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New ALEC Report Blasts "Pension Fund Cronyism"

A new report from the American Legislative Exchange Council (ALEC), released December 14, 2016, charges that public pension funds are intentionally making "inferior investment decisions" in order to "advance political agendas" of many pension plan officials and lawmakers. Instead of managing pension fund investments for the exclusive purpose of providing retirement benefits to government employees, ALEC charges that many state and local government pension fund assets are being invested in "a misguided attempt to boost their local economies, provide kickbacks to their political supporters, reward industries they like, punish those they don't and bully corporations into silence and behaving as they see fit."

ALEC is a nonprofit organization of conservative state legislators and private sector representatives that drafts and shares model state-level legislation for distribution among state governments. It has been described by *The Guardian* as "a dating agency for Republican state legislators and big corporations, bringing them together to frame rightwing legislative agendas in the form of 'model bills.'" According to *The New York Times*, "special interests effectively turn ALEC's lawmaker members into stealth lobbyists, providing them with talking points, signaling how they should vote, and collaborating on bills affecting hundreds of issues like school vouchers and tobacco taxes." And *Bloomberg Businessweek* has described the organization as a "bill laundry" that "offers companies substantial benefits that seem to have little to do with ideology."

The new ALEC report, entitled "Keeping the Promise: Getting Politics Out of Pensions," was produced by the ALEC Center for State Fiscal Reform, and is the second publication in their series on public pension reform; the first volume, "Keeping the Promise: State Solutions for Government Pension Reform," was released in August of 2013. It was written by former Utah state Senator Dan Liljenquist, and is purported to describe and analyze major pension reforms in Utah, Alaska, and Michigan.

The new ALEC report begins by offering its view of the current state of public pensions. Using what it claims is the correct discount rate for determining unfunded liabilities, namely a risk-free rate of return, ALEC claims that the national funded ratio for state pension plans is a "meager" 35.1 percent, with almost $5.6 trillion in unfunded liabilities. "That staggering figure is more than 30 percent of the gross domestic product (GDP) of the United States," ALEC intones.

"Of course, ALEC conveniently ignores the fact that any funding shortfall, no matter how measured, will generally be spread out over the next 30 years," noted Meredith Williams, NCTR's Executive Director. "During those 30 years, economists expect that total US economic activity will likely be more than $750 trillion," he continued. "That is the number that ALEC's purported $5.6 trillion in unfunded liabilities should be compared with, and not the current annual GDP," Williams concluded.

ALEC also criticizes the fiduciary standards that public pension trustees must follow. Noting that while private sector pension plans must adhere to "the strict fiduciary responsibilities outlined in the Employee Retirement Income Security Act of 1974, better known as ERISA," ALEC points out that public plans are not subject to ERISA, and that public pension trustees' responsibilities—derived from multiple sources, including state constitutions, statutes, judicial opinions, and pension board bylaws—vary considerably from state to state. ALEC then claims that these standards "tend to be far less rigorous than what ERISA requires of private-sector trustees," and that "these weak fiduciary standards governing public pension trustees…have enabled pension fund cronyism to become widespread in America today."

As support for this damning statement, ALEC footnotes a Pew Charitable Trusts report prepared for the Joint Committee on Alabama Public Pensions in January of 2016. However, when this report is carefully examined, Pew actually finds that the concept that the pension plan is to be established and operated for the exclusive benefit of employees and their beneficiaries is one that the majority of states have "clearly spelled out in law." Indeed, Pew goes on to note that "many have also expanded upon the provisions of prudent investing and primary duty to be more explicit as to how investment with collateral benefits may be analyzed."

Nevertheless, ALEC points to economically targeted investments (ETIs) as one of what it claims are the three primary forms of "pension fund cronyism"; the other two are given as political kickbacks and political crusades.

ETIs are described as local investments selected for their supposed economic or social benefits in addition to the investment return to the pension fund. ALEC claims that they are a form of cronyism because they "favor local investments over broad-based investing." In addition, ALEC says that they consistently underperform broad-based, diverse investments.

This section of the ALEC report focusses primarily on the Retirement Systems of Alabama (RSA), which manages three statewide defined benefit pension plans: The Teachers' Retirement System (TRS), the Employees' Retirement System (ERS) and the Judicial Retirement Fund (JRF). ALEC's criticism includes the following discussions:

- Poor Performance of ETIs in Alabama;
- ETIs Weigh Down RSA Investment Returns;
- RSA's Real Estate Investments: A Key Contributor to Poor Performance;
- Alabama's Weak Fiduciary Standards Enable ETIs;
- Opaque Pension Reporting Conceals Performance of RSA's ETIs.

