State Pensions Wasted $6 Billion on Wall Street Fees: Study

Active management not worth the expense, Maryland Tax Education Foundation says

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State pension systems, which represent the retirement security of millions of American public workers, spent some $7.8 billion in management fees in 2011, according to a new study by the Maryland Tax Education Foundation.

Yet, evidence is lacking that active management provided public pensions higher investment returns, according to the study.

It noted that 84% of actively managed U.S. equity funds underperformed their benchmarks during 2011, citing S&P Indices and Morningstar.

The report said the vast majority of U.S. public pension systems contract with Wall Street firms to select the publicly traded stocks and bonds that make up the bulk of their investment portfolios.

“The firms’ typical ‘sales pitch’ to a pension fund is that the Wall Street firm can ‘outperform’ a given section of the stock or bond market; therefore, the pension fund should pay the Wall Street firm a fee for the firm's stock (or bond) picking prowess.”

The foundation reviewed comprehensive annual reports for statewide retirement systems in all 50 states in order to determine the ratio of state pension system fees paid to Wall Street to their net assets.

The U.S. average was 0.409, and the median was 0.359. The states with the highest fee ratios were the following:

Missouri—1.385; Pennsylvania—1.117; Hawaii—0.742; Oregon—0.705; Maryland—0.693;

The report said many states indexed only a small portion of their portfolios to public indexes. Extending this practice to 80% or 90% of their portfolios would provide annual savings in excess of $6 billion, it said.