



North Carolina
Total Retirement Plans
401k | 457 | 403b



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DRAFT MINUTES
SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

The regular quarterly meeting of the Supplemental Retirement Board of Trustees was called to order at approximately 9:00 a.m. on December 3, 2020, by the Chair, State Treasurer Dale R. Folwell, CPA. The meeting was held with some attendees in the Dogwood Conference Room of the Longleaf Building at 3200 Atlantic Avenue, Raleigh, NC 27604 and with most attending via teleconference. The Chair indicated there would be a public comment period for organizations and individuals to address the board later in the agenda.

Members Present

The following board members were present: Treasurer Dale Folwell, Melinda Baran, Lorraine Johnson (by phone), Michael Lewis (by phone), Nigel Long (by phone), Nels Roseland (by phone), Steve Beam (by phone), and Chevella Thomas (by phone).

Members Absent

James Lumsden

Guests Present

The guests attending (all by phone) were: William Claxton and Greg Wilcox from BNY Mellon; Elizabeth Hood and Weston Lewis from Callan; Paul Langanki from Galliard; Mary Conti, Matt Herrmann, Michael McCann, and Jessica Quimby from Prudential.

Department of State Treasurer Staff Present

The following staff members were present: Mary Buonfiglio, Tom Causey, Reid Chisholm, Loren de Mey (by phone), Chris Farr (by phone), Christy Farrelly, Joan Fontes (by phone), Patti Hall, Alan Jaquith (by phone), Rekha Krishnan (by phone), Fran Lawrence (by phone), Frank Lester (by phone), Doug Mayer (by phone), April Morris (by phone), Christopher Morris (by phone), and Sam Watts (by phone).

The Chair called the meeting to order and reminded members that, since this meeting is being held in a hybrid format in person and by teleconference, members must announce their names when they arrive, when they depart, and when speaking. He explained that all votes will be taken by roll call and that making a motion will be assumed to be a vote for the proposal.

Ethics Awareness and Identification of Conflicts or Potential Conflicts of Interest

The Chair asked, pursuant to the ethics rules, about conflicts of interest of the board members. No conflicts of interest were identified by the board members.

Approval of Board Minutes

The Chair entertained a motion to approve the minutes of the August 27, 2020 board meeting. Ms. Melinda Baran so moved, and Mr. Steve Beam seconded. The motion passed unanimously by roll call vote.

NC Supplemental Retirement Plans Annual Strategic Communication Plan

The Chair recognized Ms. Christy Farrelly to present the annual strategic communication plan update. Ms. Farrelly reviewed the 2020 plans which included efforts to engage, educate, and empower members through a variety of new tools and resources, including refreshing website content, launching a new employer education webpage, and the continued success of the Nearing Retirement email campaign. She said that 70% of current participants can be contacted by email which is an effective way to communicate. Visitors to the website grew and the average user session increased by five minutes. The “Nearing Retirement” email marketing campaign had a 97% open rate and a 40% click through rate to the cost comparison tables. A new webinar around National Retirement Security month was the largest ever, with over 1,600 registrants.

Ms. Farrelly said that staff looks forward to continuing to engage, educate, and empower members in 2021. Staff intends to broaden outreach and simplify education. One key area of focus will be to ensure members know that they can remain in the Supplemental Retirement Plans after they have retired. In response to a question from Ms. Baran regarding retention, Ms. Farrelly commented that in evaluating lump sum withdrawals alone, 15% more participants remained in the plans after retiring in 2020 as compared to 2019.

The Chair added that Open Enrollment for 2020 was the first time that members had the opportunity to enroll in one of the Supplemental Retirement Plans while signing up for health coverage and benefits.

