

Should Public Pension Plans Go Toxic?

Pension managers with huge recent losses are looking at Uncle Sam's PPIP plan to sell off troubled bank assets. Golden opportunity or bad idea?

By [Nanette Byrnes](#)

Over the past 18 months, the investments of public pension plans—the retirement security for thousands of police officers, firefighters, and teachers—have lost a combined \$1.3 trillion. But now some fund managers think they may have hit gold: the government's programs to clean up toxic assets.

On Apr. 3, a group of public pension fund managers met with Sheila C. Bair, chairman of the [Federal Deposit Insurance Corp.](#), to talk about the toxic assets burdening large banks. The FDIC, along with the U.S. Treasury, is looking for investors to [buy up those troubled assets](#) in a program called the [Public-Private Investment Program for Legacy Assets](#) (PPIP). At the table with Bair were representatives of several large local funds, including the New York City pension plan, the Connecticut plan, and New Jersey's pension plan. Representatives from at least a half-dozen other big plans from California to Florida joined in by telephone.

"We had more people than could fit into the room interested," says Orin Kramer, chairman of the New Jersey State Investment Council and general partner in hedge fund [Kramer Spelman](#), who helped organize the meeting. The federal government has come under criticism for structuring the deals in a way that leaves taxpayers with much of the risk while offering a handsome upside to private equity and hedge funds. But if taxpayer-funded public pension funds are investing alongside the hedge funds and reaping the upside as well, Kramer argues, the programs become less controversial.

But should public pensions, which are backed by taxpayers, be dabbling in these toxic assets? Kramer acknowledges the risk. "Look, if you own anything other than short term T-bills, it's always possible to lose money," he says. "That's true if you're buying art or stock or corporate bonds or anything else." Alicia H. Munnell, director of the Center for Retirement Research at [Boston College](#), notes that the largest public pension plans have sophisticated managers, but "you do need financial savvy to stick your toe in this pond. People should think carefully about whether they have it before they do this."

Public Pensions Lost \$1.3 Trillion

Like everyone else in America, the managers of the country's public pension plans are in a budget squeeze. According to one estimate by the Center for Retirement Research, public funds lost \$1.3 trillion in assets since the market peaked in October 2007. And while assets have been falling, obligations are rising. A recent study of 59 state pension

plans by [Wilshire Associates](#) found that their collective assets shrunk sharply in 2008 while their obligations rose. The result: a \$237 billion shortfall for just those 59 funds.

The options for filling that gap come in varying unappealing degrees: Cut benefits to future public servants such as police officers and school teachers, raise taxes, or search for some way to get more out of your investments. In recent years, public pension plans greatly increased their exposure to equity markets, from roughly 55% of plan assets in 1994 to about 70% today, according to the Center for Retirement Research.

Trent May, chief investment officer of the \$4.4 billion [Wyoming Retirement System](#), is a former hedge fund manager who took the job in March, after the fund lost almost \$2 billion in just over a year. Filling that hole for a system with 19,000 retirees won't be easy. May, who was plugged in by phone during the Bair meeting, is also actively looking at investing in the Term Asset-Backed Securities Loan Facility, or TALF, created by the Federal Reserve Board in November to support investing in asset-backed securities and small-business loans. May says estimated returns on TALF funds of between 15% and 20% are extra enticing because they come with a government guarantee: "If this is successful, not only do we reap returns on the TALF investments, but if it gets the economy moving, that would be good for our other investments, too."

PPIP: "Very Early in the Process"

May has been listening to pitches from fixed-income managers such as [Pimco](#) and Alliance Bernstein ([AB](#)), which are putting together deals of 3½ years in length. These firms would assess, choose, and manage the TALF assets—collecting payments on them while investors such as the public funds would get a cut of the upside for having loaned capital for the initial purchase. May says he can minimize his risk by not putting too high a stake into these assets and by sticking to AAA-rated investments, a grading he expects credit rating agencies are now tougher about doling out than they once were.

But the program Bair discussed Apr. 3, the Public-Private Investment Program, is not nearly so far advanced. Sherry Reser, a spokeswoman for [CalSTRS](#), California's \$114 billion teacher's pension fund, confirmed that her fund's staff was in on the call, but described the meeting as "very exploratory." CalSTRS is now moving 5% of its total portfolio from equities to private equity, real estate, and fixed income, with the goal of finding and investing in solid assets from distressed sellers. "The PPIP may certainly meet our criteria," Reser says. But it's "very early in the process. We're definitely in a wait-and-see mode. We think we're uniquely positioned. We have staff geared up, a process in place, and we are ready to take advantage of the opportunities that do come up in these troubled times."

To guard against going too far out on a limb, CalSTRS' upper-level investment staff has put in place a system called the Devil's Advocate, in which one staffer tears any prospective investment apart, posing hard questions. "Because of these potentially toxic assets," says Reser, "we want to make sure the only distress is the sellers'."

With Christopher Palmeri in Los Angeles.
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