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Illinois Plan for Pensions Questioned

By MARY WILLIAMS WALSH

Federal regulators are examining disclosures by Illinois about its unorthodox pension funding method, trying to determine whether the state misled bond investors about the risks.

The [Securities and Exchange Commission](#) has said it has a special team devoted to investigating public pensions, and last year it brought its first case ever against a state, accusing New Jersey of securities fraud for claiming to have pension assets that did not really exist.

If the commission decides at some point to bring a case against Illinois, it would send another warning.

Some other states, including Arkansas, Ohio, Rhode Island and Texas, have used variations of Illinois's method, which reduces their annual contributions to their pension funds. The effect is to save money at a time of tight budgets, but it can also weaken the pension funds.

The S.E.C.'s inquiry was disclosed in a prospectus for a \$3.7 billion bond offering planned by Illinois for February. The state wants to use the proceeds from the sale to make its annual contribution to its pension funds, which are among the most poorly funded in the country. Illinois must sell [bonds](#) to come up with the cash because the state is low on money.

The prospectus said that the S.E.C. contacted the state last September and that Illinois was

cooperating with the inquiry.

The state also disclosed that even before it heard from the S.E.C., it had decided to improve its pension disclosures. The prospectus said officials had made that decision as a precaution last August, after the S.E.C. accused New Jersey of securities fraud for making **false statements** about its pension fund. The New Jersey case was **the S.E.C.'s first enforcement action** against a state, and the state settled without admitting any wrongdoing.

“We feel our disclosures have always been accurate and complete,” said Kelly Kraft, a spokeswoman for the Illinois governor’s office of management and budget, which handles communications with the capital markets.

The S.E.C. contacted Illinois after **an article appeared in The New York Times** about an unusual actuarial technique the state had been using to save money by shrinking its annual pension contributions.

The method, enacted last year, is based on sharp cuts in benefits for state workers who have not yet been hired. Although the cuts will not produce an appreciable savings until far in the future, Illinois has begun funding its plans as if its current workers were already earning the smaller benefits of the future.

For more than a decade, Illinois failed to put into its pension funds the amount needed to cover the promised benefits. The gap between how much is needed and how much is actually in the funds has grown so big that the state is overwhelmed by the required contributions. The benefit cuts were presented by state officials last year as a reform that would get the situation under control.

Some actuaries who have studied the funding method have said they doubt it meets the standards of their profession. Some have called it reckless when used by a state with a severely stressed pension system, like Illinois. That is because it deprives the pension fund of the substantial yearly contributions it needs now, to pay for the benefits already earned by today’s workers.

Because the calculations are esoteric, it is hard for anyone besides a seasoned actuary to see that a program that Illinois ushered in as a reform could be harmful.

Actuaries have also expressed concern that other states and cities will adopt methods like the one Illinois is using, because many of them are cutting benefits for future workers, to save money and close budget gaps.

Rather than cutting benefits of existing workers, governments usually cut benefits for future workers. Laws and state constitutions make it very hard to do otherwise.

Illinois's method does not appear to comply with current governmental accounting standards, but governmental accounting rules are voluntary.

The S.E.C. has no direct jurisdiction over public pension funds and cannot order a government to follow any particular funding method. Its interest is in protecting investors, and making sure they have enough information to make well-informed decisions. It appears to be trying to determine whether Illinois adequately explained its method to bond buyers, giving them an understanding of how the reduced contributions may ultimately affect the state's finances.

News of the S.E.C.'s Illinois inquiry comes at a sensitive time. Many economists have been reviewing public pension disclosures and challenging the way governments calculate their obligations, saying the method in use tends to hide debt. The governments have generally responded that their accounting methods are correct and that long-term obligations should not be measured the same way as bills the states must pay right away.

Moody's Investors Service issued a report on Monday holding the state's rating steady, with a negative outlook. Along with its long-term pension funding problems, Illinois is grappling with a short-term budget deficit, largely stemming from reduced revenue, that it is trying to close in part with big tax increases.

Members of Congress have recently begun looking into whether a new chapter of the federal bankruptcy code, or some other legal framework, could be created to allow states with the most troubled finances to restructure their long-term debts.

The California state treasurer, [Bill Lockyer](#), on Monday held a conference call in which he took issue with the critics of the current pension system. “They’ve confused the near-term budget shortfalls with the long-term funding obligations, and grossly inflated the size of the long-term liabilities,” he said.

Mr. Lockyer, who has a seat on the board of California’s big public pension funds, is also responsible for signing the state’s disclosures to investors. California does not use the unusual Illinois method that is drawing attention from regulators. But the S.E.C. has been looking into disclosures by the state’s biggest pension fund, known as Calpers, under the tenure of a previous state treasurer, according to officials with knowledge of the inquiry.



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