



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
 - Net returns = Gross returns – 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
Management fees	Fees paid to investment management firms	
Incentive fees	Performance-based fees paid to investment management firms	
Operating expenses	Costs of administering individual investment vehicles	Audit, tax, legal, custodian
Other expenses	Costs incurred at the plan level	Staff salaries and benefits, consultants, third party vendors

Calendar Year 2019 Fees

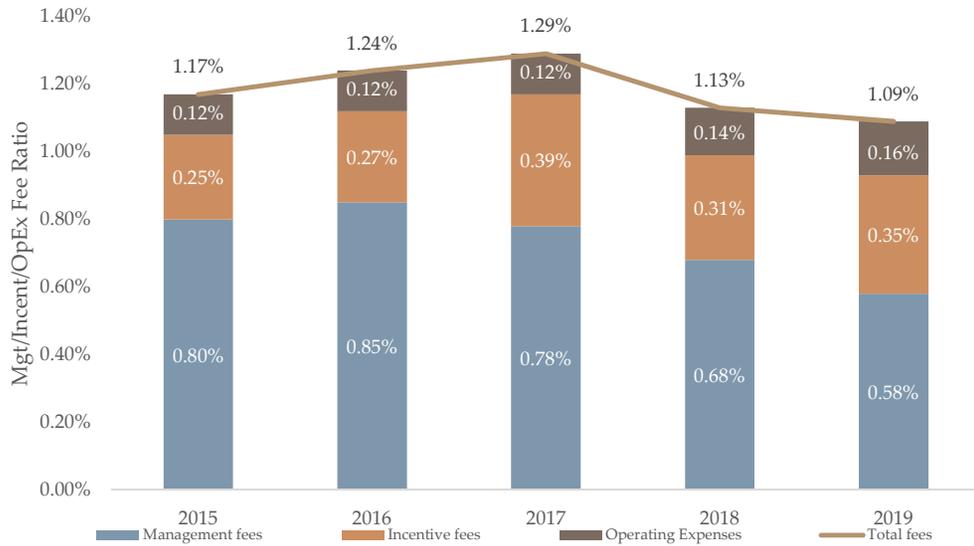
	Management Fees (\$)	Incentive Fees	Operating Expenses	Mgmt, Incent, and Op Exp	Average Balance	Expense Ratio
Federated Pension	\$14.1	\$5.2	\$3.8	\$23.0	\$2,159	1.07%
Police & Fire Pension	\$22.9	\$17.3	\$6.5	\$46.6	\$3,856	1.21%
Federated Health Care	\$0.7	-	\$0.0	\$0.8	\$302	0.26%
Police & Fire Health Care	\$0.1	-	\$0.0	\$0.2	\$150	0.15%
All 4 ORS Plans	\$37.8	\$22.5	\$10.3	\$70.6	\$6,467	1.09%

Source: ORS 2019 Fee Report
Values show are in \$ millions

	Investment Staff Salary and Benefits	Consultants	Custodian	Travel and Other Third Party Vendors	Total Other Costs	Expense Ratio
All 4 ORS Plans	\$1.6	\$1.5	\$0.7	\$1.0	\$4.7	0.07%

Source: ORS 2019 Fee Report
Values show are in \$ millions

Total Expense Ratio (Comprehensive)



-2.0% (2015) 6.4% (2016) 11.6% (2017) -3.2% (2018) 14.1% (2019)

