MANAGEMENT FEES

MPERS' Board Meeting

Supplemental Information
November 18, 2021

Key Points

- MPERS' overall fee structure is appropriate given our asset allocation.
  - Alternative assets account for the bulk of the System's management fees.
  - Alternative investments lower the volatility of a plan and have played a key role in MPERS' strong performance.
- MPERS takes a proactive approach to managing our fees, aligning our interests with the underlying managers and addressing the transparency demands of interested parties.
  - The fee structure of MPERS' traditional portfolio has greatly benefitted from internal management.
  - Emphasis on co-investments
  - Membership in ILPA, an organization that works towards establishing "best practices" for transparency and reporting standards for alternative asset classes.
- Fees are not the primary driver of manager selection
- MPERS' performance is always reported on a "net of all fees" basis, and the results confirm our approach has generated value for our members.
- Inconsistent reporting of partnership fees leads to unreliable comparisons.
- MPERS approached GASB about advising public plans on reporting standards for fees and was part of a working group addressing fee reporting.

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Fiscal Year 2021 Performance

Traditional vs. Alternative Asset Classes

Asset Class	% of Assets	Market Value	1-year Return	5-year Return	10-year Return
Total Plan		$3,002,883,720	30.80%	11.10%	9.59%
Traditional Assets*	51.13%	$1,535,403,301	30.86%	10.61%	8.58%
Alternative Assets	48.87%	$1,467,430,419	30.92%	11.51%	10.53%

* Includes cash account

Performance is calculated net of management fees.

	1-year	3-year	5-year	10-year
MPERS Total Plan Standard Deviation	5.45%	7.08%	5.70%	5.22%
MPERS Traditional Assets Standard Deviation	9.61%	11.91%	9.62%	8.77%
MPERS Alt. Assets Standard Deviation	4.56%	5.32%	4.28%	3.81%
Peer Universe Standard Deviation	8.85%	11.87%	9.58%	8.89%

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Comparison of Fees

Fee Types	2019	% of AUM	2020	% of AUM	2021	% of AUM
Investment Management Fees	$20,717,585	0.86%	$20,840,769	0.88%	$22,026,476	0.73%
Performance Fees	$8,621,264	0.36%	-$4,418,675.93	-0.19%	$44,711,650	1.49%
Pass Through Fund Expense	$4,278,862	0.18%	$3,589,419	0.15%	$6,714,564	0.23%
Portfolio Company Expenses	$204,116	0.01%	$310,828	0.01%	$96,246	0.00%
Total Expenses Reported	$33,821,827	1.40%	$20,322,339.65	0.86%	$73,548,936	2.45%
MPERS Total Portfolio 1 Year Return	6.84%		-0.46%		30.80%	

- Performance fees are driven by the fund’s performance.

