A New Challenge (and Challenger) Facing Public Pension Funds

How a Select Few Are Framing the Pension Debate for Financial Gain

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In recent articles we have addressed the challenges facing the public pension industry — from difficulties meeting investment return targets and funding issues, to demographic issues within the aging plan participant population, to significant public and media pressures. In the years following the financial crisis, and the resultant perceived pension crisis, many U.S. public pension systems took steps to protect their respective funds by cutting retiree benefits in all areas, modifying asset allocations, and reducing administrative costs. And on an annual basis, public pension funds in many states across the country have been faced with stiff battles in their respective state legislatures to protect their defined benefit plans. In the past few months, several pension industry authors and analysts have shed increasing light on another challenge.

David Sirota, nationally syndicated newspaper columnist, magazine journalist and best-selling author, has offered another wrinkle to the raging public debate over pensions. In a report completed in September 2013 for the Institute for America's Future, entitled "The Plot Against Pensions," Sirota explains how billionaire former Enron trader John Arnold, aided by non-partisan groups, is attempting to undermine America's retirement security to protect states' corporate welfare, and tangentially, enrich Wall Street.[1] The report evaluates both the general state of the national debate over pensions and the specific effects of the partnership between the Pew Charitable Trusts' Public Sector Retirement Systems Project and the Laura and John Arnold Foundation (run by conservative political operatives and funded by John Arnold) — offering some alarming findings:

• Conservative activists are manufacturing the perception of a public pension crisis in order to both slash modest retiree benefits and preserve expensive corporate subsidies and tax breaks.

• The amount states and cities spend on corporate subsidies and so-called tax expenditures is far more than the pension shortfalls they face. Yet, conservative activists and lawmakers are citing the pension shortfalls and not the subsidies as the cause of budget squeezes. They are then claiming that cutting retiree benefits is the solution rather than simply rolling back the more expensive tax breaks and subsidies.

• The pension "reforms" being pushed by conservative activists would slash retirement income for many pensioners who are not part of the Social Security system. Additionally, the specific reforms they are pushing are often more expensive and risky for taxpayers than existing pension plans.

• The Pew Charitable Trusts and the Laura and John Arnold Foundation are working together in states across the country to focus the debate over pensions primarily on slashing retiree benefits rather than on raising public revenues.

• The techniques used by conservative activists to gain public support to privatize the public pensions that public workers have instead of Social Security are, if successful, likely to be used in efforts to privatize Social Security in the future.

Sirota contends that the Pew-Arnold partnership began informally in 2011 and 2012 when both organizations worked to set the stage for retirement benefit cuts in California, Florida, Rhode Island and Kansas, and with legislative success in three of those four states, a formal partnership was created in late 2012 to target Arizona, Kentucky and Montana. Sirota says the partnership continues today (with the organizations issuing joint reports and conducting joint legislative briefings advocating cuts to guaranteed retirement income), and could expand into Colorado, Pennsylvania, Oklahoma and Nevada. But Sirota argues that cutting payments to retirees is not the endgame — but rather — preserving money for corporate welfare. His study estimates that states spend up to $120 billion a year on offshore tax loopholes, gifts and other corporate subsidies, which is more than 2.5 times as much as the $46 billion a year that Pew says states are short on pension payments.

Matt Taibbi, an author and journalist for *Rolling Stone*, has also written extensively on the interplay between Wall Street and public pension funds and may have said it best: "the bottom line is that the 'unfunded liability' crisis is, if not exactly fictional, certainly exaggerated to an outrageous degree. Yes, we live in a new economy and, yes, it may be time to have a discussion about whether certain kinds of public employees should be receiving sizable benefit checks until death. But the idea that these benefit packages are causing the fiscal crises in our states is almost entirely a fabrication crafted by the very people who actually caused the problem."[2] In his September feature entitled *Looting the Pension Funds: How Wall Street Robs Public Workers* (intentionally released on the same day as Sirota's report), Taibbi looks at the hiring of expensive hedge funds by public pensions and the role of right-wing financiers like Third Point billionaire Dan Loeb in the pension reform movement.[3] Loeb, whom Taibbi refers to as a Gordon Gekko wanna-be (hey, this is *Rolling Stone*), received a $66 million mandate for his hedge fund from the State of Rhode Island (part of $1 billion of the state fund, or 14% of the overall portfolio, that was re-allocated to hedge funds). This award came after the Rhode Island General Assembly in 2011 approved a monumental overhaul of the state retirement system that cut public employees' benefits, froze retirees' cost-of-living increases and attempted to put the severely underfunded pension fund on firmer financial footing. Taibbi states that Loeb and his cohorts are "positioned to receive tens of millions in fees every single year by the already overburdened taxpayers of an ostensibly flat-broke state."[4] Separately, Taibbi points to three main themes that are applicable to the overall pension v. Wall Street fight: [5]

