

DRAFT

NORTH CAROLINA SUPPLEMENTAL RETIREMENT BOARD OF TRUSTEES

MINUTES OF MEETING

September 21, 2017

Time and Location: The North Carolina Supplemental Retirement Board of Trustees (the Board) met at 9:00 a.m. on Thursday, September 21, 2017 in the Dogwood Conference Room, 3200 Atlantic Avenue, Raleigh, North Carolina.

Members Present: The following members were present: Dale R. Folwell, CPA (Chair), Melinda Baran, Ron Copley, Heyward McKinney, Gene Hamilton, Karin Cochran, and Michael Lewis. Rob Orr attended via telephone.

Staff Present: The following Department of State Treasurer (DST) staff were present: Steve Toole, Mary Buonfiglio, Loren de Mey, Reid Chisholm, Maja Moseley, Catherine Jarboe, Rekha Krishnan, Patti Hall, Laura Rowe, Fran Lawrence, Renee Bezaire, and Frank Lester.

Guests Present: The following guests attended the meeting: Michael McCann, Ann Cashman, Aaron Koval, Kathleen Neville, Jessica Quimby, and Kelly Keen (via phone) from Prudential Retirement; Kelly Henson and Liana Magner from Mercer Investment Consulting. Allan Torrance from CEM Benchmarking.

AGENDA ITEM – WELCOME AND INTRODUCTIONS

The meeting was called to order at 9:02 a.m.

Dale R. Folwell, Chair, welcomed Board members, staff and guests. The Chair asked members of the public, if interested, to sign up to make a comment which are held until the end of the meeting.

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

The Chair asked if there were any comments or changes to the minutes of the June 22, 2017, Board meeting. There were no changes and Ms. Baran made a motion to approve the minutes. Mr. Hamilton seconded and the motion passed unanimously.

AGENDA ITEM – RESOLUTION

The Board considered a resolution regarding Walter Gray's service on the Supplemental Retirement Board of Trustees. Mr. Gray served as a member from July 15, 2013 until January 19, 2017. Board members and staff expressed appreciation of Mr. Gray's service and the resolution passed by acclamation.

AGENDA ITEM – LEGAL UPDATES

The Chair recognized Mr. Chisholm who noted that the vote to amend revisions to the NC 403(b) Plan Document and Adoption Agreement will be postponed until the Board meeting in December. The memorandum included in the Board materials outlines the proposed revisions.

Mr. Chisholm provided a summary of IRS Announcements 2017-11 and 2017-13 regarding temporary relief for retirement plans applicable to hardship withdrawals and loans to victims of hurricanes Harvey and Irma, respectively. Supplemental Retirement Plans (SRP) staff recommended implementing the relief for hardship withdrawals and if necessary amending the SRP Plans before the December 31, 2018, deadline.

Ms. Cochran made a motion to approve the implementation of the relief for the Plans and Mr. Lewis seconded. The motion passed unanimously.

AGENDA ITEM – 2017-18 BUDGET PROPOSAL

The Chair recognized Ms. Buonfiglio. Ms. Buonfiglio noted that no changes have been made to the budget since the June 22, 2017, Board meeting and no action is required of the Board members. The trustees briefly discussed the asset balance in the administrative reimbursement account and the frequency of billing. Ms. Buonfiglio confirmed the steady growth of assets in both Plans.

AGENDA ITEM – ADMINISTRATION UPDATE

Ms. Buonfiglio provided a summary of four documents included in the administrative update: Compliance at a Glance, Service Provider Performance Guarantees, NC Total Retirement Plans Metrics and Proxy Voting Service Provider Update.

The trustees and staff discussed the Retirement Readiness results, the Social Security assumptions used in the Annual Benefits Statement (ABS) and the Retirement Income Calculator (RIC) available to participants.

The Chair noted that the extended partnership with Glass Lewis as proxy advisor for the Plans will build value and reduce complexity; the new contract resulted in a reduced fee.

AGENDA ITEM – CEM BENCHMARKING REPORT

The Chair recognized Mr. Torrance who briefly summarized the firm's background in cost and performance data analysis, and presented the highlights of the benchmarking report for a five year period, ending on December 31, 2016. He focused on peer group composition, fee comparison and reasonableness, as well as investment options and their attributes.

