

Introduction

TODAY, U.S. PUBLIC pension plans manage nearly \$4 trillion in retirement assets. There are more public pension assets in the U.S. than in any other country. Public pension trustees are the fiduciaries ultimately responsible for the management and the administration of these assets for the benefit of plan beneficiaries. The job of the public pension trustee is often an unheralded and underappreciated job. However, it is a job of immense importance to the lives and long-term well-being of our country's federal, state, and local government employees.

The public pension trustee represents many things to me: public servant, public advocate, client, and friend. I am always amazed at the dedication of the pension trustees I have grown to know well. Their commitment is to a job that not only affects the lives of millions of public servants but also impacts domestic and global financial markets. As both the sheer size and complexity of the public pension portfolio has dramatically increased, so too has the role and responsibility of the public pension trustee.

Over the last two decades, I have spent much of my time working with public pension trustees and their investment staff. As an advisor, my job has always been to be the “go to” resource for trustees and staff on a multitude of public pension issues. Trustee requests have often required me to conduct independent research on various topics. In fact, my investigation into one such topic planted the earliest seed of the idea of this book. A trustee once asked, “What is the practical difference between a public pension investment policy statement and a statement of investment philosophy?” This trustee

continued and asked, “How often do public plans have formal statements of investment philosophy?”

I initially thought satisfying this information request would be a simple assignment. Most, if not all, public pension plans in the U.S. publish formal statements of investment policy outlining general investment goals including return, volatility, and asset allocation targets. Larger public plans had begun augmenting their investment policy statement with a statement of investment philosophy, a set of primary organizational beliefs about their plan, its membership, and the value the plan strives to add to the lives of its beneficiaries. However, after much effort, I could find no information on this very visible, emerging trend. I ultimately answered the trustee’s questions through my own informal review of the websites of a selected peer group of public plans. It should be noted that years later a more comprehensive study on statements of investment policy and philosophy, with results echoing my more cursory approach, would be published by a lesser known governmental trade organization that I would still not know of today had I not conducted the research for this book.

In fact, in researching the answers to trustees’ questions in general over the years, it became blatantly clear that there was a real scarcity of readily-accessible, publicly-available, information on U.S. public pensions in the marketplace. To find answers to basic questions about public pensions far too frequently required lengthy investigation through hard-to-find, esoteric research reports produced by low circulation academic periodicals, small nonprofit trade organizations, niche private sector think-tanks, or remote branches of the government offering data through downloadable (“user-friendly” though generally indecipherable) Excel databases.

Simply put, too much effort was required to track down important and necessary public pension plan information and data. No single source existed that represented at least “a first stop” in a research effort on the various areas of public pension governance, investment management, infrastructure, accounting, and law. I even Googled the phrases “public pension handbook” and “public pension trustee handbook” hoping to simplify my own research efforts and found nothing close to comprehensive enough to satisfy my needs. However, what these searches did reveal is that this book did exist (albeit more in title than in ambition) in multiple versions and editions

for the UK public pension sector, the second largest public pension market behind the United States.

So leveraging my more than two decades of experience working with public pension fiduciaries, my formal legal training, and my public policy training and background, I wrote the book that I wished already existed for the United States market. The *U.S. Public Pension Handbook: A Comprehensive Guide for Trustees and Investment Staff* is just that, both a handbook and a guide for public pension fiduciaries, professionals, and anyone interested in learning more about some of the largest institutional investors participating in financial markets around the world.

This book is a handbook in its most practical sense, representing a comprehensive collection of information from over 300 sources about public pensions in the United States. This book is also a guide in that it takes this volume of public pension data and information and organizes it by subject-matter, in a very digestible format and language. In addition, by design, the “Chapter Note” section at the end of each chapter both provides the reader with a quick summary of the chapter’s subject-matter and also highlights key source materials referenced for those interested in a deeper review of the topic(s).

Similarly, for ease of use, the book is divided into four parts. Part I is the introduction focusing on the history of public pensions in this country and the current global and domestic public pension marketplaces. Chapter 1 discusses the history of public pensions in the U.S which sets both the framework for, and many characteristics of, today’s public pension systems. Chapter 2 presents a snapshot of the global pension marketplace, focusing on the primary macroeconomic trends affecting pension systems worldwide. Chapter 2 also discusses in more detail the size and growth of the U.S. public pension market specifically, highlighting current trends within our domestic market.

