

## **NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES**

### **MINUTES OF MEETING SEPTEMBER 19, 2013**

**Time and Location:** The North Carolina Supplemental Retirement Board of Trustees (the “Board”) met on Thursday, September 19, 2013 in the Banking Commission Board Room of the Reynolds Building, 316 W. Edenton Street, Raleigh, North Carolina.

**Members Present:** The following members attended in person: State Treasurer Janet Cowell, Melinda Baran, Karin Cochran, Walter Gray, Gene Hamilton, and Clay Thorp.

**Members Absent:** Mona Keech and Charles Leedy. Two positions on the Board were vacant. Before the meeting, Ms. Keech provided a letter to Ms. Baran authorizing Ms. Baran to vote as Ms. Keech’s proxy on all matters before the Board during the meeting.

**Staff Present:** The following Department of State Treasurer staff members were present: Steve Toole, Mary Buonfiglio, Joan Fontes, Chris Frazier, Rekha Krishnan, Lisa Page, Kevin SigRist, Rhonda Smith, Christina Strickland, and Blake Thomas.

**Guests Present:** Robert Luciani, Michael McCann, Jessica Quimby, Jodie Musselwhite, Travis Swartwood, and Ann Cashman from Prudential Retirement; Bruce Corcoran, Brian Senatore, and Jim Simone from TIAA-CREF; Jay Love and Kelly Henson from Mercer Investment Consulting; Amar Majmundar and Staci Meyer from the North Carolina Department of Justice; Kerry Crutchfield from Forsyth County Schools; Vincent Smith from Charlotte-Mecklenburg Schools; and member of the public Robert Slade.

#### **AGENDA ITEM- WELCOME AND INTRODUCTIONS**

The meeting was called to order at approximately 9:05 a.m. The Treasurer welcomed Board members and guests. As there were several new Board members attending their first meeting, the Board members and staff introduced themselves.

#### **AGENDA ITEM- SWEARING-IN CEREMONY**

The Treasurer administered the oath of office to new and existing members of the Board.

#### **AGENDA ITEM- ETHICS AWARENESS AND 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**

Ms. Baran noted that the draft June 5, 2013 Board meeting minutes left Ms. Baran's name off of the list of "Members Present." Ms. Baran made a motion to correct this omission, but otherwise approve the minutes. Mr. Thorp seconded the motion, which was unanimously approved.

**AGENDA ITEM- RESOLUTION FOR MS. KATHY CROOKE; RESOLUTION FOR MS. ELIZABETH GEORGE**

The Board recognized the service of former Board members Kathy Crooke and Elizabeth George to the Supplemental Retirement Plans, the Board, and the State. A motion was made by Mr. Thorp to approve the attached resolutions, which express the Board's appreciation. Mr. Gray seconded the motion. The resolutions were unanimously approved.

**AGENDA ITEM- BOARD CHARTER**

Ms. Buonfiglio presented a proposed Charter for the Board. Mr. Hamilton moved to adopt the proposed Charter. Mr. Thorp seconded the motion, which was unanimously approved by the Board.

**AGENDA ITEM- BOARD INDEMNIFICATION- RETIREMENT GOVERNANCE BILL, HB357**

The issue before the Board was whether additional liability coverage is necessary. Mr. Thomas noted that during the 2013 session, the North Carolina General Assembly passed a new statute, N.C.G.S. § 135-97, that provides Board members "shall be immune individually from civil liability for monetary damages," unless covered by insurance, for those Board members' acts or omissions arising out of their service on the Board. Section 135-97 does not apply if the Board member was not acting in good faith, committed gross negligence or willful or wanton misconduct, derived an improper personal financial benefit, acted outside the scope of his or her official duties, or incurred the liability from operation of a motor vehicle. Mr. Thomas noted that although G.S. § 135-97 is North Carolina law, no state statute can absolutely eliminate the risk of being sued as a result of one's service to the State, particularly if the lawsuit is based on federal law or other states' law.

