
How Pooling Assets Could Help Sustain Public Pension Funds.

They badly need to improve their ability to generate investment returns. A Canadian province's initiative looks like a model worth studying.

For all of the angst about the burden of funding public employees' pension funds on state and local government budgets — and on the public workers who contribute part of their paychecks to their retirement funds — the most critical factor in the equation is the funds' ability to achieve their investment-return targets. The money the funds earn on investments pays, on average, more than 60 cents of every dollar that is disbursed to retirees.

But the news is not good on the investment front. According to the Wilshire TUCS performance tracking service, median returns in fiscal years 2014 and 2015 were 3.43 percent and 1.07 percent, respectively — nowhere close to the sector's average assumed rate of return of 7.5 percent. And experts say that it will be even harder for public pensions to make money in stocks and bonds over the coming decades.

Yet efforts to increase the efficiency and effectiveness of investment-management practices for retirement assets, such as the Investment Modernization and Cost Reduction Act proposed by the Oregon State Treasurer's Office or the Bloomberg Liu initiative for the New York City Retirement System, have met with great resistance.

One modernization approach in particular, pooling assets to invest on a collective basis, holds a lot of promise. But only a handful of governments have moved to pool assets to one degree or another. Most pooling proposals, such as combining the Chicago and Illinois teachers' retirement systems or Pennsylvania's attempt to combine its 3,200 local pension plans, have involved consolidation or mergers that would mean giving up control of the assets. This has been a non-starter for pension trustees and board members.

But a new pooled-asset entity just launched in Canada could provide a model for U.S. public pensions funds to move forward, not only in protecting retirement systems' long-term sustainability but also in increasing their ability to compete in the global financial markets.

This $38 billon pooled platform, the Investment Management Corporation of Ontario (IMCO), is organized as a nonprofit corporation, and it provides investment management services to pension funds at cost. Seeded with assets from the Ontario Pension Board and another public agency, IMCO enables pension funds to enhance returns by lowering costs and leveraging scale while retaining control of their assets. Remarkably, pension funds join IMCO as members, on a voluntary basis, and elect board members from their own ranks. What's more, it hasn't cost Canada's national government a dime.

Ontario's initiative offers encouragement to U.S. policymakers and researchers who have recognized the benefits of asset pooling. A 2010 Government Accountability Office study found that pooling pension assets could achieve economies of scale and reduce the investment fees paid to outsourced managers. As the study suggested, that could alleviate some of the budgetary pressures on states and municipalities due to unfunded pension obligations. The GAO study cited the mandate of the Massachusetts Pension Reserves Investment Trust Fund “to reduce the state’s significant unfunded liability and to assist participating local retirement systems in meeting their future pension obligations.”

State investment boards chartMassachusetts’ investment fund is one of 15 state pooled-asset structures, which are commonly called state investment boards and often are responsible for managing several different types of funds in addition to pensions. The North Dakota State Investment Board, for example, invests the assets of the state’s sovereign wealth fund, funded by tax revenues from oil extraction and production, as well as the assets of two pension funds for public employees and teachers. As the table here shows, 12 of the 15 state investment boards already oversee pooled public pension funds.

Ontario’s approach takes the advantages of the asset pooling already being realized by the U.S. state investment boards to the next level by introducing a cost-recovery model designed to end pension funds impoverishing reliance on money managers and consultants.

American policymakers interested in ensuring the long-term sustainability of our public-sector employee retirement systems might look at what the Canadian province has done. As healthy investment returns prove tougher than ever to come by, it’s hard to see an argument for failing to modernize our struggling retirement systems’ organizational structures as a step toward maximizing their ability to make money for the benefit of retirees and taxpayers alike.

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