

MINUTES
BOARD OF TRUSTEES
OF THE TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM
July 17, 2014

The regular quarterly meeting of the Board of Trustees was called to order at 9:30 a.m., July 17, 2014, by the Chair, State Treasurer Janet Cowell. The meeting was held in the North Carolina Museum of Natural Sciences' Nature Research Center Conference Facility at 111 West Jones Street, in Raleigh.

Members Present

The Board members present were: Janet Cowell, John Aneralla, Lentz Brewer, Jack Brooks, Loris Colclough, William Grey, Alberta Hall, Michael Jacobs, Michael Mebane, and LouAnn Phillips on behalf of Superintendent June Atkinson.

Members Absent

Members absent were: Van Dowdy and Greg Grantham.

Guests Present

The guests attending were: Robert Curran, with the Attorney General's Office; Jan Hartford, with CEM Benchmarking; Michael McCann, with Prudential Retirement; and, Larry Langer and Michael Ribble, with Buck Consultants.

Department of State Treasurer Staff Present

The staff members present were: Steve Toole, Mary Buonfiglio, Jaclyn Goldsmith, Erica Hinton, Fran Lawrence, Schorr Johnson, Lisa Page, Rosita Sabrosso-Rennick, Kevin SigRist, Anthony Solari, Christina Strickland, and Sam Watts.

Conflicts of Interest

The Chair asked, pursuant to the ethics rules, about conflicts of interest of Board Members. There were no ethics conflicts identified by the Board members.

Approval of the Minutes

It was moved by Loris Colclough, seconded by Lentz Brewer, and carried that the minutes of the Board meeting held on April 17, 2014, be approved.

Mission, Vision, and Top-Level Metrics Results for 2013

The Chair recognized Steve Toole, Director of the Retirement Systems Division (RSD), to give a presentation on RSD's Mission, Vision, and Top-Level Metrics for 2013 and to present the goals for fiscal year 2014. Mr. Toole reviewed the Mission and Vision Statement with the Board. He presented the 2013 Top-Level Metric results, stating that goals were reached in

Retirement Readiness by exceeding the goal of 60 percent, with 67.56 percent of active members are on track to replace 80 percent of their income at age 62. Member Satisfaction results scored 4.41, with a goal of 4.0. Employee Engagement remains unchanged, pending the state's selection of a new vendor to perform the engagement survey. He updated the Board on the Department of State Treasurer's continued efforts to uphold the fiscal integrity of the North Carolina Retirement System. As a result of the Fraud, Waste and Abuse Review, the Department recently requested that the North Carolina General Assembly create new positions for a compliance team. During this Short Session of the General Assembly, the Department is also pursuing legislation that would establish a contribution based benefit cap that would provide authority for the Department to prevent losses to the Retirement System caused by extreme cases of pension spiking.

Mr. Toole introduced Michael McCann, with Prudential Retirement, to give a presentation on the Financial Education Study conducted by Prudential Retirement. Mr. McCann gave an introduction on the Annual Benefits Statement that is offered annually to active North Carolina employees and informs active employees on their retirement readiness. Mr. McCann reported that of the 393,000 Annual Benefits Statements generated last year, 185,000 of those members also participated in a 401(k) and 457 Plan, estimating that approximately 47 percent of contributing active members of the defined benefit plan also are participating in the Supplemental Retirement Plans. Mr. McCann presented that of the members participating in either a 401(k) or 457 plan, 77 percent of those members were on their way to securing a retirement income of 80 percent of their employment income prior to retirement, versus the members who only contributed to the defined benefit plan and average an income replacement rate of 67 percent. Mr. McCann presented that Prudential Retirement conducted a Financial Education Study to evaluate individual's views on their financial future. When participants were asked about their financial goals related to retirement, it was found that participants in the study cared most about not running out of money in retirement, followed by affordable health care in retirement and maintaining a desired lifestyle in retirement. Participants in North Carolina rated these financial goals as more highly than nationwide results. He stated that only 33 percent of participants were confident about achieving the goal of not running out of money in retirement. Mr. McCann further revealed that the study found that males were more confident of that goal than females, retirees were more confident than active employees ten to thirty years away from retirement, and public employees were more confident than private employees. Mr. McCann stated that more than a fifth of working age and retired North Carolina residents lack basic knowledge of investing and saving for retirement, and many do not have a good grasp of the fundamental concepts of economics and finance. Treasurer Cowell mentioned that the department is currently seeking to hire a staff member that will lead the department's efforts on advancing financial literacy across North Carolina.

