

DRAFT

NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

MINUTES OF MEETING

December 10, 2015

Time and Location: The North Carolina Supplemental Retirement Board of Trustees (the Board) met at 9:00 a.m. on Thursday, December 10, 2015 in the Dogwood Conference Room, 3200 Atlantic Avenue, Raleigh, North Carolina.

Members Present: The following members were present: Melinda Baran, Karin Cochran and Gene Hamilton. Robert Orr attended via telephone.

Staff Present: The following Department of State Treasurer (DST) staff were present: Steve Toole, Mary Laurie Cece, Rekha Krishnan, Lisa Page, Catherine Jarboe, Rhonda Smith, Blake Thomas, Marni Schribman, Kevin SigRist, Tim Viezer, Fran Lawrence, Joan Fontes, and Maja Moseley.

Guests Present: The following guests attended the meeting: Michael McCann, Tom Conlon, Kathleen Neville, Aaron Koval and Jessica Quimby from Prudential Retirement. Jim Simone from TIAA-CREF. Kelly Henson, William Dillard, and Andrew Ness (via phone) from Mercer Investment Consulting.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

Steven Toole, Director of the DST Retirement Systems, called the meeting to order at approximately 9:02 a.m. and informed everyone that the Treasurer would not be in attendance due to illness.

Mr. Toole welcomed Board members, staff and guests. He also introduced and welcomed Catherine Jarboe, newly hired Communications Officer for the Supplemental Retirement Plans (SRP). Mr. Toole noted Ms. Jarboe previously served as the Director of State Networks and Organizations for the Catholic Mobilizing Network and holds a bachelor's degree in marketing and communications from Virginia Tech, and a master's degree in education from Bellarmine University.

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

Mr. Toole 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

Mr. Toole asked the Board members if there were any changes to the minutes of October 15, 2015 Special Board meeting and Ms. Cochran noted that Mr. Gray's last name was misspelled on page 5. The correction was duly noted and Ms. Baran moved to approve the minutes, pending the correction. Ms. Cochran seconded and the motion passed unanimously.

AGENDA ITEM – RECORDKEEPER AND CUSTODIAN TRANSITION UPDATE

Mr. Toole presented a summary of the transition, noting the implementation date of January 1, 2016. He recognized the Prudential, Bank of New York Mellon, and Mercer teams for having offered great support. He also noted that the contract with Prudential was bridged from December 18, 2015 until January 1, 2016 to make the transition seamless. Mr. Toole highlighted one of the main goals of the unbundling and that is to have greater clarity of roles and improved service provider oversight. Additionally, the consolidation of Stable Value Fund will make the Fund more efficient and will also offer small cost savings. Mr. Toole noted that as of the time of the meeting, 23 out of 24 Investment Management Agreements and guidelines were repapered; the paperwork for the foreign segregated markets was completed; the work on the custody contract, as well as the recordkeeping contract, was nearing completion; and all changes in the Plans were being communicated to the members. Starting next year, Prudential's Retirement Counselor will be available on site at DST to assist the members. Mr. Toole stressed the importance of having one voice around NC Total Retirement Plans, adding that Prudential's data analytics will be used to define the Plans' strategic plan and the GoalMaker enhancements are also planned. Overall, the 401(k) and 457(b) are on track to move assets on January 1, 2016. Mr. Toole thanked the Mercer team specifically for their support in creating the job description for the SRP Investment Assistant Director position and noted that Mercer's Statement of Work is to be finalized shortly.

AGENDA ITEM – 401(k) PLAN DOCUMENT RESTATEMENT AND 457(b) ADOPTION AGREEMENT AMENDMENT

Mr. Toole recognized Ms. Cece who summarized plan document updates:

- Both the NC 401(k) plan document and the NC 457(b) adoption agreement are restated and amended for the automatic cash out of balances less than \$1,000.00 for terminated employees; cash out of Bailey vested members would require their affirmative approval.
- Auto-enrollment provision was added to the NC 401(k) as a place holder as the plan will be applying for the IRS Letter of Determination in January, 2016.

