

## **DRAFT**

### **NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES**

#### **MINUTES OF MEETING**

**March 24, 2016**

**Time and Location:** The North Carolina Supplemental Retirement Board of Trustees (the “Board”) met at 9:00 a.m. on Thursday, March 24, 2016, in the Dogwood Conference Room, 3200 Atlantic Avenue, Raleigh, North Carolina.

**Members Present:** The following members were present: Melissa Waller, Acting Chair, Melinda Baran, Karin Cochran, Keith Burns, Heyward McKinney, Walter Gray, and Michael Lewis. Gene Hamilton, and Robert Orr joined via phone.

**Staff Present:** The following Department of State Treasurer (DST) staff were present: Steve Toole, Andrew Holton, Mary Buonfiglio, Mary Laurie Cece, Rekha Krishnan, Catherine Jarboe, Casey High, Tim Viezer, Lisa Page, Rhonda Smith, Blake Thomas, Lisa Allnutt, Fran Lawrence, Paul Palermo, Kevin SigRist, and Maja Moseley.

**Guests Present:** The following guests attended the meeting: Michael McCann, Kathleen Neville, Michael Knowling, Lawanda Best-Rush, Aaron Koval, Margaret Hendershot and Jessica Quimby from Prudential Retirement; Jim Simone from TIAA-CREF; Kelly Henson, Liana Magner, and Andrew Ness from Mercer Investment Consulting. Karolyn Ferris and Sarah Baluch from Bank of New York Mellon.

#### **AGENDA ITEM – WELCOME AND INTRODUCTIONS**

The meeting was called to order at approximately 9:03 a.m.

Ms. Waller welcomed Board members, staff and guests. She introduced new Board member, Heyward McKinney. Mr. McKinney replaces Mr. Stell as the Governor’s appointee and is the retired Chief Operations Officer for the Division of State History Museums. Ms. Waller stated that Mr. McKinney’s experience in finance and state government makes him an asset to the participants in the Supplemental Retirement Plans.

Next, the Ms. Waller introduced two representatives from the Bank of New York Mellon custodial team, Sarah Baluch and Karolyn Ferris who would be presenting an update regarding the unbundling transition.

Lastly, Ms. Waller introduced Casey High, the Senior Investment Analyst and newest addition to the Public Equity Team within the Investment Management Division.

Ms. Waller asked to hold the public comments until the end of the session.

**AGENDA ITEM – ETHIC AWARENESS AND IDENTIFICATION OF CONFLICTS OR POTENTIAL CONFLICT S OF INTEREST**

Ms. Waller asked Board members to review the agenda for the meeting and identify any actual, implied or potential conflicts of interest. No conflicts were identified.

**AGENDA ITEM – APPROVAL OF MINUTES**

Ms. Waller asked if there were any comments or changes to the minutes of the December 10, 2015, Board meeting. There were no comments and Ms. Baran made a motion that the minutes be approved. Mr. Gray seconded, and the motion passed unanimously.

Ms. Waller noted that the meeting will continue in the open session until the arrival of Mercer compensation team at which time a closed session will commence.

**AGENDA ITEM-401(k)/457(b) STRATEGIC UPDATE**

Ms. Waller recognized Mr. Toole who commended Board members and staff for the past 18 months of work toward the change in structure of the Plans, noting the successful completion of transition to unbundled structure. He stated that the Board and staff attention now turns to strategic initiatives to drive goals and metrics. Mr. Toole highlighted several notable events, such as: implementation of flat \$31.00 recordkeeping fee; plan-wide small balance account cash-out in connection with the fee implementation; and “Save Early and Save More” campaign success. Mr. Gray asked whether the fee change information was published in the newsletter and Mr. Toole said yes. Mr. Toole added that Prudential hired a data analyst who will be reviewing the pension members’ data which will then be used to customize marketing campaigns. In addition, a dedicated retirement counselor from Prudential is present on-site few days per week and available to discuss total financial plans with members. Mr. Toole noted the importance of Retirement Income Calculator and Transfer Benefit process as valuable tools and options for members. He stated there is a need to develop an asset retention strategy as many members erroneously believe they must remove their money from the plan when they leave employment. In cooperation with Prudential, a survey will be send to retired members who left the plans to determine where they chose to take their money. Currently, the plans struggle to determine what financial products are purchased after the retirees take a full distribution from their accounts. Mr. Burns remarked that members may need additional reassurance at retirement, and both Ms. Baran and Mr. Hamilton agreed, adding that members want to consolidate their assets to arrive to the total financial picture. In response to Ms. Cochran’s question, Mr. Toole stated that there is no change in fee when a member transitions into retirement from active status.

