The Personnel Is Political: Restoring Trust in Pension Fund Trustees

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Public retirement systems across the United States face looming fiscal shortfalls, forcing state and local policymakers to grapple with the budgetary challenges emerging from years of underinvestment and neglect. A significant source of neglect in the administration of public retirement systems arises from the poor quality of governance provided by trustees, many of whom need more experience and better incentives to properly manage significant financial institutions like public pension funds. The politicization of public retirement contributes to ongoing governance issues, especially given the ongoing debate over ESG investment strategies—although the problem extends far beyond ESG and implicates how overreliance on politically appointed trustees has contributed to the existing financial challenges facing many significant pension funds. Given the considerable body of scholarship that addresses the broader issue of public pension governance, this Note aims to revitalize the discussion by emphasizing the centrality of the trustee selection process to the public retirement crisis, observing case studies of proper and improper pension governance, and using those case studies to inform realistic policy recommendations. While the scale and scope of the public retirement crisis suggest a need for comprehensive reform, limited public pressure and the prevalence of entrenched interests make such an approach unviable. Thus, this Note recommends that policymakers adopt a more piecemeal approach to reform by introducing economic incentives such as market-level compensation and greater liability exposure into the existing framework, thereby addressing both issues of board quality and pension (mis)governance.

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Introduction

The Dallas Police and Fire Pension Fund (Dallas Fund) has notably made headlines as city officials have struggled to stabilize the fund amid a $3 billion shortfall.[1] The Dallas Fund has been operating in crisis mode since 2016 due to a toxic combination of poor investments, overly optimistic forecasting, and poor governance from its board of trustees.[2] To make matters worse, this pension crisis is occurring while the local police and firefighter departments face staffing shortages.[3] The city government now faces the

1. *E.g.*, Bethany Erickson, *Dallas Vows to Solve Its $4 Billion Pension Shortfall—But How?*, D MAG. (Jan. 30, 2024, 10:35 AM), https://www.dmagazine.com/frontburner/2024/01/dallas-vows-to-solve-its-4-billion-pension-shortfall-but-how/ [https://perma.cc/SB2Y-6GE7].

2. *See id.* (explaining the challenges facing the Dallas Fund, which "nearly collapsed in 2016" and has been struggling with solvency ever since); *see also* Brandon Formby, *Texas Rangers Launch Criminal Probe into Dallas' Pension Shortfall*, TEX. TRIB. (Dec. 30, 2016, 12:00 PM), https://www.texastribune.org/2016/12/30/texas-rangers-launch-criminal-probe-dallas-pension/ [https://perma.cc/L2ZV-LCGQ] (explaining that the Texas Department of Public Safety launched a criminal investigation into the Dallas Fund's shortfall).

3. *See* Alex Magg, *Dallas Pension Fund Crisis Reaches Breaking Point*, PATCH (Aug. 18, 2023, 8:27 AM), https://patch.com/texas/dallas-ftworth/dallas-pension-fund-crisis-reaches-breaking-

difficult decision of either recapitalizing the pension fund or reinvesting in its public services.

Unfortunately, the problems bedeviling the Dallas Fund are by no means unique to Dallas. Public-sector pension plans across the country face similar financial challenges, forcing state and local lawmakers to grapple with the fiscal challenges emerging from burgeoning benefit obligations and inadequate revenues.[4] In 2023, the RAND Corporation, a major policy think tank, issued a report lamenting the deplorable state of public-sector retirement in the United States, observing that state and local pension funds face a collective shortfall in unfunded liabilities[5] amounting to at least $1.5 trillion as well as projected deficits for the foreseeable future.[6] Several factors have contributed to this challenging fiscal situation—namely, questionable investment strategies, overly optimistic economic forecasts, and political pressure to overpay benefits and underinvest in contributions.[7] A significant source of dysfunction in the administration of these public-sector pension

point [https://perma.cc/2C4P-SEV2] (highlighting how "city officials are advocating for increased recruitment" of police and firefighters during the crisis).

4. *See* PEW CHARITABLE TRS., PUBLIC RETIREMENT SYSTEMS NEED SUSTAINABLE POLICIES TO NAVIGATE VOLATILE FINANCIAL MARKETS 5 (2023), https://www.pewtrusts.org/-/media/assets/2023/11/public-retirement-systems-need-sustainable-policies_v5.pdf [https://perma.cc/8LQC-SFPG] (finding that twenty-one states in 2021 faced expenditures greater than existing revenues); *see also* John Reitmeyer, *NJ, Other States Get Noticed for Public-Worker Pension Fund Progress*, NJ SPOTLIGHT NEWS (Nov. 10, 2023), https://www.njspotlightnews.org/2023/11/nj-makes-public-worker-pension-fund-progress-report-says-but-has-not-enacted-some-good-policies-other-states-use/ [https://perma.cc/Z9H8-T8S5] (observing how New Jersey "will take decades" to achieve pension solvency); Hadriana Lowenkron & Steven Church, *Crippled by Pension Debt, Pennsylvania City Seeks Bankruptcy*, BLOOMBERG (Nov. 10, 2022, 3:41 PM), https://www.bloomberg.com/news/articles/2022-11-10/crippled-by-pension-debts-city-near-philadelphia-goes-bankrupt [perma.cc/LGR4-93MN] (describing how pension debt drove the city of Chester, Pennsylvania, into bankruptcy).

5. Unfunded liabilities indicate that "states have set aside less than is needed to cover the expected full costs" of the promised benefits. Joanna Biernacka-Lievestro & Joe Fleming, *States' Unfunded Pension Liabilities Persist as Major Long-Term Challenge*, PEW CHARITABLE TRS. (July 7, 2022), https://www.pewtrusts.org/en/research-and-analysis/articles/2022/07/07/states-unfunded-pension-liabilities-persist-as-major-long-term-challenge [perma.cc/C7UJ-P86T].

6. DAVID KNAPP, BETH J. ASCH, PHILIP ARMOUR & ZHAN OKUDA-LIM, RAND CORP., CAUSES AND CONSEQUENCES OF THE CRISES IN STATE AND LOCAL PENSION FUNDING 1–2 (2023).

7. *See* Merrill Matthews, *The Next Financial Hammer to Fall: Public Pension Funds*, HILL (June 28, 2022, 4:00 PM), https://thehill.com/opinion/finance/3539537-the-next-financial-hammer-to-fall-public-pension-funds/ [https://perma.cc/YF8U-UXAT] (describing how public pension funds, under pressure from government employee unions, are turning to the risky strategy of using leveraged funds when "no one knows" if the market will rebound); *see also* Dion Rabouin & Heather Gillers, *Pension Funds Plunge into Riskier Bets—Just as Markets Are Struggling*, WALL ST. J. (June 26, 2022, 4:11 PM), https://www.wsj.com/articles/pension-funds-plunge-into-riskier-betsjust-as-markets-are-struggling-11656274270 [https://perma.cc/3JEZ-G6DV] (describing how some pension fund managers are looking to risky investment practices, such as investing borrowed money, for higher returns).

funds—particularly those structured around defined-benefit (DB) plans[8]—is the poor quality of governance provided by pension trustees.[9] These bodies are primarily staffed with political appointees, many of whom lack the necessary experience to manage complex financial institutions.[10] The politicization of public retirement has become especially relevant given the debate over ESG investments,[11] although the problem is much broader and implicates the very structure of these pension trustee boards.[12]

Unsurprisingly, the overly politicized nature of the trustee selection process provides a major source of pension misgovernance: Many trustees at state and local pension funds are appointed by local politicians. Public pension funds should be governed to serve the interests of current and future beneficiaries, and crucial decisions should be made to maximize value for beneficiaries in the form of greater investment yields and long-term risk management.[13] Unfortunately, the proximity between politicians and the trustee selection process increases the likelihood that trustees will deviate from this approach of fully funding existing obligations to beneficiaries,

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8. "Defined-benefit" retirement plans offer fixed, preset benefits for employees upon retirement, as opposed to "defined-contribution" plans, where future payouts depend on how much employees and employers contribute to the plan. *Retirement Plans Definitions*, INTERNAL REVENUE SERV. (Aug. 1, 2024), https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-plans-definitions [https://perma.cc/WMH5-F9XH].

9. *See* Neil Weinberg, *Investing Novices Are Calling the Shots for $4 Trillion at US Pensions*, BLOOMBERG (Jan. 3, 2023, 6:00 PM), https://www.bloomberg.com/news/features/2023-01-04/us-public-pension-plans-run-by-investing-novices-are-on-the-edge-of-a-crisis [https://perma.cc/3JEZ-G6DV] (highlighting the connection between underqualified trustees and underperformance).

10. *See id.* (describing how public pension board members are "selected more for group ties than financial expertise").

11. "Environmental, social, and governance" (ESG) investing prioritizes investments based on a company's stated commitment to preexisting social factors such as environmental concerns, social welfare, or internal governance policies. *Environmental, Social and Governance (ESG) Funds—Investor Bulletin*, U.S. SEC. & EXCH. COMM'N (Feb. 26, 2021), https://www.sec.gov/resources-for-investors/investor-alerts-bulletins/environmental-social-governance-esg-funds-investor-bulletin [https://perma.cc/VHF3-DRE5].

12. *See* Leah Malone, Emily Holland & Carolyn Houston, *ESG Battlegrounds: How the States Are Shaping the Regulatory Landscape in the U.S.*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 11, 2023), https://corpgov.law.harvard.edu/2023/03/11/esg-battlegrounds-how-the-states-are-shaping-the-regulatory-landscape-in-the-u-s/ [perma.cc/NZM5-FUF8] (discussing the political divide between red and blue states regarding ESG-focused investing); Joshua Lichtenstein, Michael Littenberg & Reagan Haas, *ESG and Public Pension Investing in 2023: A Year-To-Date Recap and Analysis*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 22, 2023), https://corpgov.law.harvard.edu/2023/11/22/esg-and-public-pension-investing-in-2023-a-year-to-date-recap-and-analysis/ [perma.cc/45FJ-3SDU] (noting complications asset managers may face due to trends in ESG legislation).