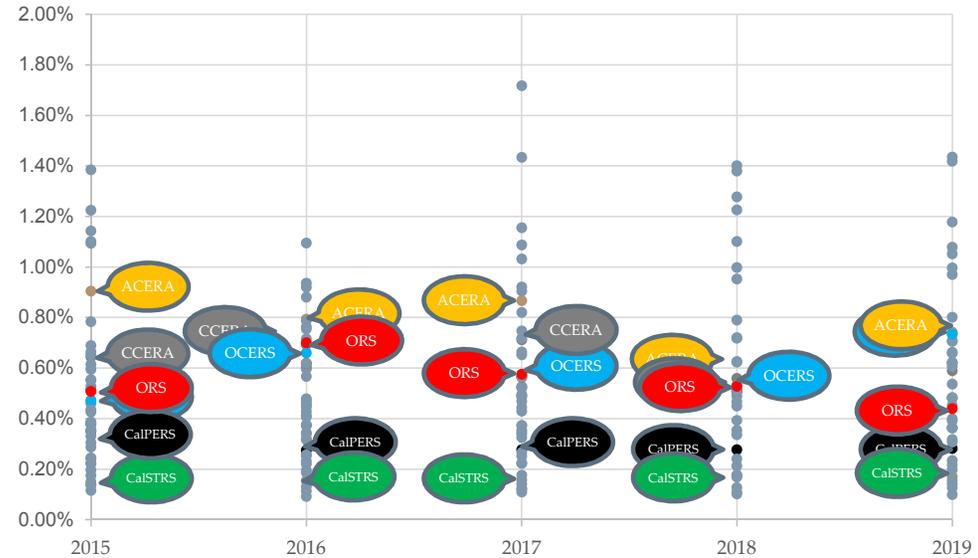
ORS Annual Fee Reports (Comprehensive)

Calendar year basis

All 4 ORS plans aggregated
(Federated and Police & Fire Pension and health care trusts)

Peer Comparison (CAFR's)

Reported Expense Ratio Over 5 Years



-1.0% (2015) -0.6% (2016) 8.8% (2017) 6.4% (2018) 4.3% (2019)

San Jose Plan Return
Source
Time Periods
Data Points

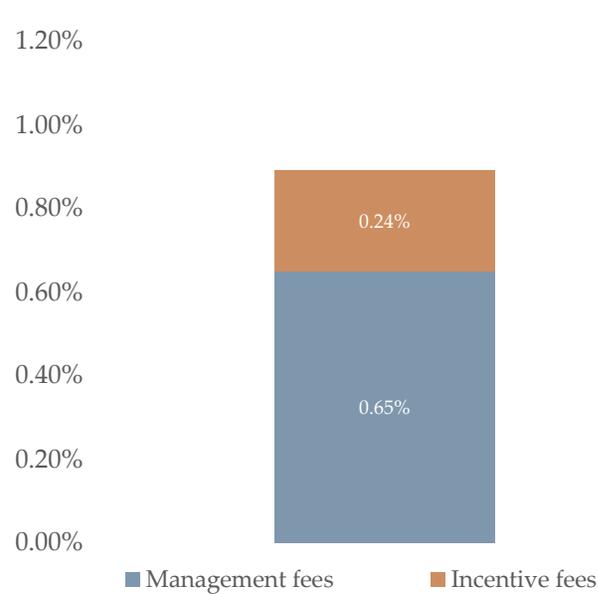
Public Plans Database (from CAFR's)

Fiscal year basis

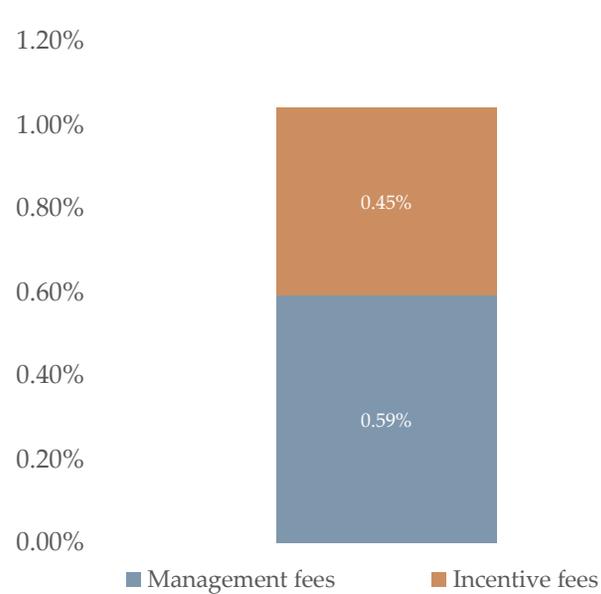
40 diversified U.S. Public Pension Plans \$2-13 B & CA
Public Plans
All 4 ORS plans aggregated

