

**INVESTMENT SUBCOMMITTEE OF THE NORTH CAROLINA SUPPLEMENTAL
RETIREMENT BOARD OF TRUSTEES**

MINUTES OF MEETING

May 19, 2016

Time and Location: Investment Subcommittee (the “Subcommittee”) of the North Carolina Supplemental Retirement Board of Trustees (the “Board”) met at 8:30 a.m. on Thursday, May 19, 2016, in the Dogwood Conference Room of Longleaf Building, 3200 Atlantic Avenue, Raleigh, North Carolina.

Members Present: The following members were present: Melinda Baran, Chair; Karin Cochran. Robert Orr attended via telephone.

Staff and Guests present: The following staff and guests attended the meeting. From the Department of State Treasurer: Steve Toole, Mary Laurie Cece, Mary Buonfiglio, Lisa Page, Kevin SigRist, Rhonda Smith, Casey High, Reid Chisholm, Rekha Krishnan, Catherine Jarboe, Maja Moseley. From Mercer: Kelly Henson and Liana Magner. From Prudential: Michael McCann, Ann Cashman, Aaron Koval, Kathleen Neville, Margaret Hendershot. Jessica Quimby attended via telephone. From TIAA: Jim Simone. From Galliard: William Weber and Nick Gage.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

Meeting convened at 8:32 a.m.

The Chair welcomed the staff and guests.

**AGENDA ITEM – ETHICS AWARENESS AND IDENTIFICATION OF CONFLICTS
OR POTENTIAL CONFLICTS OF INTEREST**

The Chair asked Subcommittee members to review the agenda for the meeting and identify any actual, implied or potential conflicts of interest. There were no conflicts identified.

**AGENDA ITEM – MINUTES FROM FEBRUARY 18, 2016 INVESTMENT
SUBCOMMITTEE MEETING**

The Chair stated that the minutes have already been approved and are included for reference only; no action is needed.

**AGENDA ITEM – INVESTMENT OVERSIGHT ROLES AND RESPONSIBILITIES –
DISCUSSION OF REVISIONS TO INVESTMENT POLICY STATEMENT:
GLIDEPATH OVERVIEW**

The Chair recognized Mr. Toole. Mr. Toole noted that the Plans have been trying to find clarity with respect to the role of investment consulting and oversight. Slocum Consulting gave their recommendation to the Plans last year. Today's agenda aims to present the reasoning behind the staff's decision, and questions and feedback on it from the Subcommittee members are welcome. Mr. Toole stated that thus far, the staff served as the extension to the Board and is well versed in fiduciary responsibilities and monitoring the operational processes. Both Mercer and the Investment Management Division (IMD) have been leveraged with respect to data research and analysis. This process has worked well, but a more formal process is now needed. Mr. SigRist added that IMD has served as an "on-call" consultant on an "as-needed" basis; however, to improve the process IMD would need to be involved earlier and engage with Mercer, in areas such as policy development and manager searches.

Mr. Toole directed the Subcommittee members' attention to the roles and responsibilities presentation slide and explained that these areas need to be formalized and the practice brought into focus. SRP staff will continue to serve as the extension to the Board to ensure that the members have all the information needed to make decisions in the best interest of the Plans. The Board's role will not change, and IMD will have a clear reporting line to the Board while Mercer will provide advice and ultimately, IMD will own those recommendations. Staff's work will be reviewed from a fiduciary perspective for its adherence to approved policy and procedure. In addition, the service level agreement between SRP and IMD is being finalized, and the RACI chart, a responsibility assignment matrix, is being developed; this chart will be made available to the Board members upon its completion.

