

NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

MINUTES OF MEETING

March 19, 2014

Time and Location: The North Carolina Supplemental Retirement Board of Trustees (the “Board”) met at 9:00 a.m. on Wednesday, March 19, 2014 in the Caswell Building, 200 W. Jones Street, Raleigh, North Carolina.

Members Present: The following members were present: Melinda Baran, Karin Cochran, Walter Gray, Gene Hamilton, Mona Keech, Ron Stell and Clay Thorp.

Staff Present: The following Department of State Treasurer staff were present: Jay Chaudhuri, Steve Toole, Mary Buonfiglio, Joan Fontes, Debra Bryan, Rekha Krishnan, Lisa Page, Jaclyn Goldsmith, Meredith Rouse-Davis, Schorr Johnson, Rhonda Johnson, Tim Viezer, Blake Thomas and Mary Laurie Cece.

Guests Present: The following guests attended the meeting: Michael McCann, Jessica Quimby, Travis Swartwood, Kathleen Neville and Ann Cashman from Prudential Retirement; Bruce Corcoran, Jim Simone, Brian Senatore and James Summerlin from TIAA-CREF; Kelly Henson, Jay Love, Paul Sachs and Sabrina Bailey from Mercer Investment Consulting. Ms. Bailey participated by phone.

AGENDA ITEM- WELCOME AND INTRODUCTIONS

The meeting was called to order at approximately 9:05 a.m. Jay Chaudhuri, acting Chair, welcomed Board members and guests. Mr. Chaudhuri welcomed new Board member Ron Stell. He noted that Mr. Stell is a former Supervisor for the Department of Transportation. He also welcomed Kathleen Neville, the new director of the North Carolina Education team for Prudential. Mr. Chaudhuri stated that there was a full agenda for the meeting and some of the agenda items were going to be moved around because Mr. Toole had to meet with the Legislature.

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

Mr. Chaudhuri 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

Mr. Chaudhuri asked if there were any comments on the minutes of the December 19, 2013 Board meeting. Ms. Keech noted that on the last page it is unclear whether the Board term was

to be extended from the current two years to a three or to a four year term. Ms. Cece agreed to make a clarifying change in the minutes. Ms. Keech made a motion that the minutes be approved with this correction. Ms. Baran seconded the motion and the minutes were unanimously approved.

Mr. Chaudhuri asked if there were any comments on the minutes of the February 6, 2014 special Board meeting. Mr. Gray made a motion that the minutes be approved. Ms. Keech seconded the motion and the minutes were unanimously approved.

Mr. Chaudhuri asked if there were any comments on the minutes of the March 7, 2014 special Board meeting. Ms. Baran pointed out a typo on the last page. Ms. Cece agreed to make the change. Ms. Cochran made a motion that the minutes be approved. Ms. Baran seconded the motion and the minutes were unanimously approved.

AGENDA ITEM- UPDATE ON INVESTMENT FIDUCIARY GOVERNANCE COMMISSION

Mr. Chaudhuri introduced Mr. Thomas who gave an update on the Fiduciary Governance Commissions progress. He noted that Board member Melinda Baran had attended all the meetings of this Commission thus far.

Mr. Thomas stated that the formation of the Investment Fiduciary Governance Commission was announced by Treasurer Janet Cowell in January. The Commission is charged with determining the most appropriate governance structure for the North Carolina Retirement System's investment program. Currently the Treasurer is the sole fiduciary. There are only four other states with this structure. Mr. Thomas noted this can be a daunting responsibility. He stated the Commission is looking at structures in other states and will make recommendations as to what the governance structure for the Retirement System should be.

Mr. Thomas stated that the Commission is made up of eleven members, chaired by Michael Kennedy. He listed the other Commission members. The Commission has had two meetings and they are still in the information gathering stage. Mr. Thomas said there appears to be no consensus yet as to what the governance structure should look like. He said that he did not think that anything the Commission would do would affect this Board, but he did say that they are looking at this Board as a potential model. Ms. Baran added that she has been very impressed by the work of the Commission.

