Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 12

MEETING DATE: **September 16, 2026**

SUBJECT: **Education: Investment Fees**

SUBMITTED FOR: ___ **Action** _X_ **Information**

RECOMMENDATION

Receive and file presentation on investment fee trends and analysis.

PURPOSE/STRATEGIC PRIORITY

The item complies with the Strategic Management Plan objective to advance the investment management function by reviewing the various investment fee structures within the SCERS portfolio and furnishing the Board with a framework for assessing investment fees within the wider context of net returns, diversification, and total portfolio risk.

BACKGROUND

SCERS invests across public markets, private markets, including private equity, private credit, real assets, and real estate, as well as absolute return strategies. These strategies have materially different fee structures. Public equity managers generally charge asset-based management fees, hedge funds may include both management and incentive fees, and private market funds typically include management fees on committed or invested capital and carried interest on investment profits.

For calendar year 2025, SCERS paid approximately $140 million in reported management fees, carried interest, and incentive fees, equal to approximately 0.90% of year-end assets. The reported information is subject to important limitations. Because certain funds do not provide complete fee and expense data at the individual-fund level, the information is compiled by SCERS Staff and its consultants from underlying general partners and has not been independently audited or verified for accuracy or completeness. Management fee data also does not include every payment made to managers or all fees incurred by underlying portfolio investments.

The presentation also explains the distribution waterfall commonly used in private market funds, including the return of capital, preferred return, general partner catch-up, and carried-interest allocation. SCERS actively seeks to invest in lower fee structures, particularly in asset classes that are more efficient and have a narrower dispersion of returns. SCERS reserves higher-cost mandates for those asset classes that are less efficient and have a wider dispersion of returns.

DISCUSSION

Fees constitute a significant element of investment oversight; however, they should not be examined in isolation. The more pertinent fiduciary inquiry is whether the net value, after all fees and expenses, has enhanced SCERS' capacity to fulfill its long-term obligations.

The presentation evaluates whether these costs have been justified by investment results. Over the trailing 10-year period, SCERS' Private Equity portfolio exceeded its benchmark by 3.27% annually, while Private Real Assets exceeded its benchmark by 2.91%. At the Total Fund level, SCERS returned 9.00% annually over 10 years, compared with 8.01% for the Policy Index, resulting in 0.99% of annualized excess return, net of all management fees, expenses, and carried interest and performance fees.

The analysis also compares SCERS' Total Fund with a benchmark portfolio assuming SCERS did not have any alternative assets exposure, which typically contain higher fee structures. This traditional portfolio contains 70% global equities and 30% core fixed income. From 2011 through 2026, the SCERS Total Fund earned an annualized return of 7.9%, compared with 7.7% for the traditional portfolio. More importantly, SCERS achieved that return with annualized volatility of 7.4%, compared with 10.4% for the 70/30 portfolio. The Total Fund also produced a higher Sharpe ratio (risk adjusted returns), a shallower worst monthly decline, and a higher cumulative return.

The central conclusion is not that higher fees are inherently desirable. Rather, higher fees may be justified when they provide access to return sources that generate meaningful net excess returns and improve portfolio diversification. SCERS should continue to maintain strong fee discipline while evaluating each strategy and manager based on the net return and risk-adjusted value delivered to the Total Fund.

ATTACHMENTS

- Board Order
- 2025 Fee Education Presentation

Prepared by:

/S/

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Jim Donohue
Deputy Chief Investment Officer

Reviewed by:

/S/

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Steve Davis
Chief Investment Officer

/S/

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Eric Stern
Chief Executive Officer

Retirement Board Order

Sacramento County Employees' Retirement System

Before the Board of Retirement
September 16, 2026

AGENDA ITEM:

Education: Investment Fees

THE BOARD OF RETIREMENT hereby approves the Staff recommendation to receive and file presentation on investment fee trends and analysis.

