Independent Democratic Conference

Reforming the Way our Pension System Does Business: Reining in the Fees of Wall Street

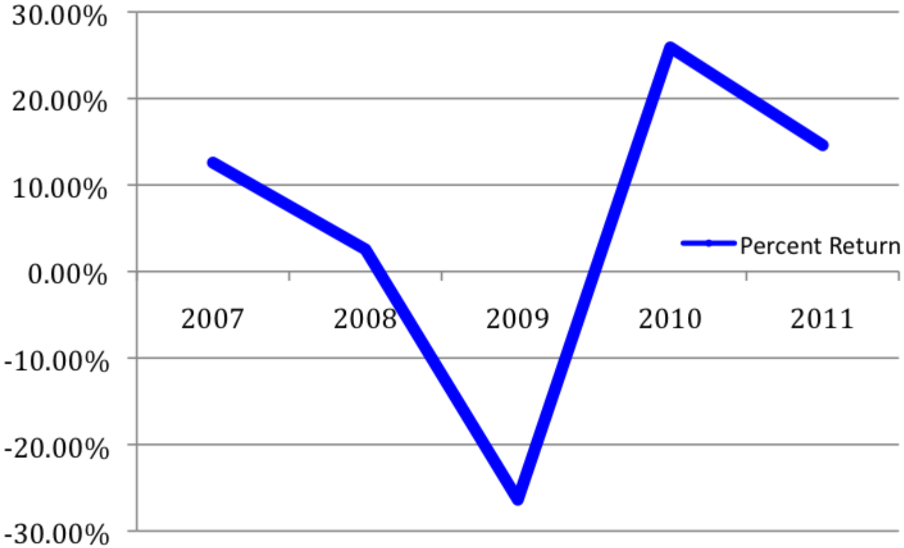
March 5th, 2012

It's Time that Our Pension System do its Part to Reform Wall Street

Each year, our pension system pays hundreds of millions of dollars in fees to Wall Street money firms that manage the system's investment portfolio.

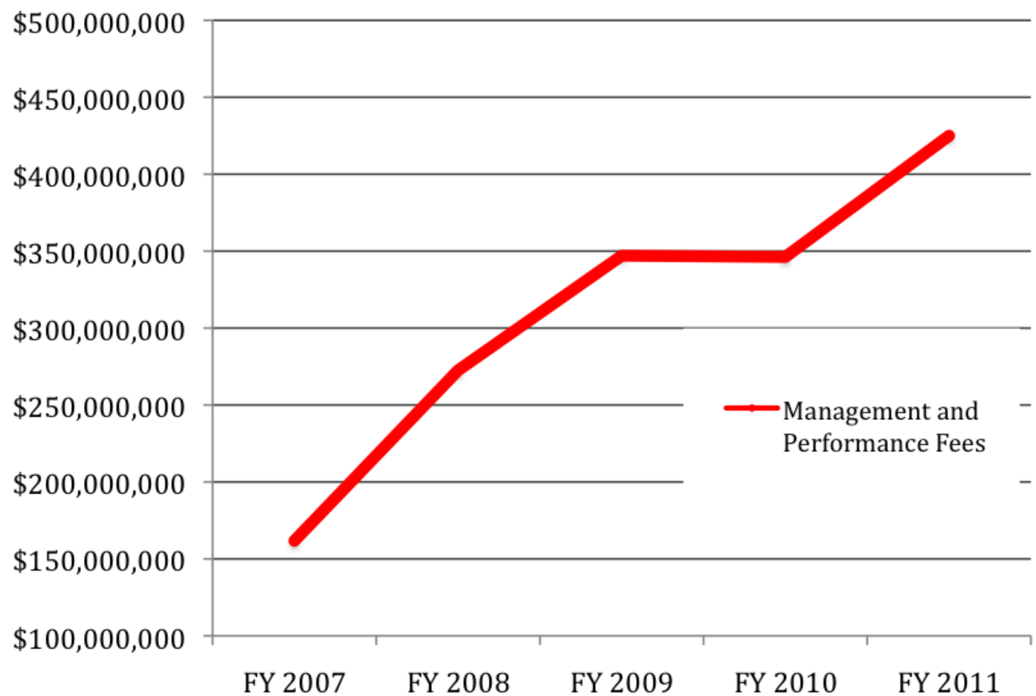
While these money managers deserve to be fairly compensated for good performance, a close examination of pension system finances reveals gross disparities between the fees we've paid and the performance we've been provided.

