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PENNSYLVANIA PENSIONS RETHINKING HEDGE FUNDS

Last month, America's largest public pension fund, California's Public Employees' Retirement System ("CALPERS") announced that it was ending its investments in hedge funds after much debate about the value offered by such alternative investment vehicles compared to recent returns yielded by more liquid funds. Recently, it was announced that two Pennsylvania retirement funds are also reconsidering their hedge fund portfolios, but in their case it is primarily a matter of fees and transparency. After 12 years of such investments, the person who chaired one Pennsylvania fund when it began hedge fund investing has now "soured" on the idea.

"What Your Retirement Might Be Worth"

The two Pennsylvania public retirement funds, the Pennsylvania State Employees' Retirement System (SERS) and the Public School Employees' Retirement System (PSERS), have fielded a number of complaints from both officials and the public as to the opacity of managers' fees and the real net return that the funds are receiving. State employees and teachers find it difficult to track what the state's return is on the hedge fund investments because unlike stock and bond funds, the pension plans do not publicize the alternative manager's annual performance. Instead, what are posted are "aggregate results" for alternative-asset portfolios that include managers' estimates of what the retirement investments might be worth some day. All that is commonly known is that the funds are fee-intensive.

A Hedge Fund NDA

When the SERS fund invested $250 million with a hedge fund in 2012, it signed an agreement that requires nondisclosure of its terms in order to prevent "the economic terms of this Agreement and any sensitive investment or financial information from public disclosure." As a result, its annual "Investment Program Expenses & Fees" report to state legislators does not list any fees paid to the hedge fund manager even though a consultant's report (which was circulated to the pension's board members but not to the public) lists "management fees" totaling $5.5 million and "incentive fees" totaling $5.7 million paid to the fund manager in 2012 and 2013.

Demand for Transparency

According to Pennsylvania Auditor General Eugene DePasquale: "This is public money. This needs to be transparent. It is very difficult to find out, through their own reporting, what the actual fee structures are." He is calling for SERS and PSERS to disclose the fees being paid to hedge fund managers, although PSERS does disclose some — but not all — of its fees paid to alternative investment managers. The PSERS reports cite "carried interest" along with management fees, but in the case of private-equity managers, carried interest accumulates until their funds are liquidated years later. What the managers ultimately collect is not reported by PSERS.

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