



NC Supplemental Retirement Plans Investment Consultant Review North Carolina Retirement Systems Division



North Carolina Department of State Treasurer
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Investment Consultant Review



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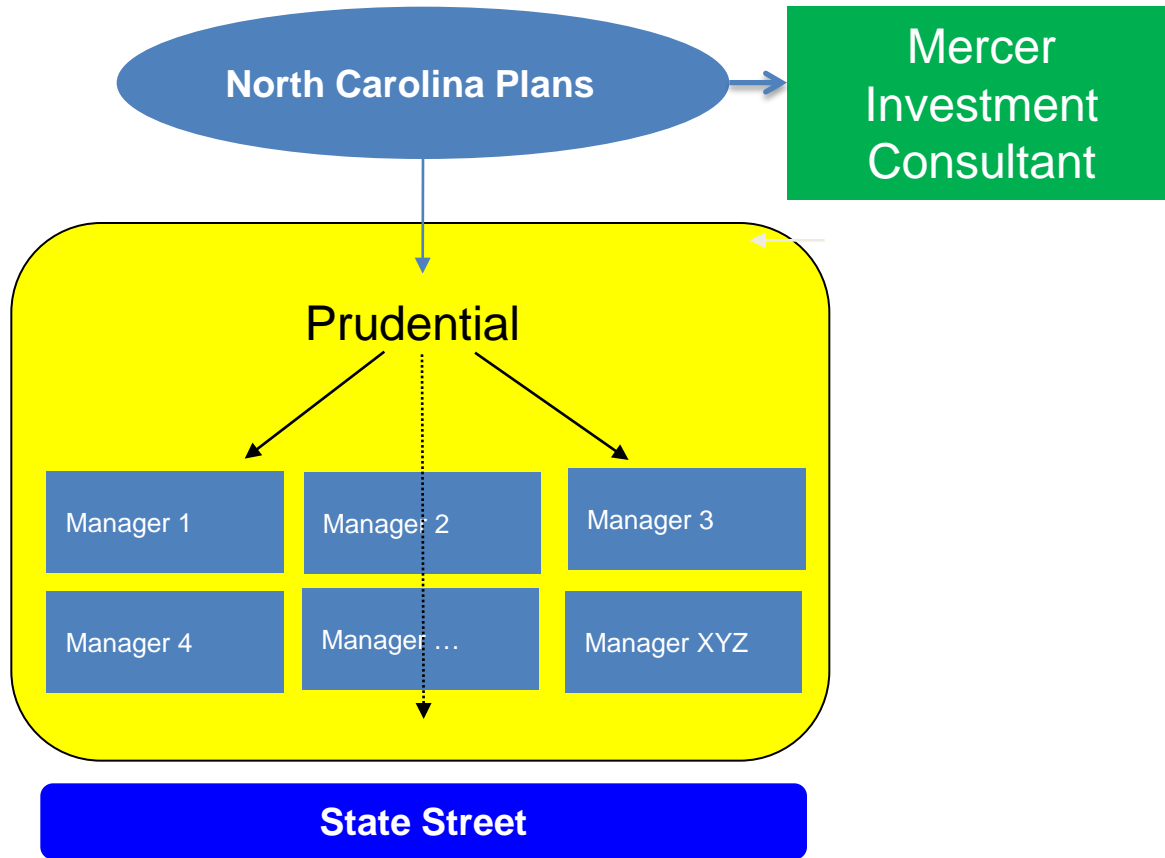


Investment Consultant RFP

- Investment Consultant RFP issued in 2011
- Mercer Consulting engaged in January 2012
- Roles & Responsibilities lacked clarity
- Bundled service provider structure inhibited fulfillment of responsibilities
- Contract negotiations broke down



Current Plan Structure



OVERVIEW

- NC, via a variable annuity structure, employs Prudential as Plan record keeper, administrator and informally delegated investment manager
- Prudential, in turn, employs all investment managers and also the custodian of underlying securities, State Street
- NC employs Mercer as investment consultant

