

# Investment Office Cost Effectiveness

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Investment Committee

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# Agenda

- INVO Cost Effectiveness Initiative
- Cost Savings Progress & Outlook
- INVO Cost Trends
- INVO Cost Structure vs. Peer Benchmarks
- Accomplishments & Upcoming Priorities
- CEM Benchmarking, Inc. Presentation

# Cost Effectiveness Initiative alignment with Investment Belief 8

## Costs Matter and need to be effectively managed

### FROM (2010)

- Manually aggregated, fragmented expense management reporting
- Limited awareness of total cost
- Insufficient focus on fees
- Fragmented cost management process incenting use of external resources
- Difficulty Benchmarking against relevant peers



### TO (2016)

- Automated, timely, meaningful expense management reporting
- Improved knowledge of total cost
- Focus on fee reduction and value-add
- Better-aligned fee structures drive improved performance
- Greater flexibility to manage internal vs. external resources in the best interest of the fund
- Development of meaningful cost benchmark statistics



# Cost Effectiveness Initiative Savings Activities & Outlook

## 2011-12

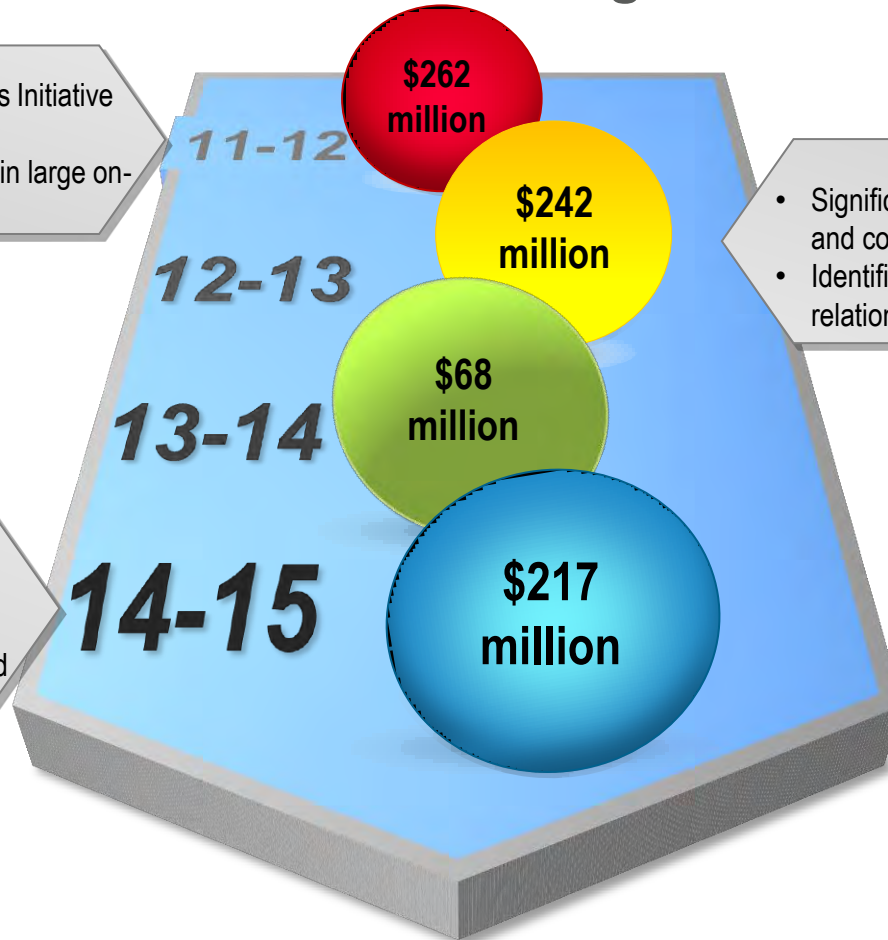
- INVO Roadmap Cost Effectiveness Initiative Implemented
- Two Rapid Results Projects result in large on-going and one-time cost savings<sup>1</sup>

## 2012-13

- Significantly improved financial data, systems and controls. Identified consulting fee savings
- Identification of key external manager relationships to re-negotiate lower fees

