



## MEMORANDUM

TO: Supplemental Retirement Board of Trustees

FROM: Reid Chisholm, Assistant General Counsel

DATE: November 20, 2019

SUBJECT: Changes to the *Policy and Procedures for Investment Transactions and Investment Manager Selection*

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The *Policy and Procedures for Investment Transactions and Investment Manager Selection* describes how the Board and the Department select the underlying investments – investment managers, mutual funds, and exchange-traded funds – for the investment options in the NC 401(k) and NC 457 Plans and the NC 403(b) Program. The policy is part of how the Board defines and fulfills its fiduciary duty to the plans.

The main revisions incorporate the Board's elimination of the Investment Subcommittee and bring Section IV.C.5 (Investment Manager Interviews) into line with current practice. The remaining revisions are administrative or clarifying in nature.

Attached is the revised version of the policy with the proposed changes tracked.

Staff recommends that the Board approve the revised policy in the attachment.

**Attachment – Revised *Policy and Procedures for Investment Transactions and Investment Manager Selection***

# NORTH CAROLINA SUPPLEMENTAL RETIREMENT PLANS

## Policy and Procedures for Investment Transactions and Investment Manager Selection

### I. Purpose

The North Carolina Supplemental Retirement Board of Trustees (the “Board”) and the North Carolina Department of State Treasurer (the “Department”) administer, and are charged with a fiduciary responsibility to manage all aspects of, the Supplemental Retirement Income Plan of North Carolina (the “NC 401(k) Plan”), the North Carolina Public Employee Deferred Compensation Plan (the “NC 457 Plan”), and the North Carolina Public School Teachers’ and Professional Educators’ Plan (the “NC 403(b) Program,”) and collectively with the NC 401(k) and NC 457 Plans, the “Plans” or “SRP”). The Board has the responsibility and authority to hire, or cause to be hired, individual Investment Managers (including sub-advisors) to execute the various investment mandates described in the Plans’ Investment Policy Statements.

### II. Application

**A. Generally.** This Policy applies primarily to the selection of Investment Managers for Investment Transactions. The Board retains an Investment Manager (i) for a new Investment Option; (ii) as an additional Investment Manager for an existing Investment Option; or (iii) to replace an existing Investment Manager. Included are the following:

1. An Investment Manager for a separate account maintained at the master global custodian or a bank collective trust vehicles;
2. A mutual fund or exchange-traded fund, regardless of whether the Board or the Department has any direct contractual with the fund or the investment advisor for the fund;
3. An Investment Manager of investment managers (*e.g.*, a stable value fund-of-funds structure with a single Investment Manager that is under contract with the Department); and
4. An Investment Manager that is retained by the Board to develop or manage a custom glidepath for a target-date fund.

This Policy also applies to Substantive Amendments to existing investment management agreements (“IMAs”) or other contracts with Investment Managers.

This Policy applies to all Investment Transactions entered into by the Board directly or indirectly on or after March 23, 2017, and revised versions of this Policy apply to Investment Transactions entered into on or after the effective date of the revision.

**B. Exemptions.** This Policy does not apply to the following:

1. A company that provides, or selects companies that provide, a guaranteed investment contract (GIC), Security-Backed Investment Contract (SBIC), or other benefit responsive contractual arrangement for a stable value fund because such contracts are considered bilateral financial guarantee products and not investment management services under this

Policy; and

2. An underlying investment manager for assets held pursuant to a contract between itself and an Investment Manager of investment managers (*e.g.*, a stable value fund-of-funds structure). The selection of underlying investment managers would typically be delegated to the Investment Manager under contract with the Department.

### **III. Statement of Policy**

The goal of the Board and the Department is to conduct the process for an Investment Transaction, including the evaluation and recommendation to approve the appointment of an Investment Manager, according to the following principles:

1. In accordance with applicable Federal and state statutes and regulations, the investment objectives and restrictions in the Investment Policy Statements, the fiduciary standards applicable to the Board and the Department, the Placement Agent Policy, and all other policies and procedures applicable to the Plans;
2. With a predominant reliance on the comparative evaluation of opportunities by the Assistant Director for SRP Investments and third-party experts (*e.g.*, a Consultant) within a defined due diligence process; and
3. In a fair and consistent manner and with a structured external communications protocol designed to facilitate transparency and efficiency.

