



INVESTMENT MANAGEMENT

To: North Carolina Supplemental Retirement Board of Trustees

From: Loren de Mey, Assistant Investment Director

Date: October 24, 2017

Subject: Investment Guideline Compliance Reporting – 3rd quarter of 2017

Divestment Policies

On September 30, 2017 the Department of State Treasurer (Department) delivered the Annual Divestment Reports, pursuant to the Iran Divestment Act and the Sudan Divestment Act, to the Governor's Office and the General Assembly. The Supplemental Retirement Plans' investment managers hold no prohibited holdings included on the Final Divestment List for Iran. The Sudan Divestment Act is not applicable to the Plans.

The Department has begun implementing the requirements of Session Law 2017-193 (House Bill 161), which requires state divestment from, and prohibits the state from contracting with, companies that boycott Israel. The Department adopted a policy to implement the law and is in the process of contracting with a prospective vendor to provide divestment screening research and advisory services. The initial divestment list will be published by November 29, and the final list will be published by February 27, 2018. The investment managers will be expected to divest from any prohibited holdings within 180 days from the date of final list.

Investment Guidelines

All existing investment manager guidelines have been appropriately coded in the custodial system and all are operational. The staff continues to monitor the reporting on a daily basis. No other material issues occurred in the third quarter and all managers are in compliance with guidelines.



Dale R. Folwell, CPA

INVESTMENT MANAGEMENT

To: North Carolina Supplemental Retirement Board of Trustees

From: Loren de Mey, Assistant Investment Director

Date: October 27, 2017

Subject: 401k/457 Plans: Large Cap and Small / Mid Cap Transition Review

Summary

As approved by the North Carolina Supplemental Board of Trustees, the new investment line up became available on September 29, 2017. The NC Large Cap Value and NC Large Cap Growth Funds were closed and the new NC Large Cap Core Fund was created. The Small/Mid Cap Value Fund and Small/Mid Cap Growth Funds were closed and the new Small / Mid Cap Core Fund was created. The Plan Design changes (adding a passive component) in addition to renegotiated fees, represent an approximate \$3.4 million in annual savings to Plan participants. Department staff worked with Prudential, BNY Mellon, and the transition manager, BlackRock, to transition approximately \$3 billion to the new white label funds. This occurred without a blackout period for participants.

Large Cap Transition

As part of the transition, two legacy managers were terminated, the allocations to the remaining four large cap equity managers were increased, and a new investment in the BlackRock Russell 1000 Index Fund was added. On October 2nd, assets were transferred to a transition account held at BNY Mellon and the target managers (the remaining large cap equity managers) provided final target buy lists. Approximately \$1.37 billion or 66% of the total legacy value remained as overlap with the new target allocation. In addition, approximately \$81.5 million of the assets transferred to the transition account were retained for the target portfolios. The remaining balances required trading which began on October 3rd and was completed that day.

Costs

The cost of the transition was estimated to be -3 basis points with a range of +/- 10 basis points depending on market impact. The actual cost was -0.6 basis points of the legacy asset value, or -\$132,150. Actual total costs were lower than estimates due to market impact (market movement was in our favor). The market impact was positive on the day of the transition and contributed a positive 2.5 basis points or \$516,394 to the final costs. Additional detail can be seen in Appendix A.



INVESTMENT MANAGEMENT

Small Cap Transition

Two existing US SMID equity options were merged into a single white label US SMID equity core option. As part of the transition, the allocations to three existing managers were reduced (the SMID Value managers), the allocations to two existing managers were increased (the SMID growth managers), and a new investment in the BlackRock Russell 2500 Index Fund was added.

On October 2nd assets were transferred to a transition account held at BNY Mellon. The same day, the target managers provided final target buy lists. Approximately \$920 million or 91% of the total legacy value, remained as overlap with the new target allocation. In addition, approximately \$3.7 million of the assets transferred to the transition account were retained for the target portfolio. The remaining balance required trading, which began on October 3rd and was completed that day with the exception of one position due to a pending corporate action. The final security was sold the following day.

Costs

The cost of the transition was estimated to be -1 basis point with a range of +/- 3 basis points. The actual cost, including market impact, was -0.5 basis points of the legacy asset value or -\$45,749. Actual total costs were lower than estimates due to market impact (market movement was in our favor). The market impact was positive on the day of the transition and contributed a positive 0.9 basis points or \$87,324 towards final costs. Additional detail can be seen in Appendix A.

Equity Brokers

BlackRock executed trades with five distinct equity brokers across the two transitions to seek best execution on all required trades. Total commissions paid on the large cap transition were \$113,673. Total commissions paid for the small cap transition were \$34,834. Average commissions paid were 0.9 cents a share, with one block trade being executed at 1.5 cents a share.



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INVESTMENT MANAGEMENT

Appendix A: Large Cap and Small Cap Transition Costs Break-Down

Large Cap Transition Cost Break-Down

Pre-Transition Estimate			Actual Results				Difference	
	US \$	BPS	Sales	Buys	Total	Total bps	Difference USD	Diff BPS
Commission	-109,580	-0.5	-94,917	-18,757	-113,673	-0.5	-4,093	0.0
Tax	-10,351	-0.0	-13,950	-3,747	-17,697	-0.1	-7,346	0.0
Spread	-115,391	-0.6	-106,557	-14,481	-121,038	-0.6	-5,647	0.0
Market Impact*	-380,799	-1.8	-313,474	-82,662	-396,136	-1.9	-15,337	0.1
	-616,121	-3.0	-528,897	-119,647	-648,544	-3.1	-32,423	-0.2
Opportunity Costs**	2,054,624	9.9	418,445	97,948	516,394	2.5		
TOTAL			-110,451	-21,699	-132,150	-0.6		

Small Cap Transition Cost Break-Down

Pre-Transition Estimate			Actual Results				Difference	
	US \$	BPS	Sales	Buys	Total	Total bps	Difference USD	Diff BPS
Commission	-33,129	-0.3	-27,649	-7,184	-34,834	-0.3	-1,704	-0.0
Tax	-1,331	-0.0	-1,911	-199	-2,111	0.0	-779	-0.0
Spread	-43,703	-0.4	-29,795	-17,417	-47,212	-0.5	-3,509	-0.0
Market Impact	-45,305	-0.4	-29,953	-18,963	-48,916	-0.5	-3,612	-0.0
	-123,468	-1.2	-89,308	-43,764	-133,073	-1.3	-9,605	-0.1
Opportunity Costs	299,493	3.0	48,027	39,296	87,327	0.9		
TOTAL			-41,281	-4,468	-45,749	-0.5		

*shows impact of trading specific to NC accounts

** shows general market impact