1) Many states and cities have been under-paying or nonpaying their required contributions into public pension funds for years, causing massive shortfalls that are seldom reported upon by local outlets.

2) As a solution to the fiscal crises, unions and voters are being told that a key solution is seeking higher yields or more diversity through "alternative investments," whose high fees cost nearly as much as the cuts being demanded of workers, making this a pretty straightforward wealth transfer. A series of other middlemen are also in on this game, siphoning off millions in fees from states that are publicly claiming to be broke.

3) Many of the "alternative investments" these funds end up putting their money in are hedge funds or PE funds run by men and women who have lobbied politically against traditional union pension plans in the past, meaning union members have been giving away millions of their own retirement money essentially to fund political movements against them.

Along these lines, just last week, it was announced that New York state financial regulators have subpoenaed numerous investment consultants to determine whether any outside advice given to New York's pension funds is clouded by undisclosed financial incentives or other conflicts of interest.[6] Benjamin M. Lawsky, the New York financial services superintendent, sent letters to the top New York state and city pension trustees, who collectively serve as stewards for $350 billion in retirement money, that he wanted to look at "controls to prevent conflicts of interest, as well as the use of consultants, advisory councils and other similar structures." [7] New York State's pension funds, some of the most well-funded in the country, paid $2.1 million in private equity consulting and $1 million to hedge fund consultants in 2012, compared to $63,000 to consultants who work with U.S. stocks. Again, New York pension funds are doing very well compared to their counterparts across the country, and it is also true that hedge fund consultants have a much tougher job than consultants who monitor U.S. large cap equity managers, but these figures do provide an example of one type of "middleman" which Taibbi asserts is involved in the alternative investment space — and the lucrative opportunity these investments present.

Conclusion

As 2014 approaches, legislative sessions will commence across the country. Public pension funds and supporting organizations are making preparations to thwart off another round of assaults on their respective funds. Seeing the successes of partnerships such as the Pew-Arnold campaign, David Sirota suggests that with the distortion of the conversation about public pensions, "the movement to convert traditional public pensions into riskier and costlier schemes will almost certainly reach into every legislature in America."[8] It will be interesting to see how this David and Goliath battle continues to play out, and if the severely out-resourced public pension funds in this country will be able to withstand the subversive efforts of a select few who have profited, and would like to continue profiting from them.

1 David Sirota, *The Plot Against Pensions*, available at http://ourfuture.org/wp-content/uploads/2013/09/Plot-Against-Pensions-final.pdf (last visited Nov. 8, 2013).

2 Matt Taibbi, *Looting the Pension Funds: How Wall Street Robs Public Workers*, available at http://www.rollingstone.com/politics/news/looting-thepension-funds-20130926 (last visited Nov. 8, 2013).

3 *Id.*

4 *Id.*

5 Matt Taibbi, *Looting Public Pensions: A New Think Tank Study*, available at http://www.rollingstone.com/politics/blogs/taibblog/looting-publicpensions-a-new-think-tank-study-20130926 (last visited Nov. 8, 2013)

6 Mary Williams Walsh, *New York Is investigating Advisers to Pension Funds*, available at http://dealbook.nytimes.com/2013/11/05/new-yorkis-investigating-advisers-to-pension-funds/?_r=1 (last visited Nov. 8, 2013).

7 *Id.*

8 Sirota, 25.