Calendar Year 2019 Management and Incentive Fee Ratios

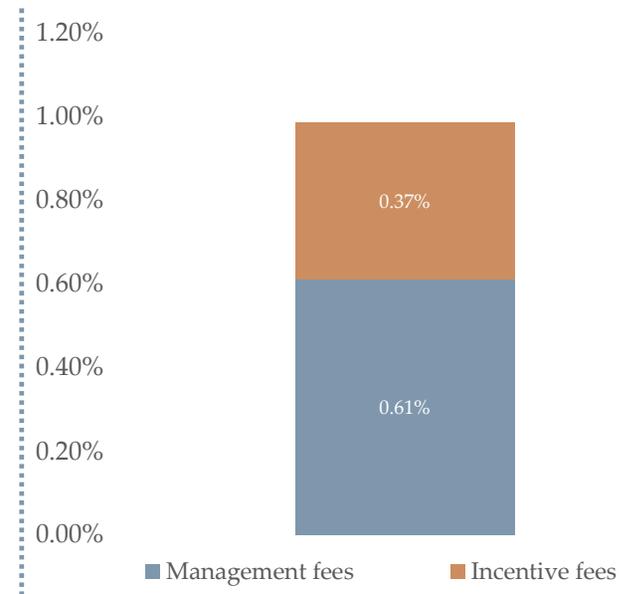
Fed Pension



P&F Pension



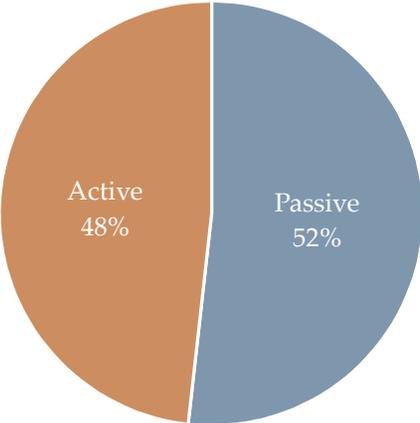
Combined Pensions



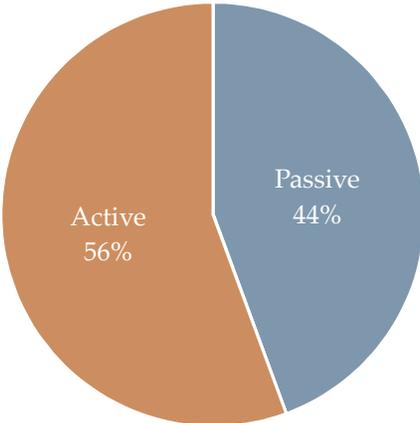
Source: ORS 2019 Fee Reports
Indirect fund operating expenses not shown (Fed Pension: 0.18%, P&F Pension: 0.17%, Combined: 0.17%)

