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NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

MINUTES OF SPECIAL MEETING
October 15, 2015

Time and Location: The North Carolina Supplemental Retirement Board of Trustees (the Board) met at 3:30 p.m. on Thursday, October 15, 2015, in the Kitty Hawk Conference Room of the Longleaf Building, 3200 Atlantic Avenue, Raleigh, North Carolina.

Members Present: The following member was present in person: Walter Gray.   Janet Cowell, Melinda Baran, Karin Cochran, Michael Lewis, Gene Hamilton, Keith Burns and Robert Orr attended via telephone.

Staff and Guests Present: The following staff and guests attended the meeting. From the Department of State Treasurer: Steve Toole, Mary Buonfiglio, Blake Thomas, Rekha Krishnan, Lisa Page, Mary Laurie Cece, Rosita Sabrosso-Rennick, Kevin SigRist, Rhonda Smith, Marni Schribman, Joan Fontes and Maja Moseley. Kelly Henson, Liana Magner and Andrew Ness from Mercer attended via telephone. Jim Simone from TIAA-CREF attended via telephone. Michael McCann (in person) and Jessica Quimby (via phone) attended from Prudential.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

The meeting was called to order at 3:30 p.m. Treasurer Janet Cowell, Chair of the Board, welcomed Board members and guests. The Treasurer also asked that any public comments be held until the end of the meeting.

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

The Treasurer 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 inquired whether there were any changes to the minutes of September 17, 2015. There were none, and Mr. Hamilton made a motion to approve the minutes of September 17, 2015; Ms. Baran seconded. The motion passed unanimously.

AGENDA ITEM – NC 403(b) FUND LINE-UP UPDATE

The Chair recognized Ms. Magner and Ms. Henson. Ms. Magner stated that the Board members are already familiar with the fund line-up materials, as well as the goal of the changes to be made in the NC 403(b) Program fund line-up, which is to better align the program options with the options of the NC 401(k) and NC 457 plans (the plans). Ms. Magner briefly outlined the funds being terminated, as well as the funds being added in their place:

- The Wells Fargo Target Date Funds will be replaced with TIAA-CREF Custom Portfolios (pre-defined portfolios designed to offer a range of investment time horizons and risk profiles)
- Vanguard Short Term Bond Index Fund will be replaced with Vanguard Total Bond Market Index Fund
- Vanguard Mid Cap Index and Vanguard Small Cap Index Funds will be replaced with Vanguard Extended Market Index Fund
- T. Rowe Price Growth & Income Fund will be replaced by T. Rowe Price Blue Chip Growth Fund
- Three international fund options – Alliance NFJ International Value Fund, American Funds EuroPacific Growth Fund and DFA International Small Company – will be replaced and consolidated in one option: MFS International Equity
- DFA Small Cap Core Fund will be added as a small cap offering
- All specialty funds will be eliminated from the program and their existing balances will be mapped over to the most like-for-like options available.

Ms. Cochran stated that the Investment Subcommittee members support Mercer's recommendations regarding the line-up changes, and that the transaction cost has been discussed for all of the changes. Ms. Magner stated that there is no direct transition cost associated with the changes.

Mr. Burns asked whether the elimination of the TIAA Socially Responsible Fund might upset participants who consider it an important option, and both Ms. Cochran and Ms. Baran replied that this investment option does not have a large number of participants or assets from the program.

Mr. Simone noted that all participants have an option to sell out of any funds being terminated prior to having their assets being mapped into another option.

Mr. Burns made a motion to approve the new fund line-up in the NC 403(b) Program, and Mr. Gray seconded. The motion passed unanimously.

AGENDA ITEM – 403(b) CUSTOM PORTFOLIO GLIDEPATH UPDATE

The Chair recognized Mr. SigRist. He stated that rather than provide a final recommendation on the NC 403(b) Custom Portfolios' glidepath at the current meeting, a set of analytics will be performed between October and November, then a recommendation will be presented to the Investment Subcommittee at their November meeting. If the subcommittee approves, the results will be presented to the Board during the December Board of Trustees meeting. Mr. SigRist stated that the ultimate goal of the project is to frame the NC 403(b) Custom Portfolios' glidepath to look as much like the GoalMaker glidepath as possible. This would be done on two levels. The first level is made up of the individual funds as the nodes of the glidepath; the second level is made up of the separate investments with unique allocations in the glidepath. Mr. SigRist noted that while the investment options line up rather well between the 403(b) Program and the 401(k) and NC 457 Plans, there are two exceptions which require further analysis: (1) a global equity option does not exist in the 403(b) Program and this will require more intricate mapping, and (2) with respect to the large- and mid-cap space, the 403(b) Program is positioned somewhat differently than the other plans, with a Russell 2500 strategy vs. Russell 1000 strategy.

