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NORTH CAROLINA SUPPLEMENTAL BOARD OF TRUSTEES

MINUTES OF SPECIAL MEETING

January 23, 2015

Time and Location: The North Carolina Supplemental Retirement Board of Trustees (the "Board") met at 1 p.m. on Friday, January 23, 2015, in the Dawson Conference Room of the Albemarle Building, 325 North Salisbury Street, Raleigh, North Carolina.

Members Present: The following members were present: Melinda Baran, Karin Cochran, Keith Burns, and Ron Stell. Robert Orr, Walter Gray, and Michael Lewis attended via telephone.

Staff and Guests present: The following staff and guests attended the meeting. From the Department of State Treasurer: Steve Toole, Mary Buonfiglio, Rekha Krishnan, Mary Laurie Cece, and Maja Moseley. From the Investment Management Division: Rhonda Smith, Kevin SigRist, and Timothy Viezer. From Slocum: Philip Becker.

AGENDA ITEM – INVESTMENT CONSULTANT STRUCTURE

The meeting convened at 1 p.m.

Mr. Toole stated that the purpose of the meeting is to educate the Board regarding the investment consultant structure for the Supplemental Retirement Plans, and to identify some of the important issues to be addressed. The staff and Board have been exploring whether to continue with Mercer in the current investment consultant structure or go to a fully delegated model, or some sort of hybrid of the two. Mr. Toole reminded the Board that the process started eighteen months ago and its purpose is to determine the most appropriate way to manage fiduciary and other risks in order for the Plans to be successful. Mr. Toole encouraged the Board to ask questions during the review process.

Mr. Toole then introduced Philip Becker from Slocum.

Mr. Becker stated that Slocum has been working on the investment consultant project for almost 2 months, with the goal of making a recommendation to the Board in March. He provided a brief overview of his background. He stated that he has 14 years of experience in the financial industry, including 10 advising plan sponsors and constructing target date funds. He has also conducted 3(38) investment consultant searches.

Mr. Becker described several different approaches to investment advisory services. He noted that there is not one standard service model, but services are usually customized, based on the plan strengths and weaknesses, as well as goals and resources. Mr. Becker described a range of service models and what those might look like based on a plan's needs. He gave a list of potential services a consultant might provide, including the development of a plan's investment policy, manager selection and termination, manager and policy compliance, and construction of the fund's glide path. Mr. Burns asked if the list presented is the right list of needs at which the Board should be looking. Mr. Becker said his presentation does delineate pretty fully the needs of the Plans. Ms. Cochran asked whether the Board might land on a model that fell somewhere on a spectrum between fully-delegated and the traditional consulting. Mr. Becker said yes, the service model can be adjusted depending on the level of responsibility the Board wants to delegate. He noted that some models utilizing a hybrid approach usually have an Investment Policy Statement that is developed internally, but the manager search is a shared or delegated responsibility.

Mr. Becker described some other industry trends stating that 1) performance measurement is usually outsourced, 2) manager selection is more often than not shared, and 3) outsourcing of all investment activities is rather rare, and mostly done by small organizations. This approach would not be feasible due to the Plan's size. One of the advantages of total outsourcing is the speed of implementation, as decisions can be facilitated quicker without Board approval.

Mr. Becker described the current trend in fees. Entities are gravitating more toward a flat fee structure rather than performance-based fee structure. Asset-based fees are still quite common. He noted that Mercer has proposed an asset-based fee with different breakpoints. Slocum will assist the Plan to determine the reasonableness of fees. Ms. Cochran asked why there is a decline in the popularity of performance based fees. Mr. Becker stated that with such fees there can be misaligned risks. The manager may take on more risk to get a higher return. He noted that, in fact, an outsourced CIO really should be a risk manager.