I HEREBY CERTIFY that the above order was passed and adopted on September 16, 2026 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

ALTERNATES (Present but not voting):

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Chris Giboney
Board President

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Eric Stern
Chief Executive Officer and
Board Secretary

Fee Education

Sacramento County Employees' Retirement System

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Management Fees by Strategy Type

Fee Dimension	Public Equity Managers	Hedge Funds	Private Markets
Management fee	0.25–0.75% of AUM	1–2% of NAV	1.0–2.0% of committed capital (steps down)
Fee basis	Market value of assets (AUM)	Net asset value (NAV)	Committed/Invested→ invested capital
Performance fee	Occasional profits interest	0–20% of profits	10-20% carried interest
Hurdle / preferred return	Benchmark index (performance fee only)	High-water mark and/or Cash return hurdle	0-8% preferred return + GP catch-up
Structure & liquidity	Open-end; daily liquidity; SMAs	Limited partnership; periodic w/ lockups	Closed-end drawdown; 10–12 yr term

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Fee Variations by Private Market Strategy

Strategy	Management Fee	Management Fee Basis	Preferred Return	Carry Rate
Private Equity	2.00–2.50%	Committed capital (annual reduction post-investment period)	0-8%	20–30%
Private Debt	1.50–2.00%	Committed / remaining invested capital	6-8%	10-20%
Real Estate	1.50%	Committed / remaining invested capital	8–9%	20%
Infrastructure	1.50–1.75%	Committed / remaining invested capital	8%	20%
Natural Resources	1.50–2.00%	Committed / remaining invested capital	8%	20%

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How much does SCERS pay in management fees, carried interest, and incentive fees?

(in USD Millions)	Target Allocation	Mgmt. Fees*	Carried Interest/ Incentive Fees	Total**
Absolute Return	7%	13.63	6.58	20.21
Credit	9%	10.43	4.01	14.43
Fixed Income	16%	2.97	-	2.97
Global Equity	39%	21.47	2.07	23.54
Overlay/Cash	1%	0.99	-	-
Private Equity	11%	26.25	18.38	44.63
Real Assets	7%	16.26	6.44	22.71
Real Estate	8%	10.28	1.27	11.35
Grand Total	***100%***	***102.28***	***38.75***	***141.03***
% of AUM 12/2025	—	0.65%	0.25%	0.90%

› SCERS finds a balance between lower fees in the more efficient asset classes with a lower dispersion of returns and higher fees in asset classes with a higher dispersion of returns

***Disclaimer:** Management fees do not encompass all payments/expenses to managers/funds, nor do they include any fees incurred by underlying portfolio investments..

****Disclaimer:** Certain investment funds do not provide complete fee and expense data at the individual-fund level. The data presented is sourced from underlying general partners by SCERS Staff and its consultants and has not been independently audited or verified for accuracy or completeness. Accordingly, the information may not reflect full fee transparency across all funds in the portfolio.

Fee Validation

- Staff reconciles quarterly fees for all of SCERS' custodied public market mandates to confirm accuracy
- Private market fees are more complex and challenging to validate
- SCERS recently hired an outside firm to validate fees and carried interest for select private equity funds and commingled public equity funds
  - The selected private equity funds were longer tenured funds where SCERS was paying carried interest
  - Results were that the evaluated funds were charging fees and carried interest accurately
    - There were some small discrepancies attributed toward methodology differences
- The outside firm also evaluated the competitiveness of the public equity commingled funds fees against the market for similar funds, which resulted in a slight reduction in the management fee for one SCERS mandate.

