[1] Accordingly, PSERS' fiscal year ends on June 30 every year, and for the annual audited financial statement for the year ending June 30, 2003, PSERS had a market value of $42.5 billion; by December 2003, the markets had started to rebound and PSERS' market value reached $47.3 billion. This is one such instance where the differences in the review periods resulted in very different conclusions regarding the market value of a public pension fund's assets.

The purpose of Table 25 (and Appendix E) is not to identify certain plans as having a low asset base or others as having a large asset base, but to provide an overview of the asset values' of the plans from the survey responses. Beyond that, given the radically different variables in calculating these market values, this report will not make any other conclusions. As indicated earlier, Table 25 contains the five plans with the smallest and largest market asset values. Appendix E contains information on all the plans that provided information to this survey question.

Table 25 provides the market value of the assets for the five plans with the lowest and highest values. Appendix E provides information for the 105 plans that responded. Of these, one, the Texas Judicial Retirement System Plan I, did not provide the market value of its assets. This lowered the number of plans with market asset information from 105 to 104. Of these 104 plans, there was a single plan with a market value less than $1 million (Georgia's Military Pension Fund); 10 plans with a market value greater than $1 million dollars but

Five Plans with Lowest and Highest Market Value of Assets

	Rank	State	Plan Name	Market Value of Assets: Value	Market Value of Assets: Date
lowest	105	GA	Georgia Military Pension Fund	$626,000	Jun-03
	104	NJ	State Police Retirement System	$1,545,700	Jun-03
	103	AK	Teachers' Retirement System	$3,602,619	Jun-03
	102	WA	Judges' Retirement System, **See Note B**	$5,000,000	Sep-02
	101	AK	Public Employess Retirement Board	$7,391,455	Jun-03
highest	5	WI	Wisconsin Retirement System	$62,829,000,000	Dec-03
	4	NY	Teachers' Retirement System	$72,400,000,000	Jun-03
	3	TX	Teachers' Retirement System	$79,122,010,645	Aug-03
	2	FL	Florida Retirement System, **See Note J**	$100,200,000,000	Mar-04
	1	CA	California Public Employees' Retirement System, **See Note K**	$161,378,337,000	Dec-03

table 25

Source: The Council of State Governments' Southern Office Survey

Note B: For this Washington state plan's actuarial liability, the Present Value of Fully Projected Benefits (PVFPB) is presented.

Note J: This is based on the market value as of March 25, 2004.

Note K: Data for CalPERS includes the Californina Public Employees' Retirement System; the Legislators' Retirement System; Judges' Retirement System I; Judges' Retirement System II; State Peace Officers' and Firefighters' Defined Contribution Program; and the Volunteer Firefighters' Length of Service Award System.

less than $100 million; 20 plans greater than $100 million but less than $1 billion; 35 plans greater than $1 billion but less than $10 billion; 36 plans greater than $10 billion but less than $100 billion; and, finally, two plans, with an asset base greater than $100 billion.

Not surprisingly, the California Public Employees' Retirement System (CalPERS) was the system with the largest market value with $161.4 billion as of December 2003, with the Florida Retirement System coming in second in this category with $100.2 billion in market value as of late March 2004. A number of other plans also had significant assets such as Texas' Teachers Retirement System ($79.1 billion as of August 2003) and New York's Teachers Retirement System ($72.4 billion as of June 2003). However, as noted at the outset of this section, given the widely divergent variables contributing to the market value of public pension system assets, this report does not draw any conclusions in this connection.

Annuitants as a Percentage of Actives

Table 26 provides details from survey responses on two member categories: actives and annuitants. Specifically, actives include members who are working and contributing (or their employer makes contributions on their behalf) toward a public pension plan. Annuitants comprise members who are receiving a regular benefit from these public pension systems and include retired employees, spouses, survivors, family members and others named as beneficiaries.

A meaningful statistic that might be extrapolated from data on annuitants and actives is the number of annuitants as a percentage of actives.[2] A lopsided ratio where the number of annuitants significantly exceeds the number of actives poses a variety of financial demands on the plan's finances. In this scenario, the demands on the liquidity levels of the pension plans to meet current obligations are much greater, forcing plans to maintain assets that are much more liquid. A corollary of a higher liquidity requirement requires that the pension plans maintain a higher percentage of their assets in cash and similar low-yielding securities to make the periodic benefit payments. Furthermore, increasing demands to preserve a greater proportion of assets in cash and low-yielding securities triggers its own set of negative consequences on the pension plans' long-term investment returns.

Once again, information on the five plans with the lowest and highest percentage of annuitants as a percentage of actives is presented in Table 26.

Five Plans with Lowest and Highest Annuitants as a Percentage of Actives							
			Number of Actives		Number of Annuitants		Annuitants as % of Actives
	State	Plan Name	Number	Date	Number	Date	
lowest	WA	School Employees' Retirement System - Plans 2 & 3	49,791	Sep-02	622	Sep-02	1.2%
	WA	Law Enforcement Officers' and Firefighters' Retirement System - Plan 2	14,011	Sep-02	244	Sep-02	1.7%
	WA	Teachers' Retirement System - Plans 2 & 3	53,607	Sep-02	1,106	Sep-02	2.1%
	NV	Deferred Compensation Plan	6,857	Mar-04	248	Mar-04	3.6%
	DE	State of Delaware Employees' Deferred Compensation Plan	8,000	Apr-04	327	Apr-04	4.1%
highest	WA	Teachers' Retirement System - Plan 1	12,456	Sep-02	33,148	Sep-02	266.1%
	WA	Judicial Retirement System	24	Sep-02	131	Sep-02	545.8%
	WA	Law Enforcement Officers' and Firefighters' Retirement System - Plan 1	1,147	Sep-02	7,987	Sep-02	696.3%
	WA	Judges' Retirement System	1	Sep-02	18	Sep-02	1,800.0%
	TX	Judicial Retirement System - Plan I	26	Aug-03	505	Aug-03	1,942.3%

table 26

Source: The Council of State Governments' Southern Office Survey.
Note: In their responses, six plans did not provide either the number of annuitants or the number of actives in their systems. Hence, it was impossible to calculate the percentage of annuitants as a percentage of actives for these six plans. This lowered the number of plans for which information is presented in Appendix F from 105 plans to 99 plans.

Appendix F contains this information for the 105 plans that responded to the survey.

In terms of the number of annuitants as a percentage of actives (see Appendix F), a vast majority of the plans (70 of the 99 plans) fell between 20 percent and 69.9 percent. In terms of specifics, New Mexico's State Deferred Compensation Plan (22.8 percent) and Washington State Patrol Retirement System (69.4 percent) occupied the two extremes of this grouping. With respect to the plans remaining from the total 99 plans, seven plans were in the 1 percent to 9.9 percent grouping and there were an additional four plans in the 10 percent to 19.9 percent grouping. In this connection Washington's School Employees' Retirement System (Plans 2 and 3), with 1.2 percent, and Texas' Municipal Retirement System, with 19.4 percent, were the book-ends for these two groupings combined. Finally, there were 10 plans in the 70 percent to 99.9 percent category, and eight plans over 100 percent. It should be noted that the final two plans on the list, Washington's Judges' Retirement System and Texas' Judicial Retirement System Plan 1, had unusually large percentages: 1,800 percent and 1,942 percent, respectively. This is because the former plan has only one active participant and the latter has only 26 active participants.

Actuarial Funding Ratio

An often cited statistic in a review of public pension plans revolves around the actuarial funding ratios of these plans. This measure is derived by dividing the actuarial value of a pension plan's assets by its actuarial liabilities. When a pension plan's assets equal its liabilities, it is considered funded at 100 percent. Similarly, a plan containing a deficit in assets has an unfunded liability and this plan is then considered underfunded. (Analysts also have contended that a pension plan only is considered underfunded when its obligations, i.e., what it owes to retirees, exceeds it assets by at least 10 percent.[3])

All pension plans, both fully funded and underfunded, rely on future contributions and investment returns to make their benefit payments. A fully funded plan has been compared to a long-term mortgage where a homeowner has a specified number of years to pay down the loan and eventually own the house. At the end of this period, when it is paid off, the mortgage would be considered fully funded. Hence, it is important to specify that a fully funded plan does not entail that future contributions to the plan are unnecessary; to the contrary, a fully funded plan only means that at a particular time, the actuarial value of the assets equaled the actuarial value of the liabilities. Notwithstanding this, future contributions and investment earnings remained critical to meet the benefit obligations that the plan continued to accrue and will have to meet in the future.

In contrast, underfunded plans require future contributions and investment earnings to make up the shortfall so as to maintain their financial viability. A major difference between a fully funded plan and an underfunded plan is that with regard to the latter, future contributions and investment earnings perform the dual task of both bridging the shortfall between assets and liabilities and funding benefit obligations that are being accrued. Fully funded plans, however, only finance the benefits currently being accrued.

