



*Investment Program*

---

## RETIREMENT PLANS' TOTAL EXPENSE RATIO

---

Office of Retirement Services

# Investment Policy Statement on Investment Fees

“The Plan will seek alignment of interests when negotiating fees while pursuing the best net of fees performance results. Investment costs shall be monitored, controlled, and whenever possible negotiated to ensure cost effectiveness. The Board shall give consideration to the impact of administrative expenses, external management fees and performance fees when establishing the asset mix policy of the Plan. The Board will be provided reports on investment costs of the Plan at least annually.”

# Understanding Total Expense Ratio

- Complex topic
- Declining return expectations → Increased focus
  - $\text{Net returns} = \text{Gross returns} - \text{Total expense ratio}$
- A function of asset allocation and asset class structuring
  - Higher complexity = higher fees
- ORS comprehensive annual fee reporting started 2015
  - Includes embedded or unobserved fees/expenses (e.g., fees not reported on statements)
  - Few public plans have comprehensive fee reporting (CalPERS, CalSTRS, LACERA, OCERS)
  - No public-sector standard methodology for comprehensive fee reporting
- Complies with California Government Code §7514.7

# Understanding Total Expense Ratio

Net returns = Gross returns – Total expense ratio

| Fee type                  | Description                                                | Examples                                                      |
|---------------------------|------------------------------------------------------------|---------------------------------------------------------------|
| <b>Management fees</b>    | Fees paid to investment management firms                   |                                                               |
| <b>Incentive fees</b>     | Performance-based fees paid to investment management firms |                                                               |
| <b>Operating expenses</b> | Costs of administering individual investment vehicles      | Audit, tax, legal, custodian                                  |
| <b>Other expenses</b>     | Costs incurred at the plan level                           | Staff salaries and benefits, consultants, third party vendors |

# Calendar Year 2021 Fees

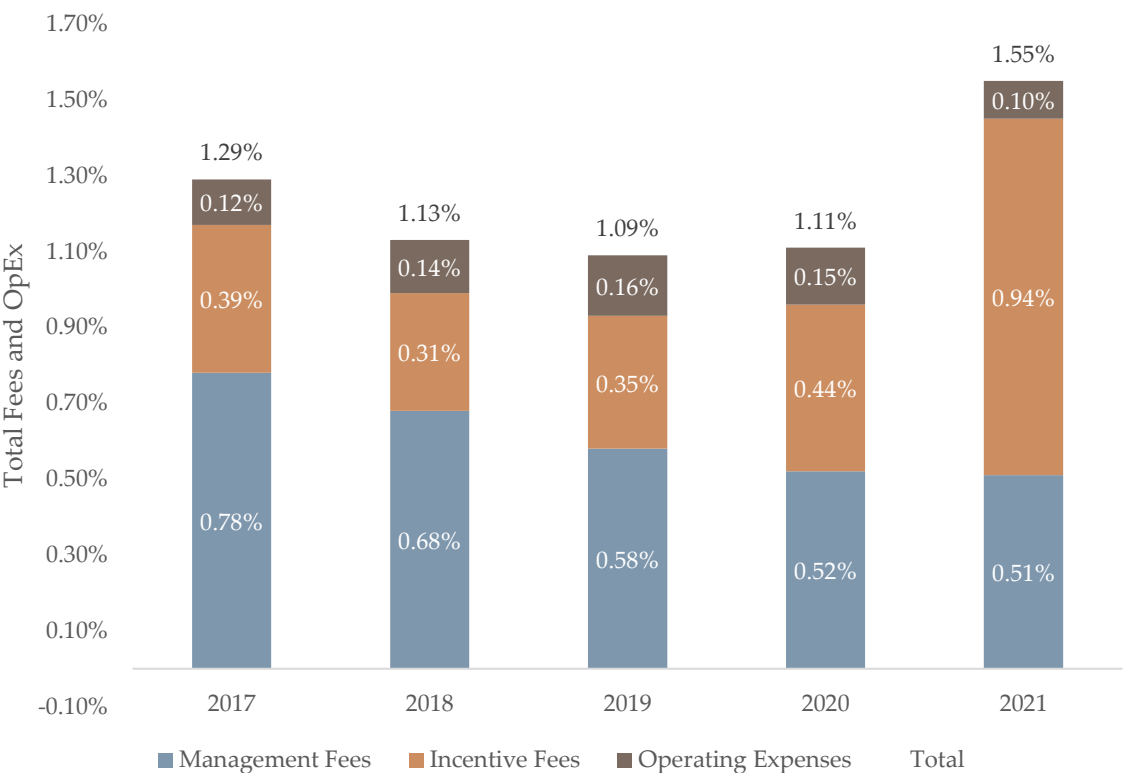
|                           | Management<br>Fees | Incentive<br>Fees | Operating<br>Expenses | Mgmt, Incent,<br>and Op Exp | Average<br>Balance | Expense<br>Ratio |
|---------------------------|--------------------|-------------------|-----------------------|-----------------------------|--------------------|------------------|
| Federated Pension         | \$15.4             | \$29.2            | \$3.1                 | \$47.7                      | \$2,870            | 1.66%            |
| Police & Fire Pension     | \$24.5             | \$47.3            | \$4.8                 | \$76.6                      | \$4,604            | 1.66%            |
| Federated Health Care     | \$0.8              | \$0.0             | \$0.1                 | \$0.9                       | \$381              | 0.24%            |
| Police & Fire Health Care | \$0.3              | \$0.0             | \$0.1                 | \$0.4                       | \$252              | 0.16%            |
| All 4 ORS Plans           | \$41.0             | \$76.5            | \$8.1                 | \$125.6                     | \$8,108            | 1.55%            |