Mr. Burns inquired whether the mapping would impact the fund line-up changes already voted on and Mr. SigRist stated that he did not think so, but first it is necessary for the Board to consider the analysis results that will be presented in December.

AGENDA ITEM – NORTH CAROLINA INFLATION RESPONSIVE FUND – PIMCO STRUCTURE IN UNBUNDLED ENVIRONMENT

The Chair recognized Ms. Cece. Ms. Cece informed Board members that during the re-papering process of the SRP investment management agreements, PIMCO and several other investment managers asked for a representation that the SRP plans are "Qualified Purchasers" under the Investment Company Act of 1940. PIMCO is the only manager of the NC Inflation Responsive Fund; because PIMCO is the only manager for the Inflation Responsive Fund, legal analysis determined that the plans might not be able to make this requested representation. Fortunately, PIMCO has a mutual fund that is managed with the exact same strategy as its current separate account in the Inflation Responsive Fund. In a mutual fund structure, there is not the same requirement for a "Qualified Purchaser" representation. Therefore, it is Ms. Cece's recommendation that the plans move to a mutual fund structure under the same strategy. Ms. Magner noted that while there is a slightly higher fee for the mutual fund, there is no additional cost associated with the transition from a separate account to the mutual fund. It is the expectation that most of the assets will transition in-kind.

Mr. Hamilton made a motion to move the existing NC Inflation Responsive Fund assets, managed by PIMCO, in the PRIAC separate account to the PIMCO Inflation Response Multi-Asset Institutional mutual fund. Ms. Baran seconded, and the motion passed unanimously.

AGENDA ITEM – RECORDKEEPER FEE STRUCTURE

The Chair recognized Mr. Toole to lead the discussion on the recordkeeping fee structure. Mr. Toole began by setting out the structure for the expected discussion. He explained that Mr. Thomas would provide Board members with some additional guidance on their fiduciary responsibility to participants in the plans, then Ms. Buonfiglio would share staff recommendations for the recordkeeping fee structure. Mr. Toole noted that if five votes (a majority of the Board) could not be obtained for a new fee structure, the plans will default to the current fee structure. He also informed the Board that, after further research, the option of $31 per participant account with a fee waiver for new participants was removed as a possible solution, unless otherwise directed, due to issues associated with administrating this option.

Mr. Thomas discussed the fiduciary duties of prudence and impartiality. He noted that with respect to the duty of prudence, the legal standard is reasonableness, with deference given by a court to decisions made after careful deliberation by the Board. He added that U.S. Department of Labor materials (which are not binding, but are useful guidance) recognize that retirement plans' fees may be charged either as a flat-fee or as an asset-based fee structure. However, conceivably either of these fee structures could be potentially challenged in court. For example, an asset-based fee could be challenged by plaintiffs' counsel if, when converted to dollars, that asset-based fee greatly exceeded the recordkeeper's actual cost per participant. On the other hand, a flat-fee could be challenged by plaintiffs' counsel if, when converted to basis points, that flat-fee was relatively large. Mr. Thomas noted that he was not aware of any lawsuit that had challenged a flat-fee on those grounds, but he noted to avoid risk and customer surprise, many plans explore cashing out small balances in terminated accounts ($1,000.00 or less).

With respect to the duty of impartiality, Mr. Thomas stated that there is no controlling authority available, but there were two persuasive sources of guidance. First, under ERISA, trustees have some flexibility in treating members differently when not all members are in the same situation. It is appropriate, at times, to weigh certain participants' interests against others. Second ,the State of North Carolina Uniform Trust Code clarifies that the duty to act impartially does not mean that the trustees must treat everyone equally; rather, the treatment must be equitable. A distribution is equitable if it is fair and just, even if it is not precisely equal.

Mr. Thomas stressed that the Board must have a full and fair deliberation and the process must be reflected in the meeting minutes. He reiterated that while there is no duty in current law to use a flat- or asset-based fee, the Board should consider it its duty to thoughtfully consider the issue based on the information provided by staff. In response to a question by Mr. Burns, Mr. Thomas noted that the trustees have their fiduciary duty to the plan as a whole, but may take action that might favor one group over another, as long as careful deliberation is conducted and the outcome is equitable.

Next, Ms. Buonfiglio presented the updated fee chart which presented the fee impact to participants, based on member median account balances, current fees, and new fee pricing scenarios. Ms. Buonfiglio used a hypothetical $10,000.00 account balance to illustrate monetary impact to the participant of the differing fee structures: under the current fee structure, the account fee is $12.30; under the proposed 9.9 bps asset-based fee, the charge would be reduced by 20 percent, down to $9.90. On the opposite spectrum would be the flat $29 for everyone, regardless of the account balance: 66 percent of the low-balance accounts would experience an increase, while 33 percent would get a decrease of fee.