## 2014-15

- Re-negotiated additional external manager relationships
- Majority of "Low-hanging fruit" harvested
- Cost continues to be a focus in INVO and Enterprise Strategic Objectives



## 2015-16 & into the future

Cost Effectiveness initiatives thru March 2016 have resulted in approximately **\$62 million** in cost savings



# INVO Cost Effectiveness Trends 2009-2015

Management fees have decreased \$161 million or 18%, while AUM has increased from \$168 billion to \$302 billion. Consultant fees have decreased \$17 million or 49%. Excluding profit sharing, the Investment Office has decreased overall costs by \$134 million or 13%

Expense Category	ACTUAL FISCAL YEAR (FY) EXPENSES (\$ in millions)						(Decrease) Increase
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	
External Mgmt. Fees – Base (Public)	98	103	96	82	83	88	(10)
External Mgmt. Fees – Base (Private) <sup>1</sup>	813	801	751	739	715	662	(151)
<b>Total External Mgmt Fees – Base</b>	<b>911</b>	<b>904</b>	<b>847</b>	<b>821</b>	<b>798</b>	<b>750</b>	<b>(161)</b>
External Mgmt. – Profit Sharing (Public)	30	57	54	70	81	73	43
External Mgmt. – Profit Sharing Paid (Private)	95	227	111	326	105	71	(24)
External Mgmt. – Profit Sharing Accrued (Private) <sup>2</sup>	-	-	-	-	632 <sup>3</sup>	452	452
<b>Total External Mgmt - Profit Sharing</b>	<b>125</b>	<b>284</b>	<b>165</b>	<b>396</b>	<b>818</b>	<b>596</b>	<b>471</b>
Consultants	35	51	38	27	21	18	(17)
Personnel Services/OE&E <sup>4</sup>	31	37	44	44	61	63	32
Portfolio Mgmt Services	19	18	21	22	28	31	12
Operating Services	26	30	24	35	24	26	0
<b>INVO Total Port Mgmt. Expense + Profit Sharing</b>	<b><u>1,147</u></b>	<b><u>1,324</u></b>	<b><u>1,138</u></b>	<b><u>1,345</u></b>	<b><u>1,751</u></b>	<b><u>1,484</u></b>	<b><u>337</u></b>
<b>INVO Total Port Mgmt. w/o Profit Sharing</b>	<b><u>1,022</u></b>	<b><u>1,040</u></b>	<b><u>973</u></b>	<b><u>949</u></b>	<b><u>932</u></b>	<b><u>888</u></b>	<b><u>(134)</u></b>