Ms. Cochran was very supportive of the proposed approach and noted that the Board should not be managing the investment consultant and that IMD is well positioned to do so. Mr. Toole added that the Deputy Director will continue to ensure that tasks are being completed and results presented to the Board in a timely manner. Mr. Orr inquired if the proposed approach would feel different from the perspective of regular Board duties, and Mr. Toole replied the change will be more formal feedback from IMD. Mr. SigRist added that the boardroom environment will not change much at all: Mercer will continue to own the first line of presentation and questions, and the SRP Investment Assistant Director role will have more visibility. Mr. SigRist will continue to assist with policy-level issues, but the Board management role remains with the Division Director and Deputy Director. Mr. Orr suggested that a process be put in place so that the Board is made aware of any potential misalignment with Mercer and/or contentious decisions. Mr. SigRist agreed that this is an important piece of information for the Board and also noted that such disagreements seldom happen. Ms. Cochran stated that the any escalations should be

brought to the Board, and Mr. Toole confirmed. Ms. Buonfiglio added that much of this process is also addressed in the Investment Policy Statement.

Mr. Toole returned to the service level agreement and thanked Mercer for their work. He informed the Subcommittee members that with respect to the Glidepath delegation, the staff will issue an invitation to bid and send a questionnaire to a few select firms to gauge their willingness and ability, as well as the cost of their respective services. The findings will be presented to the Board for approval. Once the consultant is hired, direction will be given to them to develop the Glidepath, and the data will be shared with the recordkeeper as system changes are pending the Glidepath development. IMD will also monitor the Glidepath manager.

Next, Ms. Buonfiglio described the proposed amendments to the Investment Policy Statement. She directed the members' attention to the redlined version of the document included in the meeting materials and highlighted some of the material updates to existing IMD, SRP and Board roles. IMD will, among other duties, monitor the adherence of investment options and investment managers to stated investment policies, provide recommendations to the Board on manager replacement, review rebalancing of investment managers and provide the Board with investment structure recommendations. The Board will continue to approve the appointments and removals of Investment Managers, including any delegated Glidepath providers, as well as the Investment Consultants. RSD/SRP staff will no longer coordinate the activities of the Investment Consultant; rather, the staff will coordinate relevant activities of IMD. Ms. Buonfiglio stated that the changes to the Deputy Director role add to its value and enhance the vendor interactions.

Mr. SigRist suggested that the Board consider an annual meeting for the purposes of relationship assessment; such assessment can be conducted in a closed session as it pertains to personnel matters, and Mr. Orr agreed that this was a good idea.

The Chair asked whether there was a motion to approve and present the proposed IPS amendments to the Board for final approval in June and Ms. Cochran so moved. Mr. Orr seconded, and the motion passed unanimously.

AGENDA ITEM – STABLE VALUE CLOSING OF ACCOUNTING ENTRY UPDATE

Ms. Buonfiglio formally notified the Subcommittee that the decision made by the Board in March to make the Plans whole by transferring \$223,000.00 from the administrative expense account to NC 401(k) Plan has been finalized and the issue is now resolved. A closing file with all relevant documentation has been prepared by the staff and is available for the Board members for review. Mr. Toole and Ms. Buonfiglio thanked Prudential, Great West and Mr. SigRist for facilitating the closure.

AGENDA ITEM – STABLE VALUE PORTFOLIO REVIEW

The Chair recognized Mr. Weber, who introduced Mr. Gage who leads Galliard's Capital Management Client Portfolio Analysis team and serves on the board of the Stable Value Investment Association.

Mr. Weber provided a brief update regarding the litigation matter initiated by one of Galliard's clients, which was discussed during the previous meeting. Galliard has filed a claim for dismissal and will continue to apprise the Board of any new developments.

Mr. Weber noted that the first quarter of the year was rather eventful for the Fund. A fee reduction was implemented, which translated to \$80,000.00 in savings annually. Transition of Prudential's enhanced index strategy collective trust to active management strategy separate account took place, which is a positive change to the Fund participants. An ongoing dialogue between Galliard and Great West Life Insurance Co. regarding contract concerns yielded positive results, and Great West accepted all proposed contract edits. Galliard will also conduct an onsite visit on June 1. Mr. Toole thanked Mr. Weber for all the effort associated with the negotiations.

