

Relatively large employee contributions, usually credited to an "annuity" fund as distinguished from the "pension" fund, become almost like a savings account, which the employee usually can withdraw upon termination of employment and often can borrow against. In conventional accounting terms, this fund from employee contributions prior to retirement has some characteristics of a deposit-type liability. A stable rate of interest is paid upon it and some withdrawals are inevitable.

Furthermore, a number of systems are not being funded on an actuarial basis by adequate contributions from the units of Government. The claims or equity of employees may in fact be a large proportion of the total assets on hand. In the two Massachusetts State funds, for example, benefits and withdrawals represented 58 percent of contributions. The locally administered systems in Illinois show a ratio of 60 percent. In such cases, it is not surprising to find bond investments constituting practically all of the systems' portfolios.

Typically, there is no provision for dealing with capital gains and losses except to include them in the current year's "earnings." The "lock-in effect" is powerful after a long period of rising interest rates. Similarly, there are no systematic provisions in general use for recognizing more than current dividends from a portfolio of common stocks. Their purchase may tend to depress the important rate of return on employee contributions. This writer's argument for shifting to a market-value basis for valuation, rate of return, and performance measurement (or in the alternative to the use of capital gain and loss reserve accounts) has received little or no acceptance among retirement system administrators.⁷

More imaginative investment policies are inhibited by a number of other factors. Retirement system trustees are not chosen just for their knowledge of and experience with investments. They have other important duties to perform as well. The practice of seeking to secure competent investment advice by competitive bidding, the inability to pay adequate salaries for expert staff, and the apparent unwillingness to lay out even very modest sums for investment management are all factors conspiring to produce uninspired and mediocre portfolio management. Despite the great progress of recent years, few systems have adequate staffs, strong investment advisory arrangements, effective finance committees, and the capability of providing first-rate management. These former sleeping giants of the pension-fund field sometimes appear to be only partially awake.

Under the circumstances, it is doubtful that State and local retirement systems will soon break out of the statutory, accounting, and institutional restraints on their effective management of huge aggregations of capital. While the high cost of pension benefits will create increasing pressure to improve rates of return, it is not likely that the public systems will greatly accelerate the pace at which they follow private funds. Nor is it likely that they will be as flexible in approaching investment opportunities as they occur in the future of a dynamic capital market structure.

⁷ See "Rates of Return: Standardizing Measurement," a paper presented at the Second Annual Conference for Public Pension Fund Administrators at New York University on Apr. 29, 1966. Reprinted in *Commercial & Financial Chronicle*, May 26, 1966.