Source: ORS 2021 Fee Report  
Values show are in \$ millions

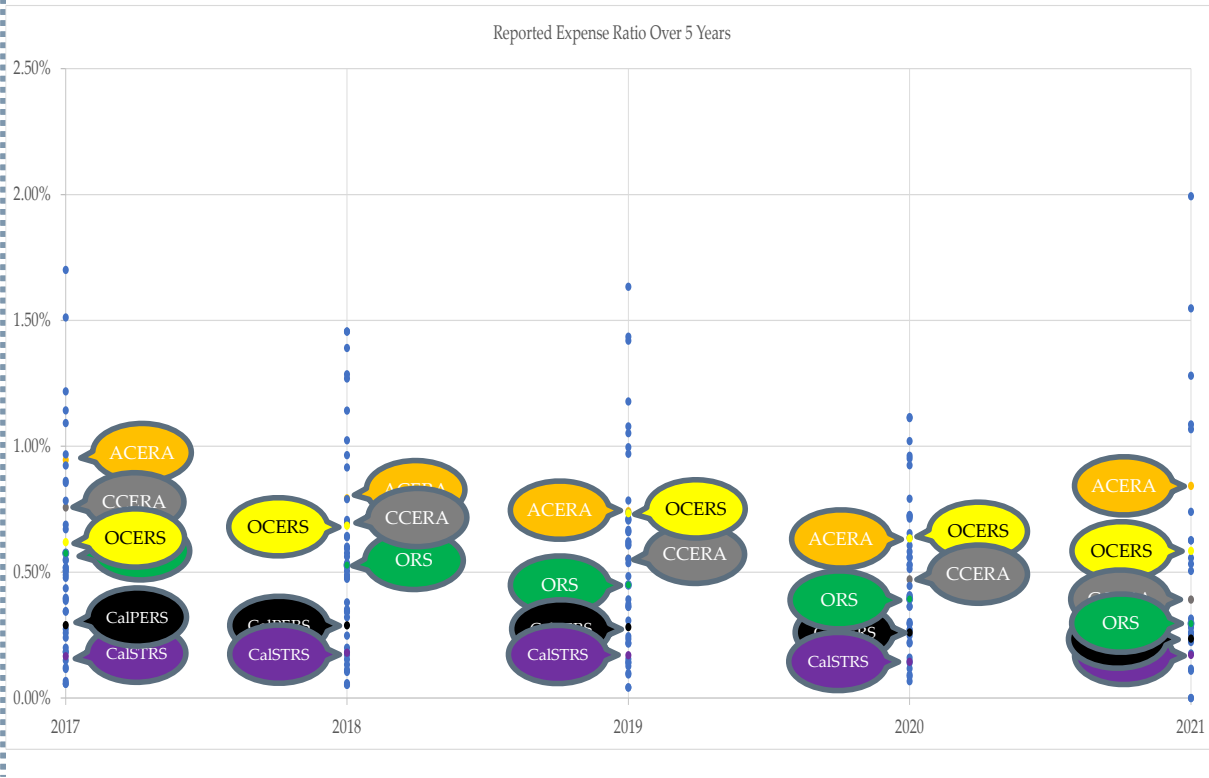
|                 | Investment<br>Staff Salary<br>and Benefits | Consultants | Custodian | Travel and<br>Other Third<br>Party Vendors | Total<br>Other<br>Costs | Expense<br>Ratio |
|-----------------|--------------------------------------------|-------------|-----------|--------------------------------------------|-------------------------|------------------|
| All 4 ORS Plans | \$2.2                                      | \$1.1       | \$1.1     | \$0.9                                      | \$5.2                   | 0.06%            |

Source: ORS 2021 Fee Report  
Values show are in \$ millions

# Total Expense Ratio (Comprehensive)



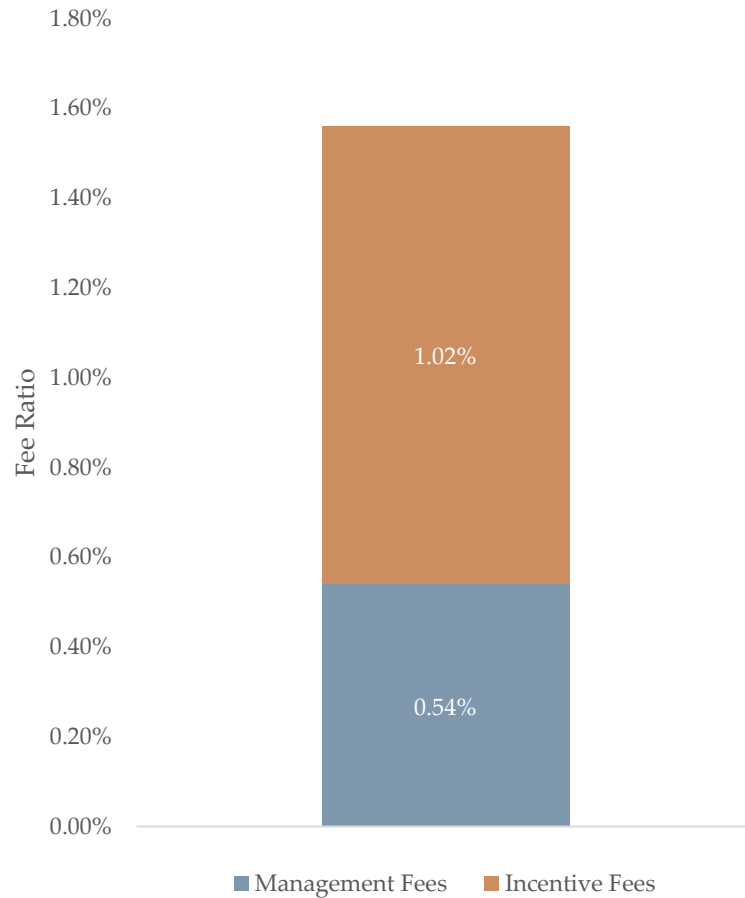
# Peer Comparison (ACFR's)



