NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

MINUTES OF MEETING
JUNE 5, 2013

Time and Location: The North Carolina Supplemental Retirement Board of Trustees (the "Board") met on Wednesday, June 5, 2013 in the Command Center Conference Room of the National Guard Headquarters, 1636 Goldstar Drive, Raleigh, North Carolina.

Members Present: The following members attended in person: State Treasurer Janet Cowell, Kathy Crooke, Melinda Baran, Mona Keech, Charles Leedy, and Clay Thorp.

Members Absent: Elizabeth "Libby" George. Two positions on the Board were vacant.

Staff Present: The following Department of State Treasurer staff members were present: Steve Toole, Mary Buonfiglio, Blake Thomas, Kevin SigRist, Rekha Krishnan, Lisa Page, Jaclyn Goldsmith, Joan Fontes, Jyothi Divya, Arlene Jones-McCalla, and Sam Watts.

Guests Present: Robert Luciani, Tim Bryan, Travis Swartwood, and Ann Cashman from Prudential Retirement; Jamie Summerlin and Jim Simone from TIAA-CREF; Jay Love and Kelly Henson from Mercer Investment Consulting; Amy Simonson from Verity Asset Management; and member of the public Robert Slade.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

The meeting was called to order at approximately 9:10 am. The Treasurer noted that the Department was testing out a new room for the meeting as part of a broader effort to evaluate alternative meeting space for the Department's board meetings, seeking a more formal setting for deliberations.

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

A motion was made by Ms. Baran to approve the minutes from the March 6, 2013 Board meeting. Ms. Crooke seconded the motion, which was unanimously approved.

A motion was made by Ms. Baran to approve the minutes from the March 28, 2013 special Board meeting. Mr. Thorp seconded the motion, which was unanimously approved.

AGENDA ITEM – RESOLUTION FOR ROBERT POWELL

The Board recognized the service of former Board member Robert Powell to the Supplemental Retirement Plans, the Board, and the State. It was moved by Ms. Baran and seconded by Ms. Keech to approve the attached resolution, which expresses the Board's appreciation. The motion passed unanimously.

AGENDA ITEM – PRESENTATION: "CAN WE DO MORE TO KEEP SAVINGS IN THE RETIREMENT SYSTEM" [1]

The Chair recognized Allison Borland of Aon Hewitt, whose presentation focused on withdrawals of funds by defined contribution ("DC") plan participants from their DC plan retirement savings. Aon Hewitt's findings were based on the data it collects as a recordkeeper for other DC retirement plans across the United States.

Plan members take funds out of their accounts before retirement in three primary ways: loan defaults, hardship withdrawals, and cashouts. Ms. Borland began with the subject of loans to participants from DC plan assets. Approximately one-fourth (27%) of DC plan members in the Aon Hewitt database hold loans, with an average outstanding loan amount of $8,074. When members with loans change employment, approximately 70% default on those loans. These defaults not only deplete the members' savings at retirement, but have negative tax consequences for the defaulting members. At default, the loan is treated for tax purposes as a distribution of assets, producing a 10% early termination penalty and immediate taxable recognition of the loan amount.

Ms. Borland noted that the majority of DC plans require immediate repayment of loans upon termination, which is very difficult for members. Ms. Borland noted a few DC plan procedures that could reduce the frequency of loans and loan defaults: restricting members to one loan at a time; enforcing a waiting period between loans; charging a nominal fee; and allowing loans to be authorized only through the call center, not the DC plan's website.

In 2012, 1.4% of DC plan participants took a hardship withdrawal. Approximately half of these participants reported the main reason for the withdrawal was to avoid a home eviction or foreclosure.

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[1] Mr. Leedy joined the meeting during this presentation.

Ms. Borland commented that cash distributions upon employment termination, or "cashouts," were the most problematic way in which members remove their DC plan funds before retirement. 43% of members, when they change employment, choose to take their full DC plan balance as a cash distribution. 28% of members choose to roll over their funds to another retirement plan, while 29% choose to remain in the DC plan kept by their former employer. The chance that a member will take a cash distribution varies based on the size of his or her account. While only 7% of members with more than $100,000 cash out, 36% of members with balances between $10,000 and $29,999 cash out, and 81% of members with less than $1,000 cash out.