Five Plans with Lowest and Highest Actuarial Funding Ratio

	State	Plan Name	Actuarial Assets Value	Actuarial Assets Date	Actuarial Liabilities Value	Actuarial Liabilities Date	Actuarial Funding Ratio
lowest	WA	Judicial Retirement System	$8,000,000	Sep-02	$95,000,000	Sep-02	8.4%
lowest	WV	Teachers' Retirement System (Defined Benefit)	$1,190,882,000	Jun-03	$6,243,834,000	Jun-03	19.1%
lowest	IL	General Assembly Retirement System	$49,676,302	Jun-03	$196,510,067	Jun-03	25.3%
lowest	IL	Judges' Retirement System	$330,053,560	Jun-03	$1,076,231,965	Jun-03	30.7%
lowest	IL	Teachers' Retirement System of Illinois	$23,124,823,000	Jun-03	$46,933,432,000	Jun-03	49.3%
highest	TX	Judicial Retirement System - Plan II	$129,425,907	Aug-03	$111,115,600	Aug-03	116.5%
highest	WA	Law Enforcement Officers' and Firefighters' Retirement System - Plan 1	$5,095,000,000	Sep-02	$4,338,000,000	Sep-02	117.5%
highest	GA	Legislative Retirement System	$26,637,000	Jun-02	$21,779,000	Jun-02	122.3%
highest	GA	Georgia Judicial Retirement System	$228,417,000	Jun-02	$175,154,000	Jun-02	130.4%
highest	ID	Public Employee Retirement System of Idaho	$6,498,685,238	Jul-03	$534,638,594	Jul-03	1,215.5%

table 27

Source: The Council of State Governments' Southern Office Survey.
Note: Twelve plans did not provide information on their actuarial assets and/or actuarial liabilities. Hence, it was impossible to calculate an actuarial funding ratio for these 12 plans. This lowered the number of plans for which information is presented in Appendix G from 105 plans to 93 plans.

Analysts are quick to point out that while a plan's actuarial ratio is an indicator of its financial health, its overall impact should not be overstated. These calculations, as expressed earlier, involve many demographic and financial assumptions that vary from plan to plan. In effect, the ratio is a snapshot of where a plan stands at a particular time given its own set of unique circumstances. The fact that a plan's obligations extend years into the future--unless a plan is terminated--provides it with opportunities to accrue assets and meet its contractual obligations.

As in the previous categories, Table 27 presents information on the five plans with the lowest and highest actuarial funding ratios. Appendix G provides information for the 105 plans that responded to the survey.

Of the 93 plans for which information was provided, five plans had an actuarial funding ratio between 1 percent and 49.9 percent; 63 plans had an actuarial funding ratio between 50 percent and 99.9 percent; and 25 plans had an actuarial funding ratio equal to or greater than 100 percent. Interestingly, there were eight plans that had an actuarial funding ratio of 100 percent, i.e., their actuarial assets equaled their actuarial liabilities. Consequently, while 25 of the 93 plans that provided this set of information had an actuarial ratio that was fully funded, the remaining 68 plans were underfunded to varying degrees.

Idaho's Public Employee Retirement System had the highest actuarial funding ratio of 1,215 percent given that the plan had actuarial assets of $6.5 billion and actuarial liabilities of a mere $535.6 million. At the other end of the spectrum, Washington's Judicial Retirement System had an actuarial funding ratio of 8.4 percent given that this plan's actuarial assets stood at $8 million and actuarial liabilities stood at $95 million.

Actuarial Unfunded Liability or Surplus Amount

The companion statistic to the actuarial funding ratio is the unfunded liability or surplus amount, presented in Table 28. Once again, the five plans with the highest unfunded liability or surplus are presented. Appendix H has information on this category for the 105 plans that responded. As indicated, a majority of the survey responses rank in the underfunded category with only 17 of these plans actually recording a surplus.

According to Table 27, as previously noted, since 12 of the 105 plans did not provide information on their actuarial assets and liabilities, it was impossible to calculate either the unfunded liability or surplus for these plans. Of the remaining 93 plans reviewed, 17 plans had an actual surplus. While the $12.6 billion in the Florida Retirement System was the largest for the plans available, Idaho's Public Employee Retirement System ($5.9 billion), North Carolina's Retirement Systems ($3.3 billion) and Pennsylvania's State Employee Retirement System ($1.3 billion) also were important here. New Jersey's State Police Retirement ($49,000) and the Washington State Patrol Retirement System ($3 million) were the two plans at the other end of plans with a surplus.

	State	Plan Name	Actuarial Assets Value	Actuarial Assets Date	Actuarial Liabilities Value	Actuarial Liabilities Date	Unfunded Liability/Surplus
Highest	FL	Florida Retirement System	$101,900,000,000	Jul-03	$89,300,000,000	Jul-03	$12,600,000,000
	ID	Public Employee Retirement System of Idaho	$6,498,685,238	Jul-03	$534,638,594	Jul-03	$5,964,046,644
	NC	North Carolina Retirement Systems	$55,183,599,877	Dec-02	$51,877,037,007	Dec-02	$3,306,562,870
	PA	State Employees' Retirement System	$27,465,000,000	Dec-03	$26,179,000,000	Dec-03	$1,286,000,000
	WA	Law Enforcement Officers' and Firefighters' Retirement System - Plan 1	$5,095,000,000	Sep-02	$4,338,000,000	Sep-02	$757,000,000
Lowest	MA	Massachusetts Teachers' Retirement System	$17,074,650,000	Dec-03	$24,519,059,000	Dec-03	-$7,444,409,000
	CA	California Public Employees' Retirement System	$156,067,000,000	Jun-02	$163,961,000,000	Jun-02	-$7,894,000,000
	CO	Public Employees' Retirement Association	$30,600,000,000	Dec-03	$40,500,000,000	Dec-03	-$9,900,000,000
	OH	State Teachers' Retirement System	$51,696,919,000	Jun-03	$68,734,061,000	Jun-03	-$17,037,142,000
	IL	Teachers' Retirement System of Illinois	$23,124,823,000	Jun-03	$46,933,432,000	Jun-03	-$23,808,609,000

Table 28: Five Plans with Highest and Lowest Actuarial Unfunded Liability or Surplus Amount

Source: The Council of State Governments' Southern Office Survey.

Of the remaining 76 plans, there were eight plans with actuarial assets equaling liabilities, i.e., a funding ratio of 100 percent. The remaining 68 plans all had unfunded liabilities of varying levels. Four of the 68 plans had unfunded liabilities between $1 and $9.9 million; seven plans had unfunded liabilities between $10 million and $99.9 million; 22 plans had unfunded liabilities between $100 million and $999.9 million; 33 plans, the majority in this unfunded liability grouping, had a liability amount between a billion and $9.9 billion; and the unfunded liability levels of two plans exceeded $10 billion. The latter two plans were the Teachers' Retirement System of Illinois (-$23.8 billion) and the Ohio State Teachers Retirement System (-$17 billion), both plans as of June 2003. However, Illinois issued $10 billion in pension obligation bonds in June 2003. The Teachers' Retirement System of Illinois' share of this bond issue, $4,330,374,000, was received after the close of the fiscal year and not included in the actuarial asset figures presented above.

Public Sector Retirement Plan News from Across the Country

Given the gravity of the financial climate confronting so many public sector retirement systems across the country, state lawmakers and members of the public are devoting increasing degrees of resources and time to restore the fiscal health of these systems. As documented in previous chapters, alongside the depleted state and local government retirement system coffers, the nation faces serious questions about retirees drawing on both Social Security payments and personal savings to last them through their 'golden' years. Consequently, state lawmakers have been pressured to act and stem the flow of red ink sweeping across the public sector retirement plans in recent years.

For instance, Iowa state Senator John Kibbie stated that "[T]he economy and our [lack of] return on investments have only been part of the problem," referring to the retirement plans in his state. "We have also got more people retiring and at higher wages."[4] Then, Kansas state Senator Jim Barone, referring to conditions in his state, noted that "[W]e are confident that the pension for everybody collecting one today is secure. The question is, what will be there 30 years from now for the people currently working? There is a lot of concern about that."[5] Consequently, practically every state in the union grapples with devising retirement systems that are financially viable in the long term so that future generations can progress towards their retirement with confidence.

The following section presents a cross-section of recent trends and information on the status of public sector retirement systems from across the country and, where possible, details on the actions taken by these states and localities to enhance these retirement systems. In the context of the battering these retirement systems have endured with the downturn in the economy recently, and the onset of a huge surge in the number of retirees in the coming decade, policymakers continue to track their individual retirement systems closely.

