



INVESTMENT MANAGEMENT

MEMORANDUM

TO: Supplemental Retirement Board of Trustees

FROM: Loren de Mey, Assistant Investment Director

DATE: August 30, 2019

SUBJECT: Investment Guideline Compliance Reporting – 2nd quarter of 2019

Divestment Policies

No prohibited holdings were held in the Supplemental Retirement Plans Group Trust during the calendar quarter.

Investment Guidelines

The Supplemental Retirement Plans staff continues to monitor the reporting on a daily basis. No material issues occurred in the 2nd quarter of 2019 and all managers were in compliance with guidelines.

Audit Sub-Committee Meeting Follow-Up

At the most recent Audit Sub-Committee meeting, a question was raised regarding one of the footnotes in the financials which addressed credit risk and custodial credit risk. The following is some additional information on each type of risk.

Credit Risk:

Defined by GASB: The risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Although the Supplemental Retirement Plans do not have a formal Policy on credit risk, credit risk is mitigated in the following ways:

1. For separate account investment managers, the investment manager guidelines specific to the NC Supplemental Plans address credit risks. For example, the guidelines will set a maximum allocation to securities rated below investment grade for the separate account fixed income manager.
2. CIT managers have their own set of guidelines within their governing documents which provide parameters on credit risk and maximum exposure to below investment grade securities.

Custodial Credit Risk:

Defined by GASB: The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government,



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and are held by either: a) the counterparty or b) the counterparty's trust department or agent but not the government's name.

Although the Supplemental Retirement Plans do not have a formal policy on custodial credit risk, this risk is low given the following:

1. The Group Trust is the beneficial owner of the securities held in the Group Trust's separate accounts.
2. For the equity and fixed income securities held in the Group Trust's separate accounts, the process of transferring securities and cash in securities transactions generally occurs simultaneously.
3. According to GASB, investments in external investment pools such as CITs and mutual funds are not exposed to custodial credit risk given their structure.