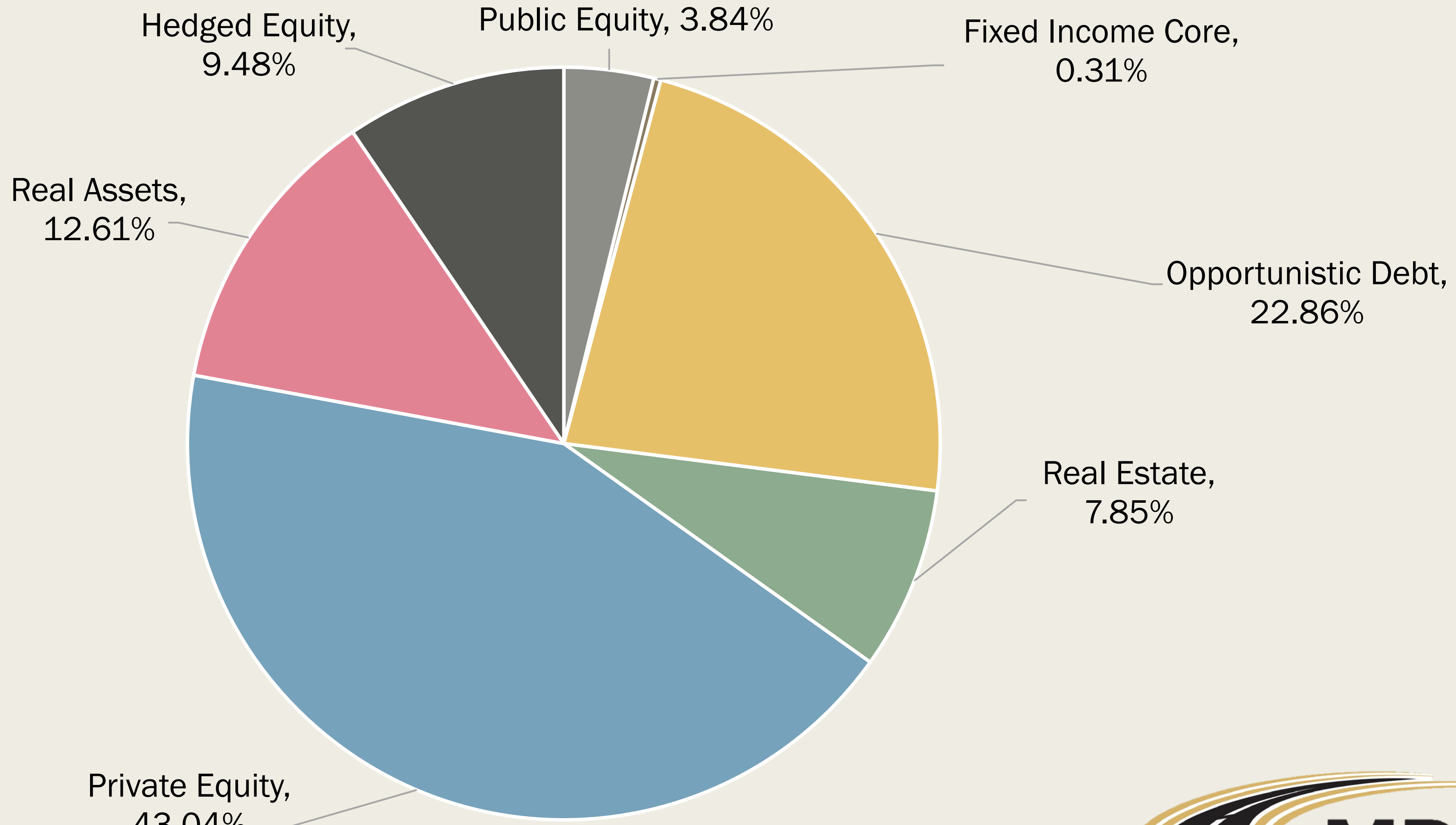
NEPC 2021 Traditional Management Fees Study

Asset Class	MPERS' Market Value 6/30/2021	MPERS' Weighted Avg. Management Fees	eVestment Alliance Universe Median
Core Fixed Income	$284,959,497	0.04%	0.30%
Long Duration Fixed Income	$154,099,888	0.00%	0.25%
US Tips	$23,726,414	0.00%	0.21%
Large Cap US Equity	$580,941,935	0.03%	0.42%
Small Cap US Equity	$92,834,447	1.16%	0.80%
All EAFE Equity (Int'l Dev.)	$166,598,502	0.71%	0.59%
International Small Cap	$108,966,760	0.75%	0.85%
Total Weighted Average Fees	**$1,412,127,443**	**0.24%**	**0.45%**

- NEPC compared MPERS' traditional investment management fees by asset class to the eVestment Alliance Universe.
- NEPC found that MPERS' traditional investment management fees are in line with or significantly lower than its respective universe.
- Internal management has generated big savings in fees.

Fees by Asset Class (as a % of total fees)

Total Fees: $73,548,936 (0.73% of total AUM)



