STATE AND LOCAL GOVERNMENT PENSION PLANS

Governance Practices and Long-Term Investment Strategies Have Evolved Gradually as Plans Take On Increased Investment Risk

What GAO Found

A variety of stakeholders, such as boards of trustees and external consultants and managers, are involved in guiding plan investments. Plan officials generally expressed a commitment to policies or principles cited by many experts as key to sound governance, such as enhancing the knowledge and skills of plan fiduciaries and increasing organizational transparency.

State and local plans reported gradually changing their asset portfolios over many years by increasing their allocations in higher risk investments partly in pursuit of higher returns but also for diversification following well-accepted techniques of portfolio management given their long investment horizon. Indeed, currently about two thirds of public pension funds are invested in such higher risk assets. Plan officials stated they are focused on the long term and generally reported they had not made any major changes to their investment strategies in response to the market downturn, in which they lost nearly a quarter of their asset value from June to December 2008. Despite these losses, plans have reported having sufficient assets to cover years of benefit payments. Still, according to our survey, an estimated 60 percent of large and medium plans anticipate changes to their investment strategies in response to the current economic environment.

Plans have devised various approaches to attempt to address governance, investment, and funding challenges. These include pooling assets to pursue lower fees and higher quality managers, consolidating the governance structures of multiple plans to improve accountability and transparency, and issuing pension obligation bonds to overcome funding shortfalls. While some of these approaches predate the market downturn, their impact on plan health remains to be seen. Still, efforts at increasing disclosure may be helping plan stakeholders understand the considerable challenges they face.

What GAO Recommends

GAO is not making recommendations in this report. We incorporated technical comments from the Departments of Labor and Treasury and the Securities and Exchange Commission as appropriate and received clarifications from select outside experts and plan officials.

View GAO-10-754 or key components. For more information, contact Barbara Bovbjerg at (202)512-7215 or bovbjergb@gao.gov.