MSRA responds to MPPI's latest commentary

By

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A careful reading of recent commentary by the Maryland Public Policy Institute (MPPI) about the Maryland State Retirement and Pension System (MSPRS), coupled with actual knowledge of public pension plans, would reveal once again the think tank's inability to be straight with its readers. The blog piece, "The MSRPS Misses its Benchmark and Lowers Discount Rate" is incomplete and misleading, including only data that supports its agenda of undermining the public's trust in the retirement security of public plan participants and beneficiaries.

While the MPPI article highlights the one- and five-year returns as falling short of the Systems 7.45% earnings target, it neglects to include the more important longer term performance: the average return, net of all manager fees, over the last ten years has been 8.61! The "think tank" also conveniently fails to incorporate the System's three-year average return of 8.17% in its analysis, as this, too would not support its narrative. Moreover, in comparing the median return for a peer group relative to the System's one-year return, MPPI uses a higher gross of fee return for the peer group while applying a lower, net of fee return for the System. Definitely not an apples-to-apples comparison.

While MPPI likes to criticize the System's returns and asset allocation, the critical concept of risk is never part of their analysis. Their solution is to invest 100% of the fund in just two asset classes: U.S. stocks and U.S. Bonds, based mainly on the recent performance of each. This concentrated allocation results in a much riskier portfolio than the System's more diversified and balanced approach. The System's Board of Trustees has a fiduciary obligation to invest System assets in a prudent and well-diversified manner to minimize investment risk and contribution volatility. As a mature pension plan, and as is expected for any mature plan, the System pays out in benefits more than it receives in contributions. Due to this negative cash flow position, the System is very sensitive to return volatility, in that periods of low returns make recovery more difficult. This sensitivity can be demonstrated by the impact low returns had on the System's financial position during the period of 2000-2010, when the System employed an asset allocation similar to that recommended by MPPI and the funding ratio fell from 101% to 64%.

In recognition of the importance of the risk management function in the investment process, the System has adjusted the asset allocation to provide a more stable and consistent return pattern. With input from a professional investment staff and expert third party consultants, the Board has incorporated a variety of risk metrics to arrive at the current asset allocation. As validation for the soundness of the Board's decisions, three separate investment consulting firms have supported the System's asset allocation over the last six years. The System's asset allocation is also consistent with life cycle fund options offered in defined contribution plans like 401(k)s. Similar to the System's allocation, these products include exposure to most investment strategies to achieve diversification and risk objectives, as opposed to the two asset classes suggested by MPPI. The changes adopted by the Board have produced the desired positive effects on the portfolio, as the System's risk-adjusted returns rank near the top quartile in appropriate peer universes.

The Board, using data compiled by the System's actuary and return assumptions from several sources, recently lowered the assumed rate of return to 7.4%. MPPI argues that the discount rate should be lower because the one-year return of the System was 6.46, choosing to ignore again the more meaningful ten-year average return of 8.61%. Surprisingly, MPPI acknowledges that the median return assumption for pension funds is 7.3%, confirming that the System's target is consistent with our peers.

The System would like to assure plan participants and state taxpayers that the assets of the fund are being managed in a professional, prudent and diversified manner. The plan enhancements that were enacted in 2011, coupled with strong investment returns over the last ten years, have resulted the System's funded status steadily improving ahead of expectations. While a foreign and unaddressed concept to MPPI, risk management is at the core of the System's mission. This commitment to best practices and standards in the management of plan assets is foundational for ensuring that the System achieves its long-term risk-adjusted return objectives.

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