Following the presentation, the trustees discussed industry fee trends, participation rates and the merits of actively managed investment options versus index investment options, including a cost comparison.

AGENDA ITEM – APPROVAL OF MINUTES

The Chair recognized Mr. Lewis who provided a brief overview of the July 27, 2017, Audit Subcommittee meeting, noting that the Plans received a clean, unmodified opinion. The Subcommittee accepted the financial statements. Ms. Baran made a motion to approve the meeting minutes and Mr. Copley seconded. The motion passed unanimously.

AGENDA ITEM – APPROVAL OF MINUTES

Ms. Buonfiglio presented the highlights of the August 16, 2017, Investment Subcommittee meeting and entertained a motion to approve the minutes. Ms. Cochran so moved and Mr. McKinney seconded. The motion passed unanimously.

AGENDA ITEM – NC 401(k)/457(b) PLANS AND NC 403(b) PROGRAM 3rd QUARTER 2017 ADMINISTRATIVE REPORT

The Chair recognized Mr. McCann. Mr. McCann emphasized the one billion dollar growth in total plan assets in a period of the past twelve months, as well as an increase in average account balance due to overall deferrals increase. He noted an increase in the GoalMaker participation and assets. Lastly, Mr. McCann summarized the net cash flow for the quarter and added that there was also an increase in rollovers out of the Plans due to multiple reasons, such as: targeted marketing by advisory firms, participants relying on existing relationships with a bank or an advisor, or participants simply feeling compelled to “do something” with retirement funds.

A detailed discussion followed, regarding the need for, and the importance of, appropriate retirement education and messaging. The Chair and Board members emphasized the need to continue to let the participants know early on that the Plans will still serve them in retirement.

AGENDA ITEM – PLAN DESIGN PROJECT UPDATE

Ms. Buonfiglio stated that the project will be implemented on September 29, 2017, and the simplified investment offering reduces fees and enhances value; the annual savings to participants is estimated at \$3.4 million. Ms. Buonfiglio added that there is no action required from participants, and the service to participants will not be interrupted. A post-transition analysis will be provided to the Board during the December 14, 2017 Board meeting.

AGENDA ITEM – GLIDEPATH PROJECT RECOMMENDATION

Mr. Chisholm provided fiduciary context regarding the new GoalMaker model recommendation. He noted that the Board's fiduciary responsibility applies to plan design, which includes selecting, monitoring, and approving changes to investment vehicles and investment managers. Plan design, and therefore, the Board's fiduciary responsibility, also includes whether and how to implement, regardless of whether the Board implements GoalMaker in the "off-the-shelf" version provided by Morningstar or a version customized for the Plans. He reminded the Board members that fulfilling their fiduciary duty is more about the process than the outcome and that their fiduciary obligation is to make decisions using reasonable care and with the best interest of participants and beneficiaries in mind.

Mr. Chisholm also made the Board aware of a recent class action against Prudential and Morningstar, which alleges that by investing in GoalMaker, class members were placed into high-cost investments which provided revenue-sharing to Prudential. Mr. Chisholm did not comment on the validity of the lawsuit but emphasized the fact that the Plans do not engage in revenue sharing, the Plans' fees are transparent the objectives, performance, and fees of the investment options are disclosed, and GoalMaker is an optional feature. He added that while the recommended GoalMaker allocations may not always be comprised of the lowest cost investment options, the options have been approved by the Board based on recommendations from investment professionals, such as Mercer and Investment Management Division.

The Chair recognized Ms. de Mey who introduced Ms. Magner and Ms. Henson from Mercer, and provided the project background summary. Ms. de Mey noted the expansion of the current "3 x 4" GoalMaker model to a "3 x 9," which will extend the glidepath through retirement and "smooth" the glidepath by providing less abrupt assets allocation changes.

Ms. Magner and Ms. Henson highlighted several sections of Mercer's report, and summarized the current and the proposed state of the glidepath, as well as the addition of TIPS and the recommendation to remove the NC Global Equity Fund from the investment lineup.

Following Mercer's presentation, Board members discussed the recommendations and debated the merits of passive versus active investment options. Mr. Copley opposed actively-managed investment options, arguing that even if markets are inefficient, marketing-beating managers cannot be identified in advance. However, Mr. Hamilton, Mr. Orr, Ms. Cochran, and Ms. Baran spoke in support of actively-managed funds. Mr. Hamilton mentioned the diversification benefits of active management. Mr. Orr noted that while "active versus passive" is an open debate on which reasonable people can disagree, the Board was relying on the input of experts.