Ms. Borland discussed testimony that her organization provided before the U.S. Senate HELP Committee in Spring 2013. One focus of the meeting was that minorities were more likely to cash out or withdraw assets. The differences between genders tend to be small compared to the differences in ethnic minorities' participation. It was noted at the hearing that it is difficult to roll over funds from plan to plan, due to the administrative burden of regulatory requirements. One reform now being discussed in pending legislation is a bill that would expand the time to repay hardship withdrawals.

Mr. Thorp observed that given the North Carolina Supplemental Retirement Plans' low fees, the best thing for members would be to keep their funds in the North Carolina Plans. The next best thing would be rolling over funds to another plan, which is difficult. The worst result would be a cash-out. Ms. Borland agreed, but noted that if funds were scattered through a number of separate plans, a rollover consolidating funds could be better than keeping those funds in the original plan. Mr. Thorp commented that if there is some way to make the cash-out hard, and the rollover easy, it would be in beneficiaries' benefit.

Board members asked whether similar data were available for North Carolina's Supplemental Retirement Plans (hereinafter, the "Plans"). Ms. Buonfiglio raised the issue for discussion during Prudential's presentation later in the meeting, but noted that the Plans have a lower-than-average percentage of outstanding loans. Mr. Bryan (of Prudential) provided some data concerning cashouts in the Plans. Approximately 60% of members stay in the Plans within a year after termination. 16% roll over their funds to another retirement plan, while 24% take a cash withdrawal. Mr. Bryan and Ms. Buonfiglio noted that broker-dealers promote withdrawal of funds through advertising and solicitation.

Ms. Baran asked whether the Plans were considering adding Certified Financial Professionals (CFPs) to the staff to provide sound financial advice. Mr. Toole and Ms. Buonfiglio responded that the Plans could provide those resources through adjustments to the recordkeeping contract, either in the form of an amendment to the existing Prudential contract or in the upcoming recordkeeper RFP to take place in 2014-15. Mr. Luciani (of Prudential) noted that Prudential was initiating a new program, partnering with MorningStar, that would allow members to select a true managed account and asset allocation for a fee.

AGENDA ITEM – 2013 AGENCY LEGISLATION

The Chair recognized Department of State Treasurer staff member Sam Watts for a legislative update. Mr. Watts noted that there were three pending retirement bills that would affect the Plans.

A governance changes bill (House Bill 357, later approved as Session Law 2013-287) clarifies statutes, streamlines procurement procedures to match those for the Department of State Treasurer's Investment Management Division, and grants immunity from civil liability for members of the Board.

An administrative changes bill (House Bill 358, later approved as Session Law 2013-288) allows a rollover from 403(b) plans into the State's defined benefit pension plan. Mr. Watts noted that to allow simpler regulatory compliance and conserve the Department's information technology resources, the 403(b) rollover would pass through the 401(k) plan. Ms. Baran noted that the rollover would be a very good argument for members to keep money in the Supplemental Retirement Plans.

Finally, Mr. Watts noted House Bill 381 (which later did not pass the House). This bill would have allowed new State employees to choose a new State defined contribution plan in lieu of the State's defined benefit pension plan. This would have matched the right available to University of North Carolina employees since 1973. Mr. Thorp asked whether this was part of a shift toward defined contribution plans for the State. The Treasurer responded that the goal was to keep the defined benefit system strong, but she noted that a large population of State employees and teachers work less than 10 years and will not vest in the defined benefit plan under current State law.

401(k) / 457(b) PLANS

AGENDA ITEM – APPROVAL OF INVESTMENT SUBCOMMITTEE MEETING MINUTES FROM MAY 16, 2013

Ms. Baran presented the May 16, 2013 Investment Subcommittee meeting minutes, noting particular features of the meeting. Ms. Baran made a motion to approve the Subcommittee meeting minutes. Ms. Crooke seconded the motion, which was unanimously approved.

