Puerto Rico Entrepreneurship Ecosystem ECONOMY PAGE 15

PUERTO RICO Daily Sun

YEAR 2, NO. 671 | THURSDAY, AUGUST 26, 2010 | 50¢

Daily Sun/Humberto Trias

Islanders beat FAS 4-1 in Champions League

SPORTS PAGE 32

School report due ASAP

Education Secretary must submit plans by Sept. 1

LOCAL PAGE 4

Daily Sun/Humberto Trías

Government officials participating in the Employee Retirement System discussion. Searching for viable solutions.

LOCAL PAGE 3

Retirement could go broke by 2014

ERS benefit payments, costs higher than members' contributions

BY JUAN A. HERNÁNDEZ
Special to the Daily Sun
jhernandez@prdailysun.net

The Employees Retirement System of the Commonwealth of Puerto Rico's unfunded actuarial accrued liability has reached more than $17 billion during the last five years and faces the possibility of running out of money by the year 2014, according to the most recent valuation report ordered by the system.

"This amount is equivalent to 27.23 percent of Puerto Rico's $62.75 billion gross national product (GNP)," Center for the New Economy's policy director Sergio Marxuach said.

Under close government scrutiny for the last year, the ERS' faces the possibility its future contributions won't be "adequate to accumulate sufficient assets to make future benefit payments when due," as stated in its actuarial valuation report.

"The report very specifically states the unfunded actuarial accrued liability (UAAL) is 'expected to grow indefinitely into the future instead of being amortized.' This means that current member and employer contributions are not sufficient to fund the system's obligations. In other words, the ERS is being disfunded," Marxuach explained.

Established in 1951 by an act of law, the ERS is to provide in pension benefits an excess of $18.9 billion to more than 160,000 government employees, under three different benefit structures.

"Having three different benefit structures is part of the problem," Marxuach argued.

For those employees who started working for the government prior to April 1st, 1990 on an agency other than the Education Department, the University of Puerto Rico (UPR), the Judiciary Branch or the Puerto Rico Electric Power Authority (PREPA) retirement age is 55, with 25 years of service, or 58 with 10 years of service. Pension benefits are standard and establish by Act 447 of 1951.

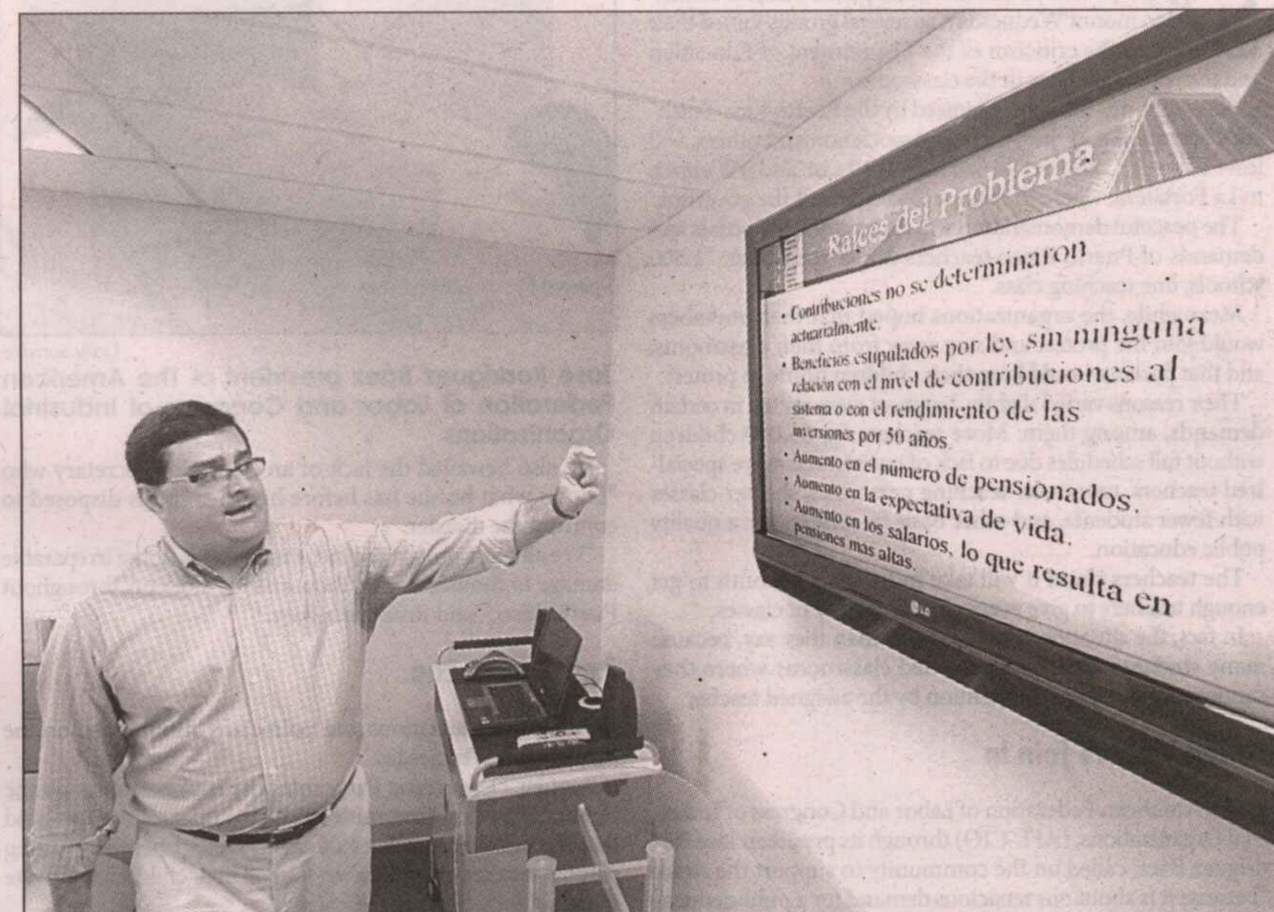
Almost 40 years later, in 1990, the ERS changed its eligibility requirements by increasing retirement age from 55 to 65, with at least 10 years of service, and reducing the original standard benefit.