### **IV. Process**

**A. General.** The process of selecting an Investment Manager is initiated by the Board or the Investment Subcommittee. The Board may delegate certain responsibilities to the Investment Subcommittee, including approval of search criteria and making recommendations regarding the selection of Investment Managers. IMD, in collaboration with the Consultant, is responsible for conducting any searches initiated by the Board or the Investment Subcommittee and recommending an Investment Manager. On a case-by-case basis, the Department's Chief Investment Officer may authorize procedures that deviate from this Policy, including for mutual funds, exchange-traded funds, sweep vehicles, and the NC 403(b) Program; however, IMD shall note any material deviation from this Policy in any recommendations to appoint Investment Managers reviewed with the Investment Subcommittee and Board. The Board retains the ultimate responsibility and sole authority to approve the appointment of an Investment Manager.

For a Substantive Amendment, the following parts of the process described in this Policy apply:

1. Completion of an Investment Manager Disclosure Letter and, if applicable, a Placement Agent Disclosure Letter by the Investment Manager;
2. Approval by the Compliance Counsel through the Compliance Review Form;
3. Submission of a recommendation memorandum from the Assistant Director for SRP Investments to the Chief Investment Officer; and

4. Any other parts of the process described in this Policy deemed appropriate by the Chief Investment Officer, after consideration of input from the Assistant General Counsel for SRP, Assistant Director for SRP Investments, and ~~Deputy SRP Director for SRP~~.

**B. Search Criteria.** The search criteria provide the broad parameters that ultimately determine the universe of eligible Investment Managers. The criteria are based on the Investment Option and the Investment Manager's expected role within such Investment Option. IMD and the Consultant collaborate on preparing draft search criteria (e.g., asset class, style, organizational qualities, minimum assets under management, minimum track-record, investment process, fees, target risk level, vehicle).

- ~~1. IMD and the Consultant collaborate on preparing draft search criteria (e.g., asset class, style, organizational qualities, minimum assets under management, minimum track record, investment process, fees, target risk level, vehicle).~~
- ~~2. IMD recommends the search criteria to the Investment Subcommittee, and if necessary, to the Board, for approval.~~

**C. Search and Evaluation.** Utilizing the approved search criteria, IMD uses the following process:

1. First-level Screen. IMD and the Consultant screen third-party investment manager databases, peer information, and internal files to identify a universe of candidate Investment Managers that meet the specific search criteria. The purpose of this step is to eliminate managers early in the process that would not be seriously considered due to size, experience, or focus and then prioritize four-to-eight relatively attractive candidates.
  - a. The Consultant prepares a list of candidate Investment Managers and applicable screens.
  - b. IMD and the Consultant develop a final consensus list of candidates, which may result in removals and/or additions to the Consultant's draft list.
2. Consultant Review and Requests for Information. The candidate Investment Managers are requested to provide comprehensive updated information regarding performance, portfolio composition, personnel, organizational history and structure, proposed fees, and any other information deemed necessary to make an informed decision.
  - a. The Consultant prepares a search book for the Investment Managers.
  - b. IMD reserves the right to provide the Investment Managers with supplemental requests for proposals/information.
3. Second-level Screen. After receipt of the Consultant's search book and any requested supplemental information, the Consultant and IMD evaluate risk-adjusted investment performance, fees, investment processes, strategy fit, and administrative, operational, risk, and compliance and other organizational issues to identify the firms that will be interviewed (the "Interviewees"). The number of Interviewees is typically two-to-four.
  - a. The Consultant provides a tentative list of recommended Interviewees to IMD.
  - b. IMD and the Consultant develop a final consensus list of Interviewees, which may result in removals and/or additions to the Consultant's draft list.
4. Preliminary Conference Calls. The Consultant and IMD coordinate with the Interviewees and SRP staff to discuss preliminary investment, administrative, operational, risk,

compliance, conflicts of interest, and contractual and other legal issues.