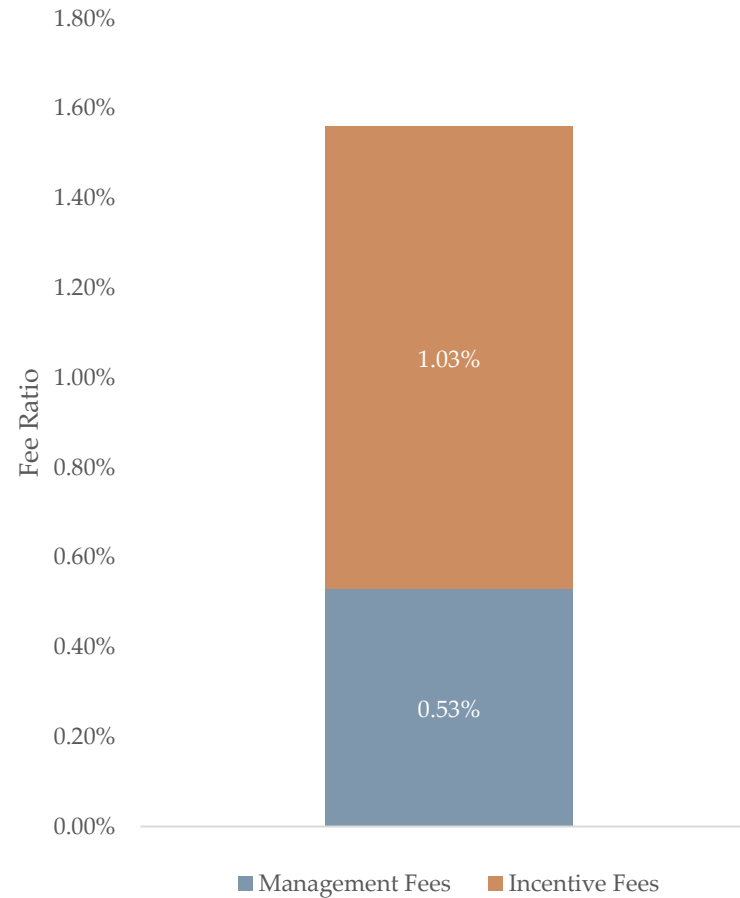
| 2017                                                                                       | 2018  | 2019  | 2020  | 2021  |                      | 2017                                                                                      | 2018 | 2019 | 2020 | 2021  |
|--------------------------------------------------------------------------------------------|-------|-------|-------|-------|----------------------|-------------------------------------------------------------------------------------------|------|------|------|-------|
| 11.6%                                                                                      | -3.2% | 14.1% | 14.3% | 14.9% | San Jose Plan Return | 8.8%                                                                                      | 6.4% | 4.3% | 3.2% | 27.2% |
| ORS Annual Fee Reports (Comprehensive)                                                     |       |       |       |       | Source               | Public Plans Database (from ACFR's)                                                       |      |      |      |       |
| Calendar Year Basis                                                                        |       |       |       |       | Time Period          | Fiscal Year Basis                                                                         |      |      |      |       |
| All 4 ORS plans aggregated<br>(Federated and Police & Fire Pension and Health Care Trusts) |       |       |       |       | Data Points          | 46 diversified U.S. Public Plans \$3-10 B & CA Public Plans<br>All 4 ORS plans aggregated |      |      |      |       |