AGENDA ITEM – INVESTMENT POLICY STATEMENT MODIFICATIONS

Ms. Baran presented a written recommendation to make changes to the Plans' Investment Policy Statement. The recommended changes would increase the country maximum limit to 60% from 50% in the Plans' Global Equity Fund and add language governing the PIMCO Inflation Response Fund. After Ms. Baran described the recommendation, Mr. Thorp made a motion to accept it. Ms. Keech seconded the motion, which was unanimously approved.

AGENDA ITEM – 1ST QUARTER INVESTMENT PERFORMANCE REPORT

The Chair recognized Mr. Love and Ms. Henson (of Mercer) for a report summarizing the performance of the Plans' investment options over the past quarter.

Mr. Love noted that it was a terrific quarter for equities, particularly domestic equity stocks. Fixed income return was in the single digits. Most foreign currencies depreciated. Value outperformed growth. Defensive sectors performed strongly.

Mr. Love then reported on the performance of each investment option (or "fund") available to members of the Supplemental Retirement Plans.

- Mr. Love commented that it was a very challenging quarter for active management. Sectors that had previously been underperforming instead outperformed during the quarter, and vice versa.
- The Large Cap Value, Large Growth, and Mid/Small Cap Growth funds trailed the benchmark over some of the time periods measured. However, all of these funds ranked within the top half of the universe over one-year and three-year time periods.
- The International Equity fund also trailed its benchmark over some of the time periods listed, and it was not in the top half of the universe over three-month and one-year time periods. Mr. Love explained that emerging markets have been underperforming. Mr. Love noted that the benchmark was not in full alignment with the International Equity fund's strategy.
- The Small / Mid Cap Value, Global Equity, Fixed Income, and Stable Value funds each outperformed their benchmarks over all time periods measured.

Mercer commented on several of the underlying investment managers within the Supplemental Retirement Plans' funds.

- Neuberger Large Cap Growth was the only manager for which Mercer had significant concern.
- Sands Capital had a challenging quarter, but Mercer had no concerns; Sands' strategy is inherently volatile, and it exhibited very good long-term performance.

- The Earnest Partners Value portfolio underperformed. This underperformance was not dramatically behind the universe, but was a greater distance behind the benchmark. Mr. Love stated that Earnest's strategy was in the value area, but Earnest tended to be more of a core manager. The recent tilt in the market has been a headwind for Earnest. Mr. Love said that he had no concerns with Earnest's results right now.
- Mr. Love noted a change in ownership for Robeco and changes in personnel at Brown and ArrowStreet.

Ms. Henson provided a report on the performance of the Plans' GoalMaker funds. The report compared the Plans' funds against benchmarks and against the universe of DC plan target date funds. In response to a question from Mr. Thorp, Ms. Henson promised to provide a breakdown of the comparison universe at a future meeting.

AGENDA ITEM – GOALMAKER / GLIDEPATH – LETTER OF REASONABLENESS

The Chair recognized Mr. SigRist, Chief Investment Officer for the Investment Management Division ("IMD") of the Department of State Treasurer. Mr. SigRist's division manages funds for the State's defined benefit pension plan. Mr. SigRist summarized the Investment Management Division's review of recommendations made by Mercer concerning changes to the GoalMaker glidepath.[2] This review was summarized in a letter to the Board.

Mr. SigRist stated that after review of the recommended changes, his staff viewed the changes favorably. Using more active management in the small / mid cap space makes sense, given the current market, and the increase to the Global Equity fund's allocation will ultimately accrue to the benefit of participants.

Mr. SigRist also commented on the PIMCO Inflation Response Multi-Asset Fund, a new addition to the Plans' investment lineup approved in the December 5, 2012 Board of Trustees meeting. IMD staff viewed the new inflation response fund positively. Mr. SigRist stated that staff's only words of additional caution or color concerned differences in the PIMCO fund from standard investments. The PIMCO inflation response fund's TIPS allocation is large, and IMD staff believe TIPS are currently overvalued. Mr. SigRist suggested that from communications standpoint, it be clearly communicated that the inflation response fund is different, and there are dimensions that investors should understand. Mr. SigRist stated that the inflation response fund was a fine offering as part of a broader investment lineup.

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[2] The Board previously discussed Mercer's recommendations at the March 6, 2013 meeting. There, the Board made a motion to accept the report, but to defer any action on the recommendations made in the report until an evaluation could be made by IMD.

