



Report Concerning Placement Agent Review

December 16, 2013

Tab 1: **Summary and Introduction**

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Executive Summary for Kellogg Huber Special Review

I. Background

The State Treasurer and her agency, the Department of State Treasurer (Department), manage the North Carolina Retirement Systems (NCRS), a collective of investment assets of seven retirement funds and pension systems, including the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, the North Carolina National Guard Pension Fund, and the Retiree Health Benefit Fund. In total, the NCRS investment portfolio totals more than \$80 billion, which is managed by approximately 25 in-house investment professionals in the Investment Management Division (IMD). Given both budgetary constraints and the small number of investment staff positions, the Department's long-standing practice has been to hire outside firms as investment managers. Today, there are more than 100 investment managers who help manage the NCRS portfolio.

Many outside investment managers who are interested in managing money for public pension funds such as the NCRS hire third-party solicitors or brokers, known in the industry as "placement agents," to help market their funds. These third-party placement agents can serve a valuable function by helping smaller managers market themselves as effectively as their larger counterparts, who generally have in-house marketing staff. Placement agents' fees are paid by investment managers, not fund investors like the NCRS. Generally, placement agents are compensated a percentage of investors' commitments ranging between one and two percent.

II. Ennis Knupp Independent Review and First Placement Agent Policy

In June 2009, the Department retained the former Ennis, Knupp & Associates, Inc. (EnnisKnupp) through a competitive bid process to conduct an independent review and evaluation of the IMD. The April 2010 Ennis Knupp Independent Review found that under the practice prior to September 2009, IMD only tracked placement agents used by private equity and real estate investment managers. The Ennis Knupp Independent Review also noted that the pre-September 2009 list did "not include other relevant information, such as the fees paid to the placement agent, whether the placement agent is registered, or whether the placement agent gave any political contributions or gifts to decision-makers."

On September 29, 2009, Treasurer Janet Cowell, in her first year in office, approved the first ever Placement Agent Policy for the Department. As the Ennis Knupp Independent Review pointed out, "The Treasurer recognized the importance of adopting a placement agent policy and made its development a priority deliverable." Under the new Placement Agent Policy, external investment managers were required to disclose the retention of placement agents and related information, including the name of the placement agents, the fees paid to them, the resumes of key people, whether the agents were registered with the United States Securities and Exchange Commission or the Financial Industry Regulatory Authority, and other similar information. The new policy applied to all external investment manager agreements made on or after September 29, 2009. In addition, the Department requested existing investment managers to voluntarily disclose the historical use of placement agents in connection with presently effective agreements.

In response to the Department's voluntary request, virtually all investment managers provided Placement Agent Policy Disclosure Forms.

III. Kellogg Huber Special Review

In July 2010, based upon the information provided by the investment managers, the Department's General Counsel, in consultation with its outside counsel Womble Carlyle Sandridge and Rice, LLP, sent follow-up correspondence seeking further clarification about these managers' use of placement agents. In late July 2010, the General Counsel received information from an investment manager that raised concerns; these concerns were then promptly shared with the North Carolina Department of Justice (Department of Justice).

A. Process

The Department of State Treasurer and the Department of Justice mutually agreed that the Department of Justice should retain an outside counsel to further review the use of placement agents by Department of State Treasurer investment managers. In September 2010, the Department of Justice invited a number of law firms to submit proposals for this independent review of placement agents. In December 2010, the Department of Justice retained Kellogg, Huber, Hansen, Todd, Evans & Figel, P.L.L.C. (Kellogg Huber) to serve as the independent counsel for the Special Review.

As part of the Special Review, from January 2011 to October 2013 investment managers and placement agents provided documents to or held fact interviews with the Department of Justice and Kellogg Huber.

As noted in the Kellogg Huber Factual Report, due to the constraints upon civil investigations under existing North Carolina law, the review was conducted without the power to subpoena documents and without the power to compel testimony. The participation of third parties, including fund managers and placement agents, was entirely voluntary.

B. Findings of Fact and Resolutions

A series of fund commitments entered into between 2002 and 2008 became the focus of the review, based on the facts disclosed. These commitments were made prior to Treasurer Cowell's first term.

In April 2013, the NCRS received initial documents from the Department of Justice. That same month, the NCRS through the Department and Kellogg Huber contacted nine investment managers based on information from the Special Review. All of these engagements provided the NCRS an opportunity to express concerns about these facts, seek assurance that undesirable conduct would not be repeated, and negotiate resolution of the NCRS concerns. During these discussions, three overarching factors guided the NCRS structured approach. First, the NCRS evaluated the severity of the facts with the investment managers. Second, the NCRS assessed each investment manager's strategy and its fit within the NCRS portfolio. Third, the NCRS reviewed the performance of the investment manager against benchmarks and

alternatives. (See the last page of Tab 2 for a summary of each subject investment manager's performance.)

The attached findings of fact come from two sources. First, the summarized facts for Avista Capital Holdings, C.B. Richard Ellis, Earnest Partners, and Longview Partners come from Kellogg Huber. Second, the summarized facts for Angelo, Gordon; Apollo Global Management; Horsley Bridge Partners; Robeco Institutional Asset Management; and StarVest Partners come from the Department's General Counsel.

Because the Special Review was conducted without subpoena power, these findings can be neither corroborated nor refuted by facts not voluntarily disclosed, and there is no guarantee that the findings are either complete or accurate. The findings of fact attached to this package merely summarize the facts observed using the limited tools available. Given these limitations, we note with great emphasis that the findings of fact summaries draw no conclusion about whether any events violated laws or State policies.

Over the last eight months, the NCRS has entered into agreements with eight of the nine investment managers resulting in a combination of either financial compensation back to NCRS or policy changes or both. Three firms have agreed to almost \$15 million in refunds and fee discounts to the NCRS. We should note that even though the NCRS did not pay any placement agent fees related to the findings of fact below, the NCRS believes it was appropriate to deposit such recovery back into the NCRS as investment fees. We believe there was the potential that such fees and expenses might have been lowered in the absence of the original placement agent fee.

Eight firms have agreed to four policy changes, which we believe will help prevent a recurrence of such conduct.¹ First, each manager has agreed to refrain from providing gifts or other items of value to employees. Second, each manager has agreed to refrain from providing donations to charitable causes solicited by or on behalf of employees of the Department of State Treasurer. Third, each manager has agreed to refrain from using placement agents to assist in obtaining investments from or doing business with the NCRS. Fourth, each manager has agreed to refrain from making or soliciting others to make political contributions to the State Treasurer or any incumbent, nominee, candidate or successful candidate for such elective office. We were unable to satisfactorily resolve our concerns with one firm during the placement agent review. As a result, the NCRS will not make any commitments to its affiliated funds in the future.

C. Observations and Recommendations

In November 2012, Kellogg Huber transmitted to the Department the Draft Preliminary Report (Preliminary Report) setting forth 32 recommendations related to the use of placement

¹ We note two slight caveats. The agreement with Avista Capital Holdings states Avista shall not make any charitable contributions in excess of \$150.00 as a result of any direct or indirect solicitations by an employee in the Department in violation of the Department's Charitable Contributions Policy. The agreement with Longview Partners does not include the political contribution prohibition because this investment manager is based in the United Kingdom.

agents in connection with investment of the NCRS funds. We note that while the Preliminary Report envisioned that the Department would issue its response in early 2013, Kellogg Huber provided the Department with additional time so that the Department's response could be informed by additional factual investigation and so that the new policies and procedures envisioned by the Preliminary Report could be adopted and implemented.

The Department agrees with Kellogg Huber's observations that the agency can do more to provide both Department employees and investment managers better guidance on the role of placement agents. The Department took action in response to all the Kellogg Huber recommendations. These actions include:

- New restrictions on when placement agents can be used, expanded disclosures required from placement agents and fund managers, and the posting of those disclosures on the Department's website. More broadly, the Department now requires industry-leading disclosures of connections or relationships between Department personnel and fund managers or their placement agents. The Department retained outside Compliance Counsel to oversee the revised Placement Agent Policy.
- Additional policies and procedures, going beyond the recommendations in the Kellogg Huber preliminary report, to make the Department's investment decision-making processes more clear and methodical. Specifically, the Department has adopted new procedures that set out a standard process to be used each time the Department hires an external investment manager. Staff now complete a detailed Investment Recommendation Memorandum in connection with each transaction.

A table immediately following this Executive Summary summarizes the recommendations made by Kellogg Huber and whether the Department took action in response to those recommendations.

IV. Revised Placement Agent Policy and Additional Department of State Treasurer Policy Changes

Over the last year, the Department adopted or revised eight new policies and procedures to make the Department's investment decision-making processes more clear and methodical. These new or revised policies are:

- *The Placement Agent, Political Contribution, and Connection Disclosure Policy* (revised November 19, 2013);
- *The Investment Management Division Code of Ethics and Conduct* (adopted June 5, 2013 and revised December 10, 2013);
- *The External Investment Manager and Vehicle Selection Policy and Procedures* (adopted June 5, 2013 and revised December 10, 2013);
- *The External Investment Management Conflict of Interest Certification* (adopted

June 5, 2013);

- *The IMD Investment Committee Charter* (adopted June 5, 2013);
- *The Form Report on N.C.G.S. § 114-8.3(b1) Review of Proposed Contract* (adopted October 4, 2013);
- *The Investment Policy Statement for North Carolina Retirement Systems* (adopted November 26, 2012); and
- *The Supplemental Ethics Policy for State Treasurer, Senior Executive Staff and Investment Management Division* (adopted August 13, 2009 and revised December 10, 2013)

In addition, the Department expects to revise shortly the North Carolina Innovation Fund Investment Policy and the Investment Guidelines for the North Carolina Innovation Fund.