Mr. Becker described the top seven reasons for having an outsourced CIO. The primary reason is lack of internal resources, and the second main reason is that the additional fiduciary oversight helps with risk management. Outsourcing also allows for faster decision-making, of which he gave an example: If a specific fund or manager falls out of compliance, the decision about how to bring it back into compliance does not need to be made by the full Board. Mr. Becker stated that another benefit to outsourcing is that it frees up the Board to look at big picture items rather than having to micromanage the Plans. Lastly, outsourcing helps from the stand point of sustainability. Turnover can be costly to the Plans. Adding an outsourced CIO helps add consistency to the Plans' management.

Mr. Becker noted Mercer has already been selected as the candidate for the outsourced CIO if the Board decides to go in that direction. Mr. Becker also described the importance of the appropriate oversight by the Board of an outsourced CIO. Slocum recommends an annual review and ongoing investment performance reporting.

Mr. Becker described some perceived disadvantages of outsourcing. He stated that organizations struggle with giving up control, for example, no longer being in charge of hiring or firing money managers. However, the main reason for not outsourcing is the organization's ability to handle the investment management internally.

Mr. Becker noted that regardless of the structure the Board chooses, the Plans' open architecture structure can be accommodated. Ms. Buonfiglio asked whether it would still be possible to choose proprietary investment products with the open architecture structure that is in in place. Mr. Becker confirmed, and stated that a dialogue should be conducted with Mercer regarding possible advantages of proprietary investments. He noted there would be a conflict of interest provision in the investment policy statement to ensure the appropriate use of an OCIO's proprietary funds.. Mr. Becker stated that from a governance perspective, the Board has the opportunity in this process to see if it has the right kinds of processes and procedures are in place. The creation of a sound Board structure is important to achieve the appropriate oversight level. For example, the Board should clearly define all responsibilities and roles and organize an effective Board/Subcommittee structure.

Mr. Becker stated that Slocum's final recommendation will be made during the March 19, 2015, Board meeting. He thinks Mercer is committed to working with the Plans in whatever capacity the Board determines is best. The Plan's current service model is comprised of many service providers and contains many moving parts, and a solid understanding of responsibilities is needed. Mr. Becker contrasted Galliard's current management of the Stable Value Fund as an outsourced manager with the advisory role that Mercer plays currently.

Mr. Becker explained that it is also important to understand how the possible solutions will affect staffing and the rearrangement of internal priorities. He noted is it important to look at internal resources when determining the investment advisory structure. Mr. Burns inquired about how the final recommendation will be made. Mr. Becker said it would be made after a detailed discussion regarding tasks and responsibilities of each party. A cost/benefit analysis will also be included in the recommendation. Mr. Burns requested that the timing of the decisions be highlighted in the final recommendation.

Mr. Orr noted that outsourcing could free up the Board to do more strategic thinking. He then asked Mr. Becker what specific strategic activities would be added to the Board's agenda in place of duties or decisions outsourced. Ms. Buonfiglio stated the Board could look to see if the Programs and Plans are properly structured to meet the goal of retirement readiness for participants. Ms. Cochran stressed the importance of strategic planning by the Board. Ms. Cochran said she thought it necessary for Slocum to identify critical success factors of outsourcing versus retaining investment decisions in-house, and to make sure we have the desired skill level internally to manage the consultant in whatever structure. She noted that cost should be included in the critical success factors overview.

Ms. Baran inquired about the current system weaknesses, and asked that the Slocum report make recommendations to improve current processes. Ms. Buonfiglio added that even with the delegated 3(38) investment consultant in place, the Plan fiduciaries are ultimately responsible for holding the consultant accountable.

Mr. Toole asked if there were any more questions, and stated that another meeting would be held internally to further the discussion. Mr. Burns asked for a presentation on enterprise risk management in order to better understand the present risk that needs to be solved for. Ms. Buonfiglio agreed to provide such an assessment.

A motion to adjourn the meeting was made by Ms. Cochran and seconded by Ms. Baran. The motion passed unanimously, and the meeting adjourned at approximately 2:18 p.m.

Secretary