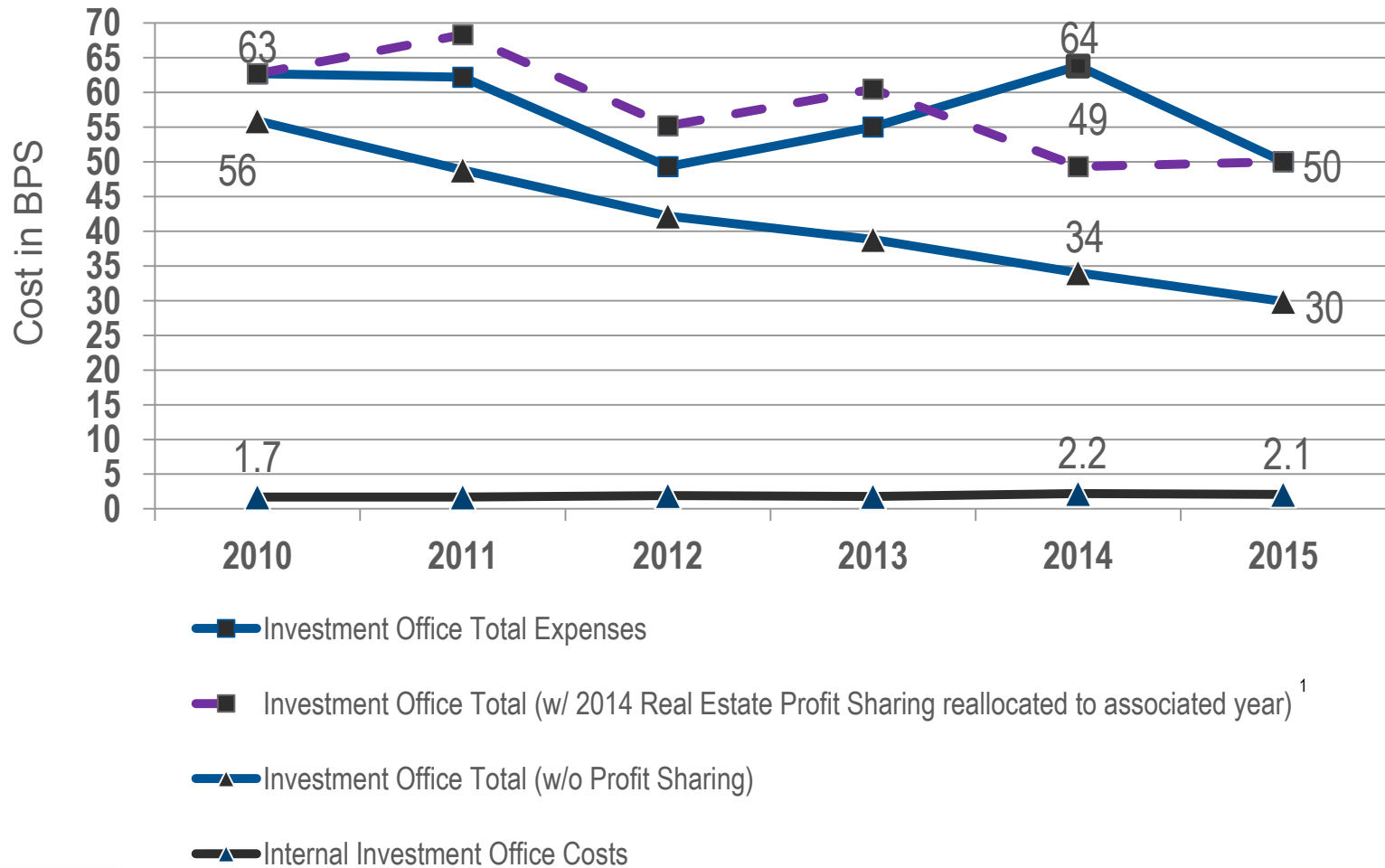
<sup>1</sup> External Mgmt. base fees paid are net of applicable fee offsets in Private Equity (PE). Does not include any fees paid directly by portfolio companies to General Partners (GPs)

<sup>2</sup> Does not include PE profit sharing (carry) – see slide 9

<sup>3</sup> Includes \$399 million one-time RE accrual “catch-up”

<sup>4</sup> Investment Office Salaries and Operating Expenses and Equipment

 **INVO Cost Trends: FY 2010-2015 Basis Points (BPS)**

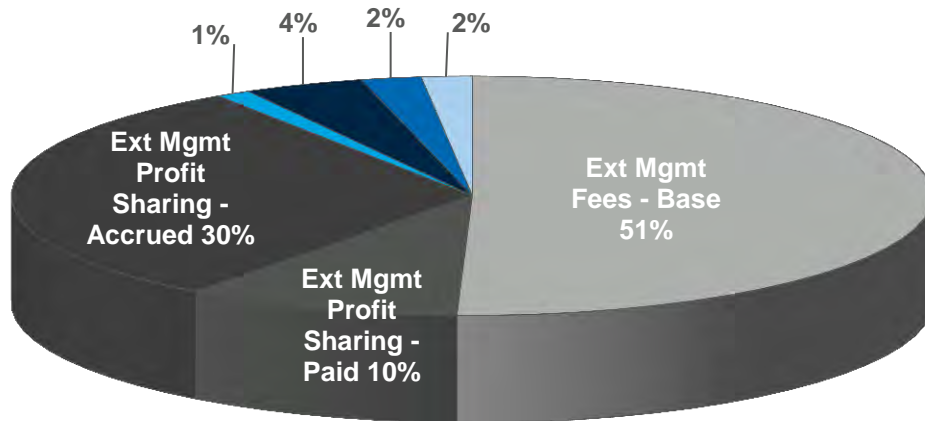


<sup>1</sup>One-time accrual “catch-up” for Real Estate profit sharing was recorded in 2014-15 due to an accounting policy change; This line allocates those accruals to the associated year