A summary of the policies can be found in this report on pages 8-12 of Tab 1.

V. Components of the Kellogg Huber Special Review

This package contains the following documents for your review:

- *Findings of Fact and Resolution Memoranda (Tab 2)*. The package contains two memoranda, the first from Kellogg Huber and the second from the Department's General Counsel. This segment also includes a table summarizing the investment performance for each fund mentioned.
- *Kellogg Huber Special Review Report (Tab 3)*. The Report contains Kellogg Huber's recommendations, the Department's response, and resolution of each of the recommendations.
- *New and Revised Policies (Tab 4)*. This section includes six of the Department's new and revised policies: the Placement Agent Policy, the IMD Code of Ethics, the Manager Selection Policy, the Conflict of Interest Certification, the Internal Investment Committee Charter, and the Supplemental Ethics Policy. The Investment Policy Statement and Review of Contracts Form have been omitted from these printed materials for reasons of length; they are available on the Department's website.

Summary of Response to Kellogg Huber Recommendations
by Department of State Treasurer

Summary Prepared by Department of State Treasurer, December 2013

| <u>No.</u> | <u>Subject</u> | <u>Summary of response</u> |
|------------|---|---|
| A(1) | Investment Policy Statement | Action taken. |
| A(2) | Contacts by IMD to placement agents | Action taken. |
| A(3) | Prohibition on placement agents if manager already has relationship with Department | Action taken. |
| A(4) | Fund-of-funds and secondary transactions | Action taken. |
| A(5) | Innovation Fund | Action taken. |
| A(6) | Change law to create fiduciary Investment Committee | Governance Commission formed to propose changes in law. |
| B(1)(i) | Relationships between fund manager or placement agent and current or former Department employee | Action taken. |
| B(1)(ii) | Recommendation of placement agent by current or former Department employee | Action taken. |
| B(2) | Allow for recusal of Treasurer | Action taken. |
| B(3) | Personnel may not solicit employment from fund managers or placement agents | Action taken. |
| B(4) | Bans on post-employment activity | Action taken. |
| B(5) | Create Compliance Counsel position | Action taken. |
| B(6) | Annual ethics training program | Action taken. |
| B(7) | Cover independent contractors | Action taken. |
| B(8) | Deadline for submission of Placement Agent Policy disclosure letter | Action taken. |
| B(9) | Restrict use of personal e-mail accounts | Action taken. |
| C(1) | Amend Placement Agent Policy disclosure letter to always require certain responses | Action taken. |
| C(2) | Disclosures required when placement agent is an employee of the fund manager | Action taken. |
| C(3) | Placement agents must certify and sign disclosure letter | Action taken. |
| C(4) | Disclosures of professional relationships and personal relationships | Action taken. |
| C(5) | Definition of “personal relationship” | Action taken. |

| <u>No.</u> | <u>Subject</u> | <u>Summary of response</u> |
|------------|---|----------------------------|
| C(6) | Amend form disclosure letter to more clearly include Treasurer | Action taken. |
| C(7) | Disclosure of political contributions | Action taken. |
| C(8) | Change law to make placement agents lobbyists | Proposal will be made. |
| C(9) | Require submission of terms of placement agent’s contract | Action taken. |
| C(10) | Clarifications to disclosure letter | Actions taken. |
| D(1) | Send policies annually to fund managers and placement agents | Actions will be taken. |
| E(1) | Disclose information on website | Action taken. |
| E(2) | Place disclosure letters on website. | Action taken. |
| F(1) | Amend Placement Agent Policy’s remedy provision | Action taken. |
| F(2) | Change law to more clearly prohibit false statements to government officials | Proposal will be made. |
| F(3) | Change law to prohibit state employees from soliciting or accepting anything of value with intent to influence state business | Proposal will be made. |

Summary of New Policies

Below, we summarize the major features of the key policies adopted, in light of the special review, by the Department to improve internal controls and bring greater certainty to procedures in the investment process.

The full text of these policies can be found at **Tab 4** in this packet. (The Investment Policy Statement and Review of Contracts Form have been omitted from these printed materials for reasons of length; they are available on the Department's website.)

I. Placement Agent Policy (*Revised November 2013*)

The revised Placement Agent, Political Contribution, and Connection Disclosure Policy reflects the recommendations of Kellogg Huber and adds additional requirements in the spirit of the Kellogg Huber recommendations.

First, the revised policy greatly expands disclosure obligations.

- The Department now requires disclosure and response to any personal relationship or family relationship between the investment manager or placement agent and Department personnel. *See* Questions 3.1 to 3.6 on each disclosure form and § VIII of the policy, which details how the Department's new Compliance Counsel will respond to any connections or relationships that may exist.
- Investment managers now must complete the portions of the form concerning relationships or connections even if no placement agent was used. *See* Questions 3.1 to 5.2 on each disclosure form.
- Disclosures are now required not only from the investment manager, but also from any placement agent. *See* § III(A) of the revised policy.
- The investment manager and any placement agent must disclose any political contributions made to the Treasurer or a candidate for Treasurer. *See* § IX(B).

Second, the revised policy limits when placement agents may be used.

- Transactions involving a third-party placement agent are barred if the investment manager manages North Carolina funds or has managed North Carolina funds within the last two years. *See* § VII(C)(1).
- Where in-house marketing staff serve as placement agents, the transaction is barred unless the investment manager discloses any known effect on the employee's compensation directly attributable to the North Carolina funds' proposed investment. *See* § VII(C)(2).
- Investment managers are also now barred from giving "tail fees" to prior placement agents or hiring third-party placement agents to market or promote contract amendments. *See* §§ VII(C)(3)-(4).
- Finally, the revised policy directly prohibits Department personnel from suggesting to an investment manager that a placement agent be engaged. *See* § VII(D).

II. Investment Management Division Code of Ethics and Conduct *(Adopted June 2013)*

The Department's Investment Management Division has adopted a new Code of Ethics and Conduct. This Code is signed annually by each Investment Management Division employee. At the time of signature, the employee certifies that he or she has been in compliance with the Code for the previous twelve months. *See* § III, p. 2.

The Code of Ethics sets out general principles of ethical conduct, serving as a promise by employees that they will act with integrity, diligence, respect, and prudence. *See* § I, p. 1. The Code of Ethics notes employees' affirmative duty to identify and promptly disclose conflicts of interest or any other personal, social, or other activities and relationships that could impact the employee's objectivity or interfere with proper performance of official duties. *See* § I, p. 1.

The policy serves as an honor code, requiring employees to immediately report actual or suspected fraud, misconduct, reports or communications that misrepresent or omit material information, or violations of laws, rules, or IMD policies. *See* § I, p. 2. The Code also requires that employees abide by the approved practices and standards of their professional associations, such as the CFA Institute and AICPA. *See* § I, p. 2.

III. External Investment Manager Selection Policy *(Adopted June 2013)*

The new Investment Manager and Vehicle Selection Policy (hereinafter, the "Selection Policy") sets out a step-by-step process to be used when selecting new investments for the state's pension funds. The Selection Policy describes two alternate approaches.

In the "Request for Information Search" approach, the Department first identifies a particular type of new investment commitment needed for an asset class portfolio. Then, the asset class Director develops search criteria, selects any third-party consultant to be used in the search, and sends out Requests for Information to a targeted group of firms. *See* § III(A) of the Selection Policy. Based on the responses, the Director selects finalists, who are interviewed by the Director, Chief Investment Officer, and Investment Management Division risk personnel. *See* § III(A). Due diligence, recommendation, contract negotiation, and approval then proceed in the same fashion as the alternate "Work Plan and Opportunistic Search" approach.

The "Work Plan and Opportunistic Search" approach is designed for investment vehicles in asset classes such as private equity and real estate, where potential investment opportunities are available only for relatively short periods of time. *See* § III(B), p. 3. Here, the Treasurer's Office will be more proactive. Asset class Directors will submit to the CIO and Treasurer for approval Annual Investment Work Plans based on factors including market analysis, cash flow forecasting, and projected availabilities for various potential investment vehicles. These work plans will be evaluated by the Chief Investment Officer and Treasurer to determine the annual capital commitment pace for the asset class. *See* § III(B), Phase I. Over the course of the year, Directors and staff will identify a broad universe of relevant offerings in the market by obtaining information from market participants such as consultants, other investors, and the representatives of funds in which the Treasurer's Office might invest. *See* § III(B), Phase II. Directors will choose the most attractive investment opportunities to reach the due diligence stage. *See*

§ III(B), Phase III. In this evaluation, directors will evaluate specified factors such as fit within overall portfolio construction, the performance of prior funds or related investments, and research by independent consultants and other third parties, then begin the due diligence and negotiation process. *See* § III(B), Phase III.