AGENDA ITEM- APPROVAL OF INVESTMENT SUBCOMMITTEE MEETING MINUTES

Mr. Chaudhuri asked for a report from the Investment Subcommittee and approval of the minutes from their February 13, 2014 meeting. Ms. Baran commended the Subcommittee

members for their handling of the February meeting that had to be held via teleconference because of the bad weather. She also noted that on that call the committee had a presentation from Wellington Management, who had been placed on the watch list. The Subcommittee is closely scrutinizing the performance of Neuberger Berman and asked to have a follow-up meeting with Mercer to look at options. Ms. Baran noted that a change needed to be made on page 2 of the minutes for the February 13 meeting. The expense ratios should be 0.21% and 0.16%, not 21% and 16%. With this correction Ms. Baran made a motion that the minutes be approved. Ms. Keech seconded and the minutes were unanimously approved.

Ms. Baran stated that a follow-up meeting occurred with Mercer to look at the potential manager change in the Large Cap Growth portfolio on February 20, 2014. Ms. Baran made a motion that the minutes of this meeting be approved and Ms. Keech seconded. The minutes were unanimously approved.

AGENDA ITEM- PLAN STRUCTURE AND INVESTMENT CONSULTANT RELATIONSHIP

Mr. Chaudhuri recognized Mr. Toole, who gave a presentation on the history behind the investment consultant request for proposal (“RFP”) process, including information on the Plans’ structure and current investment consultant relationship. Mr. Toole noted that after his presentation the Board would go into closed session for discussion on the responses to the investment consultant RFP.

Mr. Toole stated that in 2012 some compliance monitoring issues came to light around investment manager compliance with the Plan’s investment policy statement. The staff looked to Mercer, the Plan’s investment consultant, to help with these issues and from this it was learned that within the current plan structure and the 3(21)-style investment consulting relationship the roles and responsibilities among the record-keeper, investment consultant and staff were not as clear as they could be. It was felt that this lack of clarity around compliance responsibilities could cause problems in the future. With that in mind, in March of 2013 the staff made a recommendation to the Board that an investment consultant RFP be issued for an investment consultant that would 1) help with the process of unbundling recordkeeping, custodial and other services for the Plans and 2) help the Plans clarify roles and responsibilities and identify whether the Plans were best served in an ERISA 3(21)-style investment consultant versus 3(38) investment consultant relationship. Mr. Toole said the RFP was issued in November of 2013. In January of 2014 five bids were received. The bids were evaluated in February. All bidders were encouraged to provide a best and final offer.

Mr. Toole noted that Prudential's recordkeeping contract expires at the end of 2015, so it is particularly important to move forward at this point with the new plan design structure. He noted the intent is that the Plans will move from the variable annuity, separate accounts structure into a master Trust/custodial account structure, which is the industry norm for a plan the size of the North Carolina Supplemental Plans. He stated that over the next year, RFP's will be issued for recordkeeping, custody and trust administration and participant services.

He pointed out slide 5 in his presentation and noted that now is an opportunity to look at the pros and cons of different structures and models for the Plans. Slide 6 shows the current investment consultant relationship with Mercer. He said that the term "style" is being used since the Plans are not subject to ERISA. He said the staff recommend staying with current 3(21) style through December of 2015 at which time the Prudential contract expires, and a new record-keeper will be in place and the structure of the Plans will change. Slide 8 illustrates the current plan structure. Mr. Toole stated the current variable annuity structure of the plans as illustrated in Slide 8 has served the plans well in the past with Prudential having the contractual relationship with the managers and working with State Street the custodian. Slide 9 shows what an unbundled structure would look like. He stated that a master trust would hold the assets and North Carolina would work directly with the record keeper and the investment advisor. He said there would be more clarity around fees in the structure, no balance sheet risk and this would allow the plans to take action more quickly.