# INVO Cost Structure: FY 2014-15 Total Costs

Fiscal Year 2014-15: \$1.4 Billion



- Ext Mgmt Fees - Base
- Ext Mgmt Profit Sharing - Paid
- Ext Mgmt Profit Sharing - Accrued
- Consultants
- Personnel Services & OE&E
- Portfolio Mgmt Services
- Operating

Expense Category	\$ (in millions)	% of Total Cost
External Mgmt Fees – Base <sup>1</sup>	750	51%
External Mgmt – Profit Sharing Paid <sup>1</sup>	144	10%
External Mgmt – Profit Sharing Accrued	452	30%
<b>Total External Mgmt Fees</b>	<b>\$1,346</b>	<b>91%</b>
Personnel Services/OE&E <sup>2</sup>	63	4%
Portfolio Mgmt Services <sup>3</sup>	31	2%
Operating <sup>4</sup>	26	2%
Consultants	18	1%
<b>Total Cost</b>	<b>\$1,484</b>	<b>100%</b>

In Basis Points	
Total Cost	50
Total Cost without Profit Sharing	30

<sup>1</sup> External Mgmt. base fees paid are net of any applicable fee offsets in Private Equity (PE). Does not include any fees paid directly by portfolio companies to General Partners (GPs). Includes paid Profit Sharing for GE, GFI, ARS, and Real Assets. Does not include PE profit sharing (carry) – see slide 9

<sup>2</sup> Investment Office Salaries and Operating Expenses and Equipment

<sup>3</sup> Costs include technology, data, analytics and fund accounting expenses

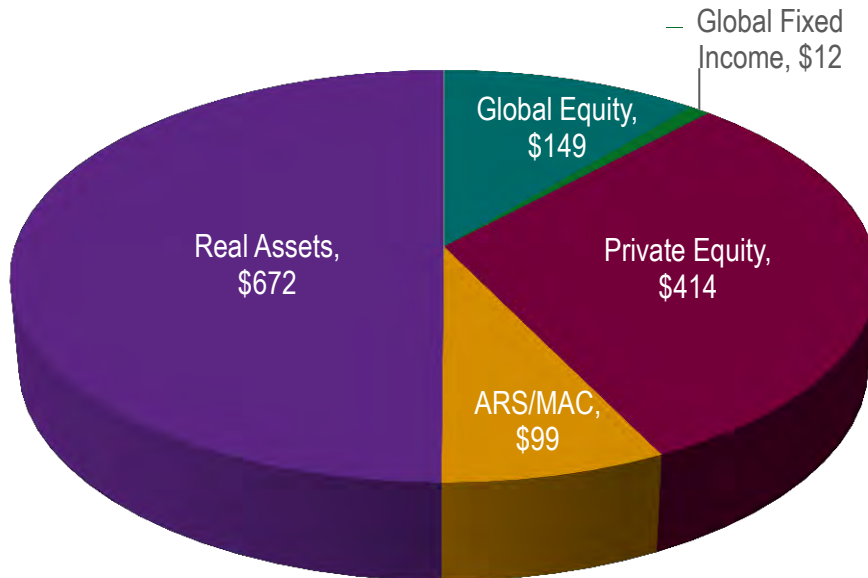
<sup>4</sup> Costs include legal, appraisal, audit, custody, and tax advisory services



# FY 2014-15 External Management Costs

Private assets are primarily externally managed and represent 88% of external management costs

Total External Mgmt Fees <sup>1</sup> and Profit Sharing<sup>2</sup> by program (%)



- Global Equity
- Global Fixed Income
- Private Equity
- ARS/MAC
- Real Assets

ASSET CLASS	5-YEAR RETURNS <sup>3</sup>	10-YEAR RETURNS <sup>3</sup>
Private Equity	14.4%	11.9%
Global Equity	12.9%	6.6%
Global Fixed Income	5.4%	6.1%
ARS	5.1%	4.6%
Real Assets	11.8%	2.2%

<sup>1</sup> External Mgmt. base fees paid includes impact of any fee offsets in Private Equity (PE). Does not include any fees paid directly by portfolio companies to General Partners (GPs)