Mr. Toole stated that auto-enrollment will be introduced again next year in long session. He also noted that the plans may consider offering self-directed brokerage accounts and managed

accounts. The possibility of employer match is also being considered as this would drive plan participation. He stated that the overall state employment compensation system is currently under review by the Human Resources. Mr. Orr inquired as to how members think of an employer “match,” particularly in terms of defined benefit, and Mr. Toole replied that some say they feel that they cannot afford to contribute anything beyond the six percent and he explained that we then should explain that, in reality, they cannot afford *not* to.

Mr. Toole also noted that many members navigate the website using smartphones and that having a wealth app would be key strategy, enabling the department to be the industry leader. The cost of the application development has been explored with Prudential but no definite numbers are available yet. Ms. Cochran remarked that the Department of Cultural resources cooperates with university teams on innovative project and uses state funding instead of utilizing the Request-for-Proposal process. She added that choosing a mobile-friendly solution for the website might be more cost effective than app updates. Mr. Orr emphasized the significant cost of data analytics and the importance of not losing sight of translating that data into strategy. Ms. Waller noted that a second generation of [www.nctreasurer.com](http://www.nctreasurer.com) will launch this fall and that external vendors are currently working on department data assessment, inclusive of State Health Plan data.

Mr. Toole continued on to the voluntary Annual Automatic Increase Program, noting that the proposed plan amendment requires approval from the Board members. The automatic increase becomes effective in August which coincides with potential salary raises.

Mr. Burns made a motion to amend the NC 401(k) Plan document to include an annual automatic increase feature and Mr. Lewis seconded. The motion passed unanimously.

Ms. Cece added that the NC 457(b) Plan will also offer the Contribution Accelerator option however a plan amendment is not needed as the plan document belongs to Prudential.

#### **AGENDA ITEM –CUSTODIAN TRANSITION UPDATE**

Ms. Waller recognized Sarah Baluch and Karolyn Ferris. Ms. Ferris presented a brief overview of custodian conversion activities. She noted that Bank of New York Mellon has over \$28 trillion of assets under custody and the staff is able to quickly capture information regarding asset numbers and movement. The Bank also offers investment management and is able to offer solutions based on holistic approach. Ms. Ferris stated that this holistic approach proved successful during the conversion of Plans’ assets. Ms. Baluch added that BNYM’s most important job is to safeguard the Plans’ assets and multiple daily and monthly processes support this function, such as: valuation, unitization, reconciliation with investment managers and compliance, and the dedicated BNYM team that worked closely with SRP staff in all aspects of the custody. Ms. Baluch emphasized that the conversion was successful and 2,700 positions were received; the conversion had a dedicated project manager, Joanne Lebruto, and all milestone dates have been met. A weekly transition call had been held during the period of April 2015 until

February 2016. BNYM team has reconciled all securities and prepared a final conversion report for the auditors.

Mr. Burns asked for more details of the reconciliation report and Ms. Baluch confirmed that there were no surprises on the conversion date or shortly after. BNYM team worked very closely with the prior custodian – State Street – team and ensured that all positions were accounted for prior to conversion date. State Street has also provided a final audited statement. Using this statement, BNYM team conducted a final side-by-side comparison and ensured that all positions were received.

Ms. Baluch discussed cybersecurity. She stated that BNYM constantly monitors the system to look for vulnerabilities; daily controls are also in place. All employees are trained on this matter multiple times a year. Ms. Baluch provided BNYM’s “Cybersecurity Risk Management Program” brochure as part of the Board meeting materials.