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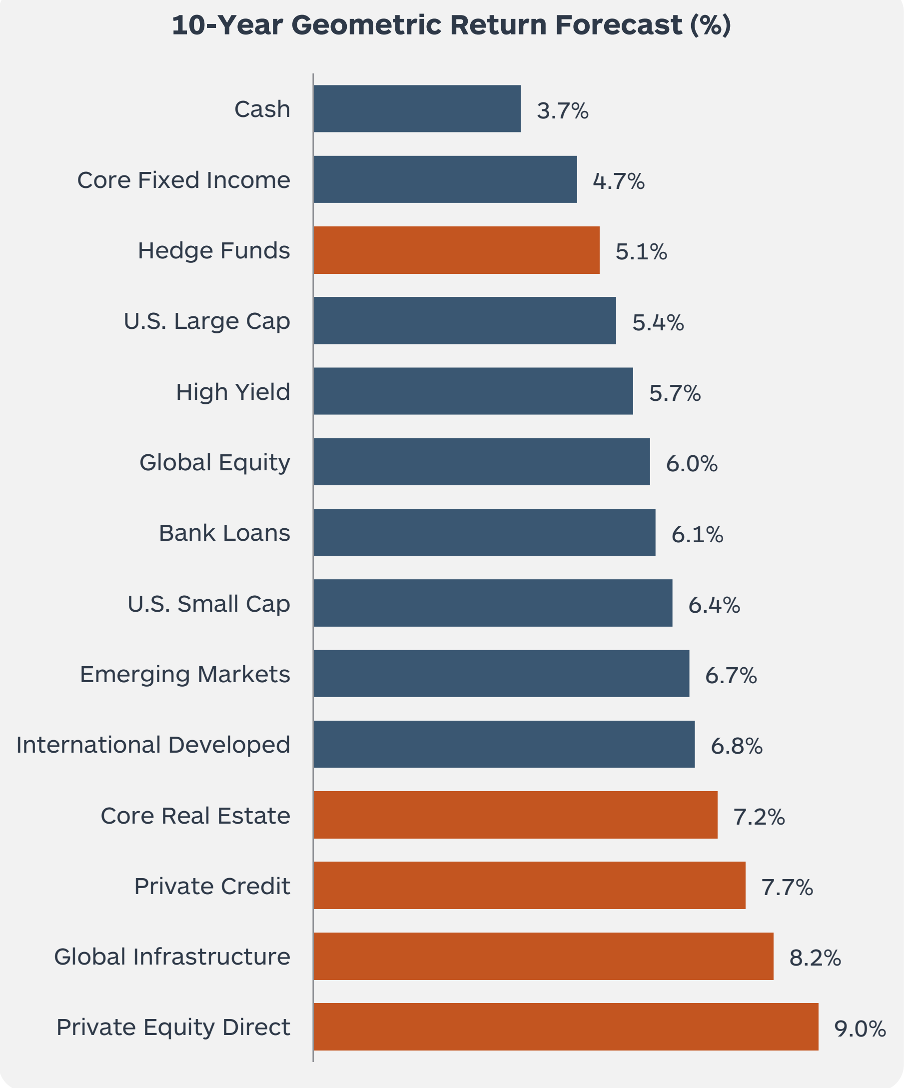
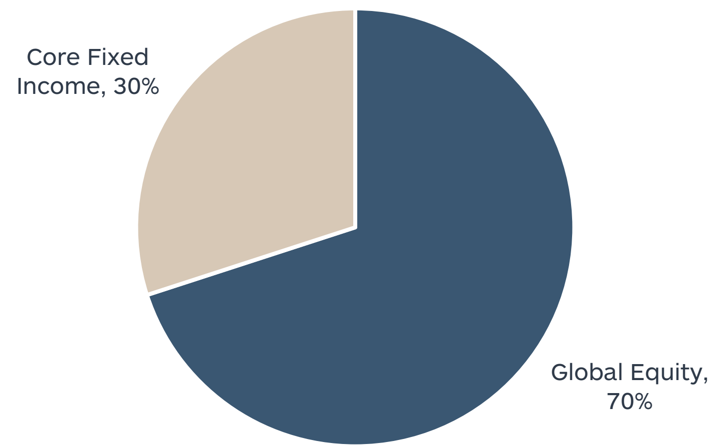
Solving for the return challenge

The need for higher returns and diversification led pensions to invest in higher cost alternatives