<sup>2</sup> Figures include paid and accrued Profit Sharing for Real Assets (RA). Does not include PE profit sharing (carry)

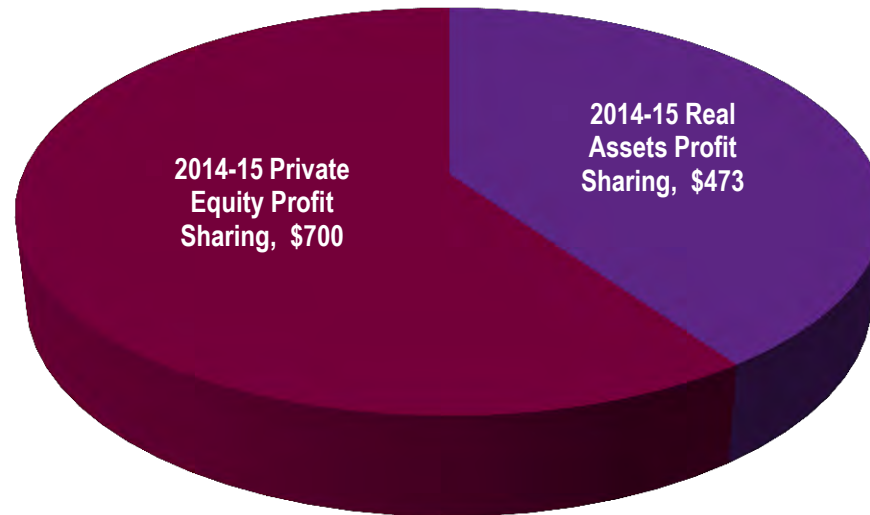
<sup>3</sup> Per 6/30/2015 CIO Report



# FY 2014-15 Profit Sharing Real Assets and Private Equity

Real Assets Profit Sharing is accrued and paid. Private Equity Profit Sharing is netted from distributions

As of June 30, 2015 (in \$millions)



■ 2014-15 Real Assets Profit Sharing    ■ 2014-15 Private Equity Profit Sharing



# Private Equity Profit Sharing<sup>1</sup>

In November 2015, CalPERS released profit sharing information for its Private Equity portfolio

- \$24.2 billion in realized net gains to the Fund from 1990 to June 30, 2015
- During the same time period CalPERS' external investment partners have realized \$3.4 billion from profit sharing agreements
- Over the 2014-15 Fiscal Year, CalPERS earned \$4.1 billion in private equity net gains while its external investment partners realized \$700 million from profit sharing agreements
- Private Equity Accounting and Reporting System (PEARS) and collection/review of ILPA fee templates on all new funds will allow CalPERS to aggregate and report prospectively on:
  - Management base fees, Management base fee offsets & waivers
  - Profit sharing netted from distributions and accrued
  - Fees and expenses paid directly to General Partners or affiliates from Portfolio Companies

<sup>1</sup> Data from PEARS

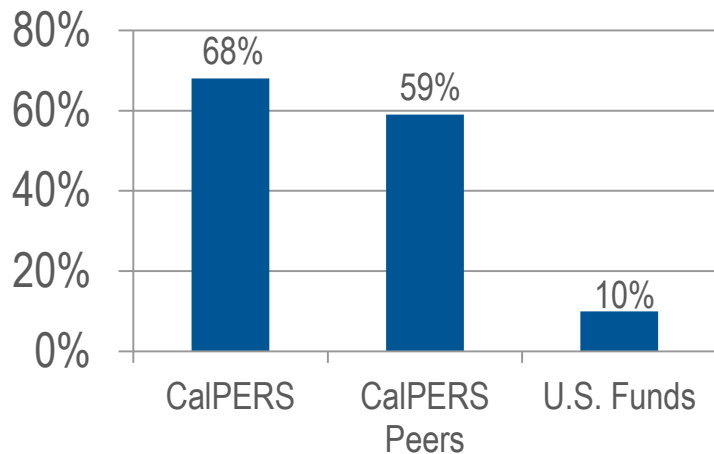


# CalPERS is Cost Advantaged vs. Peers per CEM

Internal Management of Public Assets and Index-Oriented management of equities drive cost advantage

