



DATE: December 18, 2020
SUBJECT: Tail Risk Mitigation Budget Recommendation for FY2020-2021
TO: Members of the Board
FROM: Thomas A. Bauer, Deputy CIO, Traditional Investments *TAB*

At the January Board meeting, the Investment Office (“IO”) will recommend that the Board permit the usage of 100%, rather than 50%, of the Tail Risk Mitigation budget for fiscal year 2020-21 for the internally managed strategy.

The Tail Risk Mitigation Strategy Policy (“Policy”) that was approved in November 2020 by the Board establishes that the budget that can be spent on Tail Risk Mitigation each fiscal year is a fixed dollar amount equal to 12.5 basis points of the Fund’s Net Asset Value (“NAV”), where the NAV is defined in the audited financial statements. For the full fiscal year 2020-21, this budget equals approximately \$72 million. The Policy further establishes that no more than 50% of the budget can be spent on either internally managed or externally managed mandates. This equates to a \$36 million maximum budget for each, again assuming a full fiscal year.

Due to the Policy’s adoption mid-fiscal year, the IO believes that the annual budget should be prorated for the portion of the fiscal year that remains. With approximately ½ of fiscal year 2020-21 remaining, the total fixed budget would then be \$36 million (rather than \$72 million) and the maximum budget for each of the internal and external mandates would then be \$18 million (rather than \$36 million).

The recommendation here is that the \$18 million otherwise allocated to the external mandate be reallocated to the internal mandate. Thus, the internal mandate’s budget for the remainder of the fiscal year would be \$36 million and the external mandate’s budget for the remainder of the fiscal year would be \$0.

The rationale for this recommendation is that the internal mandate is highly likely to be up and running in late December/early January, but that the external mandate is not likely to be up and running for some time. To be specific, the external Tail Risk Mitigation manager selection process, in its entirety, is likely to take three to six months for completion. As a result, during this period, no tail risk protection would be in place from external managers. We would expect to have one or more managers selected and brought to the Board for approval prior to July 1, 2021. If approved, the manager(s) would be funded July 1, 2021.

The primary purpose of tail risk mitigation is to provide a level of protection against large equity drawdowns. Permitting usage of the entire prorated budget for internal management will allow for a greatly increased level of protection.

This allocation of the budget fully to the internal strategy would only be for this fiscal year 2020-21. Starting July 1, 2021, the annual budget would be evenly split between internal and external managers.

Please contact me at 717-720-4992 with any questions.