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New Arnold Foundation Pension Propaganda Efforts Target State Attorneys General

The Laura and John Arnold Foundation is helping to fund a new event for state Attorneys General entitled "Symposium on the Economics and Law of Public Pension Reform." The event is being hosted by the Mason Attorneys General Education Program, which is affiliated with the Law and Economics Center of Virginia's George Mason University School of Law.

According to a summary of the event, it will "discuss the looming financial and structural crisis facing state pensions systems across the nation." "With several dozen states adopting modest to major reforms, the economic impact on plan beneficiaries will be substantial," the Law and Economic Center explains, "and at least twenty-five jurisdictions are facing lawsuits due to the reforms adopted."

The symposium, to which AGs and staff from the 50 states, DC, and the US territories are invited, "will comprehensively outline the underlying structure of pension systems, address the differences between public and private pensions, and detail the unfunded liabilities and potential bankruptcy issues arising from this crisis." It will also "discuss the legal challenges to reform efforts under state constitutions citing both the contracts clause and the takings clause," according to the program's website.

The symposium is to be held beginning Thursday night, October 29, 2015, and wrap up at noon on Saturday the 31st at the Sheraton Palo Alto Hotel in Palo Alto, California. The Law and Economics Center will fully cover the cost of all travel, as well as two nights' accommodations. An opening night reception and dinner, two breakfasts and one luncheon, as well as a reception on the second night are included. "Participation in all classes, group meals, and social activities is mandatory," the website explains, as they are "an integral part of the symposium in that they facilitate important discussions between participants and instructors, thereby enhancing the learning process."

Speakers at the event include well-known critics of public pension plans such as Professor Joshua Rauh from Stanford University; Eileen Norcross with the Mercatus Center at George Mason University; Michael Podgursky, Professor of Economics at the University of Missouri–Columbia; and Anthony Randazzo, director of economic research for the Reason Foundation. (The Arnold Foundation has given the Reason Foundation $2.013 million for the period 2013–2017 "to expand access to information about public sector retirement systems," which it has used in part to fund a *Pension Reform Handbook: A Starter Guide for Reformers* that states that "Reform should follow the clear and undeniable trend in the private sector and convert employees from DB plans to self-directed, 401(k)-style DC plans as much as possible.")

Professor Todd J. Zywicki, a Professor of Law at George Mason University School of Law, is a moderator and instructor for several of the sessions. In 2009, Professor Zywicki was the recipient of George Mason's Institute for Humane Studies 2009 Charles G. Koch Outstanding IHS Alum Award. (Yes, <u>that</u> Charles Koch!)

Zywicki's name may not be as familiar as some of the others on the agenda, but fear not, he, too, has drunk the Arnold Foundation's Kool-Aid. In a 2010 article entitled "How Public Worker Pensions are too Rich for New York's—And America's—Blood," Zywicki and Norcross claim that in New York City, "[f]or every dollar police officers contribute to their retirement, taxpayers contribute nine." "States and local governments will soon find themselves up against a painful tradeoff," they intone, "between closing schools and libraries and cutting other essential services or paying inflated pensions to 50-year-old retirees."

Of course, Zywicki and Norcross have a solution, and it will probably come as no surprise that it involves closing defined benefit plans to new hires, in favor of 401(k) type plans. This, they note, "will give younger workers the ability to take their retirement accounts with them if they move to a private sector job." Clearly, these professors' research does not extend to an examination of the rate at which these younger workers actually roll over these accounts into other tax-sheltered retirement savings vehicles as opposed to simply cashing them out.

No official from a public pension plan, no public pension actuary, no other public pension professional, or any supporter of public pension plans is included on the Symposium's program.

This new pension symposium is only one of several initiatives targeting the legal profession that George Mason's Law and Economics Center is conducting, funded in part by Arnold Foundation grants totaling $2.545 million for 2013–2017 to "support symposia on public pension reform."

As NCTR has previously reported, two symposia for judges were held last year—one in Charleston, South Carolina, and the other in San Francisco, California, and a new "Judicial Symposium on the Economics and Law of Public Pension Reform" will take place October 4–6, 2015, in San Francisco, California. Its summary reflects language describing its purpose that is identical to that used for the AGs event, noted above. Judges will also have all their travel, lodging, and meals paid for by the Law and Economics Center. Once again, no public pension officials or supporters are included on the program.

Recently, George Mason also announced a new "Workshop for Law Professors on the Economics of Public Pension Reform." To be held in September 2015, once again in Palo Alto, this tuition-free event includes food and lodging, but no travel; however, a $2,000 honorarium upon successful completion of the workshop is offered. As with the other symposia, the program includes only public pension critics.

"I continue to be appalled at this blatant attempt to influence decision makers by presenting them with a one-sided, totally unbalanced presentation concerning public pension plans, with a pre-packaged solution bought and paid for by the Arnolds and other opponents of public pensions," said Meredith Williams, NCTR's Executive Director.