**CalPERS Internal Management vs. Peers<sup>1</sup>**

■ % of Total Assets Internally Managed



**CalPERS Public Market Assets Managed Internally<sup>2</sup>**

	Global Equity	Global Fixed Income	Liquidity	Inflation Assets	Total
Total Public Assets (\$ billions)	155	56	5	14	230
% Managed Internally	81%	93%	100%	100%	86%
<b>BPS<sup>3</sup></b>	<b>2.0</b>	<b>4.4</b>	<b>0.7</b>	<b>2.0</b>	<b>3.4</b>

<sup>1</sup> Data per CalPERS CEM CY 2014 Report

<sup>2</sup> Per 12/31/2015 CIO Quarterly Performance Report presented at February 2016 Investment Committee

<sup>3</sup> Estimate of total FY 2014-15 INVO expenses including an allocation of all direct program and shared service expenses



# CalPERS is Cost Advantaged vs. Peers per CEM

## Independent Benchmarking cost analysis validates Investment Office is low cost compared to its peers

- CEM Benchmark cost is the cost peers would incur if they had CalPERS actual asset mix
- CalPERS actual base cost of 41.1 bps is less than benchmark cost of 42.9 bps due to:
  - Internal management of public assets
  - Index-oriented management for 2/3 of equity portfolio
  - Less use of fund-of-funds for private assets

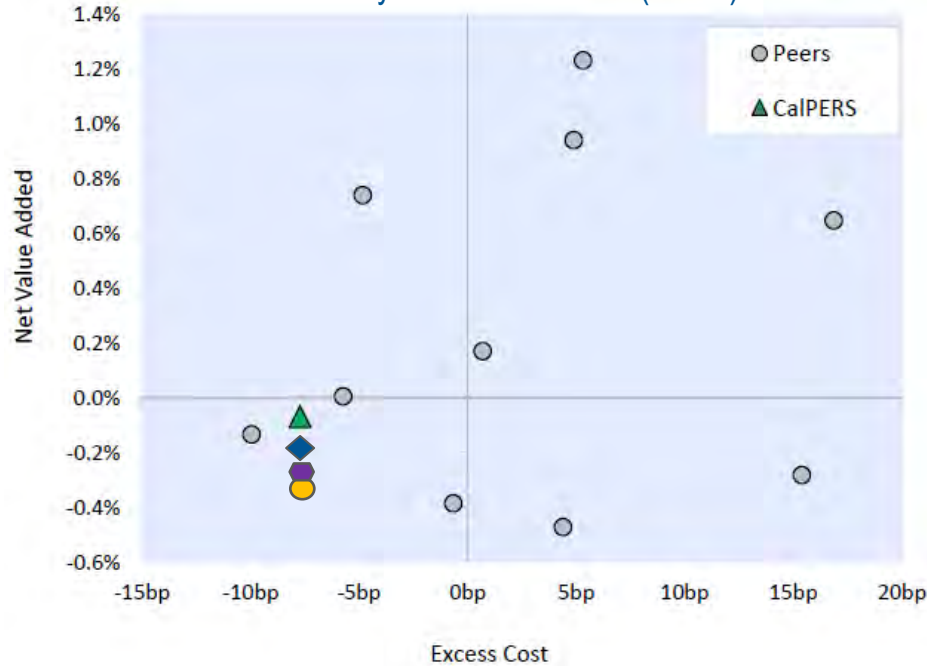
Calendar Year 2014	BPS <sup>1</sup>
CalPERS Actual Cost	41.1 bps
CalPERS CEM Benchmark Cost	42.9 bps
<b>CalPERS Cost Advantage</b>	<b>(1.8) bps</b>