Traditional 70/30 Portfolio



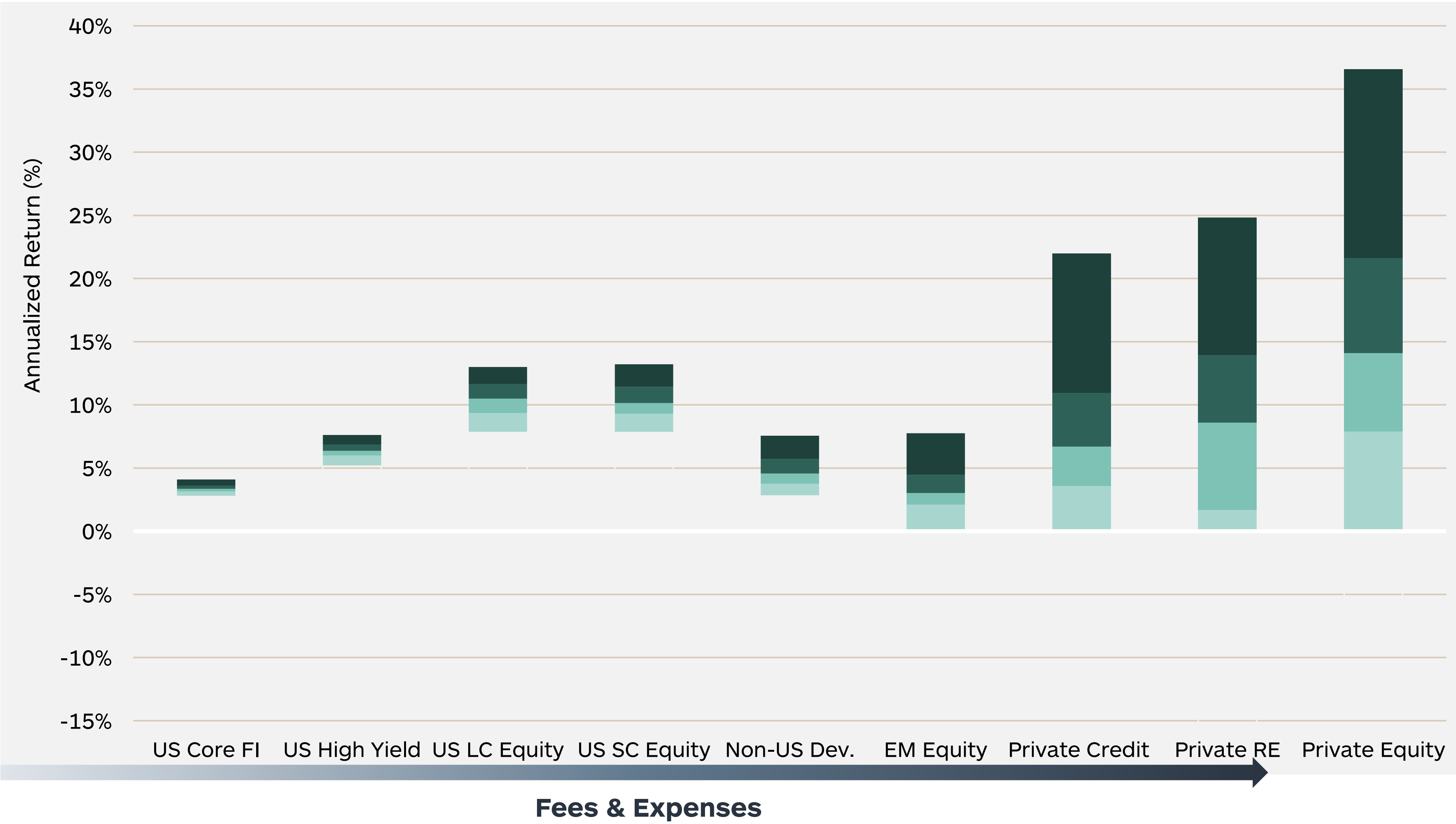
EXPECTED 10-YEAR RETURN[1]: 5.6%

- SCERS Required Rate of Return: 6.75%
- The push into alternatives, which typically carry higher fee structures, was driven by the need to achieve higher rates of returns that simple stock/bond portfolios could not deliver
- The push into alternatives was also made to increase diversification, and to reduce correlations and downside risk of the portfolio

1: Based on Cerity Partners' 2026 Capital Market Assumptions

Alpha opportunity and fees by asset class

Dispersion of manager returns by asset class – Based on returns over 15 Years[1]



[1] Source: eVestment Alliance and Refinitiv C|A. Universe returns for public equity, fixed income and hedge funds are average annualized time-weighted returns (TWRs) for 15 years ending June 30, 2023. Universe returns for real estate, private equity and venture capital are internal rate of returns (IRRs) calculated since inception to June 30, 2023. Vintage years include 2005-2020.

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Have the fees been worth it?

