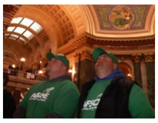
Audits Raise Cautions about Pension Fund Management

Posted on Jan 23, Posted by Kathleen Vinehout, State Senator 31st District Category Wisconsin



The Legislature's Joint Audit Committee scheduled a public hearing on the Wisconsin Retirement System pension fund after recent audits revealed it's performance fell to 9th among ten comparable state pension plans.

MADISON - "GOOD NEWS" read the text with a short article about how our pension funds grew 8.5%. My friend forwarded the article with a cryptic note, "apparently the lies keep working."

In what seems to me to be an effort to get ahead of a bad story, the agency responsible for investing almost $100 billion in pension funds – the largest single pot of money anywhere in state government - issued a press release touting an 8.5% increase in its core fund.

As radio commentator Paul Harvey used to say, here's the rest of the story.

Yes, things are better in 2016. However, in 2015, the state pension funds lost money. An increase over a loss is good but not nearly as good as continual year-to-year growth. Especially when the fund is assumed to return over 7% a year!

Recently the nonpartisan Legislative Audit Bureau (LAB) released several audits related to the Wisconsin Retirement System (WRS). Among many findings, auditors reported 20-year returns fell from over 10% in 2006 to about 7% in 2015.

To understand how well Wisconsin is doing compared to other states, auditors contrasted performance in ten comparable state pension plans. Wisconsin's performance ranked 9th of ten states in nearly every measure. Wisconsin's core fund 5-year return was also considered 3rd most volatile of all of ten plans.

Wisconsin had a history of ranking well compared to other states. For example, in 2013, Wisconsin ranked 4th of nine states in 5-year returns.

The State of Wisconsin Investment Board (SWIB) oversees management of WRS and five other state insurance and trust funds. The governor appoints seven of the nine member board – 6 members directly and the governor-appointed secretary of administration.

In 2011, the governor and legislative majority gave SWIB authority to set its own budget and positions. No other state agency has this authority. Since 2011, the operating budget of SWIB grew by 78% and the number of positions grew by 48 or a 38% increase.

Some out-sourcing of fund management was brought back in-house. It is still unclear if this practice saved money.

Despite the fact the fund lost money in 2015, the board waived its own policy of not giving bonuses when the funds lost money. The board awarded bonuses of $1,100 to $468,300 to employees.

One of the reasons the funds lost money was poor performance in high-risk investments. Over the past few years, Wisconsin increased investment in risky financial devices like hedge funds and derivatives. These investments are among the speculative instruments that led to the financial crash in 2008.

Hedge funds, managed by an outside firm, cost the funds a staggering $57 million for a meager .6% return – about what you might get from a savings account. Auditors note that several other large public pensions eliminated the use of hedge fund investments.

Wisconsin also uses a risky strategy of borrowing to leverage assets. The use of debt to leverage assets lost money in all periods as of December 2015 including a negative 30% return in 2015. The leverage strategy contributed to the fund losses in 2015. Despite this, SWIB still has a goal of leveraging a staggering 20% of its funds.

Other audit findings raise questions about the structure and oversight the board provides the funds. Especially concerning is a finding that the board does not review final budget-to-actual expenses.

In addition, a recent audit of the Department of Employee Trust Funds, which manages the operations of the WRS, found a number of accounting errors, including mistakes in reporting over $90 million and bank reconciliations that were not done on a monthly basis for several months.

The state investment board oversees the retirement benefits of over 600,000 public employees and is now largely out from under legislative oversight. These recently released audits give us red flags about how things are going. Legislators have a responsibility to ask hard questions and insist on responses to protect the investments made by employees and retirees.

Tags: Untagged