Ms. Crooke made a motion to accept Mercer's recommended changes to the GoalMaker program, including the addition of the PIMCO inflation response fund to GoalMaker. Mr. Leedy seconded the motion, which was unanimously approved.

Ms. Buonfiglio noted that on the normal GoalMaker rebalancing date in September, the PIMCO inflation response fund would be added as a new investment option and the GoalMaker changes would be implemented. Ms. Buonfiglio noted that this was a big communication and operational task, and the Plans would be looking to hire a transition manager.

The Chair adjourned for a short **BREAK** at 10:30 a.m. The Board reconvened at 10:40 a.m.

The Chair provided an update on appointment of Board members. Mr. Thomas noted that the current members of the Board would continue to serve until any replacement was named.

AGENDA ITEM – 1ST QUARTER ADMINISTRATIVE REPORT

The Chair recognized Mr. Bryan for a report on the 401(k) and 457 plans' administration. At the end of the first quarter, 235,260 persons held an account balance in the 401(k) plan, while 42,937 persons held an account balance in the 457 plan. These numbers were up by 14,135 persons, combined, since the first quarter of 2012. Mr. Leedy noted that average and median account balances were down from one year ago. Mr. Bryan responded that this was the result of growth in the Plans' members, which pushes average account balance down.

Mr. Bryan noted:

- Approximately 85% of enrollments were done by paper, but 98% of contribution changes were made through the Plans' Internet site.
- Slightly more than 50% of all participants (including more than 85% of all new participants) participated in GoalMaker.

Mr. Toole noted that employee contributions have been stagnant. Ms. Buonfiglio and Mr. Bryan discussed following up on this issue.

Mr. Bryan stated that 24% of all 401(k) members and 14% of all 457 members held outstanding loans. (These numbers were less than the 27% average DC plan figure reported by Aon Hewitt earlier in the Board meeting and less than the 28% figure reported by the Washington Post in a January 2013 article.)

In response to questions from the Board, Mr. Bryan and Mr. Swartwood explained the basic features of the Plans' loan policies:

- A $60 loan initiation fee, with no fees thereafter;
- Only one allowed outstanding loan per member;
- A 15-day waiting period, once a loan is repaid, before a member can initiate another loan;
- A 1-year to 5-year loan repayment period, at the option of the member;
- An interest rate of prime + 1% fixed for the term of the loan, with interest paid by payroll deduction;
- No justification required from the member to explain his or her need for the loan; and
- Quick response to loan applications, with funds available in as few as two days.

Loans generally may be no more than 50% of the member's account and may not exceed $50,000. In the 457 plan, home loans are also available. When employment ends, members with outstanding loans have an opportunity to make monthly payments via coupon book. Terminated members are encouraged to leave their money in the Supplemental Retirement Plans and are warned about the potential tax consequences of a cashout. Mr. Thorp commented that the loan program is a benefit to employees. Treasurer Cowell asked for the topic of loan treatment to be further discussed at a future Board meeting.

AGENDA ITEM – BUDGET UPDATE

Ms. Buonfiglio presented a proposal to the Board for an updated budget covering the next fiscal year. The Board materials included a summary and table summarizing the details.

Ms. Buonfiglio began her discussion of the topic by turning to the administrative fee charged by the Board. Mindful of the IRS exclusive benefit rule, any revenues are divided separately between, and kept within, each of the 401(k), 457, and 403(b) plans. For the 401(k) and 457 plans, a 2.5 basis point administrative fee is charged. Staff's recommendation was to continue charging at that level. For the 403(b) plan, it is more difficult to determine a proper basis point fee, because the 403(b) program is currently being implemented. To forecast revenue from the administrative fee for the budget, staff made projections concerning the 403(b) plan's growth. Ms. Buonfiglio and Mr. Toole noted that they believed inflow of $22 million over one-year period was a reasonable, conservative assumption. Given that the 403(b) plan is a startup, staff suggested, for the upcoming fiscal year, a higher administrative fee of 5 basis points. Over time, this administrative fee could be reduced.