Special Deputy Attorney General Amar Majmundar and Special Deputy Attorney General Staci Meyer presented to the Board on "General Liability, Tort Claims, and Excess Coverage." The Tort Claims Act or the Defense of State Employee Act would apply depending on who the named party is. Tort claims against the State are filed with the Industrial Commission and then sent to the Attorney General's Office, which represents the State in these matters. The Commission's jurisdiction is limited to negligence actions. The negligence must occur while the named negligent State employee was acting within the scope of his office or employment. It is

the duty of the Attorney General's Office to represent all departments, institutions and agencies of the State in connection with claims brought pursuant to the Tort Claims Act. There are approximately 500 active tort claims at any given time. Usually the state is sued rather than an individual. The filing of a tort claim against the state is initiated by filing an affidavit that must include the name of the State agency and the individual State officer or employee who the plaintiff alleges committed the negligent act.

The Defense of State Employees Act provides that, upon the request of an employee or a former employee, the State may provide for the defense of any civil or criminal action brought against him or her in his official capacity. The claimant's recovery is limited to \$1,000,000 and the claimant may not recover under both the Tort Claims Act and the Defense of State Employees Act. The State also maintains excess insurance coverage that pays judgments in excess of the \$1,000,000, for errors and omissions of employees for losses in the performance of their jobs and losses resulting in bodily injury and property damage. However, the excess coverage would not extend to an occurrence which is not within the scope of employment; which is fraudulent, corrupt or malicious; which creates a conflict of interest between the State and the employee; which would not be in the best interest of the State; or which is a conflict between two insured individuals.

The recently enacted statute, North Carolina General Statute 135-97, would provide immunity from civil liability for monetary damages for a person serving on the Board, except when the person acted outside of his duties, acted in bad faith, acted with gross negligence, acted with willful or wanton misconduct, derived a benefit from improper financial transaction or when the liability resulted from a motor vehicle accident.

The newly enacted statute provides immunity from suit and is aligned with the Defense of State Employees Act with respect to coverage, such that the same acts would be covered or would prevent coverage. Mr. Majmundar stated that it is very unlikely that a lawsuit would be filed against the Board that would exceed \$1,000,000, since the Board is charged with handling supplemental plans. Mr. Thorp inquired about the coverage in the case of a class action suit. Mr. Majmundar explained that the limit is \$1,000,000 per claim. Mr. Thorp stated that his understanding is that the Board members would be covered, other than if they were involved in an accident on the way to the Board Meeting. Mr. Majmundar answered that even in the case of a car accident, the Board member would be acting as an agent for the State and would be covered.

The recommendation to the Board was that fiduciary insurance is not necessary in light of the recent enactment of the statute. The Board agreed that it was sufficiently protected by the existing laws.

**AGENDA ITEM- APPROVAL OF INVESTMENT SUBCOMMITTEE MEETING  
MINUTES FROM AUGUST 15, 2013**

Ms. Baran provided the Investment Subcommittee report from the August 15, 2013 meeting. She stated that the Subcommittee heard a report on the Stable Value Fund investment options for the 401(k) and 457 Supplemental Retirement Plans, and that the Stable Value Fund is in good condition. The Subcommittee also heard a presentation by Earnest Partners, one of three investment managers in the Supplemental Retirement Plans' Small/Mid Value Cap Fund. The presentation focused on the long term performance of the portfolio and the process by which Earnest manages the portfolio. Following the conclusion of Earnest's presentation, the Subcommittee discussed the presentation and the performance of the Earnest Value strategy portfolio, as well as the Investment Policy Statement and the criteria for placing a manager on the watch list. Ms. George and Mr. Leedy stated that they did not believe that it would be consistent with the plan's IPS to place Earnest on the watch list. Ms. Baran provided a dissenting opinion at the meeting, stating that they should place Earnest on the watch list. The Subcommittee did not take a formal vote, but decided to continue to closely monitor the Earnest portfolio's performance, and to raise the issue again at the next Board of Trustees Meeting. Ms. Baran moved to accept the Investment Subcommittee Meeting minutes. Ms. Baran utilized Ms. Keech's proxy in accepting the minutes as presented. The motion was unanimously approved.