Alabama

In March 2004, the state's finance director announced that Alabama's unfunded liability for retirees' healthcare amounted to approximately $10.9 billion, a significantly higher number than the $7.5 billion cost estimated provided a scant four weeks before.[6] This staggering amount was likened to paying every man, woman and child in Alabama the sum of $2,400 each if the state were to fully fund retiree healthcare. Even more disturbing is the fact that this liability level will continue to grow by almost $1 billion every year as the state takes on about $283 million in new debt for state employees and $712 million for employees in education every year. In devising a solution, the finance director noted that the state could increase retiree contributions toward healthcare and change the retirement eligibility requirements. In response, during the 2004 legislative session, Alabama Governor Bob Reilly proposed "fundamental changes in the way we are operating today" and proposed legislation that would require future state employees and teachers to have 30 years of service instead of 25 years to draw full retirement benefits; however, this measure did not emerge from committee in the Legislature during 2004. The governor also appointed a 13-member task force comprising a cross-section of legislators, business executives and academics to examine the soaring cost of health insurance for public employees.[7]

Any discussion of Alabama's public pension funds has to include reference to the record of the Retirement System of Alabama (RSA) and its executive director Dr. David Bronner.[8] In news coverage, Dr. Bronner's "unorthodox series of investments and uncanny timing have won him comparisons to the billionaire financier Warren E. Buffet," along with the moniker "a man who has enjoyed a Midas touch for most of a three-decade career," has led Alabama's pension fund from $500 million in assets in 1973, to $26.2 billion in assets in the space of 30 years. These "unorthodox investments" include the following:

» investing in Consolidated Edison bonds in New York City in 1975, setting the stage for becoming its largest investor;
» purchasing $200 million in New York City bonds in the late 1980s, a time when the city was experiencing a fiscal crisis;
» investing $100 million in the late 1980s (an amount that later rose to $364 million) to purchase 55 Water Street, a 54-story office tower and a 15-story annex in the vicinity of Wall Street in New York City*;
» allocating $2.5 billion to purchase Raycom Media of Montgomery, Alabama, a media company with 36 television stations in 19 states and Puerto Rico;
» investing $1.8 billion in Community Newspaper Holdings' daily, weekly and semi-weekly newspapers in more than 200 communities;
» setting aside $160 million to invest in Battle House Tower, a landmark project in downtown Mobile, Alabama, that includes restoration of the historic Battle House Hotel;
» financing a 35-story office tower that will become the tallest building in the state; and
» investing $142 million in the Robert Trent Jones Golf Trail of Opelika, Alabama, the renowned chain of golf courses that spans 23 courses and 378 holes at eight sites throughout the state, and the Lodge, a 129-room, 15-suite hotel and conference center.

The latest RSA acquisition involves the teetering US Airways, the nation's seventh largest airline. In late 2002 and early 2003, RSA outbid the private equity firm Texas Pacific Group, renowned for its resuscitation of then ailing Continental Airlines, with an offer of a $240 million investment and $500 million in financing for a 36.2 percent stake to keep the airline financially afloat and flying. RSA then further "sweetened the deal" by agreeing to slash payments for leases that the pension fund already held on $340 million worth of US Airways aircraft. However, in mid-September 2004, US Airways nose-dived into bankruptcy reorganization court for a second time in its history and the possibility of RSA's investment taking a major hit loomed large.[9] In response to the querying of his decision to acquire a portion of US Airways, Dr. Bronner indicated that RSA's financial condition remained on solid ground since the state retirees' exposure amounted to less than 1 percent of their more than $25 billion in total savings.

Arkansas

For the fiscal year that ended June 30, 2004, the market value of the Arkansas Teacher Retirement System's assets increased by almost 18 percent to $8.2 billion, an increase in value of about $1.2 billion from the prior fiscal year.[10] The stellar performance of the Arkansas Teacher Retirement System was better than 77 percent of the nation's public retirement systems for the most recently concluded fiscal year; the average growth in the value of these public retirement systems' assets, according to the plan's investment consultant Ennis Knupp & Associates, was 15.8 percent. In terms of the specific components, the value of the system's domestic stock holdings increased 25.7 percent to $3.4 billion (which is better than 86 percent of the nation's public systems), the value of foreign stock holdings increased 28 percent to $1.4 billion, and the value of bond holdings increased 1 percent to $1.6 billion.

* This investment had appreciated to $830 million by late 2002

California

Like a number of other large and small states (New York, Illinois, Kentucky, Massachusetts), California started fiscal year 2005 (July 1, 2004 through June 30, 2005) without a budget. Governor Schwarzenegger and the Legislature could not agree on a number of items, and one of the major obstacles to clinching an agreement was related to the state's pension fund. In order to cover payments owed to public pension funds, the governor had proposed borrowing nearly $1 billion. Specifically, the governor's proposal sought to link $929 million in borrowing to long-range pension fund changes, a move he argued would save the state $2.6 billion over 20 years.[11] However, given that the Legislature's chief attorney immediately expressed concerns about the legality of this borrowing plan, a move that further widened the gulf between the Legislature and the governor expeditiously clinching a budget deal.

In this connection, given the multi-billion dollar budget shortfall plaguing the state of California, Governor Schwarzenegger also proposed pruning retirement benefits for future state employees to the benefit levels state workers were getting before 1999, when the Legislature and former Governor Gray Davis approved higher pensions and early retirement.[12] In fact, the cost to taxpayers for state worker pensions soared from $200 million in 2001, to more than $2.5 billion in 2004; the post-1999 benefit increases alone amounted to an annual expenditure of $600 million. While the most sizable increases went to public safety workers, including prison guards and the state highway patrol, all state workers and retirees shared in the boost. As in the case of the previously described (in Chapter 2) generous DROPs provided to employees of the city of Houston, the booming stock market resulted in a series of actions by various governments around the country that proved to be extremely costly when both the stock market and the economy started sputtering. California fell into that category, with the additional benefits legislated by state government in 1999.

The California Public Employees' Retirement System (CalPERS), the nation's largest public pension plan, garnered a great deal of media attention in 2004 as a result of a number of positions it took. For instance, in May 2004, CalPERS voted to oust 38 hospitals from its Blue Shield HMO network because they were deemed too expensive, a measure expected to influence healthcare purchasing decisions across the country.[13] Given that premium increases topped 50 percent in the prior three years, CalPERS, the nation's third largest buyer of employee health benefits for 1.2 million public agency employees and retirees, will save about $50 million annually with this step.

Another action involving CalPERS in 2004 concerned Safeway, the grocery store chain.[14] In April 2004, CalPERS announced that it would withhold its vote for the chairman and two directors of Safeway seeking re-election at the company's annual meeting. In explaining its rationale for this announcement, CalPERS indicated that it was a reflection of the failure of the grocery chain's board to make shareholder-friendly moves such as expensing stock options and Safeway's $20 billion loss in shareholder value since 2001. At that time, the giant pension fund held 2.7 million Safeway shares.

In mid-August 2004, CalPERS announced that it had posted its largest annual return in six years as a result of gains in its stocks, bonds and real estate holdings.[15] For the year ending June 30, 2004, CalPERS earned almost 17 percent (16.7 percent) on investments, the giant pension fund's largest increase since a 20 percent gain in 1998. The fund, which oversees pension benefits for more than 1.4 million state and local government employees, increased its assets by $22.7 billion and lifted its holdings to a gargantuan $166 billion. While its United States stock investments improved by 20.8 percent in the year, real estate investments grew by almost 12 percent and international bond investments expanded by 8 percent.

Pension-related information in the city of San Diego also has been in the news recently. Specifically, the city of San Diego's $1.1 billion unfunded pension system liability has resulted in both bond rating downgrades and an investigation of possible violation of federal law.[16] Specifically, the Federal Bureau of Investigation and the Securities and Exchange Commission opened a preliminary investigation to determine whether San Diego intentionally underfunded its City Employees Retirement System since 1996 and then deployed the extra cash to balance the city's budget. According to financial disclosure reports that were made public in January 2004, the city's mayor and city council voted to continue underfunding the city's pension fund through 2009, even though they were made aware of the city's unfunded liability and errors in the 2002 financial statements by a pension trustee in November 2002. In light of these revelations and the federal investigations, San Diego will be stretched to bridge the funding gaps with the mayor acknowledging that the city may have to cut services, raise taxes and even sell city assets to meet its neglected pension obligations. The credit downgrades will pose additional challenges and Moody's Investors Service, the credit rating agency, warned that just to maintain its current funded ratio of 66 percent, the city will have to increase its general fund contributions from $55 million in 2004 to $90 million in 2005.

San Diego's unfunded pension liabilities are further compounded by the fact that two years ago, the city offered individual pension accounts to certain employees and, now, some of these employees stand to earn more by retiring than by working.[17] This situation is similar to the scenario played out in Houston and several other cities. When San Diego offered this incentive to its employees, the city indicated that it would perform a cost study to assess its feasibility; this study was never done.

Further information on San Diego's financial bind, released in September 2004, highlighted the shortfall in its pension fund for municipal workers and raised the real prospect of the city filing for bankruptcy in the near future.[18] This report provided additional details on how the city, year after year, used its pension fund earnings that exceeded projections to pay for a variety of local projects, and paying health insurance premiums for retired teachers and firefighters. Since actuarial projections are long-term averages, when the above-average earnings are deployed toward other expenditure categories, the city's pension plan is left with inadequate funds to offset the below-average earnings experienced in the past few years. The report's authors were quick to point out that this practice is sanctioned by law in California (and a number of other places) and it was "not something done in stealth." Their findings also raised the specter of other communities that allow this practice facing similar financial complications.

