

North Carolina Supplemental Retirement Plans Annual Review

FEBRUARY 2013



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Defined Contribution Trends

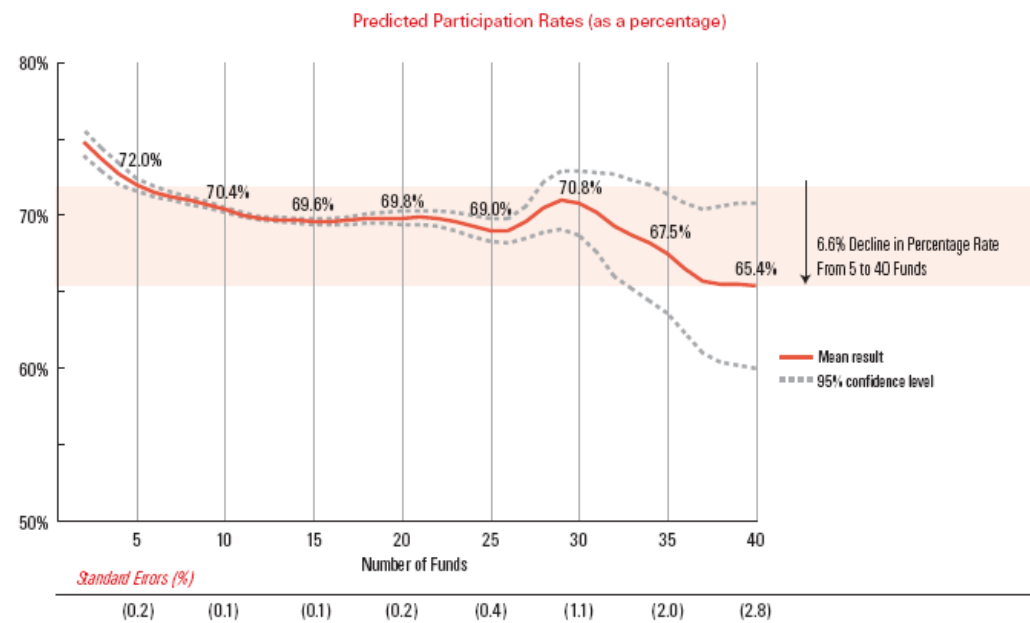
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Trends for Large Plan Sponsors

- Streamline number and types of investments offered
 - Combine style-specific (value/growth) choices for participants
 - Removes need to rebalance among styles
 - One fund choice that includes multiple underlying strategies across the style spectrum
- Focus on retirement income

Streamlining Investment Choices

- Research has shown that participants are neither good at making their own investment choices nor happy about this responsibility
- Limited participant understanding remains one of the most significant challenges for plan sponsors
- Plan sponsors are looking to:
 - Reduce redundant investment choices
 - Blend styles and managers
 - Lower risk for participants
- Offering limited options allows clear and simple communication of plan
- Allows each participant to create a portfolio that fits their risk tolerance and time horizon

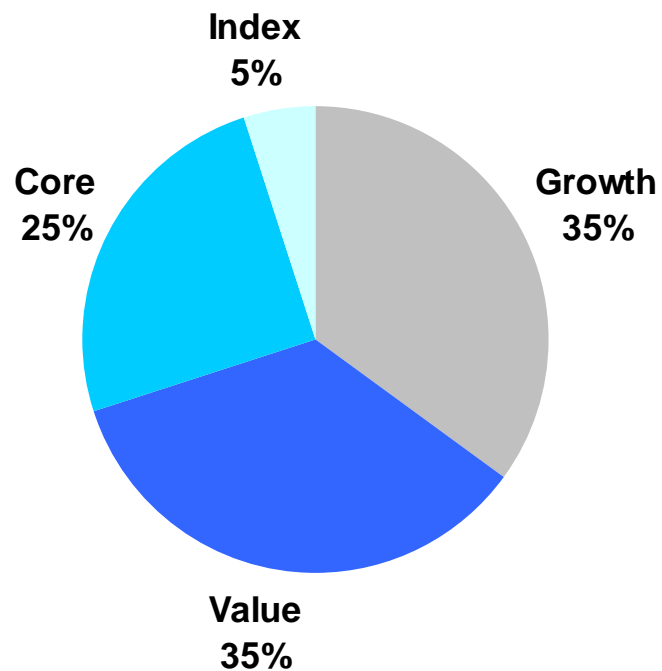


Source: Iyengar, Jiang, and Huberman, 2003.

Custom Funds

Sample Large Cap Multi-Manager Structure

Large Cap Equity Fund



- Combining strategies with low or negative excess return correlations are expected to reduce the tracking error and increase the fund's expected information ratio and excess return
- The selection of underlying managers is not restricted to style boxes, allowing for greater flexibility in selecting and constructing the fund
- Active managers will tilt their portfolios, and thus the fund, to the most opportune areas of the market
- Participants maintain diversified exposure without the need to actively allocate and rebalance among styles
- Eases participant communications