Annual Performance of NY Pension Fund



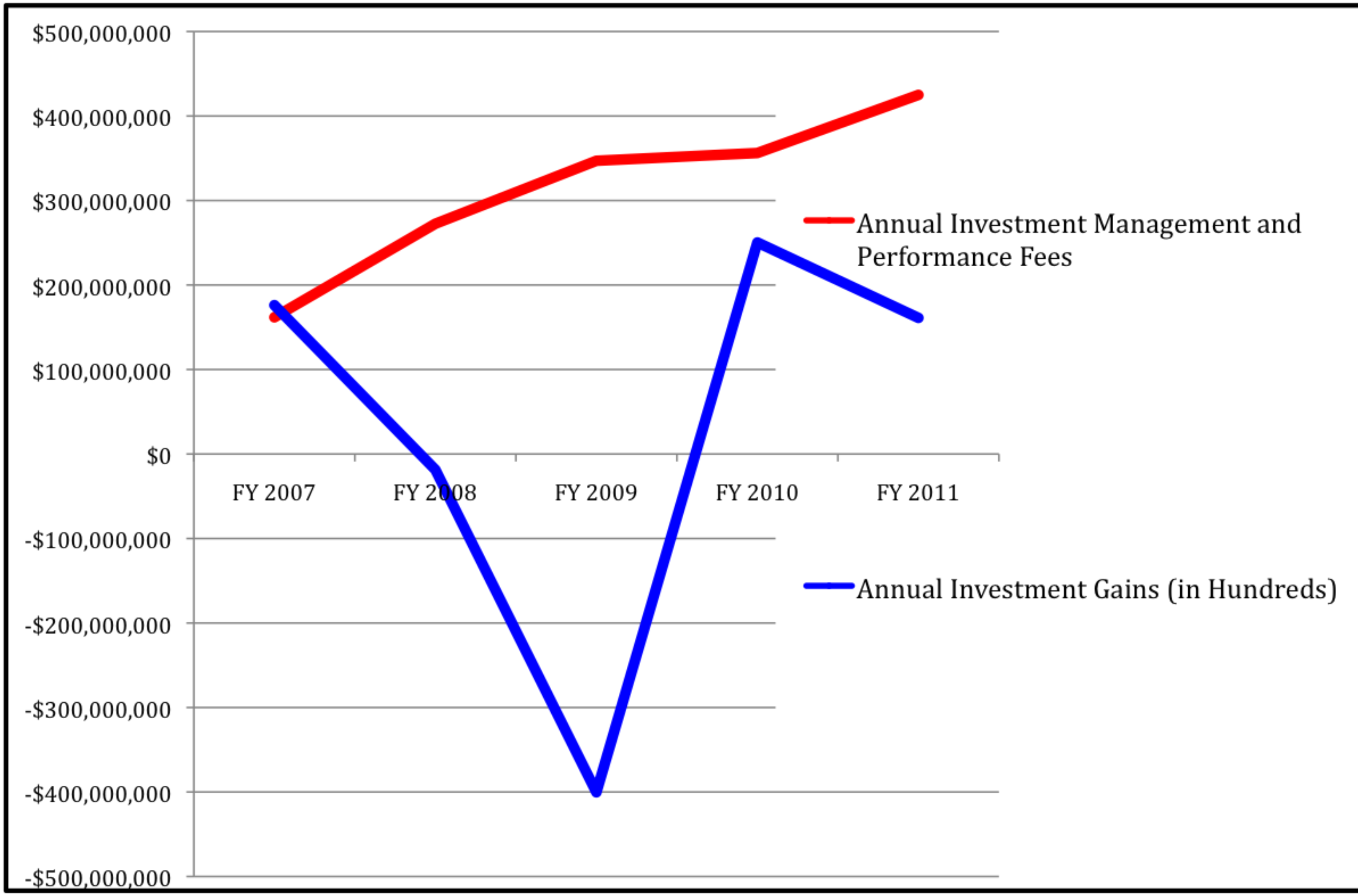
The pension fund's investment portfolio has has net negative growth since FY2007, meanwhile…

Annual Management and Performance Fees Paid by Pension Fund to Wall St



Management and performance fees have skyrocketed by over 160%

Fees vs. Investment Gains
FY 2007 - 2011



It's Time to Reform the Way Our Pension Fund Pays Wall St.

- Since 2007, while the NY State Pension Fund's investment portfolio has experienced negative overall returns, **Wall Street "management and incentive fees" have grown by over 160%**.

- In essence, NY's pension fund has paid Wall St. $1.5 BILLION in management and "performance" fees for definitively mixed results.