The Chair inquired whether the Plan participants will be notified appropriately and the actions are transparent to them; Ms. Buonfiglio confirmed, stating that a written notification will be sent

out in advance of the changes taking place in June 2018. Participants have the choice to opt out of GoalMaker.

The Chair further inquired about the fixed income recommendation and potential change to a fully active allocation in GoalMaker. Mr. McCann provided current fixed income asset balances in each plan, as well as their split between the GoalMaker and outside of the GoalMaker. Ms. Magner described detailed returns of actively versus passively managed fixed income funds and noted that the existing managers will still be used in the active strategy. In addition, there is the potential for lower fees in the active NC Fixed Income Fund as assets increase. In response to the Chair's question, Ms. Magner affirmed that Mercer recommends a similar course of action to all clients who use a custom Glidepath. Ms. de Mey added that the Federal Reserve is raising rates, which typically denote a favorable environment for active managers. Ms. Buonfiglio agreed with Ms. de Mey, noting her support for the fixed income recommendation in its entirety. Ms. Baran noted the active management in the defined benefit plan's fixed income portfolio, and Mr. McKinney stated that the active management recommendation was consistent with CEM Benchmarking's report.

The Chair expressed reservations regarding the fixed income portion of the recommendation; overall, he was supportive of the recommendation and made a motion to: adopt Prudential's new 3 x 9 GoalMaker model, with the modifications and implementation as described in IMD's memorandum and Mercer's presentation; add a TIPS white label fund to the core investment lineup; and eliminate the NC Global Equity Fund from the core investment lineup.

Ms. Baran seconded the motion. Mr. Copley voted against the motion and the remaining members voted for. The motion passed by majority vote.

AGENDA ITEM – GALLIARD GUIDELINES REVISION

Ms. de Mey directed the attendees' attention to the memorandum included in meeting materials and provided a brief summary of staff's visit with Galliard on May 23, 2017, in Minneapolis. Galliard did a "clean slate" review of Plans portfolio and staff discussed the lowering of fees and evaluation of existing wrap providers. Ms. de Mey also discussed the current and proposed fee structure, highlighted in the memorandum.

Ms. de Mey and Mercer proposed a recommendation to amend Galliard investment guidelines as follows: no more than 50% of the Account's assets (including management of the liquidity buffer) shall be managed by Galliard or its affiliates. The current guidelines call for no more than 40% of assets to be managed by Galliard or its affiliates.

The Chair entertained a motion to accept the recommendation and Ms. Baran so moved. Mr. Hamilton seconded, and the motion passed unanimously.

AGENDA ITEM – NC 401(k)/457(b) PLANS 3rd QUARTER INVESTMENT PERFORMANCE REPORT

Due to time constraints, this report was not presented during the meeting but has been included in the meeting materials for review.

AGENDA ITEM - NC 401(k)/457(b) PLANS AND NC 403(b) PROGRAM INVESTMENT POLICY STATEMENT AMENDMENT

Ms. de Mey directed the attendees' attention to the memorandum regarding proposed revisions to investment policy statements for the NC 401(K)/457(b) Plans and the NC 403(b) Program. Both policies, as well as a memorandum summarizing the main changes, were included in the meeting materials. She noted that the amendments are intended to reflect the changes in plan design, as well as clarify the roles and responsibilities of the vendors and staff.

Ms. Baran moved to approve the amendments to the Plans' and the Program's Investment Policy Statements and Mr. Hamilton seconded. The motion passed unanimously.

AGENDA ITEM – NC 403(b) PROGRAM 3RD QUARTER INVESTMENT PERFORMANCE REPORT

Due to time constraints, this report was not presented during the meeting but has been included in the meeting materials for review.

AGENDA ITEM – BOARD QUESTIONS/COMMENTS

The Chair noted the next meeting date on December 14, 2017.

AGENDA ITEM – PUBLIC COMMENTS

No public comments were offered.

Mr. McKinney made a motion to adjourn and Mr. Lewis seconded. The meeting adjourned at 12:19 p.m.

Secretary