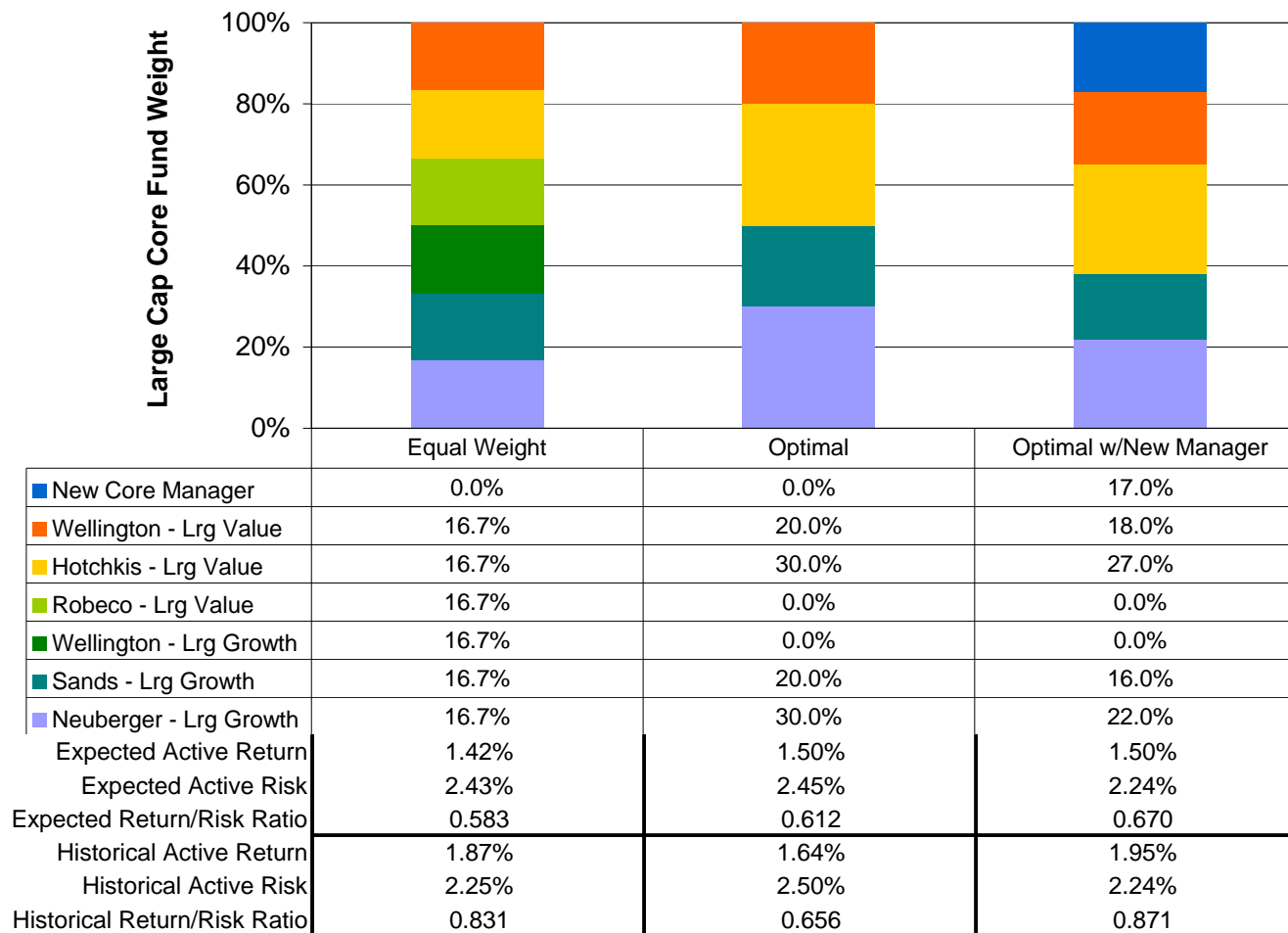
Large Cap Equity and Small/Mid Cap Equity Funds

Potential Streamlining Actions

- North Carolina may consider the following streamlining actions:
 - Merge the Large Cap Value and Growth Funds into a single Active Large Cap Equity Fund
 - Merge the Small/Mid Cap Value and Growth Funds into a single Active Small/Mid Cap Equity Fund
- Streamlines the number and types of investments offered and provides a combined style choice for participants
- Participants maintain diversified exposure without the need to actively allocate and rebalance among styles
- Ease of communication when replacing an underlying strategy within the fund
- Combining strategies with low or negative excess return correlations are expected to reduce the tracking error and increase the fund's expected return
- May be able to achieve fee savings through larger portfolio sizes

