Another Political Hack Job

By David G. Bronner

(The ALEC Report is on our website under "Fake News")

As you may be aware, the American Legislative Exchange Council (ALEC) recently released a report titled "Keeping the Promise: Getting the Politics Out of Pensions" (the "ALEC report") that criticized, at length, RSA's Alabama investments.

ALEC's criticisms were taken primarily from the January 13, 2016, report made by the Pew Charitable Trusts (the "Pew report") to the Joint Committee on Alabama Public Pensions (JCAPP). Unlike Pew, however, ALEC failed to include any of the positive data regarding RSA investments (such as the relatively high returns in the past few years and having the lowest investment expenses in the country), and did not attempt to discuss the subject matter of the report with RSA prior to publication. ALEC also presented much information that is misleading and just plain wrong.

For example, ALEC represents that RSA's unfunded liability is $75B, five times that calculated by RSA's actuaries. In order to reach this shocking and over-inflated number, ALEC employs a risk-free rate of 2.344% in substitution of RSA's assumed rate of return of 8.00% (soon to 7.75%). ALEC does so even though GASB specifically rejected the use of this rate in calculating future liabilities and despite the fact that this calculation has little practical value.

ALEC's approach to calculating the unfunded liability also ignores the reality of RSA's investment returns. For the past seven years after the economic crisis, the ERS has averaged 9.36% and TRS has averaged 9.42% returns annually gross of fees. These returns are better than more than 80% of the universe of public pension plans in RSA's peer group. For the last 35 years, the TRS has averaged 9.40% and ERS has averaged 8.98% annual returns. The use of 2.344% assumed rate of return to calculate pension liabilities cannot be justified in light of these historic returns.

In addition, ALEC presents two charts (Figs. 3 and 5) that purport to represent a comparison of the fiscal year 2014 investment returns for RSA's non-Alabama and Alabama real estate, private placement, and preferred and private equity holdings. ALEC states that the RSA's Alabama investments returned 1.21% and the non-Alabama investments returned 3.24%, and RSA's Alabama real estate investments returned 0.28% and non-Alabama real estate investments returned 6.73%. It is hard to understand how ALEC came up with these numbers when RSA's investment returns for these three asset classes were 8.48% for real estate, 13.55% for private placements, and 17.71% for preferred and private equity in fiscal year 2014.

Furthermore, ALEC falsely represents that Alabama investments comprise 16.3% of RSA's portfolio, more than three times the actual percentage of Alabama investments. ALEC disingenuously includes Raycom and CNHI in these calculations just as Pew did in its reports to the JCAPP. Both Pew and ALEC ignored the facts that Raycom derives only 8.5% of its revenues from Alabama operations and CNHI receives only 1.6% of its revenues from Alabama operations. In addition, the headquarters of both companies were moved to Alabama only after the RSA invested in the companies. If these two companies are properly categorized and excluded, only about 5% of RSA's overall portfolio is in Alabama investments. ALEC further compares this asset allocation to only three other states with no mention of how many states have in-state investments, what the average allocation is for each state, etc., rendering the comparison meaningless.

ALEC also mischaracterizes the fiduciary standards that apply to the TRS and ERS Boards, and argues that they should be strengthened for the purpose of prohibiting the Boards from investing in Alabama real estate and businesses. In Table 4, ALEC ignores the Alabama Constitution and statutes, Alabama Supreme Court decisions, Alabama Attorney General opinions and Board investment policy and makes the spurious claim that the TRS and ERS are not governed by four of six basic fiduciary rules. In fact, all of the fiduciary principles listed in the table govern the conduct of TRS and ERS Board members.

Moreover, the underlying premise – that Alabama investments are somehow inferior and always violate fiduciary standards – is false and not supported by fiduciary law. The TRS and ERS Investment Policies apply the same prudent man standard to Alabama investments and both provide that "investments in Alabama businesses are encouraged to the extent the investment return meets the criteria delineated by this policy statement. Any Alabama investment must be forecast to have a return comparable to other investments in the same asset class."

These are just a few points that we thought were important to raise after our review of the ALEC report. Unfortunately, there are many more flawed arguments and inaccurate data included in the report.