The new Selection Policy provides a more well-defined process for documenting how due diligence will be performed by staff and how the full details of the transaction will be presented to the Treasurer and Chief Investment Officer for approval. *See* §§ IV-X. The asset class Director will prepare an Investment Recommendation Memorandum that includes due diligence results, analyses of strategic investment matters such as portfolio construction considerations, investment merits and risks, and expected contractual terms. *See* § VI. The Investment Recommendation Memorandum is reviewed by the Department's compliance staff, including the Compliance Counsel. *See* § VII. After review by the Compliance Counsel, the Memorandum is provided to the Chief Investment Officer, who will provide feedback, request changes, or provide a conditional approval. *See* § VIII. Following the completion of contractual negotiations, the Investment Recommendation Memorandum and the contractual documents are sent to the Treasurer for rejection or final approval. *See* § X.

Finally, the Selection Policy sets out an external communication protocol that specifically applies the principles of the Department's No Contact Policy to communications concerning potential new investments, commitments or relationships. *See* § XI. A particular person assigned by the Director will be the point of contact for all communication to the Department from the investment manager or any placement agent. *See* § XI(1). Concerns about adequacy of the IMD evaluation process can be brought to the Chief Investment Officer or the Treasurer. *See* § XI(5).

IV. Role of Compliance Counsel under New Manager Selection Policy and Revised Placement Agent Policy

The new Selection Policy and the revised Placement Agent Policy include a number of provisions that describe how DST's new Compliance Counsel will monitor ethics for each transaction. The Investment Recommendation Memorandum will include DST staff disclosures concerning the source of each investment opportunity. These disclosures will include the source who suggested the investment opportunity and a list of all persons who participated in the marketing or due diligence process on behalf of the external investment manager, but who were not employees of the manager or one of its affiliates. *See* Selection Policy, § VI at p. 6, and Placement Agent Policy, § III(E).

The Compliance Counsel will make an independent review of these disclosures, the rest of the Investment Recommendation Memorandum, and the Placement Agent Policy disclosure forms. *See* Selection Policy, § VII, and Placement Agent Policy, § VI(A). The Compliance Counsel will then complete a signed Compliance Review Form that includes a report concerning any aspect of the transaction's recommendation, negotiation, or approval that, in the view of the Compliance Counsel, raises significant reputational risk concerns related to conflicts of interest or may reasonably violate law or policy. *See* Selection Policy, §§ VII(1)-(3), and Placement Agent Policy, § VI(B). If the Compliance Counsel cannot provide a clean report, he or she will notify the Chief Investment Officer and General Counsel, and the issue will be jointly resolved

through discussion with the Chief Investment Officer, the Department's in-house legal counsel, and the Investment Management Division Investment Committee. *See* Selection Policy, § VII, and Placement Agent Policy, § VI(C)(2). This group, or the Treasurer, can agree to terminate consideration of the proposed transaction. An investment transaction cannot be completed unless it has been approved by the Compliance Counsel, the General Counsel, or his or her attorney designee. *See* Placement Agent Policy, §§ VI(C)(2) and VII(A). The resolution of the issue raised by the Compliance Counsel will be documented in writing and provided to the Treasurer before execution. *See* Placement Agent Policy, § VI(C)(2).

V. Conflict of Interest Certification *(Adopted June 2013)*

For each commitment of funds by the Treasurer's Office to an investment manager, the Treasurer and the Department employees who evaluated the investment now complete a signed Conflict of Interest Certification form verifying that they have not violated the Code of Ethics and Conduct, do not hold any personal financial interest in the transaction, and have no conflicts of interest in recommending, negotiating, or approving the transaction.

VI. Internal Investment Committee Charter *(Adopted June 2013)*

The Investment Management Division has formalized the procedures of its internal Investment Committee through the creation of an Investment Committee Charter. (This is a separate group from the Treasurer's Investment Advisory Committee, which will continue to meet quarterly to discuss general investment strategy. The internal Investment Committee will meet more frequently and be focused on tactical decisions as well as matters of general strategy.) Among the internal Investment Committee's responsibilities are the forward calendar of potential investment opportunities, asset class work plans, liquidity assessments, maintenance of IMD policies, and risk and compliance standards. *See* § V of the Charter. The Investment Committee will meet at least monthly and, in addition, on an ad hoc basis whenever a risk, compliance, or ethics issue arises that requires immediate review. *See* § V.

VII. Review of Contracts Under New G.S. § 114-8.3(b1) *(Effective October 2013)*

In spring and summer 2013, the Department worked with members of the General Assembly on new subsection (b1) of N.C. Gen. Stat. § 114-8.3. New subsection (b1) requires the Department's in-house counsel to review and confirm certain matters in connection with all investment contracts. The Department's outside private counsel have been reviewing these matters for many years, but this new process serves as an additional safeguard. No contract can be signed without subsection (b1) review and approval. The Department's form for subsection (b1) review includes specific line items on which in-house counsel will confirm that the Placement Agent Policy form has been approved and the Department's standard ethics provisions have been included in the contract. *See* § D of the review form. The form is provisional, as the new law went into effect on October 1, 2013. Over the coming weeks, the Department will revise the form and issue a new procedure for subsection (b1) review.

VIII. Supplemental Ethics Policy *(Revised December 2013)*

In March 2009, Treasurer Cowell implemented a new policy which prohibited the Treasurer, senior Department staff, the Chief Investment Officer, and Investment Management Division asset class Directors from taking certain actions after leaving their employment with the Department. Under this Supplemental Ethics Policy (informally referred to as the “Revolving Door Policy”), covered ex-employees shall not represent any person, except the State, by making a formal or informal appearance before Department personnel to influence administrative or legislative action.

In response to Kellogg Huber’s recommendations, we are strengthening and clarifying the Supplemental Ethics Policy. The prohibited period will now be four years for appearances before the Department. *See* Supplemental Ethics Policy, § IV(B)(2). There is a new six-year prohibition on appearances before the Department as a placement agent. *See* § IV(B)(3). We have also added a two-year period in which the former Department employee may not work at the outside firm on Department business, even if it does not result in an appearance before the Department. *See* § IV(B)(1). Another new section bars Investment Management Division personnel from soliciting employment with Department fund managers or their placement agents. *See* § IV(A)(2).

IX. Investment Policy Statement *(Adopted November 2012)*

The Treasurer’s Office adopted an Investment Policy Statement for the North Carolina Retirement Systems (“NCRS”) on November 26, 2012. The 2012 Investment Policy Statement set out in writing the principles that the Department of State Treasurer has followed since the term of Treasurer Janet Cowell began in 2009. The Department is currently working on revising the Investment Policy Statement as part of an “asset liability study” analyzing its overall investment strategy for the pension fund.

The Investment Policy Statement discusses objectives and guidelines for the selection of new investments in each of the NCRS asset classes. *See* §§ II-IV in each section of the Investment Policy Statement dealing with particular asset classes. It also sets out detailed procedures for the administration, monitoring, and assessment of existing NCRS investments. *See* pp. 5-7 of the Policy Statement and § V of each Policy Statement section dealing with particular asset classes. Further, it establishes the day-to-day division of responsibilities among the Treasurer, the Investment Advisory Committee, and the Investment Management Division. *See* pp. 3-4 of the Policy Statement.

Tab 2: **Findings of Fact**

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KELLOGG, HUBER, HANSEN, TODD, EVANS & FIGEL, P.L.L.C.

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December 11, 2013

Via Electronic Mail and Federal Express

Jay Chaudhuri
General Counsel
North Carolina Department of State Treasurer
325 N. Salisbury Street
Raleigh, NC 27603

Re: *Review of North Carolina Retirement Fund Related to Use of Placement Agents*

Dear Jay:

In accordance with the December 2010 engagement of Kellogg, Huber, Hansen, Todd, Evans & Figel, PLLC, by the North Carolina Department of Justice, I am pleased to transmit the enclosed Findings of Fact regarding the Special Review for the North Carolina Department of State Treasurer. These Findings of Fact concern four investment funds: Avista Capital Holdings, C.B. Richard Ellis, Earnest Partners, and Longview Partners. As stated in the enclosure, these Findings of Fact bear significant caveats due to the limited tools available to the review.

We thank you for the cooperation that you and your office have provided throughout the course of the Special Review.

Sincerely,

A handwritten signature in blue ink that reads "David C. Frederick" followed by a stylized monogram or initials.

David C. Frederick

Enclosure

cc: Kip Sturgis – Assistant Attorney General, North Carolina Department of Justice

Kellogg, Huber, Hansen, Todd, Evans & Figel, P.L.L.C.