Ms. Cochran asked whether auto-enrollment legislation would be introduced in the short session and Mr. Toole affirmed the Plans' readiness to do so. Ms. Cece also confirmed that the members can see the plan document online at www.nctreasurer.com.

Mr. Toole entertained a motion to approve the proposed amendments to the plan documents and Ms. Baran so moved. Mr. Hamilton seconded and the motion passed unanimously.

AGENDA ITEM – BOARD CHARTER UPDATE

Next, Ms. Cece directed the Board's attention to the memorandum regarding the effects of new board terms, noting how the expanded length and staggered terms will affect each member's term. All current terms will end effective June 30, 2016 and DST staff will seek re-appointments of all current members unless the member requests otherwise. Ms. Cece explained that under the staggered terms, each member may serve no more than eight consecutive years.

Ms. Cochran asked about the best practice and Ms. Cece replied that while institutional memory is very valuable, two to three year terms remain best practice.

Ms. Cochran made a motion to approve the updates to Board Charter and Ms. Baran seconded. The motion passed unanimously.

AGENDA ITEM – NC TOTAL RETIREMENT READINESS TOUR UPDATE & 2016 STRATEGIC MARKETING PLAN OVERVIEW

Mr. Toole recognized Ms. Schribman to give a report on marketing plans for the Total Retirement Plans. Ms. Schribman thanked the Financial Education Director, Ms. Marquita Robertson, and all service providers for their involvement in the Retirement Readiness Tour project. Ms. Schribman stated that the staff visited four sites during the national "Save for Retirement" event and over one thousand people attended. Attendees discussed retirement challenges with Mr. Toole and Prudential Retirement Counselors. Social Security Administration, State Health Plan, Credit Union and Education Retirement Group (ERG) were also on site to provide additional guidance. Mr. Toole, ERG and Human Resources representatives participated in the round table discussion and a Q&A session followed: all questions were captured by Prudential's Kathleen Neville and answered. Ms. Schribman noted that 43 new participants signed up with Prudential, and 51 members increased their contributions. All participants were asked to update their emails for further communication purposes, and "thank you" notes were sent back with a survey invitation: out of 118 responses received, 93 attendees felt the event was useful and 96 plan to use it in future decision-making. In addition, 53% of responders intend to make plan changes.

Mr. Hamilton inquired whether the near-retirees felt prepared for retirement and Ms. Schribman replied that in fact, most wished they had acted sooner and felt overwhelmed. In response to Ms.

Cochran's question, she also noted that Human Resources staff was very candid with the NC Total Retirement Plans team during each roundtable and asked for a follow-up presentation.

Ms. Baran asked about the top three most important takeaways from the event and Mr. Toole replied that the participants want to hear from the DST staff through their entire careers, expressed a need for Social Security education and that the Board and staff need to help people manage their assets in retirement. Mr. Hamilton added that the Social Security Administration is updating their distribution rules next year and that the younger generation needs to be educated regarding correct asset allocation. Ms. Schribman noted that market segmentation and asset allocation education present a great opportunity in the year 2016 and stressed the importance of customized messaging for different generations. Ms. Schribman also listed several upcoming initiatives: partnership with the State Health Plan and Credit Union, educational events with the participation of the Financial Education Director, electronic newsletters, as well as additional education regarding the NC 403(b) Program Custom Portfolios service. Ms. Baran expressed interest in attending some of the events and asked for the meeting schedule to be forwarded to her. In response to Mr. Hamilton's question, Ms. Schribman confirmed that Roth contributions are also discussed with members and Prudential team has been instrumental in those discussions. Ms. Cochran asked about the staff relationship with OSHR and Ms. Schribman stated it is very good and the team expects more invitations from them to do presentations. Ms. Cochran noted the importance of appropriate training for HR staff in the various state agencies and making them feel invested in the information they provide to employees. Ms. Cochran was willing to spearhead such training program. Ms. Baran also emphasized the need to highlight the rising costs of long-term care health expenses.

AGENDA ITEM – APPROVAL OF MINUTES

Ms. Baran asked the Investment Subcommittee members if there were any changes to the minutes of the November 12, 2015 Investment Subcommittee meeting. There were no changes, and Mr. Hamilton moved to approve the minutes. Ms. Cochran seconded, and the motion passed unanimously.

