



# PERA

## Fee Analysis

*Investments and Pensions Oversight Committee*

*Senator George Muñoz, Chair*

*Representative Monica Youngblood, Vice-Chair*

*July 21, 2015*

*Patty French, PERA Board Chair*

*Wayne Propst, Executive Director*

*Jon Grabel, Chief Investment Officer*

# Fee Study Genesis

- In July of 2014 the PERA Board directed Staff to perform a comprehensive review of the value of its money manager relationships
  - *Defined as “fee investment”*
  - *Motivated by PERA’s mission to its members to prudently manage Trust Fund assets*
- Identified no industry-wide standard methodology to assess fees
  - *Incentive fees often ignored*
  - *Some performance measures are reported gross and some net of fees*
  - *Not adjusted for asset allocation*
  - *One-dimensional analysis – fees without context of risk-adjusted performance*

# PERA Methodology

- A top-down analysis adjusted for asset allocation
- Intra-asset category analysis with each manager evaluated with respect to:
  - *Performance benchmarks*
  - *Peers*
  - *Risk measures*
  - *Fees*
- Analysis reviewed both asset based and performance fees

# Fees Paid – FY 2014

2014 Fiscal Year Management & Performance Fees				
Asset Categories	Management Fees	Carry/Performance Fee	Total	Percentage
Total US Equity Composite	\$ 8,887,000	\$ -	\$ 8,887,000	7.45%
Total Non-US Equity Composite	\$ 6,685,000	\$ -	\$ 6,685,000	5.61%
Total Fixed Income Composite	\$ 6,765,000	\$ -	\$ 6,765,000	5.67%
Public Real Estate/Asset Composite	\$ 1,341,625	\$ -	\$ 1,341,625	1.12%
Private Equity*	\$ 11,926,073	\$ 6,321,622	\$ 18,247,694	15.30%
Private Real Assets*	\$ 5,122,500	\$ 2,260,586	\$ 7,383,086	6.19%
Private Real Estate*	\$ 5,136,495	\$ 2,454,649	\$ 7,591,144	6.37%
Absolute Return**	\$ 17,319,760	\$ 27,808,012	\$ 45,127,771	37.84%
Portable Alpha**	\$ 7,668,307	\$ 9,561,971	\$ 17,230,278	14.45%
* 12 months as of 3/31/2014				
**12 months as of 12/31/2013				
Total	\$ 70,851,760	\$ 48,406,839	\$ 119,258,599	100%

*PERA returned 17.03% for FY 2014 and generated \$2.1 billion in investment gain (All of PERA's returns are reported net of fees)*

\*

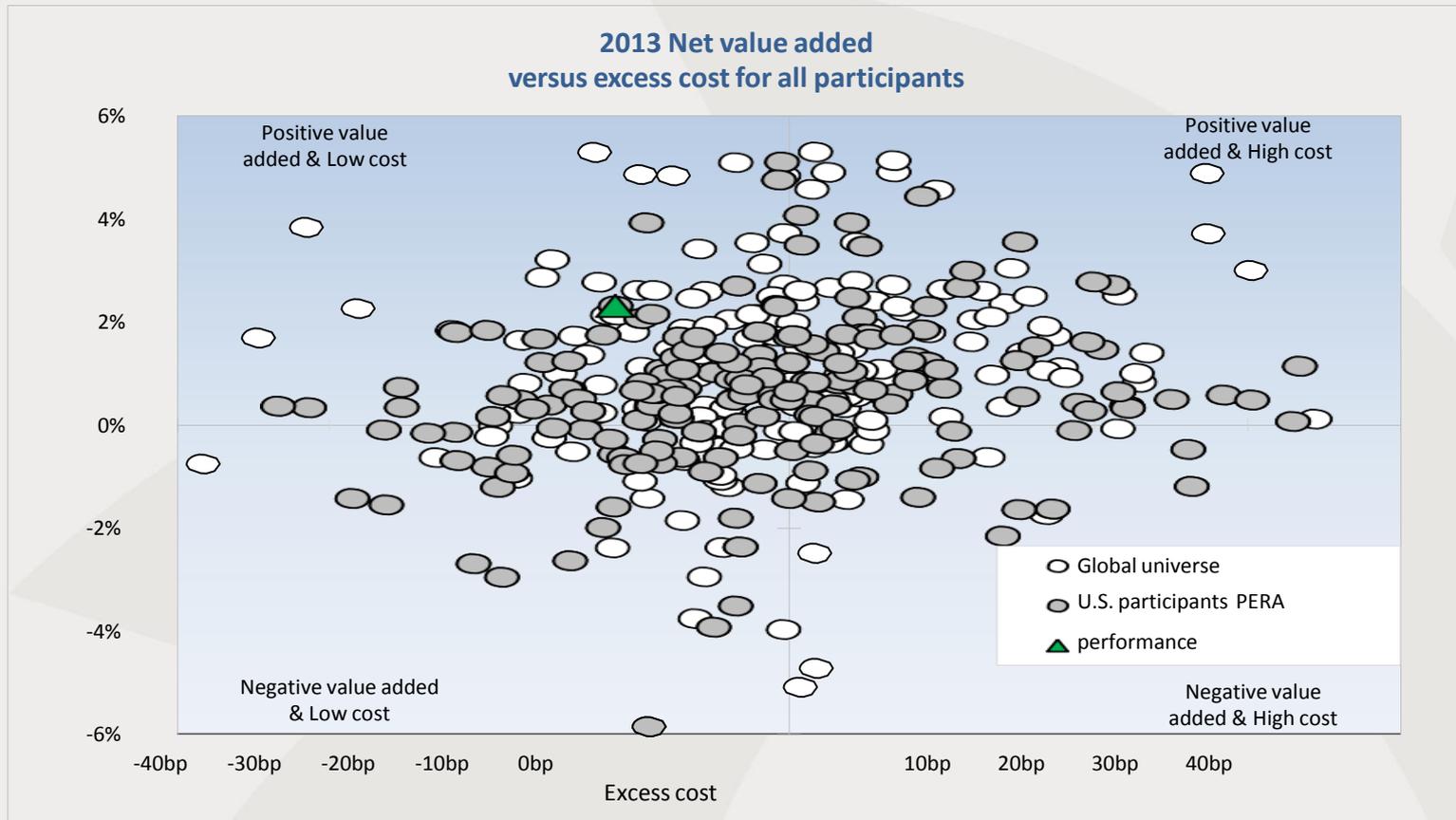
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# Top Down Analysis

