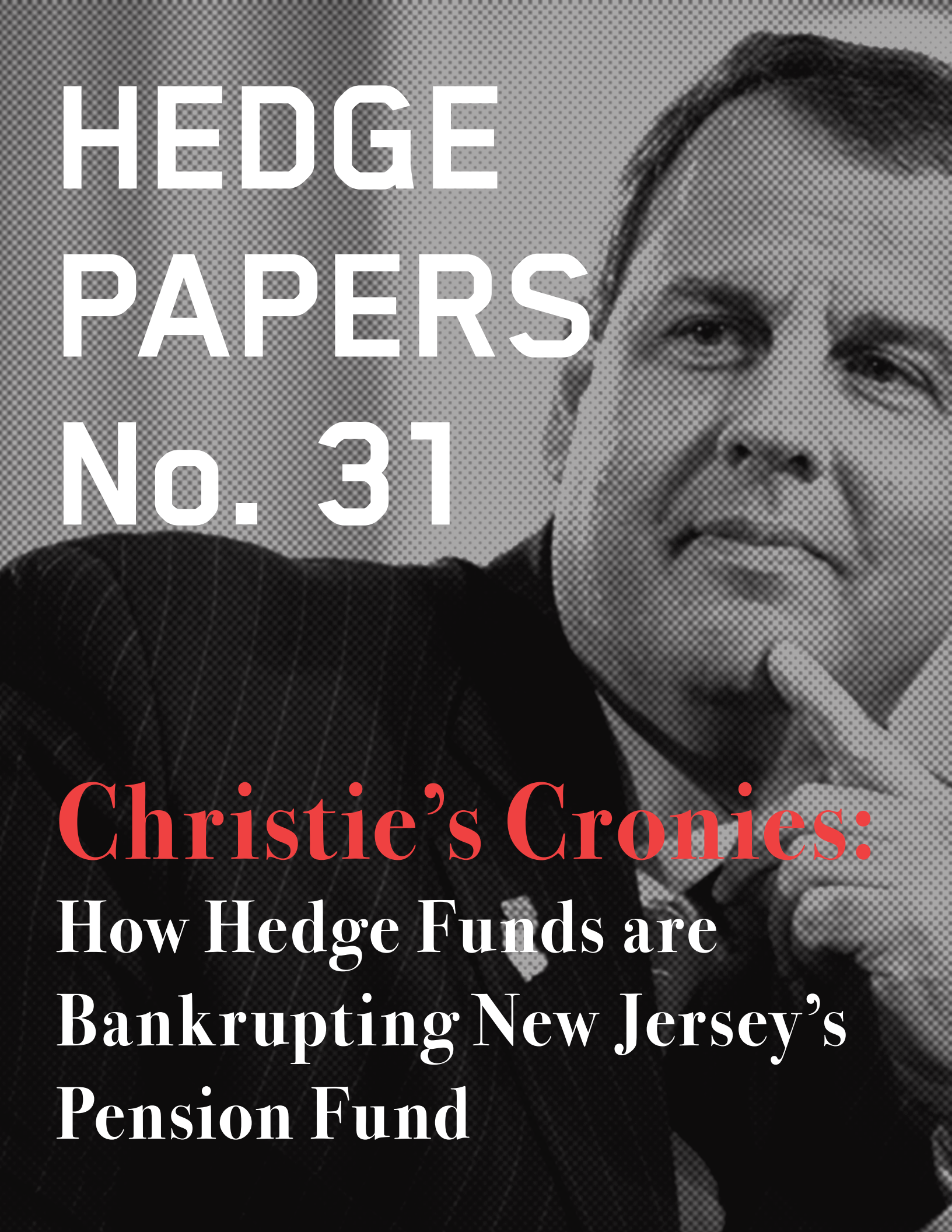


HEDGE PAPERS No. 31

Christie's Cronies:

How Hedge Funds are Bankrupting New Jersey's Pension Fund

OVERVIEW AND INTRODUCTION

In July 2015, New Jersey Hedge Clippers released a report, *Diminishing Returns: How Chris Christie is Wasting Billions on Bad Hedge Fund Investments*, outlining how Governor Christie led the New Jersey State Investment Council to take increasingly risky bets on hedge fund investments—leaving New Jersey taxpayers and public employees on the hook for over $2 billion in fees and lost returns.