Ms. Buonfiglio highlighted the option recommended by the staff: a hybrid fee of $12.00 per year plus 5.9 basis points ("bps") asset-based fee, applied to each account. This option involves an increase of fees to 53 percent of the population; however, 47 percent would experience a decrease in the range of 3 to 48 percent.

Ms. Buonfiglio noted the importance of having a reliable cash-out strategy for small balance, terminated accounts. Regardless of the fee structure decision, the plan should implement the cash-out strategy for balances of $1,000.00 or less, which is about 22,000 accounts in the plans. The action would be communicated to the impacted members (and Bailey-vested class of members, in particular) and the funds sent back to them. The staff will present a proposed plan amendment during the Board meeting in December 2015 concerning the cash-out strategy.

Mr. Burns inquired whether there was any difference in the cost of recordkeeping a particular account based on the balance of the account. Ms. Buonfiglio replied that there was none: it is the same cost, regardless of the balance.

Mr. Toole requested that each Board member briefly state their preference for the new fee structure and present the rationale behind their respective choice.

Mr. Gray stated that his decision-making was really based on the notion of transparency and fairness, and to act in the best interest of the plans. Mr. Grey stated that in his opinion, a flat-fee achieves all of these objectives. Mr. Gray reiterated that the participation in the plans is purely voluntary and it is reasonable for a participant to expect that there is an annual cost associated with such participation. Mr. Gray also noted that the Board should be mindful of near-retirees who most likely have the larger account balances transitioning to fixed income, and it would not be fair for this specific member population to subsidize small balance accounts, or cover the cost of account administration for inactive participants. Mr. Gray also considered the fact that the account balance does not impact the cost of servicing an account. He stated that a flat $29.00 fee would be his choice.

Mr. Orr was next to state his opinion. He said that he differed from Mr. Gray. He said that if the plans were just now starting from scratch, then he would agree that a flat-fee probably made the most sense, but said the reality is that the plans do currently have an asset-based fee and changing to a flat-fee would disrupt the status quo too much and cause a fee increase on too many participants. Mr. Orr noted that the plans have already received a significant reduction on the recordkeeping fee in this latest RFP process, and this reduction does in fact gives a fee decrease to every member from the fee they currently pay. He felt that it would be difficult to explain the change in status quo to the members under these circumstances, and to justify the change being equitable. Mr. Orr stated that the plans should charge the new rate of a 9.9 basis point fee, with no flat-fee component.

Mr. Hamilton said he would support the combination fee of $12.00 and 5.9 bps, noting that this seemed fair to him regardless of the account balance, and that every member should pay some sort of a percentage of the assets under management. He also noted that he was not aware of any type of investment account where there is not some sort of a basis point charge to manage the money.

Ms. Baran stated that she gave the matter a great deal of thought and also discussed it with colleagues during the NAGDCA conference. In her opinion, the flat-fee of $29.00 per year is still the most fair, transparent and responsible choice. Ms. Baran stated that she could not justify having 50 percent of members subsidizing the rest of the population which, in the long run, would reduce their own retirement readiness score. In Ms. Baran's opinion, the recordkeeping charge is a fixed cost for fixed services, not linked to account size; consequently, the most equitable action to take would be to approve the flat $29.00 fee.

Mr. Burns pointed out that the actual cost of servicing each account is a fixed amount. He stated he would be unable to make an argument for charging large balance account members more than the actual cost. He also noted that in the current structure, accounts below the $1,000 threshold are heavily subsidized and he cannot make an argument that he has a fiduciary duty to do so. He stated that his recommendation would be the flat $29.00 fee.

Mr. Lewis agreed that if the plans were hypothetically in the implementation phase today, his preference would be the $29.00 fee. He noted, however, that this is not the case and that it is a difficult direct transition from asset-based fee to flat-fee. Mr. Lewis said he would support either of the two combination fees, of $12.00 and 5.9 bps or $16.00 and 4.5 bps, respectively.

Ms. Cochran stated that she appreciated the fact that a large part of the plans' population will be impacted, no matter the decision. Ms. Cochran stated her view of the pros and cons of each option with the goal of simplicity, transparency and the retirement readiness in mind and, in her opinion, the flat $29.00 fee is the best option with regard to attaining these goals. She also noted that there is no evidence that the members with low account balances in the plans' are not actually saving for retirement somewhere else and that the Board cannot justify asking those who are saving to subsidize those who do not. She pointed out that cost associated with the account servicing may in fact become an additional incentive to save more for some members. Ms. Cochran's choice is the flat $29.00 fee.

The Chair noted that fee restructuring can be also used as an educational opportunity.

