

MINUTES
BOARD OF TRUSTEES
OF THE
NORTH CAROLINA SUPPLEMENTAL RETIREMENT PLANS
September 5, 2012, 9:00 a.m.
Dawson Conference Room
Albemarle Building, 325 N. Salisbury Street
Raleigh, NC

The meeting of the Board of Trustees for the Supplemental Retirement Plans was called to order at 9:02 a.m. by the Acting Chair, Melissa Waller, Chief of Staff for the North Carolina Department of State Treasurer.

Members Present

Members present were: Chuck Leedy, Robert Powell, Kathy Crooke, Clay Thorp, Libby George, Melinda Baran, and Mona Keech.

Members Absent

There were no members absent.

DST Staff Present

Staff members present were: Steve Toole, Arlene Jones-McCalla, Rhonda Smith, Joan Fontes, Jaclyn Goldsmith, Blake Thomas, Timothy Dale, Mary Buonfiglio, and Julia Vail.

Guests Present

Prudential representatives attending were Bill Walsh, Rob Luciani, Travis Swartwood, and Tim Bryan. Mercer representatives attending were Jay Love, Tom Murphy, Kelly Henson, and (by telephone) Jeremy Francis. Plan member Robert Slade was also in attendance.

Conflicts

The Chair asked if there were any actual, potential or apparent conflicts of interest concerning any item on the meeting agenda. No conflicts were reported.

As required by N.C.G.S. § 138A-15(c), we note in the minutes that the State Ethics Commission cited the potential for a conflict of interest concerning Ms. Baran. This potential for a conflict of interest arises because Ms. Baran is the Assistant Vice President of Investments with Wells Fargo Advisors. The Ethics Commission concluded in its August 24, 2012 letter, "The potential conflict identified does not prohibit service on this entity."

Approval of Minutes

It was moved by Mona Keech and seconded by Kathy Crooke to approve the minutes of the Supplemental Retirement Board of Trustees meeting held on June 6, 2012. The motion passed unanimously.

Resolutions

The Board recognized the service of former Board members Dexter Perry and Janet Pittard to the Board and Supplemental Retirement Plans. It was moved by Robert Powell and seconded by Chuck Leedy to approve the attached resolutions, which express appreciation for the service of Mr. Perry and Ms. Pittard. The motion passed unanimously.

Nomination of Members to the Investment Subcommittee

Because the previous Chair of the Investment Subcommittee, Dexter Perry, was not reappointed to the Supplemental Retirement Board of Trustees, the Investment Subcommittee contained one vacancy and had no Chair. The Chair recognized Mary Buonfiglio to discuss appointment of a new Chair and a new member for the Investment Subcommittee. A motion to designate Ms. George as Chair of the Investment Subcommittee passed unanimously. A motion to appoint Ms. Baran as a member of the Investment Subcommittee also passed unanimously.

Report from Investment Subcommittee

The Chair recognized Steve Toole to report on the August 15, 2012 Investment Subcommittee meeting. Mr. Toole stated that the Subcommittee received reports regarding the performance of the investment options sponsored by the Plans. Mr. Toole noted that no major issues were identified with the investment options or the underlying managers. Mr. Toole noted, however, that staff had identified gaps in the monitoring of the Plans' investment policy statement. He stated that this issue would be discussed in greater detail later in the agenda.

It was moved by Robert Powell and seconded by Mona Keech to accept the report from the Investment Subcommittee. The motion passed unanimously.

Report from Audit Subcommittee

The Chair recognized Robert Powell to provide a report to the Board concerning the Audit Subcommittee meeting held on August 2, 2012.

Mr. Powell stated that the Audit Subcommittee received a report from the Plans' independent auditors, PriceWaterhouseCoopers ("PWC"), on the 2011 calendar year financial statements. The Plans received an unqualified opinion on the financial statements. PWC found no material misstatements in, or needed corrections to, the financial statements. No irregularities or fraud were identified. The auditors commented favorably upon the additional preparation and internal controls displayed by Plans staff.

It was moved by Chuck Leedy and seconded by Clay Thorp to accept the Audit Subcommittee report. The motion passed unanimously.

Administrative Updates

The Chair recognized Tim Bryan from Prudential to provide a 2nd Quarter administrative report.

Mr. Bryan began by recognizing Bill Walsh, who had worked with the Plans since Prudential began administering the 401(k) Plan in 2008. He noted that Mr. Walsh had accepted another position within Prudential and would be leaving the North Carolina team. He then recognized Rob Luciani, who would be replacing Mr. Walsh, and Lisa Belgrove, who would be leading communication efforts from Prudential moving forward.

Mr. Bryan noted the following:

- Enrollments are positive for the year;
- Employer contributions are up compared to the previous year;
- The number of new loans initiated is decreasing;
- The number of participants using GoalMaker continues to grow; and,
- The annual benefits statement was completed during the quarter.