# Calendar Year 2021 Management and Incentive Fee Ratios

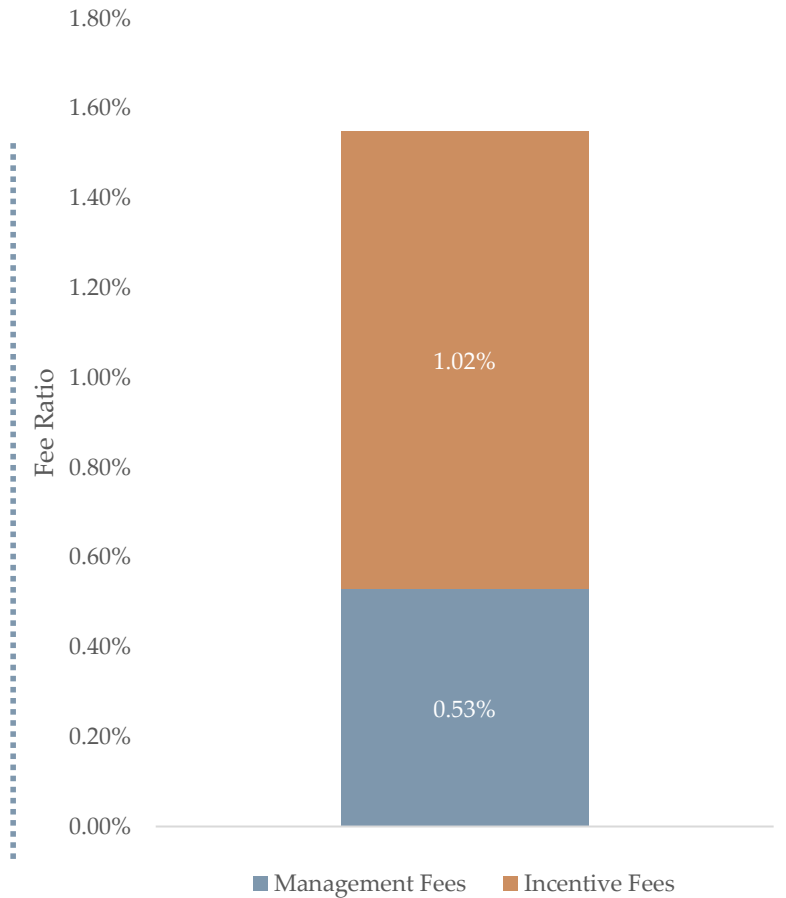
## Fed Pension



## P&F Pension



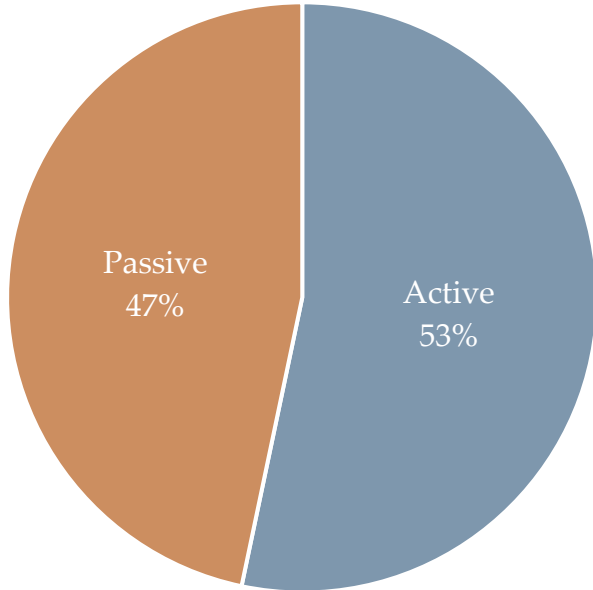
## Combined Pensions



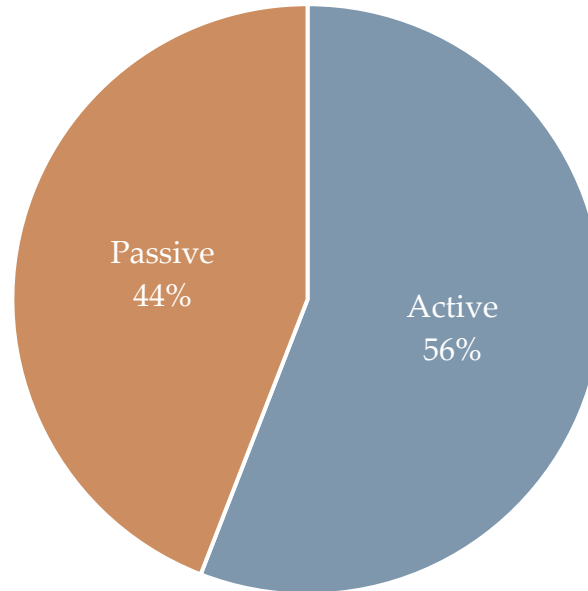
Source: ORS 2021 Fee Reports  
Indirect fund operating expenses not shown (Fed Pension: 0.11%, P&F Pension: 0.10%, Combined: 0.10%)

# Active vs. Passive average allocations in 2021

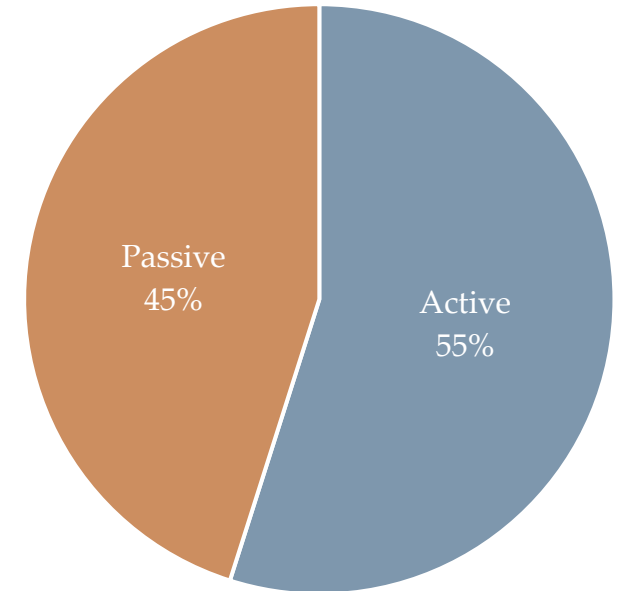
Fed Pension



P&F Pension



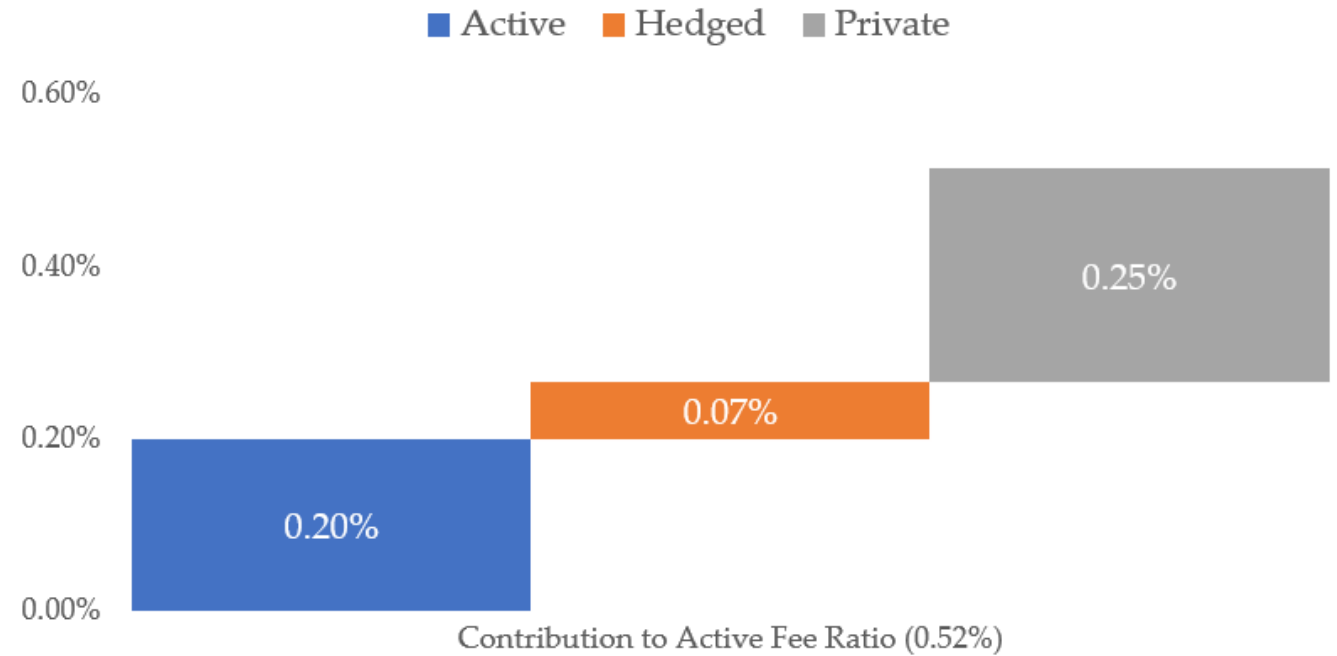
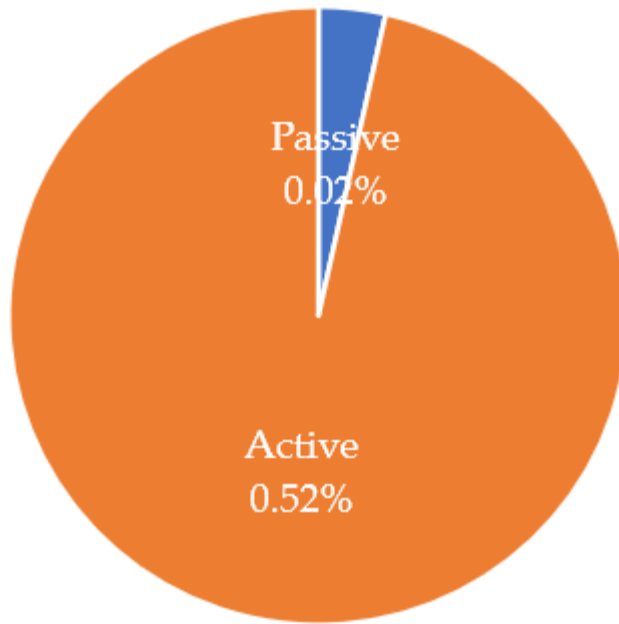
Combined