13. *See* KNAPP ET AL., *supra* note 6, at 62–63 (outlining goals of public pension reform).

thereby resulting in poor governance and systemic underperformance relative to other comparable institutional investors.[14]

Scholars have recognized the problems inherent in pension governance, relating to both the trustee selection process and the decisions those trustees make once appointed to the board.[15] Various solutions have been touted to address these issues of pension misgovernance, from imposing stricter eligibility requirements for trusteeship[16] and reducing the influence of political appointees[17] to revising the fiduciary relationship between board members and pension beneficiaries.[18] This Note attempts to further this scholarship by highlighting the relationship between the trustee selection process and overall fund performance. Moreover, this Note identifies recent cases concerning proper and improper pension governance and uses those case studies to propose concrete policy solutions addressing the twin problems of board quality and malign fiduciary incentives.

This Note contends that the trustee selection process in significant public-sector pension funds is insufficiently insulated from political influences and contributes to the ongoing crisis in public-sector retirement. Reforms should be undertaken with an eye toward shielding trustees from political influence and realigning their interests with those of their current and future beneficiaries. For brevity's sake, the scope of this analysis will be restricted to state and local pension funds with DB-only plans. It will focus primarily on the governance issues generated by the political appointment of pension trustees. The Note proceeds as follows: Part I will briefly review the political appointment process and the governance issues that emerge from it. Part II will sketch out three potential reforms to the trustee selection process: (A) revamping the trustee selection process, (B) strengthening credential and professional experience requirements, and (C) introducing economic

14. *See id.* at 62 (explaining how interests in politician-led pension boards may conflict with the need to implement policies ensuring that contributions will fully fund existing obligations).

15. *See, e.g.*, *id.* at 39–40, 45–46 (examining problems in public pension governance, such as conflicts of interest, arising from the political makeup of pension boards); Gordon L. Clark & Roger Urwin, *Best-Practice Pension Fund Governance*, 9 J. ASSET MGMT. 2, 6–8 (2008) (discussing various governance problems faced by pension funds).

16. *See, e.g.*, Jeffrey Carmichael & Robert Palacios, *A Framework for Public Pension Fund Management*, *in* PUBLIC PENSION FUND MANAGEMENT 1, 11 (Alberto R. Musalem & Robert J. Palacios eds., 2004) (explaining that the practice of appointing representative trustees is unlikely to ensure good pension governance and suggesting instead that trustees pass a "fit-and-proper test" requiring relevant skills and no criminal record).

17. *See* David Hess, *Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices*, 39 U.C. DAVIS L. REV. 187, 216–17 (2005) (recommending the inclusion of member-elected trustees on pension boards because they are "independent of political influence" and improve funds' financial performance).

18. *See* Steven L. Willborn, *Public Pensions and the Uniform Management of Public Employee Retirement Systems Act*, 51 RUTGERS L. REV. 141, 143, 160–61 (1998) (analyzing the Uniform Management of Public Employee Retirement Systems Act, which proposed tougher fiduciary liability exposure as an incentive for trustees to make prudent investment decisions).

incentives to encourage good governance. Part III will then examine the advantages and disadvantages of each proposal. This Note highlights the importance of the trustee selection process in shaping pension governance incentives and overall performance.

I. The Problem with Public-Sector Pension Funds

There are approximately 5,300 public-sector pension funds for state and local employees in the United States, with roughly 12 million active beneficiaries and 14.9 million currently employed participants.[19] These 5,300 pension funds control a sizeable share of the nation's wealth: The total value of assets under management was approximately $6.25 trillion as of Q3 2024.[20] Unfortunately, these institutions are drastically undercapitalized and face significant fiscal shortfalls. Many estimates project that the total value of unfunded liabilities is roughly $1.6 trillion, though estimates vary depending on the financial assumptions used—more pessimistic models estimate shortfalls as high as $5.1 trillion.[21] This undercapitalization poses a considerable financial burden on state and local governments and redirects resources away from other vital areas such as education, infrastructure, and public health.

The Dallas Fund provides a case study in pension fund mismanagement. In 2023, the Dallas Fund bore nearly $3 billion in unfunded liabilities, translating to a funding ratio[22] of approximately 34%[23]—less than half the national average.[24] This massive debt burden can be attributed largely to poorly chosen investments and chronic misgovernance.[25] The fund's portfolio was heavily concentrated in risky and illiquid ventures, including

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19. *National Data*, PUB. PLANS DATA (July 31, 2024), https://publicplansdata.org/quick-facts/national/ [perma.cc/WJE8-9STV].

20. *Public Pension Assets*, NAT'L ASS'N OF STATE RET. ADM'RS, https://www.nasra.org/content.asp?admin=Y&contentid=200 [https://perma.cc/AKC7-LV5Y].

21. *E.g.*, Lee Simmons, *Public Pensions Are Mixing Risky Investments with Unrealistic Predictions*, STAN. INST. FOR ECON. POL'Y RSCH. (Feb. 5, 2024), https://siepr.stanford.edu/news/public-pensions-are-mixing-risky-investments-unrealistic-predictions [perma.cc/S9LW-CRV6].

22. "Funding ratio" refers to the ratio of pension assets relative to expected liabilities. *Funding Ratio*, NASDAQ, https://www.nasdaq.com/glossary/f/funding-ratio [https://perma.cc/WP5Y-9A37].

23. Erickson, *supra* note 1.

24. *See* John Iekel, *Pension Plans in '23: Glass Half Full and Half Empty*, AM. SOC'Y OF PENSION PROS. & ACTUARIES (Jan. 11, 2024), https://www.asppa-net.org/news/2024/1/pension-plans-23-glass-half-fulland-half-empty/ [https://perma.cc/7ZQC-3AAW] (noting that public pension funds in the United States had an average funding ratio of 78.1% in 2023).

25. Erickson, *supra* note 1; *see also* Formby, *supra* note 2 (discussing the Texas Department of Public Safety's investigation into whether criminal behavior contributed to the shortfall); Eric Celeste, *Why Richard Tettamant Could Cost Dallas $1 Billion*, D MAG. (Dec. 22, 2016, 9:00 AM), https://www.dmagazine.com/publications/d-magazine/2017/january/why-richard-tettamant-could-cost-dallas-1-billion/ [perma.cc/AE9J-CGFP] (explaining that the Dallas Fund's director was forced out of the pension before the FBI began investigating it).

luxury and commercial real estate, and severely overestimated its value relative to existing liabilities.[26] Oversight from the Dallas Fund's board of trustees was practically nonexistent, with sparse attendance at regular board meetings from 1990 to 2009.[27] Not coincidentally, the Dallas Fund paid out large amounts to "compensate" trustees for expenses incurred on "supervisory trips" to their luxury out-of-state properties, including $1 million in travel expenses recorded over a four-year period.[28] Suffice it to say that the sorry state of the Dallas Fund illustrates the real-world effects of pension misgovernance. The rest of this Part will focus on the problems with the trustee selection process, the process's contribution to systemic underperformance, and a contrasting case study of responsible governance from the acclaimed Ontario Teacher's Pension Plan.

A. The Typical Public-Sector Pension Fund

Like their counterparts in the private sector, most public retirement systems are managed by a board of trustees that handles everyday administration and performs its fiduciary duties concerning asset management and investment forecasting.[29] Unlike in the private sector, however, most substantive policymaking authority affecting fund performance, such as the power to determine benefits and set contribution rates, is vested in the political branches or external investment regulators.[30] Although some pension funds go even further and subdivide the responsibilities of fund administration and investment planning among two separate boards,[31] this Note will focus exclusively on funds managed by a single governing board of trustees.

While the structure and composition of pension boards vary from system to system, most funds reserve at least several seats for politically appointed members.[32] For example, six of the Dallas Fund's eleven trustees

26. Celeste, *supra* note 25; *see also* Formby, *supra* note 2 (comparing the Dallas Fund's debt to other pension shortfalls and noting that risky real estate ventures composed nearly half of the system's assets).

27. Celeste, *supra* note 25.

28. *Id.*

29. KNAPP ET AL., *supra* note 6, at 39–40; JEAN-PIERRE AUBRY & CAROLINE V. CRAWFORD, CTR. FOR RET. RSCH. AT BOS. COLL., DOES PUBLIC PENSION BOARD COMPOSITION IMPACT RETURNS? 2–3 (2019), https://crr.bc.edu/wp-content/uploads/2019/08/SLP67_.pdf [https://perma.cc/TK77-KEVC].

30. *See* KNAPP ET AL., *supra* note 6, at 39–40 (describing the key players in public pension governance); AUBRY & CRAWFORD, *supra* note 29, at 2 (noting that boards are constrained by "statutory environments" and often lack "authority to change plan benefits or set the contribution rates").

31. AUBRY & CRAWFORD, *supra* note 29, at 2–3.

32. *See id.* at 3 (reporting that 15% of public pension board members in 2018 were ex-officio members); Weinberg, *supra* note 9 (noting that 17% of public pension fund directors were government officials in 2021).

are appointed by the Dallas mayor and confirmed by the city council.[33] Board quality is heavily influenced by the selection process, as pension funds with a relatively higher share of politically appointed board members have been found to significantly underperform funds with fewer political appointees.[34] The politicized nature of the trustee selection process undermines fund performance in two ways: (1) by shaping the board's decision-making concerning portfolio management and financial planning; and (2) by jeopardizing board quality through the selection of underqualified candidates. As explained in the following sections, the twin issues of governance incentives and board quality contribute to the ongoing public retirement crisis.

1. Poor Incentives for Good Governance.—As mentioned in this Note's introduction, the ideal public-sector pension fund would work to fully pre-fund all benefits promised to current and future retirees, ostensibly through maximizing yields on invested assets.[35] However, the presence of political appointees necessarily complicates this relationship by inserting non-fiduciary motives into the board's policymaking calculus.[36] Boards dominated by political appointees have lower financial returns than other public pension funds, partly because they commonly deviate from fiduciary principles when setting investment policies.[37]

33. Tex. Rev. Civ. Stat. Ann. art. 6243a-1, § 3.01(b)(1).

34. *See* Aleksandar Andonov, Yael V. Hochberg & Joshua D. Rauh, *Pension Fund Board Composition and Investment Performance: Evidence from Private Equity* 3 (Hoover Inst., Economics Working Paper No. 16104, 2016), https://www.hoover.org/sites/default/files/research/docs/16104__pension_fund_board_composition_and_investment_performance_-_andonov_hochberg_and_rauh.pdf [https://perma.cc/AE4J-AVMJ] (finding that increasing the percentage of politically appointed trustees on a board by 10% "reduces [investment] performance by 0.9 net [internal rate of return] percentage points"); *see also* Clark & Urwin, *supra* note 15, at 4 (noting that research has suggested that improved governance can influence pension fund investment returns by as much as 100–300 basis points per year).