- a. IMD prepares a package of information to be provided to the Interviewees (*e.g.*, search criteria, form IMA, policies, and required disclosures) and coordinates conference calls with the Interviewees, IMD, and the Consultant.
- b. After completion of the conference calls, the Consultant and IMD discuss the calls and, if applicable, how to address any Interviewees that withdraw from the process.

5. Investment Manager Interviews.

- a. IMD and the Consultant develop and distribute interview materials to the Interviewees and schedules interviews. ~~at the Department's offices.~~
- b. The Consultant has the option to participate in the interviews in person or by phone. Upon IMD's request, the Consultant's Investment Manager research staff participates in the interviews, as well.
- c. The following Departmental staff ~~should-may~~ participate in the interview: SRP Director, Assistant Director for SRP Investments, Chief Investment Officer, legal counsel, IMD's asset class staff and compliance staff. ~~The Deputy Director of SRP and IMD's asset class staff are optional participants.~~
- d. The Board or the Investment Subcommittee members will participate in interviews only to the extent they have formally adopted a motion to that effect for a specific search.

6. Final Due Diligence.

- a. After finalist interviews, the Consultant and IMD determine any final due diligence and negotiation points for each remaining candidate, including the following:
  - i. On-site visits;
  - ii. Reference checks;
  - iii. Feedback from the Investment Managers on the proposed IMA;
  - iv. Administrative, operational, risk, compliance, and/or conflicts of interest issues; and
  - v. Analysis of fees and performance.
- b. IMD has the option to conduct on-site visits and negotiate terms and fees prior to requesting the Consultant's recommended finalist(s). The Consultant has the option to participate in the on-site visits in person or by phone. Upon IMD's request, the Consultant's Investment Manager research staff participates in the on-site visits.

**D. Investment Recommendation Memorandum and Required Documents.** Following the completion of final due diligence, IMD and the Consultant discuss the strengths and weaknesses of the Interviewees, with the goal of developing a consensus recommendation to the Investment Subcommittee and the Board. The Consultant and IMD collaborate on draft recommendation memoranda and written materials for the Investment Subcommittee and the Board. If no consensus is reached, the opinions of both IMD and the Consultant will be provided to the Investment Subcommittee or the Board.

The Assistant Director for SRP Investments is responsible for collecting the following documents from an Investment Manager and reviewing them prior to preparing an investment recommendation memorandum for the Chief Investment Officer:

1. Investment Manager Disclosure Letter

2. Placement Agent Disclosure Letter
3. Conflict of Interest Certification (Attachment 1)
4. Code of Ethics
5. Compliance Manual Table of Contents
6. Organizational Chart
7. Valuation Policy
8. SSAE 16 Certification
9. Insurance Certificates
10. ADV Parts I and II
11. IRS Form W-8 (Foreign firm) or Form W-9 (U.S. firm)
12. Audited Financial Statements

The investment recommendation memorandum includes a “SWOT” analysis (*i.e.*, Strengths, Weaknesses, Opportunities, Threats) considering fit within portfolio construction and statutory qualifications (if any), background on the investment firm, historical returns, investment merits and risks, competitive analysis versus comparable or competing alternative offerings, operational assessment, liquidity considerations, expected contract terms, and other relevant information.

The Assistant Director for SRP Investments provides the investment recommendation memorandum, the Investment Manager Disclosure Letter, Placement Agent Disclosure Letter, and Conflict of Interest Certification to the Compliance Counsel and the Assistant General Counsel for SRP.

The Assistant Director for SRP Investments provides the investment recommendation memorandum and the documents in Numbers 3-12 above to the SRP Compliance Officer. Upon review of these documents, the SRP Compliance Officer completes and signs SRP’s compliance checklist and sends it to the Chief Investment Officer and the Assistant General Counsel for SRP.

