

Date: September 29, 2015

To: THE TRUSTEES

From: THE PRESIDENT and CHIEF EXECUTIVE OFFICER

Subject: New York Power Authority Nuclear Decommissioning Trust Funds – Selection of Fixed-Income Investment Managers

SUMMARY

The Trustees are requested to approve the award of multiyear procurement contracts to Prudential Investment Management, Inc. (“Prudential”), Earnest Partners LLC (“Earnest”), Garcia Hamilton & Associates LP (“Garcia Hamilton”), and Bradford & Marzec, LLC (“Bradford & Marzec”) for professional investment management services in connection with the Authority’s Nuclear Decommissioning Trust (“NDT”) Fund. Specifically, Earnest will replace fixed-income manager Schroder Investment Management North America Inc. (“Schroders”).

BACKGROUND

Section 2879 of the Public Authorities Law and the Authority’s Guidelines for Procurement Contracts require the Trustees’ approval for procurement contracts involving services to be rendered for a period in excess of one year.

The Authority’s Expenditure Authorization Procedures (“EAPs”) require the Trustees’ approval for the award of non-personal services, construction, equipment purchase or non-procurement contracts in excess of \$3 million, as well as personal services contracts in excess of \$1 million if low bidder, or \$500,000 if sole-source, single-source or non-low bidder.

Pursuant to U. S. Nuclear Regulatory Commission (“NRC”) ruling NUR-0584, the Authority established the NDT Fund in 1990. The purpose of the fund is to ensure that there are sufficient funds available to pay for the decommissioning costs (i.e., removing the spent fuel and dismantling any systems or components containing activation products) of the James A. FitzPatrick (“FitzPatrick”) and Indian Point 3 (“IP3”) Power Plants at their license expiration. On November 21, 2000, the Authority completed the sale of its IP3 and FitzPatrick nuclear plants to two subsidiaries of Entergy Corporation pursuant to a purchase-and-sale agreement dated March 28, 2000. In accordance with the Decommissioning Agreements, the Authority retains contractual decommissioning liability until its license expiration, a change in the tax status of the fund or any early dismantlement of the plants, at which time the Authority will have the option to terminate its decommissioning responsibility and transfer the plant’s fund to the Entergy subsidiary owning the plant. At that time, the Authority will be entitled to be paid an amount equal to the excess of the amount in the fund over the Inflation-Adjusted Cost Amount (a fixed estimated decommissioning cost amount adjusted in accordance with the effect of increases and decreases in the NRC’s minimum cost-estimate amounts applicable to the plant), if any. The Authority’s decommissioning liability is limited to the lesser of the Inflation-Adjusted Cost Amount or the amount of the plant’s fund, guaranteeing that no additional cost burdens may be placed on the Authority.

As of July 31, 2015, the market value of assets held in the NDT Fund totaled \$1.44 billion, of which \$550 million were invested in equities and \$887 million were invested in fixed-income securities. The fixed-income portion of the NDT Fund is currently managed by five portfolio managers: Prudential, with assets under management of \$240 million; Garcia Hamilton, with assets under management of \$230 million; Schroders, with assets under management of \$127 million; Bradford & Marzec, with assets under management of \$132 million; and CS McKee, with assets under management of \$158 million. All agreements, with the exception of CS McKee, are scheduled to expire in accordance with their terms on or about October 26, 2015.

DISCUSSION

On April 2, 2015, staff solicited proposals for professional fixed income investment management services for the NDT Fund by notice to a number of firms providing such services and advertisement in the New York State *Contract Reporter*. On or before May 5, 2015 the Authority received a total of thirty-one proposals.

Authority staff, with the support of its financial advisor, PFM Advisors (“PFM”), evaluated each proposal taking into consideration quantitative and qualitative criteria. From a quantitative standpoint, staff evaluated historical performance; various risk metrics (including, but not limited to, each manager’s standard deviation, Sharpe Ratio, tracking error and Information Ratio), and the schedule of fees. From a qualitative standpoint, firms were evaluated based on team duration and experience, investment style and research capabilities. After conducting an extensive review and analysis of each proposal, Authority staff, with the concurrence of PFM, invited the six firms with the top tier rankings to give oral presentations. The six firms were Schroders, Lazard, Prudential, Pyramis, Earnest, and Sit Investment Associates. In addition, two incumbent managers with top tier rankings, Garcia Hamilton and Bradford & Marzec, were not required to give oral presentations because of their outperformance in managing the Authority’s NDT assets and strategy consistency. Based on the above criteria, portfolio diversification benefits evaluation and oral presentations, the following firms were identified to have the highest overall rankings to manage the fixed-income assets in the NDT Fund: Prudential, Garcia Hamilton, Bradford & Marzec, and Earnest. These firms have identified M/WBE firms to fulfill the Minority and Women-owned Business Enterprise (“M/WBE”) goal requirements as set forth in the RFPs.