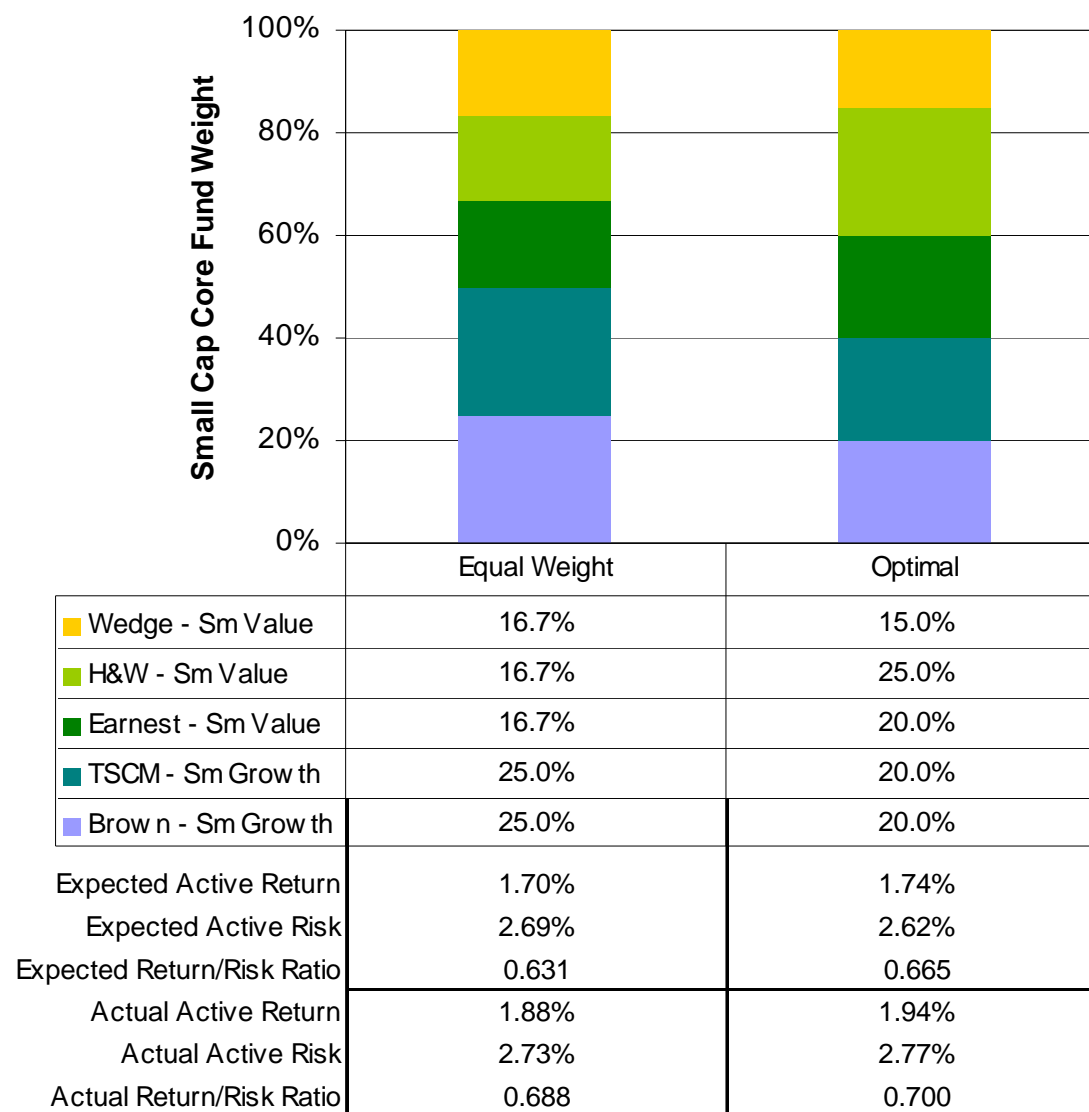
Large Cap Equity Fund

Potential Structure



Expected results reflect long-term (20-year) projections. Historical results are for the 10-year period ending 12/31/2012.

Small/Mid Cap Equity Fund Potential Structure

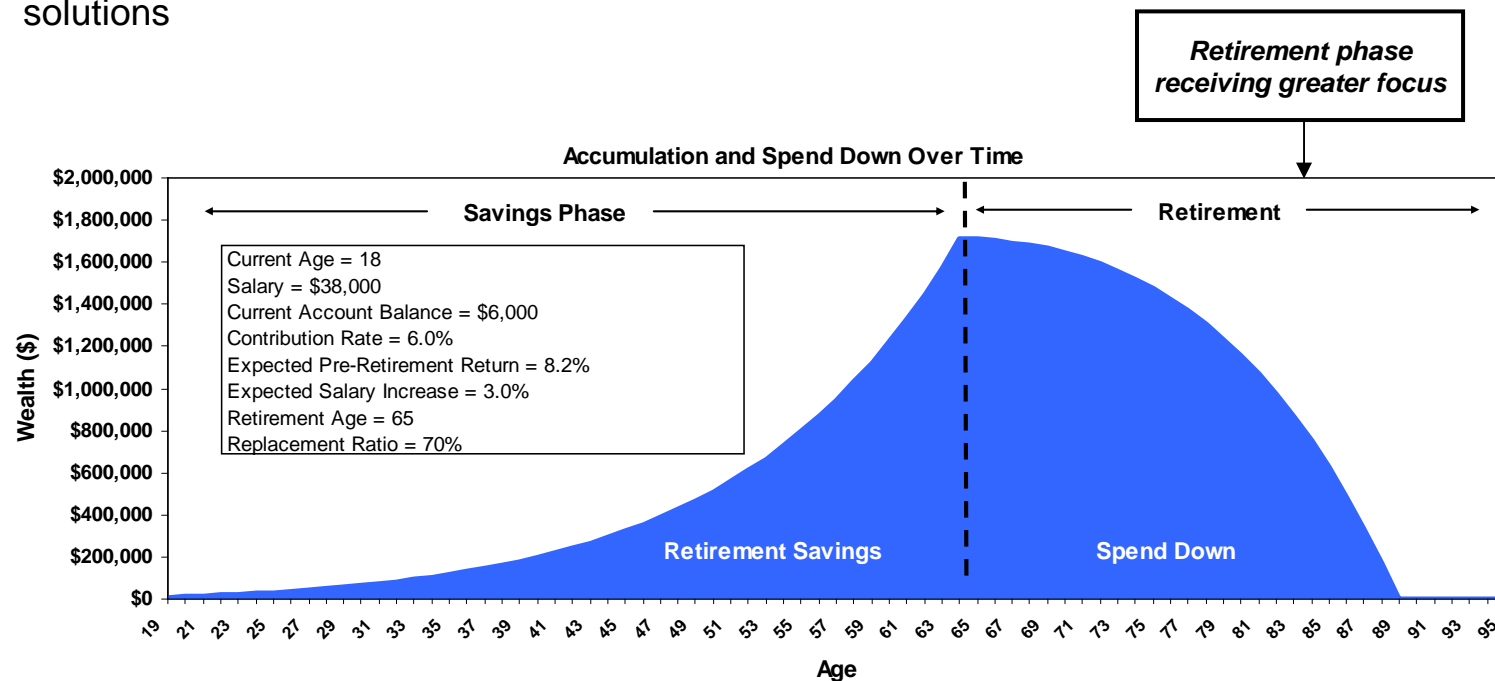


Expected results reflect long-term (20-year) projections. Actual results are for the 10-year period ending 12/31/2012.

