Admit Claims of Major Pension Gains Tied To New Board Are Dicey

By RICHARD STEIER | Posted: Monday, November 21, 2011 5:00 pm

The top aide to City Comptroller John C. Liu Nov. 15 acknowledged that the Comptroller and Mayor Bloomberg had no hard evidence that their plan to shift investment decisions for the city's five pension funds from the Comptroller and other fund trustees to an independent board would improve earnings as much as they projected late last month, even as he insisted the proposed change would leave the systems stronger and less politicized.

Mr. Liu joined with the Mayor Oct. 28 in announcing an agreement in principle with most union representatives on the boards of the pension funds that they said would yield an additional $1.2 billion annually if there was just a 1-percent improvement in performance. They said that the savings could be considerably greater if a move to a smaller and independent investment board acting on the recommendations of a Chief Investment Officer compensated based on his performance produced the kind of returns that some Ivy League university endowments have achieved in recent years.

Dissenters Detail Pitfalls

But two union critics of the plan used the board meeting of the New York City Employees' Retirement System to challenge the assumptions in those projections and outline what they believe are pitfalls to the shift from the standpoint of both union trustees and the employee members of the five funds.

Among them, said Larry Cary, an attorney who represents Transport Workers Union Local 100 on the NYCERS board, is what he called a loss of accountability if the Comptroller turns over his role of making investment recommendations to the trustees of the funds to an investment officer who is chosen rather than elected by voters and whose compensation agreement was likely to give him an incentive to maximize short-term returns without regard to the long-term impact on the health of the funds.

"I have a great distrust for what I call 'the Wall Street mentality,'" he said, alluding to the actions by top managers at some investment firms that earned them huge bonuses but eventually played a key role in the national economic meltdown three years ago.

First Deputy Comptroller Eric Eve took exception to Mr. Cary's claim that the new system would turn over the funds' assets to "Wall Street types. No one has said anything about outsourcing $120 billion to Wall Street staff. We want to in-source" by improving the investment capabilities of both in-house staff and the streamlined investment board, which he has proposed should consist of 12 members rather than the 58 (including some duplication because the Mayor and Comptroller are each represented on all five boards) who currently serve as trustees of the funds.

Mr. Cary's concerns were echoed, however, by Albert Rodriguez, who as General Counsel to Bronx Borough President Ruben Diaz Jr. represents him on the NYCERS board. (Each Borough President has one-fifth of a vote, while the three union representatives and the Mayor, Comptroller and Public Advocate each cast a full vote at NYCERS.)

Political, Job-Security Concerns

Mr. Eve had contended that under the current system, it was inevitable that politics intruded, simply because it was tough for investment advisers to make decisions based on long-term interests "when you're appointed by a Comptroller who has to run every four years." Noting he spent six years working on Wall Street before joining Mr. Liu's staff last year, he said some top professionals might be reluctant to take in-house jobs as investment advisers because their job security might last only as long as their boss remained in office, or because current salary strictures meant they would earn hundreds of thousands—if not millions—less than what they could receive doing such work for a private investor. He said a Chief Investment Officer would, in addition to fair compensation, want a "depoliticized" atmosphere in which the priority would be long-term results. (Mr. Eve said that while the chief investment officers for the Harvard and Yale endowments earned $4 million or more, it would be "politically untenable" for the city to offer that much.)

But Mr. Rodriguez said he had seen no signs of "political decisions" by the NYCERS trustees, and that a greater danger existed in giving $120 billion to a single board to invest. He cited the case of the California Public Employees Retirement System, which last year was beset by a major pay-for-play bribery scandal and huge unfunded liabilities that grew because of the market meltdown.

"The [Chief Investment Officer] and this [independent] board won't be accountable to anybody once they are put in place," Mr. Rodriguez said. He contended NYCERS should instead "professionalize the staff" and create a risk-management division while taking other steps to speed board decisions.

Objects to Veto Power

Mr. Cary also took exception to Mr. Eve's proposed criteria for choosing trustees for the independent board, which would include, once board members are in place, their evaluations of each other and a requirement that they be "knowledgeable" about investment strategy.

"I don't like the idea that the people on the other side would have a say-so on who's on the labor side of the board," he said. "The idea that there should be some test or testable expertise I find very objectionable." He also, not surprisingly, questioned a proposed requirement that union representatives on the board actually be union members, noting that the typical city employee or union official is not well-grounded in the economics of pension investing.

Teamsters Local 237 President Greg Floyd, the second NYCERS board member who is opposed to the change (the third union representative, District Council 37 Executive Director Lillian Roberts, favors it), said that while he believed some improvements could be made in the investment operation, he was "confused" by the urgency being attached to the situation in light of NYCERS having just enjoyed an outstanding return on investment of 23 percent in the fiscal year that ended June 30.

"Only a few short months ago I hear the sky is falling," Mr. Floyd told his fellow board members, "and we need some drastic changes."

'It's Not About One Year'

"The sky is not falling," Mr. Eve responded. "These five funds beat the pants off their competitors" in fiscal 2011. But, he said, the change would make a tangible difference in decades to come, adding, "Don't think of this as about next year or the following year."

When he mentioned that nonprofit agencies were sending him recommendations about how the planned board could operate with "openness and transparency," Mr. Cary interjected that it was a mistake to believe that the current system was a detriment to those qualities, since each of the five fund boards acted independently but when they were faced with similar issues, "It's a decision that's not made in a small room."

He questioned how effectively a single board could serve the needs of its diverse constituencies, since the police and fire funds need to peg investment decisions to a steady flow of cash to fund benefits for workers who are permitted to retire sooner than most of the workforce, and the Teachers Retirement System has different needs than NYCERS because most of its members are female and would on average live longer than the male employees who make up a greater proportion of the latter system's membership.

Needs, Timetables Differ

Alluding to previous remarks by Mr. Liu and Mr. Bloomberg about the proposed setup offering a chance to match the investment performance of some university endowments, he called that "a fantasy." Speaking of the Harvard and Yale endowments, Mr. Cary said, "They measure their investment horizon in centuries. We do not. We have to pay a pension benefit," requiring a far greater amount of available cash than is needed to cover the yearly expenditures of the endowments.

He also expressed suspicion about neither Mr. Samuelsen nor Mr. Floyd having been told of the discussions on an independent board until the morning of the announcement of an agreement in principle by the Mayor, Mr. Liu, and other union leaders. he also cited what he charged was misleading information given to the New York Times for a story the following day comparing the five funds' investment performance to that of the Ivy League endowments. The figures for Harvard and Yale reflected their performance in fiscal 2011, which raised the 10-year averages to 9.4 and 10.1 percent, respectively. The 10-year average for the city funds of 2.7 percent reflected performance only through fiscal 2010, even though more-recent returns that raised the average to 5.6

percent had been published in an industry journal more than a month prior to the press conference.

Mr. Eve took responsibility for not informing the two union representatives sooner but insisted, “The intent here is to do the right thing for public employees... and taxpayers.” Following the meeting, he took exception to a question about the wisdom of negotiating the changes without consulting two of the three union members of the NYCERS board.

‘Changes Not So Radical’

“I think the vast majority of public employees were represented,” he said. “The goal now is to get everybody on board. Changes are not as radical as some make it seem.”

But Mr. Floyd during his concluding remarks at the meeting said his concerns went beyond his fiduciary responsibility as a trustee, which would likely vanish if, as expected, only one of the NYCERS union reps is part of the proposed board. “I really and truly believe we would be making a big mistake in creating this new entity. It’s not about Local 237 having a vote,” he said. “The potential for corruption and not being able to get rid of that person until they go to jail will be there.”