35. *See* Odd J. Stalebrink, *Public Pension Fund Investments: The Role of Governance Structures*, 14 J.L. ECON. & POL'Y 35, 38–39 (2017) (describing the shift in recent decades of public pension fund goals toward maximizing investment yields, as well as the effects of this shift on governance structures); *see also* Michael Useem & Olivia S. Mitchell, *Holders of the Purse Strings: Governance and Performance of Public Retirement Systems*, 81 SOC. SCI. Q. 489, 491 (2000) (explaining how ideal pension management is governed by fiduciary principles and thus uses prudent investment strategies).

36. *See* David Hess & Gregorio Impavido, *Governance of Public Pension Funds: Lessons from Corporate Governance and International Evidence*, *in* PUBLIC PENSION FUND MANAGEMENT 49, 59–60 (Alberto R. Musalem & Robert J. Palacios eds., 2004) (offering examples of politically appointed trustees acting in self-interest and furthering political goals while violating their fiduciary duties).

37. *See* Aleksandar Andonov, Yael V. Hochberg & Joshua D. Rauh, *Political Representation and Governance: Evidence from the Investment Decisions of Public Pension Funds*, 73 J. FIN. 2041, 2083–84 (2018) (finding that boards dominated by public officials invested in private equity funds with lower returns, in part, because those boards are more likely to base investment decisions on non-fiduciary concerns such as encouraging local or regional development).

One such example of deviation from fiduciary-based policymaking comes in the form of politically motivated investing. As some of the largest institutional investors in the world, public-sector pension funds exercise considerable influence over issues relating to firm-specific governance.[38] Many pension funds leverage their influence to shape corporate behavior through proxy voting[39] and shareholder activism.[40] Pressure from elected officials is particularly influential on political appointees, shaping their investment decisions in ways that need not align with their beneficiaries' best interests.[41] Indeed, some trustees use pension board investments to further other policy objectives, such as encouraging local economic development.[42] This is particularly evident in the case of the Dallas Fund, which invested heavily in the Dallas real estate market.[43] The rise of ESG investing has also highlighted the outsized influence of public pension funds in capital markets and how politics shapes pension fund investment strategies.[44] Many states have barred public pensions from investing in ESG assets or considering ESG concerns in their planning.[45] Ultimately, elected officials often use public pension funds to achieve specific policy goals that are far removed from the overriding fiduciary objectives of prudent asset management.

Bad incentives also play a crucial role in shaping pension board policies. Politically dominated boards serve a patronage function in state and local politics, where elected officials make appointments in exchange for influence

38. *See* Useem & Mitchell, *supra* note 35, at 489–90 (explaining how institutional investors' rising share of ownership of large companies allows investors like pension funds to "pressure for improved corporate governance" and "shap[e] corporate investment policy around the globe"); *see also* Hess, *supra* note 17, at 196–97 (noting that political pressure shapes how trustees invest pension assets and engage in proxy voting).

39. "Proxy voting" refers to when shareholders assign the right to vote on corporate affairs to agents who attend board meetings in their stead. *Proxy Voting*, U.S. SEC. & EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/glossary/proxy-voting [https://perma.cc/9ED7-T8DH].

40. *See* Hess, *supra* note 17, at 205–06 (discussing public pension funds' shareholder activism, which is influenced by political pressures).

41. *Id.* at 196–98.

42. *See* Andonov et al., *supra* note 37, at 2083–84 (finding bias toward in-state investments in politically dominated boards).

43. *See* Celeste, *supra* note 25 (listing a $200 million investment in a downtown Dallas building as an example of the Dallas Fund's riskier investments); dallasnews Administrator, *Dallas Police-Fire Pension Fund Has $400 Million Bet on Luxury Real Estate*, DALL. MORNING NEWS (Feb. 16, 2013, 10:50 PM), https://www.dallasnews.com/news/investigations/2013/02/17/dallas-police-fire-pension-fund-has-400-million-bet-on-luxury-real-estate/ [https://perma.cc/SMR6-E8P3] (describing the Dallas Fund's expansion into the real estate market).

44. *See* Stéphanie Lachance & Judith C. Stroehle, *The Origins of ESG in Pensions: Strategies and Outcomes*, *in* PENSION FUNDS AND SUSTAINABLE INVESTMENT 58, 60–61 (P. Brett Hammond, Raimond Maurer & Olivia S. Mitchell eds., 2023) ("Due to their size, pension funds have an important and expanding influence on the capital markets . . . ."); Malone et al., *supra* note 12 (discussing how a state's political leanings impact whether it accepts or rejects ESG investing).

45. Malone et al., *supra* note 12; Lichtenstein et al., *supra* note 12.

on board policies.[46] Additionally, third parties such as labor unions play an outsized role in shaping board policies in accordance with their interests.[47] Indeed, the Dallas Fund is mandated by law to consult with local police and firefighter unions in nominating individuals for board elections.[48] Also, most trustees work without compensation except for reimbursement for work-related expenses, creating another potential source of misconduct.[49] The Dallas Fund, for instance, reportedly spent $1 million on travel-related expenses for trustees over a four-year period.[50] By contrast, private pension trustees (and public pension trustees abroad)[51] usually receive compensation for their time and effort; pension fiduciaries in the United States can expect "reasonable" compensation for their skills, though the concrete amount varies from jurisdiction to jurisdiction.[52]

Boards dominated by political trustees often deviate from fiduciary-based policymaking by adopting overly optimistic modeling assumptions into their decision-making calculus.[53] Most pension funds vest trustees with the power to set actuarial assumptions that dominate the financial models used for investment strategizing.[54] Trustees often focus on crucial metrics such as the discount rate[55] used to value future liabilities against current

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46. *See* Daniel DiSalvo, *How Public Pension Boards Are Making a Crisis Worse*, GOVERNING (Sept. 27, 2018), https://www.governing.com/gov-institute/voices/col-how-public-pension-boards-making-crisis-worse.html [perma.cc/4UWJ-Z6JY] (discussing how politically appointed trustees are often more responsive to constituent interests rather than those of the fund's beneficiaries).

47. *See* KNAPP ET AL., *supra* note 6, at 42–44 (discussing the influence of labor unions on public pension funds and the finding that union-dominated boards are "more likely to adopt policies that understate[] the cost of pension liabilities").

48. Tex. Rev. Civ. Stat. Ann. art. 6243a-1, §§ 3.01(b)(2), 3.011(a), (e) (requiring that police and firefighters associations be represented on the nominations committee that selects nominees for three reserved, elected board positions).

49. *See* Andonov et al., *supra* note 37, at 2047 (giving examples of trustees who are uncompensated); Weinberg, *supra* note 9 (explaining the problems created by U.S. public pension funds being led by "a lineup of unpaid union-backed reps, retirees and political appointees").

50. Celeste, *supra* note 25.

51. *See, e.g.*, Pub. Appointments Secretariat, *Ontario Teachers' Pension Plan Board*, ONT., https://www.pas.gov.on.ca/Home/Agency/213 [https://perma.cc/T8W8-DGPB] (noting that trustees for the Ontario Teachers' Pension Plan Board are paid from the fund itself).

52. *See* NAPA Net Staff, *Determining Reasonable Compensation*, NAT'L ASS'N OF PLAN ADVISORS (Sept. 8, 2016), https://www.napa-net.org/news-info/daily-news/determining-reasonable-compensation [https://perma.cc/P27U-H5L9] (explaining the factors considered when determining whether compensation is reasonable for fiduciaries in ERISA-governed plans using a market-based standard).

53. *See* Stalebrink, *supra* note 35, at 45–46 (discussing previous research that suggested politically appointed trustees influence pension fund discount rates); Hess, *supra* note 17, at 202–04 (explaining how boards, influenced by political incentives, manipulate actuarial assumptions to create the appearance of a well-funded pension).

54. Hess, *supra* note 17, at 201–02.

55. Here, the term "discount rate" refers to a metric used to estimate the present expected value of future pension liabilities; the discount rate is usually set relative to standard interest rates in the general financial market. *Explaining the Discount Rate*, LOC. AUTHS. PENSION PLAN,

assets, as well as the assumed rate of return on fund investments, which influence how policymakers negotiate benefits and secure financing (through employee contributions or budget allocations) for fund operations.[56]

Public pension funds are notorious for employing overly optimistic assumptions regarding expected investment returns and asset valuations, with politically dominated boards frequently being the worst offenders. Again, the Dallas Fund offers a valuable example of the dangers of politically motivated investing. One of the critical causes of the fund's fiscal problems was rooted in the overly optimistic valuations of its real estate portfolio.[57] Politically dominated pension fund boards often use these accounting gimmicks to minimize the burden of existing liabilities and present a false veneer of fiscal health.

2. Professional (In)expertise.—Although politically motivated deviations from fiduciary concerns are a significant source of fund underperformance, they are not the only source of dysfunction. A far more mundane concern involves board competence: Public pension trustees lack many of the basic professional and financial literacy skills needed to properly oversee fund activities. While many states, including Texas, have minimum eligibility requirements for trustees, many of these requirements are too vague to ensure expertise,[58] ultimately resulting in subpar performance.[59] The Dallas Fund, for example, is legally mandated only to select trustees who demonstrate expertise in one of several broad fields, including "financial, accounting, [or] business . . . expertise."[60] Yet, there is limited regulatory guidance on how individuals must demonstrate expertise in these fields; not all states have clear standards set by credential requirements, and in many cases, public pensions have primarily

https://www.lapp.ca/page/explaining-the-discount-rate [https://perma.cc/WTS3-QJE4]. A higher discount rate implies a higher rate of return on invested assets and thus a lower cost for future liabilities, and vice versa. *See id.* (explaining the effect that changes in the discount rate have on the cost of a fund's liabilities).

56. *See* Stalebrink, *supra* note 35, at 45–46 (noting that discount rates, which may be influenced by politically appointed trustees, affect the "funding of pension system[s]"); KNAPP ET AL., *supra* note 6, at 48–49 (discussing how overly optimistic assumed rates of return "understat[e] pension underfundedness," underestimating contributions needed for future liabilities while reducing the "perceived cost" of increasing benefits).

