

**NEW MEXICO**  
**PUBLIC EMPLOYEES RETIREMENT ASSOCIATION**  
**SMART SAVE**  
**COMMITTEE MEETING**

**April 12, 2016**

This second meeting of the Public Employees Retirement Board Smart Save Committee was called to order by Chair John Reynolds at approximately 9:00 a.m. on the above-cited date in the PERA Building, Senator Fabian Chavez, Jr. Board Room, 33 Plaza La Prensa, Santa Fe, New Mexico.

Following the Pledge of Allegiance roll was called by Executive Director Wayne Propst and a quorum was established:

**Members Present:**

John Reynolds, Chair  
Jackie Kohlasch, Vice Chair  
Dan Mayfield  
Loretta Naranjo Lopez

**Member(s) Excused:**

Tim Eichenberg  
Brad Winter

**Other Member(s) Present:**

Patty French  
Dan Esquibel  
James Maxon  
Paula Fisher  
Cathy Townes  
John Melia

**Staff Members Present:**

Wayne Propst, Executive Director  
Susan Pittard, Chief of Staff-General Counsel  
Jonathan Grabel, Chief Investment Officer  
Greg Trujillo, Deputy Executive Director  
Renada Peery-Galon, ASD Director  
Karen Risku, Deputy General Counsel  
Dana David, Assistant Counsel  
Misty Braswell, Assistant General Counsel

Natalie Cordova, Financial Manager  
Karyn Lujan, Deferred Compensation Plan Manager

Jude Perez, Deputy CIO  
LeAnne Larrañaga-Ruffy, Portfolio Manager  
Emily Lopez, Financial Specialist  
Christine Ortega, Portfolio Manager  
Lalleh Dayeny, Investment Division  
Mark Montoya, Investment Division  
Zarina Martinez, ASD

**Others Present:**

Matt Kline, Director, Galliard Capital Management  
Ted Benedict, Meketa  
Paul Lium, Nationwide  
Lou Moreno, Nationwide

**2. APPROVAL OF AGENDA**

Ms. Kohlasch moved to approve the agenda as presented. Her motion was seconded by Ms. Naranjo Lopez and passed by unanimous [4-0] voice vote.

**3. APPROVAL OF CONSENT AGENDA**

Chair Reynolds indicated he reviewed the February 8, 2016 minutes.

Ms. Naranjo Lopez moved approval. Ms. Kohlasch seconded and that motion passed by unanimous [4-0] voice vote.

**4. CURRENT BUSINESS**

**A. NM Stable Value Fund Review:**

- 1. Galliard Update**
- 2. Stable Value Market Update**
- 3. State of NM Portfolio Update**

*[Exhibit 1: Galliard Report dated 4/12/2016]*

Karyn Lujan, Deferred Comp Plan Manager, said the NM Stable Value Fund is the only non-mutual fund investment option that is offered in PERA's Smart Save plan. Stable value funds are common in defined contribution plans and are the most conservative fund that is offered in PERA's Smart Save plan. Stable value was the default option for new enrollees.

Matt Kline, Galliard Capital Management, said the firm is a fixed income and stable value manager with over \$85 billion in assets. Of that \$85 billion, \$76 billion is

in stable value. They are a wholly-owned subsidiary of Wells Fargo with 114 employees and there have been no changes to the senior leadership of the investment team or the firm over the last five years.

Mr. Kline said stable value is one of the most conservative and most popular options in DC plans. The popularity is attributed to principal preservation and provides competitive returns and lower volatility than other principal preservation options, i.e., money markets. At its core, stable value is a bond fund or a fixed income fund but different from traditional bond funds because of its investment or wrap contracts.

The wrap contracts allow participants to transact at book value – principal plus any accrued interest – and smooth out the bonds reducing the daily volatility associated with traditional bond funds. Stable value has captured intermediate bonds with less volatility than money market funds which means higher returns and lower volatility.

