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Pension Cuts Face Test in Colorado, Minnesota

By JEANNETTE NEUMANN

A showdown is looming over whether commitments made to retirees by government pension funds can be scaled back in dire economic times.

Facing shortfalls, some public pension funds are responding by paring back payouts pledged to retired workers. Earlier this year, pension funds in Colorado and Minnesota curtailed annual cost-of-living increases.

"No matter how draconian you got on the new hires, you ran out of money" if you didn't cut benefits to current retirees, said Meredith Williams, chief executive of the Colorado Public Employees' Retirement Association, with \$34.2 billion in assets.



Nathan W. Armes for The Wall Street Journal

Retired special education teacher Kathy Ratz is opposed to legislation to reduce the pension benefits to current retirees that was proposed by Brandon Shaffer, the Colorado Senate president.

In February, Colorado lawmakers passed a bill that reduced the pension system's cost-of-living adjustment from a fixed 3.5% a year to a maximum of 2%—but possibly less for current and future retirees. The new law also increased contributions from employees and employers. For example, retirees who were expecting a 3.5% increase in cost-of-living adjustments this year will receive no increase.

In response, Colorado and Minnesota have been hit by lawsuits filed by retirees, who claim the changes violate state law. Those retirees have "lived up to their end of the bargain, and the state is not living up to theirs," says Stephen Pincus, a Pittsburgh lawyer representing plaintiffs in both states.

The legal fight could decide whether financial commitments to retired public workers are sacrosanct, as many employees have long assumed.

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While many retirees from the private sector have seen retirement benefits weakened in recent years, retirees at public pension funds largely have avoided such cuts.

But investment losses, reduced contributions and benefit boosts are making it far more costly for public pensions to live up to their obligations. To replenish assets, many pensions have reduced benefits to new hires and increased contributions by employees and employers, says Ron Snell, director of the state-Services division for the National Conference of State Legislatures.

Far fewer funds have taken the more-drastic approach of curtailing benefits to retired public-sector employees. The outcome of the Colorado and Minnesota lawsuits could embolden other pension funds to make their own cuts, though the legal landscape varies from state to state.

"The lessons of Minnesota and Colorado will be interesting, but they also won't be considered absolute guidance," says Keith Brainard, research director for the National Association of State Retirement Administrators.

The move to scale back cost-of-living increases in Colorado gained momentum last year following a study that estimated the Colorado Public Employees' Retirement Association would be out of money in around 30 years, assuming its investments generated a 7% annual return.

Colorado Gov. Bill Ritter, a Democrat, signed the bill into law without fanfare, says state Senate President Brandon Shaffer, also a Democrat. "We didn't celebrate this because we know that there is real pain associated with the changes we enacted through this legislation," Mr. Shaffer says.

According to a benefits booklet provided to Colorado retirees, the pension fund said it "will increase your benefit each year by 3.5% compounded annually."

Kathy Ratz, a 63-year-old retired special-education teacher who lives in Golden, Colo., says she was "totally blindsided" by the extent of the change. She gets a \$54,000 annual pension and has \$89,000 in savings with her husband, she said. He receives less than \$1,000 a month in Social Security.

"I started out thinking I wanted to do my share to help, but I think this is way beyond helping," she says. "What we're going to do is sit down and put more into savings than we have."

Mr. Pincus's law firm has said in court documents that the new law could mean a loss of more than \$165,000 in benefits over 20 years for a retiree who received an annual pension of \$33,264 in 2009.

The retirees point to a 2004 opinion written by then-Attorney General Ken Salazar, now secretary of the Interior in the Obama administration, that a retired public-sector worker's pension "becomes a vested contractual obligation of the pension program that is not subject to unilateral change of any type" by the legislature.

Seeking to dismiss the case, the defendants, which include the Colorado pension fund, contend that "to claim that a cost-of-living adjustment can never be adjusted defies law and logic."

The defendants also highlight the exigencies of financial stress: "There can be no dispute that preserving the solvency of the Public Employees' Retirement Association is a legitimate governmental interest."

The Minnesota lawsuit came after the state legislature passed a bill in May that reduced retirement benefits from a 2.5% annual increase to between 1% and 2%, depending on the pension fund.

Mary Vanek, executive director of the Public Employees Retirement Association in Minnesota, which reduced the cost of living adjustment from 2.5% to 1%, said potential lawsuits were a concern considered amid the rollback. "We weren't letting that override our fiduciary concerns," she says.

Some experts say that if judges decide in favor of the retirees, public pension funds will have to find another potentially painful way to bridge the funding gap.

"If benefit promises can't be adjusted, then contributions are going to have to go up a heck of a lot," says Olivia Mitchell, director of the Pension Research Council at the Wharton School of Business in Philadelphia. "It's not likely anybody is going to win here."

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