## **V. Independent Review by Compliance Counsel**

The Compliance Counsel conducts an independent review of the Investment Manager Disclosure Letter, the Placement Agent Disclosure Letter (if applicable), IMD’s investment recommendation memorandum (including any supporting documentation), the Conflict of Interest Certification, and the proposed IMA or other contract for compliance with the Placement Agent Policy and any other applicable ethics policies (including policies related to gifts and charitable donations). The Assistant Director for SRP Investments and the Assistant General Counsel for SRP provide these documents to the Compliance Counsel. After reviewing these documents, the Compliance Counsel completes and signs a compliance review form that includes the following (the “Compliance Review Form”):

1. The Compliance Counsel’s approval of the disclosure letters under the Placement Agent Policy (*i.e.*, the Investment Manager Disclosure Letter and, if applicable, the Placement Agent Disclosure Letter) with respect to responsiveness and completeness;
2. The Compliance Counsel’s report concerning any aspect of the Investment Transaction’s recommendation, negotiation, or approval that in the view of the Compliance Counsel may reasonably violate any law, regulation, or Departmental or Board policy; and
3. The Compliance Counsel’s report concerning any aspect of the Investment Transaction’s

recommendation, negotiation, or approval that in the view of the Compliance Counsel raises significant concerns regarding Conflicts of Interest.

If the Compliance Counsel determines that the test stated by item (1) above is not met, the Compliance Counsel contacts the Investment Manager or Departmental staff to seek correction of the disclosure letter(s). If the Compliance Counsel determines that the test stated by item (2) or (3) may not be met, the Compliance Counsel notifies the Chief Investment Officer, Executive Director of the Retirement Systems Division, and General Counsel. The Chief Investment Officer has the authority to reject the Investment Transaction or to refer it to the Department's Investment Subcommittee to consider input from the Compliance Counsel, General Counsel (or designee), ~~Deputy SRP~~ Director ~~for SRP~~, and Executive Director of the Retirement Systems Division on the materiality of the risk and recommended approaches to remediate the risk, including recusal and third-party due diligence.

The Assistant Director for SRP Investments' investment recommendation memorandum must include a statement, as required by the Placement Agent Policy, listing (1) the person(s), if any, who initially suggested the investment opportunity to IMD or the Consultant; and (2) any person(s) who appeared before IMD or the Consultant in the marketing or due diligence process on behalf of the proposed Investment Manager and who were not employees of the proposed Investment Manager or one of its affiliates.

The Compliance Counsel sends the completed Compliance Review Form to the Chief Investment Officer and the Assistant General Counsel for SRP.

The Board shall not enter into an Investment Transaction without a signed Compliance Review Form. The Chief Investment Officer and Compliance Counsel are responsible for disclosing to the Investment Subcommittee and the Board if the Compliance Counsel determines that the test stated by item (2) or (3) may not be met for a recommended Investment Manager and substantive actions taken thereon to address the attendant risks.

## **VI. Conditional Approval**

The Chief Investment Officer is responsible for evaluating the Assistant Director for SRP Investments' investment recommendation memorandum and the Consultant's analysis and opinions developed through the search. The Chief Investment Officer may reject the investment recommendation memorandum, request changes or provide other feedback to the Assistant Director for SRP Investments and the Consultant, or approve the recommendation(s) for presentation to the Investment Subcommittee and the Board.

## **VII. Approval by the Board**

The Board has the sole authority to approve an appointment of an Investment Manager and enter, or cause the Plans to enter, into an Investment Transaction. If the Consultant and IMD agree on the recommended finalist(s), then they will provide a joint recommendation to the Investment Subcommittee and, if approved by the Investment Subcommittee, to the Board. In the event that the Consultant and IMD do not agree on the recommended finalist(s), the perspectives of both IMD and the Consultant will be provided to the Investment Subcommittee or the Board to inform the Investment Subcommittee's recommendation to the Board. Any recommendations from IMD and the Consultant to appoint an Investment Manager are contingent upon successful contract



negotiations. If the Board does not have an Investment Subcommittee, then the items to be presented to and approved by the Investment Subcommittee will be presented to the Board for approval.

## VIII. Contracting

Upon approval of the recommendation by the Board, the Assistant General Counsel for SRP and the Assistant Director for SRP Investments negotiate an IMA, amendment to the IMA, or other appropriate contract with the Investment Manager. Such negotiation is based upon the Board's - standard IMA or other standard terms and conditions. Upon completion of negotiations, the Assistant General Counsel for SRP submits to the Chief Investment Officer final contractual documents, a memorandum addressing key legal terms and deviations from the form IMA, the final Compliance Review Form signed by Compliance Counsel and other executed compliance forms, including the conflict of interest certification form. After the Chief Investment Officer's final review and approval, the Assistant General Counsel for SRP compiles all final legal and compliance documents and obtains signatures on behalf of the Board and the Department as well as countersignature from the Investment Manager.