- Worked with third-party benchmarking service (CEM Benchmarking)
- CEM universe includes 189 funds with plan size ranging between \$155 million and \$283 billion with a median plan size of \$6 billion
- PERA's total investment cost of 58.9 bps was below the benchmark cost of 70.2 bps
  - *Benchmark cost adjusts for asset allocation*
  - *Excludes performance fee*
- The 11.3 bps differential between PERA's investment costs and the benchmark cost is an opportunity savings of approximately \$15 million for the Plan
- Not conclusive, but provides a good check on plan level expenses

# CEM Results – Cost Effective Ranking



*PERA is located in the best quadrant*

# Examples From Asset Category Analysis

# Asset Category Analysis – Efficient

- US Equity
- Non-US Equity
- Total Fixed Income
- Public Real Estate
- Public Real Asset

## Example of Efficient Asset Category: Domestic Equity

Total Assets	Total Fees Paid	Percent of Total Fees	5 Year Return**	Sharpe Ratio – 5 year**
\$4.7 Billion	\$8.9 Million	7.45%	21.13%	1.23
Benchmark	1st Quartile*	N/A	19.32%	1.21

- PERA’s domestic equity portfolio accounted for 7.45% (\$8.9 million) of the total investment management fees paid in fiscal year 2014
- Five of the nine managers fees ranked in the fifth percentile or below
- The total fees paid were 23 basis points, ranking in the 25th percentile according to the Wilshire Universe

*\*The lower the percentile ranking, the lower the fee in the peer universe.*

*\*\*Returns are reported net of fees*

# Domestic Equity Actions Steps

- Eliminated 3 managers
  - Ranked by information and Sharpe ratios
  - Researched downside capture and active share
  - Evaluated manager overlap
- Positioned Domestic Equity portfolio for higher Sharpe Ratio
  - Market beta reduced by 4%
  - Tracking error reduced to 0.45% from 1.7%
- Increased the fee efficiency of the composite (45% fee savings) or \$3 million

# Core Fixed Income

Total Assets	Total Fees Paid	Percent of Total Fees	5 Year Return**	Sharpe Ratio – 5 year**
\$3.8 Billion	\$6.8 Million	5.67%	7.14%	1.98
Benchmark	2nd Quartile*	N/A	4.34%	1.28

- Four of the six managers ranked in the 25th percentile or better
- The total fees paid were 19 basis points, ranking in the 2nd quartile according to the Wilshire Universe
- Managers were taking uncompensated risk versus PERA's mandate objectives
- Action Steps
  - *The portfolio transitioned from 6 managers to 4*
  - *Reduce fees by \$3 million*
  - *Lower the risk in the portfolio*
    - *Tracking error decreased from 1.5% to 0.8%*

\*The lower the percentile ranking, the lower the fee in the peer universe.

\*\*Returns are reported net of fees

# Asset Category Analysis – Inefficient

- Private Equity
- Private Real Assets
- Private Real Estate
- Absolute Return
- Portable Alpha

# Hedge Funds – Portable Alpha

Total Assets	Total Fees Paid	Percent of Total Fees	5 Year Return**	Sharpe Ratio – 5 Year**
\$579.7 Million	\$17.2 Million	14.45%	27.20%	1.44
Benchmark	N/A	N/A	18.91%	1.23

- PERA’s portfolio is comprised of absolute return and those that are combined with the S&P 500 futures in the Portable Alpha program
- The Portable Alpha program accounted for 14.45% (\$17.2 million) of the total investment management fees paid in fiscal year 2014
- For the 12 months ending December 31, 2013, PERA paid approximately \$7.7 million in manager fees and \$9.6 million in carry
  - Since carry is a profit sharing calculation, this equates to approximately \$40 million in net gains assuming an 80/20 split

*\*\*Returns are reported net of fees*

# Hedge Funds – Portable Alpha Action Steps

- Actions Steps
  - An RFP was completed to enhance the mandate
  - The updated Portable Alpha program;
    - 19 managers reduced to one
    - Better liquidity
    - Lower fee
    - Lower volatility
    - Better downside protection
  - Annual management fee savings about \$5 million on base fee

# Conclusion – NM PERA Is Taking Actions to Reduce Fees and Ensure Absolute Transparency

- PERA has a positive fee investment
  - High value added performance
  - Prudent asset category level adjustments in process
- Continually monitor fees and expenses
  - PERA implemented new templates for managers requiring full fee disclosure
  - Begin collecting quarterly starting June of 2015
- Recognize that fee effectiveness is a multi-dimensional analysis
- Focus on SAA
  - SAA accounts for 90% of investment returns
  - Fees are a small component of investment outcome
- Low fees should not be the sole basis of a decision
- PERA Fee Study presented and recognized as a “Dangerous Idea” at the 2015 Chief Investment Officer Summit