



SENT VIA EMAIL ONLY

Janet Cowell, State Treasurer  
Department of State Treasurer  
325 N. Salisbury Street  
Raleigh, NC 27603

February 27, 2014

**RE: Failure to Disclose Significant Pension Fees Paid to Wall Street**

Dear State Treasurer Cowell:

As you will recall on January 8<sup>th</sup> my client, the State Employees Association of North Carolina (SEANC), asked you to disclose the total annual fees paid by the Teachers' and State Employees' Retirement System (TSERS) to Wall Street money managers since January 1, 2003, including any fund-of-fund and manager-of-manager multiple layers of fees; asset-based fees; operating fees and expenses; and performance fees by manager or fund.

Based upon my preliminary review of the limited information you have provided to date in response to SEANC's public records request, it is apparent that you have failed to disclose a significant portion of the hedge fund and alternative investment manager fees paid by TSERS to money managers.

Indeed, it appears that the massive hidden fees you have failed to disclose dwarf the excessive fees you have disclosed to us.

For example, the fee information you have provided to SEANC indicates that with respect to Franklin Street Advisers in 2012-2013, TSERS paid \$1.8 million in asset-based fees and \$800,000 in incentive fees, or a total of

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approximately \$2.6 million for managing approximately \$360 million. This amounts to an apparent 50 basis point asset-based fee and a 5 percent incentive fee.<sup>1</sup>

Since Franklin Street is a fund of funds, the underlying hedge fund managers are generally paid a 2 percent asset-based fee and a 20 percent incentive fee. It appears that you are not disclosing the significant fees paid to the underlying hedge fund managers actually managing the money—fees which are far greater than Franklin’s fees for simply overseeing them.

It appears that the undisclosed underlying fees related to the Franklin investment alone—just one of the hundreds of funds in which TSERS has invested—amount to \$7.2 million in asset-based fees and \$3.2 million in incentive fees or \$10.4 million in 2013.

Since it appears that Franklin has managed this account for approximately 12 years, the undisclosed asset management fees paid to this single manager appear to exceed \$120 million.

However, based upon a review of relevant SEC filings, it appears that there may be additional significant fees amounting to an estimated \$3 million annually paid to Franklin that you may have failed to disclose.

While Franklin Street’s website indicates that the firm does not deal in any securities and maintains an arm’s length relationship with all external managers on its platform, according to SEC filings, Franklin Street Securities, Inc., an affiliate of the firm, is a FINRA registered broker/dealer utilized to execute trades for many accounts.

The broker-dealer firm, which does not actually execute trades itself but serves as a middleman, earns as compensation the difference between the fee it pays to its correspondent clearing broker for execution and the commission it charges clients. The trading commissions clients pay to Franklin’s affiliated brokerage are significantly higher than the best rates available today.

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<sup>1</sup> To date you have failed to provide the investment advisory contracts SEANC requested which recite, in part, the fees money managers charge TSERS.

To be clear, any such brokerage compensation, which may be substantial (given high portfolio turnover generally related to hedge funds) is in addition to the asset-based and incentive fees paid to Franklin for selecting and monitoring external managers and the fees paid to the underlying hedge fund managers.

In summary, total asset management and brokerage fees related to the Franklin investment appear to be approximately \$16 million annually, not the \$2.6 million you have disclosed.

Again, I, on behalf of SEANC ask that you provide all of the fee information SEANC previously requested, including specifically any alternative investment (hedge, venture and private equity) fund-of-fund and manager-of-manager multiple layers of fees and expenses.

As of this point in time, it is apparent that the fee information you have disclosed to the public and even the additional information disclosed to SEANC, is incomplete and materially understates TSERS investment management fees and expenses.

Finally, we note that while Franklin Street and the other hedge fund of fund managers were listed in the 2011 Annual Report, they disappeared, without explanation, from the list of managers in the most recent 2012 annual report produced by your office—even though these managers continue to manage assets.

SEANC and I look forward to receipt of the complete fee and other information SEANC previously requested, as we proceed in our forensic review of TSERS.

Thank you,

Edward Siedle  
President