Source: ORS 2021 Fee Reports  
Active includes all non-passive investments (active, hedged, private)

# Active vs. Passive Management Fees

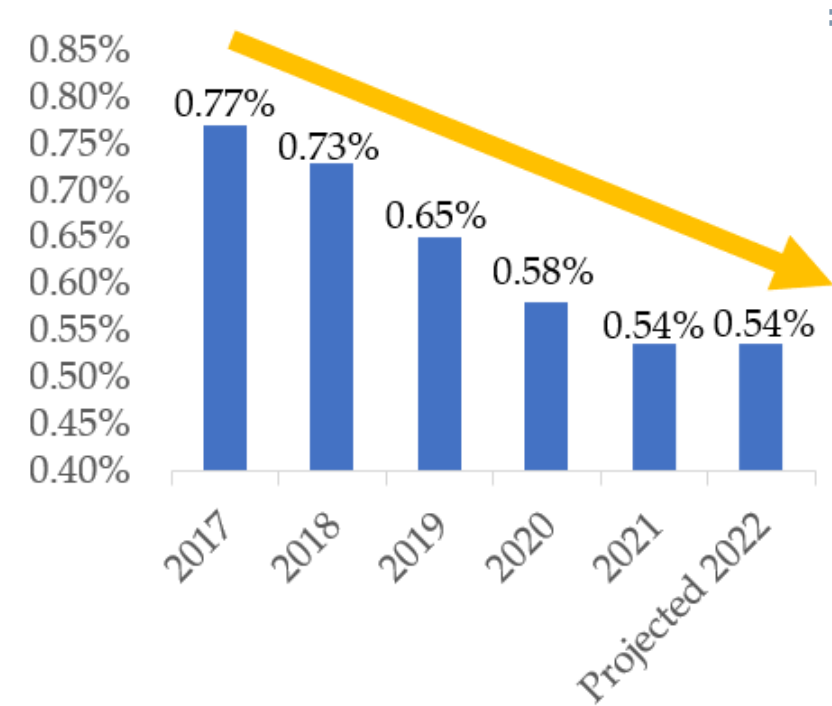
## Combined



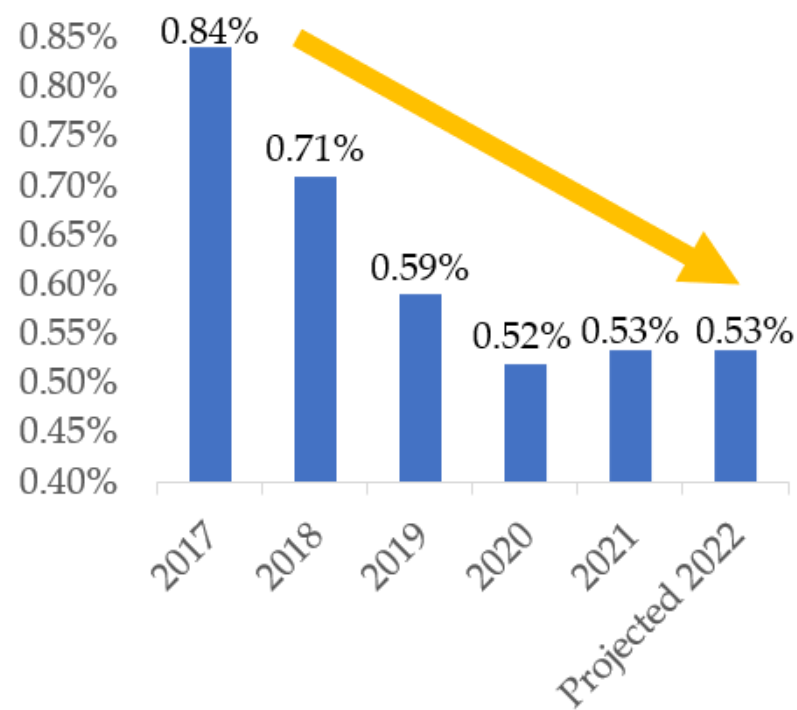
Source: ORS 2021 Fee Reports  
Active includes all non-passive investments (long only active, hedged, private)  
Charts only represent fund management fees, not incentive or fund operating expenses

