

DRAFT

NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

MINUTES OF MEETING

June 23, 2016

Time and Location: The North Carolina Supplemental Retirement Board of Trustees (the Board) met at 9:00 a.m. on Thursday, June 23, 2016 in the Dogwood Conference Room, 3200 Atlantic Avenue, Raleigh, North Carolina.

Members Present: The following members were present: Janet Cowell (Chair), Melinda Baran, Karin Cochran, Gene Hamilton, Michael Lewis, Heyward McKinney, and Walter Gray. Robert Orr attended via telephone.

Staff Present: The following Department of State Treasurer (DST) staff were present: Steve Toole, Mary Buonfiglio, Mary Laurie Cece, Rekha Krishnan, Lisa Page, Kevin SigRist, Reid Chisholm, Maja Moseley, Catherine Jarboe, and Jennifer Carroll.

Guests Present: The following guests attended the meeting: Michael McCann, Kathleen Neville, Ann Cashman, Aaron Koval, Jessica Quimby, and Lionel Gruslin from Prudential Retirement; Jim Simone and Kevin Orr from TIAA-CREF; Kelly Henson and Liana Magner from Mercer Investment Consulting. Tonya Hoam from TSS.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

The meeting was called to order at approximately 9:05 a.m.

Janet Cowell, Chair, welcomed Board members, staff and guests. The Chair asked to hold the public comments until the end of the session. Mr. Toole noted that all Board members have now received the nctreasurer.com email addresses and reminded the attendees that all media inquiries should be directed to the DST Communications and Marketing Department. Mr. Toole also announced the upcoming NAGDCA conference in Denver, in September.

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

The Chair asked Board 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 – APPROVAL OF MINUTES

The Chair asked if there were any comments or changes to the minutes of the March 24, 2016, Board meeting. Ms. Cochran requested that the language regarding the procurement process at the Department of Natural and Cultural Resources be updated to reflect the nature of her comment more precisely and Mr. Gray noted that the Audit Subcommittee meeting date needs correction. Both changes were duly noted and Mr. Gray made a motion to approve the minutes subject to corrections. Ms. Cochran seconded and the motion passed unanimously.

AGENDA ITEM – INVESTMENT OVERSIGHT ROLES AND RESPONSIBILITIES

The Chair recognized Mr. Toole and Mr. SigRist. Mr. Toole emphasized the importance of the clarity of roles and responsibilities in order for the Board members to be set up for success. The RACI chart (Responsible, Accountable, Consulted and Informed) was used to identify those responsibilities. Mr. Toole described the internal consulting model with external support where RSD and SRP staff serve as the extension of the Board and oversee the policy processes. Investment Management Division (IMD) staff has a clear reporting line and is accountable to the Board. IMD staff also manages the Investment Consultant, Mercer, which was hired by the Board. In the event of a disagreement between Mercer and IMD, for example regarding the use of a certain Investment Manager, the final recommendation will be made by IMD. If the Investment Policy Statement guidelines are not followed, a report will be made available to the Treasurer and any weighty debates will be brought to the Board's attention. Mr. Toole also described the next steps of the roles and responsibilities process: finalizing the Service Level Agreement between SRP and IMD, hiring the Supplemental Retirement Plans Assistant Director of Investments and finalizing the agreement between Mercer and the Department. Mr. Toole thanked Mercer's staff for their assistance. He also noted that the Glidepath creation will be delegated to an investment manager and that IMD staff is drafting the invitation to bid; the staff will present the finalist(s) for the Board's approval.

Mr. SigRist added that little will change in the boardroom itself. Once the Assistant Director of Investments is hired, this person will interface most frequently with the Board while Mr. SigRist will oversee the policy and process. Mr. SigRist also recommended that a personnel meeting be conducted annually in a closed session for the purpose of assessing the new relationship structure and the Board's interaction. This process is currently in place for the IMD Advisory Committee.

Ms. Baran inquired whether any other plans utilize a similar investment oversight model, and Mr. Toole confirmed, noting the Plans' focus on resource capitalization and economies of scale. Ms. Baran thanked the Chair for her oversight, and Mr. Toole thanked the Board members and staff for their involvement in the process.

Mr. Toole continued on the proposed Investment Policy Statement revisions, noting that the revisions represent the new roles and responsibilities. The delegated Glidepath manager has also been added and roles of IMD staff have been expanded by way of adding oversight of

rebalancing, investment managers, investment consultant and monitoring the adherence to investment options.

