



## *Investment Program*

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## INVESTMENT FEES

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## Joint Investment Committee

# Outline

## Part 1: March Joint Investment Committee

Robust discussion on the import and appropriate approach to managing fees.

- Staff's annual fee reports provide objective measures. Today's discussion and any deliverables may help add context and frame how those measures should be evaluated.

Discuss the development of a fee policy, to be included in staff procedures.

## Part 2: May Joint Investment Committee

Presentation of Draft Fee ~~Policy~~ Procedures for IC discussion.

# Why Fees Matter

Fees are more than the cost of the investment strategies – fees and fee structures speak to the goals and value proposition of the investment program.

## Simple goals

Lower is better, “A penny saved is a penny earned.”

## Slightly more sophisticated

Fee structures should show an alignment of interests between asset owners and managers.

## Holistic view

Fees are a result of asset allocation, and should reflect the priorities and strengths of the investment program. Understanding how the program utilizes its “fee budget” is one step in optimizing the program’s resources. Opaque fee structures can lead the program to create an inefficient structure that overspends to achieve results that are not optimal.

# Objectives and Evaluation

## Simple

Lower the level of fees

Pay the market rate for different types of mandates

- Benchmark to peers

Understand what exposures the program is paying for

- (Expensive) Alpha versus (Cheap) Beta
- Different approaches to achieve similar factor exposures

Metric: Year over year changes in fees for similar mandates.

## Slightly More Sophisticated

Strong preference for performance fee structures for active strategies

- What is the market rate for alpha share
- Additional mechanisms to protect the program from paying for underperformance

Metric: Year over year changes in alpha shares.

## Holistic

Understanding how the program deploys its scarce resources: fee budget, staff bandwidth, absolute volatility / tracking error.

Creating a long term plan to optimize the program's resources while leveraging its strengths.

Metric: Creation of a fee policy; incorporation of fees into a strategic plan for the investment program.

# Implementation

## **Simple**

Consolidate strategies across both plans, and/or across investment managers.

Consider prioritizing situations where program has fee leverage: emerging managers, seeding new strategies.

Consider sharing fee information with other asset owners.

## **Slightly More Sophisticated**

Establish the program's strong preference for performance fee structures.

Consider additional fee levers: liquidity, index hurdles, high water marks and clawbacks.

## **Holistic**

Understand the constraints under which the program operates: fees, staff resources, risk.

Develop a strategic plan that evaluates the structural model of the program: how does the program optimize its strengths while operating under its constraints?

# Policy Considerations

## People

Guidelines should address the roles and responsibilities of internal and external participants involved in the investment management fee negotiations.

## Process

Establish guidelines that identify the actions the defined benefits plan should take in negotiating investment fees.

## Performance

Establish instructions for how each manager should manage each portfolio, using a specific investment strategy within certain risk parameters. Smaller defined benefit plans that don't have access to higher-returning alternative investments should consider entering into cooperative arrangements with other plans.

## Price

Ensure that the defined benefit plan is paying a reasonable, competitive fee

## Part 2: Draft Fee Procedures

- Governance Pathway
- IPS Language
- Policy Structure
- Alpha Share

# Part 2: Draft Fee Procedures: Governance Pathway

## VII. Manager Selection, Retention, Evaluation & Termination Policy

### Background

- A. The Board has delegated to the CIO the authority to select and terminate all investment managers of the System subject to constraints and parameters contained herein. Such authority shall be further subject to Manager Selection, Retention, Evaluation & Termination Procedures ("Procedures"), approved by the CIO, that provide more detailed constraints and parameters.

### Manager Selection

#### Manager Selection Process

- B. The Procedures shall include any **checklists and templates** to be used in the due diligence process. Such Procedures shall be presented to the Investment Committee for review and input at least every three years, or sooner upon request of the Investment Committee or any member of the Board.



# IPS Language on Fees

## VII. Manager Selection, Retention, Evaluation & Termination Policy

### Manager Selection

#### Manager Selection Process

- I. The System 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 System. The Board will be provided reports on investment costs of the System at least annually.
- J. The System's staff, in coordination with its investment consultants and legal counsel, will negotiate, monitor, and report on fees with investment managers regularly to ensure market competitiveness and appropriateness.
- K. The System will seek to ensure that excessive fees are not being paid for alternative assets by reviewing manager fees at least annually. Fee structures could incorporate fixed fees, performance based fees, high water marks, waterfall, hurdles, floors and caps. The System may also incorporate multi-year performance periods with clawbacks as needed.