Five minute break took place at 9:48 a.m.

AGENDA ITEM – GLIDEPATH FOR CUSTOM PORTFOLIO RECOMMENDATION

Mr. Toole recognized Mr. SigRist to present a summary version of the recommendation already provided to the Investment Subcommittee in November, based on the approved fund line-up changes and mapping exercise. In October, the Board approved the termination of Wells Fargo Target Date Funds in the NC 403(b) Program and in their place to use TIAA-CREF Custom Portfolios to mimic the structure of GoalMaker in the Plans. Mr. SigRist directed the Board's attention to the memorandum containing the full background and analysis of the mapping and the glidepath. He highlighted in his discussion with the Board three issues from the memorandum: mapping of the 403(b) Small Cap Core fund, different International Fund benchmarks and the

lack of Global Equity Fund in the Program. Mr. SigRist recommended utilizing the model allocations proposed.

Ms. Baran made the motion to approve the Custom Portfolios Glidepath recommendation and Ms. Cochran seconded. The motion passed unanimously.

AGENDA ITEM – 3rd QUARTER INVESTMENT PERFORMANCE REPORT

Mr. Toole recognized Ms. Henson and Mr. Dillard to give an update on the 3rd quarter investment performance for the NC 403(b). Mr. Dillard summarized the structural changes in the Program for the year 2016 and noted that after the implementation of the changes, the Program's investment offerings will be more in line with the NC 401(k) and NC 457. Mr. Dillard discussed the performance of individual SRP investment managers. Among other topics, this discussion included the following. Mr. Dillard noted that the 3rd quarter of 2015 was volatile and four funds are on watch, including the PIMCO IRMAF which struggled due to emerging market currencies. In addition, the appreciating dollar created more headwind for PIMCO. The firm also experienced a bit of a headline risk associated with the damages suit from Bill Gross, however, Mercer feels this risk does not directly affect the fund. Mr. Dillard noted that the Vanguard Windsor Fund is focused on higher quality equities and consequently struggled in the quarter as well. As for Allianz NFJ International Value Fund, it underperformed the benchmark and 25% of the Fund is invested in emerging markets which caused much of its underperformance.

Ms. Henson asked whether there were any additional questions regarding performance, and there were none.

AGENDA ITEM – 3rd QUARTER ADMINISTRATIVE REPORT

Mr. Toole recognized Mr. Simone. Mr. Simone noted that the 3rd quarter of the year is typically slower due to school summer months. As of the end of the quarter, 44 districts were enrolled: 3 as sole recordkeeper, 15 as "soft" sole recordkeeper and 26 as multi-vendor. There was a 9 percent increase in assets under management to \$4,613,162.00. 715 counselling sessions were delivered across the state but the number of group meetings was lower due to staff absences during summer break. Mr. Simone emphasized that many people attend staff meetings however the number of attendees does not necessarily translate to many enrollments and the goal of 15 percent participation can be challenging. TIAA-CREF's message to educators on behalf of the Program is that they still need retirement savings of their own.

Ms. Baran asked whether annuity surrender fees are posing problems for teachers and Mr. Simone replied that the counselors advise them to stop contributing new funds to the annuity and start contributing to the Program instead, and consider transferring funds from the annuity to the Program at a later date. Mr. Simone stressed the importance of not incurring surrender charges if they do not make sense financially.

Mr. Hamilton inquired whether any members changed their asset allocation from a fixed option and Mr. Simone noted that the Program does not provide a true fixed option however many members chose the Lifecycle funds for their contributions which will be replaced soon by the Custom Portfolios service. Assets are well diversified and there are not a lot of funds in the Stable Value option.

In response to Ms. Baran's question, Mr. Simone noted that TIAA-CREF's field staff focuses on messaging to the following key decision makers within the school districts: finance departments and human resources. The staff works closely with the department heads and superintendents to ensure they are aware that this is a state Program and not just another 403(b) plan. Ms. Baran also suggested direct mailing to all school board members and Mr. Simone confirmed this approach has been implemented.