The Chair entertained a motion to approve the revisions to the Statement of Investment Policy for the NC 401(k) and the NC 457(b). Mr. Hamilton so moved and Ms. Baran seconded. The motion passed unanimously.

AGENDA ITEM – AMENDMENT TO THE NORTH CAROLINA SUPPLEMENTAL RETIREMENT PLAN GROUP TRUST

The Chair recognized Ms. Cece who noted that the trust amendment is a simple one: Internal Revenue Service has granted the favorable Letter of Determination to the trust subject to this minor amendment, the clarification of tax-exempt status under Sections 457(g) and 501(a) of the Internal Revenue Code of 1986.

The Chair entertained a motion to adopt the amendment, and Mr. Lewis so moved. Mr. Hamilton seconded, and the motion passed unanimously.

AGENDA ITEM – LEGISLATIVE UPDATE

Mr. Toole provided the short session update, noting how challenging it was and the Administrative Changes Retirement System/Treasurer House Bill 1134 is in trouble and may need to be added in critical pieces to different legislation. Technical Corrections Retirement System/Treasurer House Bill 1101 was submitted to the Governor's Office for his signature. Much work has been done with respect to establishing a normal retirement age; RSD staff proposed that full retirement be defined as 30 years of service and 50 years of age. The staff will also review the proposed Internal Revenue Service amendments to section 457 of Internal Revenue Code. In addition, 50 employers in the retirement systems have been contacted in writing regarding anti-pension spiking; an estimated \$6 million in assets may be recovered, and RSD will offer a payment plan. The General Assembly was also asked to allow online beneficiary designation changes for employees with more than 10 years of service and for some Human Resources flexibility regarding RSD staff – similar to the flexibility available to SRP staff. The administrative bill also contains purchasing clarification for SRP.

Ms. Baran inquired about the changes to Board members' terms of service, and both Mr. Toole and Ms. Cece clarified that members continue to serve until replaced or renewed.

AGENDA ITEM – 2015 ANNUAL BENEFIT STATEMENT

Mr. Toole presented the 2015 Retirement Readiness Summary, noting the Mission Statement: Retirement readiness for 480,000 active retirement systems members, meaning that each can replace 80% of his/her pre-retirement income for each year in retirement. The current Retirement Readiness (RR) score as of the end of 2015 is 60.24%. The RR score declined in 2015 due to flat investment performance, salary increases, and the lack of proportional contribution increases.

Mr. Toole emphasized the importance of getting members enrolled in the supplemental retirement plans NC 401(k), NC 457 and NC 403(b), as the RR score for members participating in both the NC pension plan and one of the defined contribution plans is 74.09% as of the end of 2015, in contrast to 50.16% of those participating only in the NC pension plan. The Plans have outlined Retirement Readiness goals for the next five years and providing an on-demand access to ABS for members is being discussed. Pension data will be shared with Prudential to target messages to the members not in the supplemental plans. New RSD Communications Manager Sherry McLamb and SRP Communications Officer Catherine Jarboe will be involved in the marketing campaigns.

Mr. Toole also noted that auto-enrollment and auto-escalation are a standard practice in private sector retirement and aid in membership retention. He added that it is imperative for the General Assembly to pass this law.

Mr. Gray stated that the long legislative session would present a good opportunity for the presentation to the assembly, and Mr. Lewis noted that this would not be a new discussion – previously, the addition of auto-escalation was considered but failed to garner support. The Chair added that there was considerable resistance from the legislative staff and the State Employee Association of North Carolina (SEANC) regarding another contribution being deducted from salary. Ms. Baran stated that auto-enrollment would in fact allow state retirees to supplement the Social Security income, which will only increase by 2/10 of one percent for next year and further, to cover the increasing cost of Medicare premiums. Mr. Toole agreed, noting that the retirees are not keeping pace with inflation and are losing purchasing power even when Cost of Living Adjustments are granted. Mr. Hamilton asked about the proposed auto-enrollment and escalation numbers and Mr. Toole replied that 2% enrollment and 1% annual increases are considered. Mr. Hamilton noted that those percentages would not have a significant impact on the take home pay. Mr. McKinney suggested involving agency-specific Human Resources departments in the auto-escalation discussion and have them present it to the newly hired personnel. Mr. Toole noted that HR Field Champions program is being created and the NC pension data sharing will begin soon. Mr. Orr noted that much can be accomplished by utilizing good analytics and segmentation and suggested a thoughtful selection of staff charged with working on the data and marketing project.