The losses to taxpayers and workers have continued—and now it looks like the fix was in.

Hedge fund and private equity fees totaled over $725 million in 2015 alone.

It now appears that Governor Christie's two hand-picked appointees to the board, Tom Byrne, Jr. and Guy Haselmann, were instrumental in leading the pension fund to increase its allocation to hedge funds.

Both Byrne and Haselmann were appointed by the Governor in 2010 and both came directly from the finance industry: Byrne is the founder of Byrne Asset Management, an investment advisory firm, and Haselmann spent fifteen years as a hedge fund manager.

It is no surprise, then, that under Byrne and Haselmann's leadership, the New Jersey pension fund more than doubled its hedge fund investment, from about 5.3% of the total portfolio at the end of fiscal year 2011 to over 12% by the end of fiscal year 2015.[1]

KEY FINDINGS

However, as our analysis shows, hedge fund performance proved to be disappointing at best for the pension fund; according to the pension fund itself, hedge fund and private equity fees totaled over $725 million in 2015 alone.[2] Our estimates suggest that nearly half of these fees—an estimated $295 million—were collected by hedge fund managers.[3]

Our analysis shows that hedge fund investments cost the New Jersey pension fund an estimated $2.7 billion over nine years—including an estimated $1.6 billion in fees, and an additional $1.1 billion in lost investment revenue.

Tom Byrne, Jr., left, Guy Haselmann, right

DIVERSE COALITION OF STAKEHOLDERS PUSHES NJ TO DIVEST FROM HEDGE FUNDS IN ORDER TO PROTECT TAXPAYERS AND WORKERS

In May, the New Jersey State Investment Council voted on a taxpayer-protecting proposal to reduce the fund's hedge fund allocation to 4%.

The charge to cut these costly and risky investments was led by a coalition of labor groups representing public employees in the state, including the AFL-CIO, CWA and AFT, who criticized the fund for paying hundreds of millions of dollars in fees to private equity and hedge fund managers.

Among those council members voting against the measure were Byrne and Haselmann.

In fact, at the May Council meeting, Haselmann—whose career includes fifteen years as a hedge fund manager—went so far as to threaten to resign if the pension fund dumps hedge fund investments, as other state and city funds have done recently.

Although the vote resulted in a 7-7 tie, it is likely that the issue will come before the Council again when the State Investment Council reconvenes in August.

As one of the largest public pension funds in the U.S. with over $8 billion invested in hedge funds,[4] **the New Jersey Pension Fund is poised to become the largest public pension fund to significantly reduce its hedge fund allocation since CalPERS voted to eliminate its hedge fund portfolio in 2014.**

HEDGE FUND INVESTMENTS COST NEW JERSEY PENSION FUND $2.7 BILLION OVER NINE YEARS

In November 2015, the American Federation of Teachers (AFT) and the Roosevelt Institute issued a report, *All That Glitters is not Gold: An Analysis of U.S. Public Pension Investments in Hedge Funds*, analyzing 11 large public pension funds' experience with hedge fund fees and returns, including the New Jersey Pension Fund.

On average, pension funds paid an estimated 58 cents in fees to hedge fund managers for every dollar of net return to the pension fund.

The report found that, on average, these pension funds paid an estimated 58 cents in fees to hedge fund managers for every dollar of net return to the pension fund.

NJ taxpayers & workers hurt: $1.6 billion in fees, $1.1 billion in lost returns

With respect to the New Jersey Pension Fund, our analysis suggests that hedge fund fees cost the pension fund an estimated $1.6 billion from fiscal year 2007-2015; furthermore, underperformance by hedge funds cost the pension fund an additional estimated $1.1 billion in lost investment revenue over this period. (For more details on our analysis, please see Appendix).