Ms. Buonfiglio turned to the details concerning expected administrative fee revenues and budgetary outflows:

- The administrative reimbursement account contained approximately $2.4 million for the 401(k) plan, $382,000 for the 457(b) plan, and no funds for the 403(b) plan.
- Staff projected administrative fee revenue of $1.66 million for the 401(k) plan, $651 thousand for the 457 plan, and $3,250 for the 403(b) plan.
- The proposed budget contained projected expenditures of $1.30 million for the 401(k) plan, $201 thousand for the 457 plan, and $3,089 for the 403(b) plan.
- These figures assumed that current Plan participant asset levels would stay the same over the coming year.
- Although the State was still working on completing the administrative approval process for the new staff positions, the budget assumed full employment for the next fiscal year.

Ms. Buonfiglio concluded her presentation by highlighting changes to the proposed Fiscal Year 2013-14 budget. Expenses rose by $114,384, driven primarily by increased personnel costs to implement the staffing structure approved in previous meetings by the Board. The budget proposal also included increased funds for a comparative fee benchmarking study, which would be useful for Board members and staff in analyzing the Plans' fees and setting expectations for negotiation. The upcoming budget included funds for an initiative to replace paper Board meeting materials with Internet distribution. Finally, the budget included a due diligence trip for the Board to inspect the operations of Prudential in Scranton, Pennsylvania.

Mr. Thorp moved to approve the budget as presented by staff. Mr. Leedy seconded the motion, which was unanimously approved.

AGENDA ITEM – STAFF UPDATE

Mr. Toole, Ms. Buonfiglio, and Ms. Krishnan provided updates on several matters.

Staffing Update – As previously approved by the Board and consistent with the newly approved Fiscal Year 2013-14 budget, new staff positions include a full-time attorney dedicated to the Supplemental Retirement Plans, a communications position, an in-house marketing position partnering with the Plans' service providers, and a full-time compliance position. Ms. Buonfiglio reported that staff were moving through the process of getting these positions approved by the Office of State Personnel and Office of State Budget and Management. It is considerably more time-consuming to create new positions than to fill existing positions that have become vacant. Ms. Buonfiglio stated that staff hoped to receive all necessary approvals in the coming week, then post the positions for two to three weeks. Ms. Buonfiglio stated that she hoped that the Plans would be fully staffed in 60-90 days.

Annual Benefits Statement – Ms. Buonfiglio presented a short summary of the Annual Benefits Statement that was recently sent to the Plans' participants. The Annual Benefits Statement is designed to encourage members to think about their retirement planning. It includes not only Supplemental Retirement Plans data, but projected benefits from Social Security and (if applicable) the State's pension plan, along with a retirement income gap analysis.

Investment Consultant RFP – Ms. Buonfiglio provided an update on the investment consultant RFP discussed at prior Board meetings, noting that staff were still working on this very complex proposal.

Hurricane Sandy Amendment – As a follow-up to the discussion of Hurricane Sandy response at the last Board meeting, Ms. Buonfiglio noted that the Plans received advice from counsel that the Hurricane Sandy response approved by the Board could be accomplished without amendment to 457 plan documents.

Proxy Voting – Ms. Krishnan presented a brief update on the Plans' proxy voting. During the past year, the Plans have had the opportunity to act on more than 12,000 shareholder proposals. Glass Lewis receives advice from Glass Lewis & Co. concerning votes on these proposals, and votes are cast based on this advice and the Plans' proxy voting guidelines.

NAGDCA Conference – Ms. Buonfiglio and Mr. Toole provided a brief update on the next annual National Association of Government Defined Contribution Administrators (NAGDCA) conference, scheduled for September 8-11, 2013 in Louisville, Kentucky. Ms. Buonfiglio and Mr. Toole were scheduled to speak at this year's conference.

403(b) PLAN

AGENDA ITEM – SUBCOMMITTEE REPORT

Ms. Baran stated that members of the Investment Subcommittee met several times with staff and with Mercer to consider which vendor to hire for a 403(b) plan stable value offering. Ultimately, the Subcommittee selected TIAA-CREF's stable value program for a variety of reasons, including but not limited to credit rating fees, costs, payout period, and participant liquidity.

