MDCEP
MARYLAND CENTER ON ECONOMIC POLICY

MARCH 15, 2022

Greater Transparency Supports Effective, Ethical Management of State Pension Funds

Position Statement in support of House Bill 905

Given before the House Appropriations Committee

Transparency in all aspects of managing public funds is essential to ensure those funds are being used in the most effective and ethical manner possible. Maryland's state pension funds manage billions of dollars that ultimately provide the livelihood for thousands of former state employees. **The Maryland Center on Economic Policy supports House Bill 905** because it would create basic transparency standards for the fees the state pays to fund managers.

Today, while it is possible that the board overseeing the state pension funds has some idea of what it is paying the various asset managers making decisions about investing portions of the pension fund, the rest of us have no idea what those costs are. There is a general public interest in knowing how much of the fund is going to fees, both for the former state employees who rely on the pension fund and for the general public whose tax dollars will be used to shore up the fund if the return on its investments do not meet targets.

Portions of the state pension fund are managed by private equity managers, or "alternative asset managers," which often charge fairly high fees. Typical fees could include management fees, often in the range of 1.5-2% of assets under management, carried interest, a cut of investment profits that can reach as high as 20%, and portfolio company fees collected from the companies in which the fund manager invests.

A 2015 analysis by the Roosevelt Institute and the American Federation of Teachers found high fees and middling performance among public pension assets managed by hedge funds, one class of high-fee investment vehicle:[i]

- The 11 pension funds in the analysis paid an estimated $7.1 billion in fees to hedge fund managers over the life of their hedge fund investments; on average, each pension fund paid an estimated $81 million per year in fees to hedge fund managers.

- For every dollar of net returns to the pension fund, the average pension fund analyzed paid 57 cents in fees to hedge fund managers – compared with 5 cents in management fees per dollar of net return for a same-sized total fund portfolio.

- While hedge funds often claim they can help pension systems manage risk by delivering returns that are not closely tied to year-to-year swings in the boarder market, the analysis found little evidence to support this claim.

- The analysis noted that "measuring hedge fund fees was daunting" because "hedge funds simply do not disclose fees to investors" and researchers could find "no reliable source on hedge fund fees."

Furthermore, analyses by Morningstar and S&P Global found that high-fee actively managed investment funds did no better than the broader market in 2020 and 2021, a tumultuous period when cutting-edge investing methods theoretically should be able to deliver excess returns.[ii] The poor track record of high-fee investment vehicles underscores the need for transparency about whether Maryland retirees are getting their money's worth.

The basic fee disclosure requirements outlined in HB 905 are reasonable. Several other states already have similar disclosure requirements in place, including California, Pennsylvania and Missouri. Transparency is an essential core value when it comes to the use of public funds, and passing HB 905 would be another positive step towards increasing fiscal transparency and accountability in Maryland.

For these reasons, the Maryland Center on Economic Policy respectfully requests that the Appropriations Committee make a favorable report on House Bill 905.

Equity Impact Analysis: House Bill 905

Bill summary

House Bill 905 requires the Board of Trustees for the State Retirement and Pension System to require annual reports from each "alternative investment vehicle" in which the system invests to disclose the primary fees and other fees and expenses related to managing pension funds. The required information includes management fees as well as profit sharing and carried interest that the investment vehicle pays to fund managers. It also requires the State Retirement Agency to publicly report the information gathered during the disclosure process.

Equity Implications

- The investment fund industry is largely dominated by white men. One report estimated that that of the $71 trillion in assets under management, just 1.3% is managed by firms owned by women or people of color, inclusive of Latinx, Black, Asian, American Indian, and other people of color[iii]. This in turn perpetuates a cycle of underinvestment in historically marginalized communities due to race and ethnicity.
- Marylanders of color disproportionately work in public sector jobs, which generally provide family-supporting wages and have stronger, longstanding anti-discrimination protections than many private sector employers.
- To the extent that the fees paid to private equity funds and the performance of those funds affect the need for additional contributions to the pension fund, it could affect the state's ability to invest in the things Maryland communities need to thrive.

Impact

House Bill 905 would likely **improve racial and economic equity** in Maryland.

---

[i] Elizabeth Parisian and Saqib Bhatti, "All that Glitters Is not Gold: An Analysis of US Public Pension Investments in Hedge Funds," Hedge Clippers, 2015, https://hedgeclippers.org/wp-content/uploads/2015/11/AllThatGlittersIsNotGold-2.pdf

[ii] Bob Pisani, "In One of the Most Volatile Markets in Decades, Active Fund Managers Underperformed Again," *CNBC*, November 1, 2021, https://www.cnbc.com/2021/11/01/in-one-of-the-most-volatile-markets-in-decades-active-fund-managers-underperformed-again.html

[iii] "Shifting Power by Addressing Racial Bias and Ensuring Equitable Representation and Decision-Making," Global Impact Investing Network. https://navigatingimpact.thegiin.org/strategy/re/shifting-power-by-addressing-racial-bias-and-ensuring-equitable-representation-and-decision-making/