Part II reviews public pension plan design and actuarial valuation concepts. Chapter 3 takes a comprehensive look at public pension design through a review of the defined benefit (DB) model, the predominant public pension design in the U.S. Chapter 3 focuses on retirement benefit design specifically, reviewing both the normal and ancillary pension benefits offered to public sector employees in a DB model. Chapter 3 concludes with a dis-

cussion of overall public pension benefit adequacy in this country. Chapter 4 reviews the financial concepts and assumptions (demographic and economic) central to the actuarial valuation of pension benefits and discusses how these assumptions differ across the public plan landscape in the U.S. Chapter 5 discusses public pension designs beyond the DB model, primarily the defined contribution (DC) and the most common hybrid pension models (side-by-side and cash balance plans); and, it touches upon other proposed design solutions including stacked, portfolio pension, defined ambition, and target benefit plans. Chapter 5 also compares the DB, DC, and hybrid models, highlighting the inherent risks assumed by public employee and employer under each pension design.

Part III focuses on public pension investment policy and its implementation. Chapter 6 discusses public pension investment policy, highlighting the common structural features and elements of policy statements among U.S. public plans. Chapter 7 discusses why strategic asset allocation is so important and how a public pension works with its investment consultant(s) and internal staff to develop an asset allocation policy. In discussing the importance of and approaches to asset allocation policy, Chapter 7 covers basic tenets and concepts of modern portfolio theory. Chapter 8 builds on the previous chapter and offers the reader a data-rich exploration into current public pension asset allocations and how these allocations have changed over time. Chapter 8 reviews public sector portfolio allocation trends at both the general and sub-asset class levels, across public pensions of different sizes.

Chapter 9 and Chapter 10 focus on public pension revenue. Chapter 9 discusses how, and to what extent, these strategic asset allocations have generated investment return over the years. Chapter 9 looks at overall aggregate public pension performance, as well as general asset and sub-asset class returns, within the context of the investment concepts and the asset allocation trends discussed in Chapter 8. Chapter 9 discusses investment performance benchmarking and the evolving trends within the benchmarking industry itself. Chapter 10 addresses state and local government pension contribution policies, discussing both the annual required contribution (ARC); its successor, the actuarially determined employer contribution (ADEC); and

the financial contribution public employees make to their own retirement security.

Part IV focuses on public pension governance, viewing public pensions as, first and foremost, organizations of people. Chapter 11 discusses public pension governance as organizational management, reviewing the most common governance structures implemented by state and local authorities in the U.S. Chapter 11 discusses the role and responsibilities of a public pension board and its trustees, reviewing board composition and committee structures across public plans. Chapter 11 also addresses trustee core competencies and shines a spotlight on public pension trustee diversity. Chapter 12 offers a representative review of current governance research and theories, sampling topics focused on the impact of governance structures and board composition on performance, funding, and other organizational results. Chapter 12 concludes that public pension governance matters and presents selected ‘best practices.’

Chapter 13 discusses trustee fiduciary responsibility, reviewing the specific duties that, in sum, make up a public pension trustee’s legal obligation. Chapter 13 offers an easy to follow framework, hopefully moving the understanding of fiduciary responsibility from the category of murky concept to usable set of rules to govern day-to-day public pension trustee decision-making and conduct. Chapter 14 is devoted to discussing public pension staff, with a focus on investment infrastructure. Chapter 14 reviews the more impactful research efforts on the topic of public pension staff size, structure, compensation, outsourcing, and insourcing. Chapter 15 discusses how changes in trust law may affect public pension trustee fiduciary responsibility and liability. The Chapter 15 suggests that the change in law may ultimately be the catalyst for a meaningful public pension evolution in the twenty-first century, as evidence of this evolution is already apparent. Finally, Chapter 16 reviews the pension systems governing both federal civilian employees and uniformed members of the military, an oft forgotten part of the public pension ecosystem in this country.

In the end, the goal of my book is to centralize valuable and important information about public pensions in the U.S. in a far more accessible and digestible manner than has been previously available. While much has been written about public pension portfolio management, *U.S. Public*

Pension Handbook: A Comprehensive Guide for Trustees and Investment Staff is the first thoughtful and practical book giving U.S. public pension trustees, fiduciaries, and professionals the basic knowledge and tools to be more effective in their roles—be it from “day one” on the job or well into a multi-year tenure. On a more fundamental level, *U.S. Public Pension Handbook: A Comprehensive Guide for Trustees and Investment Staff* was written to be a simple educational resource for anyone who is interested in how public pensions are operated and managed today, with a possible glimpse of how these organizations may be operated and managed in the years to come.