57. Celeste, *supra* note 25; *see also* Formby, *supra* note 2 (discussing the Dallas Fund's overreliance on real estate investments).

58. *See, e.g.*, Tex. Rev. Civ. Stat. Ann. art. 6243a-1, § 3.01(b-1)(1) (requiring only that trustees have expertise in one of several broad areas).

59. *See* Andonov et al., *supra* note 37, at 2084 (finding that lack of "prior financial experience explains the poor performance of boards with a high proportion of participant-elected board members"); *see also* KNAPP ET AL., *supra* note 6, at 61 (noting that "lack of expertise was a common issue" on pension boards, with some trustees "not understand[ing] the consequences of the actuarial assumptions they . . . approve[]"). *But see* Stalebrink, *supra* note 35, at 39 (noting how some states have imposed more stringent eligibility requirements for public pension board members).

60. § 3.01(b-1)(1).

relied on under-experienced and underpaid "novices" to make complex investment decisions.[61] Again, the Dallas Fund offers an excellent case study in pension misgovernance: Many of its poor investments were engineered by an underqualified manager acting with virtually no oversight from a pension board staffed with political appointees.[62] The board's failure to provide adequate oversight is a testament to the dangers posed by underqualified and inexperienced trustees.

Poor economic incentives provide another explanation for the deplorable oversight provided by boards dominated by political appointees.[63] Most public pension trustees are uncompensated except for nominal reimbursements for work-related expenses, making the position a genuinely thankless task unlikely to attract even the most civically minded professional, especially given the allure of well-compensated private sector opportunities.[64] And this problem extends beyond the board to other non-trustee fiduciaries, such as investment managers and risk analysts: Even the paid positions are hobbled by paltry and inflexible public-sector wage schedules that pay well below market levels for comparable private-sector roles.[65] Indeed, this downward pressure on available levels of expertise ultimately forces public pension funds to rely heavily on novices or third-party consultants for planning and implementing their investment strategies, further increasing operational expenses and providing another avenue for potential misconduct.[66]

An analogy may be drawn between the trustee selection process and state-level judicial appointment proceedings; many states rely on governors and state legislators to approve judicial nominees, with correspondingly

61. *See* Weinberg, *supra* note 9 (explaining how unpaid, inexperienced directors oversee an increasingly complex system with no national standards for selecting trustees).

62. Celeste, *supra* note 25; *see also* Formby, *supra* note 2 (discussing the Dallas Fund criminal investigations).

63. *See* Hank Kim, *Public Pensions Are Losing Top Talent. Isn't It Time to Rethink Compensation?*, GOVERNING (Dec. 6, 2023), https://www.governing.com/work/public-pensions-are-losing-top-talent-isnt-it-time-to-rethink-compensation [https://perma.cc/YQ8C-DX3M] (explaining that inadequate compensation compared to the private sector makes it difficult for pension funds to recruit top talent).

64. *Id.*

65. *See* Charles E.F. Millard, *Commentary: Public Pension Staff Pay Needs Less Politics*, PENSIONS & INVS. (Jan. 4, 2023, 3:22 PM), https://www.pionline.com/industry-voices/commentary-public-pension-staff-pay-needs-less-politics [https://perma.cc/7VD5-TAEL] (comparing the salaries of portfolio managers at public pensions and private mutual funds and arguing that pensions should pay market compensation to investment staff).

66. *See* Weinberg, *supra* note 9 (explaining how the novices directing public pensions cannot handle the system's complexity and often turn to costly outside advisers); Stalebrink, *supra* note 35, at 43–44 (suggesting that another issue with using third-party agents in alternative investments is the undersupply of highly skilled investment professionals).

negative effects on the quality of judicial administration.[67] The politicized nature of judicial selection has been criticized for undermining legal professionalism and distorting the impartial administration of justice in court cases.[68] Consequently, jurists have sought to improve professional standards in state judiciaries through various policy proposals, most of which are targeted at improving eligibility requirements and insulating judicial appointments from the political branches.[69] Pension reformers should take inspiration from their counterparts in state judiciaries and focus on the malign consequences of politicized trustee selection. It is highly likely that improved pension governance will require similar reforms concerning board quality and more substantive autonomy from political influence.

3. The Oracle of Ontario: Ideal Pension Governance.—The preceding sections cast a dim and sobering light on the state of public retirement in America. Unfortunately, these problems are not unique to the United States: Public pension funds across the developed world are struggling to balance their books amid increasing life expectancy and aging demographics.[70] That said, there are examples of well-run public investment bodies at the international level. One such example is the so-called "Canadian model" of pension governance, epitomized by the stellar performance of the Ontario Teachers' Pension Plan (Ontario Plan).[71] The Ontario Plan, an internationally recognized organization and industry leader in pension governance,[72] offers a proper case study for reformers in the United States.

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67. *See* Alicia Bannon, *Rethinking Judicial Selection*, 24 PRO. LAW., no. 1, 2016, at 1, 2–4 (discussing the "threat to the fairness of courts" posed by reappointment pressures, as well as the lack of diversity of judicial appointees); *see generally* U.S. CHAMBER INST. FOR LEGAL REFORM, PROMOTING "MERIT" IN MERIT SELECTION (2009), https://instituteforlegalreform.com/wp-content/uploads/media/meritselectionbooklet.pdf [https://perma.cc/L3YA-QE2R] (describing best practices for implementing "merit selection" and avoiding politicization in the judicial appointment process).

68. *E.g.*, Bannon, *supra* note 67, at 1–2.

69. *See, e.g.*, U.S. CHAMBER INST. FOR LEGAL REFORM, *supra* note 67, at 5–6, 10 (proposing an independent, bipartisan commission to evaluate judicial candidates, as well as a list of qualifications for judicial candidates).

70. *See* Kalyeena Makortoff, *Little Planning for Looming Retirement Crisis, BlackRock Chief Warns*, GUARDIAN (Mar. 26, 2024, 10:43 AM), https://www.theguardian.com/money/2024/mar/26/little-planning-for-looming-retirement-crisis-blackrock-chief-warns [https://perma.cc/M3XH-PUPV] (explaining how aging populations increase the financial burden on retirement plans throughout the world).

71. *Maple Revolutionaries*, ECONOMIST (Mar. 3, 2012), https://www.economist.com/finance-and-economics/2012/03/03/maple-revolutionaries [perma.cc/PQT5-8JEU].

72. *See generally* THE WORLD BANK, THE EVOLUTION OF THE CANADIAN PENSION MODEL (2017) (describing the emergence of a "Canadian model" of public pension management and the Ontario Plan's success in helping pioneer the model).

The Canadian model for pension governance relies heavily on institutional guarantees of organizational autonomy.[73] Founded in 1990, the Ontario Plan was explicitly insulated from the political branches through internal reforms.[74] Unlike traditional American pension funds, like the Dallas Fund, the Ontario Plan is characterized by its arm's-length relationship with its critical sponsors in the Ontario provincial government and the local teachers' union: Each organization receives five seats on the pension's board of directors[75] in exchange for guaranteed pledges of noninterference in the Ontario Plan's strategic planning and operations.[76] The Board seats are allocated based on merit, with strict professional eligibility criteria and a policy of avoiding conflicts of interest.[77] One interesting development from this institutional autonomy is flexibility concerning compensation: The Ontario Plan and similar funds are free to provide market-level compensation, attracting skilled talent and enabling them to shift much of their portfolio management and planning in-house to reduce their reliance on external consultants.[78] Overall, the Canadian model's emphasis on organizational autonomy minimizes external influence and contributes to its core business model of maximizing value for beneficiaries.[79]

Empowered by institutional autonomy, funds like the Ontario Plan have pioneered a professional business model that focuses solely on financing existing pension arrangements in an "intergenerationally fair" manner.[80] This

73. *See id.* at 8 (describing the Ontario Plan as an "independent institution").

74. *Id.* at 7–8; *see* Keith Ambachtsheer, *How Peter Drucker Revolutionized Canada's Public Sector Pension System: Lessons for Americans*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 8, 2022), https://corpgov.law.harvard.edu/2022/12/08/how-peter-drucker-revolutionized-canadas-public-sector-pension-system-lessons-for-americans/ [https://perma.cc/3NJS-59M8] (describing how the Ontario Plan is an "arms-length" pension organization).

75. Pub. Appointments Secretariat, *supra* note 51. The eleventh member, the chair of the board of directors, is "selected jointly by the partners." *Id.*

76. *See* Ambachtsheer, *supra* note 74 (explaining that although the government and union would be involved in the appointment process, they agreed to "delegate full organizational oversight" to the board and not "meddle in" the Plan's strategies).

77. *See* Pub. Appointments Secretariat, *supra* note 51 (listing the qualification requirements for board members); Ambachtsheer, *supra* note 74 (noting that the government and union agreed board members would "be free of any conflicts of interest").

78. *See* Ambachtsheer, *supra* note 74 (outlining the Ontario Plan's model as including "a substantial in-house investment function" with competitive compensation); *see also* Amanda White, *OTPP Makes Paying Well Pay Off*, TOP1000FUNDS.COM (Mar. 16, 2018), https://www.top1000funds.com/2018/03/otpp-makes-paying-well-pay-off/ [https://perma.cc/4932-QDUG] (explaining how market-level compensation has enabled the Ontario Plan to keep the "vast majority" of its assets under in-house management).

79. *See* Ambachtsheer, *supra* note 74 (attributing the Canadian model's financial success in part to its focus on board independence).

80. *Id.* Here, "intergenerationally fair" refers to fully prefunding existing benefit arrangements to ensure pension sustainability for both current and future beneficiaries. *Cf.* THE WORLD BANK, *supra* note 72, at 9 (defining "intergenerational inequity" as "heavy subsidies from younger generations to older generations").

contrasts with traditional American pension governance, which is generally conducted on a "pay-as-you-go" basis[81] that often fails to account for the latent conflict between current and future beneficiaries.[82] This is especially notable given the strong presence of organized labor in Canadian public-sector employment.[83] Public-sector unions in the United States have frequently been criticized for exploiting the unique nature of government employment to negotiate excessive benefits for current recipients at the expense of future beneficiaries and the taxpaying public.[84] However, the Canadian model for pension governance suggests that labor unions can be a vital asset in ensuring stable governance. Indeed, the Ontario Plan and other similarly structured pension plans have successfully integrated union representatives into their governance structures without compromising the integrity of their respective business models.[85] While American pension plans like the Dallas Fund offload the cost of existing benefit structures onto future beneficiaries, the more integrated Canadian model sets investment strategies to harmonize the relationship between current and future recipients.[86] The Ontario Plan and other Canadian-style funds are given complete discretion over investment planning, enabling them to set investment strategies focused on maximizing value for beneficiaries.[87] This is in marked contrast to American-style funds, which are often used as vehicles to fund pet projects or regional development schemes.[88] Greater fund discretion translates into better financial performance—pension funds can invest based on value creation instead of other non-fiduciary motives.