SPECIAL REVIEW FOR THE
NORTH CAROLINA DEPARTMENT OF STATE TREASURER

FINDINGS OF FACT AND REMEDIAL MEASURES REGARDING
AVISTA, C.B. RICHARD ELLIS, EARNEST PARTNERS,
AND LONGVIEW PARTNERS

December 11, 2013

I. Overview

Beginning in April 2013, the Department of State Treasurer (Department) engaged in discussions with eight investment managers based on information from the Kellogg Huber special review. During these discussions, three overarching factors guided the structured approach undertaken by North Carolina Retirement Systems (NCRS). First, NCRS evaluated the finding of facts. Second, NCRS assessed investment manager's strategy and whether such a strategy could be substituted in the marketplace. Third and finally, NCRS reviewed the performance of the investment manager against its peer group.

Below are findings of fact regarding four of those investment managers: Avista Capital Holdings, C.B. Richard Ellis, Earnest Partners, and Longview Partners. The summarized facts below represent findings of fact by Kellogg Huber based on documents from various sources, including the Department and third parties, and interviews with various individuals.

It is important to point out significant caveats about these findings of facts. This special review was conducted without the power to subpoena documents and without the power to compel testimony. The participation of third parties, including fund managers and placement agents was entirely voluntary. Accordingly, the review revealed only information those third parties chose to share in voluntary interviews and through voluntary productions of documents from various sources. Moreover, the NCDOJ did not provide us with all of the documents that it received from those third parties. Therefore, these findings can be neither corroborated nor refuted by facts not voluntarily disclosed, and there is no guarantee that the findings are either complete or accurate. The summaries below merely recount the facts observed using the limited tools available. Given these limitations, we note with great emphasis that this report draws no conclusion about the whether the facts set out below could be construed to violate any criminal or civil laws.

II. Avista Capital Holdings

A. Findings

The review revealed that Avista secured an investment of \$50 million from NCRS for its Avista Fund I in April of 2006. Avista hired two placement agents in connection with Avista Fund I: Arapaho Partners and Merrill Lynch. In December of 2007, Avista began raising funds for Avista Fund II. Despite having a preexisting relationship with NCRS by virtue of its investment in Fund I, Avista hired Cue Capital as a placement agent in connection with Fund II. Thompson Dean, the President of Avista, secured meetings with officials from NCRS to discuss Avista Fund II in January of 2008. NCRS proceeded to conduct due diligence of Avista Fund II starting in February of 2008, including several on-site visits at Avista's offices in New York. NCRS also used Strategic Investment Solutions ("SIS"), a third-party consultant that provided

NRCS with independent evaluations of potential investments, to conduct due diligence of Avista Fund II. On June 5, 2008, Craig Demko emailed Pat Gerrick an evaluation memorandum prepared by SIS, which rated Avista Fund II “average,” with a score of 68 out of 100. On June 12-13 of 2008, Gerrick and Demko visited Avista’s offices in New York to conduct more on-site due diligence.

In an interview with NCDOJ, Avista’s co-CEO Tom Dean expressed that Avista was concerned about securing NCRS’s commitment to invest in Fund II prior to the closing of the first round of funding at the end of July 2008. According to Tom Dean, sometime after NCRS’s on-site due diligence meetings on June 12-13, 2008 but before June 25, 2008, Dean met personally with Richard Moore in the Hamptons, New York. Moore had called Dean and told him that he was going to be in the Hamptons and requested a meeting at the Southampton Inn to discuss North Carolina’s investment in Avista Fund II. According to Dean, at the meeting Moore said that North Carolina was considering an investment into Avista Fund II. Moore stated that he understood that Avista wanted North Carolina’s commitment to be finalized no later than July 2008, but Moore was not comfortable with that tight a timeline. Moore then told Dean that he wanted Avista to hire Aqueduct Capital Group to conduct additional due diligence on Avista Fund II. According to Dean, Moore did not say why he wanted Avista to hire Aqueduct other than to say that Moore trusted Aqueduct. Moore also did not specify whether he wanted any specific work product from Aqueduct. Dean understood Moore to be saying that NCRS would not invest in Avista Fund II unless Avista hired Aqueduct to perform this “due diligence.”

The President of Aqueduct Capital Group was Frank Edwards, who had a close relationship with Richard Moore. Edwards had made several campaign donations to Moore including \$4,000 from each Edwards and his wife. On June 25, 2008, Edwards sent an e-mail to Dean proposing that they meet on June 27, 2008. In the same e-mail, Edwards also asked Dean to provide a copy of Avista’s presentation materials. On the same day, Dean e-mailed Edwards back and confirmed a meeting for June 27, 2008. Around that time, Avista retained Aqueduct. Unlike similar agreements produced by Avista for other placement agents, that retainer agreement was undated. Avista retained Aqueduct as a “consultant” with respect to Avista Fund II. The agreement appears to have been revised from a standard form placement agent agreement used by Avista, and provided that Aqueduct had the following “duties:”

“During the Engagement Period, [Aqueduct] shall arrange and attend meetings between representatives of [Avista] and representatives of [NCRS]. Nothing contained herein shall prohibit or restrict [Avista] from appointing any other person to act as a *placement agent* for the Fund. . . .” Avista Contract ¶ 1 (emphasis added).

The agreement also provided that Aqueduct would be paid only if its “due diligence committee” decided to “approve” Avista Fund II, and furthermore only if North Carolina made an investment in the fund no later than July 31, 2008.

Avista did not investigate whether Aqueduct had a “due diligence committee” or the capacity to conduct due diligence on Avista Fund II. While it directly retained Aqueduct as its “consultant” and ultimately paid it \$1 million for at most a few weeks of work, Avista did not determine whether Aqueduct prepared any due diligence, reports or analysis, whether it had performed any meaningful work, or whether it shared any information or analysis with NCRS. In response to requests, neither Avista nor Aqueduct produced any due diligence reports or any other documents prepared by Aqueduct analyzing Avista Fund II. NCRS has no record of any due diligence reports or any other documents prepared by Aqueduct analyzing Avista Fund II, or any other record of Aqueduct’s involvement in the Avista Fund II transaction. Craig Demko, the Department staff member most directly involved with the review of Avista as a potential investment, was unaware that Avista had used any placement agent for Avista Fund II and did not recall ever having any contact with anyone from Aqueduct concerning Avista Fund II. According to Edwards, neither he nor Aqueduct had previously conducted due diligence on behalf of any investor. The review uncovered no evidence that Aqueduct had a “due diligence committee” or that it was equipped to conduct due diligence.

In late July 2008, less than one month after Dean first met with Frank Edwards, NCRS committed to make a \$100 million investment in Avista Fund II. Immediately before Moore approved the investment, Dean repeatedly e-mailed Edwards to push for Moore to sign the approval documents immediately in order to meet the deadline for the closing of the first round of funding for Avista Fund II. Avista later paid Aqueduct a fee of 1% of the North Carolina’s investment, for a total fee of \$1 million.

B. Remedies

On July 12, 2013, NCRS and Avista agreed to resolve issues related to Avista’s use of placement agents with respect to Avista Fund II. The agreement secures both policy changes and financial compensation from Avista. Avista agreed to the following policy changes: (1) not to use a placement agent in connection with any future investments with NCRS; (2) to amend its Political Contribution Policy to conform to the Department’s Political Contribution Policy by prohibiting any direct contribution by any employee of Avista that would violate the Department’s Policy; and (3) to ban any gifts from Avista or its officers, partners, or principals to any employee of the Department and to ban contributions by Avista or its officers, partners, or principals in excess of \$150 to any charitable organizations as a result of a direct or indirect solicitation by an employee of the Department.

Avista further agreed to compensate NCRS as follows: (1) Avista agreed to an unconditional payment of \$1 million when management fees for Avista Fund I or Avista Fund II become due to NCRS on or before December 31, 2016; and (2) Avista agreed to either a management fee discount or a cash payment in connection with Avista Fund III, depending on whether the Limited Partnership Agreement Amendment (“LPA Amendment”) to Fund III were to go into effect. Avista agreed that if the LPA Amendment went into effect, then Avista would

provide to the NCRS a discount of 25 basis points on its management fees for Avista Fund III. The LPA Amendment later went into effect on July 31, 2013. The NCRS estimates that the value of this discount will be approximately \$3.2 million. If the LPA Amendment had not gone into effect, then Avista would have paid \$1.75 million when management fees for Avista Fund III become due to NCRS on or before December 31, 2016. Accordingly, the total financial compensation from Avista to NCRS will be approximately \$4.2 million.

III. C.B. Richard Ellis Global Investors

C. Findings

The review revealed that C.B. Richard Ellis Global Investors (“CBRE”) engaged Louis Dworsky sometime in 2005 as a placement agent in connection with NCRS’ investment in CB Richard Ellis Strategic Partners US IV, a real estate investment fund managed by CBRE. When asked how he came to be retained by CBRE, Dworsky said that Tim Head at CBRE had learned that Dworsky had connections with the Department of State Treasurer. Vance Maddocks, head of CBRE’s private equity business, confirmed that Dworsky was referred to him through another employee at CBRE. Maddocks explained that CBRE hired Dworsky because he offered “an introduction to Richard Moore.”