Mr. Weber noted a personnel change: managing partner John Caswell will be retiring on June 1 after a 40-year career. The phasing out of his duties started two years ago and the responsibilities were seamlessly transitioned to two successors. Mr. Caswell will stay on in a consulting role.

Mr. Gage stated that a favorable environment for the Stable Value Fund and its participants prevailed in the first quarter, which added leverage in Galliard's fee negotiations. Regulators are yet to complete the Dodd-Frank study, but the money market reform is an opportunity to reconsider principal capital preservation options. The Department of Labor has also issued the final fiduciary rule; however, this update does not impact Galliard directly as the firm is already a fiduciary. The portfolio shows a healthy excess return – net of fees performance is better than the benchmark's. Market/book value ratio has increased and the credit rate is stable and improving. Outside of enhancements made to Prudential's strategy, there were no material changes to strategy allocation or managers. Mr. Weber remarked that the historical cash flows chart can be modified by stripping the merger assets and presenting the combined history. Ms. Baran asked about the percentage of manager distribution for Galliard and Mr. Weber confirmed it is capped at 30% and currently at 22.1%. Ms. Cece added that the Plans do not pay an advisory fee to Galliard under the existing contract.

Mr. Gage noted that performance of all managers was positive for the quarter, and six outperformed their respective benchmarks. Ms. Buonfiglio noted the performance shown for Great West, which was impacted by the account receivable write-off, and inquired whether Galliard is in agreement with Great West's methodology. Mr. Weber confirmed, adding that Galliard requested that Great West provide GIPS-compliant performance data.

Mr. Gage summarized the presentation by remarking on the state of the global economy and prevailing volatility, as well as noting that the bond markets performed well under those conditions and that the Plan holdings are well diversified; Galliard also continues to work with contract issuers to negotiate lower fees where possible.

Break took place from 9:40 a.m. until 9:45 a.m.

AGENDA ITEM – ECONOMIC OVERVIEW AND 1st QUARTER INVESTMENT PERFORMANCE REPORT

The Chair recognized Ms. Henson and Ms. Magner, who also re-introduced Mr. Dillard. Ms. Magner provided a summary of global market conditions, which were dominated by extreme volatility but also a reversal mid-quarter, due to diverging monetary policies, falling oil prices and overall slow economic growth. Equities rebounded during the reversal; however, credit markets remained cautious and more focused on the risk-averse assets while the U.S. dollar declined. This proved to be a hard market for active managers in the Plans, and for growth managers, like Sands Capital in particular. Large cap stock fared better than small cap, and value strategies did better than growth. With respect to sectors, utilities, telecom and materials were leaders while healthcare and financials went down by 6.1% and 3.7%, respectively.

Globally, Japan continued the disappointing streak, and the MSCI EAFE Index declined; however, a strong rebound was led by Latin America and commodities. With respect to fixed income, emerging market debts were also on the rebound, and credit outperformed Treasuries. This boded well for Prudential Investment Management as its strategy is overweight to credit. REITS also posted strong results for the quarter, up by 5.85%, which was advantageous for PIMCO IRMAF. Commodities showed a slightly negative performance, but a rebound was observed in oil and gold.

There were no changes to managers on the current fund line up, and Ms. Magner shared a couple of news items: Mercer removed the provisional rating placed on Sands Capital due to organizational changes and reaffirmed the B+ rating for Hotchkis and Wiley. Mercer also reaffirmed the A rating for Delaware and removed the watch designation that was due to the prior departure of the portfolio manager, Anthony Lombardi. Mercer will conduct an on-site visit in Columbus, OH, with J.P. Morgan's fixed income team in June; this visit is the result of two senior portfolio managers' departures, which Mercer views as significant loss to the team. Ms. Magner emphasized that Mercer is also concerned about the possible change in investment philosophy due to the merging of research reports into what J.P. Morgan calls a "global approach." Mercer recommends placing the strategy on watch and starting the search and replace process. Ms. Magner noted that if the site visit results are positive there will may not be a need to replace.