# Management Fee Ratio Trend\*

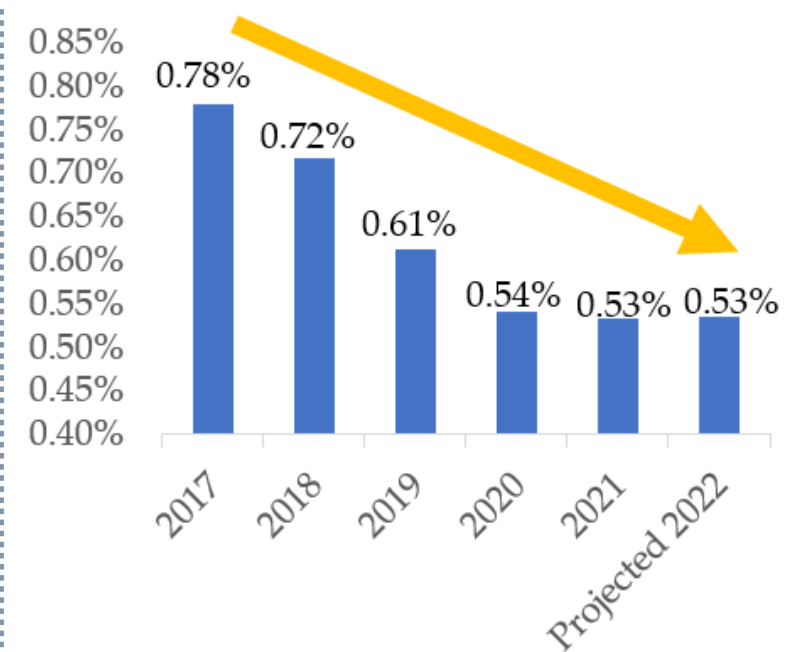
## Fed Pension



## P&F Pension



## Combined



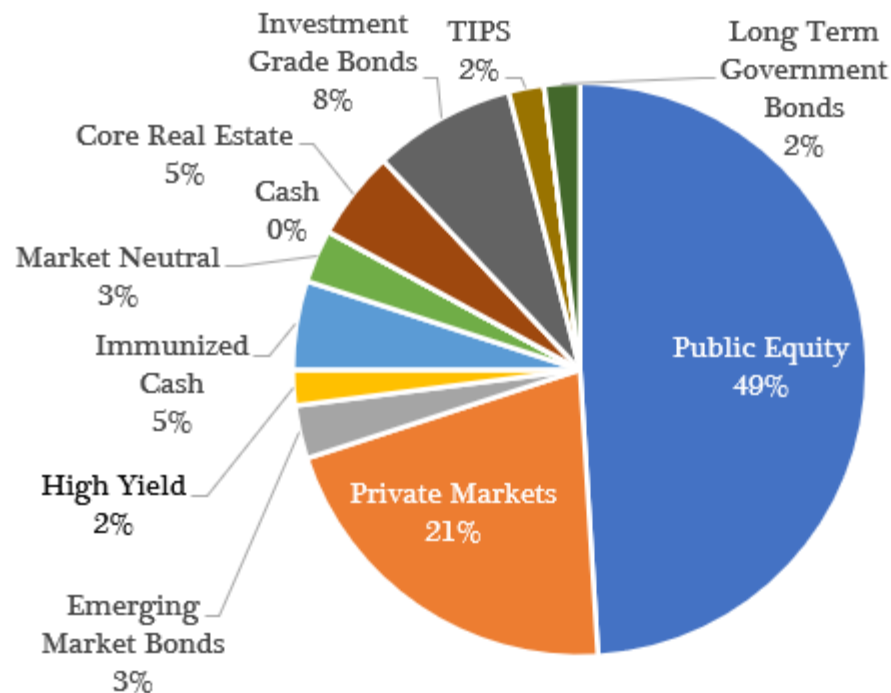
Source: ORS, State Street, BNY Mellon

\* Projections are based on many assumptions with a wide margin of error. Actual fund management fees will vary as the composition of underlying funds and fund types changes over time  
 Projections calculated by multiplying the calendar year 2021 fee ratios for each fund type within an asset class by actual December 31, 2021 allocations  
 Charts only represent fund management fees, not incentive or fund operating expenses