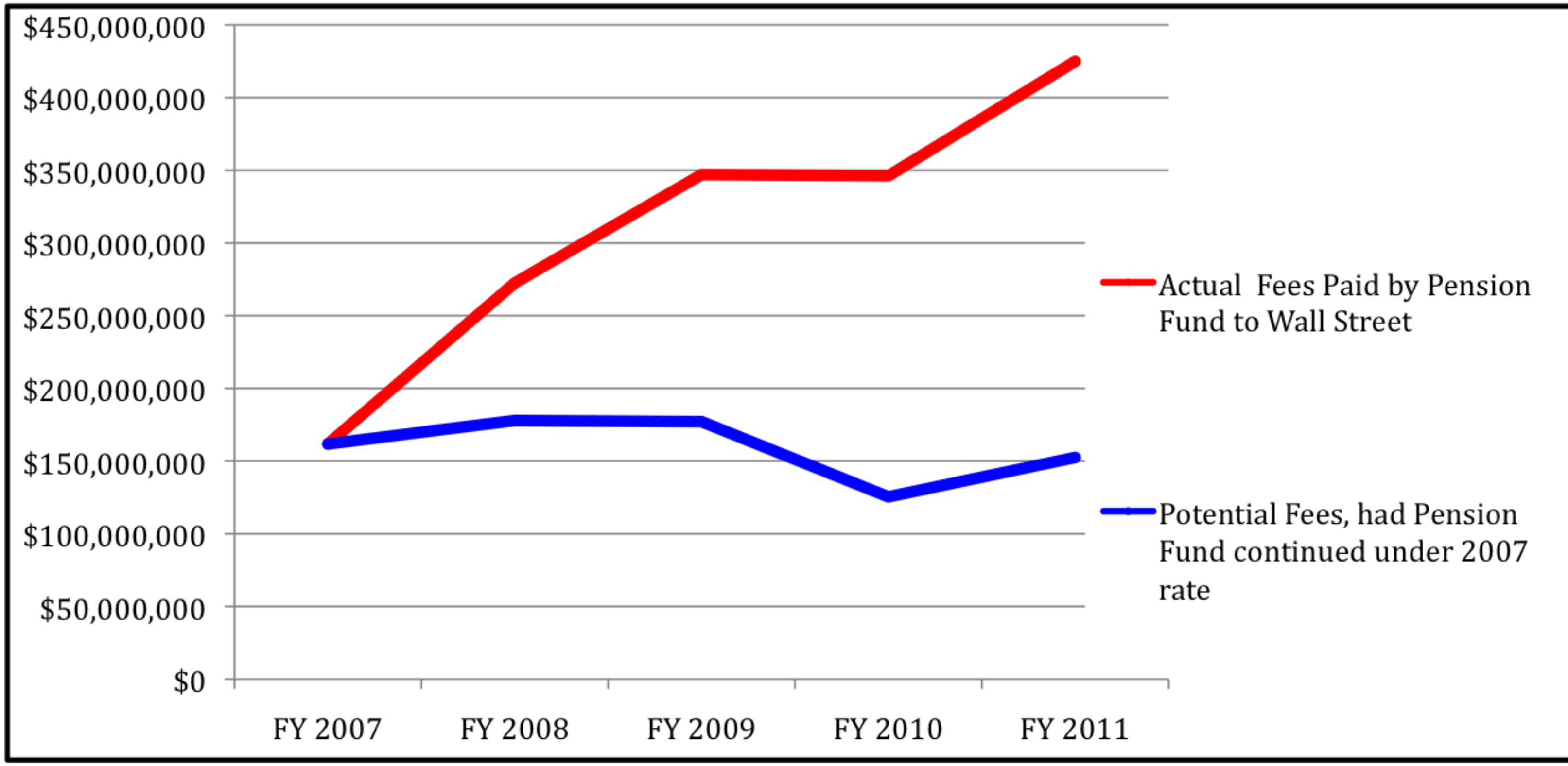
- For example, in 2008, the NY pension system paid $272 million in fees to Wall Street. The next year, when the market crashed and the pension fund **lost $45 billion**, the pension fund paid **even more** in fees.

- **As we can see from the numbers, the past five years tell a similar story — no matter how our investment's perform, the dollar amount and rate of fees simply never go down!**

- It's time to reform the way we compensate outside pension fund managers.

