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Study: State Pension Systems Poorly Served by Investment Managers

Funds with highest money management fees see below average investment returns

ROCKVILLE, MD—A new study shows that state pension systems that pay the most for Wall Street money management get some of the worst investment returns. The study, conducted by the Maryland Public Policy Institute and the Maryland Tax Education Foundation, reviewed investment returns and fee ratios for 35 state pension systems and found startling results.

The ten states paying the highest Wall Street fee ratios saw annualized five-year returns of 1.34 percent while the ten states paying the lowest fee ratios saw annualized returns of 2.38 percent. The five states paying the most were South Carolina, Missouri, Pennsylvania, Maryland, and Delaware. The full study can be viewed at mdpolicy.org or marylandtaxeducation.org.

"The study's findings make money management fees paid by state pension systems difficult to justify," said Jeffrey C. Hooke, chairman of the Maryland Tax Education Foundation and the study's co-author. "Taxpayers, public employee unions and policy makers should think hard about what they are paying for and start considering alternatives."

State public pension systems contract with investment firms to select publicly traded stocks and bonds that comprise the bulk of the systems' investment portfolios. The Wall Street firms' typical sales pitch is that they can outperform a given section of the market; therefore, the system should pay them a fee for their investing prowess.

An alternative may be low-cost index investing, the study shows. By indexing most of their portfolios, the authors conclude that state funds surveyed could save $6 billion in fees annually, while obtaining similar or better returns compared to active managers. The study found that a composite index fund that 'mimics' state pension fund allocations easily beat the 35-state median results.

"There is simply no correlation between high money management fees and high investment returns," said John J. Walters, co-author and visiting fellow at the Maryland Public Policy Institute. "Retired state employees and taxpayers across the country are not getting their money's worth. They deserve a simpler, more effective investment strategy for their retirement savings."

State pension funds can ill afford questionable costs. The Pew Center on the States estimated in June 2012 that the state pension systems have unfunded liabilities of $1.38 trillion. To ensure an "apples to apples" comparison, this investment return analysis included all pension funds with fiscal years ending June 30, 2012. Thirty-five funds met this criterion. A total of 46 six states were surveyed.

About the Maryland Public Policy Institute: Founded in 2001, the Maryland Public Policy Institute is a nonpartisan public policy research and education organization that focuses on state policy issues. The Institute's mission is to formulate and promote public policies at all levels of government based on principles of free enterprise, limited government, and civil society. Learn more at mdpolicy.org.

About The Maryland Tax Education Foundation: The Foundation is a Maryland nonprofit established in 1998 to help the public understand tax and expenditure policies of State and local government in Maryland. Learn more at marylandtaxeducation.org.

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