NC 401(k) and NC 457 Plans Administrative Fee

The Chair recognized Ms. Mary Buonfiglio and Mr. Reid Chisholm to discuss the NC 401(k) and NC 457 Plans’ administrative fee. Ms. Buonfiglio explained that a waiver of the 2.5 basis point (bps) administrative fee was in place for 2019 and 2020 because of the size of the accumulated balance in the administrative expense account. However, the funds in the expense account are insufficient to continue the fee waiver throughout all of 2021. She said that staff is proposing legislation to give the Board greater flexibility to set administrative fees. Mr. Chisholm discussed a proposal to amend the statutory authority to set administrative fees and provided a draft Board resolution in support of a statutory amendment. Mr. Chisholm explained that the administrative fees were established in the North Carolina Administrative Code, and the Board only has the right to set the fee at either 0 bps or 2.5 bps.

The Chair commented that currently there is not enough in the administrative expense account to waive fees for another year. He said that his desire is to revise the statute wording from “at 2.5 bps” to “up to 2.5 bps”. He said that in his opinion, this puts us where we need to be and provides greater flexibility to the Board.

Mr. Chisholm explained that statutorily there is no fee cap; the fees are in the Administrative Code. The Chair recommended that the current fees be used as statutory caps. The Chair and Mr. Chisholm also noted that the fee for the NC 403(b) Program is 5.0 basis points due to the smaller total asset balance in the program.

The Chair entertained a motion to approve the resolution seeking legislation for greater fee flexibility for the Supplemental Retirement Plans, with the addition that the current fees should be included as statutory caps. Mr. Beam so moved, and Ms. Chevella Thomas seconded. The motion passed unanimously by roll call vote.

Vendor Matters

The Chair recognized Ms. Buonfiglio to present updates on vendor matters. First, Ms. Buonfiglio shared that the current contract with E&Y (formerly known as Ernst & Young) to provide foreign tax consultant services expires in January 2021 and that Supplemental Retirement Plans (SRP) staff has requested a six-month extension through June 30, 2021. She requested the Board's permission to evaluate global tax compliance vendors and to recommend a vendor to the Board after the evaluation process.

The Chair asked if SRP staff anticipated experiencing challenges with investments in China due to proposed federal divestment legislation. Ms. Loren de Mey said that one manager has reached out to her regarding China American Depositary Receipts (ADRs). She said that if a restriction is placed on investments in China ADRs, it might be possible for our managers to purchase shares directly in the local Chinese marketplace.

The Chair entertained a motion to enable SRP staff to evaluate global tax compliance vendors and to provide a recommendation. Ms. Baran so moved, and Ms. Thomas seconded. The motion passed unanimously by roll call vote.

Secondly, Ms. Buonfiglio spoke concerning the custodian for the NC 401(k) and NC 457 Plans' Stable Value Fund. She reminded the Board that Wells Fargo sold their stable value custodial business to Principal. She shared that the stable value assets must transition to the new custodian and that the transition is likely to occur in the second half of 2021. Ms. Buonfiglio shared that staff has met with both BNY Mellon and Principal to evaluate each firm, including background and experience, technology systems, level of financial resources, and cost. She commented that the quotes were quite similar and that BNY Mellon agreed to reduce their cost further. She said that SRP staff is recommending that BNY Mellon be chosen as the custodian for the stable value assets.

The Chair entertained a motion to amend the existing BNY Mellon contract to include serving as Custodian for the Stable Value Fund and to begin transitioning the Stable Value Fund's separate account assets to BNYM as the new custodian. Mr. Roseland so moved, and Mr. Lewis seconded. The motion passed unanimously by roll call vote.

IRS Audit of the NC 457 Plan

The Chair recognized Mr. Chisholm to discuss the ongoing IRS audit of the NC 457 Plan. Mr. Chisholm explained that the IRS contacted BEACON to audit the NC 457 Plan because the audit was specific to employees in the plan who are paid through BEACON (which provides payroll services to state agencies and departments). The audit was specific to calendar year 2018. He said that SRP staff worked in tandem with BEACON to gather the information that the IRS requested. He said that SRP staff and BEACON representatives provided all the requested information and met with the IRS agent via a conference call. He commented that staff anticipates that the audit will be clean and will likely be closed with no negative findings. Mr. Chisholm said that SRP staff was grateful to Ray Scerri and his staff at BEACON for all the help they provided.

The Chair asked how often these audits occur, and Mr. Chisholm replied that this was the first tax audit for SRP. Ms. Thomas asked what might have triggered this audit. Mr. Chisholm explained that the audit was routine.