Mr. Toole then discussed slide 10 and explained some of the differences between an ERISA style 3(21) consulting relationship and an ERISA-style 3(38). He noted that the 3(38) fully delegated model is more common in the private sector, but is becoming more popular in the public sector. The Plan now has a 3(38)- style relationship with Galliard managing the Stable Value portfolio. Galliard hires and fires the managers. The fees in this structure are a little higher, but the consultant is taking more fiduciary responsibility. In going forward to determine what a future business model might look like, Mr. Toole said that the staff will look at both structures and at a hybrid structure, especially from a cost perspective. This will all need to be done by December 18, 2015. He stated that over the next 6-9 months, the staff will work to find the right mix and then will come back to the Board as to whether we think it is best to delegate and to what degree to delegate responsibilities to an investment consultant.

Mr. Thorp clarified that today there are two the decisions. One decision is on hiring a new investment consultant and the second is whether to go to a more delegated model in the next 6-9 month. Mr. Toole said that is correct and thinks more investigative and comparison work around the 3(38) model needs to be done to determine the specific impact.

At this point Mr. Chaudhuri asked for a motion to go into closed session to review the investment consultant RFP.

AGENDA ITEM- CLOSED SESSION –INVESTMENT CONSULTANT RFP

In the closed session the Board discussed the investment consultant RFP. A motion was made by Clay Thorpe and seconded by Ms. Baran to accept the Evaluation Committee's recommendation to award Mercer Investment Consulting the contract as Investment Consultant to the Supplemental Retirement Plans. The motion passed unanimously.

Mr. Thorpe then made a motion to go out of closed session and Ms. Keech seconded. The motion passed unanimously.

AGENDA ITEM- OPEN SESSION – RECOMMENDATION ON INVESTMENT CONSULTANT RFP

Five minute break.

In the open session Ms. Baran announced that the Board had accepted the recommendation of the evaluation committee and had asked the staff to begin negotiating a contract with Mercer Investment Consulting. Mr. Chaudhuri congratulated Mr. Love and Ms. Henson from Mercer. They thanked the Board and stated that they are looking forward to working together in the future.

AGENDA ITEM- 403(b) PROGRAM

Mr. Chaudhuri noted that there was a successful launch of the statewide 403(b) program last Friday. He thanks Mr. Toole and his staff for its efforts in getting this accomplished. He then recognized Bruce Corcoran and Jamie Summerlin to present a report on the 403(b) program.

Mr. Corcoran gave background on the origins and evolution of the 403(b) marketplace. He noted that North Carolina is the first system to take all three retirement plans (the 401(k), 457 and 403(b)) and put them under one umbrella. He stated that what North Carolina is doing should evolve into the best practice for the rest of the industry. He commended North Carolina on what it is doing for its educators.

Mr. Summerlin then gave an update on the roll out of the program. He stated that there are four pillars to TIAA's service to the 403(b) program;

1. Helping secure a better retirement for NC employees by offering best in class products and fee transparency
2. The multi-channel delivery system of the products (online and one-on-one services)
3. Exceptional customer service
4. Help protect the integrity of the Department of State Treasurer (DST) through good compliance and education in the school districts.

Mr. Summerlin went on to describe the roll out of the program in the districts. He noted that TIAA has attended conferences and has had one-on-one meetings with school district's finance officers. He said the next several months will be spent signing up the school districts. In August they hope to begin enrolling teachers. Ms. Cochran asked whether there had been any good media coverage of the program. Mr. Summerland said that there was. Ms. Rouse-Davis noted that the story of the launch of the program was picked up across the state and the DST will promote the program as new districts sign up. Ms. Johnson asked how we educate school districts about the competitive advantage of TIAA. Mr. Summerlin said the best way to do this is to lay the TIAA plan side by side with school districts current offerings. Ms. Baran asked whether TIAA will educate participants as to their ability to pay Registered Investment Advisors ("RIA") fees from sources outside of their accounts. Mr. Summerlin said yes. Ms. Baran asked that TIAA emphasize to participants the benefits of paying for RIA fees with after tax dollars instead of having them directly debited from the participant's account.

