NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

MINUTES OF MEETING
MARCH 6, 2013

Time and Location: The North Carolina Supplemental Retirement Board of Trustees (the "Board") met on Wednesday, March 6, 2013 in the Dawson Conference Room of the Albemarle Building, 325 North Salisbury Street, Raleigh, North Carolina.

Members Present: The following members attended in person: Jay Chaudhuri (General Counsel of Department of State Treasurer, and Chair of the meeting as designee of the State Treasurer), Kathy Crooke, Elizabeth "Libby" George, Mona Keech and Robert Powell.

Members Absent: Charles Leedy, Melinda Baran and Clay Thorp.

Staff Present: The following Department of State Treasurer staff members were present: Steve Toole, Mary Buonfiglio, Blake Thomas, Kevin SigRist, William Hockett, Julia Vail, Rekha Krishnan, Lisa Page and Jaclyn Goldsmith.

Guests Present: Rob Luciani, Tim Bryan, Travis Swartwood, Ann Cashman, Lisa Belgrove from Prudential Retirement; Bruce Corcoran, Jamie Summerlin, Aaron Knode from TIAA-CREF; Jay Love from Mercer Investment Consulting; Robert Curran and Shannon Conley from the Attorney General's Office; Robert Slade (member of public); Scott Dauenhauer (SST Benefits Consulting, by phone).

AGENDA ITEM – WELCOME AND INTRODUCTIONS

The meeting was called to order at approximately 9:05 am. Kevin SigRist was introduced as the new Chief Investment Officer for the Department of State Treasurer's Investment Management Division. Rekha Krishnan was introduced as the new Operations Analyst for the Supplemental Retirement Plans. It was announced that Dalip Awasthi is no longer on the Board due to time commitments. The Chair requested public comments be withheld until the end of the meeting.

AGENDA ITEM – ETHICS AWARENESS & 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 FROM DECEMBER 5, 2012 BOARD MEETING

A motion was made by Mr. Powell to approve the minutes from the December 5, 2012 Board Meeting. Ms. Crooke seconded the motion, which was unanimously approved.

AGENDA ITEM – APPOINT MEMBERS TO THE 2013 AUDIT SUBCOMMITTEE

A motion was made by Ms. Keech to appoint Mr. Powell and Ms. Crooke as the Board's Audit Subcommittee. Ms. George seconded the motion, which was unanimously approved.

AGENDA ITEM – INVESTMENT SUBCOMMITTEE MEETING MINUTES

There was not a quorum of Investment Subcommittee members to approve the minutes from the February 14, 2013 meeting. Approval of those minutes was postponed to the following meeting of the Investment Subcommittee.

AGENDA ITEM – 403(b) TPA SUBCOMMITTEE RECOMMENDATION

Investment Policy Statement

Ms. Buonfiglio provided the 403(b) program's proposed Investment Policy Statement ("IPS"). Ms. Buonfiglio stated that the governing theme was to craft a document that was broadly consistent with the existing IPS for both the 401(k) & 457 Plans and would provide the guidance necessary to create the initial 403(b) fund lineup, knowing that in the next 12 months there will be a full review of the IPS for all Plans. Staff worked with Board members Leedy and George, and with SST Benefits Consultant Scott Dauenhauer, to develop the 403(b) IPS. Ms. Buonfiglio reviewed the document in its entirety with the Board, pointing out particular features of the text.

After Ms. Buonfiglio's review, Mr. Toole publicly thanked Mr. Dauenhauer and noted that there was tremendous consistency between this IPS and the 401(k) and 457 IPS documents. Mr. Toole informed the Board that Groom Law Group had been consulted about developing a plan for investment monitoring during the interim period while there is no investment consultant in place.

Ms. Keech made a motion for approval of the 403(b) IPS. Ms. Crooke seconded the motion, and the Board unanimously approved the 403(b) IPS.