Connecticut

In August 2002, in response to the $1.8 billion loss in the prior year in the fund that holds retirement monies for state and local government employees, Connecticut's treasurer proposed a series of measures to stave off the flow of red ink.[19] For fiscal year 2002, the fund declined from $20.5 billion to $18.7 billion, prompting Treasurer Denise L. Nappier to propose maintaining the pension system as a defined benefit plan, rather than converting to one that would depend on market returns. As principal fiduciary for Connecticut Retirement Plans and Trust Funds (CRPTF), which consists of six state pension and eight state trust funds, the treasurer is responsible for prudently managing the retirement funds for approximately 160,000 teachers, state, and municipal employees who are pension plan participants and beneficiaries, as well as academic programs, grants, and initiatives throughout the state.[20] In this capacity, Treasurer Nappier also proposed that the state fully fund the Teacher Retirement System, from the 85 percent picked up by state at that time, placing any unappropriated surplus money into the retirement fund, and requiring state money managers to adhere to stricter standards. According to the fiscal year 2003 report, the net assets of the funds declined by approximately $400 million to $18.3 billion as a result of net cash outflows.[21]

Connecticut, like the large pension funds in several other states, in May 2004, "citing pervasive conflicts of interest and dismal company performance," decided to withhold their votes for the head of Safeway and two other directors.[22] Similarly, Connecticut also decided to withhold voting for the election of Michael Eisner to the Board of the Walt Disney Corporation.[23]

Florida

In 2002, the Florida Legislature and the State Board of Administration set up a defined contribution plan in which the state makes the same established pension payment and the employee has the option of directing its investment.[24] The Florida Retirement System had been a defined benefit plan for years where the employee secured a pension credit (usually 1.6 percent in career service), multiplied by the employee's years of service and multiplied the employee's average peak earning years. The move to the defined contribution investment plan was an effort to provide employees with investment choices. However, the State Board of Administration indicated that of the 21,270 state employees who signed up for presentations on the two retirement plans, only 540 opted for the defined contribution format.

Georgia

The flameout of the Enron Corporation in late 2001 destroyed the portfolios of certain investors and negatively affected every category of investor that had invested in the company. Included in the latter list were the two major Georgia public pension funds. Yet, in early 2002, information trickled out that a portion of the whopping $122 million that Georgia's retirees lost might have been prevented by emergency triggers designed to sell plummeting stocks.[25] According to information, the state's Teachers' Retirement Fund, which had a value of $39.7 billion at that time, lost $79 million during the Enron meltdown while the smaller, state employees' fund, which was worth $14 billion at that time, lost $43 million. The combined $122 million loss made Georgia's retirement system one of the biggest losers to Enron in the country; only much larger pension systems in Florida and California were affected more deeply. In an effort to enhance their assets, pension fund managers have been increasingly investing in equity markets. In 1999, the General Assembly and then-Governor Barnes gave pension fund managers the option to increase the portion of retirement system monies to 60 percent, from the previous limit of 50 percent.

In contrast to the state pension plans, the city of Atlanta's three pension funds each have about 40 percent of assets in the market and do have the aforementioned "stop loss strategies." Even though it is estimated that the combined police, fire and city employees' funds with the Atlanta pension system lost about $3 million on Enron investments, the city's emergency trigger mechanism prevented further asset erosions as a result of the Enron collapse. It should also be mentioned that the presence of these trigger mechanisms poses the following issue: in the event of a general stock market slide, the stop loss triggers could spur a large-scale sell-off of a fund's assets.

Illinois

Like a number of other states, Illinois discovered during the downturn of the economy in the last few years that its pension plans' liabilities were significantly underfunded.[26] In fact, Illinois' retirement system was the most underfunded of any state in the country. Given the twin facts of extremely low interest rates and tenuous fiscal position of the state budget, Governor Rod Blagojevich proposed, and the Legislature approved, selling up to $10 billion in bonds, with part of the proceeds paying off the state's 2003 and 2004 obligations to the fund and the rest being invested by the fund.

Further boosting the state's efforts was the impressive demand for the bonds; the state had orders for more than twice the amount it sold. Since the state planned to invest part of the funds raised, the bonds had to be issued on a taxable basis. Notwithstanding this, Illinois secured a 5.05 percent rate, the lowest ever for a 30-year taxable government bond.

Kansas

In early February 2004, Kansas lawmakers, including Governor Kathleen Sebelius, Senate President Dave Kerr and other legislative leaders, voted 8-1 in a state finance council meeting to borrow $500 million and buttress the state's beleaguered public employees' pension system, KPERS (Kansas Public Employees Retirement System).[27] KPERS is a retirement fund for 240,000 state workers, teachers, city and county workers and classified employees at Kansas University and the other state universities. While there was disagreement over how to pay off the bonds, the importance of ensuring the long-term financial viability of the pension fund was the objective of lawmakers from both political parties. While Governor Sebelius, a Democrat, maintained that the state should pay off the KPERS bonds with revenue from expanded gambling, Senate President Kerr, a Republican and a strong supporter of the $500 million bond issue, stressed that expansion of gambling was an independent issue.

According to the agreed upon proposal, the state was authorized to borrow $500 million within the month and then deposit the money with KPERS. The pension system was then to deploy the additional funding to try to narrow the nearly $3 billion gap between future pension obligations and current assets, a shortfall officials contend was created by the collapsing stock market and insufficient contributions from the state. KPERS intends to invest the funds raised in the recently revived stock market and secure a greater rate of return than the amount of interest the state has to pay to retire the bonds. While some legislators note that the expected extra revenue could evaporate with another dip in the stock market, others maintain that KPERS investments historically have a higher rate of return than the bond issue's interest rates. (KPERS investments have earned an average return of 8 percent per year, while the bonds typically carry an interest rate of less than 6 percent.) Like supporters of bond issues in other states, those in Kansas also maintained that the very low interest rate environment made borrowing a more attractive strategy. The state will start retiring the debt in 2005, paying $10 million the first year, $15 million the second year, $27 million the third year, and $37 million the fourth year and for each year after that through 2034.

Louisiana

There has been a great deal of activity regarding public pension plans in Louisiana in the past few years. Like so many other retirement systems, Louisiana's state retirement systems are underfunded and reputed to carry between $8 billion and $11.5 billion in unfunded accrued liability, i.e., the amount estimated to cover retirement benefits for active and retired employees over the long haul.[28] Complicating the retirement issue in Louisiana is a constitutional amendment that requires the Legislature to make payments to cover the unfunded accrued liability by the year 2029. To enforce the constitutional amendment, the Legislature has required the state's retirement boards to charge a percentage from the payrolls of employees and set aside these funds to avoid future unfunded liabilities.

The situation with the different retirement systems was so dire that in late February 2004 the state's retirement boards for teachers and other school employees began notifying school boards, universities and community and technical colleges that they would have to pay a significantly higher percentage of their payroll into the retirement programs on July 1, 2004, in order to bolster the unstable systems. Just for the 67 parish and city school districts in the state, the increase added up to $180 million every year; this was in addition to the annual $60 million increase in health insurance premiums faced by the state's school systems. For instance, the Caddo Parish school system expected an increase of $7.5 million more for retirement than it paid in fiscal year 2004; similarly, Bossier Parish calculated the increased cost to amount to $3 million in the next fiscal year. In mid-October 2004, the Bogalusa City School System announced that due to an $800,000 shortfall in its budget, the city had failed to make payments in the prior two months toward group benefits and retirement for teachers and system employees. Similarly, the Franklin and Point Coupee Parish School Boards also reported the nonpayment of group benefits.[29]

Consequently, during its 2004 session, the Legislature dealt with a number of issues related to the dire circumstances of the state's retirement funds. A major portion of these discussions pivoted around a suitable package to refinance a segment of the huge retirement debt accumulated by the state's retirement systems.[30] During the months of May and June 2004, discussions in both the Senate and House Retirement Committees revolved around lengthening the payment of retirement debt for the teachers' and state employees' retirement systems. After months of negotiations, particularly because some lawmakers were concerned that the refinancing plan would expose future generations to extra debt, both chambers endorsed a compromise to spread out the payment of $1.7 billion in certain state retirement payment debt from 25 years to 30 years. Without these changes, school boards and the state would have been forced to pay more in retirement costs in the current fiscal year (2005) and cut other spending priorities. The new 30-year payment schedule--Governor Blanco had pushed for a 40-year payoff--required that that state generate an extra $22 million in increased retirement funding in the current fiscal year. Without this refinancing measure, school boards would have had to come up with an additional $52 million more in retirement contributions and the state would have had to allocate an additional $25 million for the state employee system. As a cautionary measure, the House Retirement Committee added in new safeguards requiring that in years of booming investment returns, a portion of these earnings are channeled toward paying down the accumulated debt.