**AGENDA ITEM – APPROVAL OF MINUTES**

Ms. Cochran, who chaired the Investment Subcommittee meeting on February 18, 2016, provided a brief summary of the Agenda to the Board members. She asked whether there were any changes to the minutes of the Subcommittee meeting and there were none. Mr. Burns made a motion to approve the minutes and Mr. Gray seconded. The motion passed unanimously.

**AGENDA ITEM – APPROVAL OF MINUTES**

Mr. Gray provided a brief summary of the Audit Subcommittee meeting agenda of February 25, 2016, to the Board members. Ms. Lawrence noted that a change to meeting minutes was needed with respect to GASB effective date for the Plans. The change was duly noted and Ms. Baran made a motion to approve the minutes, pending the correction. Mr. Hamilton seconded and the motion passed unanimously.

Mr. Burns recommended that the transition reconciliation be reviewed via audit and cautioned against waiting one full year for transition results. Ms. Lawrence added that it would be worthwhile to engage external auditors to review the transition process and to confirm that everything went well.

Mr. Burns made a motion to refer to the Audit Subcommittee to assess the transition and the scope of engagement. Ms. Baran seconded, and the motion passed unanimously.

**AGENDA ITEM – COMPENSATION STUDY UPDATE** and

**AGENDA ITEM – REPORT ON OPEN ACCOUNTS RECEIVABLE IN STABLE VALUE PORTFOLIO**

Ms. Waller asked that a member of the Board to make a motion to enter closed session pursuant to G.S. 143-318.119(a)(3), and (a)(5). For the purposes of Subdivision (a)(3), the session

involves matters regarding potential litigation that are not yet the subject of any existing lawsuit. For purposes of Subdivision (a)(5) the session involves matters regarding personnel and compensation.

Ms. Cochran so moved, and Mr. Burns seconded. The motion passed unanimously.

11:44 a.m. Mr. Burns made a motion to reopen the meeting, and Ms. Cochran seconded, The motion passed unanimously.

Upon return to open session, Mr. Burns made a motion to authorize market level compensation for the SRP core staff, subject to Treasurer's discretion: Operations Analyst, Compliance Officer, Senior Compliance Officer, Assistant General Counsel, Deputy Director and Director. Ms. Cochran seconded, and the motion passed unanimously.

Ms. Baran made a motion to approve the transfer of funds from administrative expense account to the Stable Value Fund for reimbursement associated with Great West accounts receivable entry. Mr. Gray seconded, and the motion passed unanimously.

#### **AGENDA ITEM – APPROVAL OF 2015-2016 UPDATED BUDGET**

Ms. Waller recognized Ms. Buonfiglio who noted a budget expansion request of \$234,326.00. The increase reflects the legislative approval of salary bonus of \$750.00, departmental salary increase and the closing of accounts receivable accounting entry. Ms. Buonfiglio provided the balance in administrative account for each plan: \$4.8 million in the NC 401(k) and \$655 thousand in the NC 457(b), respectively, as well as revenue projections for the fiscal year end. She added that the administrative fee of 2.5 percent is invested in the Plans' Stable Value portfolio.

Mr. Burns made a motion to approve the updated budget, and Ms. Cochran seconded. The motion passed unanimously.

#### **AGENDA ITEM – NC 401(k)/457(b) PLANS 4<sup>th</sup> QUARTER INVESTMENT PERFORMANCE REPORT**

Ms. Waller recognized Ms. Magner and Ms. Henson. Ms. Magner presented market performance summary, noting that while volatility was still present in the 4<sup>th</sup> quarter of the year overall it was a bright spot in the year and optimism increased in the U.S and in Europe. The Federal Reserve raised short term rates, and S&P index was up 7 percent. Large cap stocks outperformed small cap, and growth fared better than value. U.S. equities outperformed non-U.S. equities, and U.S. dollar appreciated considerably. Best performing sectors were materials, technology and health while utilities, energy and consumer discretionary were weak performers. The NC Large Cap Growth Fund was the best performer, while the NC Large Cap Value Fund did not do as well. Yield curve flattened in the quarter, and short duration bonds fared better than long. Overall, the year-end results were muted and defensive sectors fared best. Emerging markets were down

almost 15 percent due to extreme volatility in China in conjunction with diverging monetary policies. Mercer expects this trend to continue. Ms. Henson noted two personnel changes: one within Delaware Investments where Senior Portfolio Manager Anthony Lombardi left the firm quite suddenly and it appears to be an isolated, undisclosed incident. Mercer is monitoring the developments and the executive managing director for Sands has departed but this does not change Mercer's rating of the manager.