CBRE appears to have entered into an oral agreement with Mr. Dworsky sometime before August 2005. CBRE and Dworsky later executed a written contract on December 2, 2005, styled a “Consulting Agreement,” for a term of 5 years. Under this written contract, CBRE agreed to pay Dworsky an origination fee 0.085% of assets invested and an additional annual fee of 0.085% of the average gross assets for any investment in a “commingled fund.” Dworsky’s responsibilities consisted in “orchestrat[ing] and arrang[ing] a Real Estate Management relationship between CBRE Investors and Client/Investor on terms satisfactory to CBRE Investors.” The contract specifically lists the North Carolina Department of State Treasurer Trust Fund Investment Program, the Teachers’ and State Employees’ Retirement System, and the Local Government Employees’ Retirement System as the “Client/Investor.” It lists no other target investors aside from those managed by the Department.

In the course of the review, Dworsky minimized his knowledge of any details regarding such large investment decisions or his ability to provide informed advice on such matters. The review uncovered no evidence that Dworsky had any subject-matter expertise regarding the investments being sold by CBRE or the particular investment needs of NCRS. Dworsky disclaimed having ever worked as a “placement agent” and described his involvement as a “referral business.” According to Dworsky, fees for those referrals would be paid to his employer (which was Wachovia Securities at the time he entered into the Consulting Agreement with CBRE) and he would receive his standard share of those fees (approximately 37%). He could not explain how he became involved in the “referral business” or how he initiated a

relationship with NCRS. He stated that he knew Harlan Boyles and Richard Moore, as well as Andy Stilton and Pat Gerrick. He eventually revealed that he has known Moore “since [he] was in grade school.” Dworsky stated that he had only two clients in the referral business – CBRE and Earnest Partners – and that NCRS was the only investor to which he referred those clients. Notably, Dworsky was successful in both referrals.

NCRS ultimately invested \$150 million in CB Richard Ellis Strategic Partners US IV. Apart from introducing CBRE to NCRS employees, the review revealed no evidence of any due diligence or substantive work performed by Dworsky regarding those investments. CBRE received no accounting of Mr. Dworsky’s time in this matter and was unable to explain what, if any, substantive work Mr. Dworsky had performed on CBRE’s behalf. In October 2006, CBRE paid Dworsky, through Wachovia Securities, \$97,465 pursuant to the fee schedule listed in the Consulting Agreement as payment for securing NCRS’s investment in CB Richard Ellis Strategic Partners US IV. Shortly thereafter, in February 2007, CBRE terminated the Consulting Agreement with Dworsky, even though the agreement was supposed to run until December 2010. CBRE made a \$1.3 million payment to Dworsky in connection with this termination. Unlike its previous payment to Dworsky through his employer, Wachovia Securities, CBRE made the \$1.3 million payment directly to Dworsky, as provided by the terms of the Consulting Agreement, because Dworsky left Wachovia Securities just before this payment was made. As with CBRE’s initial oral agreement with Dworsky, the grounds for the termination were not well documented. According to Maddocks, he believes it was designed to assuage concerns by the staff at NCRS regarding Dworsky’s close relationship to Moore.

D. Remedies

In December of 2013, NCRS informed CBRE that because of the lack of a satisfactory resolution to its concerns regarding the events uncovered by the review, the Department will not engage in any further business with CBRE in the future. NCRS is bound by the terms of the Limited Partnership Agreement that governs its current investment with CBRE, and is therefore unable to exit that existing investment.

IV. Earnest Partners

E. Findings

The review revealed that in August of 2002, Earnest Partners engaged Louis Dworsky at Prudential Securities as a placement agent tasked with securing an investment from NCRS. Paul Viera, the President and Founder of Earnest Partners, was unable to recall the circumstances in which he met Dworsky, nor did he recall any due diligence that Earnest Partners performed on Dworsky prior to engaging him as a placement agent. Viera stated that he decided to hire

Dworsky on the basis of Dworsky's claim that he had "connections" within NCRS, including a direct relationship with Richard Moore.

The review uncovered inconsistent information about Dworsky's expertise with respect to investments for NCRS. In a July, 2002 letter to Earnest Partners, which was copied to Moore, Dworsky claimed:

"For the past year I have been providing the NCRS with advice and counsel with respect to investment policy, asset allocation guidelines and manager searches and evaluation. After extensive review, I was pleased to present Earnest Partners, L.L.C. as a small cap value equity investment manager for the NCRS's consideration. In the future, I expect to provide similar service to the NCRS as may be requested of me from time to time."

As indicated in the Findings regarding CB Richard Ellis, the review uncovered no evidence that Dworsky had any subject-matter expertise regarding the investments being sold by Earnest Partners or the particular investment needs of NCRS. As explained above, Dworsky disclaimed having ever worked as a "placement agent" and described his involvement as a "referral business." According to Dworsky, fees for those referrals would be paid to his employer (Prudential or, before that, Paine Webber, during the time he was engaged by Earnest Partners) and he would receive his standard share of those fees (approximately 37%). He could not explain how he became involved in the "referral business" or how he initiated a relationship with the NCRS. He stated that he knew Harlan Boyles and Richard Moore, as well as Andy Stilton and Pat Gerrick. He eventually revealed that he has known Moore "since [he] was in grade school." Dworsky stated that he had only two clients in the referral business – Earnest Partners and CBRE – and that NCRS was the only investor to which he referred those clients. Notably, Dworsky was successful in both referrals.

NCRS ultimately made two investments in Earnest Partners: \$100 million in 2002 and an additional \$40 million in 2009. Apart from introducing Earnest Partners to NCRS employees, we found no evidence of any due diligence or substantive work performed by Dworsky regarding those investments. From the first quarter of 2004 until the fourth quarter of 2006, Earnest Partners made quarterly payments to Prudential Securities in amounts ranging from \$14,947 to \$21,262, for a total of \$218,699. Additionally, Earnest Partners donated \$500 to Richard Moore's campaign for Treasurer in 2004 and \$2500 to Moore's campaign for Governor in 2008. John Whitmore, the COO of Earnest Partners, donated \$2,500 to Moore's campaign in 2008.

F. Remedies

On December 6, 2013, NCRS and Earnest Partners agreed to resolve issues related to Earnest Partners' use of placement agents. The agreement secures both policy changes and financial compensation from Earnest Partners. Earnest Partners agreed to the following policy changes: (1) not to use a placement agent in connection with any future investments with NCRS; (2) to prohibit Earnest Partners and its affiliates and their respective partners, managers,

employees, or agents acting on their behalf from making political contributions to the State Treasurer or any incumbent, nominee, candidate, or successful candidate for that office; and (3) to ban any gifts to any employee of the Department from Earnest Partners and its affiliates and their respective partners, managers, employees, or agents acting on their behalf and to ban contributions to any charitable organizations solicited by or on behalf of an employee of the Department. Earnest Partners further agreed to further rebate management fees to NCRS in the amount of \$660,000.

V. Longview Partners

G. Findings

The review revealed that Longview Partners (“Longview”) hired Whitman & Co. in 2006 as a placement agent to assist in securing an investment by NCRS. Whitman & Co. was founded by Eugene “Gene” Whitman, who served as its President until his death in January of 2007. After Gene Whitman’s death, his son Eugene “Chip” Whitman became President of Whitman & Co. After its engagement by Longview, Whitman & Co. in turn hired Howard Street Partners, the partners of which were Teresa Myers and Elie Sullivan. Longview and Whitman had a written placement agency contract. Whitman, in turn, entered into an oral agreement with Howard Street Partners which provided that Whitman would pass on to Howard Street a percentage of the fees that Whitman received from Longview for the NCRS investment. Whitman and Howard Street initially agreed that Whitman would pass on 30% of its fees, and then subsequently agreed to increase that percentage to 50% after Gene Whitman died. The fees paid under the arrangement between Longview and Whitman, and the arrangement between Whitman and Howard Street, were contingent on the successful placement of an investment with NCRS.

The review also revealed that Teresa Myers, the partner at Howard Street, is married to John Burns, who at the time was working as a contract consultant for the NCRS with the title of Director of Public Equities. At NCRS, Burns was responsible for reviewing potential investments, including a potential investment in Longview. Burns’ role at NCRS and his marriage to Myers created a serious conflict of interests because a decision by NCRS to invest in Longview would result in a payment of fees to Burns’ wife. During an interview with NCDNJ, Myers acknowledged this conflict, but incorrectly claimed that Burns had not worked on evaluating the Longview investment.

The review uncovered substantial evidence that Burns played a central role in NCRS’s decision to invest in Longview. The first known contact between any representative of Longview and any Department staff member was a meeting in New York on June 8, 2006 between John Burns and Chip Whitman. Several employees of Longview attended that meeting, which was followed by a dinner for which Longview paid. On August 10, 2006, Whitman sent

Burns updated marketing information about Longview that included “the most recent quarterly performance” for one of Longview’s portfolios. On November 13, 2006, Burns and Patricia Gerrick participated in a meeting and dinner with representatives of Longview in Chapel Hill, North Carolina. On December 15, 2006, Burns contacted Whitman to solicit a proposal from Longview for a potential investment. Burns drafted the Request for Proposal, and listed himself as the contact for Longview’s response. On January 3, 2007, Longview submitted its proposal directly to Burns.