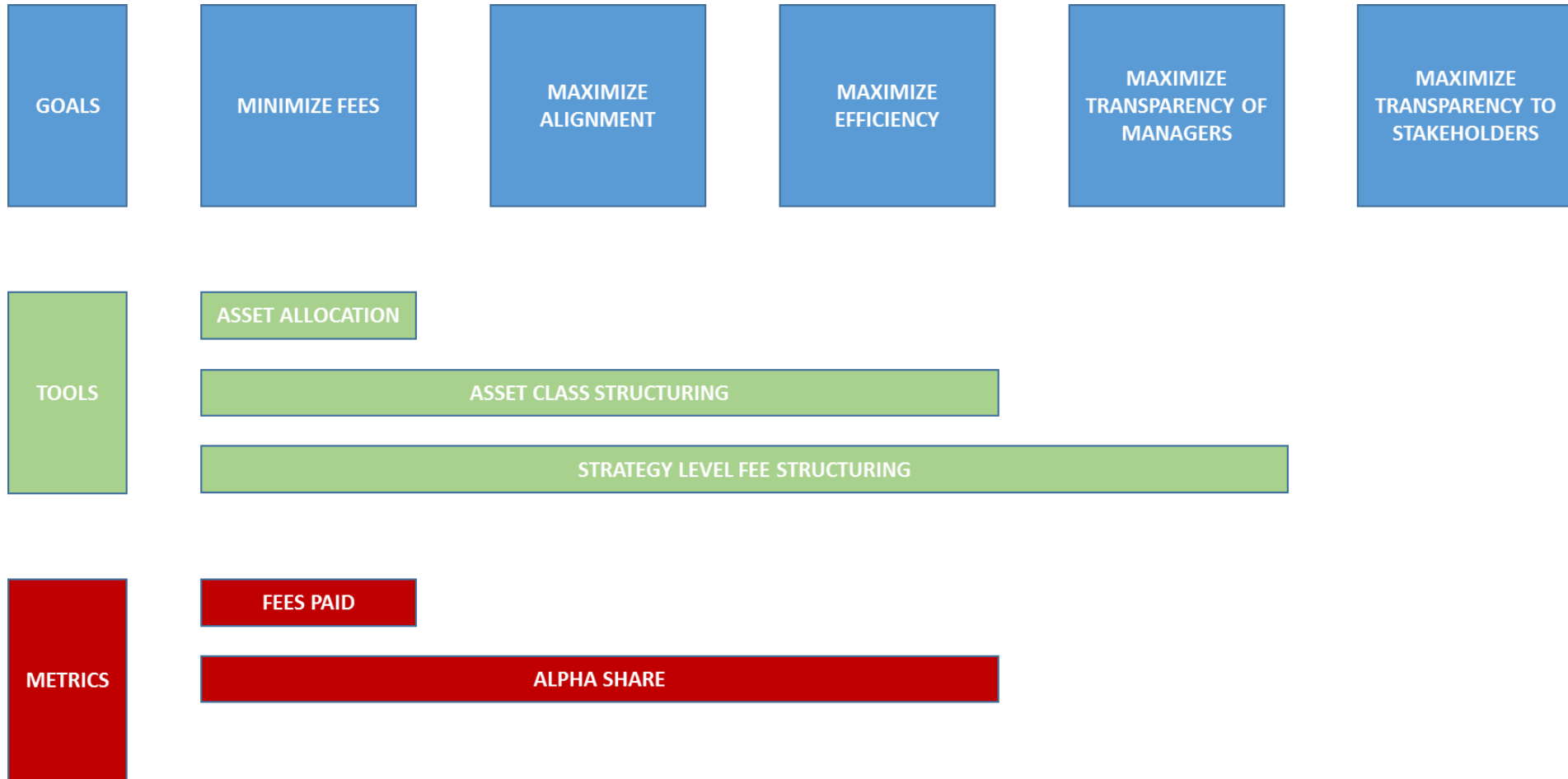
*"alignment of interests"*

*"monitored, controlled .. negotiated"*

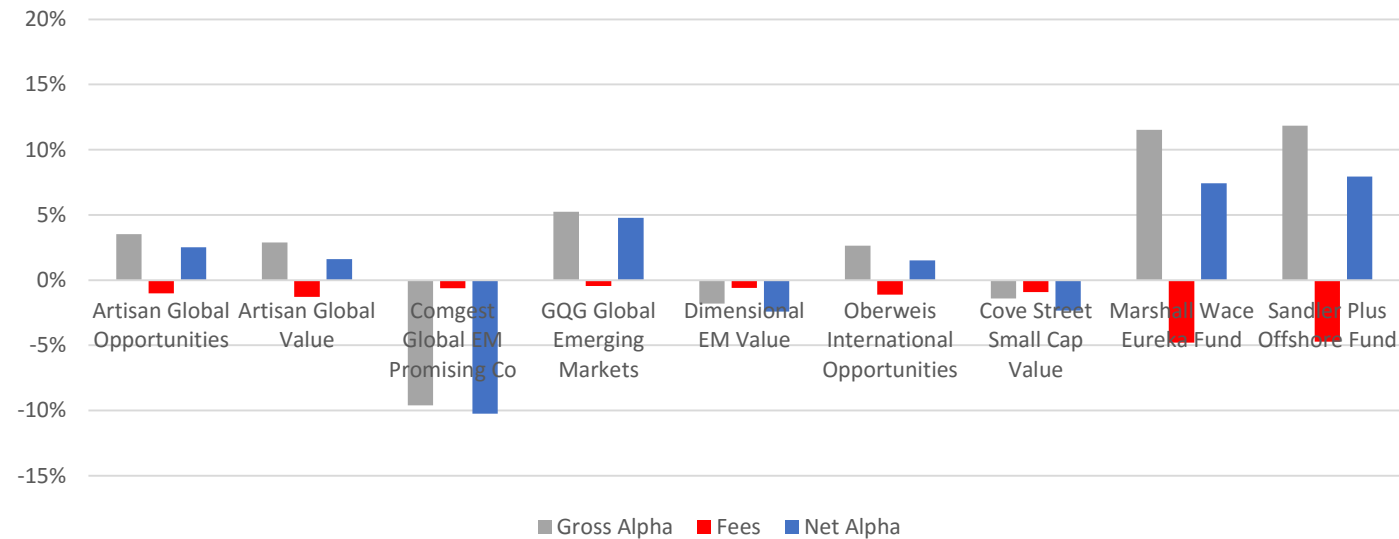
*"provided reports .. at least annually"*

*"market competitiveness and appropriateness"*

# Goals, Tools, and Metrics



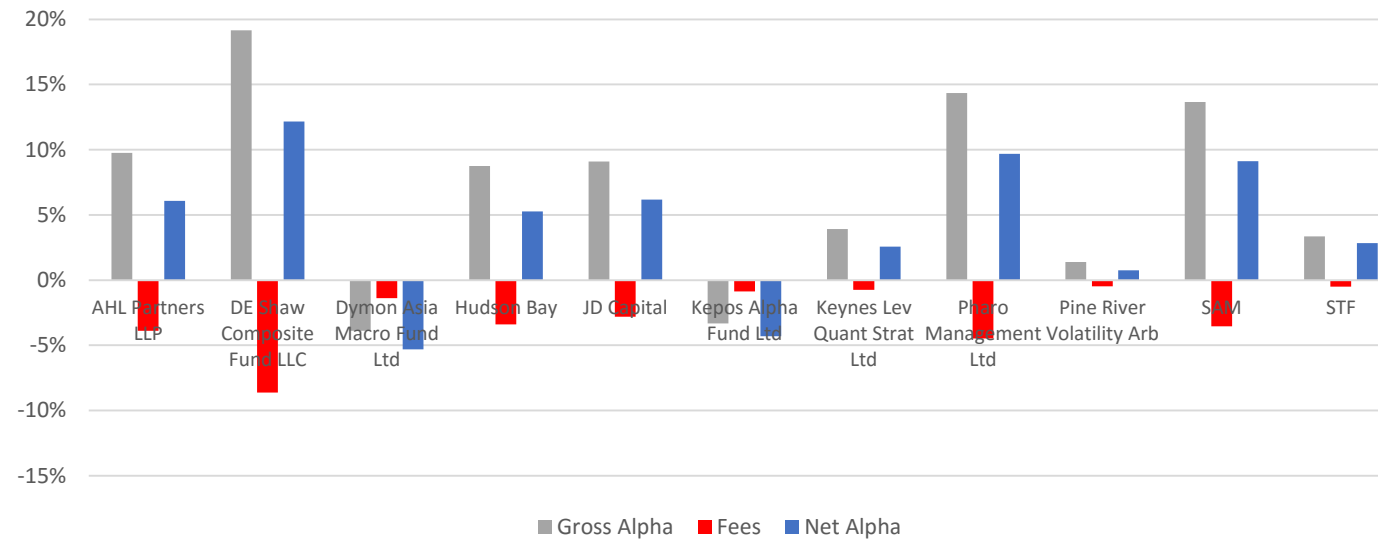
# Public Equity



The proportion of alpha kept by managers ranges from zero, for strategies which did not beat their benchmark, up to >90%.

*Alpha was calculated using policy benchmarks, over the longer of the holding periods between the Federated and P&F Pensions. All figures above are annualized.*

# Absolute Return



The proportion of alpha kept by managers ranges from zero, for strategies which did not beat their benchmark, up to >80%.

*Alpha was calculated using policy benchmarks, over the longer of the holding periods between the Federated and P&F Pensions. All figures above are annualized.*