Mr. Kline reviewed the typical construction of a stable value fund that includes two primary components: 1) a portfolio of high quality diversified bonds or fixed income securities referred to as the market value; and 2) the investment wrap contract referred to as the book value. The bonds drive the long-term performance of a stable value fund. Wrap contracts use a crediting rate formula – duration, yield and the performance of the bonds – that determines the yield paid to the participants.

Stable value returns and yield, generally, track the trend of interest rates with a slight lag, stated Mr. Kline.

Mr. Kline reviewed the portfolio's performance net of all fees noting it has outperformed the benchmark of the 3-year Constant Maturity Treasury since Galliard assumed inception of fund in 2012 by an annualized 66 basis points.

PERA's portfolio currently has assets of \$140 million which is relatively flat compared to this time last year. There are five wrap providers/contract issuers in the fund which provide the participants good diversification. The fund has a healthy market to book ratio of just 101 percent.

Chair Reynolds asked whether PERA's portfolio performance was typical compared to Galliard's other clients. Mr. Kline said New Mexico is in line with a current yield at 1.68 percent and from a historical performance standpoint. Galliard's expectation is to beat the benchmark by 40 to 50 basis points.

Mr. Kline said after the wrap and Galliard's fees the yield is 1.52 percent.

Mr. Kline reviewed the actual bonds/market value: 4.5 percent in cash and cash equivalents, 7 percent invested in a larger stable value collective fund which provides daily liquidity and a healthy yield of 1.8 percent, 44 percent invested in short strategy with a two-year duration, 10 percent invested in a short intermediate with a three-year duration, and 35 percent in an intermediate strategy with a duration of four years. Also managing approximately 50 percent of the bonds in the portfolio are Dodge & Cox, Jennison, PIMCO and Voya. Over 70 percent of the bonds are rated AAA. Mr. Kline

noted that the fund was well diversified at the sector and issuer levels.

Mr. Kline reviewed the net cash flows of the portfolio noting the annual has been 2 to 3 percent which appears to be the industry standard. Participants leave stable value and move into stocks when the stock market is reaching a peak and overvalued. When there is a negative volatility in the equity markets, participants return to stable value.

Mr. Kline identified the five wrap/contract issuers used by Galliard as American General Life, Pacific Life, Prudential, Transamerica and Voya, all very high quality and rated single A and above. Adding to diversification and risk mitigation no single wrap provider makes up more than 25 percent of the portfolio. The wrap fees reached 25 basis points last year and Galliard successfully negotiated lower fees down a few basis points with some of the managers.

Chair Reynolds asked whether each of the wrap providers with fees ranging from 20 to 22 basis points guaranteed principal the same. Mr. Kline said, yes, 98 percent of what is provided is the same. There may be different contract provisions or investment guidelines but it is a commodity. The wrap providers have investment guidelines, i.e., nothing below investment grade. What is guaranteed is that the participant can exit the fund with their principal plus any accrued interest. The only way he could conceive that a participant would lose money is if the market to book ratio fell below par, all the fund participants were exiting and the wrap provider filed for bankruptcy.

PERA CIO Grabel said unlike other investments in the DC or DB plan the sole measure of risk is market risk and perhaps liquidity risk. This investment has counter party risk when the insurance companies' balance sheet becomes stressed or challenged and they cannot make good on the premium that Galliard has paid 20+ basis points for. Mr. Kline pointed out that Galliard has never experienced a loss of money in a stable value fund.

Mr. Grabel reminded the committee that there is no guarantee. Even in stable value the guarantee is only as good as the credit worthiness of underlying issuer – the insurance company.

#### **4. Change in External Manager Allocation within NM Stable Value Fund**

Mr. Kline said Galliard has been working with Meketa to implement changes to the external managers. Commencing May 1<sup>st</sup> the allocation to external managers will be reduced to 20 percent from the current 45 percent and PIMCO will be removed from all of Galliard's discretionary accounts. The shift in managers will result in a fee savings of approximately 3 to 4 basis points and expected higher returns. The three

managers will be Voya, Dodge & Cox and Jennison.