On January 19, 2007, Burns participated in a meeting with other Department staff members to engage in a detailed review of Longview’s proposal. Burns and Gerrick then conducted an on-site review of Longview on January 23, 2007 in London. Prior to the on-site due diligence, Burns sent Whitman a substantive agenda for the meeting. On February 21, 2007, Burns attended a meeting between Department staff and senior Longview executives in Raleigh, North Carolina. Burns drafted notes at that meeting analyzing and evaluating Longview as a potential investment. Burns then drafted a preliminary memorandum to the Treasurer analyzing Longview as a potential investment and recommending an “initial investment of \$250 million” which “could be increased to a longer term allocation of \$500-\$750 million.” In May of 2007, Burns participated in drafting the final memorandum to the Treasurer which also recommended an initial investment of \$250 million “with an intended goal of \$500 - \$750 million.” Finally, Burns participated in contract negotiations between NCRS and Longview, including corresponding with Whitman about specific provisions of the agreement.

In response to an inquiry from NCRS in 2013, Longview acknowledged the conflict created by Whitman’s retention of Howard Street Partners, but stated that it believed that Burns had been recused from the process of considering Longview as a potential investment. However, the review confirmed that Longview knew that Burns was married to Myers, and that Longview should have known that Burns was nonetheless working on the potential Longview investment. For example:

- 1) 11/13/2006 – Burns attended a face-to-face meeting with representatives of Longview.
- 2) 12/15/2006 – Whitman emails Longview saying “Just got a call from John Burns, the Director of Public Equities for the State of NC. Apparently, Pat Gerrick liked you enough to have John send us the questionnaire.”
- 3) 1/3/2007 – Longview emails John Burns providing materials in response to the questionnaire referenced in the 12/15/2006 email.
- 4) 1/16/2007 – Whitman emails several officers at Longview, relaying a message from “John Burns” that NCRS would like to do an on-site visit at Longview’s offices. This email says “The attendees will be Pat Gerrick, John Burns (Teresa Myer’s husband) and maybe a third person.”

- 5) 1/23/2007 – Burns attends face-to-face meetings with representatives of Longview during on-site due diligence in London.
- 6) 2/12/2007 – Whitman emails Longview to “lay out some directions your conversation with Richard Moore might go.” Whitman “propose[s] a conference call with Elie and me ... to cover these and any lingering questions you may have ahead of your meeting.” Whitman also states that “John Burns had to interview with [Moore] last year to get the consulting position he now holds. He described him as very gregarious and passionate about several issues.”
- 7) 4/15/2007 – Whitman emails Burns touting “Longview’s performance in 2007,” which Whitman stated “continues to build on an impressive historical record.”

The review uncovered no evidence that Longview took any steps to institute the safeguards to avoid the conflict that it had created through its placement agent.

Longview disclosed to NCRS its engagement of Whitman in June of 2007. There is no indication that Longview disclosed at that time either its indirect engagement of Howard Street, of which Longview was aware no later than December of 2006, or Teresa Myers’ relationship with John Burns, of which it was aware no later than January of 2007. Longview ultimately revealed its indirect retention of Howard Street on November 20, 2009, in response to the NCRS’ new Placement Agent Policy. Longview’s responses states: “Longview Partners ... retained Whitman & Company as their third party marketer in North America. Whitman & Company, in turn, retained Elie Sullivan from Howard Street Partners to help provide the introduction to North Carolina Retirement Systems and other state pension funds.” It then listed Teresa Myers as one of the partners of Howard Street, and disclosed that “Myers’ husband, John Burns, previously served as a Consultant to the Investment Staff at NCRS.”

Longview has paid over \$3.2 million in placement agent fees to Whitman & Co., which in turn paid almost \$1.5 million to Howard Street Partners.

H. Remedies

On December 6, 2013, NCRS and Longview agreed to resolve issues related to Longview’s use of placement agents. The agreement secures both policy changes and financial compensation from Longview. Longview agreed to the following policy changes: (1) to refrain from using placement agents, as defined in the Department’s Placement Agent Policy, to assist in obtaining investments from or doing business with the NCRS; and (2) to refrain from providing any gifts or items of value from Longview, its affiliates, or anyone acting on its behalf, to any employee of the Department, and to refrain from making donations to charitable causes solicited by or on behalf of employees of the Department. NCRS did not seek an agreement from Longview to refrain from making or soliciting others to make political contributions, because

Longview is already prohibited by law from making such contributions as a foreign-based investment manager.

Longview further agreed to refund to the State Treasurer \$500,000 each quarter, beginning and including the current fiscal year ending December 31, 2013 and continuing for every fiscal quarter for a period of five years. The aggregate total of these refund payments is \$10 million.

Findings of Fact and Resolution Measures

The Department of State Treasurer has developed the factual summaries below based on documents gathered or received as part of the special review conducted by the North Carolina Department of Justice and Kellogg Huber. As stated in Section III(A) of the Executive Summary and in the Kellogg Huber Findings of Fact, due to the constraints upon civil investigations under existing North Carolina law, the special review was conducted without the power to subpoena documents and without the power to compel testimony. Therefore, these findings can be neither corroborated nor refuted by facts not voluntarily disclosed, and there is no guarantee that the findings are either complete or accurate. The summaries below merely recount the facts observed using the limited tools available. Given these limitations, we note with great emphasis that this report draws no conclusion about whether any events violated any laws or State policies.

I. Angelo, Gordon & Company

A. Findings

The review found no evidence that Angelo, Gordon & Company (Angelo, Gordon) used a placement agent in connection with any of the investments made in Angelo, Gordon funds by the NCRS. However, the review found conduct by internal Angelo, Gordon marketing personnel that caused concern. At least two gifts or favors appear to have been provided in 2008 by employees of Angelo, Gordon to Patricia Gerrick, then the Chief Investment Officer at the NCRS. These gifts or favors were provided at the same time that the NCRS was considering investments in several funds managed by Angelo, Gordon. In May 2008 and subsequently, the NCRS made several billion dollars of investments in Angelo, Gordon sponsored funds.

First, Angelo, Gordon employees passed along the resume of Gerrick's daughter to a law firm of which Angelo, Gordon was a client. This firm ultimately hired Gerrick's daughter. Second, an Angelo, Gordon Managing Director, Colleen Casey, allowed both Gerrick and her daughter to stay at her apartment on at least one occasion. The total value of this free lodging is estimated to be less than \$1,000. In addition, Angelo, Gordon stated that "[o]n one occasion, personnel at Angelo, Gordon may have acquired two tickets to a Broadway performance for personnel from the [NCRS]." We have found no further details or evidence concerning this gift or favor, if it occurred. The review revealed no evidence that Angelo, Gordon disclosed any of these favors and gifts prior to May 10, 2012.

In addition, Angelo, Gordon personnel contributed to Richard Moore's 2004 campaign for Treasurer and Moore's 2008 campaign for Governor, and facilitated donor networking for the campaign. Angelo, Gordon principals and personnel did not contribute to Janet Cowell's 2008 campaign for Treasurer, but facilitated donor networking.

B. Resolution

In November 2013, the NCRS and Angelo, Gordon agreed that Angelo, Gordon would make policy changes consistent with the NCRS's commitment to ethics and accountability. Angelo, Gordon and its affiliates and their respective partners, managers, employees, or agents shall adopt the following policy changes to all current and future NCRS investments: (1) refrain

from providing gifts or other items of value to employees; (2) refrain from providing donations to charitable causes solicited by or on behalf of employees of the Department of State Treasurer; (3) refrain from using placement agents to assist in obtaining investments from or doing business with the NCRS; and (4) refrain from making or soliciting others to make political contributions to the State Treasurer or any incumbent, nominee, candidate or successful candidate for such elective office.

II. Apollo Global Management

A. Findings

The review found that Apollo Global Management, LLC (Apollo) engaged as a placement agent Pamela Joyner, who had a pre-existing personal relationship with Gerrick which began in 1990, more than a decade before Gerrick's arrival at the NCRS. In March of 2005, Leon Black, the CEO of Apollo, contacted Joyner in order to inquire about her services as a placement agent. The retention agreement between Apollo and Joyner's firm, Avid Partners, was oral; no written contract was ever created or signed.

After Apollo engaged Joyner as a placement agent, she contacted Gerrick about a possible investment by the NCRS. On April 29, 2005, Apollo met with the investment staff at the NCRS, including Gerrick. The investment staff then conducted due diligence on Apollo. The NCRS used Portfolio Advisors as a neutral third-party consultant. Joyner participated in some meetings between the NCRS and Apollo, including accompanying Black to a meeting in North Carolina. On December 21, 2005, the NCRS made an investment commitment in Apollo Investment Fund VI for \$150 million. Afterward, Joyner and Black agreed upon a fee of \$2.4 million for her services.

As part of the relationship, Joyner and Gerrick exchanged gifts after the 2005 Apollo-NCRS investment. For example, in 2007, Gerrick solicited from Joyner a donation to a charity, and Joyner ultimately contributed \$2,500 to the organization. Fred Giuffrida, who is Joyner's husband and a managing director of the investment fund Horsley Bridge Partners, LLC (Horsley Bridge), paid for a dinner in Dubai at the Burj Khalifa on November 20, 2008 during an investment conference which Gerrick, Joyner, and Giuffrida attended. Giuffrida billed the cost of the meal – \$1,213.55 – to Horsley Bridge. Gerrick never disclosed such a gift on her Statement of Economic Interest Form.

