

DRAFT
MINUTES
BOARD OF TRUSTEES
OF THE
NORTH CAROLINA SUPPLEMENTAL RETIREMENT PLANS
September 7, 2011, 9:00 am
Dawson Conference Room
Albemarle Building, 325 N. Salisbury Street
Raleigh, NC

The meeting of the Board of Trustees for the Supplemental Retirement Plans was called to order at 9:02 am by the Chair, State Treasurer Janet Cowell.

Members Present

Members present were: Chuck Leedy, Robert Powell, Melinda Baran, Dexter Perry, Mona Keech, Libby George, and Janet Pittard. Kel Landis joined by phone.

Members Absent

There were no members absent.

DST Staff Present

Staff members present were: Kara Petteway, Steve Toole, Greg Beuris, Fran Lawrence, Joan Fontes, Melissa Waller, Jaclyn Goldsmith, Timothy Dale, Julia Vail, and Chris Frazier.

Guests Present

Prudential representatives attending were: Bill Walsh, Tammy Lewert, Travis Swartwood, and Tim Bryan. Mercer representative Jay Love was in attendance. Attending via phone was Prudential representative Robb Craddock.

Reappointments

The Chair recognized the appointment of Board member Kathy Crooke who had been recently appointed by the Governor.

Conflicts

The Chair asked the Board members if there were any actual, potential or appearances of a conflict with any item on the meeting agenda. No conflicts were reported.

Approval of Minutes

It was moved by Robert Powell and seconded by Dexter Perry to approve the minutes of the NC Supplemental Retirement Board meeting held on June 8, 2011. The motion passed unanimously.

2nd Quarter Investment Performance Report

The Chair recognized Jay Love from Mercer to present a report on the investment performance for the 2nd Quarter. Mr. Love spoke briefly on the economic environment for the 2nd Quarter and focused heavily on the market turbulence occurring after the 2nd Quarter ended.

Mr. Love noted the following regarding the 2nd Quarter economic environment:

- GDP growth was up over the 1st Quarter of 2011, but still not adequate for sustained growth;
- Year over year inflation was 3.6%, which is more than the original estimate of 2.5%;
- International markets performed slightly better than domestic markets;
- The dollar slightly depreciated against other currencies;
- Federal funds rate remained at or near 0%; and,
- The unemployment rate was approximately 9.2%, with most of the employment gains attributable to the private sector as government employment cut 111,000 jobs.

Mr. Love stated that most of the investment options were performing as expected relative to their benchmark. He pointed out that the SMid Cap Growth fund had lagged the benchmark by a respectable margin over the past year, and this was due to both of the underlying managers having a high quality investment selection bias. Over the past year, higher quality investments have underperformed when compared to their respective benchmark. He noted that higher quality investments may prove beneficial in the future, but the Board may want to consider adding an additional manager to help diversify the fund in the future.

At this time, Board Member Kel Landis and Prudential representative Robb Craddock joined via phone.

Mr. Love continued by mentioning that the Stable Value Fund continues to perform as expected and its performance is in the top 20% of the Stable Value universe. The Chair thanked Mercer for their presentation.

Report from Investment Subcommittee

The Chair recognized Dexter Perry to report on the recommendations resulting from the August 17, 2011 Investment Subcommittee meeting. Mr. Perry stated that the Board heard a summary of reports heard by the Investment Subcommittee and general information relating to the Board.

Investment Manager Searches

Mr. Perry asked Mercer to describe their manager selection process for the addition of the new investment managers in the SMid Cap Value and Global equity funds. Mr. Love described their evaluation process and listed the top three managers that would best fit each respective investment option. He noted that the changes were not major changes, but the SMid Cap Value fund would benefit from an additional quality manager. He also noted that adding a manager to the Global equity fund would add beneficial diversification to the fund since it currently only has one underlying manager. As a result of Mercer's analysis and recommendation, the Investment Subcommittee recommended to the full Board that WEDGE Capital Management be added to the SMid Cap Value investment option and Arrowstreet Capital be added to the NC Global equity investment option. The addition of these managers should reduce the risk associated with each investment option while allowing each respective fund to capture the majority of market growth. The manager additions would bring the total number of managers in the SMid Cap Value option to three and the total number of managers in the Global equity option to two. Asset in each respective investment option will be equally split amongst the underlying managers in the investment option. It was noted by the Board that it appreciated the recommendation of a firm based in North Carolina, WEDGE Capital Management.

It was moved by Janet Pittard and seconded by Robert Powell to accept the recommendation of the Investment Subcommittee to add WEDGE Capital Management to the SMid Cap Value investment option and Arrowstreet Capital to the Global equity investment option. The motion passed unanimously.