DC Spend Down: The Next Big Challenge

- Historically, sponsors focused on wealth accumulation and retirement readiness
- Sponsor focus is now shifting to the drawdown of assets – challenges include:
 - Addressing longevity, inflation and market risks
 - Providing education and tools to help participants plan and manage retirement
 - Understanding and evaluating the available product solutions

What is *spend down*?
The process of drawing down DC plan assets for purposes of providing income and meeting expenses in retirement



DC Spend Down: Available Options

- There are several broad categories of spend down strategies, each with a variety of implementation options
 - Annuity Products
 - Guarantees return and/or income flow
 - Eliminates longevity risk
 - No liquidity/flexibility
 - Immediate or Longevity
 - Managed Payout or Installment Products
 - Designed to provide stable income stream
 - Return is not guaranteed; based on interest rates and/or historical returns
 - Generally have liquidity/flexibility
 - Some aim to payout all principal by certain date; others indefinitely
 - Hybrid Products
 - GLWB – combines guaranteed lifetime income with upside potential, and ability to withdraw
 - Combination strategies, such as managed payouts with reserve for longevity annuity or target date funds with embedded income guarantees

Service Provider Disclosure Update

The background of the slide features a series of overlapping, wavy horizontal bands in various shades of blue and teal. The top band is a dark navy blue. Below it is a medium blue band. A lighter, pale blue band follows, and at the bottom is a bright cyan band. The boundaries between these bands are wavy and fluid, creating a modern, abstract aesthetic.

ERISA 408(b)(2) Regulations

Service-Provider Fee Disclosures

Summary of new rules

- Provider-to-sponsor disclosures due July 1, 2012
- Requires disclosure of direct and indirect compensation in writing to plan's fiduciaries
- Covered service providers (CSPs) include fiduciaries, investment advisers, most DC plan recordkeepers and certain other providers receiving indirect compensation
- Noncompliance constitutes an ERISA prohibited transaction

Responsibilities of fiduciaries

- Identify covered plans and covered service providers
- Verify that all disclosures are complete and adequate
- Determine that fees are reasonable for the services provided

Fee Review

The background of the slide is composed of four distinct horizontal bands of color. From top to bottom, the colors are: a dark navy blue, a bright cyan, a very light sky blue, and a medium teal. The boundaries between these bands are slightly wavy, giving the background a fluid, organic feel.

Investment Management Fees

Review/Evaluation

- Fees are generally below typical fees for similar-size accounts
- Fees for passive management are higher than typical for NCSRP account size
 - Revisit and evaluate

NCSRP Fees

Funds and Sub-Advisors	Assets	Inv. Mgmt. Fee	Other Inv. Exp.*	R/K Fee	NC Budget**	Total Estimated Expense	Mercer Median Expense	Difference
North Carolina Stable Value Fund	\$2,214,104,500	0.322%	0.000%	0.096%	0.025%	0.443%	0.45%	-0.01%
Galliard	\$2,214,104,500	0.322%	0.000%				0.45%	-0.13%
North Carolina Fixed Income Passive Fund	\$241,841,488	0.070%	0.055%	0.096%	0.025%	0.246%	0.20%	0.05%
BlackRock	\$241,841,488	0.070%	0.055%				0.03%***	0.04%
North Carolina Fixed Income Fund	\$511,374,404	0.219%	0.076%	0.096%	0.025%	0.416%	0.53%	-0.11%
50% JP Morgan	\$257,327,525	0.188%	0.071%				0.23%	-0.04%
50% PIMCO	\$254,046,880	0.250%	0.081%				0.26%	-0.01%
North Carolina Large Cap Passive Fund	\$1,028,877,955	0.025%	0.055%	0.096%	0.025%	0.201%	0.20%	0.00%
BlackRock	\$1,028,877,955	0.025%	0.055%				0.01%***	0.02%
North Carolina Large Cap Value Fund	\$704,391,637	0.381%	0.067%	0.096%	0.025%	0.569%	0.79%	-0.22%
33.3% Hotchkis & Wiley	\$235,272,418	0.500%	0.071%				0.44%	0.06%
33.3% Wellington Management Company	\$228,813,741	0.290%	0.072%				0.44%	-0.15%
33.3% Robeco BP	\$240,305,478	0.352%	0.058%				0.44%	-0.09%
North Carolina Large Cap Growth Fund	\$688,681,864	0.392%	0.067%	0.096%	0.025%	0.580%	0.88%	-0.30%
33.3% Sands Capital Management	\$242,963,833	0.551%	0.071%				0.48%	0.07%
33.3% Wellington Management Company	\$228,394,213	0.350%	0.072%				0.49%	-0.14%
33.3% Neuberger Berman	\$217,323,818	0.275%	0.058%				0.49%	-0.22%
North Carolina SMID Cap Passive Fund	\$353,945,565	0.050%	0.055%	0.096%	0.025%	0.226%	0.29%	-0.06%
BlackRock	\$353,945,565	0.050%	0.055%				0.04%***	0.01%
North Carolina SMID Value Fund	\$229,295,326	0.725%	0.066%	0.096%	0.025%	0.912%	1.00%	-0.09%
33.3% Hotchkis & Wiley	\$81,446,848	0.671%	0.071%				0.68%	-0.01%
33.3% EARNEST Partners	\$73,677,607	0.653%	0.071%				0.80%	-0.15%
33.3% WEDGE Capital Management	\$74,170,872	0.850%	0.057%				0.80%	0.05%
North Carolina SMID Growth Fund	\$141,137,391	0.803%	0.071%	0.096%	0.025%	0.995%	1.05%	-0.05%
50% TimesSquare Capital Management	\$70,720,212	0.971%	0.071%				0.82%	0.15%
50% Brown Advisory	\$70,417,180	0.636%	0.071%				0.88%	-0.24%
North Carolina International Passive Fund	\$289,192,400	0.140%	0.055%	0.096%	0.025%	0.316%	0.40%	-0.08%
BlackRock	\$289,192,400	0.140%	0.055%				0.06%***	0.08%
North Carolina International Equity Fund	\$436,251,135	0.463%	0.119%	0.096%	0.025%	0.703%	1.04%	-0.34%
50% Baillie Gifford	\$218,252,444	0.457%	0.119%				0.62%	-0.17%
50% Mondrian Investment Partners	\$217,998,692	0.469%	0.119%				0.58%	-0.11%
North Carolina Global Equity Fund	\$163,483,895	0.622%	0.092%	0.096%	0.025%	0.835%	1.10%	-0.26%
50% Wellington Management Company	\$83,497,976	0.500%	0.091%				0.65%	-0.15%
50% Arrowstreet	\$79,985,918	0.744%	0.093%				0.65%	0.09%
Total	\$7,002,577,560	0.292%	0.047%	0.096%	0.025%	0.460%	0.559%	

*Includes the ongoing administration, legal, accounting, auditing, custody, NAV calculation, reporting, compliance, and other miscellaneous fund expenses associated with the separate account.