ALEC also criticizes what it calls Alabama's "poor pension board composition and governance." Specifically, it charges that the boards lack diversity in their representation as they primarily consist of plan participants. Furthermore, ALEC is particularly concerned with the fact that board members are not statutorily required to have any "financial expertise." It is also highly critical of the record of the RSA's Executive Director, Dr. David Bronner.

"I am truly dismayed that, without offering any factual support, ALEC's report suggests that Alabama's board trustees have effectively breached their fiduciary duties to plan participants by permitting certain investments," NCTR's Williams observed. "I have gotten to know several of these trustees as part of NCTR's trustee education programs over the past years," he continued, "and I would match their good common sense with so-called 'financial expertise' any day." Williams said that he also thought that Dr. Bronner's record of success in Alabama "speaks for itself."

The ALEC report also looked at what it referred to as political "kickbacks," which it described as pension trustees directing pension investment dollars to politically connected businesses, individuals, and other interests. "These investments also correlate with lower returns and poorer fund performance," the report claimed, and it focused on the California Public Employees Retirement System (CalPERS) as "one of the most egregious offenders in the realm of political kickbacks."

For example, ALEC claimed that "union leader Charles Valdes," a former member of the CalPERS board who also served as chair of its Investment Committee, "made several poor financial decisions, some of which appear to have been politically motivated." ALEC specifically notes that during his time as Investment Committee chair, "CalPERS consistently granted investment contracts to some of the state's biggest political givers."

"Given ALEC's relationships with some of the nation's biggest political givers, I hardly think that they have grounds for any criticism based on this sole criteria," Williams pointed out. "Furthermore, the extent to which a business participates in politics is no indication that it cannot also provide a prudent and profitable investment opportunity," he continued. "And ALEC conveniently ignores the swift and effective steps that CalPERS has taken in recent years in combatting any improper and illegal activities by board members or staff when they have been discovered and documented," he continued.

The last type of pension cronyism the report discusses is "political crusades," which ALEC says occur when trustees use pension investment dollars to advance certain viewpoints or causes. "These political crusades regarding such issues as the environment, political speech and income inequality are frequently waged through divestment initiatives and by promoting shareholder resolutions at publicly-traded companies," the report says. "When pension funds pick a side in political disputes and decide they are going to use the pension fund as a weapon, investment returns decline and many citizens find their hard-earned retirement funds used to support political positions antithetical to their beliefs," it concludes.

Once again, California is singled out for it recent decisions regarding investments in fossil fuels. And the American Federation of Teachers (AFT) concerns with hedge funds investments is characterized as creating "blacklists" to punish individuals based on their personal beliefs—in this case, their views on education policies.

"This just fascinates me," said NCTR's Williams. "ALEC seems to forget that it is legislatures that adopt divestment mandates and impose them on pension plans, and not the other way around," he noted. "Pension trustees are often at the forefront in insisting that if any such legislation is to be adopted, it must preserve and respect their fiduciary duties to plan participants," he continued.

"Finally, for ALEC to complain that efforts to require corporate political spending disclosures is 'shareholder activism to silence free speech,' in the same report that it also criticizes CalPERS for supposedly making investment decisions based on political spending, is just absurd," Williams said. "How in the world can you avoid the latter if you don't know about the former," he asked.

The ALEC report concludes by returning essentially to its opening premise: pension trustees are to blame. It calls for "strong fiduciary standards for pension trustees, transparency rules that allow the public to see how pension funds are being managed and smart pension board reforms that hold trustees accountable."

"It makes me literally laugh out loud that these so-called 'reforms' are coming from the same group that refuses to disclose its membership list or the origins of its model bills, was able to be excluded specifically by name in statutes in Colorado, South Carolina, and Indiana from having to register as a lobbyist and report lobbying expenditures, and argues that it is akin to a charity for the purposes of Federal taxation and disclosure laws," Williams stressed.

"Unfortunately, however, ALEC is no laughing matter," Williams continued. And if some other state legislators are correct, the combination of "a Trump nation in an ALEC land" may suggest that ALEC's reports and legislative priorities could have an even greater impact in 2017 and beyond.

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