

**INVESTMENT SUBCOMMITTEE OF THE NORTH CAROLINA SUPPLEMENTAL
RETIREMENT BOARD OF TRUSTEES**

MINUTES OF MEETING

AUGUST 16, 2017

Time and Location: Investment Subcommittee (the Subcommittee) of the North Carolina Supplemental Retirement Board of Trustees (the Board) met at 9:00 a.m. on Wednesday, August 16, 2017, in the Dogwood Conference Room of Longleaf Building, 3200 Atlantic Avenue, Raleigh, North Carolina.

Members Present: The following Subcommittee members were present: Treasurer Dale R. Folwell, CPA (Chair), Melinda Baran, Karin Cochran, and Hal McKinney. Ron Copley, Supplemental Retirement Board of Trustees member, was also in attendance.

Staff and Guests present: The following staff and guests attended the meeting. From the Department of State Treasurer: Steve Toole, Reid Chisholm, Mary Buonfiglio, Loren de Mey Mary Laurie Cece, Casey High, Rekha Krishnan, Catherine Jarboe, Maja Moseley, Patti Hall, Frank Lester, Renee Bezaire, and Fran Lawrence. Joan Fontes attended via phone. From Mercer: Liana Magner and William Dillard. From Prudential: Michael McCann and Joseph Fein. Ann Cashman, Kelly Keen, Jessica Quimby, and Kathleen Neville attended via phone. From Galliard: William Weber.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

The meeting convened at 9:00 a.m. The Chair welcomed the staff and guests.

**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. There were no conflicts identified.

**AGENDA ITEM – MINUTES FROM MAY 17, 2017, INVESTMENT SUBCOMMITTEE
MEETING**

The meeting minutes have already been approved and were included for reference only; no action was needed.

AGENDA ITEM – GLIDEPATH PROJECT UPDATE

The Chair recognized Ms. de Mey who summarized the GoalMaker and Glidepath review background, noting the Board approved the recommendation from the March 23, 2017, Subcommittee meeting. Ms. de Mey emphasized that today's meeting serves as an opportunity to discuss the changes in detail, while the final recommendation and vote will take place during the upcoming Board meeting in September. She described the current and prospective GoalMaker models, as well as enhancements to the current model including smoothing of the glidepath and adding a "through retirement" income component. Mr. Toole added that the staff and vendors are committed to the June 2018 deadline for implementation of changes.

Ms. de Mey turned the floor over to Liana Magner and Will Dillard from Mercer. Ms. Magner presented Mercer's research regarding the GoalMaker glidepath and explained the details of increasing the number of portfolios to three risk settings and nine retirement target years. Ms. Magner presented additional allocation recommendations within GoalMaker as well as recommended active/passive implementations within each asset class. She noted an additional recommendation was to maintain an allocation to real assets but to add in an allocation to short-term TIPS as participants near retirement. She stated that Mercer's study included a fee comparison between the current portfolios and proposed implementation, and fees would decrease across the board, translating to savings of approximately 10 bps per participant.

The Mercer presentation was followed by a discussion between the Board members, staff and the consultant as to whether the outside assets, such as pension or Social Security, should also be included in the evaluation. Ms. Baran noted the responsibility of participants in this regard and also noted that the plans' website allows participants to consider their outside assets. The Chair commented that the solvency of Social Security will be a big issue over the next 12 years. Ms. Magner emphasized that GoalMaker is an "in plan" solution and as such, only plan assets would be considered. Subcommittee members agreed that while the idea had merit, this task was not within the scope of this particular project.

Mr. Copley inquired about Mercer's TIPS recommendation and the overall need for TIPS in the plan. Ms. Magner noted that TIPS represent a good hedge against inflation, especially for older participants, as they approach retirement.

AGENDA ITEM – INVESTMENT POLICY STATEMENT UPDATE

Ms. de Mey noted that the updates to the Investment Policy Statement (IPS) for the NC 401(k) and NC 457 Plans are meant to reflect plan design changes approved in the June Board meeting, the clarification of roles and responsibilities, and the addition of a general compliance statement to Watch List and termination. The updated version of the Investment Policy Statement (IPS) will become effective October 2, 2017.

Mr. Copley inquired whether the IPS was a public document and Ms. de Mey confirmed, noting that, the IPS is made public via the Department's website. However, the audiences most often interested in the policy and other governing documents tend to be members of Investment Subcommittee and the Board

In addition, Mr. Chisholm recommended a change to the IPS for the NC 403(b) Program to allow the Subcommittee to place a manager on watch, which is also one of the changes to the recommended changes to the IPS for the NC 401(k) and NC 457 Plans

Ms. Cochran made a motion to approve the revisions to both IPSs and submit them to the Board in September for approval. Mr. McKinney seconded the motion and it passed unanimously.

AGENDA ITEM – STABLE VALUE PORTFOLIO REVIEW

The Chair recognized Mr. Weber who noted that the fixed income space remained fairly uneventful over the quarter. He also mentioned that Ms. de Mey and Mr. SigRist conducted an onsite due diligence visit to Galliard's office in May.

Mr. Weber summarized the detail of firm level assets and book value performance of the Stable Value Fund (SVF). He noted that while no staffing changes occurred at Galliard, David Musto, the President of Great-West Investments, has left the firm. Galliard and Great-West are discussing his replacement.