Breakdown of SCERS excess returns by asset class

Portfolio / Benchmark	Trailing 5 Years			Trailing 10 Years		
	Net	Benchmark	Net vs. Bmk	Net	Benchmark	Net vs. Bmk
Total Fund (Net) *Policy Index*	**7.07%**	**6.53%**	**+0.54%**	**9.00%**	**8.01%**	**+0.99%**
Global Public Equity *MSCI ACWI IMI (Net)*	8.61%	9.03%	**−0.43%**	11.36%	11.10%	**+0.26%**
Domestic Equity *Russell 3000 Index*	10.83%	10.87%	**−0.03%**	13.69%	13.72%	**−0.02%**
International Equity *MSCI ACWI ex USA (Net)*	6.64%	7.02%	**−0.38%**	8.81%	8.38%	**+0.43%**
Private Equity *Cambridge All PE (1Q Lag)*	12.02%	9.12%	**+2.90%**	16.01%	12.74%	**+3.27%**
Liquid Credit *Brigade Custom*	4.83%	5.06%	**−0.22%**	6.84%	5.85%	**+0.99%**
Illiquid Credit *CS Lev. Loan +2% (1Q Lag)*	8.14%	8.50%	**−0.36%**	8.82%	7.90%	**+0.92%**
Fixed Income *Fixed Income Custom*	0.62%	0.61%	**+0.01%**	2.24%	1.93%	**+0.30%**
Absolute Return *HFRI FoF Conservative*	5.18%	4.95%	**+0.23%**	3.96%	4.95%	**−0.99%**
Real Estate *Real Estate Custom*	2.84%	3.40%	**−0.56%**	5.58%	4.69%	**+0.89%**
Private Real Assets *Private Real Assets Custom*	11.58%	10.40%	**+1.19%**	10.66%	7.75%	**+2.91%**

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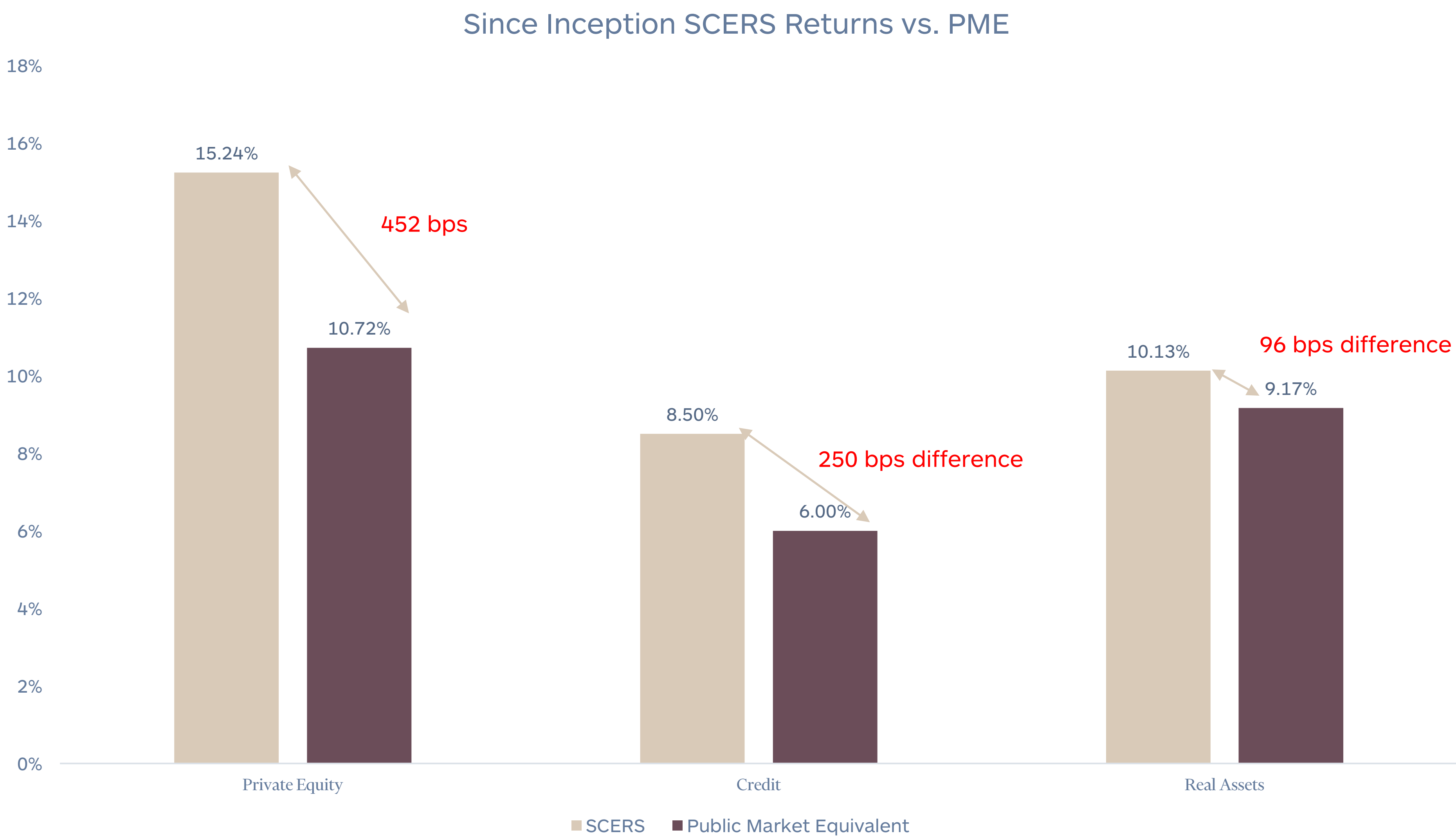
Private vs Public Market Equivalent