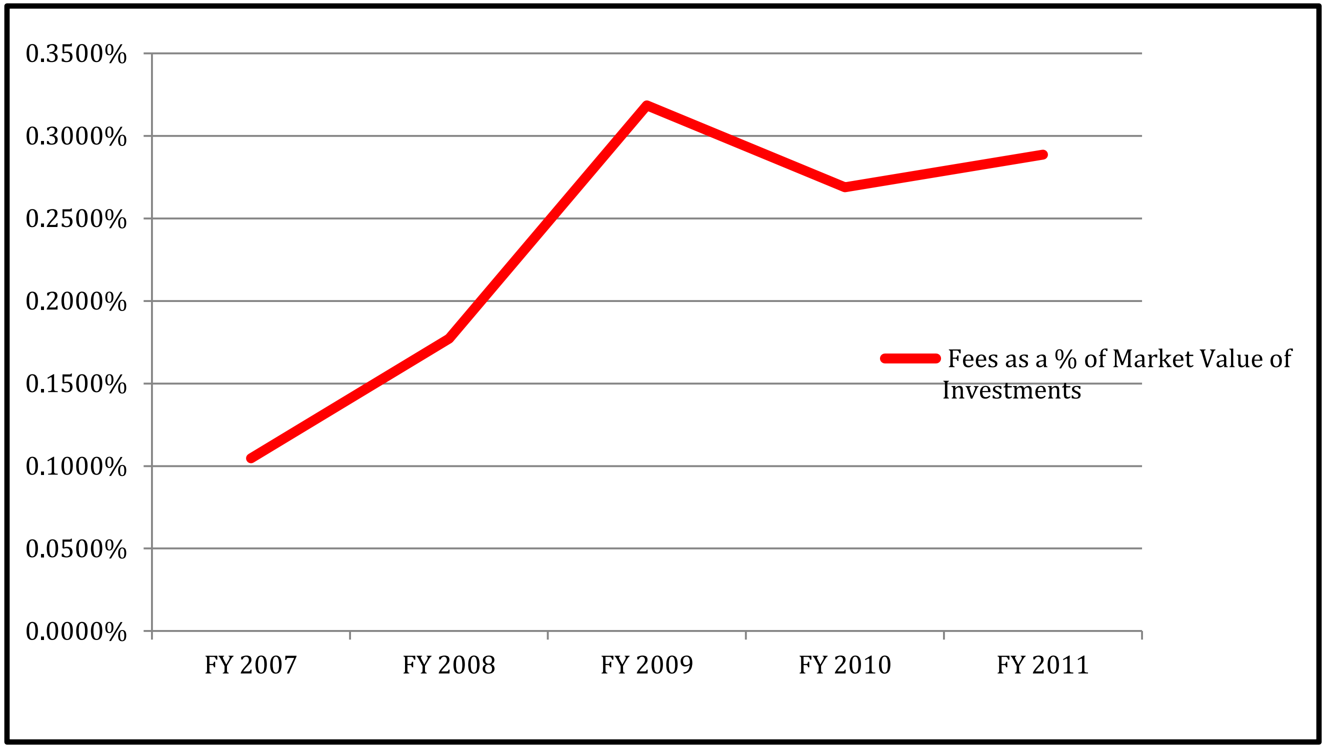
- **By implementing management and performance fee reforms, NY could potentially save itself hundreds of millions right away.**

Over the past 5 years, if our pension fund had maintained a consistent level of fees—rather than increasing them every year—our pension system would have saved **$757,831,721 Million**



Total 4 Year Savings to Pension Fund: $757,831,721

Fees as a % of Market Value of Investments



Fiscal Year	Fees as a % of Market Value of Investments
FY 2007	0.1046%
FY 2008	0.1771%
FY 2009	0.3185%
FY 2010	0.2689%
FY 2011	0.2886%

Pension Fund Investment Performance

Year	Performance	Initial (2007) Investment = $100
FY 2007	Base Year	$100.00
FY 2008	-0.50%	$99.50
FY 2009	-29.20%	$70.45
FY 2010	21.60%	$85.66
FY 2011	11.10%	$95.16
Annualized Rate of Return:	**2.62%**	
Overall 4 year Investment Performance		**-$4.84, or -4.84%**

Fee Increases

Year	Fees	% Increase
FY 2007	$161,755,000	Base
FY 2008	$272,517,000	68.00%
FY 2009	$347,032,000	27.34%
FY 2010	$346,245,000	-0.23%
FY 2011	$424,989,000	22.74%
4-year Increase in Fees		**162.74%**

Source: New York State and Local Retirement System, Comprehensive Annual Financial Reports, FYs 2007-2011, Office of the State Comptroller

