

Toward Pension Sustainability: Principles for Pension Trustee Accountability

Dennak Murphy, SEIU Capital Stewardship

California's public pension funds have combined assets approaching \$750 billion. Hundreds of elected and appointed trustees sit on pension boards that take actions and make decisions affecting the long-term sustainability of our member's pension benefits and the quality of their lives today and into the future.

Fiduciary duty is often used to stifle dissent, questions and open discussion. Fiduciary principles of prudence and loyalty should engender a culture of questioning and use of everyday language rather than technical terms that confuse and obscure genuine understanding. Long-term investing, sustainability and an appreciation of risk beyond volatility and tracking error are central fiduciary issues that every trustee has a duty to pursue.

The recent economic crisis called into question many long-held beliefs and assumptions about investment practice. Unbelievably, pension investment practices have changed very little since 2008.

Opportunities for pension trustees to engage in meaningful discussions are critical to ensuring the lessons from the "Great Recession" result in more effective investment policies and practices that protect plan beneficiaries rather than Wall Street agents.

1. **KNOW THE MATERIAL AND ASK QUESTIONS...DEMAND INFORMATION!** A trustee is not representing our members if they do not read/study all the material and if they do not ask questions. Learning to ask good questions of investment staff, consultants, managers and other trustees is the strongest way to protect the interests of our members.
2. **INVEST PRODUCTIVELY...INVEST FOR THE 99%.** Ultimately, pension fund returns mirror the returns produced by the overall economy. They are beta (the market's return) dependent. If the economy thrives, pension funds will as well. Alpha, (the ability to outperform the market) is marginal at best, very hard to achieve consistently and very expensive. Risk of a failed or sluggish economy is the greatest risk facing pension investors today. Some investment practices help strengthen and grow the economy; others do not.
 - a. **Productive investments:** Job creating investments, infrastructure, real estate, long-term investments in corporations and investments that help companies grow.
 - b. **Destructive investments:** Destructive private equity investments, hedge funds, speculation, derivatives, etc.
 - c. **Steps trustees can take to support productive investments:**
 - i. Measure the economic impact of investments on local and national economy. Demand data from external and internal managers.
 - ii. Adopt policies and asset allocations that create jobs and promote local and regional economic activity.
 - iii. Adopt policies that discourage extractive investments like hedge funds, destructive leveraged buy-outs and those investments where
 - iv. Adopt policies that promote targeted investments (like California investments).

3. **REDUCE COSTS:** California public pension funds spend more than \$4 billion each year on external investment management fees and costs. Few investors fully account for management fees, incentive fees and carried interest. Fees for “active management” fly in the face of deep research that investors do better over time with passive investments like index funds. Unnecessary fees compounded over decades, is simply a shift in wealth from plan participants, sponsors and tax-payers to investment management firms. Investment management firms spend millions each year to wine and dine trustees to ensure their fee revenue remains intact.
 - a. Steps trustees can take to support the reduction of investment costs:
 - i. Request detailed investment costs/expenses linked to specific allocations and asset managers at easy and then more challenging levels.
 - ii. Adopt policies that require full public disclosure of investment fees.
 - iii. Adopt policies that eliminate, restrict or disclose gifts, meals, trips and other “trustee perks” from investment firms.
 - iv. Fire expensive and non-successful investment managers (some funds simply never fire anyone).
 - v. Avoid expensive investment approaches like hedge funds, private equity and real estate where returns are largely attributable to leverage.
 - vi. Make sure fund boards hear dissenting views from staff and consultants and bring in outside contrary views.
 - vii. Internalize investment management functions especially in equities and fixed income.
 - viii. Reduce exposure to hedge funds.
4. **PROMOTE GOOD CORPORATE GOVERNANCE AND A SAFE AND SOUND FINANCIAL SYSTEM** (as if your life depended on it)
 - a. The second greatest risk to pension fund sustainability is weak regulatory structures. Downside risk is largely the result of the political and regulatory influence of the finance industry.
 - b. What trustees can do to promote Corporate and Market Governance (regulation).
 - i. Make sure your fund has a strong corporate governance program in place and policies that support corporate and manager engagement on corporate governance issues like compensation, access to the proxy, independent board chair, and sustainability issues like climate risk, political spending disclosure, financial regulation, human relations and worker rights, economic risk and other areas.
 - ii. If you are invested in hedge funds to “hedge” a downturn in the market, invest instead in safe and sound financial markets by promoting sustainable public policy at the SEC, Congress and other relevant venues.
5. **BUILD NEW SUSTAINABLE STRUCTURES, POLICIES AND PRACTICES:**
 - a. The job of a trustee is to protect and promote the interests of plan participants. How is your fund structured to support or promote that?
 - b. What can trustees do?

- i. Get training and support from independent sources not tied to Wall Street.
- ii. Engage with trustees outside your fund.
- iii. Learn what other pension investors are doing.
- iv. Examine yours and your fund's investment beliefs and practices. Do they match the policies and structures of your fund? If not, perhaps changes are needed.
- v. Begin a process to develop investment beliefs shared by the board and staff.