**401(k) / 457(b) PLANS**

**AGENDA ITEM- MEMO ON AUDIT SUBCOMMITTEE REPORT**

The Audit Subcommittee met on July 26, 2013 for the purpose of receiving reports and recommendations from PricewaterhouseCoopers on the Plans' annual audit and financial statements. PricewaterhouseCoopers auditors presented a report on the annual audit and the December 31, 2012 financial statements. They offered an unqualified opinion and found the financial statements to be in good order. The Subcommittee unanimously accepted the auditors' report and approved the release of the 2012 financial statements of the Supplemental Retirement Income Plan and Deferred Compensation Plan. A motion to accept the auditors' report was unanimously approved by the Board.

**AGENDA ITEM- 2ND QUARTER INVESTMENT PERFORMANCE REPORT  
PROPOSED CHANGES TO IPS**

Jay Love from Mercer provided the Capital Markets Review and a report to the Board on the Second Quarter Investment Performance Report. Ms. Baran asked whether they are beginning to discuss trends for next year. Mr. Love stated that the interest rates are gently rising, and that as rates rise, fixed income securities will be negatively effected. Mr. Thorp asked about commodities. Mr. Love stated that he is not sure that there is a good model for valuation of

commodities. Mr. Thorp also asked about GoalMaker. Mr. Love explained that GoalMaker is a set of models for participants to choose from.

The Board voted on changes to the Investment Policy Statement (IPS) with respect to Arrowstreet, PIMCO and JP Morgan. Arrowstreet proposed to make the following two changes to their Investment Manager Guidelines (and subsequently the IPS). The first change was that the portfolio may invest in equity securities across a broad range of market capitalizations, including, but not limited to, small capitalization stocks, which may or may not be within the capitalization range of the Benchmark. The portfolio's exposure to small capitalization stocks shall not exceed 10% of the net asset value of the portfolio. The second change was that the portfolio may invest in equity securities of issuers from a broad range of countries including countries outside of the Benchmark. This may include frontier market countries. In the aggregate, the value of investments in frontier markets shall not exceed 10% of the net asset value of the portfolio. Mercer's analysis indicated that even at 10% to each of small cap and frontier stocks, the additional risk to the portfolio is negligible. A motion was made by Ms. Baran to allow Arrowstreet to make the proposed change. Mr. Thorp seconded the motion, which was unanimously passed by the Board.

The Board considered the PIMCO Investment Manager Guidelines related to leverage language. Mercer and the Staff have been working with PIMCO to refine the guidelines for the Inflation Responsive strategy added to the plans. There is one particular guideline that is difficult to conform to the Investment Policy Statement without also inhibiting PIMCO's management process. PIMCO uses certain techniques that can be interpreted as leverage. The Investment Policy Statement prohibits the use of leverage unless an exception is granted by the Board. Mercer and the Staff recommended that the Board approve the guidelines for PIMCO, including the limit of 25% Lambda Cash. Since this technique can be interpreted as leverage, they adjusted the wording of the Investment Policy Statement to clarify that leverage is not permitted unless authorized by the Board. They stated that they do not believe that this technique will result in economic or market leverage, they suggested planning for the broadest interpretation of the policy and thus granting PIMCO explicit authority to use this technique. Ms. Baran moved to approve the recommended change to the Investment Policy Statement. Mr. Hamilton seconded this motion, which was unanimously approved.