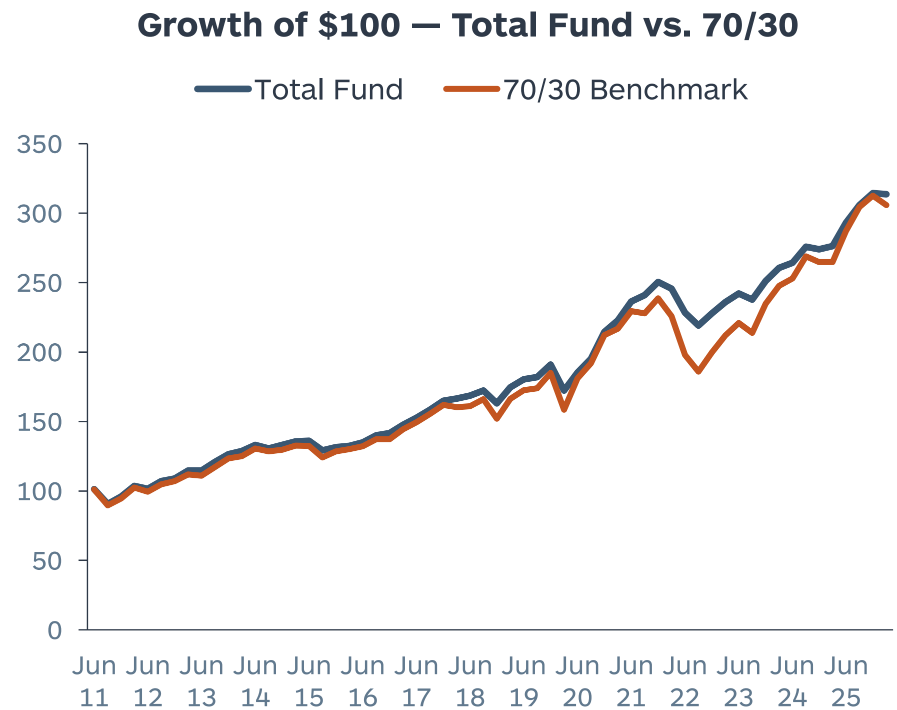
Note: Data provided by Cliffwater: Private Equity: MSCI ACWI Credit: CS Leverage Loan Index, and Real Assets: 65% S&P Global Infrastructure Index + 35% S&P Global Natural Resources

Has diversification been worth it

Yes. Over 15 years the Total Fund earned more than a 70/30 portfolio with roughly one-third less volatility — a meaningfully higher Sharpe ratio. Spreading risk across low-correlation asset classes did the work.

