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Bad Apple: New ACCF Report Finds New York City's Public Pension Fund System in Bad Shape and Getting Worse

As city leaders use retirees' pensions to advance political causes, taxpayers may be on the hook for $56 billion shortfall

WASHINGTON, D.C. (Jan. 11, 2018) – On the heels of New York City's push to divest its investments in fossil fuels, a new report finds politicized investment decisions are a recurring example of the city comptroller advancing social causes over financial results.

In Volume Two of its "Point of No Returns" series, the American Council for Capital Formation (ACCF) takes a closer look at how the five public-sector pension funds that collectively comprise the New York City Retirement Systems got in the shape they're in today – and how taxpayers are ultimately the ones who will bail-out the program if it cannot meet its future obligations. The ACCF report also examines the role that politics continues to play in how fund beneficiaries' money is being invested, and whether too much of the focus of fund managers, board members, and the city comptroller himself is on using pensioners' money to advance political and social causes – actions that are done at the expense of maximizing returns and doing what's necessary to improve the system's underfunded status.

"Divestment is just one example of politics taking precedence over returns for New York City beneficiaries. Fund managers responsible for the pension-fund system of New York City routinely invest in things that have no reasonable expectation to yield acceptable returns for investors," said Tim Doyle, ACCF's executive vice president and general counsel, and author of the report. *"We concur with previous reports on the role that poor management has played in growing the unfunded gap, as well as how the use of certain accounting tactics has allowed fund managers and the comptroller to shield from public view the true consequences of their mismanagement."*

Today, four out of every five taxpayer-dollars collected by New York City's personal income tax are spent paying down the city's public pension fund system's liabilities, a 567 percent increase over the past 15 years. The city's budget will soon allocate more spending on pension costs than on social services (excluding education). At the same time, the funds' liability ratio continues to grow more severe by the day: while "official" reports estimate the funds to be merely $56 billion in the red today, other analyses based on more realistic projections of future returns point to an actual funding gap more than double the official figure.

Fund managers insist that performance expectations drive every investment decision they make, but in the case of the New York City funds, the data simply do not back that up. According to the ACCF report, three of the 10 worst performing NYCERS private equity funds this year were focused on supporting Environment, Social and Governance (ESG) ventures. None of the system's top 10 performing ones were in the ESG category. Significant fund resources have also been allocated to projects and initiatives that have historically underperformed relative to key benchmarks. For example: 12 percent of the funds' assets ($22 billion) are invested in a group called the "Developed Environmental Activist" asset class, which has underperformed overall funds' returns by an average of 600 basis points over the last three calendar years for which full data are available.

On divestment, Scott Stringer, the city comptroller and the funds' primary custodian, has announced plans to divest New York City's two largest pension funds, New York City Employees' Retirement System and Teachers' Retirement System, irrespective of the potential for weaker fund performance. Just last week, the state of New York's comptroller, Thomas DiNapoli, said the public pension funds he controls have "no plans" to divest, citing his fiduciary responsibilities to pension holders. An analysis commissioned by the Suffolk County (N.Y.) Association of Municipal Employees found divesting from energy companies could cost the state pension funds more than $3 billion in lost returns over 20 years. Previous economic reports estimate divestment would cost the city up to $1.5 trillion over a 50-year timeframe and up to $120 million annually.

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The ACCF report also comes on the heels of a new independent survey released last week by the Chicago-based investor research firm Spectrem Group, which surveyed pension fund beneficiaries on issues related to fund performance and ESG investing. Spectrem found nearly 80 percent of respondents who identified themselves as New York City pension fund beneficiaries believed fund managers should focus exclusively on doing what's necessary to maximize returns, and not on using their money to promote particular political or social causes. Surprisingly, that was true even when respondents happen to personally support the cause or issue being advanced.

While the New York City retirement systems remains grossly underfunded, the city comptroller continues to devote a disproportionate amount of official resources toward undermining many of the funds' own portfolio companies through the near-constant filing of various shareholder proposals. In fact, the number of proposals submitted by his office has almost doubled over the past three years, vaulting the New York City Retirement Systems onto the top-10 list of most prolific sponsors of such resolutions anywhere in the country. Very few of these proposals have ever come close to achieving majority support – and most have sought to impose changes on portfolio companies that have very little to do with improving their business or making them more profitable.

ACCF's report on the New York City funds follows the release of the inaugural paper in its continuing "Point of No Returns" series, which focuses on the California Public Employees Retirement System, or CalPERS. That report is available here; the New York City paper can be accessed here; and additional materials and commentary can be found on ACCFcorpgov.com.

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