Lastly, Mr. Toole announced the 2014 Top Level Metrics Goals:

- Retirement Readiness goal of 70 percent of all active North Carolina public employees at age 62 are on track to replace 80 percent of their pre-retirement income
- Member Satisfaction goal of 4.25 out of 5.0
- Employee Engagement goal of 3.05 out of 4.0
- Fiscal Integrity: to expand the Compliance team

Michael Jacobs asked if the selection of the financial literacy staff person will participate in the Financial Literacy Counsel. Treasurer Cowell answered Mr. Jacobs' question with confirmation that the hired staff member will participate.

2014 Retirement Systems Division Legislative Update

The Chair recognized Anthony Solari to give a legislative update to the Board. Mr. Solari announced that House Bill 1195: "Fiscal Integrity/Pension Spiking Prevention Act of 2014" was reported favorably by the Senate on the morning of the Board meeting. Mr. Solari highlighted some of the key provisions in the bill, which are the contribution based benefit cap, return of contributions with accumulated interest for service under five years, and the restoration of the five year vesting period from the current ten years. Mr. Solari reported that House Bill 1194: "Retirement Administrative Changes Act of 2014" and House Bill 1193: "Retirement Technical Changes Act of 2014" also passed out of committee favorably on the morning of the Board meeting.

Mr. Solari also reported on the State Budget bill and stated that the Department was confident that the Annual Required Contribution (ARC) would be met for the Retirement Systems and state system retirees would most likely receive a cost of living adjustment (COLA). Mr. Solari stated that the only system that did not receive the full appropriation requested by the Board was the National Guard Pension Fund; however the ARC was still met for that pension fund (not the additional amount that was requested by the Board to increase the funded ratio).

Treasurer Cowell announced that the Department is anticipating that several critical issues are likely to be debated during the upcoming 2015 Long Session of the General Assembly, including investment governance models and defined benefit vs. defined contribution plan options. Treasurer Cowell thanked Anthony Solari, Sam Watts, Steve Toole and his staff for the great work during this Session of the General Assembly.

Mr. Solari and Treasurer Cowell both commended Mr. William C. McGee for his tremendous work during the past two legislative sessions and announced that Mr. McGee's last day working with the Department was the day of the meeting. The guests, staff members and Board all applauded Mr. McGee for all his work in support of the Department.

Update from Michael Mebane and John Aneralla on Investment Advisory Committee Meetings

The Chair recognized John Aneralla and Michael Mebane for an update on the Investment Advisory Committee (IAC) Meetings. Mr. Aneralla stated that he and Mr. Mebane were appointed to the IAC and they attended their first meeting on May 22, 2014. Mr. Aneralla explained that they both only serve an advisory role on the Committee and do not vote on individual investments, managers or asset allocations. He stated that during the meeting and the orientation, it was both apparent to him and Mr. Mebane that the individuals that worked in the Investment Management Division were conscientious and there was a strong team atmosphere. He commented on the leanness of the organization and the pride the division has in being part of one of the best run state pension systems in the country. At the IAC meeting, Mr. Aneralla and Mr. Mebane also observed a level of frustration with the constant challenge of balancing the inflexibility of the statute governing investment allocations with the state legislature's desire for

oversight. Lastly, Mr. Aneralla stated that he and Mr. Mebane both liked the general direction the portfolio is moving under the leadership of Mr. SigRist and commented that beneficiaries and contributors should feel confident in the professionalism and diligence of the individuals managing their assets.

Mr. Mebane stated that there has been considerable press coverage on the transparency of the Investment Management's operations primarily related to alternative investments, and that the IAC was thoroughly briefed on the issue during the IAC meeting on May 22, 2014. Mr. Mebane explained that two competing bills were introduced during this Short Session of the General Assembly, House Bill 1237: "Retirement Investment Accountability" sponsored by Tim Moore with support of State Employees Association of North Carolina (SEANC) and House Bill 1209, with the same title, sponsored by Representative Nelson Dollar who participated in the Investment Fiduciary Governance Commission (IFGC) that Treasurer Cowell convened this year. Mr. Mebane stated that House Bill 1237 did not emerge from committee. He mentioned that the Investment Management Division helped prepare and supported House Bill 1209, which would ensure transparency and accountability in the investment operations over the long-term, while protecting the integrity of the contracts signed with private-sector partners. He explained that the bill made it through the House Personnel Committee and was then referred to Appropriations, and will not likely be acted upon in the Short Session.