Amendments to the Plan Documents for the NC 401(k) and NC 457 Plans

The Chair recognized Mr. Chisholm to discuss minor amendments to the plan documents for the NC 401(k) and NC 457 Plans. The proposed revisions to the NC 401(k) Plan include making the

distributions of small accounts discretionary instead of mandatory. The proposed revisions to the NC 457 Plan include returning the maximum “normal retirement age” to 70 ½

The Chair entertained a motion to approve the proposed revisions to the plan documents for the NC 401(k) and NC 457 Plans. Ms. Thomas so moved, and Ms. Baran seconded. The motion passed unanimously by roll call vote.

Administrative Update

The Chair recognized Mr. Michael McCann and Mr. Matt Hermann from Prudential to provide the Third Quarter 2020 Administrative Report on the NC Supplemental Retirement Plans. Mr. McCann shared that Prudential has added new summary pages that provide a rolling 13-month overview. He shared that total plan assets have grown approximately 8% over the past year. While the percentage of active participants declined slightly over the past year, the average participant account balance and deferral rate both increased. He said that the coronavirus-related distributions and loans have totaled over \$188 million and more than 19,000 transactions. He shared that the active employee average deferral rate has continued to rise. Total enrollments fell early in the pandemic and are now increasing again. He commented that at this point, no employers have stopped or decreased their employer contributions.

Mr. Hermann said that Prudential has 18 dedicated Retirement Education Counselors across North Carolina. They have been meeting virtually with participants and employers. When the pandemic hit, Prudential recorded webinars, which are now available on demand, and have already been viewed over 1,300 times. He shared that October was a huge month for Prudential with large retirement focus sessions, regional general education sessions, and these reached over 10,300 employees. Their goal is to increase employer engagement. Mr. Hermann shared that Prudential has launched “retiree courtesy calls”. Retirement Education Counselors attempt to contact recent retirees to educate them about available tools and plan options, including that they may remain in the Supplemental Retirement Plans. They have made 1,200 calls so far and spoke directly with more than 600 retirees. They find retirees to be very receptive to these calls and the response has been overwhelmingly positive.

Mr. Tom Causey thanked Mr. McCann and Mr. Hermann, expressing his appreciation for the new summary pages. He added that Prudential has agreed to reduce the annual recordkeeping fee from \$31 to \$28 annually. The Chair echoed Mr. Causey’s appreciation and commented that this fee reduction is one that members will actually see on their statements. Ms. Buonfiglio said that the contract amendment for the fee change would be drawn up and ready for the Treasurer’s signature the following week. Mr. McCann stated that Prudential is already making steps to lower the fee based on the verbal agreement and would begin charging the lower fee amount starting with the January 2021 quarterly fee payment.

Investment Update NC Small/Mid Cap Fund

The Chair recognized Ms. Elizabeth Hood from Callan to present the current recommendations from staff and Callan. She explained that Callan looked at overall plan design. She said that multiple options are available. She reviewed the current structure, history of changes, and practical considerations. She explained that the fund had a structural bias to value and an overweight to passive investments beginning in 2018. When one of the fund’s growth managers was terminated in 2018, funds were reallocated to existing value managers. She discussed the three proposed options and said that Callan recommends Option (Mix) Two (in Callan’s Board materials), which will minimize disruption and transition costs relative to introducing an additional manager. Option Two will maintain the current number of managers, but it will shift the mandate for Earnest Partners from value to core and will reduce the allocation to passive

management. Option Two lowers risk (standard deviation) and will have slightly higher fees than the current structure since the fund will have a greater percentage of active management. She added that the fee would still be lower than 90% of peers.

Mr. Long thanked the Chair and Ms. Johnson for the background information. He stated his goal of addressing the issue to the benefit of participants. He explained that he had a productive discussion with two other board members (Ms. Johnson and Mr. Beam) earlier this week. He stated that they agree with Callan that the current structural bias is a risk and should be removed. He commented that Option Two balances risk and that the increase in cost is offset by a potential increase in return. He said that Option Two has lower risk than the other proposed options. He expressed concern with increasing the allocation to Wedge Capital and requested that Callan evaluate and recommend to the Board whether Wedge Capital should be retained or terminated.

