

# Alabama's One-Man Pension Show

BY: [Liz Farmer](#), [Daniel C. Vock](#) | May 2016

**The office suite** of David Bronner, head of the Retirement Systems of Alabama (RSA), rivals those of governors in much bigger and much richer states. Perched on the top corner of a building completed in 2008, Bronner's spacious office is full of the framed photos, cartoons and assorted knick-knacks indicative of a long career in politics. A large rug in front of his desk prominently displays RSA's circular logo. Bronner's real trophy case, though, can be seen through his floor-to-ceiling windows and adjoining balcony: the panoramic view of downtown Montgomery, which shows just how much he has changed the skyline of this city of 200,000 people. Five mammoth concrete-and-glass buildings, much like the one his office occupies, stand nearby. The green-capped buildings are designed primarily to house state agencies, yet they're outfitted with flourishes fit for big-city law firms, from fountains, marble, granite and towering lobbies to polished metal cauldrons at major entrances. Beyond them stands the city convention center and the adjoining hotel that Bronner also oversees.

The Montgomery real estate makes up just a small slice of RSA's \$33 billion in investments. But it highlights Bronner's grand ambition to use the pension funds to transform the state's economy, which is the only way, he insists, that Alabama can fulfill its guarantees for the 339,000 state and local workers covered by RSA. "If you have the fifth-poorest state, where are you going to get the revenue to pay the teacher's benefit and the state employee's benefit? The state is not going to be sending me any money if it's broke," says the 71-year-old Bronner, who's led RSA for the past 43 years. Alabama has fewer corporate headquarters and large institutions than most states. "We've got to invest in ourselves," he insists. "We are the only player in town. There isn't anyone else."

"Investing in yourself" is a strategy that many state pension plans have explored. Indeed, the notion that pension plans can contribute directly to their own state's economy is an attractive one. The practice is called economically targeted investments, or ETIs, and the idea is that some investments are preferable to others with equal returns because they offer benefits to the local economy. But the scope of this home-state investing varies enormously. Some states, such as Florida and Montana, cap their in-state investments at around 2 or 3 percent. Others, such as Arkansas, allow for as much as 10 percent. California puts 8.5 percent of its assets toward in-state investments. But with Bronner at the helm, Alabama has taken this idea further than anyone else, investing as much as 16 percent of its pension money in the state and local economy, according to one outside assessment. (The RSA says that assessment is too high.)

*It's not hard to spot the green-roofed RSA-owned office buildings that tower over Montgomery.*

Leaning back in his leather desk chair, Bronner ticks off the ways that he, the son of a Minnesota pool hall owner, has improved the lot of everyday Alabamians by investing their retirement funds back in Alabama. He made the state into a tourist golf destination. He recruited auto manufacturers: first Mercedes, then Toyota and Hyundai. Bronner briefly served as the chairman of US Airways more than a decade ago when RSA owned a big piece of the airline, and he says he brought aerospace manufacturing to Alabama. "I recruited Airbus, and [former Gov. Bob Riley] takes credit for that," he says. "I let every governor do that. Doesn't make any difference. I'm not like Donald Trump and saying, 'I did it, I did it.' No, I'm not interested in that."

Maybe. Bronner certainly shares some traits with the brash real estate tycoon and presidential candidate. Both Bronner's and Trump's marquee investments have been similar: golf courses, hotels and top-tier office buildings (RSA actually owns the biggest office building in Manhattan). Both are masters at branding, affixing their logos to every eligible surface on property they control. Both relish their notoriety and jump at the chance to take on their critics. For both men, too, questions have arisen lately about whether the legend of their investing prowess holds up upon closer inspection.