Ms. Baran asked how many Bailey tax-exempt accounts remained in the Plans. Mr. Bryan stated that the latest numbers he had seen listed approximately 21,000 accounts.

Mr. Thorp then asked if the Board had the ability to change the asset allocations in the GoalMaker tool. Mr. Bryan stated that the Board has the

ultimate authority in determining allocations in GoalMaker, and the Board has made changes from time to time.

Retirement Systems Division Strategic Plan

The Chair recognized Mr. Toole to discuss the Retirement Systems Division strategic plan. The Department's Retirement Systems Division holds responsibility for administration not only of the Supplemental Retirement Plans, but also the state pension plans which comprise the North Carolina Retirement Systems.

Mr. Toole stated that over the past several months, he had been in consultation with experts in strategic planning to develop the new strategic plan for the Retirement Systems Division. The Division has developed four main operating goals:

1. Retirement readiness;
2. Employee engagement;
3. Member satisfaction; and,
4. Fiscal integrity.

Mr. Toole stated that the Supplemental Retirement Plans would serve as a key part of the Division's effort to meet the retirement readiness goal, since the Plans are provided to help close the retirement income gap. Staff will use the findings from the Plans' annual benefits statement to report on the number of North Carolina public employees on track to replace 80 percent of their final salary throughout retirement. The Board thanked Mr. Toole for his presentation.

At this time, Ms. Keech asked how GoalMaker interacts with members subject to required minimum distributions. Mr. Swartwood from Prudential responded that if no election is made by the member, the distribution will be processed across all of the GoalMaker allocations. However, if the member directs the withdrawal to be taken from one or more specific funds, the distribution can be processed according to the member's direction.

Strategic Marketing Plan Update

The Chair then recognized Julia Vail to update the Board on the Plans' strategic marketing plan.

Ms. Vail highlighted recent planning events designed to provide more comprehensive communication to the Plans' members. She noted an initial planning meeting that listed the following priorities:

- Segregate employee groups for targeted communications;

- Streamline drafting and review process; and,
- Raise retirement readiness awareness.

The Board thanked Ms. Vail for her presentation.

Third Party Administrator Contract Extension

The Chair then recognized Mary Buonfiglio to discuss the two one-year options for contract extension available to the Board for the existing third party administrator, Prudential. At the June 6, 2012 meeting, the Board had moved to begin the process to award both one-year contract extensions to Prudential. Ms. Buonfiglio noted that Prudential had taken steps to make changes to the contract requested by the Department. The Department had requested:

- A data review and verification project,
- Additional communication resources, and
- Fee savings.

Blake Thomas then provided an update on the process of exercising the two one-year options available under the Prudential contract. He noted that the contract extension would be accomplished by a contract amendment, which was currently in draft form.

Fiduciary Training/Fiduciary Liability Insurance

Mr. Thomas then reminded the Board of the fiduciary training session scheduled for September 12, 2012. He noted that this session should help the Board determine whether to pursue the purchase of fiduciary liability insurance. Mr. Thomas noted that the Board would soon be receiving a memorandum created by Groom Law Group that summarizes key considerations when determining whether to purchase liability insurance.

Mr. Thomas also stated that the Department of State Treasurer had received quotes solicited by the Department of Insurance for fiduciary liability insurance to cover Board members and related staff. Mr. Thomas noted that premium amounts required to provide additional liability coverage decreased significantly as the total liability coverage increased. Under the Department of Insurance's quote, the fiduciary liability insurance could be shared between all of the Department of State Treasurer's boards of directors and staff, potentially leading to cost savings. Mr. Thomas noted that under the quotes provided by the Department of Insurance, it would require as many as nine separate insurers to reach a liability limit of \$100,000,000.

Mr. Powell asked why providing the insurance would require so many vendors. Mr. Thomas stated that each company was only willing to provide a portion of the overall liability coverage requested by the Department.

Administrative Reimbursement Account

Ms. Buonfiglio then provided an update on the administrative reimbursement account. She referenced the continuous, but slowing growth in the administrative expense accounts. She stated that staff planned on reserving some funds for "go-green" initiatives or service provider audits. After these initiatives, funds are expected to remain in the administrative account. Ms. Buonfiglio stated that staff is currently working on a proposal, to be presented at the December board meeting, that will distribute the excess funds to Plan members.

Mr. Thomas then stated that with the funds currently available, staff requests to use some of the funds to temporarily retain an internal legal contractor to provide counsel to the Plans. He noted that the position would be part-time only and would assist with the growing amount of legal review required by the Plans.

Mr. Powell asked what the scope of services would be for the position. Mr. Thomas indicated that the position would be responsible for reviewing procurement documents and member correspondence, drafting and reviewing contracts, and generally providing legal counsel. Ms. Crooke asked how long the contractor would be retained by the Department. Mr. Thomas stated that he anticipated the position would work approximately 15-20 hours per week and would be retained 9-12 months. In response to a question from the Board, Mr. Thomas clarified that the attorney contractor would assist the Department of State Treasurer generally with various legal matters, working on an hourly basis. The Supplemental Retirement Plans' administrative reimbursement account would be billed only for work on Supplemental Retirement Plans matters.