Investment Solutions Offering

Ms. Buonfiglio reviewed a proposed 403(b) initial fund lineup, which was reviewed in the previous meeting of the Investment Subcommittee and developed over several meetings with a workgroup consisting of Investment Subcommittee members, staff, representatives from TIAA-CREF, and Scott Dauenhauer. The Board was provided with the criteria for inclusion in the fund lineup. The workgroup reviewed the strategy, asset class, capitalization, style, fees and expenses, and geographic region of each investment option, along with data from Morningstar and other relevant sources, seeking an appropriate fit. Other due diligence conducted on the investment options included review of fund performance, strategy, management changes, and the presence or absence of excessive personnel turnover or organizational changes.

Mr. Dauenhauer commented that they sought to determine whether the existing 401(k) and 457 investments had equivalent mutual fund options suitable for inclusion in a 403(b) program. They found that the 401(k) and 457 investment managers' funds did not exist or were much more expensive in the mutual fund format.

An overarching goal of the process was to ensure that participants had asset classes available to them at a very low cost basis. The committee mandated that all revenue-sharing fees would be paid back to the participants, not the Plan's recordkeeper. As a result, TIAA-CREF's administrative fee will be reduced by any 12b-1 revenue-sharing fee.

Ms. Buonfiglio noted that missing from the present asset lineup is the fixed / stable value solution. Ms. Buonfiglio stated that several offerings were reviewed and are still being discussed. The Board will have the opportunity at an upcoming regular or special meeting to select the fixed / stable value solution that will be used in the 403(b) program.

Ms. Keech made a motion to approve the 403(b) investment lineup. Ms. George seconded the motion, and the Board unanimously approved the 403(b) investment lineup.

AGENDA ITEM – GOALMAKER GLIDEPATH REVIEW

Mr. Chaudhuri introduced the review by saying that Mr. SigRist will present a letter of reasonableness at the June 5th meeting, and that Mr. Love's presentation is simply a review.

Jay Love from Mercer stated that the investment subcommittee has been working on this recommendation for several months. Historically, the Board of Trustees has periodically reviewed the asset allocation weights utilized in the Goalmaker service every 12-18 months. Mercer, on behalf of the Board, received Prudential's standard asset allocation weights as determined by Morningstar. The Board then makes adjustments based on the North Carolina Plan structure.

In this Goalmaker review, the Board would also consider how to incorporate into Goalmaker the PIMCO Inflation Response Multi-Asset Fund, a new addition to the Plans' investment offering lineup approved in the December 5, 2012 Board of Trustees meeting.

The first segment of Mr. Love's presentation showed the asset allocation glidepath to retirement. The presentation reviewed the glidepath "to retirement" vs. "through retirement." He went on to demonstrate how a "to retirement" glidepath is designed primarily to build savings up to an individual's target retirement date, as opposed to being designed to help investors save "through retirement."

Mercer reviewed the GoalMaker standard asset allocation weights provided by Morningstar and presented a set of adjustments developed by Mercer. Mr. Love noted that Morningstar's 2013 standard glidepath matches essentially what the Board of Trustees developed and adopted in 2010.

Mr. Love turned to the incorporation of the Inflation Response fund into Goalmaker. Over the last 10 years, the dollar has lost about 40% of its purchasing power. Mr. Love stated the importance of inflation protection, particularly for individuals approaching or in retirement. Mr. Love compared Morningstar's standard glidepaths for portfolios with and without an inflation fund. Morningstar suggests higher allocations to inflation-sensitive funds for people close to retirement; Mercer disagrees, believing that it is appropriate to protect people close to retirement as much as people further from retirement.

Mr. Love presented to the Board the details of Mercer's recommended glidepath enhancements, discussing expected return and risk for each bracket (conservative, moderate, aggressive) across all glidepath portfolios. Mercer's proposed asset allocation reflects an increased weighting in active managers in the Small and Mid-Cap area. In addition, Mr. Love recommends an increase in the allocation to the Global Equity Fund and a decrease in the International Equity Fund. A global manager has the ability to pick stocks from any area of the globe, tilted toward or away from the United States as appropriate. In contrast, an international fund picks stocks exclusively from outside the United States. By increasing the global allocation, greater flexibility will be garnered to obtain superior stock selection.