Active vs. Passive Allocations as of 12/31/2019

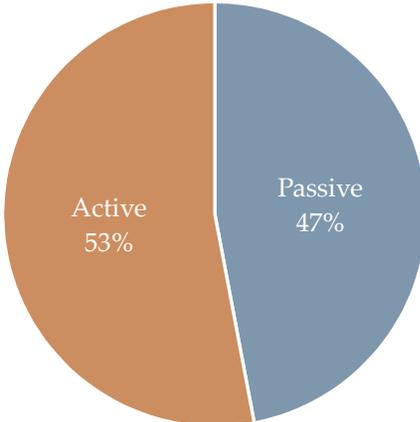
Fed Pension



P&F Pension

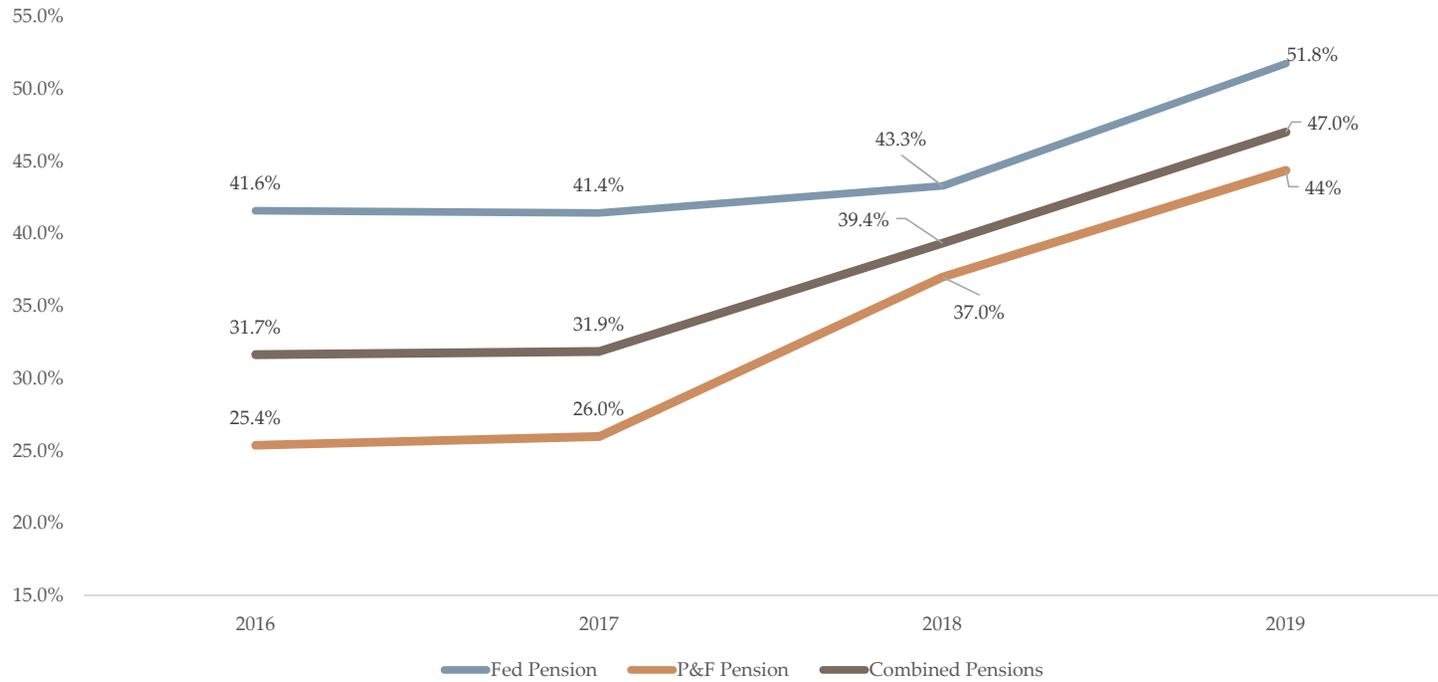


Combined



Source: ORS, State Street
Active includes all non-passive investments (active, hedged, private)