## VII. External Communication Protocol

1. The Assistant Director for SRP Investments (or other IMD staff as determined by the Chief Investment Officer) is the point of contact for all communications with representatives of Investment Managers (including placement agents). Departmental staff and Board members are required to refer representatives of Investment Managers accordingly.
2. Participation by various IMD and SRP staff in Investment Managers' presentations may occur in the normal course of the diligence activities described in this policy.
3. No representative of an Investment Manager (including its placement agent) is permitted to contact Departmental staff (other than the Assistant Director for SRP Investments) or members of the Board regarding (a) the merits of the Investment Manager; (b) whether the Board should retain the Investment Manager; or (c) whether the Board should enter into an Investment Transaction. Any such contact may be cause for rejection of the Investment Manager.
4. An Investment Manager is permitted to continue communicating as normal with the Department concerning investments and day-to-day business interactions that are not part of the proposed Investment Transaction to which this Policy applies. Interactions at social events also are not prohibited. In either case, discussion of the potential new Investment Transaction is not permitted.
5. An Investment Manager or other external party may escalate concerns about the adequacy of the evaluation process by contacting the Chief Investment Officer or the ~~Assistant Deputy SRP~~ Director. ~~for SRP.~~

Except as noted in the following sentence, Departmental staff shall not use personal e-mail addresses to communicate with Investment Manager candidates or placement agents regarding state business related to potential Investment Transactions. Personal e-mail addresses may be used only if the Department's e-mail system is not functioning or is not available to the staff member and it is necessary for the efficient evaluation or negotiation of the Investment Transaction to send

such e-mail prior to the time the staff member regains access to the system. Any Department documents sent using a personal e-mail account must be promptly copied by staff onto the Department's shared drive.

## VIII. Definitions

“Board”: The North Carolina Supplemental Retirement Board of Trustees.

“Compliance Counsel”: Legal counsel utilized by the Department to review ethics and placement agent compliance matters for Investment Transactions.

“Conflict of Interest”: Circumstances that create a material risk that professional judgment or actions regarding the Investment Transaction's recommendation, negotiation, or approval have been or will be unduly influenced by a direct or indirect personal interest.

“Consultant”: An investment adviser(s) retained by the Board.

“Department”: The North Carolina Department of State Treasurer.

“IMA”: An investment management agreement.

“IMD”: The Investment Management Division of the North Carolina Department of State Treasurer.

“Investment Manager”: A person or entity, other than Departmental employees, given authority or discretion by the Board through contract to make decisions concerning the investment of Plan funds. The term also includes a person or entity that seeks to become, or is evaluated by the Consultant or IMD for the purpose of being selected as, an Investment Manager. The term also includes mutual funds and exchange-traded funds.

“Investment Option”: An investment fund or other vehicle in which participants in the Plans can invest, including model asset allocations and other target-date funds.

“Investment Manager Disclosure Letter”: The disclosure letter provided by an Investment Manager pursuant the Placement Agent Policy.

“Investment Policy Statements”: The (i) *Statement of Investment Policy for the NC 401(k) and NC 457(b)*; or (ii) *North Carolina Public School Teachers' and Professional Educators' Plan Statement of Investment Policy*, as applicable.

“Investment Subcommittee”: The Investment Subcommittee of the North Carolina Supplemental Retirement Board of Trustees.

“Investment Transaction”: (i) A business undertaking agreed upon between the Board and an Investment Manager to invest the assets of one or more of the Plans; or (ii) a Substantive Amendment.

“Placement Agent Disclosure Letter” The disclosure letter provided by the placement agent for an Investment Manager pursuant the Placement Agent Policy.

“Placement Agent Policy”: The *Placement Agent, Political Contribution, and Connection Disclosure Policy* adopted by the Board for the North Carolina Supplemental Retirement Plans.