Mr. Simone continued on to speak about ongoing and future Program initiatives, noting that Mr. Toole will be speaking with community colleges' representatives during the spring conference and that community colleges will be on-boarded later in the year. Ms. Cochran asked about the market size for community college and Mr. Simone stated that while the market is larger than K-12 market in terms of asset size, the legislation was backed by only one college, Guilford Technical Community College. However, TIAA-CREF now has three potential candidates interested in adopting the Program and efforts are being made to convince them of sole recordkeeper of soft sole recordkeeper adoption. Ms. Baran asked whether technical and vocational schools are included and Mr. Simone noted the possibility of such addition can be explored. Mr. Hamilton added that sending a letter to county boards of education might be a good idea.

Ms. Cochran asked about the minimum target for breaking even and potential financial burden due to membership risk. Mr. Toole noted that the risk lies in not being able to pay the Program bills and this risk is now being managed from month to month. Mr. Toole added that IMD has been utilized to minimize investment consultant expenses associated with the Program.

Mr. Hamilton asked about possible scenario of discontinuing the Program as it potentially competes with the two Plans however Mr. Toole stressed the importance of this offering to teachers who are used to the 403(b) structure thus creating the need for such option. Mr. Simone also added that the 18 sole recordkeeper and soft sole recordkeeper districts will eventually become exclusive to the Program.

AGENDA ITEM – 3rd QUARTER INVESTMENT PERFORMANCE REPORT

Ms. Henson highlighted one aspect of 403(b) Program transition from Wells Fargo Target Date Funds to the Custom Portfolios service, noting that this event will have an impact on fees to members. While there is no fee for the Custom Portfolios model, the members will receive the aggregate fee for funds underlying the model, and that moving from index to mostly an active mix with result in a fee increase. Ms. Baran added that better performance will offset the fee. In

Mr. Toole's opinion, this transition gives the Program much needed flexibility in managing the glidepath in a consistent manner with the NC 401(k) and NC 457 and this constitutes an important fiduciary duty.

Ms. Henson noted that the market was quite volatile in the 3rd quarter but there were a few positive fund performances associated with the volatile environment. She pointed out that the Russell 2000 was down by 13 percent and international equities, including emerging markets, were down 18 percent. GDP was also weak, as was the Chinese stock market and weak job growth and falling energy prices further contributed to the volatility. Fixed income noted some positive results, but not within the high-yield bonds. Commodities and REITs were weak performers as well. The month of October saw a small rebound from negative performance numbers, and November numbers were somewhat flat. Emerging markets continued to be the area of uncertainty, remaining at negative 13 percent. Energy and healthcare sectors had big impact on managers, particularly the biotech equities. Ms. Henson noted that Brown Advisory was underweight in biotech and consequently performed well.

Ms. Henson continued on the fund performance review where the NC Large Cap Value and Growth Funds underperformed, as Sands Capital was impacted by their energy and biotech weighting. Strong results from Brown Advisory were observed in NC Small/Mid Cap Growth Fund as compared to benchmark: negative 11 percent versus negative 9.9 percent result. Fixed income proved to be a difficult area for active managers as Barclays benchmark is weighted heavily toward treasuries. Ms. Henson stressed that overall, looking at the 3-5 year period, no funds lag behind their respective peer groups or benchmarks and the line-up is very strong.

Ms. Henson also noted that PIMCO IRMAF is still on watch list due to media noise but that stability was observed within the firm and personnel changes. Mercer also recommends maintaining Brown's Small-Cap Growth on watch, but noted that markets are performing in Brown's favor currently. Ms. Henson added that fees are being evaluated systematically and that all fund level fees are competitive, but the Plans' may pay slightly more for strong-performing individual managers.

AGENDA ITEM – INVESTMENT POLICY STATEMENT UPDATE

Ms. Henson noted two major changes to the Investment Policy Statement. First, all manager guidelines, including detailed sector and holding information, have been transferred from the Investment Policy Statement to instead appear solely in each manager's Investment Management Agreement. Mercer staff worked with Ms. Cece on this project. Secondly, the roles and responsibilities were thoroughly revised and vetted, and the roles of the custodian and Investment Assistant Director roles were added. Performance standards remain as a part of the IPS and the plan structure with objectives was also maintained.