JP Morgan Asset Management manages a core bond portfolio for the plans. JP Morgan Asset Management has requested clarification on whether they are allowed to purchase bonds when issued, if JP Morgan Bank is a member of the underwriting syndicate of multiple underwriters. There is a conflict of interest if JP Morgan Asset Management benefits JP Morgan Bank at the plan's expense by purchasing these issues. JP Morgan Asset Management limits potential liability by following a strict set of procedures. JP Morgan Asset Management has indicated that such issues are not critical to its ability to successfully manage the portfolio for the North

Carolina Supplemental Retirement Plan. Mercer and the RSD Staff recommended denying the request due to the potential conflict of interest and the lack of a compelling reason to permit this potential conflict. They recommended adding an explicit prohibition to the Investment Policy Statement prohibiting the purchase of initial offerings from an affiliated entity on a principal basis. Mr. Thorp made a motion to include such a statement that would prohibit such transactions. The motion was seconded by Ms. Cochran and passed unanimously by the Board.

#### **AGENDA ITEM- 2ND QUARTER ADMINISTRATIVE REPORT**

Michael McCann of Prudential provided the Second Quarter Administrative Report. Mr. Thorp asked whether there are efforts to educate the people who are not Goal Maker aligned. Mr. Toole stated that RSD is using every touch point at its disposal to educate them. Ms. Cowell stated that some percentage of people want to make their own decisions. Enrollments are up for 401(k). Goal Maker participation for 401(k) has risen from 42% to 52.5 %. Mr. Toole stated that RSD issues 400,000 Annual Benefit Statements to inform people about gaps in their retirement. Participants can take action after reviewing their statements. Many people have increased their deferrals to reach retirement goals. There is a re-branding effort and an upcoming roll out that will occur in conjunction with National Save for Retirement Week, which is October 20-26. There are also efforts to infuse behavioral analysis to best understand the decision making process for funding retirement. Ms. Musselwhite from Prudential shared success stories from the field. Ms. Baran inquired about the individuals who are employed as representatives. Ms. Musselwhite explained that they span all demographics and are all licensed, maintain appropriate continuing education, and most have a financial background.

#### **AGENDA ITEM- CEM FEE BENCHMARKING STUDY**

The CEM Fee Benchmarking Study was presented by Alan Torrance. The report compared the effectiveness of the services being provided to the plan and participants, the cost effectiveness of the plan and its investment alternatives, the investment value-add, and the fiduciary processes needed for continual plan improvement. The report also serves as a decision-support tool. The plan's total net value added from all investment options was 1.46% in 2012 and 1.46% for the 1-year period ending 2012. Total plan net value added shows how the plan's investment options performed on an overall basis. Positive net value added indicates that, on average, the plan's investment options are outperforming their benchmark after fees. CEM calculates a benchmark cost for the plan based on the median cost that its peers pay for the plan's participants' mix of investment options. The total plan cost was 0.46%. This was 0.04% above its peer-based benchmark cost of 0.42%. The Board was told that as fiduciaries they should understand where and why they are paying more or less than peers and they should be comfortable that they are receiving value for what they are paying. The reasons why the plans costs more is because they are paying more for similar-style investment options, there is added cost from more active options, and higher administrative and fiduciary costs. The Board was advised that they should

pay the closest attention to the investment options with outlier performance or costs relative to similar style options. They were also advised that too many investment options can increase plan costs, increase participant confusion and decrease participation rates. Monitoring asset mix is important because it is often the biggest reason for differences in the total returns of plan participants. On average, the plan's participants had a combined 32% of their assets in stable value and/or cash options. This is above the U.S. universe average of 20%. Professionally managed defined benefit plans typically have less than 1% of their assets in these options. The Staff and Board noted that there were a few inaccuracies in the report, including that GoalMaker is the plan's version of a Target Retirement Date Fund. Mr. Torrance stated that he would make the changes, including adding a page on GoalMaker and would then re-issue the report.