CONSIDERATIONS

- Variable annuity structure is restrictive and opaque.
- NC assets are held on Prudential balance sheet within an insurance separate account. Potential issues include counterparty risk and/or access to assets.
- Bundled structure lacks transparency on fees and also legal liability
- Very difficult to change any single service provider as the offering/structure would need to be unbundled



Investment Policy Statement

- Monitoring routine lacked clarity at fund level vs. money manager level
- IPS not communicated to money managers
- Procedure for resolution of IPS breaches unclear
- Responsibility for updates / maintenance unclear
- Interim monitoring of IPS is in place to ensure compliance



3(21) versus 3(38)

Sec. 3(21) Fiduciary Consulting Relationship vs. Sec 3(38) Consulting

ERISA Section 3(21) Fiduciary

ERISA section 3(21) provides the standards by which any individual performing services for the plan might become a fiduciary due to the functions they actually (or have ability to) perform. Any individual can be a fiduciary under section 3(21) if he or she exercises any authority or control over the management of the plan or the management or disposition of its assets; if he or she renders investment advice for a fee (or has any authority or responsibility to do so); or if he or she has any discretionary responsibility in the administration of the plan.

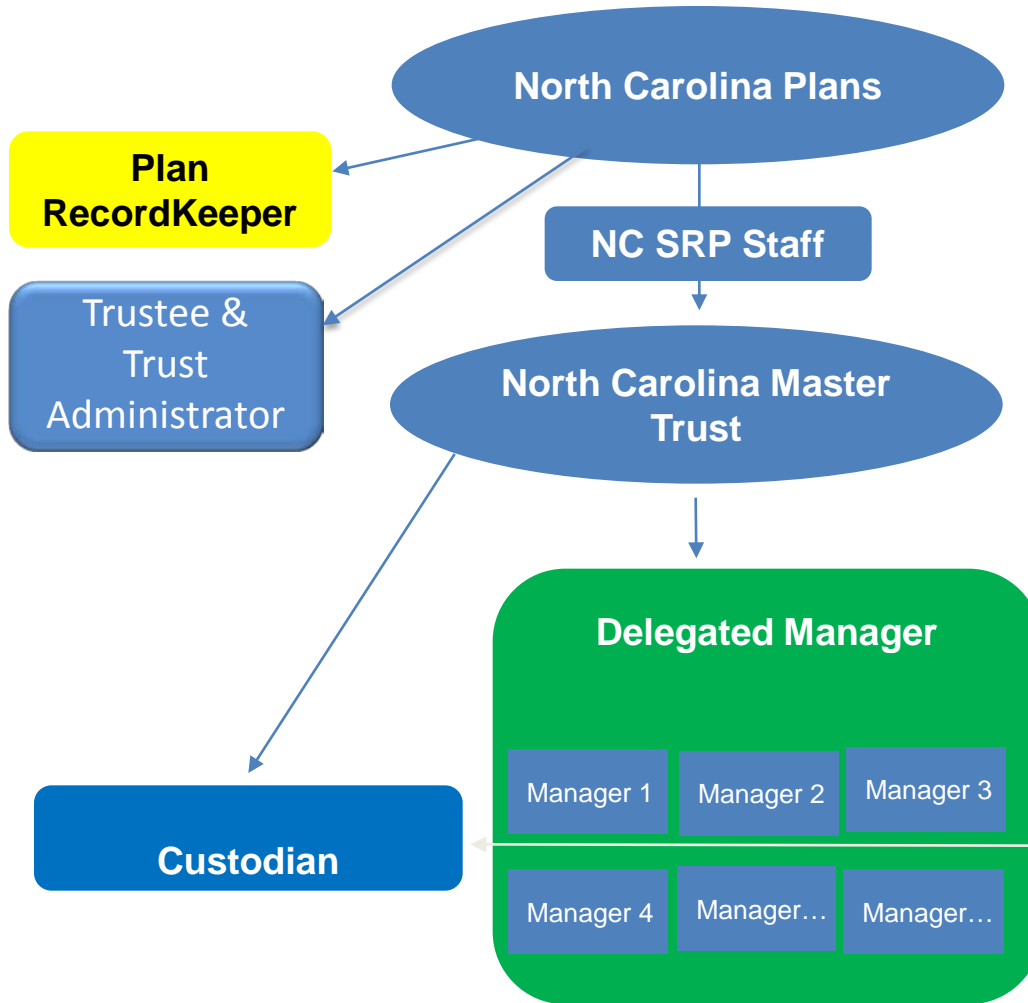
ERISA Section 3(38) Fiduciary

Section 3(38) is an “investment manager” and by definition is a fiduciary because of their ability to manage the plan’s assets. ERISA provides that a plan sponsor can delegate the significant responsibility (and significant liability) of selecting, monitoring and replacing of investments to the 3(38) investment manager/fiduciary. A 3(38) fiduciary can only be (a) a bank, (b) an insurance company, or (c) a registered investment adviser (RIA) subject to the Investment Advisers Act of 1940.

Once a 3(38) is properly named, the plan sponsor effectively hands over authority to the 3(38) fiduciary to make investment decisions. The 3(38) fiduciary therefore assumes legal responsibility and liability for the decisions it makes, which gives a plan sponsor significant cover from fiduciary liability.

	Non-Delegable		Investment Decisions		Operational Actions/Implementation				Ongoing Support
3(21) Consulting <i>Provides Investment Advice</i> <i>Traditional Approach – Current Model</i>	Investment Committee /Board	Investment Committee /Board	Investment Committee /Board	Investment Committee /Board	Staff	Staff & TPA	TPA	Staff & Consultant	Staff & TPA
3(38) Consulting <i>Consultant is Plan Fiduciary</i>	Consultant & Investment Committee/Board	Investment Committee /Board	Consultant & Investment Committee/Board	Consultant	Consultant	Consultant	Consultant	Consultant & Investment Committee/Board	