81. "Pay-as-you-go" refers to a method of pension financing in which current employee contributions and taxes are used to pay current beneficiaries. *See* Leonard Gilroy, Truong Bui & Steven Gassenberger, *PAYGO Is the Most Costly Way to Fund a Public Retirement System and Would Be Bad for New Mexico*, REASON FOUND. (Jan. 13, 2020), https://reason.org/commentary/paygo-is-the-most-costly-way-to-fund-a-public-retirement-system-and-would-be-bad-for-new-mexico/ [perma.cc/YAR7-DA9X] (explaining the costs of a pay-as-you-go system).

82. *See id.* (commenting that a "pay-as-you-go" system "creat[es] an intergenerational equity problem and political incentives to underfund retirement promises to workers").

83. *See Union Membership Trends and Challenges*, CANADIAN UNION OF PUB. EMPS. (Oct. 3, 2016), https://cupe.ca/union-membership-trends-and-challenges [https://perma.cc/AS82-25AN] (reporting a unionization rate of roughly 72% in the Canadian public sector).

84. *See, e.g.*, John O. McGinnis & Max Schanzenbach, *The Case Against Public Sector Unions*, HOOVER INST. (Aug. 1, 2010), https://www.hoover.org/research/case-against-public-sector-unions [perma.cc/8TK4-YBER] (criticizing public-sector unions for their impact on public policy initiatives and state budgets, lack of transparency, and exploitative tendencies).

85. *See* Ambachtsheer, *supra* note 74 (discussing how the inclusion of political appointees and teachers' union representatives in the Ontario Plan Board of Directors was balanced by institutional guarantees of board independence).

86. *See id.* (discussing the Ontario Plan's focus on intergenerational fairness).

87. *See id.* (emphasizing the role of "value creation" as both a concrete priority and an achievement of the Canadian pension model).

88. *See supra* notes 38–45 and accompanying text.

Indeed, the core elements of organizational autonomy and a fiduciary-centered business model have contributed heavily to the Canadian model's superior performance. Canadian-style funds are more fully funded than the average American public pension fund, which is noteworthy given that the latter has excessively generous modeling assumptions.[89] The Ontario Plan, for instance, has a funding ratio of roughly 107%,[90] which sharply contrasts with the Dallas Fund's funding ratio of 34%.[91] Canadian-style plans are also more fully diversified and generate significantly higher average returns than their American counterparts, with the performance gap being as large as 220 basis points.[92] This superior performance is true even when Canadian plans invest in illiquid asset categories like real estate, reflecting the critical role that governance structures play in shaping overall outcomes.[93]

That said, there are clear limits to the Canadian model's applicability to American pension plans. The Canadian model relies heavily on institutional autonomy to generate superior performance outcomes, but at the expense of public accountability.[94] By contrast, the American public retirement system eschews institutional autonomy by fragmenting authority across separate entities and setting hard limits on funds' discretionary authority; this increases their accountability to public regulators but at the considerable expense of organizational health and performance.[95] Admittedly, navigating

89. *See* Keith Ambachtsheer, *The Canadian Pension Model: Past, Present, and Future*, J. PORTFOLIO MGMT., Apr. 2021, at 1, 7, https://www.pm-research.com/content/iijpormgmt/47/5/150 [https://perma.cc/B9XT-JRGZ] (showing that despite having more conservative financial modeling assumptions, Canadian plans outperform their American counterparts on basic metrics like the funding ratio).

90. *See Ontario Teachers' Delivers Positive Return in First Half of 2023*, ONT. TCHRS.' PENSION PLAN (Aug. 15, 2023), https://www.otpp.com/en-ca/about-us/news-and-insights/2023/ontario-teachers-delivers-positive-return-in-first-half-of-2023/ [perma.cc/448E-HVXZ] (reporting that the Ontario Plan had a total of $244.1 billion in net assets with a $17.5 billion funding surplus).

91. Erickson, *supra* note 1.

92. *See* Ambachtsheer, *supra* note 89, at 7 (showing how Canadian plans outperformed their American counterparts with average net investment returns of "9.0% versus 6.8%"). A "basis point" is a financial unit of measurement that represents 1/100th of 1%, or 0.01%. Jason Fernando, *Basis Point: Meaning, Value, and Uses*, INVESTOPEDIA (Oct. 17, 2024), https://www.investopedia.com/terms/b/basispoint.asp [https://perma.cc/6HPS-8RA7].

93. *See* Ambachtsheer, *supra* note 89, at 7 (describing the success of Canadian plans, which, on average, had more real estate and infrastructure investments than U.S. plans); Julie Segal, *The Oracle of Ontario*, INSTITUTIONAL INV. (Sept. 20, 2012), https://www.institutionalinvestor.com/article/2bsvlpv7mufhojj8wm7ls/corner-office/the-oracle-of-ontario [perma.cc/63NH-5BK6] (describing the governance structure as key to the success of the Ontario Plan, which notably invested in a large real estate company).

94. *See* THE WORLD BANK, *supra* note 72, at 47–48 (describing the accountability mechanisms for Canadian pension models as publishing publicly available reports and creating a governing code of conduct rather than direct accountability to the public).

95. *See* KNAPP ET AL., *supra* note 6, at 39–40, 46 (discussing the numerous parties involved in public pension governance and how the involvement of more political appointees can lead to worse fund performance); AUBRY & CRAWFORD, *supra* note 29, at 2 (discussing how "statutory limits on

the tradeoffs between institutional performance and public accountability is a perilous venture, especially for public pension funds and other large institutional investors. That said, there are diminishing returns to public accountability, and American pension funds could arguably improve overall performance without totally removing trustees from governmental oversight.[96] But absent a revolutionary transformation, state and local governments are unlikely to embrace greater organizational independence for pension trustees. Pension reformers should lower their expectations and instead use the Canadian model as a valuable lodestar to guide more piecemeal efforts at improving overall pension governance—efforts that will be more thoroughly investigated in Parts II and III of this Note.

II. Suggested Policy Solutions

As discussed in subpart I(A), politically dominated trustee boards reduce overall fund performance in two ways: by motivating board members to make decisions based on political concerns and by encouraging the selection of trustees for political expediency rather than professional competence. Part II will introduce several policy solutions to resolve these corporate governance issues, and the advantages and disadvantages of these solutions will be evaluated in Part III. These proposals address different facets of the pension governance problems illustrated in Part I.

The first policy suggestion focuses on procedural reforms to depoliticize the trustee selection process, drawing inspiration from foreign case studies and the example set by recent developments in state judicial selection. By contrast, the second suggestion entails substantive changes to the trustee selection process by tightening eligibility requirements and mandates relating to professional experience and continuing education. The third suggestion goes beyond the trustee selection process and entails reforming the fiduciary relationship between pension boards and beneficiaries by introducing economic incentives to strengthen the fiduciary relationship. These policy suggestions are piecemeal attempts at a broader objective: ensuring that public retirement systems in the United States are adequately incentivized and autonomous to satisfy the fiduciary duties they owe to current and future beneficiaries.

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permissible investment options . . . can restrict board members from developing the portfolio mix that best achieves their investment strategy”).

96. *See* Ambachtsheer, *supra* note 89, at 7 (describing a recommendation for U.S. plans to follow the Canadian model and “[c]reate arms-length pension plans that are jointly sponsored by governments and unions”).

A. *The "Missouri Plan" for Public Pension Trustees*

As mentioned previously, the problems of politically dominated pension boards mirror the troubles generated by the direct political appointment of judges to state courts. In response to such troubles, many states have adopted merit-based procedural reforms to minimize the role of politics in judicial selection.[97] One such proposal is the so-called "Missouri Nonpartisan Court Plan," first implemented by the state of Missouri in 1940.[98] More popularly known as the "Missouri Plan," this procedural regime reformed the judicial appointment process by outsourcing the duty of vetting candidates to a nonpartisan, independent commission staffed by legal professionals and public officials.[99] This independent commission reviews judicial applications, conducts professional interviews, and recommends a panel of candidates to fill each vacancy, subject to gubernatorial approval.[100] These recommendations are by no means merely advisory: If the governor fails to appoint any of the commission's candidates within a specified time limit, the commission itself installs one of the candidates to fill the vacancy.[101] Many states have adopted variations of the Missouri Plan to improve the professional competence of their judiciaries and insulate the nomination process (and judicial deliberations more generally) from the political machinations of the elected branches.[102]

States looking to rationalize and depoliticize public pension management could adopt a similar, modified approach that accounts for the diverse professional expertise trustees need to provide responsible oversight over complex financial institutions. Under a hypothetical "Missouri Plan" for public pensions, all vacancies controlled by the chief executive of a given political authority (state, county, or municipality) would instead be selected by an independent and nonpartisan commission of professionals. In the case of the Dallas Fund, this would require legislation stipulating that all eleven trustees of the Dallas Fund will be selected through this independent commission. Representatives of respective professional stakeholders would staff this hypothetical Dallas pension commission: Two would be elected by the Dallas Bar Association, another two would be elected by the Dallas City

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97. *See* Bannon, *supra* note 67, at 4–5 (describing proposed reforms to replace judicial elections with merit selection and noting that merit selection was adopted by many states in the 1960s and 1970s).

98. Rebekkah Stuteville, *Judicial Selection in the State of Missouri: Continuing Controversies*, MO. POL'Y J., Fall/Winter 2014–15, at 7, 8.

99. *Id*. at 8–9.

100. *Id.* at 9.