**The cost of the budget associated with the management of the Supplemental Retirement Plans, borne by each investment option in proportion to the pro-rate share of the applicable assets in that fund.

***Mercer conducted a blind survey of passive providers' proposal based on NCSRP account size.

Stable Value Fund Fees

401(k) Plan Stable Value Fund

Benefit Responsive Wrap Fees

Great West Life	0.15%
Prudential	0.17%
MetLife	0.20%
United of Omaha	<u>0.25%</u>
Weighted Average Wrap Fee	0.17%

Investment Management Fees

Payden & Rygel	0.14%
Prudential	0.06%
Great West Life	0.05%
PIMCO	<u>0.23%</u>
Weighted Average Management Fee	0.08%

Galliard Oversight & Management 0.07%

Fund Admin / Audit 0.00%

Total Management & Wrap **0.32%**

Admin Fee 0.12%

Total Fees 0.44%

457 Plan Stable Value Fund

Benefit Responsive Wrap Fees

Great West Life	0.15%
Prudential	0.17%
MetLife	0.20%
United of Omaha	<u>0.25%</u>
Weighted Average Wrap Fee	0.17%

Investment Management Fees

Payden & Rygel	0.14%
Prudential	0.06%
Great West Life	0.05%
PIMCO	<u>0.23%</u>
Weighted Average Management Fee	0.08%

Galliard Oversight & Management 0.07%

Fund Admin / Audit 0.00%

Total Management & Wrap **0.33%**

Admin Fee 0.12%

Total Fees 0.45%

GoalMaker Discussion

Separate Slides

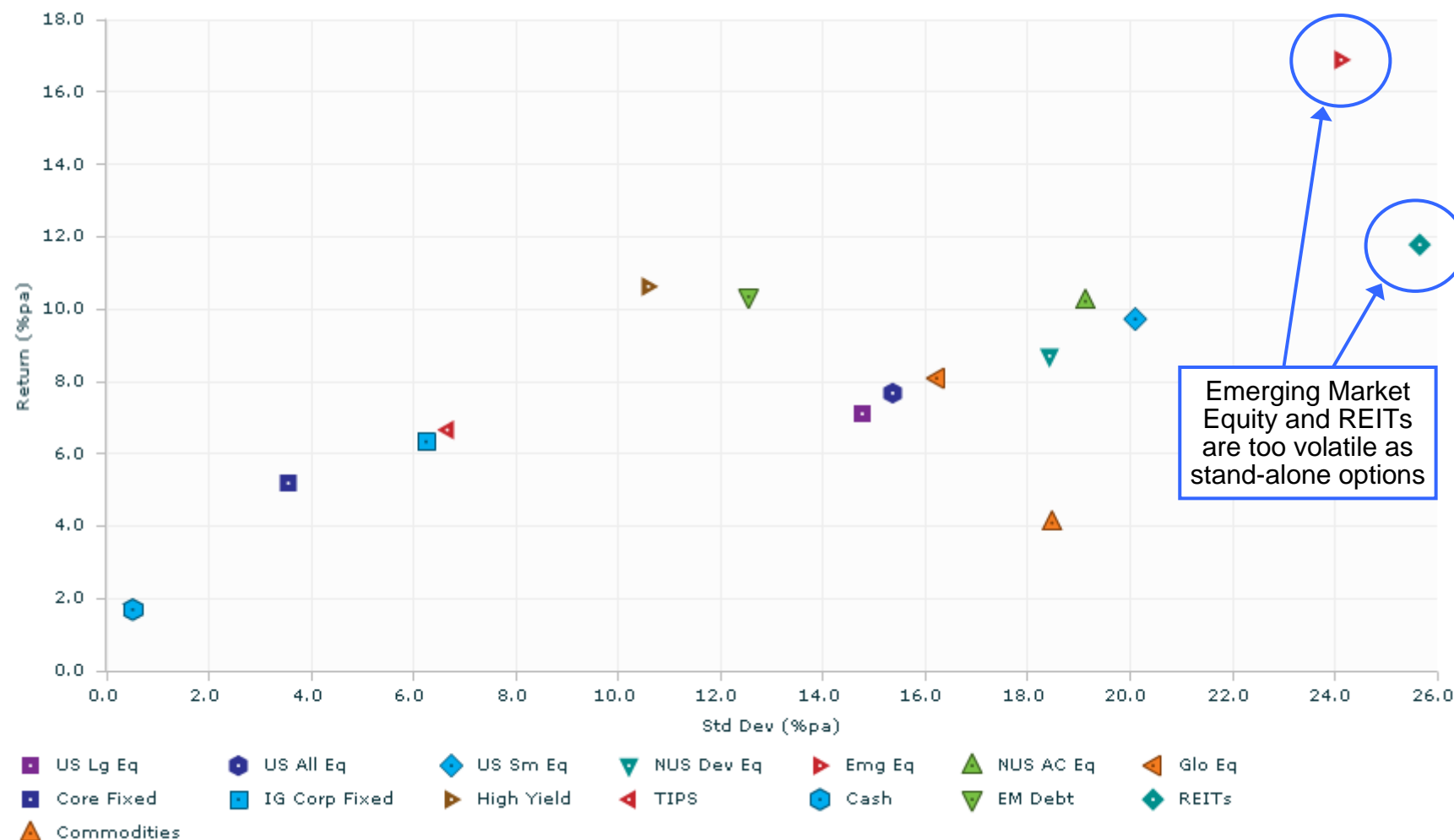
Considering Other Fund Lineup Options

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Considering Other Fund Lineup Options