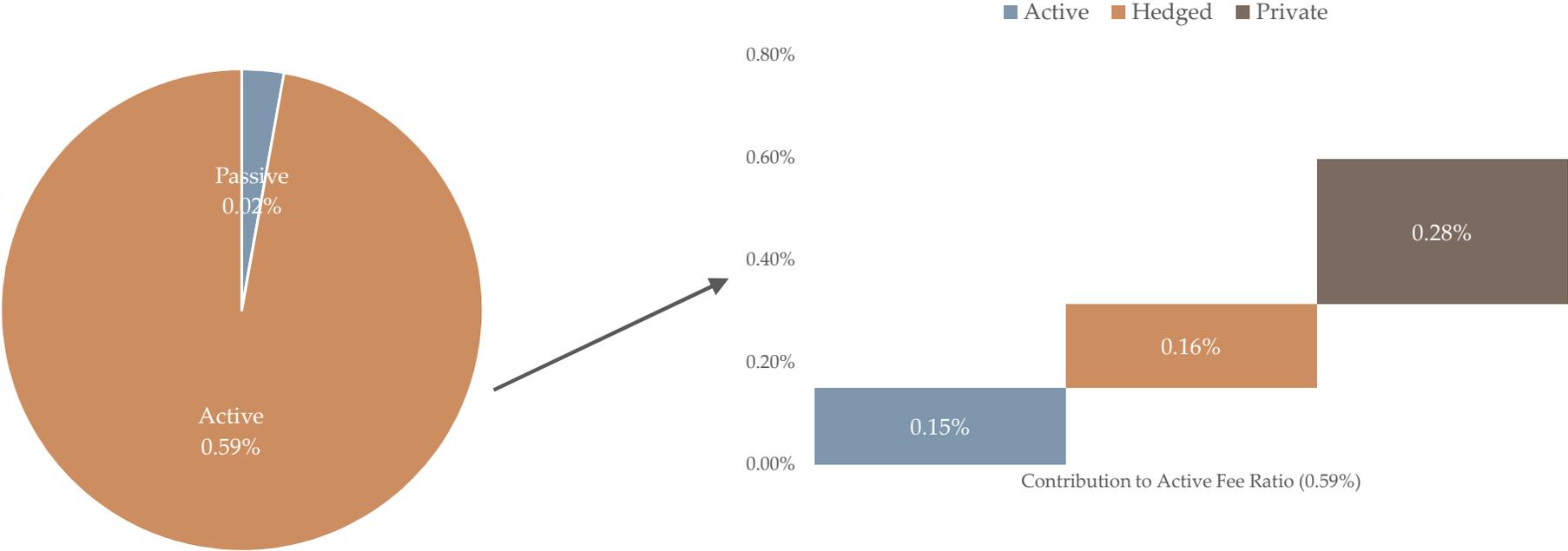
Average Passive Allocations 2016 - 2019



Source: ORS, State Street

Active vs. Passive Management Fees

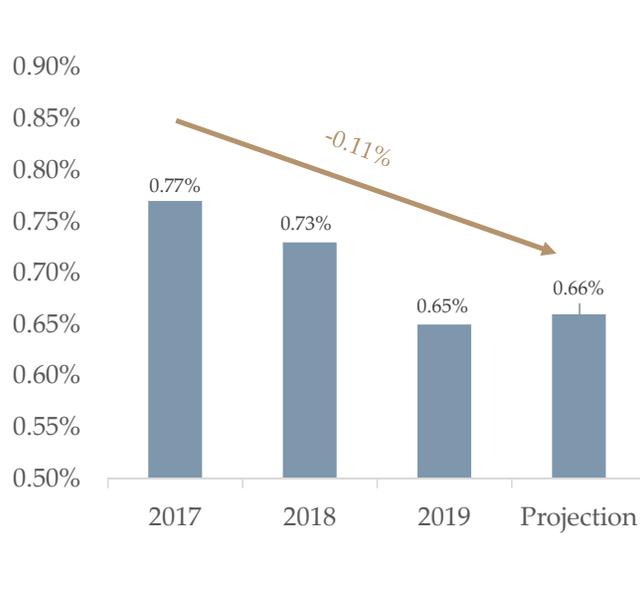
Combined



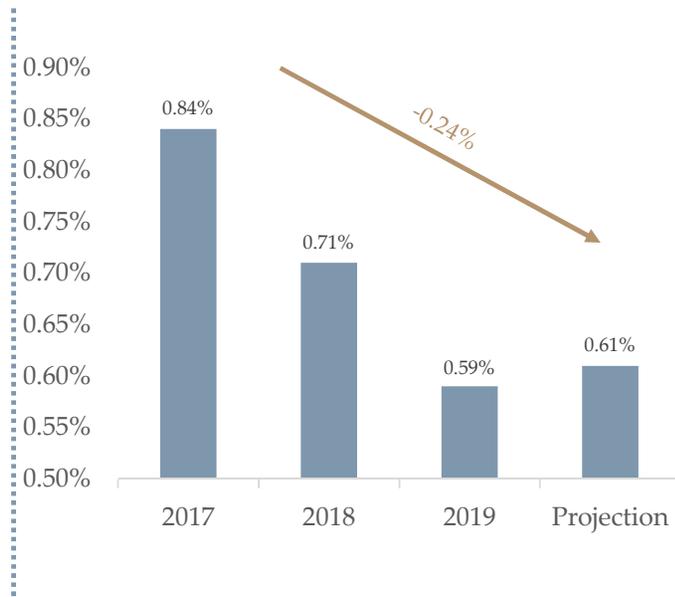
Source: State Street, ORS 2019 Fee Reports
Active includes all non-passive investments (long only active, hedged, private)
Charts only represent fund management fees, not incentive or fund operating expenses