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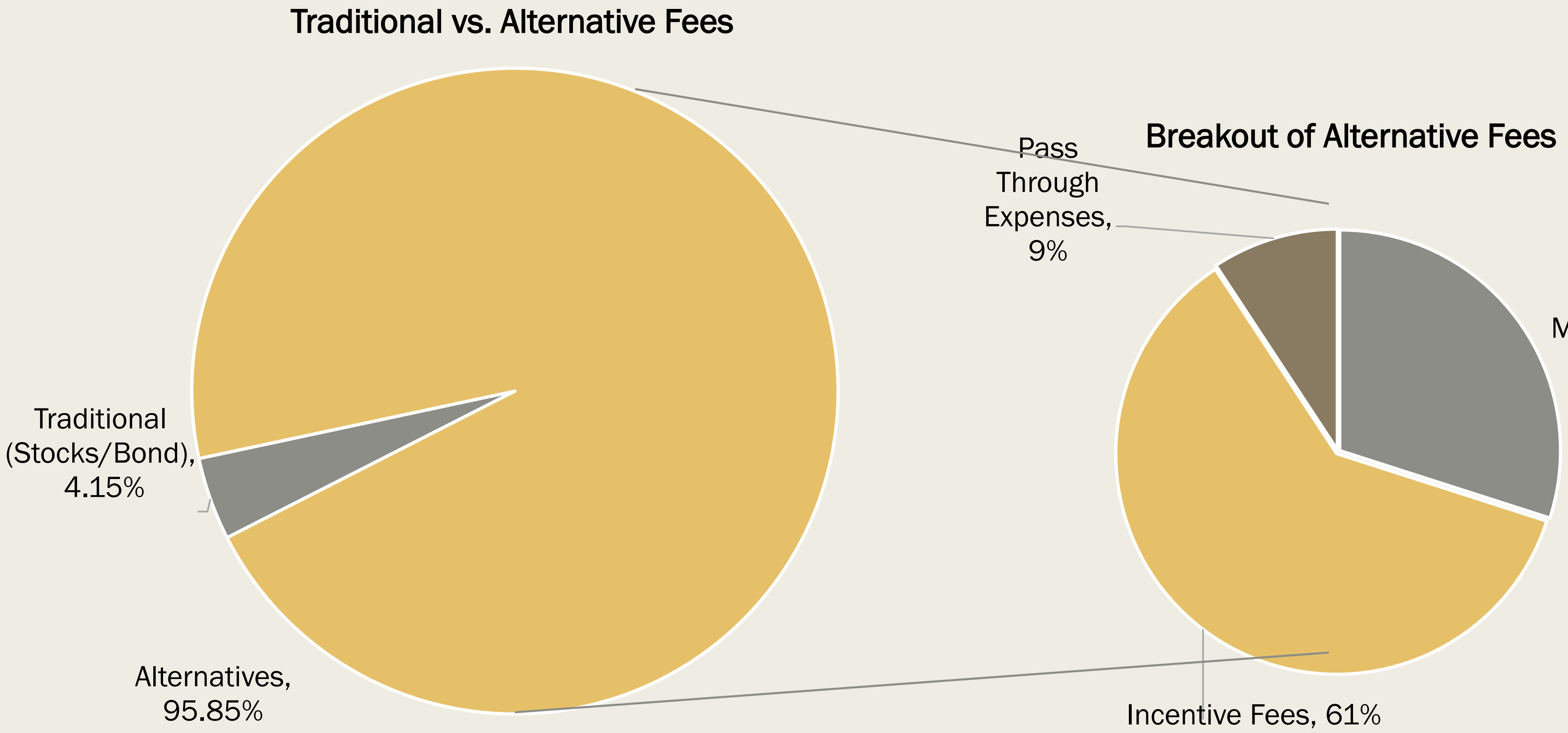
Breakdown of Fees

(as a % of total fees)



Types of Fees Reported

- Investment management fees are fixed fees based on a percentage of assets under management or committed capital.
- Performance fees (AKA profit sharing) are a percentage of gains and, in most cases, are earned once a manager has returned all paid in capital (including fees) and has met a specific rate of return.
  - Reported as accrued; therefore, can be negative or positive in any given year depending on performance
- Pass through expenses are fees that are paid because of the structure of the investment. For example, because MPERS requires that all investments in private partnerships be audited, the cost for the audit is a pass through expense paid pro rata by the investors in the fund.
- Portfolio company fees are fees that are paid by the individual portfolio companies within private partnerships. For example, if a fund manager is paid for advising a portfolio company, that fee could be listed as a portfolio company fee. A portion of these fees, but more often than not all of these types of fees, will offset management fees to ensure that fund managers are not being paid by the companies and by the fund investors (MPERS) for the same costs.

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Inconsistent Methods of Reporting Fees

- MPERS aims to disclose fees in the most transparent and comprehensive approach.
  - The result of this approach is that our fees appear higher than many of our peers who take other approaches to disclosing fees.
- Some plans only disclose actual fees paid in a given year, and do not disclose any incentive fees accrued during a year.
- Other plans treat return of capital in certain partnership structures as a return of management fees.
  - Most partnership structures require that all paid-in capital is returned to the investor before paying performance fees to the general partner - with management fees considered part of that paid-in capital.
  - This “refunding” of management fees can result in negative management fees.
- Another method is to not disclose incentive fees (carry) as a fee at all; but to consider carry as part of a profit sharing structure.
- Rarely do others disclose pass-through expenses or portfolio company fees.
- The various approaches and methods used to calculate fees makes it very difficult to compare MPERS’ overall fee structure against a peer universe.

Fee Disclosure Sample – Year 1

	Year-to-Date
Beginning Balance	$10,000,000
Unrealized Investment Gains/Losses	$2,000,000
Management Fees (1%)	-$100,000
Total Ending Balance	$11,900,000
Accrued Carry (20% of profits)	-$400,000
Total Net of Carry Ending Balance	$11,500,000

	Management Fees	Performance Fee	Total Fees ($)	Total Fees (Basis pts)	
MPERS	$100,000	$400,000	$500,000	4.35	Reports management fees, performance fees, and expenses
PEER 1	$100,000	$0	$100,000	0.94%	Reports only management fees
PEER 2	($100,000)	$400,000	$300,000	2.83%	Reports both management fees and performance fee but reports return of capital as negative management fees
PEER 3	$0	$0	$0	0.00%	Reports fees paid and nothing that is netted

All four plans will report the same net of fee return for this reporting period.