That last point might be the only thing that could bring the high-flying Bronner back to earth. For as much as he likes to tout his investment successes, in many cases Bronner's portfolio hasn't lived up to expectations, and that makes him vulnerable politically. The legislature, out-of-state groups and Bronner's own pension fund boards have stepped up their scrutiny of RSA as its investments have lost ground. But in a state where, for all intents and purposes, Bronner is the retirement system, it's unclear how far other players can or will depart from the path he has laid out. Can a state that consistently ranks among the poorest, least healthy,

least educated in the country afford to further spread out one of its biggest pools of money? Should it follow Bronner's lead and double down on local investments? And, if so, should it continue to let one man call the shots on his own?

**Bill Newton**, Alabama's finance director, sits in a wood-paneled office at the Capitol, dispassionately discussing Bronner's various investment strategies. Newton repeatedly comes back to a central point. "You're going to recognize that most of my answers over time are going to include 8 percent," he says. "That is by far the most important function of our investing approach. Everything else is not as important."

*Alabama Finance Director Bill Newton insists an 8 percent return on investment is paramount. "Everything else is not as important."*

Eight percent is Alabama's target for average annual investment returns for its pension plans. Long an industry standard, the 8 percent mark is now viewed by many as too lofty for a post-recession economy in which inflation is negligible and interest rates are near historic lows. A number of pension plans in the country are lowering their targets, and Alabama later this year will re-evaluate whether its 8 percent rate is realistic. In the meantime, though, a lot is riding on RSA's ability to meet that goal. Alabama lawmakers set aside roughly \$1 billion every year to pay the state's share of retirement benefits for its employees. If, over time, RSA falls short of the 8 percent return, the state would have to chip in more money to cover the difference. Just falling short a fraction of a percent could divert tens of millions of dollars from other state services to shore up the pension plan.

Newton flips over two sheets of paper on the desk in front of him. One displays a bar graph; the other, a table. They both illustrate the same point: The financial health of Alabama's pension funds, as measured by its funded ratios, has declined from where it was 15 years ago. In other words, the retirement system's liabilities have grown faster than its assets. Many factors affect the funded ratio, including life expectancy and how long employees work before they retire. But one of the few factors states do control is their investment portfolio. In Alabama, the vast majority of pension money is contained in two systems. Since 1997, the funded status of the employees retirement system, which includes state and local workers, has plummeted from 111 percent funded to 63 percent in 2014. The teachers retirement system, which is nearly twice as big, fell from 105 percent funded to 68 percent in 2014. The current unfunded liability of the two Alabama pension plans together is about \$15 billion.

"This is the primary issue for me in our retirement system, as a board member," says Newton, who by virtue of his position sits on the boards of both retirement systems, which oversee Bronner and his staff. It's not just Newton who's concerned. His fellow board members, lawmakers and some judges have taken a closer look at RSA's investments in recent years. Many are unsatisfied with what they've seen.

The legislative scrutiny began in earnest in 2011, when Republicans took control of the Alabama Legislature for the first time in 134 years. The new GOP majority confronted a state budget still devastated by the Great Recession, and like their counterparts in most states, Alabama legislators took steps to reduce overall pension costs. One way they did this was to create a new, less generous tier of benefits for new employees. Legislators also hiked the contribution rates imposed on current employees from 5 to 7.5 percent. The raft of changes reduced RSA's total liability by \$2 billion. That meant that the state -- and thus its taxpayers -- would save \$5 billion over the next 30 years in pension costs. As a result of the changes, the funded ratio of the pension plans has remained about the same for the past several years, after a long period of decline.

But lawmakers still worried it was not enough. National data from Boston College's Center for Retirement Research showed that RSA's investments performed worse overall than most pension plans, averaging just 6.4 percent over the last 10 years. Certainly the Great Recession hurt RSA's ability to meet its 8 percent goal, but Alabama's returns ranked in the lowest quartile among major pension plans over the last decade.