Ms. Baran then turned to the topic of emerging market investments in the 403(b) plan. Since the last meeting of the Board, the Subcommittee and staff had discussed whether a dedicated emerging market fund was the best choice for the upcoming 403(b) lineup of investment options.

The Vanguard Total International Stock Fund better met the Subcommittee's management criteria. Twenty percent of that Vanguard fund is made up of emerging managers.

Mr. Thorp made a motion to approve the TIAA stable value fund and Vanguard Total International Stock Fund as investment options. Mr. Leedy seconded the motion, which was unanimously approved.

AGENDA ITEM – IMPLEMENTATION UPDATE

Mr. Summerlin (of TIAA-CREF) presented an update on 403(b) program implementation. TIAA-CREF attended NC ASBO events in February and March, speaking to over 250 administrators at those events, and held a webinar to roll out the program on May 9. Over the six weeks following the June 5 Board meeting, TIAA-CREF was set to hold meetings with 40% of the State's school districts. Mr. Summerlin reported that districts' reaction was very positive. Mr. Summerlin stated that, based on his review and analysis of districts, he felt that roughly 85% of districts would be early adopters, while roughly 15% would be a challenge. In response to a question from the Treasurer, Mr. Summerlin explained that these challenges came chiefly from third party administrators or contracts that created exclusive relationships. TIAA-CREF was working with Bob Clark at N.C. State to perform a survey of districts prior to the 403(b) program, understanding fees; this survey will be repeated later to examine how the 403(b) program has changed things in the State.

AGENDA ITEM – STAFF UPDATE

Mr. Thomas noted that very limited resources in the Department's in-house legal department were slowing down the drafting process and finalization of the 403(b) contract.

Mr. Summerlin discussed the proposed usage of Registered Investment Advisors (RIAs) by the 403(b) plan. Individuals who wish to receive individualized, face-to-face investment advice will be able to hire an RIA for an additional fee. A list of prescreened RIAs will be available for any particular area. Mindful of cost, participating RIAs on this list will have their fees capped at 1%. If members wish to use an RIA not on the list, they may do so.

Finally, Ms. Buonfiglio raised with the Board the question of what level of auditing would be appropriate for the 403(b) program. The initial small size of the program may make a comprehensive audit financially impracticable. Staff will return with a recommendation.

AGENDA ITEM – BOARD QUESTIONS/COMMENTS

There were no additional comments or questions from the Board.

AGENDA ITEM – PUBLIC COMMENT

Mr. Slade provided a public comment.

A motion to adjourn was made by Ms. Keech and seconded by Ms. Crooke. The motion passed unanimously, and the meeting adjourned at approximately 12:00 p.m.

Janet Cowell

CHAIR

RESOLUTION

WHEREAS, Robert Powell served as a member of the Board of Trustees of the North Carolina Supplemental Retirement Plans from August 13, 2008 until March 31, 2013; and

WHEREAS, Mr. Powell was always interested in advancing the use of the Plans by public employees; and

WHEREAS, Mr. Powell made invaluable contributions to the work of the Board through his leadership on the Board and of the Audit Subcommittee; and

WHEREAS, Mr. Powell's service proved to be of the highest value in the enactment of many improvements to the provisions of the Plan; and

WHEREAS, Mr. Powell rendered outstanding leadership in preserving and promoting maximum benefits for Plan members; and

WHEREAS, the Board of Trustees of the North Carolina Supplemental Retirement Plans are composed of distinguished citizens serving as Trustees;

NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF TRUSTEES OF THE NORTH CAROLINA SUPPLEMENTAL RETIREMENT PLANS THAT:

Section 1. The Board of Trustees hereby expresses its deep appreciation and gratitude to Mr. Robert Powell for his leadership, dedication and public service in securing the advancement of the Plans.

Section 2. The Chair of the Board of Trustees is hereby directed to prepare and deliver a certified copy of this Resolution to Mr. Powell.

Section 3. This Resolution shall be placed within the Minutes of the Board of Trustees for the meeting held on Wednesday, June 5, 2013, in Raleigh, North Carolina.

Janet Cowell
North Carolina State Treasurer
Chair, Supplemental Retirement Board of Trustees