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Defending Wall Street Fees.

The performance fees that public pension plans pay private equity and hedge fund managers are coming under scrutiny. Some say the high fees aren't worth the returns on investment and complain that many costs remain hidden. Those two points were part of a critical report last month by the right-leaning Maryland Public Policy Institute on Maryland's hidden Wall Street fees.

Now, the Maryland State Retirement Agency has issued a lengthy response questioning the institute's conclusions. In a letter published this month by Executive Director R. Dean Kenderdine and Chief Investment Officer Andrew C. Palmer, the system's officials attack the institute's methodology while defending its own financials.

Maryland reported paying $85 million in performance fees in 2014, but according to the report it may have actually paid more than $250 million. The policy institute made that estimate by comparing Maryland's disclosed performance fee rate against the rate of performance fees disclosed by New Jersey, which has a similarly sized alternative investment portfolio and fairly comprehensive fee disclosure policy.

But Kenderdine and Palmer say Maryland's $85 million in reported fees are accurate because New Jersey has been "much more aggressive in its pacing of investments." In other words, the private equity funds New Jersey invests in are designed to start producing returns soon after the pension puts money in the fund. Maryland's private equity funds, however, haven't hit that so-called harvesting period when investments are sold and managers receive performance fees from that profit, said Kenderdine and Palmer. So the performance fees are smaller but could theoretically be larger in the coming years.

Though Maryland's investment performance is lagging compared with most plans, according to Kenderdine and Palmer, they may be better off later. That's because stock market losses in the 2001 and 2008 financial crises left them feeling too exposed to one of the "most volatile asset classes," so Maryland now has less of its investments in public stocks than most other plans. That means that "during periods of strong public equity performance, as has been experienced over the past five years, [Maryland] will lag the peer group," the officials said. But, Maryland "should perform better during periods of market stress."

The Takeaway: The pension system's dispute of the figures in the institute's study shows just how murky the issue of reporting Wall Street fees is. In their response, Kenderdine and Palmer also say they support an effort to standardize performance fee reporting. But they join many public pension officials in arguing that even if Maryland's fees were higher, they would be worth it.

"Large amounts of [performance fees] should be considered a positive result, as this would imply much greater gains to the investor," they noted.

In other words, the higher a performance fee, according to them, the higher Maryland's profit from that investment is. While that's true, many contend that cheaper funds can produce comparable (or better) returns on investment.

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