Ms. Henson provided a summary of funds' performance. The NC Large Cap Growth and the NC SMID Cap Growth saw improved results during the quarter while the NC Large Cap Value strategy was hurt by energy weighting with Hotchkis&Wiley being a deep value manager. The NC International Equity Fund fared well against the benchmark. The NC Fixed Income Fund matched the benchmark for the year with Prudential outperforming the benchmark for the quarter, while J.P. Morgan slightly underperformed. Ms. Henson noted that, overall, all funds have outperformed either the peer group or their respective benchmark which is a good sign.

Mr. Toole asked about the Stable Value Fund performance and Ms. Henson replied that it did well compared to its benchmark. She added that the SVF peer group is rather small. Ms. Magner emphasized that the market to book value ratio of the fund is in the top half of the universe and the crediting rate is also above median. She added that in the light of upcoming money market fund reform, Mercer supports the use of stable value funds in retirement plans.

Ms. Henson continued to the watch list overview: Brown Small Cap Growth is still on the list however the manager recently posted a strong performance and returns. Mercer continues to monitor the fund and will conduct a formal one year review in another quarter. PIMCO Inflation-Responsive Multi-Asset Fund will remain on watch until personnel changes stabilize and news around those changes settles.

Lastly, Ms. Henson directed the members' attention to the fee review page which will change considerably in the future due to the completion of conversion. Mercer will work with the new custodian to supply the numbers for the new fee chart and the recordkeeping fee column will be removed and "other investment expenses" column will reflect the cost of custody. The goal is to keep the fee chart consistent.

#### **AGENDA ITEM – 401(K)/457(B) PLANS UNBUNDLING TRANSITION UPDATE**

Ms. Henson stated that the transition was a huge undertaking and that it went very well. All investment management contracts were drafted and executed, and weekly calls were held with IMD Portfolio Manager Rhonda Smith, regarding investment guidelines.

#### **AGENDA ITEM – NC 401(k)/457(b) PLANS 4<sup>th</sup> QUARTER ADMINISTRATIVE REPORT**

Ms. Waller recognized Mr. McCann who introduced Ms. Quimby and Ms. Neville, as well as Ms. Best-Rush, the data analytics coordinator, and Ms. Margaret Hendershot, the new retirement counselor.

Mr. McCann focused on the highlights of the 4<sup>th</sup> quarter, noting the significant utilization of GoalMaker by the members and the uptick in enrollments: 25 percent in the NC 401(k) and 3 percent in the NC 457(b) in comparison to last year. Eight new employers were added to the 401(k) and 38 to the 457(b). Prudential is also tracking the details of plans' distributions, contributions and roll-ins. He emphasized that there is an educational opportunity, especially for members nearing retirement, to learn about distribution options in order to make the best choice for their unique situation.

Next, Ms. Quimby presented an overview of the regularly produced communication materials that are distributed to the members, such as the *Signature* newsletter. Ms. Quimby noted that Prudential has addressed the issue of market volatility by emphasizing in its educational communications and resources the ongoing need for diversification and asset allocation, as well as by addressing market unpredictability and the choice of tools available to member to alleviate it. Four of eight newsletters produced in years 2014 and 2015 discussed this specific issue, as well as demonstrated the features of GoalMaker which ensures appropriate allocation and discourages rushed decisions. She stated that the plans' overall communications and educational outreach strategy includes these themes.