## CEM Methodology vs. Investment Office Actuals

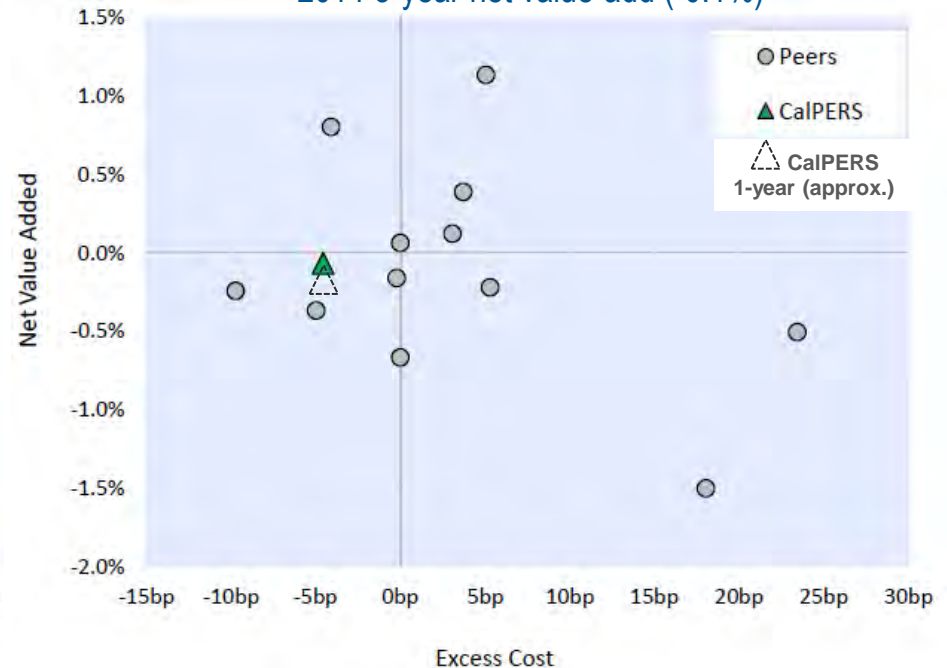
- CEM Benchmark Survey collects calendar year performance and assets from CalPERS and its global peers, and uses a standard methodology to compare the peer funds.
- CalPERS reports costs with CEM on a fiscal year basis (2014 CEM report uses 2013-14 fiscal year-end Investment expenses).
- CEM total cost data for peer comparison excludes profit sharing/carry for real estate, infrastructure, natural resources and private equity.
- Profit sharing is included for the public market asset classes and hedge funds.
- CEM figures include an allocation of CalPERS Enterprise support costs in our Investment costs.

# CEM Peer Benchmarking: INVO Net Value-Add<sup>1</sup>Trend

2014 5-year net value-add (-0.1%)<sup>1</sup>



2014 3-year net value-add (-0.1%)



	CEM Report	CalPERS 5- Year Net Value-Add <sup>2</sup>
▲	2014	-0.1%
◆	2013	-1.9%
●	2012	-3.0%
⬡	2011	-2.8%

## Investment Office Activities:

- Restructured portfolios to improve returns
- Re-negotiated existing terms with current managers to more favorable economics and fee structures
- Investing in risk management and control capabilities

<sup>1</sup> Data per CalPERS CEM Reports. 5-year chart is from most recent 2014 CEM report which shows CalPERS peers in 2014

<sup>2</sup> Net Value-Add = Net total fund return – Policy Return



# Cost Effectiveness Accomplishments & Upcoming Priorities

## INVO continues to partner with the Financial Office (FINO) on the Cost Effectiveness Initiative

### Accomplishments:

- ✓ INVO's Cost Effectiveness Initiative has yielded approximately \$790 million in absolute cost savings activities from 2011-2015, while INVO internal costs increased \$25 million
- ✓ Interim cost savings reporting to-date for FY 2015-16 estimates approximately \$62 million arising from improved fee structures negotiated on new commitments made by the private asset classes
- ✓ As of July 1, 2015, internal investment expenses are recognized in net returns, to support INVO's GIPS (Global Investment Performance Standards) Compliance Initiative
- ✓ PEARS data now captures Private Equity (PE) management fees and profit sharing. Reported PE management fees in FINO mid-year expense agenda item for the first time
- ✓ Released profit sharing information for PE in November 2015

### Upcoming priorities:

- ✓ Continue to work with FINO to further automate manually aggregated expense data
- ✓ Move forward with GIPS Compliance Initiative
- ✓ Continue to partner with CEM to obtain meaningful net value-added number
- ✓ Leverage new ILPA fee template and new LPAs to capture PE fees and profit sharing