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INVESTMENT MANAGEMENT

To: NC Supplemental Retirement Board of Trustees

From: Loren de Mey, Assistant Investment Director

Date: August 4, 2017

Subject: Galliard Capital Management Annual Review

Annual Review

IMD Staff conducted an annual review of Galliard Capital Management which consisted of the following:

- A. Contract Review
- B. Review with Mercer
 - a. Conducted conference call with Mercer staff and their Head of Stable Value to review Galliard, North Carolina's Stable Value Fund, and trends within the stable value industry
- C. Onsite Due Diligence Meeting
 - a. Staff conducted an onsite due diligence meeting with Galliard in Minneapolis on May 23, 2017
 - b. Staff performed an in-depth review of the following areas: organization, philosophy and process, risk management, due diligence and monitoring, contract management, operations, compliance and the underlying components of the North Carolina Stable Value Fund.
 - c. Staff came away from the meeting feeling confident in the organization and in Galliard's ability within stable value investment management as well as their underlying fixed income investment capabilities.
 - d. As one of the largest stable value managers, Galliard works with all of the major wrap providers providing them with the industry knowledge and scale to determine the best contract terms and costs available for clients.
 - e. Galliard demonstrated their contract and fee monitoring procedures which all seemed robust.
- D. Competitive Landscape Review
 - a. Staff conducted meetings with several other stable value providers in order to stay current of trends in the market and the competitive landscape.

Key Areas of Focus

- A. Contract Review
 - 1. Pursuant to Galliard's current contract, Galliard has primary discretion and responsibility to select and enter into contracts with wrap providers and investment managers; however, the Department reviews and approves these contracts prior to execution.
 - 2. Staff plans to clarify the language in the contract to move to a fully-delegated approach in which Galliard has the discretion to enter into wrap contracts and investment management agreements on behalf of the Board and the Department without prior review and approval by Staff as long as Galliard is operating in a manner consistent with the constraints and objectives defined in the contract and the investment guidelines.



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3. The revised contract with Galliard will include certain guidelines to restrict Galliard's discretion and manage risk to the Plans (such as guidelines and required provisions for investment management and wrap contracts). Staff and Mercer will continue to provide oversight of the investment management process.

B. Portfolio Review

During the onsite meeting, Staff asked the Galliard Stable Value team for a 'clean slate' review of North Carolina's portfolio in order to maximize cost efficiencies. Staff received an initial proposal from Galliard outlining recommendations for enhanced cost efficiencies.

1. Galliard proposed assuming a larger percentage of the underlying fixed income investment management. Galliard does not charge additional fees for the underlying investment management so the larger percentage Galliard manages directly, the larger the fee savings.
 - a. To maintain sufficient diversification across managers, staff recommends retaining underlying sub-advisory investment managers. Staff will work with Mercer and Galliard to determine the optimal percentage of the Galliard and sub-advisory allocation to be most cost efficient while still maintaining appropriate diversification.
2. Galliard recommended underlying changes to the Fund (potential manager and wrap provider changes) to improve efficiencies of the Fund (expected crediting rate, fees and risk characteristics).

C. Fees

1. Galliard has been managing the Stable Value account for North Carolina since December 2010 and offered a fee concession in January 2016, which lowered fees from approximately 7.2 basis points to 6.7 basis points (current Galliard fees).
2. In order to maximize the cost efficiencies of the fund, Galliard's recent proposal to Staff recommended decreasing the allocation to the underlying sub-advisory investment managers. Reducing the number of the underlying investment managers may reduce fees further. As fees decrease, this may also enhance the crediting rate.
3. There is also the potential for wrap provider fee reductions. Galliard will begin discussions with the wrap providers to achieve best pricing.

D. Next Steps

1. Staff will clarify the language in the contract to reflect a fully delegated relationship.
2. Galliard will provide a new proposal to Staff to restructure the portfolio to improve efficiencies of the Fund (expected crediting rate, fees and risk characteristics), while maintaining the existing investment objective.
3. Galliard will continue to negotiate with the underlying investment managers and wrap providers and seek to lower fees as they restructure the portfolio, with an expected completion date by the end of the year.