Mr. Toole stated that he is interested in getting the Investment Management Division's approval on the approach, but that retirement staff is generally supportive. He commended Mercer on their work. The Chair noted that staff will continue to work with Prudential to add two features to GoalMaker: (1) additional points along the glide path, and (2) an income fund for people in retirement. Those will not be ready for the June meeting, but are in development.

Ms. George made a motion to accept the report, but to defer any action on the recommendations made in the report. Ms. Crooke seconded the motion. The Board unanimously passed the motion to accept the report.

AGENDA ITEM – INVESTMENT CONSULTANT RFP UPDATE

Mr. Toole started his presentation by stating that when considering procurement for the Board's investment consultant, the overall question is plan design. Mr. Toole presented a proposal for a linked series of procurements over the next 30 months, stating that the proposal would better manage fiduciary liability for the Board and staff and increase transparency.

Mr. Toole noted that in the current structure, we are in a bundled service environment with Prudential, which is not inherently good or bad, but in order to increase transparency, the Plans need to be unbundled. What may have met the needs of the Plans 5 or 10 years ago may not be the best alternative today, with a $7 billion plan.

Mr. Toole reviewed the current plan structure:

- Prudential implements the Board's decision in the selection of managers, but Prudential, not the Board, is ultimately the contracting party with the Plans' investment managers.
- Prudential also contracts with State Street, the custodian.
- The assets are held on Prudential's books in a separate account.

Under this structure, if Prudential failed as a business, the assets would come back to the Plans' members, but it would be a long process with a reduction in liquidity during that period.

Other key issues are fees and flexibility. In the current bundled structure, fees are not as transparent as one would like. Also, if the custodian was not providing optimal service, replacing them would be complicated because the Board does not have a direct contractual link with State Street.

Mr. Toole then described the Investment Consultant structure today by referencing (as frameworks for understanding the issues rather than as governing law for these non-ERISA plans) ERISA Sec. 3(21), which describes a fiduciary consulting relationship, and ERISA Sec. 3(28), which describes a delegated fiduciary investment manager environment. Ms. Buonfiglio further compared the duties of a 3(21) fiduciary to that of a 3(38) fiduciary. A fiduciary under the 3(38) framework would be distinguished by the fact that it would have full discretion over the management of the portfolios, including the selection of investment managers, as long as the fiduciary operated within the parameters established by the Board. In addition, Ms. Buonfiglio stated that a 3(38) fiduciary would be a named fiduciary to the Board; as such, it would bring one more named fiduciary into the Plans. A 3(38) investment manager and the board would determine the strategic asset allocation and investment structure of the Plans. The consultant would then be tasked with implementing the defined structure.

Staff interviewed several other states' defined contribution staff and interviewed several investment consultant firms to understand the advantages and disadvantages to utilizing a 3(38) investment consultant and transitioning to an unbundled structure for the North Carolina Supplemental Retirement Plans. For plans of the size of North Carolina, it is common to see an unbundled structure. The 3(38) Investment Consultant would negotiate contracts, communicate, manage and monitor the Investment Policy Statement and review investment guidelines supplied by the managers. The plans would benefit from the negotiating practices and flexibility of the 3(38) Investment Consultant including a "Most Favored Nation" pricing structure. In addition, unbundling the Plans' service provider structure is recommended because on a net basis the plans would save money, improve compliance and improve transparency.

Staff also recommended utilizing a master trust structure as opposed to the variable annuity structure utilized today. Assets would be held in the name of the trust and thereby would create greater clarity and liquidity in the event of a financial crisis.