Chair Reynolds observed the Voya was a wrap provider as well as an external manager and asked whether that presented any conflict. Mr. Kline said it is not a conflict and Voya has a separate collective fund managed solely for Galliard clients.

Mr. Grabel reminded the committee of the discussion during an asset allocation review regarding diversification in name only. In terms of underlying credits these stable value portfolios are “plain vanilla” and having multiple managers conjures a false sense of diversification security. He noted that this change is within Galliard’s discretion and is considered a manager-level decision in terms of managing the underlying pool.

Ted Benedict, Meketa, said he has participated in discussions with Mr. Kline regarding the allocations and finds the recommendation to be in the best interest of the plan participants.

Mr. Esquibel asked how Galliard dealt with management fees to ensure the participants get the best from their investments. Mr. Kline said a very competitive fee schedule was negotiated by PERA staff for Galliard’s asset management fees. The fee is approximately 16 basis points which includes all the management fees. When negotiating fees with managers, Galliard presents a lot of “scale” in the business and is able to negotiate for the best fee.

Mr. Grabel stated that the closer the investment is to cash where the markets are more efficient and returns are tighter it is advantageous to go with a scale provider. As the investment moves out to venture capital where there is no benefit to scale that’s where more niche firms are identified.

Addressing her question to staff and Nationwide, Ms. French asked whether participants are educated to know that placing money in bonds will not make money. Mr. Grabel said the members tend to be over allocated to stable value. He said the rebranding of deferred comp to PERA Smart Save and changing the default option to an age appropriate target date fund have been implemented to strengthen the effectiveness of stable value.

Ms. Lujan said she would continue to work with Nationwide to expand their presentations to better educate the participants.

#### **B. FY16 Smart Save Audit Recommendation**

Ms. Lujan said this action item is presented annually to begin the audit process. PERA staff recommends approval to engage Eide Bailey, LLP to conduct the independent audit for the PERA Smart Save Deferred Compensation Plan for the fiscal

year ending June 30, 2016. Eide Bailey is on the State Auditor's list of approved audit firms and successfully completed the previous two audits for this plan.

GASB 72 will be included in the FY16 audit and Ms. Lujan said Mr. Berman of the Eide Bailey firm is well versed in the world of securities and will be helpful in this issue.

Mr. Mayfield moved to approve Eide Bailey, LLP, to conduct the FY16 Smart Save audit as recommended by staff. Ms. Naranjo Lopez seconded and the motion passed by unanimous [4-0] voice vote.

Noting this would be the third year Eide Bailey performed the audit, Ms. French asked whether staff thought that was a good idea. Mr. Grabel said yes. After six years the auditor should be changed to ensure there is not too much comfort with the client. He noted that Eide Bailey is truly independent and he greatly appreciates that.

**5. OTHER BUSINESS**

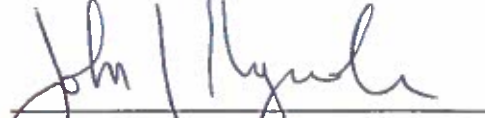
Paul Lium, Nationwide, introduced Lou Moreno, regional vice president of the southwest south region of Nationwide. Mr. Moreno said Nationwide was part of the team in helping the PERA employees prepare for and live in retirement. He thanked PERA for the opportunity to work with them.

Chair Reynolds commended Nationwide for their efforts in keeping the plan growing and expanding.

**6. ADJOURNMENT**

Upon motion by Mr. Mayfield and second by Ms. Naranjo Lopez, Chair Reynolds adjourned this meeting at approximately 10:05 a.m.

Approved by:

  
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John Reynolds, Chair  
Smart Save Committee

ATTEST:

  
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Wayne Propst, Executive Director

Attached Exhibit(s)

*Exhibit 1: Galliard Report dated 4/12/2016*

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