"Now they are trying to influence the perceptions of State AGs with an all-expenses-paid junket to California for a one-sided indoctrination session on public pensions' perceived wrong-doings," Williams continued. "These Attorneys General know that every 'accused' is entitled to effective, adequate representation, with a presumption of innocence," he said. "This symposium, with its biased presenters, lack of balance, and foregone conclusions, promises to be anything but a fair trial," Williams warned, noting that NCTR is considering a letter to the National Association of Attorneys General regarding "our most serious concerns with this undertaking."

- State Attorneys General Symposium on Public Pensions
- Judicial Symposium on Public Pensions
- Zywicki and Norcross: "How Public Worker Pensions are too Rich for New York's—And America's—Blood"

Supreme Court Marriage Equality Ruling Has Implications for Retirement, Benefits

The United States Supreme Court's decision in *Obergefell v. Hodges*, announced on June 26, 2015, finding that the Fourteenth Amendment requires all states to recognize same-sex marriages that were licensed and performed in other states, while at the same time voiding same-same marriage bans in those states that had them, will have significant implications for the retirement security of same-sex spouses and the organizations that provide them with it.

First, pension plans in those states that did not recognize such marriages prior to the recent landmark decision will now have to review all references as to "spouse" in plan documents, as well as update notices, forms, and protocols that could be affected, if they have not already done so in response to the Supreme Court's decision in 2013 in *United States v. Windsor.* That ruling invalidated a key provision of the Federal government's 1996 Defense of Marriage Act (DOMA), thereby permitting same-sex married couples to enjoy the same Federal benefits as traditional married couples.

Generally, it would appear that the terms "spouse," "husband and wife," "husband," and "wife" should now be read to include an individual married to a person of the same sex if the individuals are lawfully married under state law, and the term "marriage" includes such a marriage between individuals of the same sex.

Furthermore, there are other areas where the decision will have a significant impact with regard to retirement and other benefits. Perhaps the most important one deals with Social Security.

Despite the *Windsor* decision, there were still apparently a lot of "loose ends" when it came to Social Security as the Social Security Administration (SSA) continued to "work closely with the Department of Justice to develop and implement additional policy and processing instructions." In practice, it appeared that for same-sex couples living in a state that did not recognize their union, there were serious problems in getting benefits approved.

The new Supreme Court ruling should finally put any such issues to bed. Furthermore, as the decision will guarantee access to Social Security's spousal and survivor benefits, which are "the most valuable features of the program," the impact will be "massive" according to some press reports.

Indeed, *Financial Adviser* writes that Financial Engines, a large financial advisory firm, ran numbers recently for a hypothetical same-sex couple and found that marriage could be worth $343,000 in additional lifetime benefits. They say that SSA should be able to issue new rules quickly to its field offices, and the SSA website says that it is taking claims from same-sex couples and "working with the Department of Justice to analyze the decision and provide instructions specific to the decision for those individuals who rely on our programs and services."

Another significant change will be at the Department of Veterans Affairs (VA), which announced on June 29th that same-sex spouses will no longer be denied VA disability pay, home loan guarantees, death pensions, and burial rights based on the laws of the states where they have lived and worked. The VA had been issuing benefits only to same-sex partners who lived in a state that permitted gay marriage at the time of their union or who lived in one of those states during their service.

Sadly, however, as an article in the *Houston Chronicle* notes, the decision has come too late for many older Americans. Written by the Mayor of Houston, Annise Parker, and Ann J. Robison, executive director of The Montrose Center, Houston's Lesbian, Gay, Bi, and Transgender (LGBT) community resource, the article notes that for many who "cared for and nurtured their life partner in the final years of their life," they will never have access to their partner's Social Security benefits or employer-sponsored pension. These LGBT seniors are also two times more likely to age alone and four times less likely to have assistance from their families of origin.

Furthermore, in senior housing communities or assisted living settings, they "often are met with social service providers and caregivers who lack the proper training to address their unique needs and who don't recognize or accept their differing identities and orientations, cultural values and support system of choice." Indeed, it is pointed out that many health care providers and senior living communities do not even ask about sexual orientation or gender identity, "further contributing to the feeling of being invisible, ignored and overlooked."

In the worst cases, the article says that LGBT seniors experience mistreatment, discrimination, and even abuse at the hands of fellow residents or caregivers. "With approximately 10,000 Americans reaching retirement age every single day, it is critical that we take steps to ensure that all seniors—who were among the first generations to defy cultural norms of discrimination and inequality—can enjoy their retirement years in the communities that they helped to define and make better places to live," the two write.

- *Obergefell v. Hodges*
- SSA: "Important Information for Same-Sex Couples"
- *Financial Adviser*: "Gay Marriage's Big Benefit Is Social Security"
- *USA Today*: "Spouses of All Veterans in Same-Sex Marriages Now Eligible for Earned Benefits"
- Parker, Robison: "Marriage Equality Too Late for LGBT Seniors"

Focus on Fees Increasing

Public pension plans often cite the fact that their ability, as defined benefit plans, to pool pension assets helps them to reduce investment fees and administrative costs. In fact, some estimates are that such costs for large public pension plans are less than one-fourth the cost of a typical individually-directed plan.

Nevertheless, there is growing concern both within and without the public pension community that high fees, often associated with alternative investments, are too steep and are producing real damage to plan funding.

