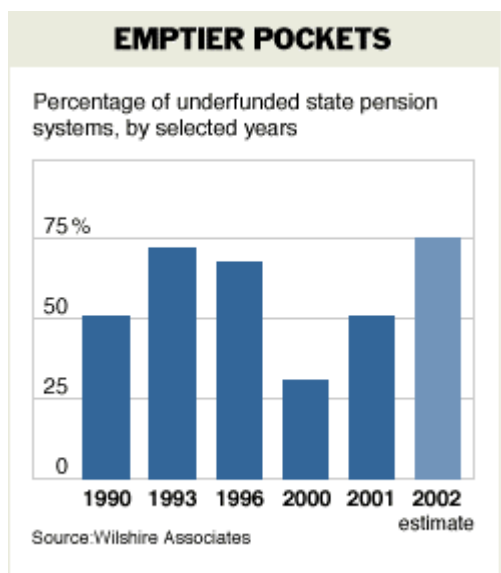


Public Pensions Come Up Short As Stocks' Swoon Drains Funds

Kara Scannell, *The Wall Street Journal*, August 17, 2002.

Steep stock-market losses are sucking money out of the nation's public pension plans.

More than half of all public pension plans are underfunded, up from 31% two years ago, a recent study shows. The pain will grow, says Wilshire Associates Inc., a Santa Monica, Calif., consulting firm that advises public pension plans on investments. According to its study of 93 pension systems, which provide pensions to teachers, firefighters and other state and municipal employees, the percentage of underfunded public plans will rise to 75%.



"When this is updated a year from now, things are going to look a lot worse," says Stephen Nesbitt, author of the Wilshire study, which is being released Friday. To put this into perspective, the last time three-quarters of public plans were underfunded was in 1993, in the wake of a recession.

The stock market is a primary culprit. The median return for public plans was a loss of 5.8% for the year ended June 30, the Wilshire study shows. (Most public pensions operate on a June 30 fiscal year, so 2002 results aren't available yet.)

West Virginia Teachers' Retirement System is the worst-funded plan, with assets as a percentage of liabilities of just 21%. Next is the Indiana Teachers' Retirement Fund, at 43%, followed by the Oklahoma Teachers' Retirement System, at 52%. Unfunded liabilities at the plans in the study leapt to \$94 billion for 2001, up from \$50 billion for the prior year.

Bad timing contributed to the stock-market losses. Many public pension plans didn't begin to invest in stocks at all until the past few years, which meant that many were diving into the market at the top.

Inexperience among pension-fund managers, who sometimes have nonfinancial backgrounds, led to poor asset-allocation decisions at some plans. "The biggest sin they might have committed at the peak of the market was that many funds, not just public funds, were reluctant to rebalance" their portfolios, so they included too risky a proportion of stocks, says Jay Kloepper, head of the quantitative consulting group at Callan Associates, a San Francisco adviser to pension plans.

Moreover, the money intended to fund public pensions is often diverted into other programs -- building highways, refurbishing schools, and other needs that elected officials feel are more urgent than providing funding for an IOU that won't be paid until after the officials themselves have retired.

Current retirees needn't worry, however, as they will continue to receive the pensions they have been promised.

Instead, it is current employees who are likely to feel the pinch. Unlike employees of corporations, public employees typically are required to contribute some of their pay toward their pensions -- a fact that helps explain why public pensions often are so generous.

When the plans become underfunded, the employees are often required to pony up more of their pay. Nevada public employees have to contribute 9.75% of their pay toward their pensions.

"My guess is next year, it will go up," says George Pyne, executive officer of Nevada's retirement system.

Pension deficits may also lead to an increase in taxes or cuts in other programs. "The burden has to be picked up by somebody," says Mr. Nesbitt, author of the Wilshire study. "Generally it's the taxpayer, or something else in the state budget will have to suffer."

So what are states doing about it? Some are toying with converting to systems that mirror what corporations have been doing during the past 20 years: putting new employees in less-generous plans and converting the pension systems to 401(k)-type plans, which would shift all the funding and investment risk to the employees.

In recent years, brokerage firms, mutual-fund companies and insurers have been lobbying aggressively at the state level to convince officials to abandon pension plans in favor of 401(k) plans. A few states have bitten: The largest is Florida, which recently introduced a defined-contribution plan as an adjunct to its pension plan, which isn't underfunded. But the recent devastation of retirement savings at many companies isn't likely to make this do-it-yourself option popular.

In any case, not all public plans are in bad shape. In addition to Florida, Arizona and New Jersey operate with a surplus of cash. Things have been bad before: the rise in underfunded public pensions today mirrors the bear market of 1990 to 1993, when underfunded plans rose from 51% to 72%. As the bull market picked up steam from 1996 to 2000, the percentage of underfunded plans dropped to 31% from 68%.

While public plans probably can't count on a bull market to bail them out any time soon, they can take steps to curb liability. Public officials, who are often tempted to award pension increases to curry political favor, may be under closer scrutiny. As a larger percentage of the population approaches retirement age, payouts will increase, raising the pressure for many public plans to address the deficit before it becomes a problem.

"If you don't recognize those liabilities, you're just digging yourself a bigger hole," Nevada's Mr. Pyne says.

Still, there's no quick fix to the underfunded problem.

"For over 30 years, we built up a fairly substantial unfunded liability. It's going to take at least 30 years to correct that," says Tom Beavers, executive secretary of the Oklahoma Teachers' Retirement System.