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Fee Disclosure Sample – Year 2

	Year-to-Date
Beginning Balance	$11,500,000
Unrealized Investment Gains/Losses	-$1,000,000
Management Fees (1%)	-$100,000
Total Ending Balance	$10,400,000
Accrued Carry (20% of profits)	+$200,000
Total Net of Carry Ending Balance	$10,600,000

	Management Fees	Performance Fee	Total Fees ($)	Total Fees (Basis pts)	
MPERS	$100,000	($200,000)	($100,000)	-0.94%	Reports management fees, performance fees, and expenses
PEER 1	$100,000	$0	$100,000	0.94%	Reports only management fees
PEER 2	($100,000)	($200,000)	($300,000)	-2.83%	Reports both management fees and performance fee, but reports return of capital as negative management fee
PEER 3	$0	$0	$0	0.00%	Reports fees paid and nothing that is netted

All four plans will report the same net of fee return for this reporting period.

[GSO Capital Opportunities Fund III – Fee Example]

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Reminder: Fees Are Not the Primary Driver of Manager Selection

- The manager must qualify as a fiduciary to the System, have a proven track record, and have an investment style and process that is compatible with the System's investment objectives and policies.
- When evaluating fee structures:
  - The System looks for qualified service providers with reasonable and competitive fee structures.
  - Staff and consultants work diligently to ensure the most favorable fee arrangement for the System.
  - MPERS' use of co-investments has resulted in significant fee savings
    - We have committed over $251 million which are at zero or a reduced fee structure.

Summary

- MPERS' Board of Trustees has established an asset allocation and a corresponding policy benchmark that has served the system very well.
    - MPERS' 10 year risk-adjusted returns have consistently ranked in the top quartile of the public fund peer universe
- Staff's responsibility is to implement the asset allocation and outperform the policy benchmark (the return which would have been earned by investing passively across the approved asset allocation)
    - The "un-investable" nature of several underlying benchmarks (i.e., private equity with the S&P + 3% hurdle and real assets with the CPI + 4% hurdle) makes it impossible to passively invest in several of the approved asset classes, making active management and the accompanying fees a necessity.
- MPERS' fees are in line with expectations given our exposure to alternatives and our preference to disclose all fees available.

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Appendix

- *Alternative assets – This term describes non-traditional asset classes. They include private equity, venture capital, hedge funds and real estate. Alternative assets are generally more risky than traditional assets, but they should, in theory, generate higher returns for investors.*
- *Capital commitment – Every investor in a private equity fund commits to investing a specified sum of money in the fund partnership over a specified period of time. The fund records this as the limited partnership's capital commitment. The sum of capital commitments is equal to the size of the fund. Limited partners and the general partner must make a capital commitment to participate in the fund.*
- *Carried interest – The share of profits that the fund manager is due once it has returned the cost of investment to investors. Carried interest is normally expressed as a percentage of the total profits of the fund. The industry norm is 20%. The fund manager will normally; therefore, receive 20% of the profits generated by the fund and distribute the remaining 80% of the profits to investors.*
- *Fund of funds – A fund set up to distribute investments among a selection of private equity fund managers, who in turn invest the capital directly. Fund of funds are specialist private equity investors and have existing relationships with firms. They may be able to provide investors with a route to investing in particular funds that would otherwise be closed to them. Investing in fund of funds can also help spread the risk of investing in private equity because they invest the capital in a variety of funds.*

Appendix

- *Limited partnership – The standard vehicle for investment in private equity funds. A limited partnership has a fixed life, usually of ten years. The partnership's general partner makes investments, monitors them and finally exits them for a return on behalf of the investors – limited partners. The General Partner (GP) usually invests the partnership's funds within three to five years and, for the fund's remaining life, the GP attempts to achieve the highest possible return for each of the investments by exiting. Occasionally, the limited partnership will have investments that run beyond the fund's life. In this case, partnerships can be extended to ensure that all investments are realized. When all investments are fully divested, a limited partnership can be terminated or 'wound up'.*
- *Preferred return – This is the minimum amount of return that is distributed to the limited partners until the time when the general partner is eligible to deduct carried interest. The preferred return ensures that the general partner shares in the profits of the partnership only after investments have performed well.*

Source: The Alternative Assets Network (www.altassets.net)