High fees for losing money

Last year, according to the New Jersey State Investment Council, the pension fund paid more than $725 million in fees to hedge fund and private equity

managers,[5] even though eight out of the state's nine hedge fund strategies lost money over fiscal year 2015, with net return rates ranging from -.26 percent to as much as -8 percent; the one hedge fund strategy that did not post negative returns returned a paltry .36 percent.[6]

HEDGE FUND FEES COST PUBLIC EMPLOYEES, RETIREES AND TAXPAYERS BILLIONS

When a pension fund pays high fees for relatively low returns, as has been the case for the New Jersey Pension Fund, this has a direct impact on pension plan participants – and on New Jersey taxpayers.

In absolute terms, New Jersey's $2.7 billion loss on hedge fund investments works out to over $3,370 per plan participant for the nine years studied.

And due to the current pension-funding crisis in New Jersey, this $2.7 billion doesn't just come out of pensioners' deferred wages—it also puts taxpayers on the hook for shortfalls. Meanwhile, hedge fund billionaires were rewarded for underperformance.

Hedge fund billionaires were rewarded for underperformance.

Another way to look at the importance of fees is to examine the impact that management fees can exert over time. According to the Department of Labor, an increase in fees for an individual participant of a 401(k) plan by 1 percent will result in a 28 percent reduction in that person's individual retirement savings over 35 years.[7]

Hedge funds charge 800% higher fees than other portfolio funds

We estimate that the New Jersey Pension Fund paid at least 8 times more in fees for hedge funds than it did in fees for a same-sized total fund portfolio, suggesting that high hedge fund fees paid now will significantly decrease funds available to pay out pensions for retirees in the decades to come.

Smart cities and states getting out of hedge fund investments

Public pension funds are now revisiting their hedge fund allocations—and some are deciding to reduce or eliminate their investments in the asset class altogether, led by trustees who are fighting for taxpayers and workers rather than their allies and former employers in the world of hedge funds.

Over the last several months, two pension funds analyzed in the *All That Glitters* report made significant changes to their hedge fund allocations.

The Illinois State Board of Investment (ISBI) voted in February to decrease their hedge fund allocation from eleven percent to three percent.[8]

And the New York City Employees' Retirement System (NYCERS) voted in April to divest from hedge funds altogether.[9]

In fact, according to a recent Wall Street Journal article, city and state pension funds have divested nearly $7 billion from hedge funds since 2014.[10]

The New Jersey Pension Fund is one of the largest public pension funds in the U.S.—and, with over $8 billion invested in hedge funds, it is also among the most prominent hedge fund investors. The New Jersey State Investment Council now faces a choice: either follow the lead of Haselmann and Byrne and double down on what appears to be a failed investment strategy, or reduce its hedge fund allocation, in order to protect public workers and taxpayers from further losses.

APPENDIX

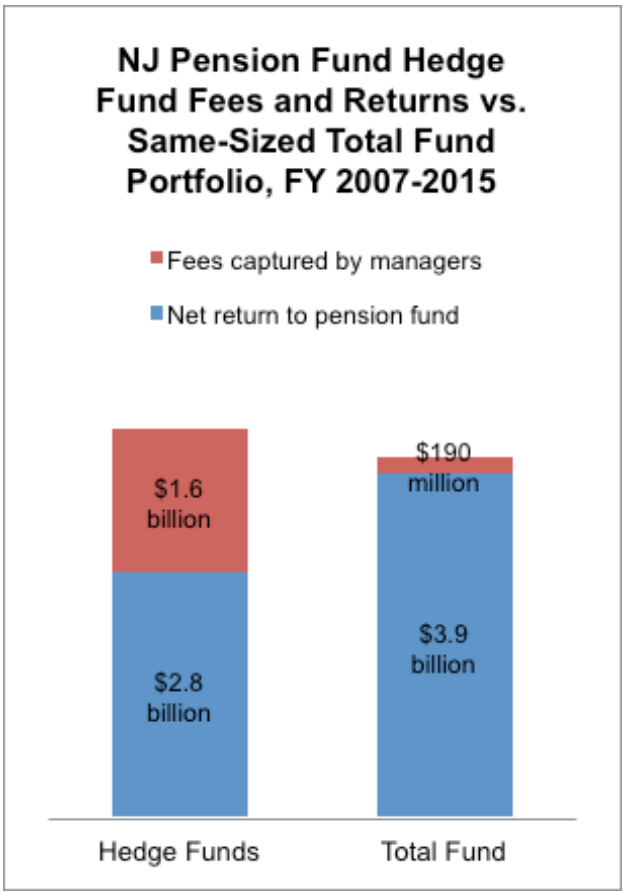
The following snapshot of the New Jersey pension fund's experience with hedge fund fees and returns was obtained from *All That Glitters Is Not Gold*:[11]