AGENDA ITEM – OPERATIONAL UPDATE

The Chair recognized Ms. Buonfiglio who presented the annual proxy voting activity update. She noted that voting is a great way of having the shareholder voice heard and Maja Moseley, SRP compliance officer, works with the custodian and Glass Lewis on proposal research and vote submissions. Ms. Buonfiglio noted that transition of voting accounts from State Street to Bank of New York Mellon was completed and a monthly audit of accounts status has been implemented. Ms. Buonfiglio briefly described the “proxy voting at a glance” report included in the Board materials. Mr. McKinney inquired as to how the social issues are decided on, and Ms.

Buonfiglio replied that the economic benefit to the Plans' members is the guiding principle behind those decisions. In addition, the Plans participate in the Corporate Governance meetings with OST and IMD staff where respective proxy policies and values are discussed.

With respect to the performance standards report, Ms. Buonfiglio noted that the plans' unbundled structure allows for increased visibility into the performance of service providers and the report will be presented to the Board on a quarterly basis. She added that TIAA did provide an outline for an NC 403(b) marketing plan but that it did not include specifics as to objectives, timelines, targets and messaging. .

At 10:10 a.m., the Chair announced a break and noted that the meeting will restart in closed session.

AGENDA ITEM – CLOSED SESSION

Next, the Chair asked for a motion to enter closed session pursuant to G.S. 143-318.11(a)(1) and (a)(3). For purposes of subdivision (a)(1), the session involves matters that the state's procurement laws and regulations make confidential. This includes confidential information covered in N.C.G.S. § 132-1.2(1). For purposes of subdivision (a)(3), the session involves matters that are not yet the subject of any existing lawsuit.

Motion to enter closed session was duly made and seconded.

At 10:59 a.m., motion to reopen the meeting was made and seconded.

Ms. Cece provided a motion language to begin the implementation of the previously approved NC 403(b) fund line up mapping with the exception of Wells Fargo Target Date Funds suite. Mr. McKinney so moved, and Mr. Hamilton seconded. The motion passed unanimously.

AGENDA ITEM – APPROVAL OF 2016-2017 UPDATED BUDGET

Ms. Buonfiglio directed the Board members attention to the budget memo, noting that revenue and fund balance projections constitute the funding available to the Plans. She noted the total balances in the supplemental retirement plans, as well as the interest earned by fees invested in the Stable Value Fund. She asked for approval of the proposed budget increase of \$197,154 due to salary adjustments, expenses associated with Financial Operations Division and Information Technology services, tax compliance consulting expenses in foreign markets, and next year's audit engagement.

Mr. Orr asked about the target balance for the administrative expense account, and Ms. Buonfiglio replied that one year's budget is the goal, however the account now contains double the amount. Mr. Toole added that there are two more upcoming expenses yet to be determined: Mercer's contractual fee and the expense for the Glidepath manager.

Mr. Hamilton moved to approve the budget proposal, and Mr. Gray seconded. The motion passed unanimously.

AGENDA ITEM – APPROVAL OF MINUTES

SRP Investment Subcommittee Chair, Ms. Baran, gave a brief overview of the highlights of the Investment Subcommittee meeting on May 19, 2016. She then asked for a motion to approve the minutes. Mr. Hamilton so moved, and Mr. Lewis seconded. The motion passed unanimously.

AGENDA ITEM – NC 403(b) PROGRAM 1ST QUARTER INVESTMENT PERFORMANCE REPORT

Mr. SigRist noted that there were no major investment allocation changes or performance issues to report. TIAA Real Estate Fund was one exception, showing significant underperformance to date, but this fund will be mapped over later this year. IMD staff will review the lower income yield in the fund in detail and will report back to the Board at the next meeting.

AGENDA ITEM – NC 403(b) PROGRAM 1ST QUARTER ADMINISTRATIVE REPORT

The Chair recognized Mr. Simone. Mr. Simone noted that 50 school districts have been enrolled to date, and three districts have chosen the sole recordkeeping arrangement. Program assets have reached a balance of \$6,674,341, and the number of participants has reached 1,087. There were 43 group meetings across the state and 865 counseling sessions have been delivered. Average contribution level has also exceeded the goal of \$140 by \$37.