That picture is complicated, though, by the fact that RSA's investments have done much better in the last three years, ranking in the top 10 percent of comparable plans. RSA is more heavily invested in stocks than most pension systems, which typically own a higher share of traditional bonds. Sixty percent of RSA's portfolio is in equities, compared to an average of about 50 percent, according to the Center for Retirement Research. So when the stock market does well -- as it did between 2012 and 2014 -- RSA does very well. The reverse is also true. The stock market slid in 2015, and so did RSA's returns. Initial estimates show that RSA made just over 1 percent in returns for its last fiscal year, which ended in September. The volatility in RSA's investments is one reason lawmakers are especially focused on longer trends.

One way RSA tries to improve its bottom line is by spending less than most pension systems on outside investment firms. The fees these firms charge can have a significant impact, reducing the rate of return for typical pension funds by as much as 0.5 percent, according to RSA. But most of Alabama's investments are managed by RSA's staff, so it pays extremely low fees by comparison. Bronner's staff says RSA's 10-year returns would look better if other plans' higher fee expenses were taken into account.

But many in Montgomery, who every day see evidence of RSA's spare-no-expense strategy for boosting the Alabama economy, suspect something else is afoot. Are the very things that made RSA unique -- especially its focus on in-state investments -- bringing about its difficulties?

State Sen. Arthur Orr, a Republican who is one of the state's top pension experts, notes that the legislature has consistently made its annual required contributions to the pension funds. Given that record of performance, Orr questions why the plans' funding levels should be so low. "We haven't shortchanged ourselves like Illinois and other states," Orr says. "So why are we in this predicament?"

*State Sen. Arthur Orr: "Why are we in this predicament?"*

To explore that and other lingering questions, lawmakers last year formed a joint pension committee. Orr, one of the two leaders of the committee, stresses that the panel has no intention of changing benefits for current workers or retirees. The idea is to see whether there are other fixes that can be made for incoming employees that will help shore up RSA's financial position.

But Orr set off alarm bells when he decided to seek outside advice. The Republican senator enlisted the help of The Pew Charitable Trusts, which partnered with the fiscally conservative Arnold Foundation. The Arnold Foundation is named for its founder, former Enron energy trader and billionaire John Arnold, who is probably the most active critic of public pension systems in the country.

Pew and Arnold had previously played a prominent role in Kentucky's decision to create so-called hybrid or cash balance pension plans. Under those plans, participants are guaranteed a lower rate of return than in a traditional plan and share any excess investment returns with the state. Public workers are likely to get less money when they retire, but their employers save more money. When Pew got to Alabama, some of the work it did for the committee was to outline how Alabama too could put a cash balance plan in place.

Bronner, who regularly runs anti-Arnold ads in his newsletter to RSA members, is incredulous about what he sees as outside interference. "Let's not put Pew in the category of good guys. That's ridiculous," he says. "It is an organized attack on public pension funds by the super rich." It's not only Arnold or Pew, either, he says. It's the oil-billionaire Koch brothers and their network paying for reports by think tanks and universities that undermine public pensions.

But some of these outside criticisms of RSA have struck close to home. In January, Pew reported that the bulk of RSA's \$15 billion unfunded liability comes from the underperformance of its investments. The main culprit, Pew said, is RSA's concentration of real estate holdings in Alabama.

**Bronner has** not only reshaped the skyline of Montgomery, he's also transformed much of the rest of the state. Pension plan investments have refashioned the center of Mobile, Alabama's third-largest city, on the Gulf Coast. RSA built top-of-the-line office towers there, including the tallest building in the state. A controversy over an all-white country club in northern Alabama that hosted the PGA championship in 1990 prompted Bronner to build a network of public golf courses across the state. The result was the Robert Trent Jones Golf Trail, which opened in 1993 and now includes 26 courses on 11 sites. The golf courses spawned adjoining hotels and resorts. Now retirement communities are sprouting up around two of the sites.

