

INVESTMENT SUBCOMMITTEE OF THE NC SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

MINUTES OF SPECIAL MEETING MARCH 18, 2015

Time and Location: Investment Subcommittee (the “subcommittee”) of the NC Supplemental Retirement Board of Trustees (the “board”) met at 3 p.m. on Wednesday, March 18, 2015, in the Human Resources Conference Room of the Albemarle Building, 325 North Salisbury Street, Raleigh, North Carolina.

Members Present: The following members were present: Melinda Baran, Chair, Karin Cochran, and 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 Buonfiglio, Mary Laurie Cece, Rhonda Smith and Maja Moseley; Kelly Henson from Mercer attended via telephone.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

The Chair called the meeting to order at 3:00 p.m. The Chair remarked that due to time constraints during the last Investment Subcommittee meeting in February 2015, the subcommittee members did not have an opportunity to discuss the investment manager presentations and any recommendations by Mercer with regard to both investment managers. The purpose of today’s meeting is to go over those presentations and decide whether any action is needed.

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. Mr. Orr stated that his investment company conducts business with Brown Advisory. The relationship does not include Brown’s small- to mid-cap investment strategy. Ms. Cece advised him to recuse himself from the active discussion.

AGENDA ITEM – WELLINGTON OPPORTUNISTIC GROWTH AND BROWN ADVISORY MANAGER PRESENTATION REVIEW

The Chair recognized Kelly Henson from Mercer to give a recap of the manager presentations.

Ms. Henson stated that the February Wellington presentation was led by the lead portfolio manager on the strategy, Andrew Shilling. Mr. Shilling noted that Wellington's philosophy and process has not changed over the years. Wellington searches for large-cap stocks of growing companies with competitive advantage and invests in those. They also invest in small- and mid-cap stocks. In 2014, Wellington also experienced a change in its mid-cap portfolio manager. Ms. Henson noted that Mercer still rates the opportunistic growth strategy as "A" and is comfortable with the overall performance of the investment manager as a high-quality manager.

Mr. Orr stated that he did not find the portfolio manager very compelling in terms of articulating its strategy, but believes that Mercer has a unique perspective, as they are closer to the manager.

Ms. Cochran agreed and expressed the need for more time to be allotted during presentations in order to discuss challenges and proposed actions in depth.

Ms. Buonfiglio confirmed that, going forward, there will be only one investment manager presentation per meeting.

Ms. Smith added that the portfolio managers from Wellington are quantitative in their approach and due to that, they may be somewhat lacking in their presentation. Ms. Smith noted that Mr. Shilling has been employed by Wellington for a long time. Ms. Buonfiglio stated that she was looking at the rolling time periods, as well as looking at performance on an annual basis. She said that she looked at 2014, 2013 and 2012, and Wellington did well in two out of the three years. Ms. Baran stated that Wellington is present among the funds in her own portfolio and thinks highly of them, but she would be interested in hearing more about the depth of their portfolio manager bench.

Mr. Toole asked Ms. Henson where Mercer is on Wellington. She stated that they are still an "A" rating. Mr. Toole then noted that Mercer has been hired as an investment consultant for the expertise and oversight of managers. The board's role is to ensure that processes are in place for effective oversight of managers. With this in place, the board should lean on the investment consultant to minimize the risk and potential liability issues.

Mr. Orr agreed, adding that Mercer is in a better position to evaluate investment managers than the board members, and that he and the board should give Mercer their feedback and opinion on the presentations.

Ms. Cece reiterated that by providing feedback to Mercer, the board is fulfilling its fiduciary duty.

Ms. Baran said that basically she agreed with Mr. Toole, but noted that on one occasion, the board was not in agreement with Mercer. That was with regard to the decision around Neuberger Berman investment management and the decision-making process. Ms. Baran then

mentioned that she is also interested in the dynamic versus static allocation to the managers. She wonders if we should have a more flexible model with regard to manager allocation.

Ms. Toole urged caution that the board not get into the investment advisory role. He also added that clarity around roles and responsibilities will be addressed during the March 2015 board meeting.