#### **AGENDA ITEM- PLAN BENEFICIARY ELECTION**

The Staff requested guidance from the Board members on the methods by which members may change beneficiary designations. The options were via mail, telephone and on-line. There were two recent telephone beneficiary changes in which there were concerns about the undue influence of third parties. Mr. Hamilton stated that changes should be in writing with a signature. Ms. Baran agreed. Mr. Thomas inquired about the Board's position on the option of accepting online changes. Ms. Baran suggested that participants could make an online request for a beneficiary change form to be sent to them. Most plans in the industry allow online changes. Mr. Thorp stated that the consensus seemed to be that changes via telephone should not be allowed, but that the Board was mixed on whether online changes could be permitted. Mr. Gray suggested the possibility of making changes online, but requiring that the participant print the change and send it with an original signature. Ms. Cochran stated the problematic cases that were discussed would not have been prevented by this change, because the third party would have moved the process along even if it had been via another medium. Ms. Baran and Mr. Hamilton stated that a written signature would prevent fraud. Mr. Thorp made a motion to instruct Prudential to no longer accept beneficiary changes via telephone. The motion was seconded by Mr. Hamilton and passed unanimously by the Board.

#### **AGENDA ITEM- UPDATE- IRS AUGUST 29, 2013 GUIDANCE CONCERNING TREATMENT OF SAME-SEX SPOUSES UNDER INTERNAL REVENUE CODE**

Mr. Thomas briefed the Board on IRS Revenue Ruling 2013-17, which stated new federal requirements concerning the treatment of same-sex spouses under the Internal Revenue Code. The Revenue Ruling interpreted the Supreme Court's June 26, 2013 decision in *U.S. v. Windsor*. In the Revenue Ruling, the IRS announced that when determining whether retirement plans qualify for tax-deferred treatment, it would interpret any Internal Revenue Code requirement that includes the word "spouse" as encompassing not only opposite-sex spouses, but also same-sex spouses who were legally married in another state. Failing to comply with federal law, as interpreted by the IRS, could endanger Supplemental Retirement Plan members' ability to have

income tax deferred on their contributions. The Revenue Ruling became effective on September 16, 2013.

Mr. Thomas commented that several aspects of the Revenue Ruling were at that time unclear, and additional guidance had been promised from the IRS over the next few weeks. The IRS Revenue Ruling did not appear to state that retirement plans were required, under federal law, to treat all same-sex married couples as “spouses” for all purposes; instead, it was limited to specific mandatory qualification requirements for tax deferral. As a result, the Revenue Ruling could have some effect on how rollovers, minimum distributions, and hardship distributions would have to be treated by the Supplemental Retirement Plans. The treatment of domestic relations orders also could be affected.

Mr. Thomas stated that the Plans’ attorneys and staff would gather further information, would consult with the Attorney General’s Office and with the Plans’ federal tax counsel, and would provide further updates to the Board. The relationship between federal law (as interpreted by the Revenue Ruling) and Article XIV, Section 6 of the North Carolina Constitution would have to be determined. Mr. Thomas advised that a decision should probably be made on response to the IRS Revenue Ruling by the end of the calendar year.

#### **AGENDA ITEM- DIRECTOR’S REPORT**

Mr. Toole presented the Director’s Report, providing updates and seeking guidance from the Board on several matters.

*Staffing Update* – Mr. Toole presented the Board with an update to the Supplemental Retirement Plans budget. For the 2012-2013 fiscal year, the Plans spent \$192,475 less than was budgeted. This was the result of two factors. First, the bill for the recently completed audit was issued in August, but related to work done in the 2012-2013 fiscal year. Second, new staff positions were approved by the Board at previous meetings, but those positions were not immediately filled, as it takes several months for a new North Carolina government employee position to be authorized by all necessary government agencies.