After the conclusion of the 2004 regular session, Governor Blanco signed legislation to refinance the $1.7 billion in retirement system debt, though the governor did veto legislation that would have "granted a lucrative pension boost to about 500 legislative employees, a move that could cost the state $60 million over the long term, according to one estimate."[31]

Another retirement system-related issue that generated attention in 2004 involved the Louisiana Municipal Police Employees' Retirement System (MPERS) decision to invest in a golf course near Fredericksburg, Texas.[32] The $1 billion retirement fund for 9,500 full-time police officers in more than 150 departments has been under scrutiny for borrowing $30 million to invest in the Texas golf course just as cities across the state brace for another increase in payments to the system. MPERS, which suffered a $200 million loss during the collapse of the stock market, also has been in the news regarding "spending $3 million building a new headquarters that sits half-empty" and nearly $90,000 to attend conferences in locales like Las Vegas, Lake Tahoe, West Palm Beach, Florida and New Orleans. Consequently, the state attorney general's office indicated in late March 2004 that it had begun an investigation of the legality of MPERS' investments and expenditures.

Louisiana's teachers' pension plan, the Teachers' Retirement System (TRSL), attracted attention in late March 2004 when an official alleged improprieties in the fund's investment strategies.[33] According to this official, who received a negative performance review and was then fired from his position after raising the investment strategies issue with TRSL officials, "private equity firms welcomed pension trustees to annual meetings at golf resorts where the atmosphere discouraged tough questions." According to this official, who began working at the TRSL in 2002, the proportion of the plan's investments in private equities was "surprising" and alleged that plan employees and trustees "receiving meals, trips and other gratuities from firms soliciting state business" clouded their evaluation of the performance of these firms in managing the TRSL's assets. In March 2004, state officials learned unexpectedly that they would have to come up with an extra $147 million for the fund, a development that spurred greater scrutiny of the TRSL's activities. The plan's trustees indicate that their funding rules require that the TRSL grow very quickly forcing them to invest in higher-risk assets in the quest for greater returns.

In late 2003, Louisiana's Legislative Fiscal Office submitted a report to the Legislature entitled "Louisiana's Retirement Systems: An Expenditure Analysis (FY96-FY03)."[34] As noted in this report,

> "The state retirement boards of TRSL and LASERS have failed miserably in this fiduciary responsibility. They have wasted hundreds of millions of dollars on unjustified administrative costs and by entering into extremely expensive contracts with out-of-state investment firms that provide little benefit to Louisiana. The benefit that the state does receive can be performed by Louisiana citizens at a fraction of the cost. This administrative waste and (especially) the unnecessary, expensive out-of-state contracts have cost the state's retiree retirement portfolio between $450 million and $500 million over the past seven years."[35]

While pension officials at these two retirement funds criticized in the Legislative Fiscal Office report "urged patience,"[36] a veteran state lawmaker immediately called for the Legislative Fiscal Office to initiate an "in-depth financial audit" of the state's public retirement systems and their officials.[37]

In relation to Louisiana awarding "active management contracts" to firms in other states, back in April 2002, then Louisiana Senate President John J. Hainkel Jr. pushed for an amendment to House Bill 130 that would require the four state-run retirement systems to handle at least 10 percent of their investments through in-state broker dealers.[38] Over a year and a half before the release of the December 2003 report by the Legislative Fiscal Office, in April 2002, Senate President Hainkel noted that "[S]tate brokers are losing out on millions of dollars in transactions as they are being bypassed by retirement systems worth billions whose money managers would rather deal in New York and other places." He also continued that other states had minimum in-state requirements; for instance, the New York State Retirement Fund is mandated by law to handle 30 percent of investments through in-state broker dealers and in Illinois, the state Investment Board, the state university retirement fund and Chicago Teacher's Pension and Retirement Fund all have 30 percent minimum in-state requirements.

In a rare burst of positive news for the state's beleaguered retirement systems, Teachers Retirement System of Louisiana and the Louisiana State Employee Retirement System could be among the largest beneficiaries of a $300 million class-action settlement with major pharmaceutical manufacturers (Bristol-Myers Squibb Company among others) that stemmed, in part, from a cancer drug scandal that also engulfed Martha Stewart.[39] Both Louisiana retirement systems (among the larger shareholders, along with retirement systems in Detroit, Michigan, and Fresno, California) were named lead plaintiffs in the case filed before the U.S. District Court in the Southern District of New York.

Maine

In a contrarian approach, and hailed as the first pension fund in the United States to do so, Maine has adopted a strategy known as matching, i.e., deliberately aiming for low but guaranteed investment income to pay for the retirement benefits of its workers.[40] After being shellacked in the financial markets in the 2000 to 2002 period, like so many other states, Maine's approach stands in contrast to other state plans that seek riskier investment instruments (such as hedge funds and venture capital projects) to generate higher returns and cover the significant losses of the initial years of this decade.

In this vein, Maine recently put a portion of its funds into very conservative bonds. The bonds pay a low interest rate, but their values will rise or fall in conjunction with the value of the pensions the state must pay its retirees, regardless of the trajectory of the markets. In sum, the bonds' duration mirror the scheduled payouts to retirees in coming years. This strategy, known as matching, often was scoffed at it in prior years even though analysts contend that adopted early enough, it could thwart the collapse and disintegration of both corporate and public retirement funds.

While Maine made the conversion last year, the state has only matched about one-third of its assets. Hence, the remaining two-thirds is still invested in stocks, a decision that does not completely safeguard the state's investments from the gyrations of the financial markets. For instance, before the conversion, the investment returns from its pension assets fluctuated from a gain of 25.7 percent in 2003 to a loss of 10.4 percent in 2002. So, the presence of some two-thirds of its asset base still in stocks is predicated on the assumption that over the long term, stocks will grow faster than the conservative bonds and bridge the unfunded portion of Maine's retirement system. Yet, by matching even one-third of its investments, Maine has made a strategic departure from the rest of the industry as it seeks to ensure the payments to its retirees.

As noted, Maine's decision ". . . represents a watershed. It meant Maine would no longer think about its investments the way most of the industry does—striving for high returns and avoiding a low peer-group ranking. Instead, Maine would strive for returns commensurate to its obligations, and it would avoid drawing more tax dollars."[41]

Maryland

In the fall of 2001, news concerning Maryland's state employee pension system, a system serving more than 80,000 retirees and 222,000 active participants (teachers, police officers, judges, prison guards and lawmakers from more than 100 state and local agencies), grabbed the attention of numerous interested parties.[42] First, a leading tracker of public retirement funds, the Trust Universe Comparison Service (the widely watched evaluation of pension fund performance compiled by Wilshire Associates) ranked Maryland's state employee pension last among its peers. Then, the Maryland General Assembly's Office of Policy Analysis issued a report indicating that the State Retirement and Pension System lost 11.2 percent of its total asset value in the fiscal year that had just ended (fiscal year 2002, July 1, 2000 through June 30, 2001). Valued at $33.1 billion at the end of June 2000, the system was worth $29.4 billion a year later; the pension fund then dropped an additional $3 billion three months later by September 30, 2001, a staggering loss of one-fifth of its value in a scant 15 months.[†]

Legislators and other policymakers informed about their state pension fund's abysmal performance expressed great concern and began a series of investigations and explorations into determining the reasons for this poor performance. In response to these queries and concerns, then-Treasurer Richard N. Dixon, who headed the pension board, and Carol Boykin, the fund's chief investment officer at that time, indicated in official testimony "that fund officials do not plan to change their strategy significantly even after $3.5 billion in stock market losses last year."[43] This was because concerned Maryland lawmakers, the state comptroller, dissident board members, analysts and certain fund members had questioned the fund's efforts to consistently increase the percentage of stocks in the fund's portfolio even after the fund had experienced unprecedented losses in 2001. Certain board members also indicated that the fund "needs a more open process to select the money managers that handle the fund's investments."[44]

After some pressure, the pension board finally agreed to a full-time outside consultant to help guide its operations and investment decisions–a measure strongly supported by legislative leaders–and consider changes to its written investment strategy. In mid-January 2002, Treasurer Dixon resigned from his position as head of the pension board citing ill health; Maryland lawmakers moved quickly to appoint one of their own, Delegate Nancy K. Kopp, as state treasurer, to head the state retirement system.

The swirling controversy surrounding the state's pension fund became more complex in August 2002 when federal authorities indicated they had revived an investigation into the pension fund's relationship with Nathan A. Chapman, Jr., a probe that traces back to April 2000 when federal agents interviewed then-state Treasurer Dixon about Chapman's activities.[45] Chapman was fired in January 2002 as manager of about $175 million in state pension funds after the pension board learned that the federal government (the Securities and Exchange Commission) was investigating some of his transactions.