*The Robert Trent Jones Golf Trail includes 26 courses on 11 sites.*

Whether those investments are dragging down RSA's real estate portfolio, which makes up about 10 percent of its total investments, is at issue. The system's New York City skyscraper, which accounts for about half of the portfolio's value, generally provides double-digit annual returns. Yet total real estate returns for RSA have averaged just 2.8 percent over 10 years. RSA says those returns will improve over time as the debts for the Alabama buildings are paid off. Still, Pew says the plans' real estate performance is nearly 5 percentage points below what similar funds have reported in annual returns, and the low-performing real estate reduces RSA's overall return by a half percent.

Besides real estate, Bronner has taken an interest in media. RSA controls a television company and a newspaper chain, both headquartered in RSA buildings in Montgomery. The TV enterprise, Raycom, owns 62 television stations affiliated with various networks in 20 states, from New York to Hawaii. Community Newspapers Holdings Inc. owns more than 130 publications across the country, mostly small dailies.

Bronner does not see the Alabama-based properties as isolated investments. He's constantly looking for ways to leverage RSA assets to help other parts of the portfolio. So, for instance, Bronner credits the golf courses not only with boosting tourism, but also making Alabama more attractive to auto and aerospace executives looking to locate new factories, with RSA offering both financial assistance and nearby amenities. RSA-controlled TV stations run Alabama tourism spots when they have advertising slots to fill; the pension fund's newspapers use extra ad space to trumpet the Robert Trent Jones Golf Trail and other Alabama attractions. The free advertising adds up. In 2008, an RSA-commissioned study pegged the value at \$30 million per year in TV advertising and \$25.4 million per year for newspapers.

"That's part of the plan," Bronner says. "What I've tried to do is see, how do I leverage up an investment? Whenever you're here, looking at me, I'm trying to figure out what can I get out of you if I give you money to do your project. And it works, because it gives [RSA] an edge."

*Bronner had a hand in bringing Mercedes, Toyota, Hyundai and Airbus to Alabama.*

But several of Bronner's ideas for stimulating the local economy have turned sour, leading to bankruptcies, embarrassment and huge expenses for RSA. One involved a company called National Railcar, whose owner defrauded RSA after bilking it for hundreds of millions of dollars. RSA agreed in 2007 to loan \$350 million to a Canadian businessman to build a railcar manufacturing facility in northwest Alabama. The vision was of a factory nearly a mile long, which would produce 12,000 railcars a year and employ more than 1,800 local residents. But the plan proved too good to be true.

Gregory Aziz, the businessman who proposed the deal, knew all along that the project would cost far more than the \$350 million price he reported to RSA, according to a grand jury indictment. For nearly a year and a half, Aziz hid the true cost of the building from RSA, until at last he admitted he needed an additional \$400 million to finish the project. Alabama authorities charged Aziz with securities fraud and arrested him. Eventually, though, they dropped the charges after Aziz agreed to pay RSA \$21 million. Now RSA owns the property, and roughly 1,150 people work there.

A second case involved RSA's investment in Signal International, an Alabama shipbuilding company that also repaired oil rigs in the Gulf of Mexico. RSA owned 47 percent of Signal International, which declared bankruptcy last summer after agreeing to pay up to \$22 million to settle lawsuits brought by Indian guest workers who accused Signal of human trafficking. Signal had brought the workers to the Gulf Coast to fix oil rigs after Hurricane Katrina with the false promise that they could receive green cards to remain in the U.S. permanently. Instead, according to the lawsuits, Signal made the workers pay \$1,050 a month to live in cramped living spaces in guarded labor camps. The action took place before RSA invested in the company, but the pension fund bought Signal's assets in bankruptcy and used them to launch a new company, called World Marine.

RSA's attempts to increase its media holdings also earned it a rebuke from federal regulators. For years, Bronner had his eye on a local Montgomery TV station. He failed at his initial attempt to buy WSFA in 1989. But Raycom did eventually acquire it and 14 other stations when it bought Liberty Corp. six years later. In the two weeks before the deal closed, RSA, which was financing the transaction, also bought 73,700 shares of Liberty. The value of its new shares increased by more than \$700,000 after

the deal closed. The move prompted a U.S. Securities and Exchange Commission (SEC) investigation for insider trading, and RSA ultimately agreed to compensate the previous owners of Liberty stock and beef up its own procedures to prevent insider trading in the future. The deeds still earned RSA a public admonition from the SEC.

