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MEMORANDUM

TO: Katie Selenski, CalSavers Executive Director
FROM: Paola Nealon, Mika Malone; Meketa Investment Group
DATE: October 13, 2020
RE: Money Market Replacement Options

On June 9, 2020, CalSavers' Executive Director requested that Meketa provide analysis regarding the state of the Money Market fund marketplace, which is utilized within the Capital Preservation Option.

Background

The CalSavers Program enables participants to direct plan account balances among one or more of five investment options. One of these investment options – which is also the default option on the first $1,000 of participant contributions – is the Capital Preservation Option, which seeks investment safety and liquidity as its primary objectives. The specific fund in place, selected through a competitive RFP process, is the SSgA Institutional US Government Money Market Fund (GVMXX), which carries low risk and whose performance is tied to the US 3-Month Treasury Index. The current market environment has caused the returns on this fund option to be very low, approaching 0. When the Administrative Fee is applied to an option with very low returns, it is feasible for participants to experience negative returns in an option that is associated with capital preservation.

Current Economic and Market Climate

As the onset of COVID-19 led to a collapse of the economy, massive fiscal and aggressive monetary measures were enacted to help support individuals and businesses. The effect of these measures has caused interest rates to drop to near zero levels, thus negatively impacting money market strategies, The stated investment objective of State Street's GVMXX money market fund is two-fold: 1) seek to maximize current income (the "interest") and 2) maintain a stable $1.00 per share net asset value (the "principal"). The current market environment has caused the interest component to decline meaningfully. Adding to this challenging environment, the Program has a state and administrative combined cost of 80 basis points in administrative fees, such that the net effect, without intervention, results in a negative return if the return on this option falls below 80 basis points. The Program is currently taking measures to ensure participants in this option do not experience negative returns net of fees, but these measures would ideally be temporary. As such, Meketa was tasked to explore the marketplace to consider whether replacement options should be considered for the Govt MM Fund in order to ease/offset the financial burden. Below, we summarize our findings.

Note that this information is provided for illustrative purposes only and is not intended to replace any required procurement processes.

Potential Marketplace Options

Stable Value Funds

Stable value funds are an offering constructed of a portfolio of bonds that are insured to protect against a decline in yield or a loss of capital. These are particularly beneficial during a recession as the owner of the stable value fund continues to receive the agreed-upon interest payment, as guaranteed by the insurance company or bank. Upon further analysis however, these funds appear unusable in the CalSavers Program, as they are offered only as a separately managed account (SMA) or commingled investment trust (CIT) and not as a mutual fund. As such, they are not permitted under the IRA construct.

Traditional Government Money Market Funds

Meketa's research team ran numerous screens on the universe of Government Money Market Funds to search for alternative candidates that might be attractive from a risk/return tradeoff. Screening was based on more attractive 7-day yield offerings, with similar or lower fees than what SSgA currently offers. The result was a short list of alternatives offering marginal improvements but not enough to make a compelling case for replacing. One manager highlighted, has waived its fee permanently and offers a 5 bps higher yield than what is currently in the program. The conclusion reached was that this was not compelling enough to warrant considering a replacement.

Prime Money Market Funds

A Prime money fund carries slightly more risk than a government money market fund, and invests in floating-rate debt and commercial paper of non-Treasury assets, like those issued by corporations, US government agencies, and government-sponsored enterprises (GSEs). While these funds do take on more credit exposure, they are still considered relatively low risk and have the potential to offer a slightly higher expected annual yield of 30-45 bps compared to 0-25 bps in Government Money Market Funds today. Meketa has identified a short list of viable candidates for further consideration, but notes that with an increase in return, there is also an increase in the potential for negative returns.

Short-Term Reserves

The strategy, currently only offered through Vanguard, as far as Meketa is aware, indirectly invests in funding agreements (traditional and separate account), synthetic investment contracts (SICs), and shares of Vanguard Federal Money Market Fund. Because of regulatory rules, similar to stable value, short-term reserves, as an asset class is not available in IRAs.

FDIC Insured Fund

These portfolios invest all of its assets into interest bearing deposit accounts at a bank. Deposits made into the account on behalf of investors are pooled in these accounts where they are commingled with deposits of other investors in the Portfolio. Due to the commingled nature of the portfolio, this is not a viable option for the CalSavers Program.