In addition to the relationship between Joyner and Gerrick, the review also showed that Black and several other executives at Apollo donated to Richard Moore's political campaigns in 2004 and 2008. The review did not find evidence that Joyner contributed to Moore's campaign, but she did contribute \$4,000 to Janet Cowell's campaign for Treasurer in 2008.

B. Resolution

In November 2013, the NCRS and Apollo agreed that Apollo would make policy changes consistent with NCRS's commitment to ethics and accountability. To the extent it has not done so, Apollo and its affiliates and their respective partners, managers, employees, or agents

shall adopt the following policy changes to all current and future NCRS investments: (1) refrain from providing gifts or other items of value to employees; (2) refrain from providing donations to charitable causes solicited by or on behalf of employees of the Department of State Treasurer; (3) refrain from using placement agents to assist in obtaining investments from or doing business with the NCRS; and (4) refrain from making or soliciting others to make political contributions to the State Treasurer or any incumbent, nominee, candidate or successful candidate for such elective office.

III. Horsley Bridge Partners, LLC

A. Findings

The review found that although Horsley Bridge Partners, LLC (Horsley Bridge) did not use a placement agent with respect to the NCRS, Fred Giuffrida, a managing director at Horsley Bridge, had a personal relationship with Gerrick through his spouse, Pamela Joyner. As discussed, Joyner had a pre-existing relationship with Gerrick. The review found that on November 20, 2008, Giuffrida paid for a dinner in Dubai at the Burj Khalifa during an investment conference which Joyner, Giuffrida, and Gerrick attended. Giuffrida billed the cost of the meal – \$1,213.55 – to Horsley Bridge. Gerrick never disclosed the gift on her Statement of Economic Interest form.

B. Resolution

In November 2013, the NCRS and Horsley Bridge agreed that Horsley Bridge would make policy changes consistent with NCRS's commitment to ethics and accountability. To the extent it has not done so, Horsley Bridge and its affiliates and their respective partners, managers, employees, or agents shall adopt the following policy changes to all current and future NCRS investments: (1) refrain from providing gifts or other items of value to employees; (2) refrain from providing donations to charitable causes solicited by or on behalf of employees of the Department of State Treasurer; (3) refrain from using placement agents to assist in obtaining investments from or doing business with the NCRS; and (4) refrain from making or soliciting others to make political contributions to the State Treasurer or any incumbent, nominee, candidate or successful candidate for such elective office.

IV. Robeco Institutional Asset Management

A. Findings

The review revealed that Robeco Institutional Asset Management (Robeco) retained as a placement agent Wanda Henton Brown, who provided at least one gift or favor to Gerrick. Robeco retained Brown on December 1, 2004, and Brown attended meetings between Robeco and Gerrick on November 1, 2006 and March 1, 2007. Strategic Investment Solutions, a neutral third-party consultant retained by the NCRS, recommended an investment commitment to the Robeco Clean Tech Fund II investment strategy. On July 30, 2008, the NCRS committed \$150 million. As previously reported in the press, Brown provided an airline ticket to the Love Festival in Bermuda for Gerrick's daughter. Gerrick never disclosed such a gift in her Statement

of Economic Interest Form.

B. Resolution

In November 2013, the NCRS and Robeco agreed that Robeco would make policy changes consistent with NCRS's commitment to ethics and accountability. Robeco and its affiliates and their respective partners, managers, employees, or agents shall adopt the following policy changes to all current and future NCRS investments: (1) refrain from providing gifts or other items of value to employees; (2) refrain from providing donations to charitable causes solicited by or on behalf of employees of the Department of State Treasurer; (3) refrain from using placement agents to assist in obtaining investments from or doing business with the NCRS; and (4) refrain from making or soliciting others to make political contributions to the State Treasurer or any incumbent, nominee, candidate or successful candidate for such elective office.

V. StarVest Partners, LLC

A. Findings

StarVest retained a placement agent, but may also have benefited from communications by a member of the Investment Advisory Committee, Steve Nelson. On December 26, 2007, Nelson forwarded to Gerrick an email from StarVest citing the fund's recent success. Over the next week, Nelson communicated with Gerrick seeking to schedule a meeting between Gerrick and StarVest. This meeting took place on January 17, 2008. Larry Bettino, a General Partner at StarVest, noted that Nelson had communicated with Gerrick. The NCRS subsequently committed \$30 million in StarVest Partners II on July 30, 2008.

On July 26, 2008, Bettino purchased a case of wine for \$3,843, which Bettino charged on his company credit card. That charge was subsequently listed on a StarVest "Expense Report" as "Wine gift to Steve Nelson for Thank-you on NC fundraising deal."

StarVest did not disclose, either at the time or in response to an inquiry by the Treasurer's Office, its relationship with Steve Nelson nor the gift it purchased for him. StarVest ultimately disclosed the relationship in response to the review in 2012.

B. Resolution

In November 2013, the NCRS and StarVest Management, Inc. (StarVest) agreed that StarVest would make policy changes consistent with NCRS's commitment to ethics and accountability. To the extent it has not done so, StarVest and its affiliates and their respective partners, managers, employees, or agents shall adopt the following policy changes to all current and future NCRS investments: (1) refrain from providing gifts or other items of value to employees; (2) refrain from providing donations to charitable causes solicited by or on behalf of employees of the Department of State Treasurer; (3) refrain from using placement agents to assist in obtaining investments from or doing business with the NCRS; and (4) refrain from making or soliciting others to make political contributions to the State Treasurer or any incumbent, nominee, candidate or successful candidate for such elective office.

Performance of investment manager funds cited in Findings of Fact

| Ultimate External Investment Manager | Funds | Effective Date | 1 Yr | 3 Yr | 5 Yr | 10 Yr | IRR |
|---------------------------------------|--|----------------|---------|---------|---------|-------|---------|
| Public Equity Funds | | | | | | | |
| Earnest Partners LLC | Earnest Partners Small Cap Value | 2002 | 38.54 | 18.63 | 17.19 | 9.47 | N/A |
| | Benchmark: Russell 2000 Value | | 32.83 | 16.33 | 14.84 | 8.78 | |
| Longview Partners Ltd | Longview Global Equity | 2007 | 36.72 | 17.43 | 17.76 | | N/A |
| | Benchmark: MSCI World/ MSCI ACWI Custom | | 23.29 | 10.61 | 12.56 | | |
| Credit Portfolio Funds | | | | | | | |
| Angelo, Gordon & Co. | AG Global Debt Strategy Partners | 2008 | 13.61 | 12.38 | - | | 17.49 |
| Angelo, Gordon & Co. | AG Capital Recovery VI | 2008 | 20.02 | 9.50 | 10.70 | | 7.93 |
| Angelo, Gordon & Co. | AG Commercial Real Estate Debt Fund | 2008 | 58.14 | 28.00 | 11.47 | | 2.13 |
| | Benchmark: Custom Credit Benchmark | | 6.00 | 2.85 | - | | |
| Fixed Income Portfolio Funds | | | | | | | |
| Angelo, Gordon & Co. | AG Opportunity C | 2008 | 19.43 | 14.41 | | | N/A |
| Angelo, Gordon & Co. | AG Opportunity R | 2008 | 9.28 | 8.24 | | | N/A |
| | Benchmark: ML Custom Index | | (3.07) | 4.13 | | | |
| Private Equity Funds | | | | | | | |
| Angelo, Gordon & Co. | AG Private Equity Partners IV - R | 2008 | 2.43 | - | - | | 0.94 |
| Angelo, Gordon & Co. | AG Private Equity Partners IV | 2008 | 13.24 | 1.86 | - | | 2.77 |
| Apollo Global Management, LLC | Apollo Investment Fund VI | 2005 | - | 2.57 | 1.35 | | 4.85 |
| Avista Capital Holdings | Avista Capital Partners II | 2008 | 13.60 | 16.33 | 10.70 | | 14.03 |
| Horsley Bridge Partners, LLC | Horsley Bridge International V | 2008 | 10.10 | 1.59 | - | | (0.05) |
| Horsley Bridge Partners, LLC | Horsley Bridge IX | 2008 | 12.68 | 15.06 | 5.38 | | 11.02 |
| Robeco Institutional Asset Management | Robeco Clean Tech II | 2008 | (6.64) | (1.03) | (1.45) | | (0.56) |
| Robeco Institutional Asset Management | Robeco Clean Tech II Co- Inv | 2008 | (13.02) | 2.39 | - | | (3.29) |
| StarVest Partners, LLC | Starvest Partners II | 2008 | (7.84) | (13.34) | (13.38) | | (7.87) |
| | Benchmark: Custom Private Equity Benchmark | | 13.78 | 15.63 | 8.34 | | |
| Real Estate Funds | | | | | | | |
| Angelo, Gordon & Co. | AG Asia Realty Fund II | 2008 | 40.95 | 3.07 | - | | 15.44 |
| Angelo, Gordon & Co. | AG Net Lease Realty Fund II | 2008 | 10.77 | 5.07 | - | | 6.56 |
| C.B. Richard Ellis Global Investors | CBRE Strategic Partners IV | 2005 | (40.12) | (15.19) | (34.29) | | (27.34) |
| | Benchmark: Custom Real Estate Benchmark | | 12.17 | 14.64 | 1.65 | | |

Prepared by Department of State Treasurer based on data as of October 31, 2013.