“Plans”: The Supplemental Retirement Income Plan of North Carolina, the North Carolina Public Employees Deferred Compensation Plan, and the North Carolina Public School Teachers’ and Professional Educators’ Plan.

“SRP”: The Supplemental Retirement Plans, *i.e.*, the Supplemental Retirement Income Plan of North Carolina, the North Carolina Public Employees Deferred Compensation Plan, and the North Carolina Public School Teachers’ and Professional Educators’ Plan.

“Substantive Amendment”: An amendment to an IMA or other contract with an Investment Manager that increases the fee, expenses, or other compensation paid to an Investment Manager or other party or otherwise substantively and negatively changes the Board’s rights or obligations.

## IX. Revision History and Effective Dates

Version	Effective Date	Description of Changes
1	June 22, 2017	Original version
<u>2</u>	<u>December 12, 2019</u>	<u>Revised for elimination of Investment Subcommittee. Minor revisions to procedures and participants.</u>

**Attachment 1 to the Investment Manager Selection Policy and Procedures for the North Carolina Supplemental Retirement Plans**

The Conflict of Interest Certification is on the following page.



## North Carolina Supplemental Retirement Plans Investment Transaction Conflict of Interest Certification

### Application and Definitions

The Department of State Treasurer personnel listed below shall read and complete this form for each Investment Transaction, as such term is defined in the Policy and Procedures for Investment Transactions and Investment Manager Selection for the North Carolina Supplemental Retirement Plans (the “Policy”). Please note that the definition of Investment Transaction includes a Substantive Amendment. Terms in this form have the same meaning as in the Policy unless otherwise defined in this form.

1. “Conflict of Interest” shall mean circumstances that create a material risk that professional judgment or actions regarding the Transaction's recommendation, negotiation, or approval have been or will be unduly influenced by a direct or indirect personal interest.
2. “Family” shall mean immediate family (*i.e.*, mother, father, brother, sister, wife, husband, or child), either by birth, by marriage, by engagement to be married, or through a live-in domestic partnership that is similar to marriage; lineal ascendants (*e.g.*, grandparents); and lineal descendants (*e.g.*, grandchildren).
3. “Transaction” shall mean the Investment Transaction described below.

### Transaction

**Name of Investment Manager:** \_\_\_\_\_

**Name of Fund/Strategy:** \_\_\_\_\_

**Type of Contract:**     IMA                       Amendment to IMA                       Other: \_\_\_\_\_

### Certification

In regards to my work on the recommendation, negotiation, and approval process for the Transaction, I understand and have adhered to the following: (A) Department of State Treasurer’s *Code of Ethics and Conduct* (Investment Management Division); (B) *Supplemental Ethics Policy for State Treasurer, Senior Executive Staff and Investment Division*; (C) *Placement Agent, Political Contribution, and Connection Disclosure Policy* for the North Carolina Supplemental Retirement Plans; and (D) any other applicable policies. Furthermore, I certify the following to the best of my knowledge:

1. My Family and I have NO material financial interest in the Investment Manager and will not receive a financial benefit derived from the compensation provided to the Investment Manager;
2. My Family and I are NOT employees or directors of the Investment Manager;
3. I have NOT been employed with the Investment Manager within the past five (5) years;
4. I have NOT sought employment NOR discussed potential employment with the Investment Manager;
5. I have NO Conflicts of Interest in the recommendation, negotiation, and/or approval of the Investment Manager or the Transaction;
6. I voluntarily choose to disclose the following facts, which I believe do not constitute a Conflict of Interest and do not preclude my unbiased participation in the recommendation, negotiation, and/or approval of the Transaction. (If so, initial in the left margin and make any disclosure on attached sheets.)
7. I understand that I have an ongoing obligation to update any changes to this form prior to closing.

**The completed form must be sent to the Compliance Counsel.**

Assistant Director, SRP Investments: \_\_\_\_\_

Date: \_\_\_\_\_

Chief Investment Officer: \_\_\_\_\_

Date: \_\_\_\_\_

Assistant General Counsel, SRP: \_\_\_\_\_

Date: \_\_\_\_\_