It was moved by Clay Thorp and seconded by Chuck Leedy to approve up to \$100,000 for one year to retain an internal legal contractor. The motion passed unanimously.

At this time Bob Slade asked the Chair if the remaining agenda items that were to be held in open session could be addressed before the closed sessions. The Chair stated that the Director's Report could be discussed in advance, but agenda item XV would be discussed as scheduled.

Director's Report

Mr. Toole provided several administrative updates pertaining to the Plans. He noted the following:

- The NC 403(b) program was being rebid to clarify some portions of the procurement document;
- The number of participants electing the Transfer Benefit option remained steady compared to previous quarters; and,
- The National Association of Governmental Defined Contribution Administrators (NAGDCA) conference was in San Diego, CA in late September.

Mr. Thorp asked general questions regarding the design of the Transfer Benefit option that allows participants to rollover their 401(k) or 457 account to the Retirement System and receive an additional monthly benefit. Staff stated that a presentation on the option would be provided at the December Board meeting.

At this point it was moved by Robert Powell and seconded by Clay Thorp to enter closed session pursuant to §143-318.11(a)(3) to consult with the Board's counsel concerning potential legal claims. The motion passed unanimously. The claims discussed in the closed session are not the subject of any lawsuit.

Upon reopening of the meeting to guests, Mercer representatives made a presentation to the Board.

IPS Review and Monitoring Report from Investment Consultant

Jay Love, Tom Murphy, and Jeremy Francis from Mercer discussed best practices for the development of investment policy statements and the monitoring of investment portfolios.

Mr. Love noted that Apple's stock appreciation in the first half of 2012 (which caused Apple to make up a large portion, measured by value, of many indices) led to discussions about investment policies that limit the portion any particular stock may be of a portfolio. These discussions, in turn, led to a discussion about inconsistencies between the Plans' Investment Policy Statement and the investment guidelines provided to particular managers. Mr. Love stated that under the current structure, the investment managers are legally required to notify the client if a breach of stated investment guidelines occurs. However, the existing agreements with the investment managers do not incorporate the investment policies detailed in the Board's Investment Policy Statement.

Mr. Francis identified four options that plan sponsors can use to ensure policy compliance within their investment portfolios.

1. The Board may delegate to the investment advisor decision-making authority on investment related issues.

2. The Board may contract with another provider to monitor investment compliance and notify staff or the Board of any non-compliance.
3. The Board may contract with an investment advisor who is responsible for providing advice and monitoring investments, but who is not delegated decision making authority. The investment advisor would then subcontract with another vendor to perform compliance monitoring.
4. The Board, through the third party administrator, may have the custodian monitor investments' compliance with stated investment policies.

In the second, third, and fourth options, the Board would remain responsible for implementing corrective action, but the Board would receive assistance in identifying noncompliance with investment policies.

The representatives from Mercer noted that the fourth option was off the table, since Prudential was unable to perform back testing. Mercer recommended the first or third option as best practices. Under the first option, the investment advisor's fee would likely be substantially higher. However, this fee increase could be offset due to "most favored nation" clauses not being applicable where investments were made through the investment advisor. Under the third option, an additional pass-through fee would be required for the monitoring subcontractor.

Mr. Powell asked Mercer which option they believed was described in the request for proposals issued by the Board in 2011. Mr. Love responded that Mercer viewed the RFP as requesting an arrangement consistent to Mercer's prior role, which was similar to Option 3 but without any subcontractor performing compliance monitoring. Mr. Love noted that Mercer had performed quarterly compliance monitoring on a best endeavors basis.

Mr. Leedy asked how the first option could be implemented. Mercer responded that they would direct the custodian to automatically program the guidelines into their reporting platform. If a compliance issue arose, the custodian would notify Mercer and Mercer would act to correct the issue.

Due to scheduling constraints, Ms. Croke left the meeting during the compliance option discussion discussed above.

After this discussion, it was moved by Robert Powell and seconded by Clay Thorp to re-enter closed session pursuant to §143-318.11(a)(3) to consult with the Board's counsel concerning potential legal claims. The motion passed unanimously.

Upon the reopening of the meeting to guests, the Board indicated that there was an apparent lack of clarity in the services sought in the request for proposals for the Board's investment consultant issued in 2011. It was moved by Robert

Powell and seconded by Melinda Baran to reissue the request for proposals for the Board's investment consultant. The motion passed unanimously.

Adjournment

There being no further business, it was moved by Robert Powell and seconded by Libby George to adjourn the meeting at 1:09 p.m. The motion passed unanimously.

CHAIR