AGENDA ITEM- 4TH QUARTER INVESTMENT PERFORMANCE REPORT

Mr. Chaudhuri introduced Jay Love and Kelly Henson from Mercer Investment Consulting to provide a report to the Board on fourth quarter investment performance. Mr. Love noted that Sabrina Bailey of Mercer would also be joining by phone. Mr. Love gave a high level review of overall market performance for the fourth quarter. He noted that in the U.S., equities had strong performance and that fixed income continued to have relatively flat returns. He said that unemployment continues to decline. He thinks that the Federal Reserve is going to review their current thinking on interest rates as the economy improves, but he does not think any interest rate increases are imminent. GDP revisions show the economy grew at 2.4% which is better than we have seen in the recent past, but not as good as originally thought. He then gave an overview of sector results. The higher beta sectors outperformed, where the more defensive sectors underperformed. Equity valuations are not dramatically overpriced, but slightly above fair value. He noted that emerging markets have struggled this past year as the expectation that there might be a rise in US interest rates may hurt these markets. He noted that the 10 year Treasury moved up over the quarter, but overall fixed income is fairly flat.

Next Mr. Love reviewed the investment managers' quarterly performance. The Manager Performance Scorecard looks at a rolling three-year period. He believes all the funds in the Plans are in extremely good shape. He noted that all of the managers are outperforming their benchmarks with the exception of two. Mr. Gray asked at what point should the underperformance of Neuberger become concerning. Mr. Love stated that he gets concerned if the manager is expected to outperform the market based on their strategy and they in fact do not. He stated that the Investment Subcommittee will get a review of potential managers to replace Neuberger. Mr. Hamilton asked why Wellington does not have a Mercer rating. Mr. Love noted that Mercer does not rate this manager, but it does review the individual managers. He stated

that they are underperforming for some of the same reasons as Neuberger. Ms. Henson pointed out that Wellington is also on the watch list. Ms. Baran asked about the other Wellington funds. Ms. Henson pointed out that all Wellington funds use the same research.

Mr. Love gave an update on some transitions within investment managers' companies. He believes that Wellington is a very stable company even though they are going through a CEO change. In general Wellington has low employee turnover and this CEO transition has been very orderly. Wellington's Opportunistic Growth strategy has had some change in staff but he has no real concerns with this. He noted that there has been a CEO change at PIMCO. Mohamed El-Erian has left the firm. PIMCO appointed six deputies to replace him. He said there are rumors about how difficult Bill Gross, founder of PIMCO, is to work with. Ms. Keech stated that she has seen articles in the financial press that said one should get out of PIMCO. She asked Mr. Love if he is worried about this. He said they are watching this. He noted that the inflation product the Plans are in has less direct involvement with Mr. Gross. Ms. Buonfiglio asked if Mercer intends to check in with PIMCO more frequently. Mr. Love said yes. Ms. Baran asked about potential management conflict between Allianz [PIMCO's parent company] and PIMCO. Mr. Love said he did not see any.

Mr. Love noted again the two managers that are on the watch list, Neuberger and Wellington. Then he moved on to fund performance. He stated that actual performance results are extremely good. He noted that over longer periods the results of the Funds are generally in the top quartile or decile of their peers. He said that International Equity is a notable exception. It has underperformed because of a large exposure to emerging markets. Overtime though, this may end up being a positive. Mr. Love noted that overall the funds have an extremely good group of managers.

Ms. Henson gave a review of the fees. Mercer continues to work with investment staff to get fee reductions, noting that the Plans are paying significantly less fees across the funds than in the industry as a whole. Mr. Henson then turned to the Annual Plan Review. She stated this is done every year to look at the Plans from a broader perspective. This helps to identify things that would be helpful to work on.

Next the presentation was turned over to Ms. Baily to discuss plan design and retirement readiness as part of the Annual Plan Review. Ms. Bailey said that North Carolina has done a good job to get participants on track to reach the 80% replacement of income in retirement goal. She said that there are other benchmarks they are looking at with regard to measuring retirement readiness, particularly since for lower income participants the 80% goal may leave them below the poverty line in retirement. She noted that Mercer is also looking at the Plans fund line up. She noted that there is nothing wrong with the current fund lineup, but they are strategically looking 5 years out. She noted that the North Carolina Plans are ahead of the industry because of the multi-manager approach and with the inflation funds. Mercer is looking at how streamlining