Our analysis suggests that underperformance by New Jersey's hedge fund investments cost the pension fund an estimated $1.1 billion in lost investment revenue over this period, giving New Jersey pension fund trustees good reason to question whether its hedge fund program advocated by hedge fund managers and consultants is worth continuing.

Net Returns. Over the nine fiscal years analyzed, hedge fund returns lagged same-sized total fund returns in all but three years. We estimate that a $100 investment in hedge funds at the beginning of FY 2007 would have grown to $146 by the end of FY 2015, compared with $180 for the total fund over the same period.

Fees. From FY 2007-2015, the NJ Pension Fund paid an estimated $1.6 billion in fees to manage its hedge fund investment—compared with only $190 million to manage a same-sized total fund portfolio. When compared with net returns, New Jersey paid an estimated 58 cents for every dollar of return to the pension fund, versus 5 cents for every dollar of net return for the total fund portfolio.

Fee Disclosure. Reports suggest that hedge fund managers and consultants refuse to disclose all fees charged to pension systems, and there are likely additional fees of which NJ Pension Fund trustees are unaware. This makes it difficult for pension fund trustees to assess whether the pension fund's hedge fund program is producing value relative to total cost for the pension fund.



WHO ARE THE HEDGE CLIPPERS?

The Hedge Clippers are working to expose the mechanisms hedge funds and billionaires use to influence government and politics in order to expand their wealth, influence and power. We're exposing the collateral damage billionaire-driven politics inflicts on our communities, our climate, our economy and our democracy. We're calling out the politicians that do the dirty work billionaires demand, and we're calling on all Americans to stand up for a government and an economy that works for all of us, not just the wealthy and well-connected.

The project is supported by the Strong Economy for All Coalition, a coalition of labor unions and community groups working to fight income inequality and build shared prosperity and economic & social justice in New York and around the country.

FOOTNOTES:

[1] Based on figures obtained from New Jersey State Investment Council monthly investment reports. http://www.nj.gov/treasury/doinvest/directorsreports.shtml http://fortune.com/2016/03/14/carl-icahn-donald-trump/

[2] http://www.nj.com/politics/index.ssf/2016/03/nj_pension_investment_fees_bonuses_top_728m_in_201.html

[3] For more details on methodology, please see *All That Glitters Is Not Gold: An Analysis of U.S. Public Pension Investments in Hedge Funds*. http://www.aft.org/sites/default/files/allthatglittersisnotgold2015.pdf

[4] Data obtained from Preqin, a database of alternative assets, including hedge funds. https://www.preqin.com/

[5] http://www.nj.com/politics/index.ssf/2016/05/nj_pension_panel_divided_on_hedge_fund_investments.html https://www.google.com/url?hl=en&q=http://wapo.st/24N1axf&source=gmail&ust=1465953412294000&usg=AFQjCNFBgKlxqtxaqM_LKyC4-3j-n8SCMg

[6] http://www.politico.com/states/new-jersey/story/2016/01/nj-pension-spent-701m-on-alternative-fund-costs-union-says-030616