Municipal Bonds

Municipal bonds ("munis") having short durations were also reviewed for potential consideration. While the Meketa research team was able to identify a short list of attractive strategies offering 30 day yields higher or equal to 92 basis points when factoring in the much higher expense ratios of these strategies (55 bps-84bps range) and taking into account front end load fees in some cases, municipal bonds becomes an unviable option. In addition, municipal bonds are less liquid than money market funds and carry a slightly higher credit risk and interest rate risk.

Summary of Options

Option	Program Applicability	7-Day Yield (bps)	IM Fee (bps)	IM Fee Waived (Y/N)[1]	Risk
Stable Value	NA	NA	NA	NA	Low Risk
Govt MM	Y	0-25	0-14	Y	Less Risk
Prime MM	Y	30-45	7-14	Y	Low Risk
Vanguard ST Reserves	NA	NA	10	NA	Low Risk
FDIC Bank Products	NA	NA	NA	NA	Low Risk
Municipal Bonds	Y	92-167*	55-84**	N	Low Risk

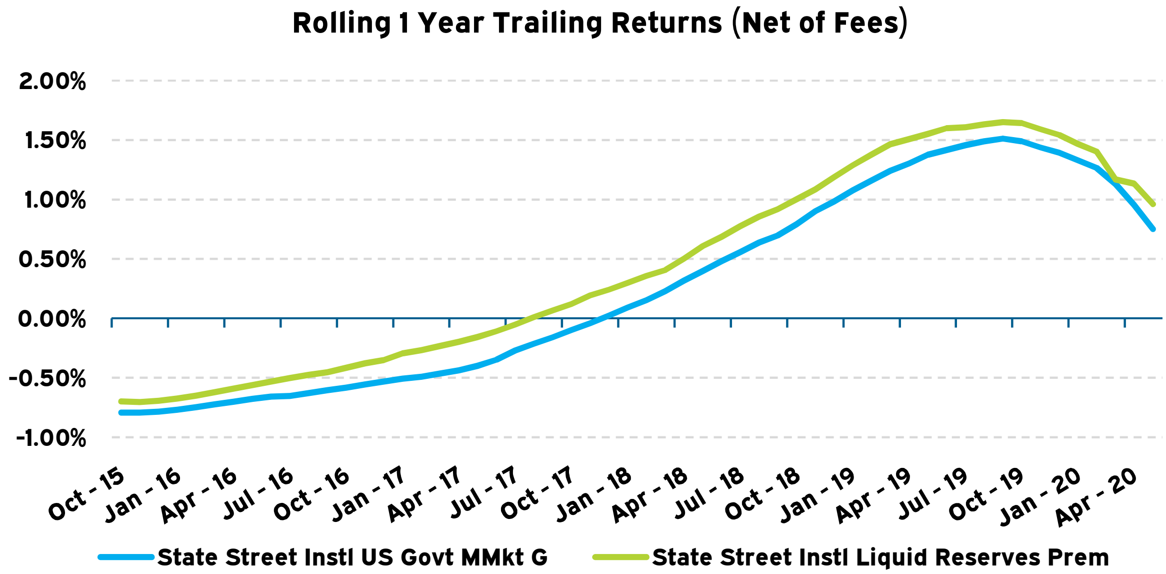
**30-Day Yield, estimated as of August 17, 2020*
*** Front end load fees excluded*

Conclusion

The following charts illustrate performance of two SSgA funds, which screened as attractive and ranked near the top decile of their universe. Results show the challenges that both Government Money Market Funds and Prime Money Market Funds would have faced over 1-year trailing periods applying an 80 basis point Program fee. With the exception of 2018/2019, the CalSavers 80 bps drag would have made almost any prime money market portfolio negative and that was the case from 2009-2017 when prime MM's were near zero. It is important to note, that while Prime Money Market Funds do offer an improvement to yield offerings above what is currently being provided through the SSgA's government money market fund, they come with additional risk. Ultimately, we believe the current Government money market fund utilized offers an appropriate combination of safety and yield, and it would be difficult, if not impossible, in the current environment, to find a replacement with a yield that would achieve >80 basis points.

[1] Managers reserve the right to change fees at any time. Fee ranges listed are sourced from Morningstar "Prospectus Net Expense Ratio" after screening for potential investment options given client criteria.

Time Horizon: Since Inception of the Government MM Fund



Time Horizon: 10 Years