Mr. Toole provided the Board with a set of recommended changes to the fiscal year 2013-2014 budget approved at the Board’s June 5, 2013 meeting. As the new staff positions were still in the process of being filled, the Plans were likely to come in under budget. The previously approved budget also reflected the envisioned future distribution of staff resources, rather than the actual distribution of resources for the July to September quarter. Mr. Toole noted that, based on guidance from the Groom Law Firm concerning fiduciary best practices, and arising out of those discussions, staff wanted to be as precise as possible with all budgetary allocations. Therefore, Mr. Toole recommended staff funding allocation changes. Mr. Gray made a motion to approve



the recommended staff funding allocations. The motion was seconded by Ms. Cochran and passed unanimously by the Board.

Immediately after this vote, Mr. Thorp left the meeting due to time constraints. Mr. Thorp authorized Ms. Baran to vote as his proxy.

***Investment Consultant RFP*** – Mr. Toole stated that staff planned to issue the investment consultant RFP shortly. Staff hoped to have the process completed by the end of January.

***Branding Initiative*** – Mr. Toole provided a summary of the Supplemental Retirement Plans' rebranding project, which was paid for by the Plans' recordkeeper Prudential and TIAA-CREF. Staff from the Supplemental Retirement Plans, Prudential, and TIAA-CREF took joint responsibility for the project, engaging CoreBrands as the project facilitator. CoreBrands reviewed five other state government retirement plans, created benchmarking standards, and developed branding concepts. The group collectively established goals for the new brand. A final creative concept titled "Bringing It All Together" was chosen and a decision was made to publicly brand the supplemental retirement program as the "North Carolina Total Retirement Plans." The overall master message would be that the Plans bring together all the resources for a successful retirement. CoreBrands has created brand guidelines to be used by the State, Prudential and TIAA-CREF, to ensure that the brand is properly represented in all communication materials. The new brand will be launched in early October 2013 in conjunction with National Save for Retirement Week and the North Carolina State Fair. Ms. Cochran suggested that they use the same font as the "Visit NC" campaign which was launched during the summer.

***BlackRock Contract / Fee Reset*** – Mr. Toole noted that the Plans, in conjunction with Investment Management Division, have successfully negotiated a decline in Blackrock's fees to 0.7 basis points. The new contract would be parallel to the Investment Management Division's contract with BlackRock, which is being amended. The contract and fee reset was expected to go into effect shortly.

***NAGDCA Conference Update*** – Mr. Toole briefly summarized the National Association of Government Defined Contribution Administrators conference, which took place in Louisville, Kentucky earlier in the month of September. Particularly helpful sessions included presentations on 457 plan audits, target date solutions, and IRS examinations of 403(b) plans. Mr. Toole and Ms. Buonfiglio participated in several panels. Mr. Toole recommended the event, stating that it provided not only assistance with details, but a grounding in the big picture for board members as fiduciaries.

**403(b) PROGRAM**

**AGENDA ITEM- 403(B) PROGRAM**

Brian Senatore of TIAA-CREF provided the presentation on the 403(B) program. He stated that he and Jim Simone have discussed the 403(B) program with 62% of North Carolina school districts, which accounts for 71 of the 115 school districts. They are in discussions with a number of Registered Investment Authority Firms to join the Advisor Network to provide objective advice to educators. TIAA-CREF hired additional internal Financial Consultants to work with 403(b) participants in the field. TIAA-CREF has participated in several events and has several scheduled for the next few months. The email from the Treasurer's Office announcing the State Sponsored 403(B) program was delivered to Superintendents, Finance Officers and Benefit Personnel on August 28. One school district recently went through a board review to select TIAA-CREF as sole recordkeeper with 14 others in internal discussions to move toward sole recordkeeping. There are 49 districts adding TIAA-CREF as a vendor to their existing options and 7 others where a second meeting has been requested.

**AGENDA ITEM – BOARD QUESTIONS/COMMENTS**

There were no additional comments or questions from the Board.

**AGENDA ITEM – PUBLIC COMMENT**

There were no public comments.

A motion to adjourn was made by Ms. Cochran and seconded by Ms. Baran. The motion passed unanimously, and the meeting adjourned at approximately 12:45 p.m.

  
CHAIR