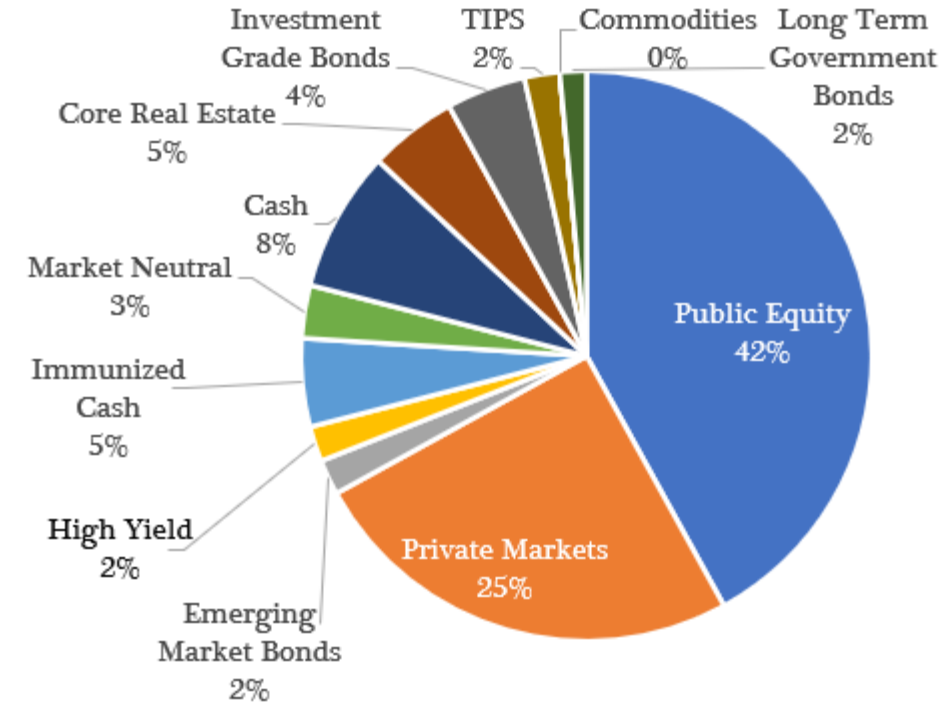
# Asset Allocation Targets

As of September 30<sup>th</sup>, 2022

## Federated Pension



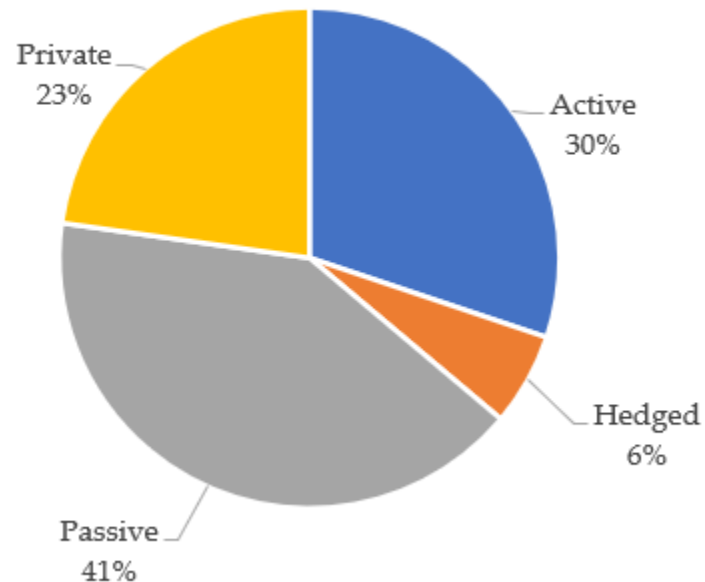
## Police & Fire Pension



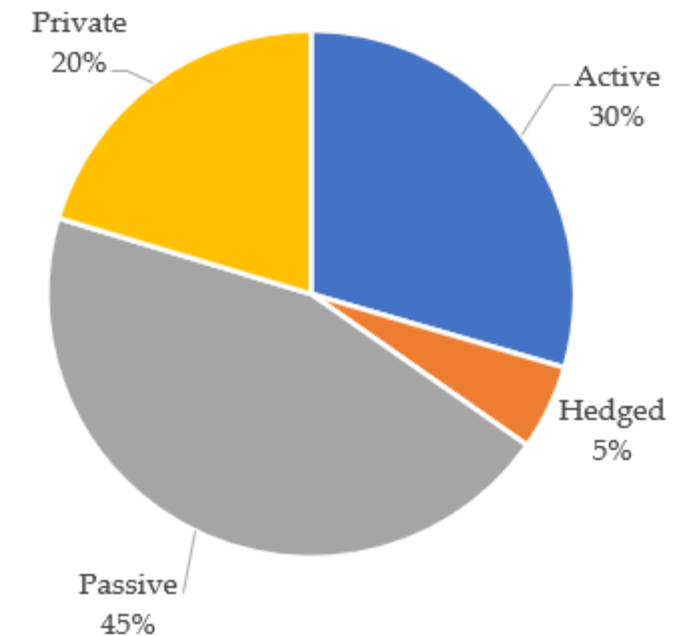
# Allocation to investment fund types

As of September 30<sup>th</sup>, 2022

## Federated Pension



## Police & Fire Pension



---

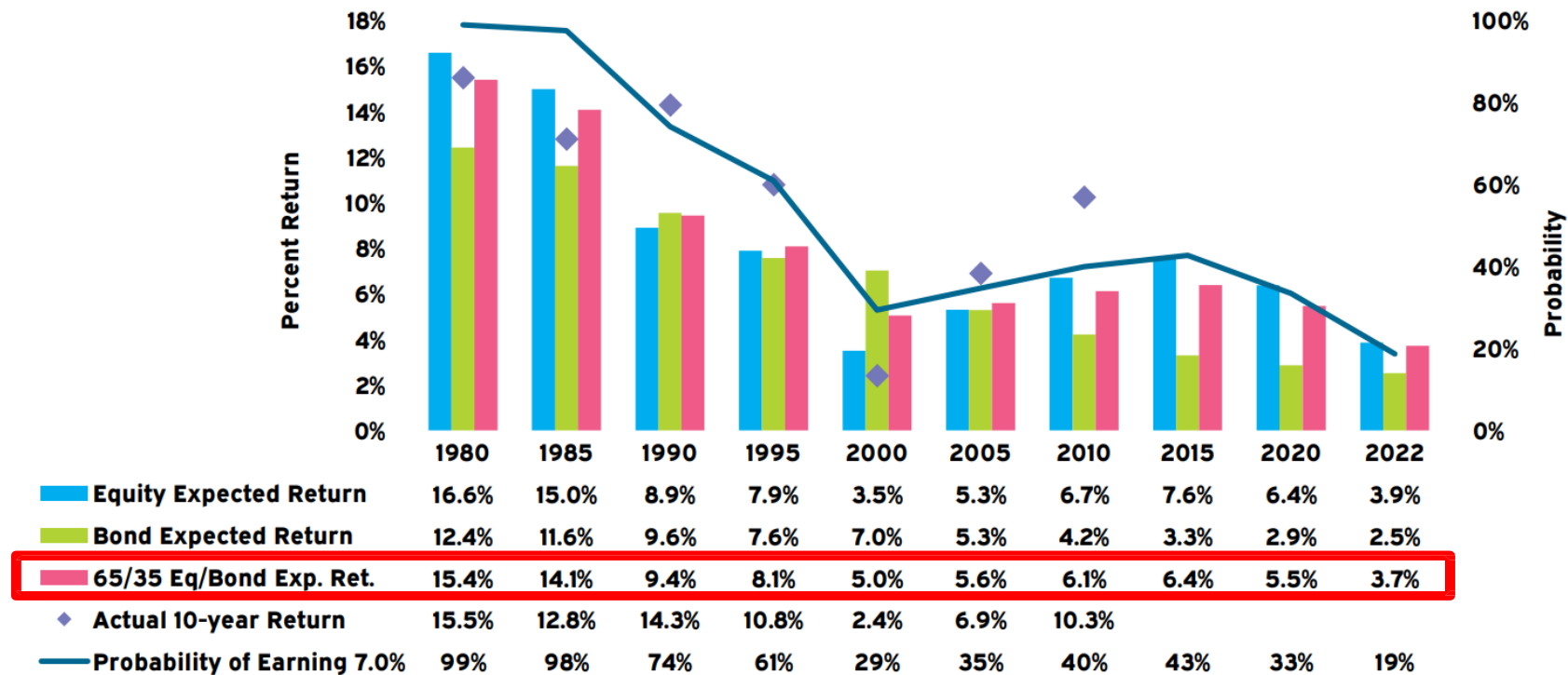
## Appendix

# Glossary of Terms

- Active strategies: Funds that attempt to outperform an index
- Asset allocation: Distribution of assets across a number of asset classes that each exhibit a unique combination of risk and expected return. Asset allocation is the most important determinant of long-term plan performance
- Hedged strategies: Investments that generally seek to achieve a return regardless of market direction
- Gross returns: Returns before the deduction of expenses
- Incentive fees: Performance-based fees paid to individual investment management firms. Incentive fees are a form of shared economics. Also known as “carried interest”
- Management fees: Asset-based fees paid to individual investment management firms
- Net returns: Returns after the deduction of management fees, incentive fees, and operating expenses
- Operating expenses: Costs of administering individual investment vehicles (not the retirement plans)
- Other expenses: Costs incurred at the plan level (staff, consultants, third party vendors, etc.)
- Passive strategies: Investments that intend to match the return of an index
- Private strategies: Investments in illiquid assets such as privately held companies or real estate
- Total expense ratio: Total expenses (sum of management fees, incentive fees, and operating expenses) divided by average plan assets

# Asset Allocation Considerations

The Secular Decline in Investment Returns<sup>1</sup>



Source: Meketa Investment Group

<sup>1</sup> Expected return assumptions for 1) Bonds equals the yield of the ten-year Treasury plus 100 basis points, and 2) Equities equals the dividend yield plus the earnings yield of the S&P 500 index (using the inflation-adjusted trailing 10-year earnings). Probability calculation is for the subsequent ten years.