Volatility Limits for Stand-Alone Asset Classes

Return and Std Deviation in \$US (before fees) over 10 yrs ending December-12 (monthly calculations)



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Fund Performance Review



Fund Performance Review

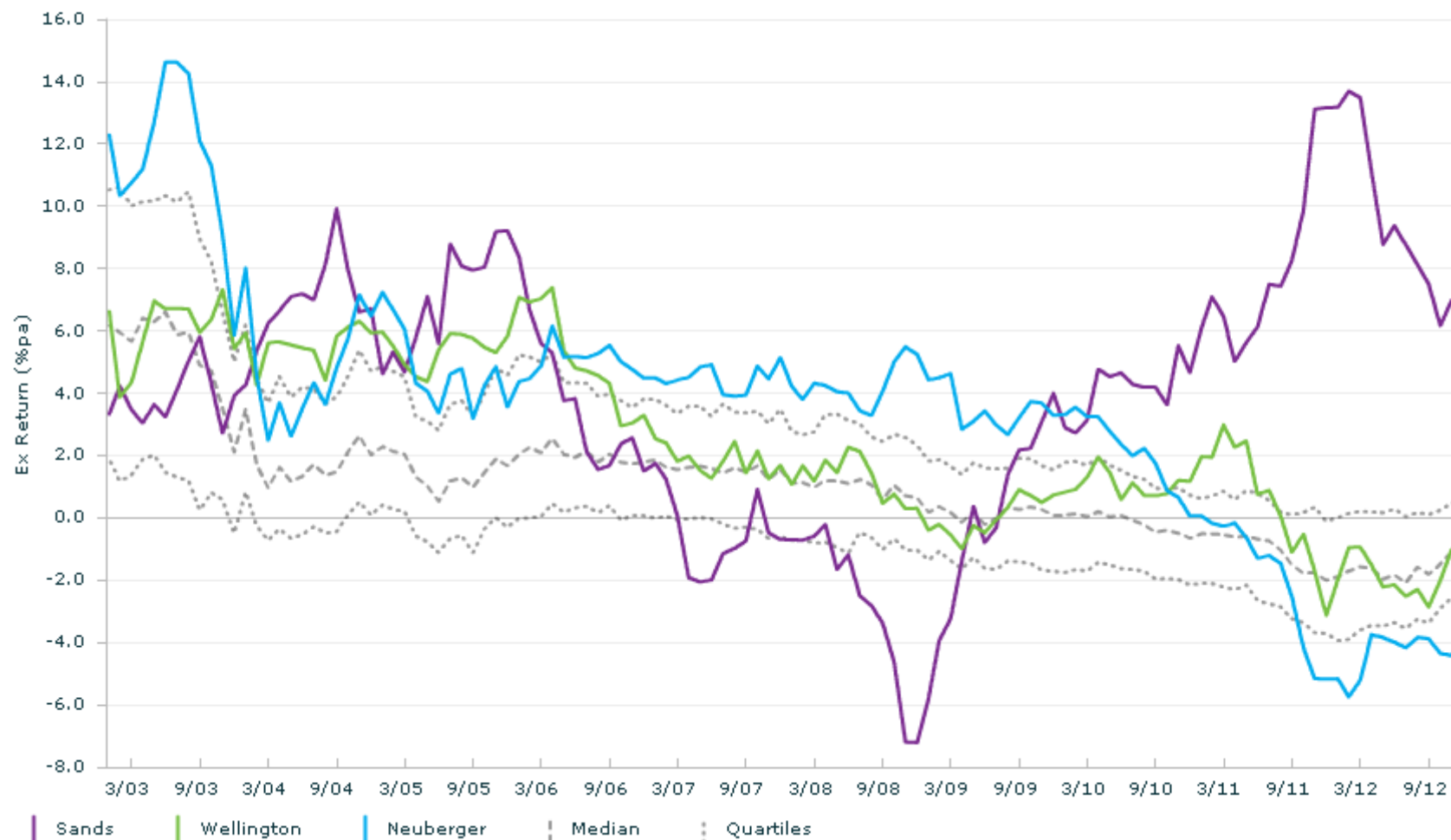
Investment Policy Statement – Performance Guidelines

	Mercer Rating	Return								Risk
		3 Years to 12/31/2012		3 Years to 9/30/2012		3 Years to 6/30/2012		3 Years to 3/31/2012		5 Years to 12/31/2012
		I	U	I	U	I	U	I	U	I
Large Cap Passive Fund		✓	NA	✓	NA	✓	NA	✓	NA	NA
BlackRock Equity Index Fund	PP	✓	NA	✓	NA	✓	NA	✓	NA	NA
Large Cap Value Fund		✗	✓	✗	✓	✗	✗	✗	✗	NA
Hotchkis & Wiley Large Cap Value	B+ (T)	✓	✓	✗	✓	✓	✓	✓	✓	✓
Wellington Quality Value	N	✗	✗	✓	✓	✗	✓	✗	✗	✓
Robeco BP Large Cap Value	A (W)	✓	✓	✓	✓	✗	✓	✓	✓	✓
Large Cap Growth Fund		✓	✓	✓	✓	✓	✓	✓	✓	NA
Sands Capital Large Cap Growth	A (T)	✓	✓	✓	✓	✓	✓	✓	✓	✓
Wellington Opportunistic Growth	A	✗	✓	✗	✗	✗	✗	✗	✓	✓
Neuberger Large Cap Growth	B+	✗	✗	✗	✗	✗	✗	✗	✗	✓
Mid/Small Cap Passive Fund		✓	NA	✓	NA	✓	NA	✓	NA	NA
BlackRock Russell 2500 Index Fund	PP	✓	NA	✓	NA	✓	NA	✓	NA	NA

Fund Performance Review

Large Cap Growth Managers

Rolling 3 yr Excess Return vs. Russell 1000 Growth in \$US (before fees) over 10 yrs ending December-12
Comparison with the US Equity Large Cap Growth universe