Mr. Powell asked which entity -- the Supplemental Retirement Plans, the Department of State Treasurer, or the State of North Carolina -- would be engaging the various contractors. Mr. Toole responded by stating that the Department of State Treasurer and Supplemental Retirement Plans would be signing together through the same agent.

Mr. Powell asked what Request for Proposals would have to be developed. In response, Mr. Toole described a recommended process.

1) Investment Consultant Procurement (2013): The current structure of the Investment Consultant role would change on December 18, 2015. A 3(21) structure would exist until that date. After December 18, 2015, a 3(38) structure would be in place. The Investment Consultant would have the duty to support and advise, but not make decisions on behalf of, the Board of Trustees in the selection of the each of the elements below – the recordkeeper, custodian, trust administrator and transition manager.

2) Recordkeeper Procurement (2013-15): The current agreement with Prudential is in place until December 18, 2015. The Supplemental Retirement Plans would issue an RFP in advance of that date for a recordkeeper under an unbundled structure.

3) Custodian, Trust Administrator and Transition Manager Procurements: Procurement for all three of these roles would occur simultaneously, with the expectation that the new service provider structure will be in place by January 2016.

4) Investment Managers: Staff do not anticipate that there would be any changes to the Plans' slate of investment managers as a result of this process.

Ms. Crooke asked if the 3(38) structure is equivalent to a manager of managers approach. Mr. Toole stated that is the case and that the 3(38) Investment Consultant would report back to the Investment Subcommittee and full Board, just as we have now.

Blake Thomas reiterated the technical difference between investment consultants under 3(21) and 3(38) frameworks. A 3(38) consultant/manager, unlike a 3(21) consultant, has the power to choose the investment providers for the Plans. The consultant is charged, however, with fulfilling its responsibilities in accordance with the parameters established by the Board of Trustees. To reject the advice of the Board of Trustees would be terms for the consultant's termination.

Under the new proposed RFP, fees would be probably comparable to what we have today until the 2015 changeover, when fees would increase. Mr. Toole went on to explain that the fees to the consultant in a 3(38) structure will be 4-5 times what we have today. The increase in consulting fees will be offset, it is believed, by savings on investment manager fees. Mercer has more buying power than the North Carolina Plans, and Mercer has stated that they believe the Plans' manager fees could be considerably less in a 3(38) delegated environment. Mr. Toole noted that the Florida Retirement System unbundled its service provider structure. It is time-consuming, but it can be done.

Mr. Chaudhuri asked Mr. Love how they address conflicts of interest when playing this role as investment consultant. Mr. Love stated that from Mercer's view, they don't have any conflicts, because they don't advise any money managers. One place where there would be cross-over is recordkeeping. As a result, Mr. Love noted the Board would probably not allow the winning investment consultant to be a bidder in the RFP for the recordkeeping contract beginning in December 2015.

Ms. George stated that an unbundled structure seems to be the way that things are set up in many foundations and endowments. She further stated that the revised structure appeared to be a plan that would clarify the roles with all the players in the system, and she supported it while understanding the pain of going through it.

Mr. Powell stated that he is in support of it and thought it was the right way to go. He noted, however, that this was a major structural change, and there were several Board members absent from the meeting. Furthermore, some Board members would roll off the Board on July 1. Mr. Powell suggested that the Board delay action so that members not present at the meeting, along with any new members appointed in the interim, could hear the information presented at the session. Mr. Powell stated that he would vote in favor of the recommended investment consultant structure if a motion is made.

Ms. Keech agreed with Mr. Powell that she would like to have the input of the new members as well, since they will be the ones going through the process of unbundling the service providers. Ms. Crooke suggested that perhaps there could be a meeting with the three Board members that were not present, to make certain that they agree with the recommendation, then have a conference call and vote.

It was agreed that staff will undertake conference calls or meetings with the three Board members who were not present, in a reasonable time.

AGENDA ITEM – 4TH QUARTER INVESTMENT PERFORMANCE

Jay Love presented the 4th quarter investment performance report. He stated that the 4th quarter was challenging for equities but for the year, equities did terrific. Fixed income performance was in line with initial expectations for interest rates for the year. People were looking for more aggressive investments; that sent equities higher.

