Report: Nevada pension liabilities vastly understated

By Sean Whaley, Nevada News Bureau

CARSON CITY – Nevada’s public employee pension system is one of the better funded plans around the country, but its financial health is far poorer than taxpayers may realize because of the way the long-term liabilities are calculated, a new analysis released this month says.

The report by Andrew Biggs, a resident scholar at the American Enterprise Institute in Washington, D.C., was prepared for the Nevada Policy Research Institute, a conservative think tank.

Titled “Reforming Nevada’s Public Employees Pension Plan” the analysis says that when the long-term unfunded liabilities of the plan are calculated using a “market-based” valuation, a measure endorsed my most professional economists, the shortfall is actually closer to $41 billion than the $10 billion cited by Public Employees’ Retirement System (PERS) and its actuary.

The funding ratio of the plan falls from 70.5 percent to about 34 percent, Biggs said in his analysis.

“Nevada PERS is far from the worst-funded or worst-managed public-sector pension system in the country,” Biggs concludes in his report. “However, this merely highlights the worrying state of public-pension financing around the nation. Using market-valuation methods – which are consistent with economic theory, the practice of financial markets and the rules under which private-sector pensions must operate and which have recently been endorsed by the Congressional Budget Office – PERS is very poorly funded.”

In a telephone interview, Biggs said: “Whether you agree or disagree with the angle I took on it, I think it is helpful for people to know how the financial health of their pensions is being calculated. What they don’t know is how much of their plan’s funding rides on market risk.

“So there is a lot being staked on winning in the market here,” he said. “And whether you think the government can do that or you think the government can’t do it, it’s good to know exactly what’s at stake.”

Report could be issue for policymakers

Geoffrey Lawrence, deputy policy director for NPRI, said the report should encourage Nevada policymakers to take a serious look at making major reforms to the state public pension plan.

“We really felt that his expertise could lend a lot to the debate here in Nevada, where, as in most states, we have kind of a major pension liability,” he said.

The huge differences in the unfunded liability are due to the method used to make the calculation.

Nevada PERS, which covers nearly all state and local government public employees in the state, uses an accepted accounting method based on the actuarial value of its assets, valued at $24.7 billion as of June 2010, according to Biggs’ analysis. With liabilities of $35.1 billion, the retirement system reports its unfunded liability at about $10 billion. This figure will be updated later this month through June 30, 2011.

This long-term unfunded liability relies on an estimated rate of return on its assets, which are invested mainly in stocks and bonds.

Biggs acknowledges that the valuation under this approach is consistent with rules set out by the Governmental Accounting

Standards Board (GASB), which sets nonbinding disclosure rules for public pensions.

But Biggs argues the actuarial valuation masks the true liabilities that taxpayers could ultimately end up having to cover because it does not factor in the risk of achieving an 8 percent return, a rate PERS officials note has been exceeded over the past 28 years.

Using a market-based valuation, which assesses the liabilities based on the much lower interest rate paid on government bonds, provides a more accurate assessment of the long-term unfunded liability, he said.

Lawrence said the report by Biggs shows what is at stake for public pension plans and taxpayers.

“Because under the actuarial approach you are allowed to understate your liabilities, it allows politicians to make bigger promises than they can afford, and then to underfund the pension account at the same time,” he said. “So in the long run they accrue this unfunded liability, which officially here in Nevada is reported at $10 billion, but of course Andrew is showing that it is really closer to $40 billion. So that is a huge gap.”

Nevada PERS officials say the plan is actuarially sound, and that the unfunded liability will be covered over time. They also note that the contribution rates required to keep the plan healthy are set by an independent actuary and are fully funded by the Legislature.

Biggs said the current housing crisis was a decade in the making and was the result of taking on too much risk. Public pension plans, with trillions of dollars at stake, are also taking on a lot of risk to deliver on their promises, he said.

Biggs published a similar analysis for public pension plans nationwide in 2010, concluding that the shortfalls facing the plans are much larger than most people realize.

In commenting on that report last year, Dana Bilyeu, executive officer of PERS, did not dispute Biggs' method of calculating the shortfall, but said the actuarial method now being used is the accepted practice for public pension plans.

Possible reporting changes

The Governmental Accounting Standards Board has been evaluating some changes to the way public pension liabilities are calculated, but Biggs said he does not expect to see it embrace the market-based approach he and other economists advocate.

"To be honest I think they just don't get it," he said. "I don't think they're willing to make the kinds of changes that would be needed to bring pension valuation in line with what economists think makes sense and in line with what financial markets think makes sense. It would be such a drastic change I just don't think they're capable institutionally of doing it."

GASB said in July it had approved the proposed standards, dubbed exposure drafts, which would lead to "significant improvements" in the usefulness of pension information. The latest guidance would require governments to report the unfunded portion of their retirement plans as a liability on their balance sheets, among other changes.

There has been a growing call nationally to move public pension plans to a state to a defined contribution plan, similar to a 401(k)-type plan, from the current defined benefit plan, where retirees are paid a set amount per month based on salary and years of service.

Gov. Brian Sandoval has advocated such a position, although the concept did not see any serious discussion in the 2011 legislative session.

Lawrence said an issue with making such a change is the big upfront cost of fully funding the current defined benefit pension plan in an accelerated fashion. But Utah got around that challenge last year by crafting a modified plan that allows employees to choose whether to participate in a defined benefit or defined contribution plan. It could be a good model for Nevada, he said.

Lawrence said one often overlooked benefit of such a plan is that it is portable, allowing public sector workers to move into the private sector if they wish and not remain trapped in jobs they no longer want.

The PERS board has not endorsed any such major change to the state public pension plan.