In December 2002, the system's executive director, Peter Vaughn, unexpectedly retired and in April 2003, *The Baltimore Sun* reported that Carol Boykin, the chief investment officer of the troubled retirement system and an ally of former Treasurer Dixon, had been ousted.[46] Chapman was then indicted in June 2003 by federal authorities on 39 counts of defrauding the pension system of millions by putting pressure on Alan B. Bond, a fund manager he hired and supervised to make significant purchases in the stock of Chapman's companies. Bond had been convicted of fraud in 2002 and is serving almost 13 years in federal prison.[47]

On the positive side, for fiscal year 2003 (July 1, 2002 through June 30, 2003), thanks to a powerful fourth quarter, the state's strained pension system turned in a 3.47 percent gain, its first year in the positive category since fiscal year 2000, according

† It should be noted and as mentioned in the Introduction to this report, in May 2000, The Council of State Governments' Southern Office, the Southern Legislative Conference (SLC), issued a ***Regional Resource*** entitled "*Recent Developments in State Retirement Systems in the SLC States*." This report analyzed information released in March 2000 by the U.S. Department of Commerce on public sector retirement systems for 1998. One of the points made in this SLC ***Regional Resource*** was that while the Southern state cash and investment growth average between 1997 and 1998 was 19 percent (the national average was 16 percent), Maryland's growth rate was an anemic 3 percent, the lowest among the 16 SLC states.

to news accounts.[48] In the prior two fiscal years, the plan lost 9.41 percent in 2001 and regressed by 7.63 percent in 2002. In the most recently completed fiscal year, 2004, the plan secured improved results in all categories of its investment program with a growth rate of 16.2 percent. Assets increased by $3.5 billion to $30.1 billion from the fiscal year 2003 level of $26.6 billion.[49]

The pension system's improved financial picture is a reflection of both the active involvement of the General Assembly in passing reform legislation and the hiring of senior management intent on developing a "culture of accountability" at the system.[50] The reform legislation included the addition of board members with financial expertise; an independent consultant to guide investment decisions; a detailed investment policy to prevent the abuses perpetrated by Chapman; a ban on the type of sub-manager arrangements that permitted Chapman to pressure a third party he supervised to buy stock in his companies; and the implementation of a series of governance procedures with a focus on checks and balances. Trustees from the prior era also have been removed, sometimes statutorily, particularly those who failed to be actively involved in the operation of the retirement system.

Mississippi

At the end of fiscal year 2003 (July 1, 2002 through June 30, 2003), like so many other plans, the Public Employees' Retirement System of Mississippi secured a positive rate of return for the first time in three years.[51] The 2003 fiscal year growth rate of 3.5 percent was the result of an increase of $452 million in total investments to $14.6 billion. For the cumulative five-and-10-year periods, the system had annualized returns of 1.6 percent and 7.8 percent, respectively. For this fiscal year, the plan covered 326,931 participants.

Shortly after the release of the fiscal year 2003 information, the system's executive director noted that contributions to the system had not increased in a number of years, since the early 1990s.[52] At that time, state employees contributed 7.25 percent of their salaries to the fund and the state contributed 9.75 percent.

During the 2004 regular legislative session, the Senate debated the merits of allowing teachers who have worked for 30 years or more and had been retired for a year to return to teaching without giving up their benefits.[53] Under Senate Bill 2600, these teachers would not continue paying into the retirement system but their employers would make contributions on their behalf. This is because there were a number of schools in the state that were in desperate need of seasoned teachers. Yet, the bill was unsuccessful because opponents raised sufficient doubts about the added strains this proposal would place on an already stretched retirement system. As the system's executive director noted, "the state's retirement system is not in a condition to handle an influx of teachers able to draw a full-time salary and a pension. . . .the retirement system is not the best avenue for dealing with the teacher shortage problem."[54] For instance, the system is paying out more money to its 62,000 retirees than is coming in; consequently, retirement officials have considered increasing employer contributions by 1 percent, which would generate $48 million annually.

Later in 2004, the city of Gulfport notified about 45 retired employees, mostly police officers and firefighters, that they must pay the full cost of their health insurance beginning November 1, 2004, if they want to continue it.[55] According to officials, the city was in violation of the state constitution as interpreted by the attorney general who held that "retired employees, while able to continue in the insurance plan provided by their prior employer, should bear the full costs of any such coverage. The employer is not to bear any costs related to providing benefits for a retired employee." Based on this ruling, officials concluded that the city could not subsidize public retiree health insurance costs since it is a form of compensation; the city could not pay compensation unless it is earned. Consequently, health insurance costs for these retirees will jump steeply, from about $200 a month to nearly $900 a month for a retiree and spouse.

New York

As states and localities strive to balance their budgets in these fiscally challenging times, chief executives of these entities often seek to slash the required contributions to pension funds to garner additional funds. New York is one of these states, and in mid-January 2003, Governor George Pataki floated "a proposal to postpone $1.3 billion in local and state payments due to the public retirement program."[56] The governor's efforts to enact a similar proposal in the prior legislative year had been unsuccessful and had included capping annual employer contribution increases to the pension system at 6.5 percent.

In opposing the governor's proposals in 2004, state Comptroller Alan G. Hevesi indicated that four of the proposals were unconstitutional; according to Comptroller Hevesi, reducing the contributions the state and local governments must make to their pension funds was unconstitutional because it would weaken the pension funds in the long term.[57] As

Comptroller Hevesi noted, the state's constitution bans the use of pension funds to bridge shortfalls in state and local budgets. While this decision resulted in the need for the governor to fill a new $500 million hole in the state budget on the eve of presenting his executive budget for the new fiscal year, county executives and mayors outside New York City also faced the likelihood of not receiving $800 million in relief from skyrocketing pension costs that they had hoped for. Comptroller Hevesi's actions will not affect the rising costs of pensions in New York City, which has its own pension funds. Even in New York City, Mayor Bloomberg had been seeking a new, lower pension tier for new city employees.

North Carolina

In early January 2002, media accounts tallied the fact that while North Carolina's pension fund lost nearly $7 billion in the prior year, the fund still outperformed a majority of the funds across the country in ranking among the top 25 percent of the nation's public pension funds.[58] As of September 30, 2001, the fund stood at $52 billion, dropping from $57 billion a year before, an 11.8 percent decline. At that time, the fund had diversified its investments with some $26.9 billion in stocks, $23.9 billion in bonds and $1.4 billion in real estate. In comparison to other plans, North Carolina suffered minimally from the Enron debacle (about $15 million), certainly a smaller amount than the $300 million loss experienced by Florida's pension fund.

In the fall of 2002, the state's Retirement System Division sought permission from the General Assembly and the governor to expand its 125-person workforce in 2003.[59] Citing a steep increase in the monthly applications for retirement, walk-in visits, telephone callers and written correspondence, retirement system officials indicated that it was imperative to expand its workforce to improve customer satisfaction. The division's annual operating budget ($9.4 million, at that time) was paid entirely from retirement system earnings, and it was proposed that the workforce expansion also be funded in that manner. At that time, the system had 645,000 retirees or active employees participating in the system.

At the end of June 30, 2002, plummeting stock prices, corporate accounting scandals and the state's budget crisis resulted in a $3.3 billion decline in North Carolina's public employee pension fund from the prior year.[60] According to news accounts of this development, state workers were "less worried about the market-related losses than they were about the state government's decision to suspend its regular contributions to the pension fund."[61] In a trend replicated in other state and local government settings, in September 2002, the General Assembly decided to withhold $144 million in payments to the plan in order to help offset the state's budget shortfall. According to an actuarial projection made by the state treasurer's office, given that the government is not contributing to the pension fund while state workers continue contributing 6 percent of their annual pay, the pension fund would face a $1 billion shortfall by 2010. In this connection, Treasurer Richard Moore, whose office oversees the fund, noted that "[W]e must get back on the road to making regular contributions to the fund."[62] In fact, in subsequent months, Treasurer Moore proposed changing the North Carolina constitution to prevent governors from seizing contributions to the fund to balance the state budget.[63]

For the year that ended June 30, 2004, the state's pension fund investments recorded a 12 percent annual return, a positive return for the second year in a row (the fund posted a 7.6 percent growth rate in 2003).[64] The state's pension fund, which serves almost 700,000 North Carolinians, had assets totaling nearly $61 billion, up from $55.7 billion in the previous year. In further positive news for the fund, the General Assembly, which pledged $154 million for the fund this year, also has started paying back $130 million of the funds retained earlier on in the decade in an effort to balance the state's budget.

In relation to an issue that attracted attention in Louisiana, in April 2003, the North Carolina board that oversees the state's retirement plan selected Prudential Financial, a giant insurance and financial services company based in Newark, New Jersey, to replace BB&T, the Winston-Salem, North Carolina-based financial services entity, as the administrator of $2.3 billion in retirement assets. Prudential emerged as the winner in a hotly contested bid among seven companies and promised "the highest level of service and the lowest fees."[65] In this connection, Prudential has agreed to waive all account fees, resulting in $22.3 million in savings over the next five years for the 175,000 participants in this particular portion of the state pension fund. Losing this contract was a major blow to BB&T given that the bank originally secured the contract in 1985 and then won additional competitive bids to secure two extensions.

Oregon

In a trend that has been replicated in many states, Oregon's pension bond offering in fall 2003 was the largest bond in its history and its first global offering ever.[66] As in the other states, Oregon's bond offering was driven by the need to buttress its pension plan. In this offering, the state borrowed more than $2 billion at 5.78 percent and hopes to earn at least 8 percent, the assumed actuarial rate on its liability. According to the Oregon treasurer's office, given the very attractive interest rate environment, the state will save $1 billion by the lower financing costs. Implementing this bond offering generated additional challenges given that the state constitution requires the approval of the state's citizens when the state seeks to borrow more than $50,000. Hence, a constitutional amendment had to be approved by its citizens and, even though the amendment was successful, a lawsuit was filed challenging the state's authority to take on the debt. While the suit was dismissed in circuit court, as of spring 2004, the state's portfolio of bond-funded investments was performing well.