Mr. Simone noted that 16 school districts are presently unable to adopt the NC 403(b) Program due to existing contractual obligations, and Ms. Baran noted potential difficulty in reaching out to and communicating with school district boards. She inquired about a possibility of the Treasurer convincing the General Assembly to make the Program mandatory for every school district, and Mr. Simone replied that this would remove one obstacle to adoption but that there may be others, such as certain Boards of Directors only authorizing a total of three vendors. The Chair added that the Department felt that such solution was politically not possible due such mandate being perceived as the state competing with private industry. Ms. Baran requested that further thought be given to linking the Program to the pension membership requirement, as well as implementing auto-escalation and auto-enrollment and that a recommendation be made to the Board.

AGENDA ITEM – NC 401(k)/457(b) PLANS 1ST QUARTER INVESTMENT PERFORMANCE REPORT

The Chair recognized Ms. Magner and Ms. Henson. Ms. Magner stated that volatility was the driver of investment performance for the quarter. The beginning of the year was difficult, and diverging monetary policies contributed to the double-digit equity fall. However, the markets rebounded sharply in the 1st quarter, and this environment can prove difficult for active

managers. Value strategies fared better than growth; utilities, communications and materials were best performing sectors. Healthcare, finances and consumer discretionary showed the worst performance. Overall, U.S. markets performed better than non-U.S. Mercer does expect to see continued volatility. The continuing volatility trend was seen in some of the Plans' underlying managers, and J. P. Morgan core bond strategy will be placed on watch due to turnover observed in their Columbus, OH fixed income team. Ms. Magner noted that long term, J.P. Morgan plans to eliminate the entire Columbus team and move to New York. The decision to begin the search for an alternative manager is a prudent one.

Ms. Henson described the respective performance scores of underlying managers in more detail, noting that even in this difficult environment most of them managed to deliver. Sands was 10 points under benchmark, but did turn around in April, and Mercer believes that this manager is set to outperform in the long term. Brown drove underperformance in the NC SMID Cap Growth Fund, and this manager will be formally reviewed in the next quarter; Mercer did meet with them and maintains their B+ rating. Additional underperformance was observed in the NC Global Equity Fund, and biotech equities proved detracting for Wellington.

Ms. Henson emphasized that there were no other concerns and no new items for the watch list; from long term perspective, the managers perform well. She also noted that some of the managers are actually doing better in the 2nd quarter of the year, and Ms. Magner added that new rate increases are not expected until the fall.

AGENDA ITEM – NC 401(k)/457(b) PLANS 1ST QUARTER ADMINISTRATIVE REPORT AND FIELD REPORT

The Chair recognized Mr. McCann and Ms. Quimby. Mr. McCann introduced a new team member, Mr. Lionel Gruslin, who will serve as retiree advocate. Mr. McCann confirmed Prudential's compliance with laws and performance standards. He also highlighted the Summary of Combined Goals for the quarter, noting good results especially with regards to the active participation rate. Due to market volatility, an influx of contributions to the Stable Value Fund was observed, and small balance cash out was completed in the NC 401(k) which impacted participation numbers. Gains are being made in the total amount of contributions driven into both plans, and auto-enrollment as well as auto-escalation remain the ultimate goal. Mr. McCann noted a considerable number of rollovers from the NC 401(k), amounting to approximately \$60 million. Prudential plans to survey the members who did roll their funds over with the goal of better understanding participant decisions for doing so, and has engaged the Retiree Advocate to go over the possible choices with the members who intend to roll their funds over.

Mr. McCann continued on the communications achievements for the quarter, thanking Ms. Jarboe and Ms. Quimby for their efforts. Ms. Quimby presented the NCPlans.prudential.com member experience web page demo, and shared its features and functions: mobility, Annual Benefit Statement and Retirement Income Calculator relationship, GoalMaker election process,

as well as a new hardship status feature. She also presented a video regarding the Retirement Income Calculator.

The Chair thanked Mr. McCann and Ms. Quimby for the presentation. Mr. Hamilton asked whether this demo is shared with employers, and Ms. Neville confirmed that Prudential's field team covers it with Human Resources.

AGENDA ITEM – BOARD QUESTIONS/COMMENTS

There were no questions or comments.

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 12:04 p.m.

Secretary