For example, a June 24th article in *MarketWatch* by Alicia Munnell, the director of the Center for Retirement Research (CRR) at Boston College, warns that, as the title of the article makes clear, "High Fees Hurt Public Plan Funding."

Munnell notes that where fees are measured as basis points of assets under management, she finds that these fees range from under 20 basis points (0.2 percent) to more than 100 basis points (1.0 percent), with average asset weighted fees in 2013 of 40 basis points. Furthermore, she points out that in some cases, according to press reports, the reported number may not include the "carry interest cost and performance costs associated with private equity investment."

But if paying higher fees resulted in what Munnell refers to as "extraordinary returns," then perhaps they could be justified. However, she points to an analysis released by New York City Comptroller Scott Stringer in April 2015 that "suggests this may not be the case." According to Munnell, Stringer's analysis found that "high fees and the failure to hit investment targets had cost the New York City five pension funds $2.5 billion over the last decade."

She points out that many public plans are now taking action to address the issue. For example, New York City intends to change how it engages with investment managers to "ensure that fees and value are better aligned," she notes. Munnell also points to the California Public Employees Retirement System (CalPERS)—which she describes as a "very high cost plan" with fees in 2013 amounting to 102 basis points—and its recent actions to lower fees, risks, and complexity by reducing the number of its direct relationships with private-equity, real estate, and other external funds from 212 to 100 over the next five years. She also notes CalPERS' elimination of its hedge fund program in 2014 as an effort to "reduce both the complexity and costs in its investment portfolio."

Would reducing fees have a noticeable effect? Munnell argues that it would, suggesting that if, for example, CalPERS could reduce its fees to the average of 40 basis points for the 150 plans in CRR's sample, doing away with this 60 basis point difference over a 30-year period would increase their assets by about 18 percent.

"Reducing fees is not a solution to the funding problems, but a step in the right direction," Munnell concludes.

In another June 24th article focusing on fees—this one in *FundFire* and entitled "Consultants Endorse Culling Manager Rosters"—reporter Michael Shagrin says that the retention of investment returns has become "a top priority for trustees in the last five years." He describes recent moves by consultants to urge their clients to "slash manager rosters in order to put downward pressure on fees and reduce reliance on active managers that mirror index products." According to these consultants, this "improves performance and deepens engagement with remaining managers," Shagrin writes.

The article reports that Nat Kellogg, associate director of research for Marquette Associates, explained at a recent *FundFire* Consultants Roundtable that a smaller number of managers "means more money with each firm and thus a greater ability to negotiate down fees," as well as offering the opportunity for "more rigorous monitoring of individual firms."

Russ Ivinjack, senior partner at Aon Hewitt Investment Consulting, is also described as telling the audience at the same event that replacing a number of active managers with a single index provider is something he endorses. "Manager creep occurs in many institutional portfolios," he is quoted as saying, and sometimes "a bit of spring cleaning" may be necessary when such investors "realize they've crept towards an 'actively managed' index fund."

However, the article also stresses that institutional investors are not giving up on active management, but that the prices managers charge "are going to remain under the microscope." Indeed, the story says that consultants "even went so far as to say that a market downturn could be the time when actively managed U.S. equities strategies could significantly dampen losses."

"If you can point to where [your firm's] research process is more value additive but also more expensive than your peers, and justify the extra fee in that way, I think that's something that resonates with clients," Kellogg is reported as saying. "But if it's just an extra fee because performance has been good and you're just trying to capture more of the pie for yourself, I think that's where clients are susceptible to using a passive option as an alternative," he warned.

Adding to the debate over active-vs-passive investing, *The Washington Post* reported on June 29th that a "metric introduced by investment-research firm Morningstar at its annual investment conference compares the returns by actively-managed funds to those of index funds in the same category, taking into account fees and which funds were shut down."

"The results weren't pretty," according to the article, as actively managed funds "lost out to their passive peers in nearly every asset class during the 10 years between 2004 and 2014, according to the report." Active funds were also more likely to get merged with other funds or closed, the article says.

However, reportedly the Morningstar research also found that over the long term, active management paid off most for small-cap, mid-cap foreign stocks and intermediate-term bond funds, which performed better than index funds and were more likely to stay open. "There was only one category where more than half of active funds performed better than the average index fund over the 10 years: U.S. mid-cap value stocks, which did better than index funds 54 percent of the time," according to the new data, the article noted. In the short term, actively-managed bond funds also showed more value.

"Of course, funds won't necessarily perform in the future the same way they did in the past," the article also points out. Morningstar says that its new "Active/Passive Barometer" does not purport to settle the active-passive debate. "Rather, it offers survivorship-bias-free data to inform this debate and help investors better assess their odds of succeeding with active managers across asset classes, time periods, and fee levels," Morningstar explains.

The debate will indeed go on!

- Munnell: "High Fees Hurt Public Plan Funding"
- Shagrin: "Consultants Endorse Culling Manager Rosters"
- NYC Comptroller: "The Impact of Management Fees on Pension Fund Value"
- *The Washington Post*: "Active vs. Passive: How Fund Managers Stack Up To Index Funds"
- Morningstar's Active/Passive Barometer

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