Pennsylvania

The Pennsylvania State Employees' Retirement System is one of the state's major public pension plans. Like other plans across the country, after experiencing serious setbacks in the initial years of this decade, in 2003, the plan bounced back to register impressive gains. For the fiscal year that ended on December 31, 2003, the plan recorded the sizable improvement of 24.3 percent in its assets. In terms of actual numbers, in fiscal year 2003, the plan's net assets stood at an impressive $24.5 billion, an increase of $3.7 billion. In the prior fiscal year, 2002, the plan's net assets declined by $3.8 billion and had slumped to $20.9 billion. The more than 24 percent asset growth in fiscal year 2003 compared very favorably to the plan's performance for the fiscal years that ended on December 31, 2002 and December 31, 2001; the plan suffered losses amounting to -10.9 percent in 2002 and -7.9 percent in 2001, respectively.[67]

Like a number of localities experiencing severe financial problems with DROPs, described in Chapter 1, the city of Philadelphia also faces difficulties.[68] Philadelphia introduced these supplementary pension accounts in 1999 with the proviso that the city would review the program in four years to determine whether it was affordable. Last year, the mayor announced that these added benefits were draining the city's pension fund and that it had to be abolished; however, the city pension trustees had made the program permanent.

South Carolina

South Carolina's pension fund ranked among the few plans to eke out a positive gain on its investments for the fiscal year that ended June 30, 2002.[69] In fact, according to the trade publication *Pensions & Investments*, South Carolina's pension system was the only one of 72 public pension funds to attain a positive return on its investments for that fiscal year, a year when the stock market plunged steeply, foisting negative returns on a majority of the plans. When the South Carolina system first invested in the stock market in June 1999, it was the last state to do so and for fiscal year 2002, the fund was authorized by law to invest up to 40 percent of its assets in the market. While the fund invested about one-third of its total assets in the market during this year, the fund lost about $1.1 billion due to the hemorrhaging stock market. Yet, the state's other investments, mainly in fixed-income instruments, enabled the fund to post the modest $195 million, or 1 percent, gain for its total portfolio for this fiscal year.

In terms of the fund's net assets for the fiscal year that ended June 30, 2003, South Carolina stood at $22.4 billion, up from the $20.9 billion reached exactly one year before. This represented a gain of 6.8 percent between fiscal years 2002 and 2003.[70] The following graph reflects the plan's net asset values for the past five years and demonstrates the relative success of the fund even during the extremely bleak years of 2000 through 2002. For instance, between fiscal years 2001 and 2002 when other public pension plans experienced huge losses, South Carolina only suffered the miniscule loss of less than a full percentage point (-.53 percent).

As indicated in Figure 12, despite the severe losses experienced in the market during the 2000-2002 period, the South Carolina pension fund managed to largely stay in positive territory given the fact that the state maintained a lower proportion of its overall assets in the market. In fact, in the three fiscal years mentioned, the state lost a cumulative $2 billion with its investments in the market. This prompted the state treasurer to unsuccessfully try and alter the way the state invests its retirement funds in the stock market in early March 2003.[71] treasurer Patterson proposed that given the market losses suffered by the fund, investing in passive funds that do not carry management fees, an added expense borne by the fund, should be considered. Yet, the Treasurer's proposal did not convince the South Carolina Budget and Control Board, the state entity that oversees the fund, which voted 4-1 to invest an additional $500 million of retirees' money in the market at this March 2003 meeting. In fact, Governor Sanford said "while the fund has lost

South Carolina Retirement System, Plan Net Assets, Fiscal Years 1999 to 2003

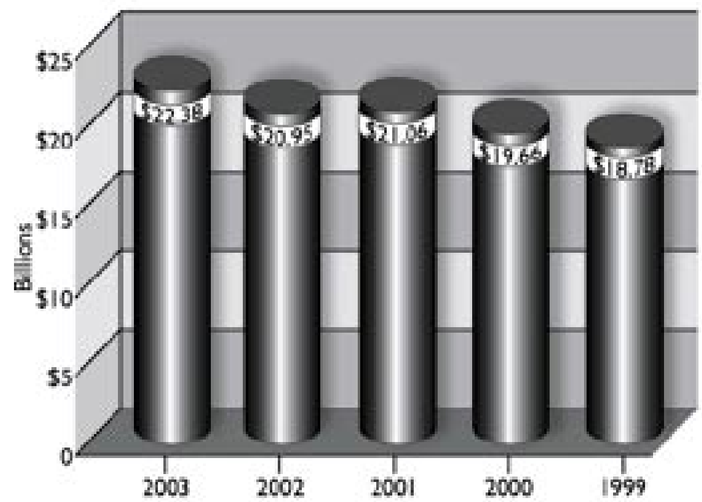

figure 12

Source: South Carolina Retirement System

money in the stock market, it could have made many more billions of dollars if it had begun investing in the 1980s."[72]

As in a number of other states and localities, during its 2004 session, there was debate in the General Assembly about the Teacher and Employee Retirement Incentive (TERI) program.[73] Devised in 2000 by the General Assembly, the TERI allowed employees to continue working for five years after retiring. The retirement payments they would have secured during these five years would have been assigned to a special account they could access upon leaving the program. The rationale in creating this program was to allow teachers and key employees to keep working after their retirement, at the request of their supervisors. Critics of the program contended that the TERI kept "nonproductive workers around too long;" "kept employees in management positions, making it difficult to groom new leaders," and "costs too much."[74] However, according to an independent study that was released in March 2004, the incentive program only added $100 million to the retirement system's liabilities instead of the previously estimated $650 million. In the House of Representatives, House Bill 4888 sought to remove the earning limitation for a retiree and then eventually phase out the entire TERI program. There was a great deal of opposition to this proposal, and the bill author requested that the bill be removed from the legislative agenda for the year.

Tennessee

In its most recent annual financial report, issued on December 15, 2003, for the fiscal year that ended June 30, 2003, the Tennessee Consolidated Retirement System (TCRS) posted a growth rate of 4.9 percent.[75] For the prior two years, TCRS' growth rate had been -1.92 percent and -1.57 percent respectively. As of June 30, 2003, TCRS had 198,917 active members while a total of 81,121 retirees and beneficiaries were receiving monthly retirement annuities.

In February 2003, Tennessee lawmakers heard from the then-state treasurer that the state will have to pay an extra $180 million to its employee pension fund for fiscal year 2004/05.[76] According to former Treasurer Steve Adams, since the $23 billion fund did not meet an assumed 7.5 percent return on its investments for the fiscal year that ended on June 30, 2002 (the fund actually shrank by 1.92 percent), the state would have to allocate the additional funds to account for the difference. For fiscal year 2003/04, the state's contribution to TCRS was expected to be $170 million and more than double that amount (about $350 million) for the following year.

In early October 2004, the Memphis City Council announced that it had terminated its early retirement program for high-ranking officials, introduced in January 2001, which allowed both elected and certain appointed officials to collect pensions after just 12 years of service, regardless of their age.[77] However, this termination decision is not retroactive, ensuring that the approximately

300 eligible employees currently on the city payroll will qualify for this attractive benefit once they complete 12 years of service. According to the council member that sponsored the amendment to terminate this provision, "the chief reason for revoking the 12-year rule was to stem the city's insurance coverage liability for those retirees."[78]

Texas

The Teachers Retirement System of Texas (TRS) is one of the largest retirement plans in the country and for the fiscal year that ended August 31, 2003, the plan recorded an impressive 11.3 percent market return on its assets.[79] The fiscal 2003 growth rate followed back-to-back losses in 2001 and 2002, and at the end of the latest fiscal year, system participation included 1,356 reporting employees and 1,080,768 members and retirees. Net assets of the plan were $77.6 billion compared to $71.7 billion at the close of the prior fiscal year (2002).

Notwithstanding the aforementioned positive information from the TRS, news from some of the other public retirement plans in the state has not been as encouraging. Specifically, in late February 2004, the city of Houston announced that its main pension program had a billion dollar funding shortfall because benefits had been boosted to heights that will enable many employees to earn more in retirement than they did while working.[80] In fact, a few will even retire as millionaires. According to reports, city taxpayers will have to set aside nearly $100 million into the fund next year to adequately reduce the shortfall and, furthermore, the city cannot reduce benefits for any employee with at least five years service, given a Texas constitutional amendment approved by voters last year.