Ms. Cochran made a motion to begin a search for an alternative manager in the core bond strategy, and Ms. Baran seconded. The motion passed unanimously.

Ms. Magner added that Loomis Sayles is considering the launch of global strategy and it would be managed by the same team managing large cap growth strategy for the Plans; Mercer will monitor their capacity.

Ms. Magner and Ms. Henson described the changes to the fee review page of the presentation, due to the new unbundled structure of the Plans. The custody fee has been added, and data will be obtained from the custodian quarterly. Ms. Buonfiglio suggested that the column be labeled as “custody fee,” and Mr. Dillard stated this would be updated in the next quarter’s presentation. More prominence was given to the “fee difference” column as the cost was always low but is especially low now when compared to a mutual fund line-up. Ms. Buonfiglio asked if the Mercer median universe includes any administrative or recordkeeping fees in the cost, and Ms. Henson replied that the administrative fee would include the custody fee but not the recordkeeping fee. She also noted that in some instances, the revenue sharing is included, but it is minimal and in general, the market is moving away from revenue sharing altogether.

Ms. Magner continued on the rolling three-year performance scorecard and stated that there were no concerns and no new candidates for the watch list based solely on performance. Mercer recommends removing PIMCO IRMAF from watch as the headline risk has declined significantly. The fund has been on watch since the third quarter of 2014, and Mercer is comfortable with the portfolio manager, Mihir Worah. Ms. Cochran asked whether Mercer was also comfortable with the new leadership and the general situation post-Bill Gross’s departure. Ms. Magner confirmed Mercer’s comfort, and she added that quarterly research will continue to be performed and that the view may be heightened should the committee decide to do so. Mercer reviewed the organizational changes and the performance thoroughly; assets outflows have settled down, and the influx of new funds has also been observed. Ms. Baran inquired about PIMCO’s level of preparedness, given the current macroeconomic and political outlook. Ms. Magner noted that most investment managers have chosen not to make a political stance just yet but they all need to be able to react to changing conditions. PIMCO is also known for their secular outlook. Ms. Smith added that some speculation is already priced into performance, and Ms. SigRist stated that PIMCO is very well resourced in terms of macro view.

Ms. Cochran made a motion to remove PIMCO IRMAF from watch, and Ms. Baran seconded. The motion passed unanimously.

With respect to Brown Small Cap Growth, Ms. Magner stated that the recommendation is to keep the manager on watch for a full year and to provide the formal recommendation at the next subcommittee meeting. Brown has rebounded, and Mercer believes they continue on a positive track.

Ms. Cochran made a motion to accept the watch status for Brown Small Cap Growth, and Ms. Baran seconded. The motion passed unanimously.

Mr. Dillard noted that volatility was most pronounced in the large cap space and managers struggled significantly during the quarter. Sands was the notable underperformer due to being overweight to Facebook, Netflix and Google stocks, as well as technology exposure, which reversed their lead. However, Mercer has conviction in their strategy. The NC SMid Cap Value Fund also struggled; REITs make up a big portion of the benchmark, and interest rate expectations were dim. Mercer continues to be confident in the fund and the managers.

The NC International Equity Fund performed well, driven by Mondrian's value approach and good performance from Baillie Gifford. Mr. Dillard clarified that the trailing three-year underperformance to peer group comes from the international managers benchmarking themselves over the international benchmarks. Lastly, the NC Fixed Income Fund was overweight to corporate credit and investment grade bonds. Ms. Baran inquired about the investment managers, including utilities in their strategy, and Mr. Dillard named TimeSquare, Hotchkis and Wiley, and Robeco. Ms. Baran noted that due to the baby boomer generation now being two years into retirement, the demand for income will continue and utilities will likely continue to be a strong sector.