Projected Management Fees *

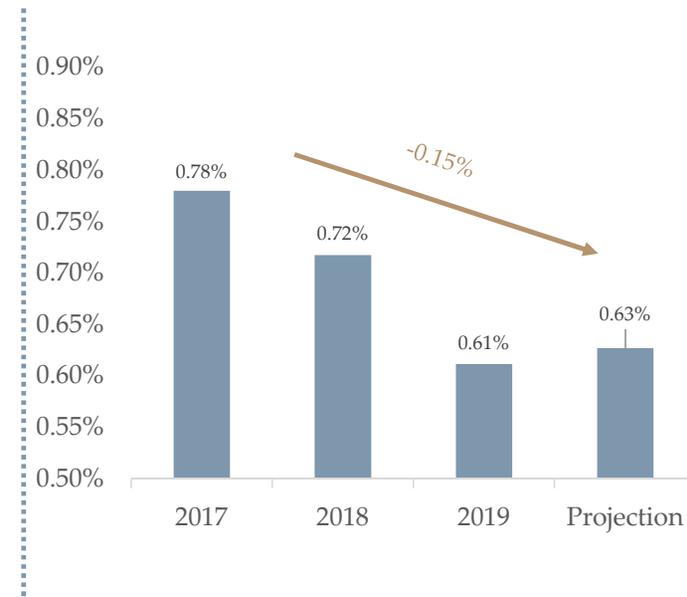
Fed Pension



P&F Pension



Combined



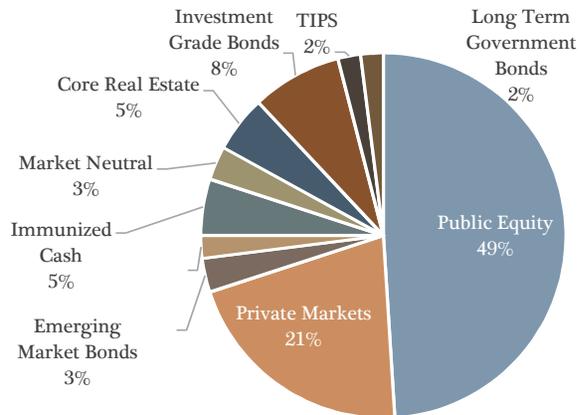
Source: ORS, State Street

* 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 2019 fee ratios for each fund type within an asset class by actual July 31, 2020 allocations
 Charts only represent fund management fees, not incentive or fund operating expenses