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Fund Performance Review

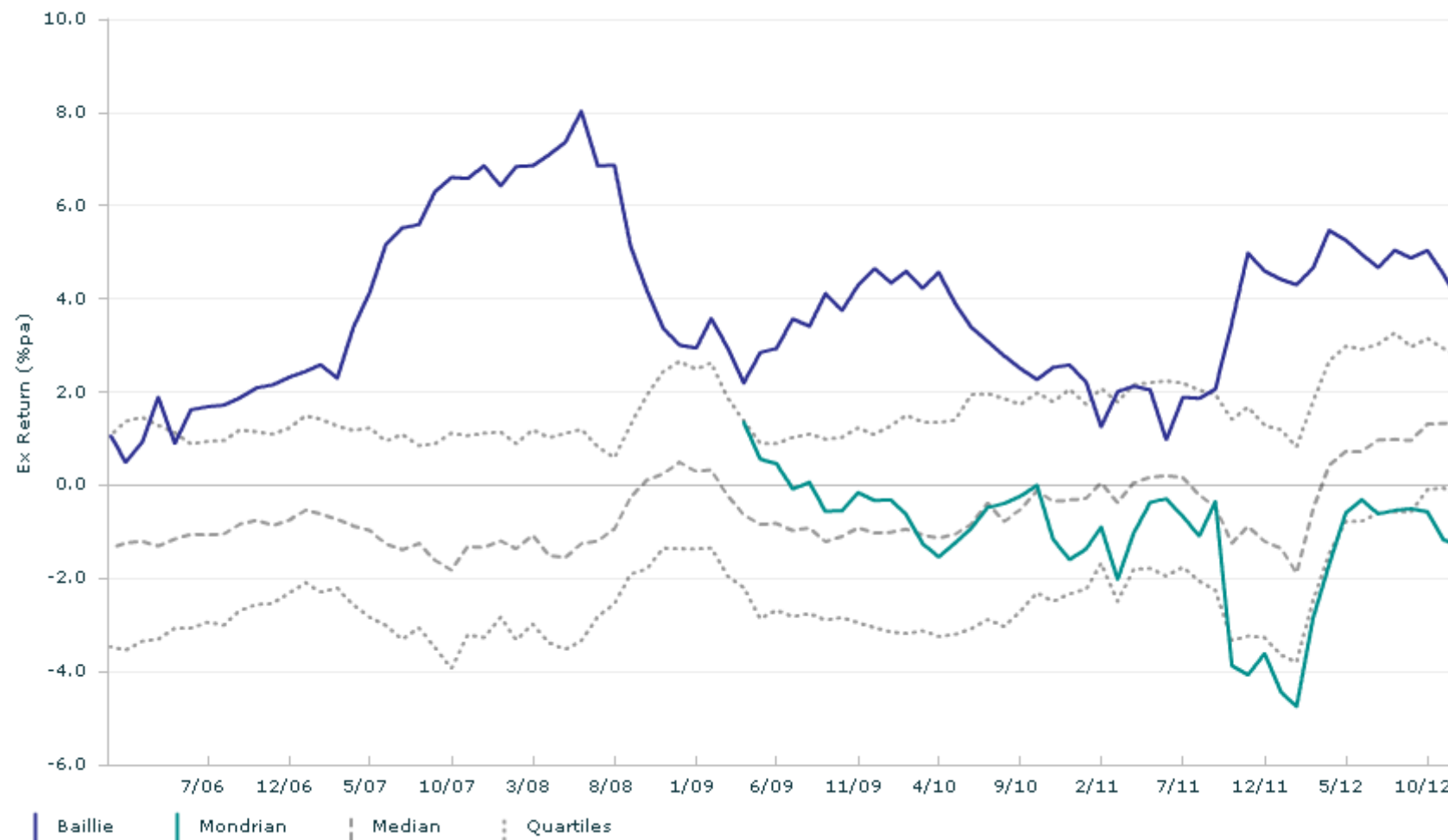
Investment Policy Statement – Performance Guidelines

	Mercer Rating	Return								Risk
		3 Years to 12/31/2012		3 Years to 9/30/2012		3 Years to 6/30/2012		3 Years to 3/31/2012		5 Years to 12/31/2012
		I	U	I	U	I	U	I	U	I
Mid/Small Cap Value Fund		✓	✓	✓	✓	✓	✓	✓	✓	NA
Hotchkis & Wiley SMID Cap Value	B+ (T)	✓	✓	✓	✓	✓	✓	✓	✓	✓
EARNEST Partners SMID Cap Value	B+	✓	✓	✓	✓	✗	✗	✓	✗	✓
WEDGE SMID Cap Value	A	✓	✓	✓	✓	✓	✓	✓	✓	✓
Mid/Small Cap Growth Fund		✗	✓	✓	✓	✗	✓	✗	✗	NA
TimesSquare SMID Cap Growth	A	✓	✓	✓	✓	✓	✓	✓	✓	✓
Brown Advisory	R	✓	✓	✓	✓	✓	✓	✓	✗	✓
International Passive Fund		✗	NA	✗	NA	✗	NA	✗	NA	NA
BlackRock ACWI ex US Fund	PP	✗	NA	✓	NA	✗	NA	✓	NA	NA
International Equity Fund		✓	✓	✓	✓	✓	✓	✗	✓	NA
Baillie Gifford ACWI ex US Growth	A	✓	✓	✓	✓	✓	✓	✓	✓	✓
Mondrian ACWI ex US Value	B+ (T)	✗	✗	✗	✗	✗	✗	✗	✗	✓

Fund Performance Review

International Equity Managers

Rolling 3 yr Excess Return vs. MSCI AC Wld ex US in \$US (before fees) over 7 yrs ending December-12
Comparison with the World ex US/EAFE Equity universe



