

Public pensions look like bad homes for failed banks

Bloomberg News reported on Monday that the Federal Deposit Insurance Corp. is encouraging public pension funds to inject capital directly into the banking system by buying failed banks.

On the surface, this feels like the act of one troubled, somewhat desperate government agency trying to take advantage of a troubled, somewhat desperate group of investors.

It's not at all clear how these investments would work. Pensions don't typically dabble in direct investments, though the success of the Ontario Teachers' Pension Fund could lead others to reexamine that strategy. And banking would be a somewhat strange place to start, especially in the current environment.

The FDIC, which had a \$21 billion shortfall in its insurance fund at the end of 2009 and has identified over 700 "problem" banks, is understandably eyeballing the more than \$2 trillion controlled by public pension funds.

At the same time, those plans aren't exactly booming.

The funding ratio for state defined benefit pension plans in 2009 fell to an estimated 65 percent, compared to 85 percent a year earlier, data from Wilshire Consulting showed, according to an article by Pensions & Investments last week.

But that's likely another reason why the FDIC would look to public pension funds: They're desperate for returns to improve that status and they're likely anxious to cut out some of the fees they're paying to private equity funds and money managers. They also know the quickest way to make up a shortfall is to take on more risk. Of course, that's also the quickest way to find yourself in an even deeper hole.

Bloomberg cites two anonymous sources in its story and the FDIC isn't talking about the matter. I could imagine a scenario in which the FDIC manages much of the banking end and possibly even backstops some losses.

But looking to pension funds to fill in an investment gap in banks still strikes me as a little odd. As Bloomberg points out, regulators have been hesitant to let private equity investors buy failed banks out of concern that they're more likely to take risks or flip them for a quick profit.

But, because of that aforementioned desperation, public pension funds have been known to take big risks with their money. Just take a look at the largest pension fund in the US, California Public Employees' Retirement System, and its disastrous \$500 million investment in the Stuyvesant Town and Peter Cooper Village apartment complexes in Manhattan, among other investment faux pas over the last two years.