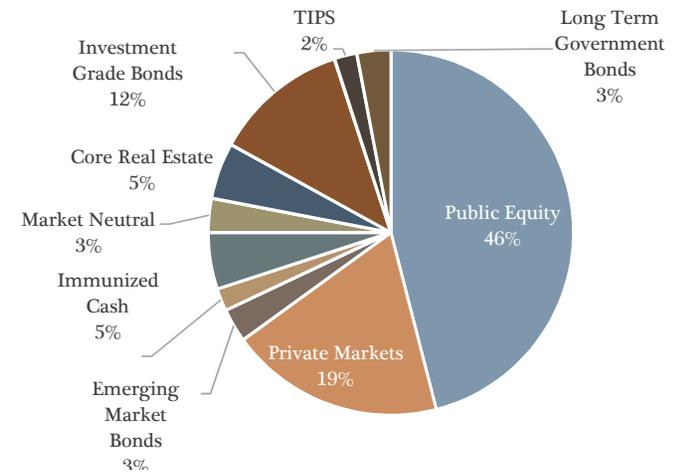
Asset Allocation Targets

As of July 31, 2020

Federated Pension



Police & Fire Pension

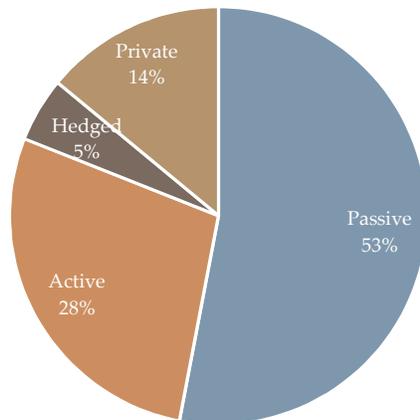


Source: ORS

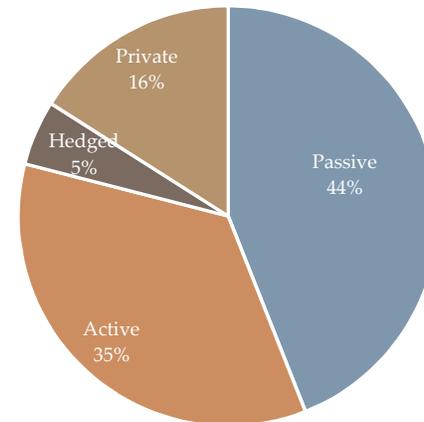
Allocation to investment fund types

As of July 31, 2020

Federated Pension



Police & Fire Pension



Source: ORS, State Street

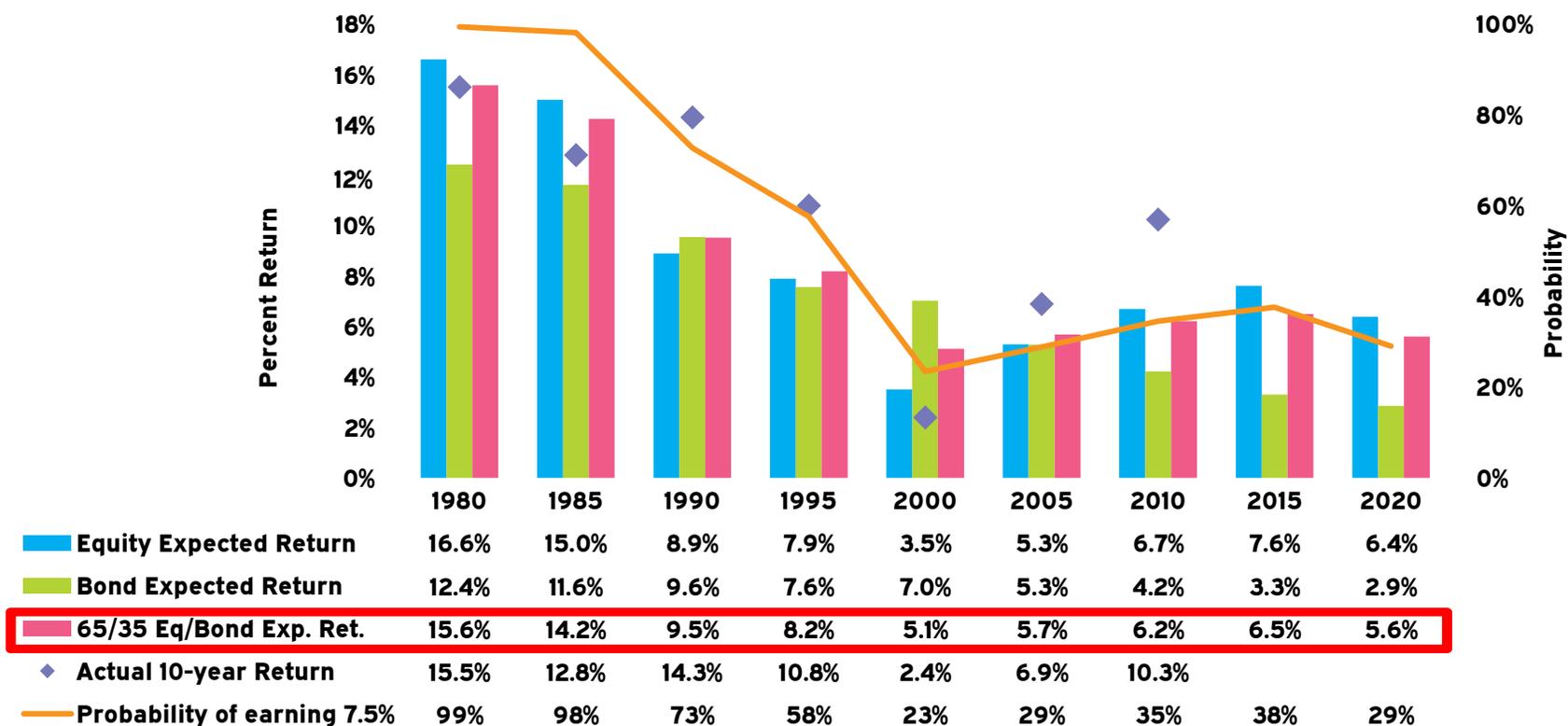
Appendix

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 Returns¹



Source: Meketa Investment Group

¹ 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

	Federated	P&F	Global 60/40
Expected Return ¹	7.3	7.1	5.8
Standard Deviation ¹	13.6	12.7	10.4
Probability of Achieving 6.75%			
1 Year	51.6	50.8	46.4
3 Years	52.8	51.5	43.8
5 Years	53.6	51.9	42.0
10 Years	55.1	52.7	38.7
20 Years	57.2	53.8	34.3
"Worst Case" Returns²			
1 Year	-19.9	-18.6	-15.7
3 Years	-9.4	-8.6	-7.2
5 Years	-5.9	-5.3	-4.4
10 Years	-2.2	-1.8	-1.5
20 Years	0.5	0.7	0.6
Expected Returns if Equities Decline 25%	-17.4	-16.1	-14.6
Expected Returns if Equities Decline 40%	-27.6	-25.8	-25.0

¹ Expected return and standard deviation are based on Meketa Investment Group's Interim 2020 Annual Asset Study and reflect our 20-year expectations. Returns for periods longer than one year are annualized.