Mr. Perry then stated that the Investment Subcommittee had asked staff to work with vendors to determine some language that would allow appropriate flexibility to protect the Plans' investments if the US credit rating were to be further downgraded by a rating agency. After staff had discussed with the investment consultant and vendors, staff recommends that staff be given authority to suspend any portfolio guidelines for a period extending up to 120 days. This would allow appropriate flexibility to allow staff to move quickly prevent portfolio liquidation in the event of further US credit rating downgrade. Mr. Perry expressed concern that staff would be given a broad window to suspend portfolio guidelines in events not attributable solely to further US credit downgrade. Staff stated that after discussion with the investment consultant, it was decided that due to the volatile marketplace and interconnectedness of investments, they felt it was appropriate to broaden the motion past US credit quality concerns to permit staff to react quickly in the event of an emergency. Ms. Pittard asked how this information would be communicated to the Board and participants. Tim Bryan from Prudential stated that information could immediately be sent to employers and employees who have online accounts. For everyone else, the information would be communicated via quarterly statement or quarterly newsletter. Timothy Dale from the Retirement Systems Division stated that once the decision was made that a suspension of guidelines is necessary to protect investments, Board members would be immediately notified and the topic would be discussed at a future Board meeting, hence the need for the 120 day suspension. The Board asked that any decision to suspend portfolio guidelines be thoroughly vetted with the Investment Management Division and the investment consultant. Staff agreed those were appropriate steps.

It was moved by Dexter Perry and seconded by Mona Keech to permit staff to suspend portfolio guidelines up to 120 days due to the ongoing market volatility. The motion passed unanimously.

The Chair then closed the session to guests pursuant to G.S. 143-318.11(a)(1) to discuss the recommendation of the Investment Subcommittee regarding the retention of the investment consultant for the Plans. Robb Craddock from Prudential left the phone.

Once the meeting was reopened to guests, it was moved by Robert Powell and seconded by Janet Pittard to approve the retention of Mercer Investment Consulting to be the independent investment consultant for the Plans. The motion passed unanimously.

Mr. Perry then recognized Mr. Love to review the rebalancing guideline revisions to the Plans' Investment Policy Statement. Mr. Love stated the revisions reflected the Plans' addition of the new managers and maintained the 3 percent allocation range between managers before the accounts are rebalanced. Mr. Craddock asked if a rebalance were to occur, would it go back to the 3 percent margin or back to being evenly split between the managers. Mr. Love replied that it should be rebalanced back to an even split.

It was moved by Dexter Perry and seconded by Chuck Leedy to approve the rebalancing guideline revisions. The motion passed unanimously.

Report from the Audit Subcommittee

The Chair recognized Mr. Perry to describe the findings from the annual audit of the Plans and the report presented to the Audit Subcommittee by PricewaterhouseCoopers. Mr. Perry noted that the Subcommittee received a report stating that in the audit of the 2010 financial statements of the Plans, staff had identified two misstatements from the 2009 financial statements that included the reporting of unallocated insurance contracts at fair value instead of contract value and the exclusion of a liquidity account entitled the Great West Group Fixed Deferred Annuity unallocated insurance contract. The auditors stated that these misstatements were significant deficiencies, but they felt that staff had taken appropriate steps to prevent this from occurring in the future. Other than the misstatements on the 2009 financial statements, the auditors found no significant issues with the Plans' investments or accounting of investments. They also found no evidence of fraud or misappropriation of assets. Due to the auditors favorable review of the 2010 financial statements they gave the Plans' an unqualified opinion. Following this report, the Audit Subcommittee recommended to the full Board that the 2010 financial statements be approved.

It was moved by Robert Powell and seconded by Mona Keech to approve the 2010 financial statements. The motion passed unanimously.

At this point, Mr. Perry indicated that due to his role on the Investment Subcommittee, he was stepping down from the Audit Subcommittee. When asked for volunteers, member Kathy Crooke indicated her interest to participate on the Audit Subcommittee. It was moved

by Chuck Leedy and seconded by Janet Pittard to appoint Kathy Crooke to the Audit Subcommittee. The motion passed unanimously.

At this time, Board member Kel Landis left the meeting.

Administrative Updates

The Chair recognized Tim Bryan from Prudential to provide a 2nd Quarter administrative report. Mr. Bryan noted the following:

- Approximately 2,000 members remaining in the frozen mutual funds were mapped over the previous weekend, effectively closing the mutual funds;
- The Plans combined had reached approximately \$6.3 Billion in total assets;
- Year over year membership had increased by 2% in the 401(k); and 11% in the 457;
- Substantial growth continued in the 457 plan, and soon the 457 enrollments will surpass 401(k) enrollments;
- The number of participants using GoalMaker continue to grow, with over \$2 Billion invested using the asset allocation tool;
- Fewer loans are being initiated over 2010;
- Department staff and Prudential changed the Loan Policy to permit terminated employees to continue remitting loan payments after the 90-day grace period to avoid default and tax consequences; and,
- The Plans received two special awards of distinction from the National Association of Governmental Defined Contribution Administrators ("NAGDCA") for the National Save for Retirement Week Campaign and the implementation of the Transfer Benefit.

The Chair thanked Mr. Bryan for his report.