Mr. Beam commented that he was probably the one who encouraged the overweight to value in 2018. He supported Option Two, which would remove the style bias. He also stated that if Callan recommends terminating Wedge Capital, he would like to see recommendations for a new manager at the same time.

In response to a question from Ms. De Mey, Mr. Beam clarified that his recommendation is to implement now because Wedge would not receive a significant increase in its allocation. Mr. Long concurred that the Board should implement the change now to resolve structural bias while recognizing that Wedge Capital is on the watch list.

Ms. de Mey stated that SRP staff does not believe that Wedge Capital is a candidate for termination. Wedge Capital has outperformed its benchmark during October and November. She added that Wedge Capital informed her of a change on their investment team, but also noted the experienced leadership of the team. Ms. Hood agreed that Callan is comfortable retaining Wedge Capital and said that if they see any reason to recommend a change, they will come prepared with recommendations at the next Board meeting.

Discussion continued about the structure of Wedge Capital's mandate with 50% small-cap and 50% mid-cap and Earnest Partners investment approach of letting winners run. Mr. Beam commented that it could be a prudent exercise of fiduciary responsibility to review Wedge Capital so that the Board will be content with the transition.

The Chair stated that his preference is for Option Three, but that the Board would focus on Option Two since the Board seemed to favor Option Two. He asked how much money would move in the transition. Ms. de Mey explained about \$200 Million would be moved in the rebalancing. She said that all active managers would get an increased allocation, the mandate for Earnest Partners would shift from value to core, and that the current allocation to passive investments would decrease.

The Chair again stated his preference for Option Three and asked if there was any additional discussion. He asked for a motion. Mr. Long motioned that the Board adopt Option Two and that it be implemented immediately. He further added to the motion that the Board request that Callan make a recommendation regarding Wedge Capital at the upcoming March 2021 meeting. Mr. Beam seconded. The motion passed via roll call with five Aye votes (Mr. Beam, Ms. Johnson, Mr. Lewis, Mr. Long, and Mr. Roseland), two No votes (Treasurer Folwell and Ms. Baran), and one abstention (Ms. Thomas).

Discussion continued on this same topic. Mr. Lewis asked the Chair why he preferred Option Three. The Chair explained that in his opinion Option Three has less change, it would be simpler to execute, and potentially it could be less costly long term.

Ms. Baran said that she takes responsibility for delaying the vote, but she wanted to see what the markets did. She supported balancing value and growth investment styles, but she proposed a different asset allocation with a higher allocation to passive and a lower fee.

Mr. Long commented that for a participant who would prefer an active small-/mid-cap option, Option Two is the best way to provide that choice. The increased cost with Option two is nominal and more than offset by increased expected performance. He also noted the significant reduction in risk from a participant standpoint relative to the current fund structure and Option Three.

Mr. Beam said that as a fiduciary, our goal is not to minimize absolute cost, but to provide appropriate choices. He stated that the fund needs more active management.

Ms. Johnson commented that she is not against passive funds and is glad that we have a passive option, but pointed out that this fund is not for that purpose.

The Chair stated that the motion passed; the Board adopted Option Two and requested that Callan evaluate Wedge Capital.

NC 401(k) and NC 457 Plans 3rd Quarter 2020 Stable Value Portfolio Review

The Chair recognized Mr. Langanki of Galliard, who stated that Galliard recently hit an all-time high for assets under management. He added that Galliard is still growing and hiring. He commented that Galliard has over 220 institutional clients. He thanked North Carolina for being a Galliard client for the past 10 years and for placing our trust and confidence in Galliard.

Mr. Langanki said the Stable Value Fund has performed as expected. He also mentioned Galliard's management fee reductions in January and July of this year. He said that the portfolio assets grew slightly in the third quarter. He explained that the average quality of the portfolio at book value dropped one notch because Galliard reallocated cash to one insurance company. Galliard had increased the cash buffer, but did not see any significant amount of cash move out of the fund despite the pandemic. Therefore, Galliard reallocated the extra cash from the cash buffer to achieve higher returns. The market/book value ratio is very strong and will help mitigate lower yields going forward.

