



INVESTMENT MANAGEMENT

To: North Carolina Supplemental Retirement Board of Trustees

From: Loren de Mey, Assistant Investment Director

Date: September 18, 2017

Subject: Action Required: Galliard Capital Management Annual Review and Recommendation

Galliard Annual Review

The Investment Management Department's (IMD) staff has conducted an annual review of Galliard Capital Management, which consisted of the following:

- A. Contract Review
- B. Review with Mercer
 - a. Staff conducted a conference call with Mercer staff and members of their Stable Value Investment Committee 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 NC 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 informal 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 reflect a fully delegated approach in which Galliard has the discretion to enter into wrap contracts and investment management agreements



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on behalf of the Supplemental Retirement Board of Trustees (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.

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 while maintaining sound portfolio and risk management guidelines. Staff received an initial proposal from Galliard outlining recommendations for enhanced cost efficiencies. Galliard proposed assuming a larger percentage of the underlying fixed income investment management. Because Galliard does not charge additional fees for the underlying investment management, a reduction in the NC Stable Value Fund's portfolio's sub-advisory allocation results in a direct reduction in overall portfolio expenses.

1. Staff reviewed the portfolio with Mercer to determine the optimal percentage of the Galliard and sub-advisory allocation to be cost efficient while maintaining diversification. Staff and Mercer recommend amending the investment guidelines to allow Galliard to directly manage up to 50% of the NC Stable Value Fund portfolio (the current guidelines permit a maximum of 40%).
2. This change would result in a fee savings of 0.026%, or approximately \$650,000 on an annual basis, to the Plans. For a participant with an account size of \$100,000 this would result in a fee savings of \$26.00 on an annual basis.
3. Going forward, Galliard will recommend additional changes to the NC Stable Value Fund, including potential manager and wrap provider changes to improve efficiencies and enhance the risk profile of the Fund.

C. Fees

1. Galliard has been managing the NC Stable Value Fund account for North Carolina since December 2010 and offered a fee concession in January 2016 that lowered fees from approximately 7.2 basis points to 6.7 basis points (the current Galliard fees).
2. Staff's current recommendation to increase the Galliard allocation to 50% will reduce the NC Stable Value Fund fees by 2.6 basis points. For a participant with an account size of \$100,000 this would result in a fee savings of \$26.00 on an annual basis.
3. Galliard will evaluate the existing wrap provider structure based on its combination of issuer quality, contract terms, and contract fees. To the extent Galliard changes the existing providers, there is the potential for modest fee increases in the short-term, if alternatives provide a better combination of issuer quality and /or contract terms. Long-term, Galliard believes there may also be the opportunity for fee savings as the market for wrap providers becomes more competitive.



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Implementation of the Proposed Changes

1. Galliard would manage the Plans' entire short duration Portfolio of approximately \$800 million.
2. The other investment manager currently managing the short duration portfolio, Payden & Rygel, would potentially move to the intermediate duration portfolio (This would be a Galliard portfolio management decision).
3. Galliard would manage approximately \$300 million (of the \$1.5 billion total) intermediate duration portfolio
4. Galliard would be one of six managers managing the Intermediate Duration portfolio.
5. Mercer and IMD reviewed the performance of Galliard's short duration and intermediate duration portfolios, and has determined that the historical performance of each is in line with or outperforms the other investment managers currently managing these strategies.
6. The table below outlines the proposed allocation changes. Note: Final reallocation amounts may change slightly from what is shown below.

	Galliard Allocation (millions) as of 6/30/17	Proposed Allocation (millions)	Proposed Change (millions)
Wells Fargo Liquidity STIF (affiliate)	\$16.8	\$0	-\$16.8
Wells Fargo Stable Value (Galliard)	\$165.6	\$125.1	-\$40.5
Short Duration (Galliard)	\$423.0	\$801.0	+\$378.0
Intermediate Duration (Galliard)	\$0	\$300.4	+\$300.4
TOTAL	\$605.4	\$1,226.5	+\$621.1

7. The table below shows the change in fees from the current to the proposed structure:

Current Fees			Proposed Fees	
Galliard Fee	0.067%		Galliard Fee	0.067%
Investment Managers	0.075%		Investment Managers	0.050%
Wrap Contracts	0.172%		Wrap Contracts	0.172%
CIT Fund Expenses	0.019%		CIT Fund Expenses	0.019%
Total Fees*	0.333%		Total Fees*	0.307%

**does not include custodial & administrative fees*



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Recommendation

Action Required: Staff and Mercer recommend amending the Galliard investment guidelines to reflect the following change:

Current Guidelines: No more than **40%** of the Account's assets (including management of the liquidity buffer) shall be managed by Galliard or its affiliates. No more than 30% of the Account's assets shall be managed by any one sub-advisor or its affiliates.

Proposed Guidelines: No more than **50%** of the Account's assets (including management of the liquidity buffer) shall be managed by Galliard or its affiliates. No more than 30% of the Account's assets shall be managed by any one sub-advisor or its affiliates.