² "WorstCase" return projections encompass 99% of all possible outcomes.

Source: Meketa Investment Group

Plan Return History

For period ending June 30, 2020

	10 years ending 6/30/20	10 years ending 12/31/19	10 years ending 6/30/19	10 years ending 12/31/18	10 years ending 6/30/18	10 years ending 12/31/17	20 years ending 6/30/20	20 years ending 12/31/19	20 years ending 6/30/19	1/31/94- 6/30/20
San Jose Federated City Employees' Retirement System	5.5%	5.5%	6.5%	6.0%	4.1%	8.3%	4.9%	5.1%	5.0%	6.5%
<i>Federated Policy Benchmark</i>	6.4%	6.3%	7.2%	6.7%	5.0%	7.7%	5.0%	5.2%	5.1%	6.8%
<i>Federated Investable Benchmark Portfolio</i>	5.4%	5.4%	6.3%	6.0%	4.1%		4.1%	4.2%		
San Jose Police & Fire Department Retirement Plan	6.2%	6.3%	7.2%	6.8%	4.6%	9.0%	5.3%	5.5%	5.4%	6.9%
<i>Police & Fire Policy Benchmark</i>	6.7%	6.8%	7.7%	7.2%	4.9%	9.0%	5.3%	5.5%	5.3%	
<i>Police & Fire Investable Benchmark Portfolio</i>	6.3%	6.5%	7.3%	6.9%	4.8%	9.0%	5.3%	5.7%		
DB Plans >\$1 Billion Net Peer Universe	7.8%	8.1%	9.0%	8.2%	6.1%	7.4%	5.4%	5.7%	5.4%	7.1%
<i>Number of Plans</i>	64	59	65	151	120	64	48	44	44	35

Source: Meketa Investment Group