Total Fund vs. 70/30 Benchmark · 2011–2026

Metric	Total Fund	70/30
Annualized return	**7.9%**	7.7%
Annualized volatility	**7.4%**	10.4%
Sharpe ratio	**0.80**	0.55
Best month	**+7.2%**	+8.9%
Worst month	**-7.2%**	-9.6%
% positive months	**69%**	67%
Cumulative return	**214%**	206%



7.4% vs 10.4%

Annualized volatility — about one-third lower

0.80 vs 0.55

Sharpe ratio — far better risk-adjusted return

-7.2% vs -9.6%

Worst month — shallower drawdowns

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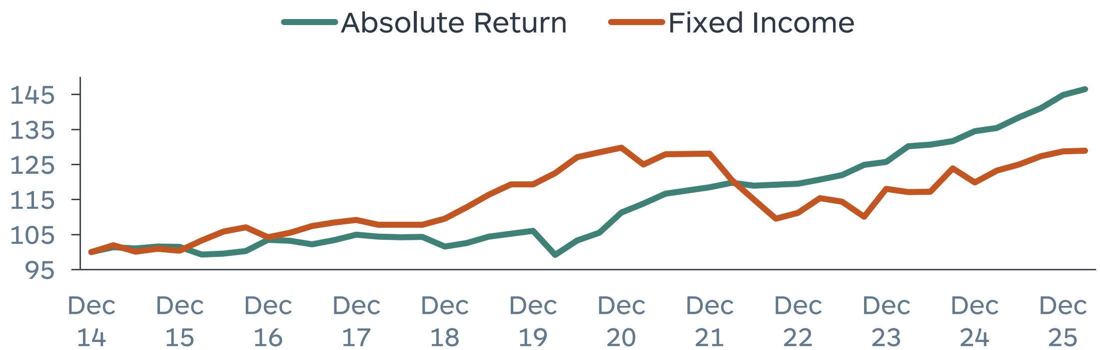
Where the diversification shows up

Low correlations across asset classes — and two diversifiers that move very differently — are what produced the Total Fund's smoother ride.

Composite Correlation Matrix · pairwise correlations through Mar 2026; common history varies (Apr 2011 – Mar 2018 starts)

	TF	GPE	PE	ILC	LC	FI	AR	RE	PRA
Total Fund	1.00	0.97	0.14	-0.08	0.72	0.41	0.40	-0.05	-0.06
Global Public Equity	0.97	1.00	-0.03	-0.11	0.69	0.39	0.43	-0.11	-0.10
Private Equity	0.14	-0.03	1.00	0.10	0.07	-0.01	-0.01	-0.03	0.25
Illiquid Credit	-0.08	-0.11	0.10	1.00	0.07	-0.01	-0.03	0.01	0.05
Liquid Credit	0.72	0.69	0.07	0.07	1.00	0.28	0.54	-0.08	-0.03
Fixed Income	0.41	0.39	-0.01	-0.01	0.28	1.00	0.03	-0.15	-0.06
Absolute Return	0.40	0.43	-0.01	-0.03	0.54	0.03	1.00	-0.08	-0.12
Real Estate	-0.05	-0.11	-0.03	0.01	-0.08	-0.15	-0.08	1.00	0.04
Private Real Assets	-0.06	-0.10	0.25	0.05	-0.03	-0.06	-0.12	0.04	1.00

Absolute Return vs. Fixed Income — Growth of $100



What it means

- Real Estate, Private Real Assets and Private Equity carry near-zero or negative correlation to public equity.
- Absolute Return and Fixed Income correlate just 0.03 — two distinct diversifiers.
- Since 2015, Absolute Return grew to $147 vs $129 for Fixed Income, on a steadier path.

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Conclusion

- Fees should be evaluated relative to net value, not in isolation.
  - SCERS should continue to seek lower fees in the more efficient assets classes while reserving higher fees for those asset classes that are less efficient with higher dispersion of returns.
  - SCERS should continue to pay higher fees only where manager selection, portfolio construction, and diversification are expected to generate superior net returns and improved risk-adjusted outcomes.
- Alternative and private market assets, with their associated higher fee structures, have added diversification, produced higher net returns, and reduced the portfolio's overall risk profile.
  - SCERS' private market investments have meaningfully outperformed their respective benchmarks after all management fees, expenses, and carried interest.
  - Private Equity and Private Real Assets have generated some of the portfolio's strongest excess returns, contributing to Total Fund performance above the Policy Index.
- The diversified portfolio has outperformed a traditional 70% equity/30% fixed-income portfolio.
- The additional return was achieved with substantially less risk.
  - SCERS experienced 30% less annualized volatility compared with a 70/30 portfolio