In the past few years, Bronner's in-state investments have become a legal issue in other ways as well. RSA came out on the winning side of one recent lawsuit, in which the plaintiffs argued that Bronner violated state law by focusing so heavily on Alabama investments, which they claimed diminished overall returns. The Alabama Supreme Court threw the case out in December 2014, ruling that monitoring RSA's pension activities went well beyond the power of the judiciary.

Meanwhile, Bronner has been under attack from the inside. In 2013, the board of the employees retirement system barred him from making investments without first consulting the board's investment committee. For years, Bronner had sidestepped the committee by securing proxy votes from two out of the committee's three members. "Nothing that the board is trying to do is about vilifying anyone," says Curtis Stewart, the gubernatorial appointee who proposed the change. "Whatever changes we do, we want to make sure the system operates the way it should operate." Bronner saw the changes as an intrusion on his authority.

Now attention has shifted to the legislative committee studying the pension system. So far, no consensus has emerged for any major new initiatives. At press time, state officials were still waiting for final numbers on RSA's performance in 2015, which could affect the appetite for further changes.

It's clear, though, that Bronner thrives on the controversy around him. He's framed dozens of editorial cartoons depicting him over the last four decades. Nearly all, he says, are critical. No matter. Bronner has a domineering tendency to look down on his challengers -- even governors. He's served under eight of them, and nearly all, he says, have wanted to fire him. Bronner attributes his dust-ups with politicians to a clash of perspectives: Governors view problems through a four- or eight-year time frame, he says, while pension fund managers must think in terms of decades.

*Bronner with his collection of editorial cartoons, most of which are critical of him.*

Clearly there's more to it than that. Bronner has created much of the resentment by building a political power base independent of the elected officials who nominally oversee him. To start with, he has on his side 339,000 working and retired state employees, who amount to 7 percent of Alabama's population. Bronner communicates with them directly through monthly newsletters mailed to them and distributed in state offices. He writes a column in nearly every issue of the newsletters, rallying members to beat back efforts at cutting their retirement benefits or reining in RSA officials. But Bronner doesn't stop there. He also speaks out on issues with more tenuous connections to the retirement funds, calling for increased staffing at state prisons and asking Gov. Robert Bentley to expand the state's Medicaid program in tandem with the Affordable Care Act.

The Raycom TV stations pick up the message. All three of the company's Alabama stations -- one in Montgomery, one in Birmingham and one in Tuscaloosa -- have run editorials criticizing Bentley for not increasing Medicaid eligibility. They all took issue with the governor's most recent education budget. Some of the stations' editorials were identical. Bronner says he has no direct say on the editorials, but it isn't hard to figure out where he stands.

As a practical matter, Bronner's job is safe for the foreseeable future. He reports to the control boards of the two major pension systems, and he has always been able to count on their support. The teachers' system is twice as big as its counterpart for state and municipal workers, and 80 percent of the board members for the teachers' fund are elected by participants in the system. So as long as Bronner keeps retirees and current workers happy, elected officials have limited options for telling him what to do. When asked why he's never been fired with so many people after him, Bronner is frank: "Because," he says, "I'd snuggle up to the teacher board. [Otherwise,] the politicians would have nailed me decades ago."

Bronner sees the recent scrutiny as no different from the heat he has withstood throughout his career. He was questioned when RSA bought the New York City office building, later when it began its media investments and again when it started the golf trail. In fact, Bronner says his critics were convinced that with the golf courses they were "going to get him on this one. So the buzzards were flying around me," he says. He waves his hand in the air like a bird, making a sputtering helicopter noise. "Keep flying, I don't give a shit."

This article was printed from: <http://www.governing.com/topics/mgmt/gov-alabama-david-bronner.html>