Presentation on the Report prepared by CEM Benchmarking on the Defined Benefit Administration Benchmarking Analysis

The Chair recognized Jan Hartford, with CEM Benchmarking, to give a presentation on the Pension Administration Benchmarking results for fiscal year 2013. Ms. Hartford reviewed CEM's universe of participants in the study and listed systems comparable to North Carolina. Ms. Hartford stated that the North Carolina Retirement System's total pension administration cost was \$23 per active member and annuitant, with a peer average of \$87 per active member and annuitant. This cost was the lowest in CEM's global universe. The results were based on economies of scale, transactions per member (workload), transactions per full time employee (FTE), cost per FTE, third party costs, and back-office activity costs. The most significant factor impacting the administrative cost was that North Carolina had lower costs per FTE, based on salary, benefits, building, HR and IT desktop. It was also determined that North Carolina had higher economies of scale of 66 percent more members than the peer average.

Ms. Hartford discussed the analysis of front office transactions and explained that the simplicity of the North Carolina Retirement System's plans may allow for less confusion by members than the plans of other systems. Therefore, members have less need for front office transactions because the North Carolina System's plans are clear to the members. Mr. Toole stated that he agreed with the effect of the plan design and the simplicity of options in North Carolina. The Chair stated that the next legislative session will focus on the future of the current defined benefit plan and could potentially lead to an overhaul of the current retirement system.

Ms. Hartford presented the service scores, stating that RSD's score was 69/100, which was below the peer median of 73. She stated that the main factor that contributed to the lower score was an increase in call center volume due to health insurance variations that occurred at the end of 2013. She discussed how NC Retirement System's online capabilities compared to other plans and stated that NC Retirement System fared similar to its peers in most respects. She

mentioned that applying for retirement online was an online capability being offered by 56 percent of other plans and not currently offered by RSD.

Ms. Hartford concluded her presentation by discussing some trends in pension administration in terms of engaging younger members through social media, videos for member education, and targeting members based on age, life cycle and preferences. Finally, Ms. Hartford noted the comprehensive Annual Benefits Statement is an industry leading practice.

Approval of Post-Disability Benefit Increase for Disability Recipients

Mr. Toole presented the fiscal year 2015 Post-Disability Benefit Increase for Disability Recipients. Since the 2014 state budget may grant a salary increase for active employees, effective July 1, 2014, it was recommended by the Retirement Systems Division that the Board authorize the Division to pay the benefit increase to state disability recipients equal to the percentage increase afforded to most active state employees in the state budget. It was moved by John Aneralla, seconded by Lentz Brewer, and carried by the Board that the Retirement Systems Division shall increase the compensation upon which state disability benefits are based by an equivalent to the salary increase for most state employees effective, July 1, 2014.

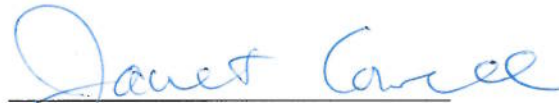
Director's Report

The Chair recognized Mr. Toole for the Director's Update. Mr. Toole gave an update on operations and stated that the number of visitors has increased by 4.8 percent from last year and the incoming call volume has increased by 19.1 percent from prior year. Call Center results have improved as the Division has added numerous temporary staff to the call center team. Mr. Toole stated that 66 percent of all calls are being answered in 20 seconds or less, and the abandonment rate is back down to an acceptable level of 5 percent. Mr. Toole also gave an update on the progress being made in enrolling schools into the 403(b) program to allow teachers to participate in the state sponsored plan. Mr. Toole reviewed the Funding Policy Administrative Memorandum with the Board. Lastly, Mr. Toole gave an update on the Request for Proposals (RFP) for the Retiree Supplemental Insurance and the partnership with N.C. Flex in this process.

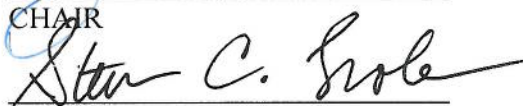
Mr. Toole reminded the Board that October is typically the longest meeting of the year, since the actuarial valuations for all of the plans will be presented to the Board. He also noted that in January, the Board will then discuss alternatives based on the assumptions and results of the valuations.

Adjournment

There being no further business and by unanimous vote, the meeting adjourned at 11:30 a.m.



CHAIR



SECRETARY