101. *Id.*

102. *See* Jay A. Daugherty, *The Missouri Non-Partisan Court Plan: A Dinosaur on the Edge of Extinction or a Survivor in a Changing Socio-Legal Environment?*, 62 MO. L. REV. 315, 319 (1997) (discussing the widespread adoption of the Missouri Plan and the goals of merit selection processes).

Chamber of Commerce, and two others would be randomly selected from a pool of applicants derived from the Texas State Board of Public Accountancy professional database. All commission members would be required to have at least five to ten years of direct professional experience in their respective fields, and a mayoral appointee would ultimately chair the commission. The commission would create its selection criteria for nominees, including professional eligibility requirements and a code of ethical conduct. The commission would review applications for trustees, screen candidates, and submit a slate of candidates for mayoral approval within a set deadline. If the mayor declined to appoint any candidates within a month, the commission would randomly select a candidate from the slate to fill the vacancy immediately.

B. Strengthen Eligibility Criteria for Trusteeship

Another approach to rationalizing public pension governance entails tightening eligibility standards to ensure that competent and professional individuals staff pension boards. Many states already have minimal eligibility requirements on the books. The State of Texas, for example, requires that trustees for certain police and firefighter public pensions "demonstrat[e] financial, accounting, business, investment, budgeting, real estate or actuarial expertise."[103] Unfortunately, these requirements are notoriously ambiguous: What constitutes "expertise" is subjective and open to interpretation, giving state and local lawmakers' broad discretion in making board appointments.[104] This excessive discretion invites abuse, politicizing the trustee selection process in a manner analogous to the contentious judicial appointment process previously discussed.[105] This is compounded by the fact that many jurisdictions provide inadequate oversight to ensure trustees retain the professional skills they are purported to possess,[106] as well as by a general shortage of candidates willing and able to actually honor their fiduciary obligations.[107] Proper governance requires a familiarity with legal and business management principles—a familiarity that cannot be acquired overnight.

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103. Tex. Rev. Civ. Stat. Ann. art. 6243a-1, § 3.01(b-1)(1).

104. *See* Weinberg, *supra* note 9 (describing the widespread problem of inexperienced trustees without the expertise needed to manage increasingly complex funds).

105. *See* discussion *supra* sections I(A)(1)–(2).

106. *See, e.g.*, *Education (MET Program)*, TEX. PENSION REV. BD., https://www.prb.texas.gov/education-met-program/ [https://perma.cc/5Z3P-M9RE] (requiring only four hours of continuing education for Texas public retirement system trustees and administrators).

107. *See* Kim, *supra* note 63 (arguing that an aging workforce, increased scrutiny, and inadequate compensation have led to a lack of qualified pension executives and high-level employees).

Accordingly, states and municipal governments should aim to rationalize the trustee selection process and place it on a sound, professional footing. The judicial branch offers promising lessons, especially at the state level: Judicial candidates in many states must have completed law school and remain in good standing with their respective state bar associations.[108] This "demand-side" approach to regulating the labor market of judicial candidates is partially reliant upon professional organizations like state bar associations to provide the necessary oversight of the process. States can imitate this demand-side approach by looking to similarly situated organizations for assistance in candidate selection. Examples include (but are not restricted to) the state-level chapters of organizations like the Society of Actuaries, the CFA Institute, the National Society of Accountants, and other professional societies. Ideally, this eligibility regime would be complemented by a rigorous routine evaluation program, where trustees would undergo formal evaluations to ensure they remain proficient in their respective fields. Such continuing education programs are ubiquitous and inexpensively offered by professional organizations, thus providing regulators with a clear model for wider use.[109]

Given the plethora of states that have codified eligibility requirements for pension trustees on the books,[110] feasibility is less of a concern here than it would be for other policy suggestions. State legislators could pass legislation altering or interpreting these statutes far more narrowly to reduce a policymaking body's discretion in nominating professional appointees for trusteeship. Alternatively, state governors could order their pension oversight bodies to issue regulatory guidance that more narrowly construes these provisions to emphasize reasonable professional experience and certification, in a manner similar to the issuing of guidance on ESG investment.[111] Regulatory bodies like the Texas Pension Review Board might issue guidelines requiring candidates for trusteeship to be certified professionals—rather than simply hold "expertise"—in relevant fields, such as law, accounting, or business management. Moreover, policymakers would

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108. *See Qualifications of Judges of State Appellate Courts and General Trial Courts*, THE BOOK OF THE STATES: THE COUNCIL OF STATE GOV'TS, https://bookofthestates.org/tables/2022-5-3/ [https://perma.cc/US5E-QPHW] (listing qualifications for judges in each state).

109. *See, e.g.*, *ALI Continuing Legal Education*, THE AM. L. INST., https://www.ali.org/about-ali/ali-continuing-legal-education/ [perma.cc/UE2E-C6KS] (offering free continuing education to members of the American Legal Institute); *CPE Self Study*, AICPA & CIMA, https://www.aicpa-cima.com/cpe-learning/course [https://perma.cc/UWF9-AHZQ] (offering self-study continuing public education courses for certified public accountants).

110. *See* Stalebrink, *supra* note 35, at 39 (recognizing that many states have regulations requiring basic eligibility criteria).

111. *See* Malone et al., *supra* note 12 (offering examples of various states that have issued policies and statements that limit the consideration of non-pecuniary factors by public pension funds when investing state resources).

conduct background checks before making nominations regarding matters such as potential conflicts of interest or past instances of (un)professional behavior. But above all, regulatory bodies must ensure that candidates for trusteeship possess the requisite skills to honor their fiduciary obligations.

C. *Financial Incentives for Trustees*

Much has been said about the importance of reforming the trustee selection process, but more needs to be said about the incentive structure trustees face after being appointed to the board. As discussed, boards dominated by political appointees are more likely to neglect their fiduciary duties or engage in misconduct due to insufficient and counterproductive incentives that discourage prudent governance.[112] By its very nature, a fiduciary relationship is tilted in favor of the beneficiary: Trustees are burdened with duties to manage the trust property and face substantial penalties for losses incurred because of negligent conduct.[113] In private settings, fiduciaries often receive generous compensation to reflect the marketable skills they bring to the relationship.[114] Yet this is not the case for trustees of public pensions, who receive comparatively little for their work.[115] In many ways, the only substantive form of compensation for public trustees comes in the form of control over trust property, inviting potential abuse from lawmakers eager to use pension assets for their own purposes.[116]

Overall, the difficulties of trusteeship and the absence of financial incentives limit the pool of skilled candidates willing to assume a fiduciary role. Accordingly, any attempt to reform the political economy of America's public retirement system requires an attendant focus on providing material incentives for good governance and talent retention.

Public pension plans would benefit immensely from a carrot-and-stick approach to talent acquisition. The carrot element of such an approach is the most intuitive: Public pension trustees should be compensated in a manner that both accounts for the requisite skills needed for prudent stewardship and attracts competent professionals in a notoriously competitive industry.[117] Reformers should take inspiration from the Canadian model of pension governance, as pension funds like the Ontario Plan have used competitive

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112. *See* discussion *supra* section I(A)(1).

113. T. Leigh Anenson, *Public Pensions and Fiduciary Law: A View From Equity*, 50 U. MICH. J.L. REFORM 251, 256–57 (2017).

114. *See supra* notes 64–65 and accompanying text; *see also* James Royal, *Fiduciary vs. Financial Advisor: How These Types of Advisors Compare*, BANKRATE (Sept. 9, 2024), https://www.bankrate.com/investing/financial-advisors/fiduciary-vs-financial-advisor/ [perma.cc/6BGB-DUTP] (describing how fiduciary compensation is structured to incentivize prudent advice and management).

115. *See supra* notes 63–66 and accompanying text.

116. *See supra* notes 38–45 and accompanying text.

117. Kim, *supra* note 63.

and performance-based remuneration to compensate trustees (and pension managers more generally) for their marketable skills.[118] Market-level compensation is an invaluable tool to attract talented professionals away from more lucrative careers in the private sector and ensure that pension trustees have the necessary skills needed for prudent stewardship.

Liability exposure provides an additional economic incentive to internalize the costs of misgovernance. Calls for more uniform state pension management standards, including liability standards, culminated in the promulgation of the Uniform Management of Public Employee Retirement Systems Act (UMPERSA), a model act drafted and ratified by the Uniform Law Commission,[119] a non-profit organization dedicated to providing governments with well-drafted model legislation.[120] Exposure to liability is a critical component of UMPERSA: Trustees (and non-trustee fiduciaries) are subject to personal liability for losses incurred due to a breach of fiduciary obligations.[121] Moreover, fiduciaries found violating their commitments are held liable regardless of their knowledge or intent to breach—a strict standard that mirrors private trust law and forces trustees to internalize the costs of their (mis)governance.[122] In the case of the Dallas Fund, board members would be on the hook for their negligent stewardship of pension assets, providing a clear disciplinary mechanism to punish wrongdoers and ensure compliance with preexisting fiduciary obligations. Complemented by market-style compensation packages for trustees and executive managers, this carrot-and-stick approach would substantially improve the incentives shaping public pension governance and ensure that pension trustees have a stake in the prudent administration of pension assets.

III. Policy Analysis

Ideally, states would enact all three aforementioned policy suggestions to improve board quality and overall pension performance. These reforms would enhance pension governance by improving transparency regarding the trustee selection process, providing greater insulation from malign political influences, and realigning the interests of the board members with those of their beneficiaries. This Part examines each policy suggestion in detail and then analyzes it as part of a holistic reform proposal.

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118. *See* White, *supra* note 78 (discussing how the Ontario Plan's incentive pay structure both compensates its trustees "handsomely" and represents a "sophisticated alignment of interests").

119. Willborn, *supra* note 18, at 143.

120. UNIF. L. COMM'N, https://www.uniformlaws.org/home [https://perma.cc/H3RM-DLH7].

121. Willborn, *supra* note 18, at 160.

122. *Id.* at 161–62.

A. *The Missouri Plan*

1. Advantages.—Insulation from political influence is a crucial pillar of good pension governance, and this objective is well-served by implementing a hypothetical Missouri Plan for public pension trustees. Absent reform, the trustee selection process inevitably hinges upon the decisions of elected officials, whose interests (and those of their appointees) often diverge from those of pension beneficiaries.[123] Indeed, elected officials can quickly pressure board members to make decisions that will reward them politically, even if it comes at the expense of the pension fund's long-term financial integrity.[124] Moreover, the lack of transparency surrounding the trustee selection process invites fraud and misconduct, especially considering that the economic consequences can be kicked down the road through clever accounting tricks. By outsourcing the power of selecting candidates to an independent commission of professionals, the Missouri Plan improves the transparency of the selection process by giving professionals an effective veto against elected officials. This veto power enables professional stakeholders to more effectively check the power of elected officials and other political interest groups in shaping board policies.

