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Public School Employees’ Retirement System (PSERS)

Over the last few months, a number of false claims have been made about PSERS (Pennsylvania’s $56 billion Public School Employees’ Retirement System). Namely, that PSERS has wasted assets and hidden fees.

In testimony we gave last week to the Public Pension Management and Asset Investment Review Commission, which was established by 2017 legislation to review the investment strategy, operations, and costs of PSERS, we had the opportunity to address the most inaccurate and troubling claims noted below.

1. **PSERS does not waste System assets.** The specific assertion is that PSERS “wasted” $3.9 billion in fees to Wall Street managers. The truth is that PSERS engages and compensates money managers in areas where we can’t internally manage the investment and only after extensive due diligence. We carefully track the manager’s performance to make sure we are getting value for these fees, and we report asset class and manager performance to our Trustees. While not every investment is productive—and we frequently terminate underperforming managers—the value of these external managers fully justifies the fees paid. Over the past 20 fiscal years, PSERS generated $10 billion in excess performance, net of fees, above a global 60/40 passive portfolio. PSERS net investment income would have been only $52 billion if we had followed this passive index portfolio instead of $62 billion.

2. **PSERS does not hide fees.** PSERS has long been a leader in fee transparency. While the Government Accounting Standards Board (GASB) only requires the reporting of “readily separable fees,” PSERS has gone above and beyond the reporting requirements of the GASB, releasing both “readily separable fees” as well as “not readily separable fees.” PSERS discloses them annually in our Comprehensive Annual Financial Report, budget requests to the General Assembly, and annual presentations to the Board of Trustees. At PSERS we pay strict adherence to reporting standards and take great pride in having been recognized for 35 straight years for excellence in public financial reporting. PSERS higher level of reporting has led to criticism of PSERS since our reported fees look higher than many peers who have chosen not to capture and report “not readily separable fees.” In fact, we are actually criticized because we report fees that other funds cover in footnotes or do not report at all.

Not only are we not wasting assets or hiding fees, we are proactively looking for ways to reduce fees in ways that will enhance net-of-fee performance without taking undue investment risk. To that end, PSERS Investment Professionals proposed a two-pronged plan of action to generate fee savings: renegotiate all management fee arrangements to create a better alignment of interest between PSERS and each investment manager and expand PSERS internal asset management to bring additional assets in-house at a much lower cost than external management.
This plan was developed in response to a resolution passed by PSERS Board in December 2017 and was adopted in August 2018. The plan will result in $2.4 billion in cumulative savings compounded over 30 years, or a 9.6% annual reduction in base management fees.

The adopted fee savings plan is by no means an end to PSERS efforts to reduce management fees. Since the plan was approved, we have already identified over $350 million in additional cumulative base fee savings compounded over 30 years. The projected fee savings have now increased to $2.8 billion, or a 10.4% annual reduction in base management fees.

PSERS is a large, complex system in a rapidly changing investment industry, where new products and strategies emerge regularly. Policy makers would be wise not to tie the hands of our Trustees and Investment Office to participate and lead in this changing investment environment. There are real costs associated with regulation. In the private sector, the cost of regulation is reflected in higher product costs. In a public pension fund regulatory costs are reflected in the employer contribution rate. Taking any actions that restrict our investment opportunities will inevitably increase employer contributions paid by our school districts and the Commonwealth and unnecessarily burden the taxpayers of the Commonwealth with the resulting increased pension costs.