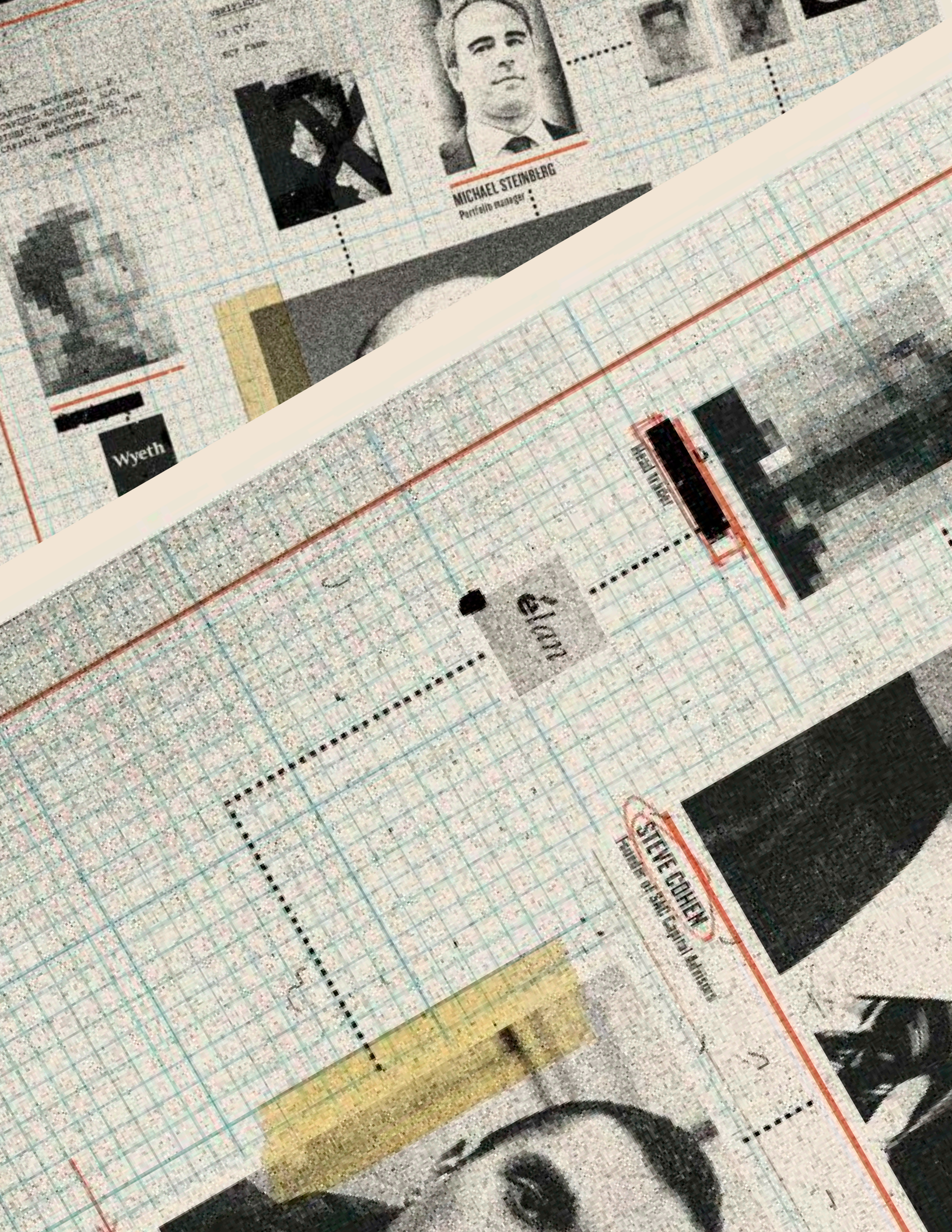
[7] "A Look at 401(k) Plan Fees," U.S. Department of Labor, www.dol.gov/ebsa/publications/401k_employee.html.

[8] http://www.pionline.com/article/20160209/ONLINE/160209855/illinois-state-board-significantly-cuts-hedge-funds-public-equity-in-new-asset-allocation

[9] http://www.pionline.com/article/20160418/PRINT/304189975/nycers-pulls-the-plug-on-hedge-funds

[10] http://www.wsj.com/articles/teachers-union-and-hedge-funds-war-over-pension-billions-1467125055

[11] For more detailed methodology, please see All That Glitters Is Not Gold: An Analysis of U.S. Public Pension Investments in Hedge Funds. http://www.aft.org/sites/default/files/allthatglittersisnotgold2015.pdf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