Ms. Johnson questioned the drop in the average quality of the portfolio at book value. Mr. Langanki explained that the rating applies to wrap providers and not the underlying securities in the Stable Value Fund. He said that overall quality remains strong, and the decline came from allocating additional cash to Nationwide. He added that fees paid to wrap providers have continued to drop and that Transamerica will be lowering their wrap fees.

Mr. Langanki noted the strong investment performance in the fund.

NC 401(k) and NC 457 Plans 3rd Quarter 2020 Investment Performance Report

The Chair recognized Mr. Weston Lewis of Callan and asked whether he had anything to add to the presentation in the Board's materials. Mr. Lewis said that all investment options are performing well and are in line with expectations.

NC 401(k) and NC 457 Plans Review of Investment Policy Statement

The Chair recognized Ms. de Mey, who said SRP reviews the Investment Policy Statement annually. As part of the recent review, SRP staff is recommending some minor changes, including a clarification to the investment objective of the Inflation Responsive Fund.

The Chair entertained a motion to approve the proposed revisions to the NC 401(k) and NC 457 Plans Investment Policy Statement. Ms. Baran so moved, and Ms. Johnson seconded. The motion passed unanimously by roll call vote.

NC 401(k) and NC 457 Plans Investment Compliance Summary Report

The Chair recognized Ms. de Mey, who said that staff continues to monitor investment managers daily for compliance with their respective investment guidelines. She commented that no managers held prohibited holdings during the quarter. She said that the transition from Russell Global Sectors (RGS) to the more widely used Global Industry Classification Standard (GICS) structure was completed during the quarter. Staff is now using the GICS for monitoring adherence to all investment guidelines.

NC 403(b) Program 3rd Quarter Investment Performance Report

The Chair recognized Ms. de Mey to review the NC 403(b) Program. Ms. de Mey shared that the transition from the Vanguard 500 Index Fund Admiral Share class to the Institutional Share class was completed on October 1, 2020. She said that almost all active funds outperformed their benchmarks for the third quarter, and all outperformed their benchmarks year-to-date 2020. She commented that DFA has been on the watchlist since September 2019. She explained that DFA has a quantitative process that focuses on specific size, valuation, and profitability characteristics. DFA continues to closely adhere to their process. Staff recommends keeping DFA on the watchlist, recognizing that the reason for underperformance is purely due to their investment strategy, which has been out of favor in the current market environment.

Ms. de Mey also presented the NC 403(b) Program Investment Policy Statement. She explained some minor corrections are needed to clarify the objective of the Real Asset Fund and to update the Vanguard 500 Index Fund share class to the Institutional share class, and she requested Board approval.

The Chair entertained a motion to approve the proposed revisions to the NC 403(b) Program Investment Policy Statement. Mr. Beam so moved, and Ms. Baran seconded. The motion passed unanimously by roll call vote.

Public Comments

No comments were offered.

Board of Trustees Comments

Ms. Thomas stated that it is good to hear everyone. She congratulated the Treasurer for his reelection and said that she is looking forward to 2021.

The Chair shared that based on recent pension discussions, North Carolina anticipates lowering the pension expected rate of return. He commented that this will increase employer costs. He said that for most cities and towns, revenues have gone down, costs have gone up, and now their pension costs will also increase. Many may need to take a hard look at what they can afford.

The Chair thanked everyone for participating and announced the next board meeting will be Thursday, March 11, 2021 at 9:00 a.m.

Adjournment

There being no further business before the board, the Chair, Treasurer Folwell, made a motion to adjourn the meeting today in honor of Deputy Sherriff Jared Allison of Nash County who was killed in a traffic accident while on duty on Thanksgiving Day. Mr. Long seconded the motion. The motion was approved unanimously via roll call, and the meeting adjourned at approximately 11:50 a.m.

Chair

Secretary