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PRUDENCY IS IN THE EYE OF THE BEHOLDER:
California Public Pension Fund Investments

by Teresa Ghilarducci

In the last few controversial weeks of the Brown Administration a report on the investments of some of the largest California pension funds was released, virtually without notice. Entitled *Investments of California Public-Sector Pension Funds, Dec. 1982*, the report contains a lot of unique data, which is graphically summarized, and no editorial comment. But the data itself implies that neither "prudency" nor any other consistent principle guides the investment of $100 billion by the managers of California's 24 largest public sector pension plans.

The lack of editorial comment or analysis might frustrate some readers of this useful report. But the investment data which is summarized raises important questions about the meaning of responsible, beneficial, and prudent investments. So much variance in investment strategy is tolerated that the guiding principle appears to be -- ANYTHING GOES.

Variations in Investment Patterns. The only identifiable trend in the investment of California's public pension funds is enormous variation in the combinations of the same stew--Fortune 500 stocks and bonds, a little housing, foreign debt, and cash. Real estate, venture capital debt, and most shocking of all, state and local bonds, are generally not bought with any of the $100 billion of public employee money in the 24 largest California plans.

Almost 50% of the San Mateo County fund is in housing and housing-related investments, but San Joaquin has none. All 24 funds together hold more foreign government and international agency debt than U.S. state and local bond debt. Only four funds have any real estate holdings, and only Los Angeles County has more than 2% of its fund in real estate. The University of California has over 70% of its fund in common stock, and is the only fund (of those who can so invest) with over 25% of its assets in corporate short term debt.

No Performance Index--Just Prudent Men. The report does not compare rates of return earned by the funds--an ommission this reader finds refreshing, since the rate of return represents the most abused data in the pension field. However, there is a desperate need for an index to rank these funds for the security and profit which is secured by the managers for the benefit of the plan's members.

The prevailing criterion defining "appropriate" investments embodies a common law principle called "the prudent man." A manager should act in the sole interest of promoting the current and future economic security of the beneficiaries and the participants. The fund should be diversified and its investments should involve no conflict of interest. Nothing in the legal literature specifies that the "rate of return" is a major criterion to judge performance. Yet debate on pension fund investments generally compares the returns of one fund to those of other funds, or to the Standard and Poor's rate, or to changes in the consumer price index, or to some other index. None of these comparisons can track a fund's success in securing a steady stream of pension income now and in the future.

While current law does not provide definite criteria to judge the performance of a fund, a major challenge exists to construct such an index. The recent summary and report on investments of 24 major public sector funds in California represents the first time the necessary data is available to do just that.

Pension Investments and Pension Benefits. Any agenda for pension investment reform must include a plan for benefits. All public employees should know that they have accepted major cuts in benefit promises, and that investment funds of the PERS (Public Employee Retirement System) are now a tempting target for a state short of revenue. Multi-tiers of PERS, and the "borrowing" of PERS and STRS (State Teachers Retirement System) funds by the state have been widely discussed for what they are: attacks on public sector pensions. Efforts to shore up pension benefits by workers may have to expand into unconventional and creative areas--such as pension investment reform.

AFSCME (American Federation of State, County and Municipal Employees) Council 4, representing Connecticut state employees won a voice in the management of their pension funds in the summer of 1982. They cited their legitimacy as a consistent apolitical influence, concerned only with "the long run well-being of the fund." They intend to seek socially responsible investments. Unions in Wisconsin, Minnesota, and California have also given meaning to that often sung and rarely explained refrain: "socially responsible investments." They have commissioned studies to look at funding for state and local development agencies, mortgage capital, and venture capital.

In addition to the distribution of assets, the report on *Investments of California Public-Sector Pension Funds* lists the total portion of short and long term debt of over 1000 corporations, owned by these 24 California funds. For example, 26.5% of the long term debt in St. Louis County Water Co., and almost 12% of the long term debt of Bank of America is held by the 24 funds. The funds involved are those of the counties of Alameda, Contra Costa, Fresno, Kern, Los Angeles, Orange, Sacramento, San Bernardino, San Joaquin, San Diego, San Mateo, and Ventura; the cities of Los Angeles, Sacramento, San Diego, and San Jose; the city and county of San Francisco; and state PERS, STRS, and UCRS funds; and the following special district funds: Los Angeles City Fire and Police, Los Angeles City Water and Power; San Jose Fire and Police; and Southern California Rapid Transit District.

The data on the investments of these funds, as summarized in the reference report, should interest anyone involved with California labor and economic development. Nationally, the report can serve as a guide to any effort to change conventional investment practices, by describing existing variations in the narrow range of current investment patterns.

–Teresa Ghilarducci

Reference: *Investments of California Public-Sector Pension Funds, Dec. 1982*, available at Institute of Industrial Relations, U.C. Berkeley, Berkeley 94720; $20 for organizations and $10 for individuals; make checks payable to Regents of the University of California.