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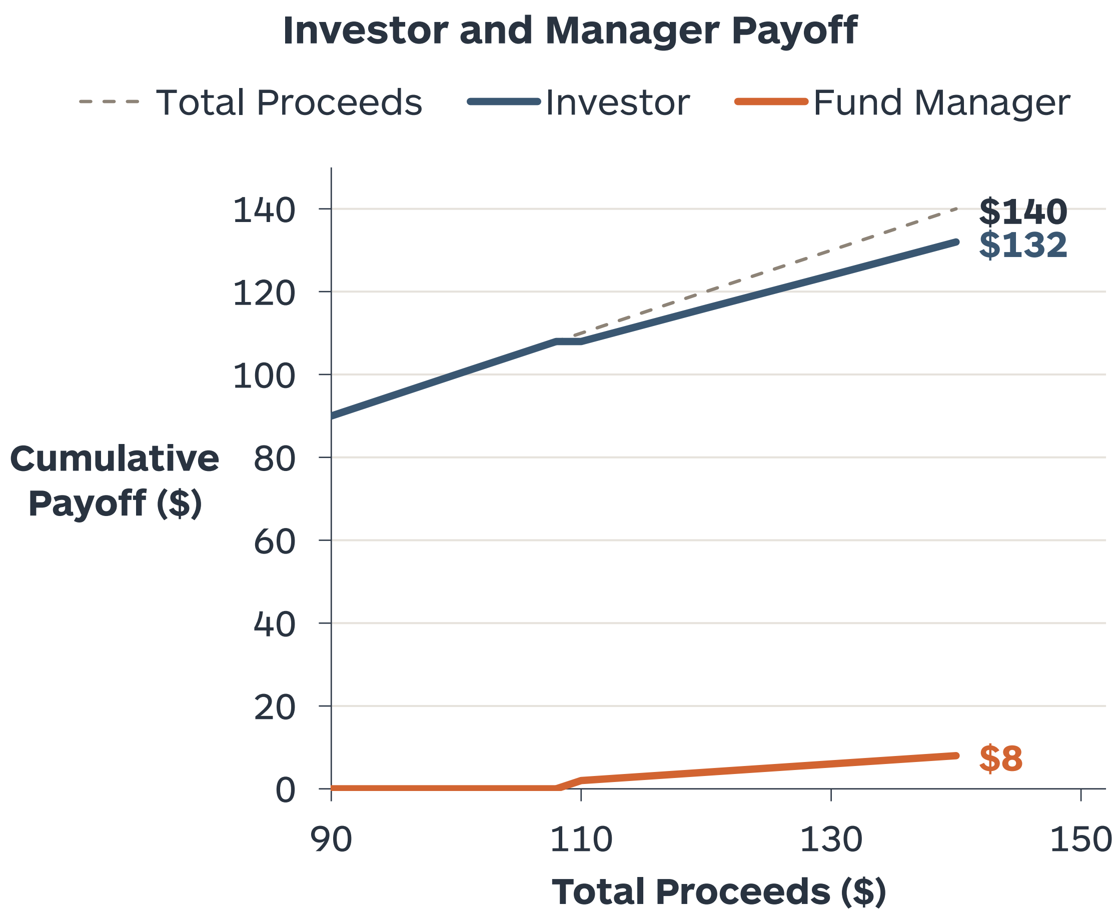
Appendix

Drawdown Fund Performance Fee Structure



Fee Waterfall Components

1. Return of Capital

All invested capital is returned to the investor before any carry accrues.

2. Preferred Return — 100% to LPs

The fund must clear a minimum return (e.g., 8%) for investors before the GP collects carry.

3. Catch-Up — 100% to GPs

Distributions go to the GP until it holds its full carry rate on profits to date.

4. Carry — 80% LP / 20% GP

Above the catch-up, remaining profits are split per the carried-interest rate.

Illustrative assumptions: $100 invested capital · $140 total proceeds (1.4x gross multiple, $40 profit) · 8% preferred return · 100% GP catch-up · 20% carried interest → Investor keeps $132, GP earns $8.