Another advantage of implementing the Missouri Plan is that it strengthens public pension boards' professional competence and integrity. The Missouri Plan mirrors the governance philosophy of stellar pension funds like the Ontario Plan by enlisting key stakeholder professional groups—like lawyers and accountants—in the trustee selection process, thereby minimizing the influence of non-meritorious considerations. These professional organizations have greater access to information about potential nominees' competence and technical expertise, which increases the likelihood that they will make better decisions.[125] Moreover, by giving these stakeholder groups a high-profile connection to pension board policies, they will be better positioned to shape board policy in a way that capitalizes on their various skill sets.

A testament to the ingenuity of a hypothetical Missouri Plan for trustees is its feasibility within existing political constraints. Ideally, the trustee selection process would be completely isolated from the political branches, thus enabling technocratic experts to select candidates and make board policies to maximize value to pension beneficiaries. Indeed, this underlying impulse to fully insulate pension governance from political pressure is a

123. *See* Hess, *supra* note 17, at 196–97 (explaining the ways in which political pressure results in conflicting interests between trustees and pension beneficiaries); KNAPP ET AL., *supra* note 6, at 62 (same).

124. Hess, *supra* note 17, at 196.

125. *See* THE WORLD BANK, *supra* note 72, at xiii (explaining how skilled talent is crucial in shaping board governance and overall performance).

crucial objective of comprehensive legislative models such as UMPERSA, which envisions a wholesale and top-down revision of how public pension governance works in the United States.[126] Yet comparatively few states have enacted UMPERSA provisions or similar initiatives, reflecting elected officials' reluctance to cede control over pension governance.[127] But by preserving a modicum of political influence through executive approval of commission candidates, the Missouri Plan is more likely to be adopted by state governments that seek to improve public pension governance without completely ceding control over to technocrats.

2. Disadvantages.—While greater insulation from political influence has apparent advantages for pension governance, it is not a free lunch. By partially outsourcing the power of vetting candidates to an independent professional commission, the Missouri Plan necessarily reduces pension boards' accountability to the democratic process. Professional organizations are by no means immune to self-serving political intrigue, and by removing democratic accountability from the process, the Missouri Plan may merely be swapping one mischievous interest group for another. While this swap may nonetheless be desirable to improve trustees' ability to honor their fiduciary obligations, its resulting insulation also increases the relative influence of stakeholder interests in shaping board governance. The high-profile connection between these institutions may reduce their overall legitimacy in the eyes of the public, endangering the viability of both the public retirement systems themselves and the professional associations linked to their governance bodies.

Another potential drawback to implementing the Missouri Plan is that it increases the overall inefficiency of pension governance by adding a layer of bureaucracy to the trustee selection process. Implementation is a crucial issue: The original Missouri Plan was confined to the comparably modest task of selecting some state judges.[128] By contrast, requiring each of the more than 5,300 individual funds[129] to create its commission would be highly costly and could overwhelm the resources of small pension plans. Moreover, implementing the Missouri Plan at the state level would redistribute power away from local governments and subject local plans to the considerations of state-level policymakers and stakeholders. Many states (including Texas)

126. *See* Willborn, *supra* note 18, at 143–45 (discussing UMPERSA's objective to give trustees more "freedom and independence in return for increased responsibility and disclosure obligations").

127. *See* T. Leigh Anenson, Alex Slabaugh & Karen Eilers Lahey, *Reforming Public Pensions*, 33 YALE L. & POL'Y REV. 1, 43 n.249 (2014) (flagging that UMPERSA lacks institutional support to shape pension governance policies).

128. Stuteville, *supra* note 98, at 9.

129. *National Data*, *supra* note 19.

regulate local retirement plans in the constitution.[130] Implementation would thus require reform-minded policymakers to wade through their respective states' amendment procedures, an expensive and time-consuming process that undermines the proposal's overall attractiveness.[131]

One more issue that the Missouri Plan does not directly address is the issue of governance incentives. While it is true that the trustee selection process casts a rather long shadow on pension governance, it is by no means the only problem. As noted, poor economic incentives also contribute heavily to issues with public pension governance.[132] The Missouri Plan does little to mitigate this, limiting its effectiveness. Indeed, given a more realistic appreciation for public retirement reform, reformers should deprioritize the Missouri Plan in favor of policies that directly address both issues of trustee selection and governance.

B. Strengthening Eligibility Requirements

1. Advantages.—One of the benefits of a demand-side approach to the trustee selection process is that it directly addresses the issue of board quality. By limiting the pool of nominees based on professional certification and evaluation, a tighter eligibility regime will ensure that pension boards are staffed by individuals proficiently familiar with the various facets of governance that affect pension administration. Moreover, tying selection to clear and identifiable markers—such as educational degrees or professional certifications—increases the overall transparency of the trustee selection process. Such transparency is enhanced when combined with a formal and routine evaluation regime, ensuring that trustees remain proficient and current regarding the latest developments in their expertise. And reforming eligibility requirements becomes even more important when one considers the dynamics of pension governance, which are ever-changing and require intellectual and professional flexibility.

In addition, reforming the eligibility criteria for trusteeship enables public retirement systems to rely more on in-house investment management. Public pensions have relatively higher administrative expenses than their private-sector counterparts, partly because they outsource much of their portfolio management responsibilities to third-party consultants and investment advisors.[133] This excessive reliance on third parties for investment expertise ultimately creates more space for fraud and favoritism and, at the same time, reduces the overall efficiency of public pension funds by

130. *See, e.g.*, TEX. CONST. art. XVI, § 67 (governing state and local retirement systems).

131. *See* Anenson et al., *supra* note 127, at 23 (noting the particular difficulty of pension reform in states where it "would require a constitutional amendment").

132. *See* discussion *supra* section I(A)(2).

133. *See supra* note 66 and accompanying text.

increasing the share of funds dedicated toward paying these fees.[134] Thus, improving board quality will improve efficiency by increasing the share of pension assets under in-house management, reducing administrative expenses, and enabling pension managers to gain and retain knowledge in asset management.[135]

2. Disadvantages.—More robust eligibility criteria, while seemingly commonsensical, nonetheless come with disadvantages. Since many states have already codified eligibility requirements,[136] the question reverts to how these statutes can be revised. As mentioned, ambiguous provisions can either be revised by legislators or interpreted narrowly through regulatory guidance.[137] Each method has drawbacks. Legislative action is time-consuming and requires concerted political pressure to guarantee results. On the other hand, executive action (by promulgating regulatory guidelines) offers a timelier method of reform, especially given that many states already regulate public pensions through public oversight bodies.[138] Yet regulatory guidance lacks the binding nature of statutory reform; after all, such regulations can quickly be repealed once a different gubernatorial administration comes into office.[139] However, given the severity of the public retirement crisis and its looming fiscal challenges, pension advocates should focus on securing reforms through executive action, which is less likely to be bogged down by legislative horse-trading and gridlock.

A counterintuitive result of implementing this demand-side approach is that it may *discourage* individuals from wanting to participate as public trustees. As mentioned, performing fiduciary duties in a public pension setting is not very remunerative, especially relative to the private sector.[140] Accordingly, the pool of potential candidates is already small; implementing tighter eligibility requirements would only worsen the matter by further shrinking the pool. Without additional incentives to make trusteeship more attractive, public pensions will face an even greater problem attracting qualified candidates. Thus, solely raising the standards for who can be a

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134. *See supra* note 66 and accompanying text.

135. *See* White, *supra* note 78 (explaining how Canadian model plans like the Ontario Plan benefit from employing qualified professionals who manage more assets in-house).

136. *See supra* note 110 and accompanying text.

137. *See* discussion *supra* subpart II(B).

138. *See* NASRA, OVERVIEW OF PUBLIC PENSION PLAN GOVERNANCE app. A, at 6–10 (2019), https://www.nasra.org/files/Topical%20Reports/Governance%20and%20Legislation/NASRA%20governance%20overview.pdf [https://perma.cc/BUK5-6P65] (listing the entities in each state charged with overseeing statewide retirement systems).

139. *Cf.* Maxim Gakh, Jon S. Vernick & Lainie Rutkow, *Using Gubernatorial Executive Orders to Advance Public Health*, 128 PUB. HEALTH REPS. 127, 130 (2013) (discussing how in the public health context, "a governor's successor may override any [executive order] with a superseding [executive order] or by failing to renew an expiring one").

140. *See supra* notes 63–66 and accompanying text.

public pension trustee, without further reforms, is likely to worsen the problem of talent retention. While not insurmountable, the potential downsides of imposing stronger eligibility regulations suggest that this policy option should be deprioritized, absent guaranteeing other reforms that introduce positive economic incentives for trusteeship.

C. Financial Incentives for Trustees

1. Advantages.—There are several significant advantages to using financial incentives to encourage good pension management. The first is intuitive: Providing competitive pay helps pension funds attract and retain highly skilled talent.[141] This is true both at the board level and within the fund itself. A key source of public pension underperformance stems from the failure to retain skilled investment professionals who can usually earn more in the private sector.[142] But the Ontario Plan and other Canadian-style pension funds rely heavily on compensation for board and management positions, using performance-based pay packages not usually found in the public sector.[143] Attractive compensation incentivizes these skilled professionals to stay put, whether on the board or in managerial positions, allowing them to build and retain institutional knowledge that helps overall fund performance. Moreover, competitive pay enables pension boards to reduce their reliance on third-party consultants—lowering administrative expenses and removing a potential source of fraud and misconduct, while at the same time bringing more asset management in-house.[144]

When liability exposure is also considered in model legislation such as UMPERSA, this further incentivizes trustees to focus on fiduciary interests rather than pet projects or political considerations in their decision-making.[145] Subjecting board members to personal liability for losses incurred by a breach of fiduciary duties reshapes the incentive structure by better exposing trustees to the consequences of their actions, thereby realigning their interests with those of pension beneficiaries.[146] It also provides a potential remedy for beneficiaries, who can claw back some losses they incur through a trustee's breach of fiduciary obligations.