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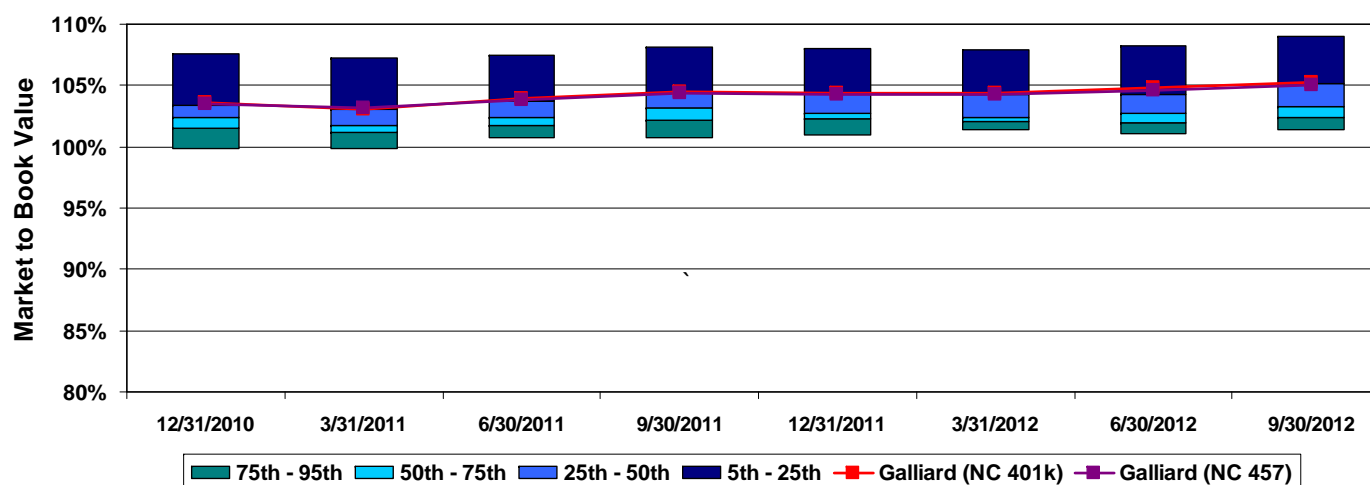
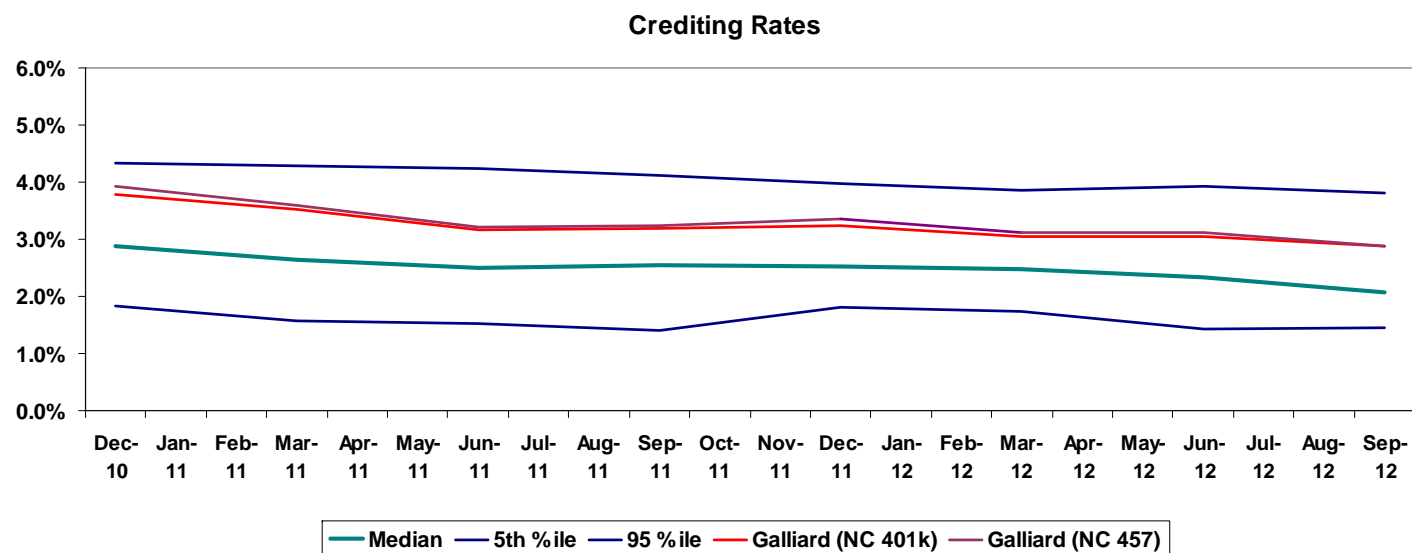
Fund Performance Review

Investment Policy Statement – Performance Guidelines

	Mercer Rating	Return								Risk
		3 Years to 12/31/2012		3 Years to 9/30/2012		3 Years to 6/30/2012		3 Years to 3/31/2012		5 Years to 12/31/2012
		I	U	I	U	I	U	I	U	I
Global Equity Fund		✗	✓	✓	✓	✗	✗	✗	✗	NA
Wellington Global Opportunities	B+	✓	✓	✓	✓	✓	✓	✓	✓	✓
Arrowstreet Global Equity ACWI	A	✓	✓	✓	✓	✓	✓	✓	✓	✓
Fixed Income Passive Fund		NA	NA	NA	NA	NA	NA	NA	NA	NA
BlackRock Debt Index Fund	N	✓	NA	✓	NA	✓	NA	✓	NA	NA
Fixed Income Fund		✓	✓	✓	✓	✓	✗	✓	✗	NA
JP Morgan Core Bond	A	✓	✓	✓	✓	✓	✓	✓	✗	✓
PIMCO Total Return Full Authority	A	✓	✓	✓	✓	✓	✓	✓	✓	✓
Stable Value Fund		✓	✗	✓	✓	✓	✓	NA	NA	NA

Fund Performance Review

Stable Value – Crediting Rate & Market-to-Book vs. Peer Group





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Returns for periods greater than one year are annualized. Returns are calculated net of investment management fees, unless noted as gross of fees.

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