According to a consultant's report assessing the pension woes troubling Houston, the city's pension plan is far more generous than those available in comparable cities such as Dallas, Phoenix, Denver and Philadelphia. For instance, employees who work 25 years and four months receive 90 percent of their final salary in retirement, plus Social Security payments that will place them well over 100 percent of their final salary. In addition, after the employees die, their spouses continue to receive this full pension amount until their own deaths. Finally, under the previously described DROPs, some longtime city employees will garner million dollar payouts along with their monthly pension benefits. There also were reports that the official in charge of negotiating changes to the city's pensions (when these enhanced benefits were introduced a few years ago) "nearly tripled his own retirement benefits."[81] Furthermore, a former city attorney, who was in charge of the city's lobbyists that worked toward passage of these pension changes in the state Legislature, secured a 79 percent increase.[82] (His estimated pension benefit, if he serves six years as chief administrative officer, will rise to $131,000 per year, up from $73,000 per year under the prior pension rules).

The current funding problem faced by Houston can be traced to 2001 when then- Mayor Lee Brown's administration agreed to the recommendations forwarded by a pension board whose majority was made up of current and former city employees. These recommendations flowed from a report conducted by the consulting firm Towers Perrin, which indicated that Houston would not have to contribute more than 14 percent of its payroll to the pension program with the added pension incentives; but, late last year, the firm reconfigured its numbers and informed the city that it would now have to contribute the considerably higher 32 percent of payroll toward the new pension plan. In fact, after the pension board secured increases in benefits from the city back in 2001, retirees with 25 years of service secured 89 percent of their final annual income compared to a mere 53 percent in 1993; also, the revised program only required 20 years of service to qualify for 65 percent of income, while other comparable cities require between 25 and 35 years. Consequently, in the spring of 2004, city officials were feverishly negotiating with the pension board to radically slash the upcoming year's city contribution to the pension fund, which is calculated to be $152 million instead of this year's $55 million.

In a desperate attempt, city officials in Houston decided in late March 2004 to seek the support of local voters in exempting the city from a state constitutional amendment (passed in September 2003) that barred Texas cities from reducing municipal employee pensions. Proposition 15 passed in September 2003 when proponents argued that it was a matter of fairness and that 41 other states had similar amendments in their constitutions. The origins of Proposition 15 in Texas in the 1930s lay in the decision of Dallas city officials to trim police pensions. According to reports, Dallas is another city with an underfunded pension fund, though the situation there is not as serious as the one faced by Houston. On May 15, 2004, Houston voters overwhelmingly approved Proposition 1, which allowed the city to opt out of the previously-described constitutional amendment prohibiting the city from cutting pensions.[83]

Virginia

In the fall of 2003, while preparing for the 2004 legislative session, the Virginia Retirement System's (VRS) nine overseers disclosed that the state and local governments would have to locate between $534 million and $546 million to buttress the fund that pays public worker pensions over the 2004-2006 biennium.[84] This was yet another complication in setting priorities for a severely stressed Virginia budget. Among the measures discussed at this time were reinstating a requirement that state employees contribute to the cost of their retirement; since the early 1980s, the state had picked up that expenditure. Given the political fallout associated with such a move, one possible compromise that was discussed was requiring only new public employees to pay this added expense. Another cost-cutting measure discussed involved considering less costly alternatives to the traditional defined benefits program provided by the VRS.

By July 2004, VRS announced that it had recovered nearly all of the losses experienced during the recession and the crumbling stock market in the initial years of the decade.[85] At this time, the value of VRS stood at $39.1 billion (down slightly from the $40.1 billion level reached in March 2004) and a scant $1.5 billion short of the $40.6 billion reached at the market's peak in March 2000. Investment returns from VRS are necessary to provide benefits to 113,569 retirees because cash contributions alone from state and local governments are insufficient to cover monthly pension checks. As of mid-July 2004, a total of 317,343 public workers were relying on VRS to assist them with their retirement plans.

West Virginia

West Virginia is another state that faces serious challenges in fully funding its public sector retirement systems. During this past legislative session, there were a number of developments concerning the issue as lawmakers grappled with devising an adequate response to this serious financial crisis.

As carried out in a number of states, Governor Wise's administration sought to sell almost $4 billion in bonds to offset the mounting shortfalls in a number of state pension programs, including plans for teachers, state troopers and members of the judiciary.[86] While the bond sale, as a strategy to raise funds, had surfaced during the administration of former Governor Underwood, the current governor issued an executive order to carry out the sale. According to advocates of the sale, Governor Wise wants the almost $4 billion bond sale to replace a 40-year plan that requires the state Legislature to devote ever-increasing amounts from the state budget every year toward these pension funds. For instance, under the state's current payment plan, the unfunded portion of the pension plan grows from $381 million this year to $634 million in 2033-34, the last year of the 40-year plan. According to Governor Wise and proponents of the bond issue, if the bond issue was allowed to progress, the favorable interest rate environment currently in play would enable the state to slash 10 years off the payment plan and save $1 billion.

In response, the state auditor and treasurer sought to stop the bond sale on the grounds that the sale entailed new debt for the state and that the state constitution required voters to approve the issue of any new debt. Proponents of the bond sale had maintained that the bond sale did not involve new debt and that it was merely refinancing old debt. In response, a Kanawha circuit judge ruled in favor of the proponents indicating that the bond sale could proceed. Both the treasurer and auditor indicated that they would appeal this decision all the way to the state Supreme Court and most recently, as of early August 2004, Governor Wise and his acting secretary of administration had filed a motion to shorten the ordinary four-month appeal period that would apply for an appeal from a final order of the Circuit Court of Kanawha County.

In early September 2004, while hearing arguments in the case, the state Supreme Court expressed "big doubts" about whether the governor's almost $4 billion pension bond proposal can evade the state constitution's ban on the state assuming additional debt without voter approval.[87] In turn, Governor Wise's attorney maintained that the proposal is an effort to refinance existing debt, not take on additional debt, and that the existing debt was brought on when the state failed to adequately fund these retirement plans in dire budget years. The governor's attorney also argued that a 1997 constitutional amendment approved by the voters permitted investments in the market and stressed that the proposed bond sale amounted to such a move.

Another issue related to public sector pensions that came up during the 2004 legislative session involved a provision in a bill that would have enhanced retirement benefits for a small number of government employees.[88] This bill (SB 563, HB 4563) "would have helped certain state employees, like legislators, who may have made a higher salary while working in another state government job."[89] Governor Wise vetoed this bill indicating that the state's pension plans could not afford to increase benefits; in addition, the lead sponsor of this bill in the Senate, along with a number of other senators, indicated their opposition to this particular provision that was added on subsequently and indicated that they would urge the governor to veto it, which he did.[90]

Another measure debated by the Legislature during the 2004 session involved merging the state's two troubled teacher retirement programs, the Teachers' Defined Contribution Retirement System and the older Teachers Retirement System.[91] A merger was envisaged to boost the older plan's assets by about $500 million alongside shaving off $1.9 billion off payments owed under a 40-year plan to eliminate this plan's unfunded liability. However, the merger effort was unsuccessful.

Wisconsin

In a measure adopted by a number of other states and localities, Wisconsin recently sold pension liability bonds. The $1.8 billion bond offered by the state was deployed to eliminate the state's obligation for both retirement and sick leave payments.[92] In particular, the state's sick-leave obligations had grown in alarming proportions and in an effort to stem the growing tide of red ink in this expenditure item, the state set up an innovative financing strategy to raise capital. Given that the state constitution forbids using general obligation bonds for operating expenses, Wisconsin issued appropriation bonds, i.e., bonds backed by the pledge to repay bondholders through an annual appropriation. In general, appropriation bonds are not as "sellable" as general obligation bonds because this category of bonds is linked to the legislative process. For instance, the failure of the Legislature to pass a budget on schedule could potentially derail the returns owed to bondholders. Yet, the state worked hard to assuage the concerns of bondholders by stressing that under the state's continuing budget authority, if the Legislature had not adopted a new budget by July 1, the executive branch could spend money based on the previous year's budget. Wisconsin diverged from the usual pension bond offerings in another important way. Normally, many pension bonds use money raised at a low rate to make money at a higher rate in the equity market; however, Wisconsin decided not to pursue that strategy and decided to treat it as a refunding obligation. Given that long-term interest rates were below the 8 percent actuarial charge on the unfunded liability, Wisconsin was guaranteed a level of savings.

As described on several occasions, pension "sweeteners" adopted by cities when the stock market was barreling ahead in the late 1990s have posed serious financial dilemmas to a number of these jurisdictions in the troubled fiscal years of this decade. Milwaukee, Wisconsin, is another jurisdiction facing the onerous burden of additional pension costs and is also the only locality where prosecutors have brought about charges against an official for misrepresenting the true cost of these added benefits.[93] Consequently, the former personnel director of Milwaukee County pleaded no contest to one felony count of misconduct in public office and two misdemeanor counts in March 2004. Court documents revealed that at least some officials were contemplating their own retirements as they devised ways to qualify for new benefits. In fact, residents of the county were so enraged to learn that supplementary pension accounts would transform some officials into millionaires that they held a recall election and voted seven county supervisors out of office. Under the previously described DROP, in Milwaukee, pension officials guaranteed 9 percent returns on their escrow accounts in addition to other measures to enhance both the lump sum payouts and the monthly annuity checks.