funds might also impact GoalMaker. She suggested that Mercer might want to analyze GoalMaker's structure in terms of North Carolina participants' characteristics. Mr. Love said that Mercer is not recommending anything at this time; rather they are just looking at aspirational ideas and trying to make the Plans optimal for participants. Ms. Buonfiglio said that as the Plans are looking at unbundling, they should look at other structural items as well. Ms. Bailey went onto say that Mercer is looking at some of the investment options from the clean slate perspective and determining how to improve participant success. She noted that they are explicitly incorporating the Transfer Benefit option when looking at the participant experience. They are looking at perhaps including in GoalMaker something like hedge funds or private real estate investments that might not be appropriate as standalone investments. Mr. Thorp asked how this would work. Mr. Bailey said it would be in the multi-manager structure and what would be considered a liquid investment in illiquid securities. She stated liquidity could be managed in a number of ways.

Ms. Cochran asked whether we should simply be educating more on GoalMaker rather than expanding investment options. Ms. Buonfiglio said what is needed is to understand why participants aren't in GoalMaker before we start making changes to it.

Ms. Henson then gave a high level performance review of all the funds and their fees. She said there are no concerns with fees. And only a few concerns on performance.

Mr. Chaudhuri noted that there is an additional item for Mercer to report on involving the foreign currency exchange (FX) audit. He asked Ms. Buonfiglio to introduce this subject. Ms. Buonfiglio stated the Plans asked Mercer to conduct for this foreign currency exchange audit with Prudential and State Street and introduced Paul Sachs. Mr. Sachs stated that an FX review is an essential element of good oversight as there has been some controversy around FX over the last few years. FX issues arise when managers are buying and selling foreign stocks and they need currency to settle the transactions. The review was designed to detect the very items that have led to the controversies. Mr. Sachs stated that the funds' results were very good for the period he reviewed. Mr. Toole asked how often this should be done. Mr. Sachs said every three years. Mr. Hamilton asked how this issue came up and how it affects the Plans. Mr. Chaudhuri said that the Board had requested the audit based on media reports and based on some issues with the pension's custodian. Mr. Chaudhuri thanked Mr. Sachs for his presentation.

Mr. Thorp left the meeting at 11:55

AGENDA ITEM- 4TH QUARTER ADMINISTRATIVE REPORT

Mr. Chaudhuri recognized Michael McCann of Prudential for an administrative report on the 401(k) and 457 plans. Mr. McCann stated that he was going to shorten his report today as he

wanted to mainly focus on the education services provided by Prudential. He stated that 2014 goals that Prudential has set f are there to challenge their team. Kathleen Neville who is supervising Prudential's educational representatives in the field will also make a presentation.

He stated that there are some changes in the charts he is presenting at the request of Ms. Buonfiglio and Mr. Toole. Previously the information was presented on a calendar year to date basis, now the information will be presented over a rolling 12 month period. He noted that assets are up 18% for the year, much of this based on market performance. The Plans have almost 12,000 new participates in 2013. The 457 Plan now has over \$1 billion in assets.

Mr. McCann discussed a chart that showed the breakdown of participation in GoalMaker by age. He also talked about the asset allocation by age of assets not in GoalMaker. This chart showed that a minimal number are in the global and international stock portfolio and that they are many young people in the Stable Value portfolio. He said this chart explains why it is important to educate members to allocate to GoalMaker. In GoalMaker the assets are much more appropriately allocated based on age. He then introduced Ms. Neville to give a report on the eighteen field representatives in NC.

Ms. Neville said she is happy to be with the Board today. She has 16 years' experience in a variety of areas working with retirement plans. She shares the same goal as the Supplemental Retirement system – 80% income replacement for members in retirement. Ms. Neville shared a chart that gave information on the field force. She explained what they do on a day- to-day basis such as educating employers about the importance of matching contributions and discussing retirement readiness. She said the field force is doing an outreach to millenials. She said they are cross training with the Retirement System and partnering with TIAA-CREF and trying to have more group learning events.