Prudential is an existing manager in the NDT Fund that employs an enhanced index strategy, which makes minor adjustments in sector and quality exposures versus the Barclays Aggregate Bond Index. Prudential serves as an index-like anchor to help dampen portfolio volatility, and has had success in managing according to NDT’s strict guidelines. It is recommended to retain Prudential.

Garcia Hamilton and Bradford & Marzec are existing managers in the NDT Fund that have outperformed the Barclays Aggregate Bond Index since its inception. They have proven to be able to manage around the restrictive NDT guidelines and still be able to generate excess returns. As such, it is recommended that Garcia Hamilton and Bradford & Marzec continue to manage its current assets.

Schroders is an existing manager in the NDT Fund and has underperformed the Barclays Aggregate Bond Index since its inception. In addition, Schroders has displaced its focus from municipal securities to the credit sector. Prior to this displacement, the municipal allocation was a diversifying complement to the other strategies in the portfolio. As such, it is recommended to not retain Schroders.

Earnest is a minority-owned firm whose fixed income strategies have high government backed exposure making it very compatible to the NDT guidelines. Almost a third of the portfolio is invested in smaller agency bonds that many larger managers do not invest in. This allocation difference serves as a good source of diversification to complement the strategies of NDT's incumbent managers. Where Earnest does invest in credit, they seek to own secured bonds, which act as a better buffer to protect against downside risks. Earnest places a strong emphasis on selecting higher quality bonds with returns that can match or exceed lower quality bonds through their "Gap Framework." Furthermore, Earnest has shown the propensity to deliver strong performances, historically, through security selection, good down market protection, and has low residual correlation over longer periods compared to other candidates. It is recommended that Earnest manage a portion of NDT's assets.

It is recommended that the four firms be awarded five-year contracts, with asset allocations as noted below, subject, however, to early termination at any time by the Authority on 60 days' notice. The allocation amounts are based on the assets' ending market value as of July 31, 2015 and will be adjusted proportionally for the actual asset value on the transition date of the assets.

	<u>Asset Allocations</u> <u>(in \$millions)</u>
Prudential	213
Garcia Hamilton	155
Bradford & Marzec	132
Earnest	<u>154</u>
Total	<u>654</u>

FISCAL INFORMATION

The fees for the four recommended investment managers are expected to range from 12 basis points to 35 basis points (a basis point is equal to 1/100th of 1%, or 0.01%) dependent on investment management style and the amount of assets under management, subject to negotiation, and will be paid from the NDT Fund.

RECOMMENDATION

The Deputy Treasurer recommends that the Trustees approve the award of multiyear service contracts to Prudential Investment Management, Inc., Earnest Partners LLC, Garcia Hamilton & Associates LP, and Bradford & Marzec, LLC for professional investment management services in connection with the Authority's Nuclear Decommissioning Trust ("NDT") Fund.

For the reasons stated, I recommend the approval of the above-requested action by adoption of the resolution below.

Gil C. Quiniones
President and Chief Executive Officer

RESOLUTION

RESOLVED, That pursuant to the Guidelines for Procurement Contracts adopted by the Authority, and the Authority's Expenditure Authorization Procedures, the award of the multiyear investment management service contracts to Prudential Investment Management, Inc., Earnest Partners LLC, Garcia Hamilton & Associates LP, and Bradford & Marzec, LLC, for professional investment management services in connection with the Authority's Nuclear Decommissioning Trust Fund, as recommended in the foregoing memorandum of the President and Chief Executive Officer, is hereby approved; and be it further

RESOLVED, That the execution of such contracts by the Executive Vice President and Chief Financial Officer or the Treasurer, subject to the approval of the form thereof by the Executive Vice President and General Counsel, on behalf of the Authority, is hereby approved; and be it further

RESOLVED, That the Chairman, the President and Chief Executive Officer, the Chief Operating Officer, the Executive Vice President and Chief Financial Officer and all other officers of the Authority are, and each of them hereby is, authorized on behalf of the Authority to do any and all things and take any and all actions and execute and deliver any and all agreements, certificates and other documents to effectuate the foregoing resolution, subject to the approval of the form thereof by the Executive Vice President and General Counsel.