Plan Document Amendments

The Chair then recognized Mr. Dale to discuss proposed Plan Document amendments. Mr. Dale noted that regulations require that qualified retirement plans offering Roth contributions and in-plan Roth conversions must have the change reflected in the Plan Document within one-year of implementation. Since the Plans began permitting Roth contributions and in-plan conversions earlier in the year, the change needed to be made to the Plan Documents. He also noted that SEP/SIMPLE IRA accounts were not currently allowed to roll into the 401(k) plan, but they could be rolled into the 457 plan. Prudential had indicated their ability to now accept these types of rollovers into the 401(k) plan, and a Plan Document change needed to be made.

It was moved by Mona Keech and seconded by Dexter Perry to approve the proposed Plan Document amendments. The motion passed unanimously.

NC 403(b) Update

Mr. Toole was then recognized to provide an update on the implementation progress of the NC 403(b) Plan. Mr. Toole noted some of the steps necessary to implement the plan post-legislative approval. He also noted that some insurance industry members have voiced their support of the Plan and some have voiced opposition to the Plan. He stated that staff were being proactive in the implementation process and were beginning to educate interest groups and legislators regarding the Plan. Mr. Toole stated that a special meeting of the Board will likely need to be called to approve the Third Party Administrator to administer the NC 403(b) Plan.

Legal Counsel RFQ Update

The Chair then recognized Kara Petteway to provide an update on the Legal Counsel Request For Qualifications ("RFQ"). Ms. Petteway stated that the solicitations went out following the meeting of the ad-hoc Legal Subcommittee on July 7, 2011. She noted that staff had received 28 responses to the RFQ. Ms. Petteway stated that the Legal Subcommittee would be reconvened via conference call to discuss the top respondents and to allow the Subcommittee to choose the top 2 or 3 finalists to invite for interviews. The Board was agreeable to the approach.

It was also noted that former Board member Melinda Baran was on the Subcommittee and a successor needed to be appointed. Board member Kathy Crooke volunteered to participate on the Legal Subcommittee.

It was moved by Janet Pittard and seconded by Dexter Perry to appoint Kathy Crooke to the Legal Subcommittee. The motion passed unanimously.

Proxy Voting Service

The next item was the approval of the proxy voting service for the Plans. Mr. Dale noted that in previous meetings staff had identified that currently the pension plan was paying for the Glass Lewis proxy voting service for the Supplemental Plans. Mr. Dale stated that upon analysis of the proxy votes cast over the past year, 25 percent of the votes were cast on behalf of the Supplemental Plans. Since the Glass Lewis invoice to the Department was \$53,100 for the year, he recommended that the Plans pay \$13,275 for their appropriate share of the expense.

It was moved by Chuck Leedy and seconded by Robert Powell to approve the payment of the proxy voting invoice in the amount of \$13,275. The motion passed unanimously.

Deputy Director Position

Mr. Toole then informed the Board that staff had completed research regarding staffing of state-sponsored supplemental retirement plans from North Carolina's peers and neighbors. A summary of the findings displayed that North Carolina was understaffed compared to other states. After presenting the findings to the Office of State Personnel the Department has received authority to pursue a Deputy Director position for the Supplemental Retirement

Plans. The position would report to the Retirement Systems Director and would have an assistant to help with the daily administrative tasks associated with the Plans. Mr. Toole stated that the Board needed to approve the position and following Board approval, the Office of State Budget and Management would need to create the position.

It was moved by Janet Pittard and seconded by Dexter Perry to approve the Deputy Director position for the Supplemental Retirement Plans. The motion passed unanimously.

Fiduciary Education Training

Mr. Toole then brought forth a proposal from Willet Consulting to provide Board and staff with fiduciary education training. Mr. Toole stated that he felt that the Board was in need of a fiduciary education program for existing and future Board members. He noted that Mary Willet was very experienced on fiduciary education materials as proven by her work for Wisconsin, NAGDCA, and the International Foundation of Retirement Education ("InFRE"). In the proposal the Board would receive an initial education program, ongoing education training for new Board members, and a fiduciary best practice checklist for a fee of \$9,000. Ms. Pittard expressed concern about securing these services due to the Board's movement to retain an outside legal counsel beginning in 2012. Mr. Perry noted that he would find the fiduciary education program beneficial, especially for new appointees to the Board, but was unsure about the need for the best practice checklist. Mr. Leedy and Ms. George noted that they would find an educational program beneficial to the Board and were willing to allocate \$9,000 to have an outside consultant review procedures and recommend improvements.

It was moved by Libby George and seconded by Chuck Leedy to approve the fiduciary education training proposal. Mona Keech, Robert Powell, Kathy Crooke, Dexter Perry, and Janet Pittard opposed the motion. The motion failed.

Organizational Chart

At this time Mr. Dale brought to the Board's attention a revised Supplemental Retirement Plans organizational chart. The chart was updated from previous versions to correct a phone number, insert the new Deputy Director position, and to reflect staffing changes.

Adjournment

There being no further business, the meeting was adjourned at 12:00 p.m.

CHAIR