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Pension Fraud in New Jersey Puts Focus on Illinois

By MARY WILLIAMS WALSH

The federal government's crackdown on the State of New Jersey this week for **misrepresenting the condition** of its pension funds raises a question: Who else might have pension numbers that could draw regulatory fire?

Cities and states are scrambling to make sure their pension disclosures are in order, and investors in distressed debt — who make money off financial trouble — are scrambling too, sensing opportunity.

“No one knows exactly how to attack this market yet, but people are going to be watching the New Jersey case and others like it very closely from an **investment** point of view,” said Jon Kibbe, a lawyer who specializes in distressed debt. Though some advisers are urging caution, New Jersey and other states have continued to issue new debt at reasonable rates as investors clamor for high-grade securities in a low-rate environment.

Harry J. Wilson, a Republican candidate for New York State comptroller, said Friday that New York was not compliant with the standard that the **Securities and Exchange Commission** established in its cease-and-desist order against New Jersey. Dennis Tompkins, a spokesman for the current New York comptroller, **Thomas P. DiNapoli**, who is running for re-election, said that “it’s ridiculous, it’s wrong

and it's reckless to make those accusations" and added that the state's financial disclosures were complete and correct.

After two prominent S.E.C. pension cases, the [American Bar Association's](#) new disclosure bible for [municipal bond](#) lawyers is selling briskly.

"The cease-and-desist order has heightened awareness of the importance of accurate pension disclosure," said John M. McNally, a partner at the law firm Hawkins Delafield & Wood, and the project coordinator of the newest edition of "Disclosure Roles of Counsel," a treatise telling municipal bond lawyers what is expected of their clients.

Mr. McNally has also been serving as a special disclosure counsel to San Diego, the first government accused of securities fraud by the S.E.C. for faulty pension disclosures. New Jersey was the first state.

The S.E.C. and other regulators found that San Diego had numerous pension problems, but in general, regulators said its government did not adequately describe the size of its obligations to retirees. In addition, there were discrepancies between the pension numbers in the official statement distributed to bond buyers and the pension numbers in other documents.

Mr. McNally said it was important to give consistent information and to explain the status of the pension fund's condition in plain English. "One of the critical disclosure points would be, what are the implications for an entity's annual budget," he said.

Instead of bristling with acronyms, he said, pension documents should tell an investor how much the government must put in the pension fund every year and whether it can afford the payments. At the moment, the municipal bond market's players — advisers, investors and underwriters — are more concerned about Illinois than any other state. Its credit was downgraded this year, and all the main ratings agencies said the poor condition of its public pension funds was a primary factor.

A spokeswoman for Gov. Pat Quinn's [Office of Management and Budget](#), Kelly Kraft, said Illinois believed its pension disclosures were complete and accurate. The state has not hidden the fact that its

pension funds have big shortfalls, she said, and there was no reason to think the S.E.C. might lodge a complaint against it, as it did with New Jersey.

She added that investors had been calling with questions in the wake of the S.E.C.'s action against New Jersey, but said that Illinois had been telling them not to worry — the regulator had not contacted state officials.

She said the state had no plans to revise any of its financial documents. Still, some actuaries are deeply concerned about Illinois's pension numbers, particularly because of a pension law enacted earlier this year.

State officials claimed the measure had sharply lowered costs by cutting the benefits that will be earned by workers hired in the future. (The current work force will continue to earn the same benefits as before.)

When it enacted the reform, Illinois issued a report, explaining in detail how it would work. Actuaries who have reviewed the numbers say that report is at least misleading and appears to be based on a type of calculation not authorized for pension disclosures. The state has not issued new audited financial statements since the law was passed.

Numbers in the report show that the state will be able to reduce its contributions to its pension funds, saving the state money, starting with \$300 million in its first year and adding up to tens of billions of dollars over time. That's because Illinois could make smaller pension contributions, on the assumption that its work force would over time consist of people earning smaller pensions.

Paradoxically, even though the state will make smaller contributions, the report forecasts that Illinois will get its pension funds back on track to a respectable 90 percent funding level by 2045. It projects that costs will increase slowly and an economic recovery will make cash available for the state to make the contributions it has failed to do in the past.

Whether that is even possible is contested by some actuaries who note that its family of pension funds is now only 39 percent funded. (If a company let its pension fund dwindle to that level, the federal government would probably step in, but federal officials have no authority to seize state pension funds.)

Some actuaries who have reviewed the state's plans said that shrinking contributions would make the pension funds shakier, not stronger.

Indeed, one of them, Jeremy Gold, called Illinois's plan "irresponsible" and said it could drive the pension funds to the brink.

Further, Mr. Gold pointed out that Illinois's official disclosures said that its pension calculations used an actuarial method known as "projected unit credit," but that the pension reform report used another method, which had not been approved for disclosure.

"According to Illinois statute, the prescribed contributions are determined under a method that may not be in compliance with the pertinent actuarial standards of practice," Mr. Gold said.

Actuaries from the two big firms that help Illinois with its pension funds conceded that the report relied on another methodology. Larry Langer of Buck Consultants said that a law allowed the state to use the alternate method outside of bond offering documents. Investors can look at both sets of numbers and draw their own conclusions, he said.

He acknowledged that using the latest pension reforms would lead to a lower funding level but said state officials were not concealing the magnitude of the problem. "They almost laud it," he said.

Brian Murphy of Gabriel, Roeder, Smith & Company, another of Illinois's actuarial consultants, said the numbers were for illustrative purposes only and unlikely to reflect what the state would actually do in coming years.

"They're going to fund it at the proper level," Mr. Murphy said.



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