AGENDA ITEM – INVESTMENT COMPLIANCE REPORT REVIEW

The Chair recognized Ms. Buonfiglio who first highlighted the memorandum which accompanied the report, noting that the past compliance monitoring was a manual process. The monitoring has now moved to daily, rather than a quarterly occurrence, and reporting is done in real-time. SRP collaborates with IMD team in reviewing reported exceptions, and the roles and responsibilities are being solidified. The report also reflects the compliance with Iran Divestment Act of 2015 and subsequent departmental policy; the Plans must divest of restricted holdings, and only one position was identified and will be sold by the end of August as per policy guidelines.

Ms. Buonfiglio directed the members' attention to the report which reflects a one day compliance status snapshot as of March 31, 2016, and provided a brief summary of guidelines and manager groups included. She noted that the added benefit of daily reporting is that the report itself is instructive and that the Plans' managers may hear from the staff on a daily basis. Going forward, the report will be placed in the team's shared drive and presented to the Subcommittee in a quarterly format.

AGENDA ITEM –BLACKROCK FUND TRANSITION UPDATE

Ms. Henson stated that the transition from a lending to non-lending vehicle was successful and there were no issues, as well as no impact to participants. Plans are now utilizing only the non-lending vehicle.

AGENDA – NC 403(b) PROGRAM 1st QUARTER INVESTMENT PERFORMANCE REVIEW

The Chair recognized Ms. Smith and Mr. High. Ms. Smith noted that the team is still in the process of familiarizing themselves with the investment philosophy and process of the managers. She turned to the asset allocation page of the presentation, noting only marginal shifts in allocation between 4th quarter of 2015 and 1st quarter of 2016; target date funds have experienced an uptick in balances, and less significant increases were also observed in tier two and three investments. Five actively managed funds outperformed their peer universe, passively managed funds were consistent in performance and several target date funds underperformed. Ms. Smith added that the team concurs with Mercer's observations regarding PIMCO and wants to be consistent with their recommendations. She also noted that funds due to be removed from the line-up due to restructuring will be monitored until the fund mapping occurs. Ms. Cochran asked about the timing of the mapping, and Ms. Smith and Mr. Toole noted that it has been delayed due to operational issues which will be discussed with the Board members in the near future. Mr. SigRist also offered to provide an update on in-depth performance examinations with managers at the next Subcommittee meeting. Mr. High has been working with Morningstar with respect to expense analysis and noted that for Vanguard in particular, the cost has been lowered. Ms. Smith added that net expenses came down slightly and there were some increases in fund balances.

Mercer's recommendation was also followed in the NC 403(b) Program, and the motion to remove PIMCO All-Asset Fund and PIMCO IRMAF Fund from the watch list was made by Ms. Cochran and seconded by Ms. Baran. The motion passed unanimously.

Ms. Baran inquired about the growth rate of the Program, and Mr. Toole admitted that it is not on track with goals. It is desirable that more school districts adopt the Program exclusively, and there is a need to help employers understand the value of it. Mr. Toole added that the Program strategy will be discussed in detail during the June Board meeting. In response to Ms. Cochran's question, Mr. Toole noted that the teacher pay increase provided a great educational opportunity with regards to saving for retirement and that the retirement readiness goal is drastically impacted by non-participation.

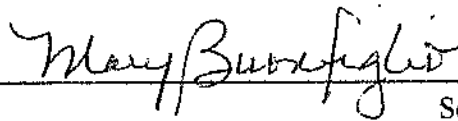
AGENDA ITEM - SUBCOMMITTEE MEMBERS QUESTIONS/COMMENTS

The Chair inquired whether the Subcommittee members and vendors wanted to move the meeting start time back to 9 a.m. After a brief discussion, it was decided that the Investment Subcommittee meetings will continue to start at 8:30 a.m. ET.

AGENDA ITEM – PUBLIC COMMENT

There were no public comments.

The meeting adjourned at 10:59 a.m. by acclamation.


Secretary