Ms. Baran commended the Mercer team and staff on their work and Mr. Toole entertained a motion to approve the recommended updates to the Investment Policy Statement. Ms. Cochran so moved and Mr. Hamilton seconded. The motion passed unanimously.

AGENDA ITEM – 3rd QUARTER ADMINISTRATIVE REPORT

Mr. Toole recognized Mr. McCann who introduced the Prudential staff members in attendance.

Mr. McCann shared an interesting discovery regarding sub-goals of contributions and active participation: both sub-goal numbers have dropped by the end of September. It was discovered that the fluctuation was caused by payroll remittance of an employer with approximately twenty thousand staff: their September payroll did not arrive until October 2nd and therefore was not included in the September average contribution calculation.

Mr. McCann noted that six new employers were added to the NC 401(k) and thirty to the NC 457(b). The NC 401(k) enrollments were also 27 percent higher than last year and 33 percent more new hires were enrolled. The NC 457(b) posted similar results: 13 percent more enrollments and 12 percent more new hires enrolled. With respect to rollovers, they went up by 7 percent in the NC 401(k) and 43 percent in the NC 457(b) compared to the 3rd quarter of 2014.

Mr. Hamilton inquired whether 401(k) funds can be rolled into a 457(b) plan and Mr. Conlon confirmed, adding that participant must have separated from service in the 401(k) plan to be able to transfer the funds out. Mr. Toole noted that the data provided in the administrative report will allow the providers and the staff to determine how exactly the assets are being used by the plan members. Ms. Baran mentioned one unintended consequence of auto-enrollment being while participation will grow small balance accounts will increase due to new hires. Mr. Toole noted that this would not impact fees as a flat fee for all members was already approved. Mr. McCann added that auto-enrollment tends to drop the average participant balance but the ongoing small balance cash out will prevent those assets from residing in the plan indefinitely. Ms. Henson also added that one of the unintended auto-enrollment consequences is an increase in plan loans, as seen by Mercer. Ms. Baran asked whether this was a problem in both plans and Mr. Conlon replied in the negative, noting that both the NC 401(k) and 457(b) were not much different from other plans in this respect. Ms. Baran was of the opinion that plan loans harm the growth of assets and should be discouraged and Mr. McCann noted that loans are currently trending down in both plans.

Mr. Toole asked for clarification regarding the plans percentage gains and earnings and Mr. McCann explained that these particular slides show the breakdown of how the assets are allocated, with the Stable Value Fund being a good example.

Mr. McCann stressed the importance of GoalMaker enrollments and making it a cornerstone of educational messages. Another important tool, the Retirement Income Calculator, allows for more personalization and significant outcome differences were found between those members

who used RIC and those who did not. The Prudential team also continues to highlight the importance of adding employer match in subplans.

Mr. Toole commended the Prudential team on their work.

Mr. McCann also informed the attendees that three new Prudential positions are being advertised: in-house retirement counselor, the retiree advocate and data analyst. The counselor was already hired and will begin on January 4th while resumes are being accepted for the two other positions.

In closing, Mr. McCann confirmed that the GoalMaker enhancements are being readied for launch in the 2nd or 3rd quarter of 2017 and updates on the project will be provided periodically to the Board.

AGENDA ITEM – BOARD QUESTIONS/COMMENTS

Mr. Hamilton noted that in 2016 public safety employees will be able to make withdrawals from their retirement savings plans without incurring the 10 percent early withdrawal penalty upon separation from service.

Mr. Toole shared the news of the passing of Mr. John David Davenport, the Chairman of InFRE, who was instrumental in creating the 457(b) legislation. Mr. Davenport was also a longtime supporter of NAGDCA and his passing is a significant loss to the public sector.

AGENDA ITEM – PUBLIC COMMENTS

No public comments were offered.

The motion to adjourn was made by Mr. Hamilton and seconded by Ms. Baran. The motion passed unanimously, and the meeting adjourned at 11:24 a.m.

Secretary