Ms. Cece then read the following flat-fee potential motion for the Board's consideration:
"So moved that the Supplemental Retirement Board of Trustees approve a per account fee of $29.00 per year be charged for recordkeeping and communication services in the NC 401(k) Plan and the NC 457 Plan. The fee will be assessed on a quarterly basis and the quarterly fee will be the lesser of $7.25 or 100 percent of the participant's account balance."

Mr. Burns stated that he needed further clarification regarding the small balance account of $1,000 or less, and Ms. Cece replied that a separate motion has been prepared for this action item. Mr. Burns requested for the motion to be made first and Ms. Cece read accordingly:
"It is also so moved that the fee will be limited to no more than the participant's account balance, and that the staff of the Department of State Treasurer shall pursue a cash-out procedure by which terminated participants with less than $1,000.00 balance in the plans will be cashed out of the plans and monies returned directly to the participants. This cash-out procedure will take place as soon as is practicable and is contingent upon an amendment of the plan documents."

Mr. Burns made this motion, and Mr. Gray seconded.

After briefly speaking with Mike McCann outside of the official Board meeting, Mr. Toole informed the Board that the cash-out of approximately 22,000 participants would impact the flat fee of $29.00 and increase it by $2.10 per participant. If the cash-out strategy were to be approved, the annual recordkeeping fee would be $31.10 per account instead of $29.00.

Mr. McCann noted the increased fee under the remaining two scenarios under the Board's recently voted cash-out provision. Under a hybrid fee structure, the fee increase would amount to $.40 of the flat-fee portion above what was originally quoted. In the event the Board chose to remain in the current asset based option there would be no additional cost increase to participants if the cash-out of $1,000 balances occurred. Ms. Cece added that fee structure can be amended at any time during the contract duration.

Mr. Toole asked the Board members whether the new information changes their respective positions on the cash-out motion and whether the motion was still on the table. Mr. Burns confirmed that he still wanted to so move on the cash-out motion, and Mr. Gray seconded. The motion passed unanimously.

Ms. Cece then read an updated version of the flat-fee motion:

"So moved that the Supplemental Retirement Board of Trustees approve a per account fee of $31.10 per year be charged for recordkeeping and communication services in the NC 401(k) Plan and the NC 457 Plan. The fee will be assessed on a quarterly basis."

Mr. Gray so moved, and Ms. Baran seconded. Ms. Baran, Ms. Cochran, Mr. Gray and Mr. Burns voted in favor and Mr. Orr, Ms. Cowell, Mr. Hamilton and Mr. Lewis voted against the motion. The motion failed to pass.

Ms. Cece reminded everyone that five votes are needed for a motion to carry, and if any motion to change the fee structure fails, the plans' will continue operating under the existing asset-based fee structure.

Ms. Cece then presented a hybrid-fee potential motion for the Board's consideration:

"So moved that the Supplemental Retirement Board of Trustees approve a combination fee be charged to participants for recordkeeping and communication services in the NC 401(k) and the NC 457 Plans. The annual fee per account will be a flat fee of $12.40 plus an asset-based fee of 5.9 basis points. The fee will be assessed quarterly."

The Chair so moved, and Mr. Hamilton seconded. Ms. Cowell, Mr. Hamilton, Mr. Lewis and Mr. Gray voted in favor and Mr. Orr, Mr. Burns, Ms. Baran and Ms. Cochran voted against the motion. Motion failed to pass.

Ms. Cece asked whether any member wanted to make another motion. Ms. Cochran inquired if the fee structure issue can be revisited at a later date. Mr. Toole replied that if the Board wanted to take this action in the context of the new recordkeeper contract and the plans' restructuring, the action must be taken today due to a the requirement of a communication being sent to plan participants 30-60 days prior to such change.

Mr. Gray moved: the Supplemental Retirement Board of Trustees approve a per account fee of $31.10 per year be charged for recordkeeping and communication services in the NC 401(k) Plan and the NC 457 Plan, and that the fee will be assessed on a quarterly basis.

Ms. Baran seconded and the motion carried on a vote of five ayes and three nays. Ms. Cowell, Mr. Gray, Ms. Baran, Mr. Burns and Ms. Cochran voted in favor. Mr. Orr, Mr. Hamilton and Mr. Lewis voted against.

AGENDA ITEM - SUBCOMMITTEE MEMBERS QUESTIONS/COMMENTS

Ms. Cochran thanked the staff for their involvement and congratulated Mr. Gray on his new position with the Department of Transportation.

Several members of the Board remarked that there was a good discussion on the change in fee structure.

Ms. Baran thanked the Treasurer for her leadership and Mr. Gray thanked the staff.

AGENDA ITEM – PUBLIC COMMENT

No public comments were offered.

Motion to adjourn was made by acclamation. The board adjourned at 5:03 p.m.

Secretary