Each fund in the Plans' lineup was ahead of the benchmark except International Equity. Most are in the top 20% of the relevant universe tracked by Mercer. Turning to the performance of individual managers within the Supplemental Retirement Plans' investment funds, it was noted that most managers exceeded their benchmarks substantially. Neuberger Berman notably underperformed; Mr. Love explained that it was hired to be a defensive manager, providing an offset to the greater sensitivity of the Sands Capital strategy. Mr. Love stated it was understandable why Neuberger Berman's performance was beneath the benchmark, and Mercer's opinion is that they are likely to turn things around. Having noted Mr. Love's report and the timeframe of underperformance by the manager, the Investment Subcommittee voted to put Neuberger Berman on watch. Mondrian is another manager that Mercer is watching very closely. Mondrian is not on watch, but its performance is poor enough that it will receive greater scrutiny in future investment reviews.

Mr. Love provided data on hypothetical returns for investments according to the GoalMaker strategies. (The returns are considered hypothetical because they reflect the investment performance that would have been earned if a participant's funds were invested in accordance with the asset allocation defined by the GoalMaker strategy over each of the defined time periods.) Based upon this assumption, the Goalmaker Funds are outperforming across the board relative to the benchmark.

AGENDA ITEM – ANNUAL PLAN REVIEW

Jay Love presented the Annual Plan Review. He stated that they are seeing less and less allocation to style funds (e.g., active value or active growth rather than one active fund). He directed the Board's attention to data indicating that the more options you have, the lower the participation rate in Defined Contribution plans. Plan sponsors generally are looking to reduce redundant investment choices.

Consistent with this concept, Mr. Love proposed merging the Large Cap Value and Large Cap Growth funds into a single Active Large Cap Equity fund, and merging Small / Mid Cap Value & Growth into a single Active Small / Mid Cap Equity Fund.

As part of the implementation of this idea, the Plan could add to the merged active funds managers with broad mandates to invest strategically. He recommends adding a new core manager with an approximate 17% share.

Mercer also suggests further consideration of spend-down investment structures. Providing this type of structure in the plan while maintaining a low-cost, sophisticated structure would be of benefit to the Plans' participants. The defined benefit transfer option is an attractive way to help participants spend down their retirement savings in a prudent low-cost fashion by managing the payout process.

Mr. Love continued his review with a discussion of service provider disclosures. He noted that new disclosures are being provided from service providers under new ERISA regulations. The North Carolina plans are not governed by ERISA, but the Board and participants may benefit from receiving these disclosures.

Mr. Love discussed a review of fees; in particular, he noted that the fees for Blackrock's passive management should be lowered. Mercer has already begun to work with Blackrock to negotiate a lower fee, and the State defined benefit plan's investment staff have partnered with the Supplemental Plans on this issue. Mr. Love had no issues or concerns with fees charged by other providers, including without limitation Stable Value fees. Mercer does not recommend providing a standalone emerging market option within the Plan's investment options, as this type of option adds to investment performance volatility substantially as demonstrated on slide 19 of the Mercer presentation.

Ms. Buonfiglio clarified the formal action taken by the Investment Subcommittee to place Neuberger Berman on the watch list. She stated that Mercer will address them specifically at each meeting. Ms. George and Ms. Buonfiglio discussed Neuberger's management changes and suboptimal performance.

AGENDA ITEM – 4TH QUARTER ADMINISTRATIVE REPORT

Tim Bryan from Prudential presented the 4th Quarter Administrative Report. He pointed out some changes to the report to better show trends. Due to time constraints he focused more on the year-to-date results. Mr. Bryan pointed out that in December 2009, there was 4.5 billion in total 401(k) plan assets; this number increased to 6.0 billion in December 2012. In December 2012, there were 231,051 members with an account balance. The 457 Plan had $713 million in December 2009 and increased to $912 million in December 2012. The membership in the 457 Plan also increased to 41,155 members with account balances. There was an 11.21% growth in the 401(k) plan assets due primarily to investment earnings.