Fiscal Year	**Actual Fees Paid by Pension Fund to Wall Street**	Potential Fees, had Pension Fund continued under 2007 rate (.1046%)	**Savings to Pension Fund**
FY 2007	**$161,755,000**	$161,755,000	$0
FY 2008	**$272,517,000**	$177,916,569	$94,600,431
FY 2009	**$347,032,000**	$177,113,253	$169,918,747
FY 2010	**$346,245,000**	$125,413,722	$220,831,278
FY 2011	**$424,989,000**	$152,507,735	$272,481,265
		Total	***$757,831,721***

Methodology:

In projecting savings over a four year period, the IDC pegged hypothetical fiscal year fees to the **Rate of Fees** charged to the pension system during Fiscal Year 2007 (Rate of Fees = Total Investment Portfolio Size / Expensed Fees). FY 2007 provides a fair and reasonable baseline for several reasons. First, FY 2007 represents the most recent year in which the pension system restructured its investment allocations to today's levels. This restructuring is characterized by an increase in allocations to alternative investment classes (asset classes typically associated with higher fees). Second, FY 2007 represents a year of substantially positive investment returns. By drawing our baseline from a FY in which the system experienced positive (if not exceptional, by recent historical standards) returns, we are assured that the pension system's Rate of Fees for that fiscal year is not artificially depressed by an anomalous one year decline.

Are All of Our Asset Managers Worth the Money that Our Pension System is Paying Them?

Hedge Funds seem to be negotiating fees that look an awful lot like **Heads, we win, Tails, you lose**. For instance:

In 2008, when hedge funds **grew our investments by 2%** the Pension Fund paid $50,000,000 in fees…but the next year, in 2009, when hedge funds **sunk our investments by 20%** the Pension Fund **again paid almost $50,000,000 in fees**!

While Hedge Funds typically receive the lion's share of their compensation in exchange for returns that far **outpace the market**, NY's pension fund does not appear to set any such contingencies in its fee agreements:

For instance, in 2010, when hedge funds **delivered returns 35% points below that of** standard (and low cost) domestic equity, the Pension Fund paid $50,000,000 in hedge fund fees. Shocking, the next year (FY2011) when hedge funds delivered **the worst returns of any asset class,** the Pension Fund paid **hedge funds $123,000,000 in fees—the most its ever paid!**

How Can This Be Happening?

Currently, there is **no public disclosure** of the contractual fee agreements made between the pension fund and its outside money managers. Without this information, it is impossible to discern what is be behind these discrepancies.

While the Comptroller provides annual reports of the total fees paid to each money manager, there is **no public reporting** of each manager's actual performance for that year. Thus, in the end, all we see is a the hit to the pension fund's wallet: we have no basis to judge whether individual payments are justified.

Making this inquiry more difficult is that some investment managers, such as private equity firms, value their assets by complex, internal, and subjective methodologies. The individualized method used by each firm determines the value of its underlying assets. Why is this so important? Because these asset values determine how well the the firm has performed during each period. Since these methodologies are so opaque — and because the valuations ultimately determine how much fees get paid—the SEC has launched its own industry wide investigation into how this process works. With our pension system so heavily invested in firms like these, our state should open its books, demand fuller disclosure, and allow outside experts and stakeholders to make their own judgments on how well this process is serving our system and our taxpayers.

As the IDC believes, until there is **complete public disclosure of these fee agreements and each individual manager's annual performance**, we can never really know how well our pension system is performing.

In addition to Enhanced Disclosure, the Time for Reforming Management and Performance Fees Has Come

- → Unlike other large public pension funds, such as CalPERS, NY has yet to outline a serious strategy for how it will negotiate competitive fee contracts with the hedge funds that manage sizeable portions of our Fund's investment portfolio. In order to make our system more efficient, our pension fund must lay out such a strategy as soon as possible.

- → Unlike most hedge fund fee contracts, which typically focus on short-term, high cost returns, NY's pension fund should ensure that all of our contracts are aligned with the pension fund beneficiaries' long term investment needs and goals.

- → When it comes to high-stakes contracts, such as those that our pension fund negotiates with hedge funds, public disclosure and independent examination is the best way to ensure that our contracts meet the standards of excellence that every New York taxpayer expects

The IDC's Legislative Solutions

1. The IDC will be drafting legislation requiring public, online disclosure of all management and performance fee agreements between the Pension System and outside investment managers.

1. Senator Klein, as Co-Chair of the bi-partisan Senate Task Force on Government Efficiency, will be calling on the Task Force to hold hearings on the terms of all current and future fee agreements. As part of hearings, Senator Klein will be seeking testimony from independent experts, beneficiary representatives, and members of the Comptroller's office.

1. The IDC calls for the Comptroller's office to ensure that all future management and performance agreements align the long-term interests of pension beneficiaries with the strategies of outside investment managers.