Ten years later, in 2000, the ERS was further changed to make benefits depend on the performance of the financial markets for all government employees hired after Jan. 1st, 2000. Employee contribution stayed at 8.275 percent of the salary. Employer contribution also stayed at its original 9.275 percent but is not credited to the employees account. Instead, it is "applied to partially fund the accrued actuarial liability (AAL)" of the defined benefit plan that was closed that same year.

"What they basically did was open a savings account for government employees," Marxuach said.

"Despite these measures the system's unfunded actuarial obligations continued to increase," he added.

Citing a study of 231 state-managed pension plans and 159 state-managed health care plans made by the Pew Center on the States, Marxuach assured this crisis scenario is not exclusive to Puerto Rico. According to the Pew Center's study several states in the United States managing retirement trusts are facing similar problems.



Daily Sun/Humberto Trías

Sergio Marxuach, policy director of the Center for the New Economy, explains the fiscal crisis affecting the government employees retirement system' the system could collapse by 2014.

"The principal finding of this study is that at the end of fiscal year 2008 there was a $1 trillion gap between the $2.35 trillion the states and participating localities had set aside to pay for employees' retirement benefits and the $3.35 trillion cost of those promises," Marxuach informed.

According to the report, the situation of the retirement programs of 19 of the 50 states is considered to be cause for "serious concern".

Analysts at the Pew Center devised a four-point scale to evaluate performance of each of the programs evaluated, with four points being the best performers, two to three points needing improvements and zero to one as raising serious concerns.

"How does the Puerto Rico retirement system compares to those of the U. S.?" Marxuach asked.

"If Puerto Rico were to be a state, it would be joining Alaska, Colorado, Illinois, Kansas, Kentucky, Maryland, New Jersey and Oklahoma after getting zero points in the scale … This score means that all these jurisdictions have failed to make significant progress toward adequately funding their pension obligation," Marxuach said.

For the economist one of the reasons for the "disfunding" of the ERS is that the contribution / benefit formula "is not proportionate to the actuarial assumptions."

"What is really frightening here is that most of the measures being considered by the states now have already been adopted by our retirement system and our funding ratio is still 9.7 percent and our UAAL as a percentage of the current payroll is 398.19 percent … only Connecticut had a higher unfunded liability as a percentage of covered payroll – 449 percent," Marxuach said.

Aside from the problems the ERS is having in terms of getting the necessary funds to meet its current obligations, the system has a serious cash flow problem, mainly because benefits and expenses are higher than yearly contributions.

"So far the government has been covering the difference using income generated by investments and by allocating funds from the Commonwealth's General Fund," Marxuach explained.

"At this rate, even if we estimate a 7.5 percent annual return on investments, the entire retirement system will run out of funds by the year 2014," the economist anticipated.

Nevertheless, for Marxuach there is still a possibility we could do something to turn things around.

"We owe almost a third of our income to five percent of the population, there is no way we can depend on creative accounting tricks to solve this situation," he said.

For Marxuach, as well as his associates at the CNE, no specific group can offer a solution to the problem … it has to be a collective effort.

"People from different sectors –economy, politics, ethics, philosophy … – must come together to present an interdisciplinary solution to the problem," said CNE president Miguel Soto.

Both Marxuach and Soto agreed on the need to "share the responsibility for the problem" and therefore "share the burden of the solution."

"We all need to chip in; government workers, the private sector, politicians, even retirees. How that burden is to be shared evenly is something we will have to figure out, but what is unquestionable is that we must all be together in this," Marxuach said.