AGENDA ITEM- BENEFICIARY ELECTION PROCEDURES UPDATE

The Chair then recognized Ms. Cece to present an update to the Board regarding the Supplemental Retirement Plans' policy for accepting a participant's change of beneficiary designation. She reminded the Board that at their previous Board meeting they adopted a policy to only accept beneficiary changes either online or in writing, but that following an initial election the written request must be notarized. She noted that nothing in the 401(k) or 457 Plan documents speaks to this so it is not necessary to amend them at this time. The staff will be working with Prudential on an outreach plan to notify members of the change. Mr. Chaudhuri asked if there were any questions. There were none.

AGENDA ITEM- PLAN DOCUMENT AMENDMENT

Mr. Chaudhuri recognized Ms. Cece to present a proposed Plan document amendment. Ms. Cece explained that every five years the Plans must file a determination letter with the IRS. Last

year, outside counsel realized that the Plans never formally adopted an amendment to change the plan documents to comply with a 2009 law. The law required Plans to amend their plan document to suspend the minimum distribution requirements for a limited period during the financial crisis of 2009. Ms. Baran made the motion to approve. Mr. Hamilton seconded and the motion was unanimously approved.

AGENDA ITEM- GOAL MAKER AGE ADJUSTMENT

Mr. Chaudhuri recognized Ms. Buonfiglio to explain the GoalMaker age adjustment project. Ms. Buonfiglio stated that staff had discovered that about 1/3 of GoalMaker participants did not turn on the automatic age adjustment feature. Most of these participants joined GoalMaker prior to that feature being offered. Prudential plans to seek a negative consent from these participants during the summer and will turn on the automatic age adjustment for them unless they affirmatively elect not to have this feature. We have worked with our internal legal team, Groom law firm and Prudential. All are supportive of this effort. Ms. Buonfiglio asked for a motion to adopt this recommendation. Mr. Hamilton made the motion, Ms. Keech seconded. The motion was unanimously approved.

AGENDA ITEM- UPDATE ON PLANS STAFFING AND BUDGET

Ms. Buonfiglio gave an update on staffing. She said staff continues to interview for marketing, communication and compliance personnel. She thinks they are close to hiring a communication person. She said that there is a great deal of internal communications review needed for the Plans. At this point internal defined benefit communication staff is being utilized for this and the funds have not been allocated to pay this staff. Ms. Buonfiglio made a request that funds be allocated to pay internal people. Ms. Baran makes a motion to approve the request. Ms. Keech seconds. The motion is unanimously approved.

Ms. Buonfiglio then reported that CEM had contacted her regarding a fee report for next year. After some discussion on the topic the Board came to the consensus that they would hire CEM bi-annually to perform a fee study. Mr. Hamilton made a motion to hire CEM to do a fee study of the Plans every other year with the first study beginning in 2015. Mr. Gray seconded and the motion was unanimously approved.

AGENDA ITEM- INTERNATIONAL PROXY VOTING

Ms. Chaudhuri recognized Ms. Cece to give a presentation on the international proxy voting guidelines for the plans. Ms. Cece stated that the staff is seeking Board approval of new guidelines. They are based on a template from our outside proxy voting firm Glass Lewis. She stated that staff had modified the template in order to make these guidelines consistent with our

domestic guidelines. Staff is going to work with Mr. Chaudhuri to develop more tailored international proxy guidelines in the future, but in the mean time they wanted to have these in place. She asked for a motion to approve the international Proxy Voting Guidelines. Ms. Baran made a motion. Mr. Cochran seconded. The motion was unanimously approved.

AGENDA ITEM- DIRECTOR'S REPORT

Mr. Toole presented the Director's Report, providing updates for the Board on several matters. Mr. Toole stated that at the next Board meeting staff would come back to them with a Placement Agent Policy recommendation. He encouraged Board members to attend the NAGDA conference. He said he had no other matters to discuss at this time except that there was a great deal of work to be done in the next 18 months.

AGENDA ITEM – BOARD QUESTIONS/COMMENTS

Mr. Chaudhuri asked the Board if they had any comments. There were none.

AGENDA ITEM – PUBLIC COMMENT

There were no public comments.

A motion to adjourn was made by Ms. Baran and seconded by Ms. Cochran. The motion passed unanimously, and the meeting adjourned at approximately 12:40 p.m.

CHAIR