In response to a question from Mr. Copley, Mr. Weber explained the background surrounding the development of the blended benchmark, and the monthly process to create a composite based on each underlying manager's specific benchmark. He noted that the blended market value performance and blended composite benchmark seeks to represent each underlying manager's performance relative to its specific benchmark. Although this is not the primary benchmark of the fund, the blended benchmark is shown to assist the Committee and Board in assessing the overall performance of the underlying managers within the Stable Value Fund relative to a market benchmark. Mr. Weber explained that the three-year Constant Maturity Treasury is also used as a benchmark because the duration of the Stable Value Fund is three years. The capital preservation objective of the SVF, as well as its place in the top third of overall stable value funds universe with respect to performance, was also discussed. The Chair recommended that the performance summary page of the Galliard report be modified to reflect the items discussed.

AGENDA ITEM – GALLIARD ANNUAL REVIEW

Ms. de Mey provided the detailed summary of the due-diligence visit, conducted in May in Minneapolis, which included a review of the contract, the structure of the portfolio, and fees. The contract language will be updated by the staff to reflect Galliard's fully delegated relationship. Staff has also asked for a "clean slate" review of the portfolio and Galliard proposed assuming responsibility for a larger percentage of the underlying fixed income investment management.

Staff is comfortable with the initial proposal and with Mercer's assistance, will determine the appropriate guidelines for the portfolio inclusive of diversification parameters. Ms. de Mey noted that this change, if made, will lower fees. Additionally, there is also the potential to lower fees with some of the wrap providers.

The Chair asked for an estimate of the fee reduction and Ms. de Mey estimated it at two to three basis points, in total dependent upon the level of manager diversification utilized in the final proposal. Mr. Weber added that Galliard's management fee for the North Carolina Stable Value Fund is already the lowest it offers. Mr. Toole recommended that both the benefits of the Stable Value and the fact that Stable Value is not available in the retail space should be emphasized in future participant communications.

AGENDA ITEM – ECONOMIC OVERVIEW AND 2nd QUARTER INVESTMENT PERFORMANCE REPORT

Mr. Dillard and Ms. Magner presented the notable economic updates from the second quarter of the year. Mr. Dillard discussed the best performing funds and sectors, stating that all active funds have outperformed their respective indices. He continued on to the fee review, noting the decrease in investment management fees due to recently negotiated concessions. He offered congratulations to Ms. de Mey for successful negotiations, noting, in particular, that all, except one, funds have lower fees, compared to their peer group median estimate.

Mr. Dillard continued on to the performance scorecard, noting that all, except Hotchkis & Wiley S/MID Cap Value, had very strong results for the quarter. Mercer continues to have a high degree of confidence in this manager. Overall, the funds posted very strong performance results.

The Chair emphasized the importance of appropriate participant messaging with regards to the fee reduction.

AGENDA ITEM – INVESTMENT UPDATE

Ms. de Mey noted that all investment managers are compliant with their respective guidelines. She also provided an update regarding NC House Bill 161, which requires state divestment from, and prohibits state agencies from contracting with, companies that boycott Israel. This bill also amends the Sudan and Iran Divestment statutes. SRP, IMD and legal staff will develop a project plan to address and implement the act's requirements, which include adoption of a policy and creation of divestment list, as well as notification to affected companies.

Ms. de Mey also provided an update regarding the investment management fee negotiations, which resulted in lowering fees with ten investment managers across twelve strategies. The total estimated annual fee savings for both Plans is approximately \$2.1 million.

Lastly, Ms. de Mey summarized the upcoming September 29th transition of NC Large Growth and Value, and S/MID Cap Growth and Value Funds into the new NC Large Cap Core Fund and

S/MID Cap Core Fund. Blackrock will serve as the transition manager. As a part of the Board's assessment and decision-making process, Ms. de Mey also provided preliminary estimated transition costs and noted that Staff would receive another cost estimate closer to the transition as well as a post-transition analysis. The transition will result in an overall fee reduction to participants and to the Plans, and reduce complexity in the Plans.

AGENDA ITEM – NC 403(b) PROGRAM 2ND QUARTER INVESTMENT PERFORMANCE REVIEW

Ms. de Mey summarized the Program funds' performance over the quarter, as well as the current asset allocation. She noted that Dimensional Fund Advisors (DFA) co-CEO, Eduardo Repetto, will be leaving his position in September but no direct impact to the Program is expected. Staff will schedule a follow up call with DFA regarding this personnel change.

Ms. de Mey continued to review funds on the Watch List, noting that the performance of Vanguard Windsor II Admiral Fund has stabilized and staff is comfortable with removing the fund from Watch List.

Mr. McKinney so moved and Ms. Baran seconded. The motion passed unanimously.

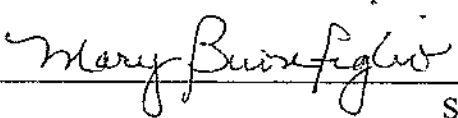
AGENDA ITEM - SUBCOMMITTEE MEMBERS QUESTIONS/COMMENTS

The Chair noted Kevin SigRist's recent departure from the Department and that Jeff Smith and Christopher Morris are serving as Interim Investment Management Division Directors. Both have been with the Department for many years and have significant experience in its Investment Management Division.

AGENDA ITEM – PUBLIC COMMENT

No public comments were offered.

Mr. McKinney moved to adjourn the meeting and Ms. Cochran seconded. The meeting adjourned at 11:08 a.m.


Secretary