	Plan’s Named Fiduciary	Define Plan’s Objectives and Parameters	Determine Strategic Asset Allocation or Investment Structure	Manager Selection, Monitoring, & Termination	Develop & Document Investment Process	Negotiate with Managers, Sign Contract, Review & Accept Manager Guidelines	Ongoing Operational Management (rebalancing, fee payment, wire transfers, etc.)	Compliance Monitoring, Resolution of Breaches	RK, Custodian Selection & Oversight





OVERVIEW

- NC establishes a Master Trust to hold all assets
- NC directly employs Prudential in role of Plan record keeper
- Master Trust directly employs Mercer (Delegated Manager) who, in turn, employs underlying managers on NC's behalf
- Master Trust (Trustee to be named) also employs State Street as Plan custodian to hold assets. State Street continuously transmits investment data to Prudential to facilitate participant transactions

BENEFITS

- To Board:
 - Clear contractual links and legal liability for services employed
 - Delegated manager can effect investment manager changes and act on compliance breaches
- To Participants:
 - No balance sheet risk to external party
 - Absolute clarity on fees for services provided at each level
- To Staff:
 - Unbundled structure much more flexible



Recommendation

- Move to an “Unbundled Structure” with a fully delegated, 3(38) Investment Consultant, effective with the next TPA RFP (December 18, 2015)
 - Clarify and better align roles & responsibilities for:
 - Investment Consultant
 - Record Keeper
 - Custodian
 - Transparent fees for service
 - Enhance ability to negotiate for best fee
 - Shifting of fees and a net reduction overall
 - Enhance ability to monitor and replace service providers
- Delegates significant responsibility and liability of selection, monitoring, and replacement of investments to a 3(38) investment manager/fiduciary
- New Staffing Level Supports Unbundled Structure
- Addresses the foundation for improved oversight while positioning for future growth



- *Implementation Timeline*
 - 2nd Quarter 2013 issue Investment Consultant RFP
 - ✓ 401(k), 457 and 403(b)
 - ✓ 3(21) structure through current TPA contract (December 17, 2015)
 - ✓ 3(38) structure with implementation of new TPA contract (December 18, 2015)
 - Leverage Investment Consultant to lead the RFP process for unbundled record keeper, custodian, transition management and development of the NC Master Trust
 - Define IMD's role in support of the Supplemental Retirement Plans





Thank you!

Together, we can build and maintain a fiscally strong and prosperous North Carolina.

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