# Asset Allocation Considerations

|                                                          | Fed Current<br>(%) | P&F Current<br>(%) | 60/40<br>(%) |
|----------------------------------------------------------|--------------------|--------------------|--------------|
| <b>Expected Return 20 years<sup>1</sup></b>              | <b>8.3</b>         | <b>8.1</b>         | <b>7.0</b>   |
| <b>Standard Deviation <sup>1</sup></b>                   | <b>14.1</b>        | <b>13.3</b>        | <b>11.0</b>  |
| <b>Probability of Achieving at least a 6.625% Return</b> |                    |                    |              |
| 1 Year                                                   | 54.7               | 54.3               | 51.1         |
| 3 Years                                                  | 58.1               | 57.4               | 51.9         |
| 5 Years                                                  | 60.4               | 59.5               | 52.5         |
| 10 Years                                                 | 64.5               | 63.2               | 53.5         |
| 20 Years                                                 | 70.1               | 68.4               | 55.0         |
| <b>Worst Case Returns<sup>2</sup></b>                    |                    |                    |              |
| 1 Years                                                  | -19.8              | -18.6              | -15.7        |
| 3 Years                                                  | -8.9               | -8.3               | -6.8         |
| 5 Years                                                  | -5.3               | -4.8               | -3.9         |
| 10 Years                                                 | -1.5               | -1.2               | -0.8         |
| 20 Years                                                 | 1.2                | 1.4                | 1.4          |
| <b>U.S. Equities decline 25%</b>                         | <b>-18.6</b>       | <b>-17.0</b>       | <b>-14.9</b> |
| <b>U.S. Equities decline 40%</b>                         | <b>-28.5</b>       | <b>-26.1</b>       | <b>-25.3</b> |

<sup>1</sup> Expected return and standard deviation are based on Meketa Investment Group's Interim 2022 Annual Asset Study and reflect our 20-year expectations. Returns for periods longer than one year are annualized.

<sup>2</sup> "WorstCase" return projections encompass 99% of all possible outcomes.

# Plan Return History

|                                                              | 10 years<br>ending<br>6/30/22 | 10 years<br>ending<br>12/31/21 | 10 years<br>ending<br>6/30/21 | 10 years<br>ending<br>12/31/20 | 10 years<br>ending<br>6/30/20 | 10 years<br>ending<br>12/31/19 | 10 years<br>ending<br>6/30/19 | 10 years<br>ending<br>12/31/18 | 20 years<br>ending<br>6/30/22 | 20 years<br>ending<br>12/31/21 | 20 years<br>ending<br>6/30/21 | 20 years<br>ending<br>12/31/20 | 20 years<br>ending<br>6/30/20 | 1/31/94-<br>6/30/22 |
|--------------------------------------------------------------|-------------------------------|--------------------------------|-------------------------------|--------------------------------|-------------------------------|--------------------------------|-------------------------------|--------------------------------|-------------------------------|--------------------------------|-------------------------------|--------------------------------|-------------------------------|---------------------|
| <b>San Jose Federated City Employees' Retirement System</b>  | <b>6.3%</b>                   | <b>7.6%</b>                    | <b>6.4%</b>                   | <b>5.9%</b>                    | <b>5.5%</b>                   | <b>5.5%</b>                    | <b>6.5%</b>                   | <b>6.0%</b>                    | <b>6.2%</b>                   | <b>6.6%</b>                    | <b>6.3%</b>                   | <b>5.7 %</b>                   | <b>4.9%</b>                   | <b>6.8%</b>         |
| <i>Federated Policy Benchmark</i>                            | 6.6%                          | 8.1%                           | 6.9%                          | 6.2%                           | 6.4%                          | 6.3%                           | 7.2%                          | 6.7%                           | 6.4%                          | 6.8%                           | 6.7%                          | 6.0%                           | 5.0%                          | 7.0%                |
| <i>Federated Investable Benchmark Portfolio</i>              | 6.0%                          | 7.5%                           | 6.3%                          | 5.7%                           | 5.4%                          | 5.4%                           | 6.3%                          | 6.0%                           |                               |                                |                               |                                |                               |                     |
| <b>San Jose Police &amp; Fire Department Retirement Plan</b> | <b>6.4%</b>                   | <b>7.9%</b>                    | <b>6.9%</b>                   | <b>6.3%</b>                    | <b>6.2%</b>                   | <b>6.3%</b>                    | <b>7.2%</b>                   | <b>6.8%</b>                    | <b>6.4%</b>                   | <b>6.8%</b>                    | <b>6.6%</b>                   | <b>6.0%</b>                    | <b>5.3%</b>                   | <b>8.3%</b>         |
| <i>Police &amp; Fire Policy Benchmark</i>                    | 6.4%                          | 8.0%                           | 7.1%                          | 6.7%                           | 6.7%                          | 6.8%                           | 7.7%                          | 7.2%                           | 6.4%                          | 6.8%                           | 6.6%                          | 6.1%                           | 5.3%                          |                     |
| <i>Police &amp; Fire Investable Benchmark Portfolio</i>      | 6.2%                          | 7.8%                           | 6.9%                          | 6.9%                           | 6.3%                          | 6.5%                           | 7.3%                          | 6.9%                           | 6.4%                          | 6.8%                           | 6.4%                          | 5.7%                           | 5.3%                          |                     |
| <b>DB Plans &gt;\$1 Billion Net Peer Universe</b>            | <b>7.6%</b>                   | <b>9.7%</b>                    | <b>8.2%</b>                   | <b>7.9%</b>                    | <b>7.8%</b>                   | <b>8.1%</b>                    | <b>9.0%</b>                   | <b>8.2%</b>                    | <b>6.8%</b>                   | <b>7.4%</b>                    | <b>6.8%</b>                   | <b>6.2%</b>                    | <b>5.4%</b>                   | <b>7.3%</b>         |
| <i>Number of Plans</i>                                       | 57                            | 68                             | 72                            | 73                             | 64                            | 59                             | 65                            | 151                            | 42                            | 50                             | 56                            | 53                             | 48                            | 22                  |

Source: Meketa Investment Group