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141. *See supra* notes 117–118 and accompanying text.

142. *See* Kim, *supra* note 63 (attributing difficulty in retaining top talent in part to inadequate compensation compared to the private sector).

143. *See Maple Revolutionaries*, *supra* note 71 (explaining how market-level compensation enables Canadian public pension funds to attract skilled talent).

144. *See id.* (discussing how Canadian funds leverage competitive compensation to minimize overall administrative expenses).

145. Willborn, *supra* note 18, at 161.

146. *Id.*

Moreover, using economic incentives reinforces the board's independence and autonomy. Proximity to elected officials is a significant source of misconduct and bad governance, as trustees face pressure from political officials and other interested parties to do their bidding.[147] Without the carrot-and-stick approach of financial incentives, trustees are more likely to be influenced by these third-party interest groups, distracting them from their fiduciary duties in ways that can incur actual costs for beneficiaries. Giving trustees a material stake in the success or failure of their respective pension plans will ultimately encourage them to more prudently invest and manage pension property.

2. Disadvantages.—That said, economic incentives come with their own shortcomings. One potential problem posed by introducing economic incentives is that doing so creates a particular class of government employees who receive uniquely competitive pay packages and increased liability exposure in comparison to other public-sector workers. Most state government employees are subject to rigid pay schedules[148] and are only subject to a willful or knowing liability standard.[149] It is debatable as to why pension trustees (as opposed to nuclear engineers or financial regulators) should be singled out for special liability treatment. Indeed, one of the reasons why financial incentives work better for Canadian-style funds like the Ontario Plan is because the Plan is both legally and operationally independent from its government sponsors, giving it the flexibility to tailor financial incentives that optimize overall performance.[150] It is unclear how injecting economic incentives into an American-style framework would work, and the political costs of failure might be high enough to disabuse policymakers from trying in the first place.

Feasibility is another pressing concern, especially given existing political scrutiny over public-sector compensation. Many public pension systems fear raising executive salaries because of the potential public backlash about excessive public-sector compensation.[151] This feeds into broader political issues surrounding public-sector compensation; indeed, some states have gone so far as to expressly limit general public-sector compensation through statutory reforms or by establishing hard limits on

147. *See supra* section I(A)(1).

148. *See, e.g.*, *State of Texas Salary Schedules*, TEX. STATE AUDITOR'S OFF. STATE CLASSIFICATION TEAM, https://hr.sao.texas.gov/compensationsystem/salaryschedules/ [https://perma.cc/87AH-VLRM] (providing the salary schedules for state employees in Texas).

149. Willborn, *supra* note 18, at 162.

150. *See supra* notes 73–79 and accompanying text.

151. *See* Millard, *supra* note 65 (acknowledging public outrage surrounding compensation at major public pension plans but finding that outrage misplaced, as underpaying staff leads to greater costs overall).

government workers' ability to unionize and collectively bargain.[152] While public-sector compensation and collective bargaining rights are beyond the scope of this Note, introducing financial incentives into the picture will necessarily draw public pensions back into the public discourse in an unfavorable light—perhaps further politicizing pension governance. And the liability issue has similar explosive potential. Only a couple states have enacted UMPERSA's strong liability provisions,[153] reflecting how difficult it is to achieve true governance reform even on the narrow question of board incentives. These concerns, while not fatal, pose considerable difficulties for reformers who want to inject more economic incentives into public pension funds and the public sector more generally.

D. A Realistic Path Forward for Pension Reform

The preceding subparts have provided a systematic, though by no means exhaustive, review of several programmatic reforms that will strengthen public pension governance and better position trustees to tackle looming fiscal challenges. Ideally, policymakers would implement all three reforms simultaneously, thus avoiding any potential drawbacks from a more piecemeal approach.

That said, comprehensive reform is as unlikely as it is desirable. Such a strategy would require concerted action by both elected branches of government in all fifty states, a tall order for the relatively niche subject of public retirement reform. Therefore, while this Note maintains that each proposal is desirable and thus the proposals should be implemented together, political realism requires a more piecemeal approach. In the interest of parsimony, policymakers should adopt a policy that tackles both issues of board quality and governance incentives. Accordingly, introducing economic incentives should be the priority for any serious attempt at pension governance reform. This subpart will briefly elaborate on the advantages of prioritizing economic incentives over the other proposals.

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152. *See, e.g.*, Adam A. Millsap, *Expanding Public-Sector Collective Bargaining in Illinois Would Restrict Worker Freedom and Increase the Cost of Government*, FORBES (Nov. 5, 2022, 10:01 AM), https://www.forbes.com/sites/adammillsap/2022/11/05/expanding-public-sector-collective-bargaining-in-illinois-would-restrict-worker-freedom-and-increase-the-cost-of-government/?sh=5c99608826fa [perma.cc/C7RY-QATT] (recognizing Wisconsin and Iowa as two states that "largely limit" the ability of government employees to collectively bargain base wages).

153. *See* W. Scott Simon, *The Law of Trusts Is the Foundation for Prudent Fiduciary Investing*, MORNINGSTAR (May 1, 2019), https://www.morningstar.com/sustainable-investing/law-trusts-is-foundation-prudent-fiduciary-investing [perma.cc/R9ZY-DUKG] (noting that "48 states . . . are not governed by UMPERSA"); see also LARRY POLLACK, OTHER PEOPLE'S MONEY: CAN INVESTING PUBLIC EMPLOYEE PENSION ASSETS TO FURTHER NONFINANCIAL GOALS BE CONSISTENT WITH FIDUCIARY PRINCIPLES? 12, (Reason Foundation, May 2023), https://reason.org/wp-content/uploads/public-pension-nonfinancial-goals-fiduciary.pdf [https://perma.cc/P2PB-N8DF] (highlighting that personal liability provisions for public pension fiduciaries "does not appear prominent in state law").

As mentioned elsewhere in this Note, public pension governance is bedeviled by two problems: the inferior quality of pension boards concerning personal qualifications and experience, and the malign incentives that invite corruption and misuse of pension property.[154] Of the three policy suggestions entertained in this paper, only the third option—introducing economic incentives—comes close to comprehensively addressing these twin problems. The other policy solutions, namely outsourcing the trustee selection process and strengthening eligibility requirements, are incomplete remedies. Imposing a tighter eligibility regime is, at best, a half-measure that only tackles the issue of board quality and leaves the question of governance incentives unaddressed. Moreover, implementing this stern regime by itself will ultimately worsen existing problems with personnel management, reducing the pool of skilled applicants and thus forcing public pensions to more heavily rely on expensive third-party advisors and consultants. Alternatively, introducing a modified Missouri Plan for selecting pension trustees will be politically costly, as state governors and legislators are notoriously reluctant to give up control over pension trustees. Furthermore, absent considerable compensation or some other form of economic incentive, few qualified candidates will be willing to jump through these procedural hurdles for such a thankless task, especially given the more lucrative opportunities in the private sector. While better insulation from the political process will do much to improve the decision-making capability of pension boards, it is not sufficient by itself.

Economic-based performance incentives are a particularly controversial topic in public policy circles.[155] Such proposals inject normativity into existing discussions about public-sector compensation, the burden on the taxpayers, and the problems of encouraging better performance in a bureaucratic public-sector setting.[156] But at the end of the day, economic incentives are effective.[157] They tackle both issues of board quality and performance (dis)incentives simultaneously: Economic incentives make it easier for pension boards to attract skilled and competent candidates while forcing them to honor their fiduciary obligations. Moreover, introducing economic incentives into public pension governance is more likely to

154. *See* discussion *supra* sections I(A)(1)–(2).

155. *See, e.g.*, Otis White, *The Worst Idea in Government Management: Pay for Performance*, GOVERNING (Apr. 7, 2017), https://www.governing.com/archive/col-worst-idea-government-management-pay-for-performance.html [perma.cc/9WQE-ZKYM] (arguing against pay-for-performance programs in government).

156. *See id.* (explaining the general drawbacks of a payment incentive program in the public sector and proposing alternative ways to view compensation).

157. *See* White, *supra* note 78 (demonstrating how market-level compensation enables Canadian pension funds like the Ontario Plan to maximize administrative efficiency by managing more pension investments in-house); *see also* Ambachtsheer, *supra* note 89, at 6–7 (demonstrating the superior performance of Canadian pension funds relative to their American counterparts).

improve public pension boards' overall independence and autonomy from the other political branches—a necessary step in the broader effort to rescue and reform America's public retirement system. Absent a revolutionary wave of public support for systemic change, piecemeal efforts to introduce economic incentives seem to be the most effective vehicle for pension reform.

Conclusion

The challenges facing the Dallas Fund are emblematic of broader dysfunctions in the American public retirement system. The trustee selection process is needlessly political, introducing distorted incentives and encouraging pension boards to deviate from their fiduciary obligations to current and future beneficiaries. Even absent ulterior motives, many politically appointed trustees are inexperienced and ill-prepared to provide adequate oversight and governance over these large and complex financial institutions. This toxic medley of bad incentives and inexperience has contributed to the fiscal challenges facing the Dallas Fund and other public-sector funds across the country, ultimately shifting the burden onto future beneficiaries and the taxpaying public.

This Note maintains that the ideal solution is an all-of-the-above approach to public retirement reform. One way to resolve the issue is by outsourcing the authority to vet and nominate candidates to an independent, nonpartisan commission composed of professionals, like how some states regulate the judicial nomination process for state court vacancies. Additionally, states should aim to improve the general expertise level of their pension boards by imposing stricter eligibility requirements for serving as a pension trustee. Trustees should be required to have secured professional credentials in critical areas such as business management and financial planning, as well as documented experience performing such functions in their careers. Trustees should also undergo training programs in requisite areas and face formal, routine evaluations to ensure they have adequately developed their respective skills in pension board governance. Finally, states should reconsider using financial incentives—by providing competitive, market-level pay and subjecting trustees to personal liability, reformers can shape trustee incentives to encourage good governance.

But given the limited opportunities for comprehensive change, reformers should prioritize introducing economic incentives into the public pension equation, thereby improving the overall quality of pension boards and encouraging prudent stewardship of pension assets. These reforms can significantly enhance how public-sector pensions are managed in the United States, ensuring longevity for the millions of current and future beneficiaries who rely on these programs in their sunset years.