Ms. Buonfiglio stated that Mercer was engaged by the board as the investment consultant and their role is to inform the board at the plan level. Ms. Buonfiglio, did state, however, that Mercer still needs to speak to the investment manager level and provide advice.

Mr. Orr stated that it's the board's obligation to oversee the investment management consultant and that board members must ask clarifying questions around the selection process when presented with a specific manager recommendations. He said the board must be able to clearly see the evidence supporting such recommendation, and if insufficient evidence is present, it must offer appropriate feedback to Mercer.

Mr. Toole agreed, adding that having an appropriate strategy in place is important and there may be a need to conduct some site visits with select investment managers to validate Mercer's recommendations.

Ms. Cochran stated that there is a need for board role definition in order for the board members' actions not to go beyond the scope of their role.

Next, Ms. Henson discussed the Brown Advisory February 2015 presentation and Mercer's recommendation. Brown Advisory is a small- and mid-cap manager; Mercer believes that the sole portfolio manager for the strategy, Chris Berrier, presented Brown's overall direction and philosophy have not changed since initially selected. In Mercer's opinion, Mr. Berrier has good insight into what has been driving their performance. Brown has taken some bets that caused some deviation from their benchmark and, in the long-term, this approach may work in the manager's favor, but may affect performance in a short-term. For example, 2014 saw underperformance of 600 bps, 2013 saw outperformance of 100 bps, and again in 2012, the fund underperformed the benchmark by 30 bps. Ms. Henson reiterated that Mercer does not see a competitive edge in Brown, when compared to other managers. Mercer will continue to monitor and evaluate.

Ms. Henson noted that Mercer discussed Brown Advisory with Ms. Smith previously and noted that Brown would not have been their top choice. However, Mercer also understands the relationship with the DB plan and the cost involved in manager termination. With that overall picture, Brown's performance did not trigger a formal watch list placement. Ms. Smith confirmed that the pension is experiencing the same issue with this manager's strategy and are monitoring it closely. In response to a question from Ms. Buonfiglio, Ms. Smith briefly described the pension ratings in comparison to Mercer's rating system. The pension uses an

“internal scored card” and assesses the following areas: personnel, processes, philosophy, material changes and records any concerns with regards to the existing fit in overall structure. The pension also perceives the lack of competitive advantage in Brown Advisory strategy, thus the rating awarded is “little conviction.”

In summary, Ms. Henson reiterated that the reason why the plan has engaged Brown Advisory is because they fill the small- and mid-cap fund space. She said that Mercer has completed a detailed evaluation of Brown, including a site visit, but do not have a deep conviction regarding Brown’s ability to add value going forward. However, the cost of possible transition away from Brown must be recognized and this was also a part of the recommendation to retain this manager and closely monitor the performance.

Ms. Cochran made a motion to place Brown Advisory on formal watch. Ms. Baran seconded the motion and it passed unanimously.

Ms. Smith asked whether the manager placement on formal watch list would trigger the search for suitable candidates in Mercer’s database. Ms. Henson replied that the watch heightens the due diligence on Brown, but a conviction letter would be presented to the board at the end of the fourth quarter that a manager is on a watch list. At that time, Mercer will begin to look for a replacement. Ms. Buonfiglio added that this process could be accelerated as needed, and Ms. Henson affirmed.

Mr. Toole reiterated that board members should expect Mercer to focus more of their attention on Brown since the manager is on formal watch, and Mercer will be providing updates.

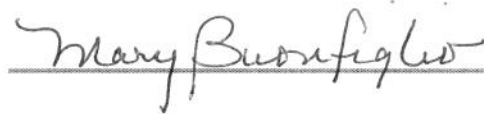
AGENDA ITEM - SUBCOMMITTEE MEMBERS QUESTIONS/COMMENTS

No further comments were offered.

AGENDA ITEM – PUBLIC COMMENT

No public comments were offered.

Ms. Cochran made a motion to adjourn and Mr. Orr seconded. The motion passed unanimously and the meeting adjourned at 3:51 p.m.


Secretary