Annual enrollments for 2009-2012 have been in a range of 12,000 to 14,000 new hire enrollments, with 2012 having 14,207. The percentage of new hires enrolled in the 401(k) in

2012 was 40%. Mr. Bryan noted that "Pseudo Enrollments" were 15.60 %. He explained that "Pseudo Enrollment" refers to the situation in which money comes in before the enrollment form comes in. He commented that people are generally enrolling by paper, but making contribution changes via the Internet.

Finally, Mr. Bryan stated that Goalmaker participation is quite high, with approximately 50% of participants utilizing this strategy.

AGENDA ITEM – 403(b) RIA STRUCTURE, COMPLIANCE STRUCTURE

Bruce Corcoran and James Summerlin from TIAA-CREF presented the advice model that will be utilized for the NC 403(b) fund. Participants will receive quality advice through TIAA-CREF via the telephone, online, and one-on-one. If they are willing to pay additional fees, they will have access to an independent registered investment advisor. Only the persons utilizing the independent advisor will pay for that service. They further explained that their website includes a Financial 360 tool which allows employees the ability to include all assets on a platform. The Board of Trustees as program sponsor has the ability to define (and change over time) a cap on fees, which gives control over fees charged to participants and the ability to monitor fees over time.

There was a brief change in the order of agenda item presentation due to time constraints.

AGENDA ITEM – HURRICANE SANDY RELIEF

As a follow up item from the December 5th board meeting, the Board agreed to vote on a motion made by Mr. Powell to finalize approval of the Hurricane Sandy 401(k) Plan Document Amendment. Ms. George seconded the Motion. The board unanimously passed the Amendment.

AGENDA ITEM – 403(b) RIA STRUCTURE, COMPLIANCE STRUCTURE (Resumed)

Mr. Corcoran and Mr. Summerlin of TIAA-CREF continued their presentation. They noted that they will report back regarding the regulatory compliance process but stated that about 70% of districts are using Third Party Administrators today to monitor compliance with IRS regulations.

AGENDA ITEM – DIRECTOR'S REPORT

Mr. Toole presented the Director's Report to the Board. He started by addressing the Administrative Reimbursement Account Refund. The 401(k) and 457 plans combined will refund approximately $8.2 million to over 275,000 participants within the next month.

Mr. Toole provided brief updates on a series of additional topics:

- On the topic of fiduciary liability insurance for Board members, the Retirement Service Division is partnering with the Department of Justice to update Department of Insurance bids and evaluate deductible levels. Legislation regarding fiduciary liability has been drafted and submitted to the General Assembly.

- The Transfer Benefit Option grew in 2012 in both dollars transferred (average $80,000.00 increased to $86,000.00) as well as the number of participants (132 increased to 152).
- The Supplemental Retirement Plan is below budget on a fiscal YTD basis, primarily due to pending invoices not yet posted.
- The Annual Benefits Statement is anticipated to be published in May with enhancements to calculation of the gap analysis and projected income streams, along with an enhanced focus on participants' asset allocation decisions.
- There are several pieces of pending legislation in the General Assembly regarding DC plans; these bills and proposed bills are being monitored.

AGENDA ITEM – BOARD QUESTIONS/COMMENTS

Mr. Powell inquired as to extending the audit contract with PWC, and made a motion to pursue extending the PWC contract for one year. Ms. Keech seconded the motion. Mr. Thomas explained that the State Auditor has taken the position that no audit contract should exceed three years total, which is the length of the current contract. No vote was taken on the motion.

There were no public comments. A motion to adjourn was made by Ms. Crooke and seconded by Mr. Powell. The motion passed unanimously, and the meeting adjourned at approximately 12:30 p.m.

Janet Cowell

CHAIR