Ms. Neville provided additional field data, stating that out of 7,000 meetings held in 2015, 4,000 were individual meetings. Those allow for in-depth conversations regarding the GoalMaker and asset allocation. The retirement counselors are able to discuss the market fluctuation and market risk, and address all facets of members' concerns. In response to Ms. Baran's question, Ms. Neville confirmed that the most frequently addressed topic is whether to leave the funds in the plan upon retirement or termination of service, or to roll funds somewhere else. All retirement counselors are trained to address the details of the process before, during and after member's retirement to help make the most informed decision. Ms. Quimby added that a checklist is also available to the members and walks them through specific distribution options. Ms. Baran remarked that the benefit most desired by members is retirement is safety and security of their money, and Ms. Quimby noted that one of the newsletter articles also addresses that issue.

Mr. Toole commended Prudential and Ms. Quimby's team on being awarded this year the Retirement Readiness Award by the Plan Sponsor Counsel of America.

#### **AGENDA ITEM – NC 403(b) PROGRAM 4<sup>th</sup> QUARTER INVESTMENT PERFORMANCE REPORT**

Ms. Waller recognized Ms. Smith to give the performance report for the NC 403(b) Program. Ms. Smith noted that performance monitoring moved from Mercer to the Investment Management Division in September of 2015. Several enhancements to the reporting format are

also planned and the staff welcomes the feedback from the Board members in this process. She noted that effective in the 2<sup>nd</sup> quarter of the year, the fund line up will change. Ms. Smith briefly summarized the highlights of the report: Wells Fargo Target Date Funds are slated to move to Custom Portfolios structure in order to better align with the Plans' structure; the staff will begin to reach out to the mutual fund managers to better understand their process and philosophy. Ms. Smith discussed several funds still on the Watch List, noting that the majority of them will be removed from the line-up due to restructuring or will map to a different fund: Allianz NFJ International Value, American EuroPacific Growth, and TIAA Real Estate. PIMCO Inflation Response Multi-Asset Fund continues to be rated as "neutral" by Morningstar, and while Vanguard Windsor II Admiral Fund underperformed for the quarter, it outperformed the benchmark for the year.

With respect to the expense analysis, Ms. Smith stated that over the next quarter, the staff will look for and determine how to move to lower cost share classes.

Ms. Baran remarked that federal legislation requires that the Program use mutual funds as investment vehicles.

#### **AGENDA ITEM – NC 403(b) PROGRAM 4<sup>th</sup> QUARTER ADMINISTRATIVE REPORT**

Ms. Waller recognized Mr. Simone to give an update on the 403(b) Program administration. Mr. Simone noted that the Program specifically targets the public educators and community colleges, a new addition. He stated that there has been some struggle to get the Program off the ground, as inertia exists, as well as public perception that the defined benefit plan will have their retirement covered. He presented the executive summary of districts enrolled, assets under management, and participation numbers. With respect to goals, he noted that out of the projected 65 plans-on-board, 46 districts have enrolled thus far, and participation and counselling session goals fell short as well. Mr. Simone also stated that due to various contractual obligations, such as the use of Third Party Administrator, a number of school districts are unable to adopt the Program at this time, and to contract with TIAA.

Mr. Simone outlined the "looking forward" steps for the Program: implementation of the Custom Portfolios in the 2<sup>nd</sup> quarter of the year, and concurrent changes to the fund line-up; targeting additional school districts to enroll once Custom Portfolios have been implemented and the presentation upcoming at the Community College Business Officers Conference in April to discuss the Program and its roll-out strategy.

Ms. Waller asked about TIAA's contribution to participant outreach and marketing, and Mr. Simone admitted it has been difficult to engage the participant as an individual cannot sign up unless the school district is on board. The Ms. Waller noted that the emphasis should be placed on additional outreach to the groups already enrolled.

#### **AGENDA ITEM – BOARD QUESTIONS/COMMENTS**

Mr. Toole reminded the trustees to notify the administrative staff should they wish to join any of the two upcoming conferences: NAGDCA in September, In Denver, CO, and/or National Institute of Public Finance: the staff will send out more information regarding the meetings and the expenses will be covered by the plans.

Ms. Buonfiglio directed the trustees' attention to "SRP at a glance" summary report included the board materials.

**AGENDA ITEM – PUBLIC COMMENTS**

No public comments were offered.

The motion to adjourn was made by Ms. Baran and seconded by Mr. Gray. The motion passed unanimously, and the meeting adjourned at 2:09 p.m.

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Secretary