Tab 3: **Kellogg Huber Report**

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December 11, 2013

Via Electronic Mail and Federal Express

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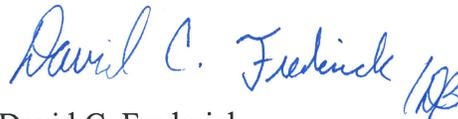
Re: *Review of North Carolina Retirement Fund Related to Use of Placement Agents*

Dear Jay:

In accordance with the December 2010 engagement of Kellogg, Huber, Hansen, Todd, Evans & Figel, PLLC, by the North Carolina Department of Justice, I am pleased to transmit the enclosed Final Report regarding the Special Review for the North Carolina Department of State Treasurer. This Final Report incorporates the Preliminary Report transmitted to you on November 2, 2012, includes the Department's formal response to the Recommendations in that Preliminary Report, and provides a special appendix with resolutions of those matters.

We thank you for the cooperation that you and your office have provided throughout the course of the Special Review.

Sincerely,



David C. Frederick

Enclosure

cc: Kip Sturgis – Assistant Attorney General, North Carolina Department of Justice

Kellogg, Huber, Hansen, Todd, Evans & Figel, P.L.L.C.

**SPECIAL REVIEW FOR THE
NORTH CAROLINA DEPARTMENT OF STATE TREASURER**

FINAL REPORT

December 11, 2013

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I. Overview

In 2009, the North Carolina Department of State Treasurer (Treasurer's Office) adopted a Placement Agent and Political Contribution Policy (Placement Agent Policy) and then solicited information from various investment managers to determine the use of placement agents in transactions involving the Treasurer's Office. After responses to those requests showed potential problems and significant information deficiencies, the Treasurer's Office contacted the North Carolina Department of Justice (NCDOJ) for assistance in obtaining further information. In the Summer of 2010, the NCDOJ and the Treasurer's Office requested proposals from law firms interested in serving as independent counsel to assist in evaluating whether any placement agent abuses have previously occurred in North Carolina. On September 13, 2010, Kellogg, Huber, Hansen, Todd, Evans & Figel, P.L.L.C. (Kellogg Huber) submitted a proposal to serve as independent counsel to conduct a review of the use of placement agents by external managers in connection with investments made by the Treasurer's Office. In December 2010, the NCDOJ retained Kellogg Huber to serve as independent counsel in connection with the NCDOJ's review of the use of placement agents by the Treasurer's Office.

Kellogg Huber was retained to review the use of placement agents by external fund managers in connection with investments made by the Treasurer's Office for the North Carolina Retirement Systems (NCRS), including an analysis of the internal process for making investment decisions, a review of any potential improprieties involving the use of placement agents, and recommendations for potential reforms. Kellogg Huber was instructed to work in tandem with the NCDOJ in all stages of this review, including in issuing document requests and seeking third-party interviews. Such requests and interviews were issued on a voluntary basis; Kellogg Huber lacked authority to employ normal investigative tools, such as subpoenas or civil investigative demands.¹

In addition to conducting the review, Kellogg Huber also has been working in concert with the office of General Counsel for the Treasurer's Office to develop recommendations for potential policy reforms. The recommendations were based on a preliminary assessment of the review that Kellogg Huber is performing with the NCDOJ; independent review and analysis of the existing policies of the Treasurer's Office; discussions with the office of the General Counsel for the Treasurer's Office; analysis of a review and evaluation of the NCRS performed by Ennis, Knupp & Associates, Inc. (Ennis Knupp) from June 2009 to April 2010; and research regarding investigations, regulations, and disclosure obligations related to placement agents in other states. Kellogg Huber submitted a Preliminary Report to the Treasurer's Office on November 2, 2012. That Preliminary Report provided an overview of the observations and recommendations that Kellogg Huber proposed the Treasurer's Office make to address various issues related to the use of placement agents. The Treasurer's Office, in turn, evaluated its existing policies and implemented new ones. It formally responded to the Preliminary Report on November 19, 2013. This Final Report incorporates the Preliminary Report and provides a special appendix with our earlier recommendations, the ways the Treasurer's Office has responded to them, and the resolution of those matters.

¹ For approximately six months, from January through June 2011, NCDOJ took the lead on the review without substantial input from Kellogg Huber.

The process by which the Treasurer's Office invests public funds for the benefit of state and local employees plays a critical role in securing the retirement assets of North Carolina's public servants. In recent years, the Treasurer's Office has taken significant steps to improve its policies and practices regarding placement agents. We are confident that the policies and procedures recommended here will complement and support those good steps. The Treasurer's Office has provided a formal response to our recommendations. In the appendix, this Final Report provides a succinct resolution of those responses.

II. Relevant Background of the Treasurer's Office

The NCRS is a collective of the investment assets of six retirement funds and pension systems, including the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, and the North Carolina National Guard Pension Fund. In total, NCRS has more than \$75 billion under management in approximately 300 funds, which are managed by more than 20 investment professionals in the Investment Management Division (IMD) using both internal and external fund managers.

The Treasurer is the sole fiduciary of NCRS funds. *See* N.C. Gen. Stat. § 147-69.3(e). The Chief Investment Officer (CIO) reports directly to the Treasurer and generally oversees the operations of the IMD, which is organized into six divisions: Fixed Income, Global Equity, Real Estate, Alternatives, Credit, and Inflation Protection. Each division is led by a Director, who manages a staff of Portfolio Managers and Analysts. An Investment Advisory Committee (IAC) advises the Treasurer regarding policies and general strategy for investing NCRS assets, including asset allocation, in consultation with IMD staff. The Treasurer serves as chairperson ex officio of the IAC and appoints six additional members. The IAC has "advisory powers only." *Id.* § 147-69.2(b1).²

From time to time, placement agents have been used in connection with the investment of NCRS assets with fund managers. Placement agents usually are third-party intermediaries paid a fee by investment managers to solicit and secure potential investors for a fund. Placement agents typically are compensated based on a percentage of capital that they are able to convince investors to commit to the fund. Because they are compensated in this manner, placement agents are regulated by both the United States Securities and Exchange Commission and the Financial Industry Regulatory Authority. In recent years, investment managers have more frequently used placement agents in connection with state retirement fund investments, particularly as states increasingly have invested in alternative and private (non-public) investment vehicles. With the increased use of placement agents in connection with the investment of public assets has also come increased scrutiny of the practices and compensation of placement agents. In particular, states have raised questions regarding the potential for unethical and unlawful tactics used by placement agents to influence state fiduciaries to invest with investment managers represented by the agents, thereby generating significant commissions or other fees or compensation for the placement agents.

² We note that, on February 17, 2010, the Treasurer's Office adopted both a Charter and a Code of Ethics for the IAC.

Mindful of these developments, North Carolina State Treasurer Janet Cowell established the Placement Agent Policy, which was approved on October 19, 2009, and revised to its current form effective March 14, 2011. The Placement Agent Policy is intended to limit the use of placement agents in connection with NCRS investments by defining specific requirements that fund managers and placement agents must satisfy before the Treasurer's Office will agree to commit funds to a particular investment. The Placement Agent Policy is accompanied by a Form of Placement Agent and Political Contribution Disclosure Letter (Disclosure Letter), which requires potential fund managers and placement agents to disclose information to the Treasurer's Office in connection with any contemplated investment contract. The Treasurer's Office maintains internal Standard Operating Procedures for the Placement Agent Policy, which set forth the mechanics of implementing the Placement Agent Policy and ensure that the Treasurer's Office and IMD comply with that policy.

In addition, the Treasurer's Office has numerous other policies concerning issues that relate to placement agents and investment ethics more generally. Those policies include a Supplemental Ethics Policy that imposes certain ethical restrictions during a covered person's employment and post-employment; a Charitable Donations Policy and a Prohibition of Gifts to State Employees Policy that limit donations and gifts from third parties who contract with the Treasurer's Office; and a Travel Policy that regulates travel and reimbursement of expenses. Finally, the Treasurer's Office is in the process of drafting a Statement of Investment Policy, which is intended to state the long-term objectives and guidelines for the IMD with respect to NCRS investment portfolio management.

III. Observations and Recommendations

Kellogg Huber makes the following observations and recommendations related to the use of placement agents in connection with the investment of NCRS funds by the Treasurer's Office. The recommendations fall into six categories: (A) modifications to investment policies and practices; (B) internal conduct and procedures of the Treasurer's Office; (C) additional disclosures from third parties; (D) additional disclosures to third parties; (E) enhanced transparency; and (F) enhanced investigative and enforcement measures. The recommendations below are intended to foster and maintain an environment in which employees of the Treasurer's Office – particularly the IMD – may perform their important duties with clear guidance regarding the role of placement agents and related ethics issues.

A. Modifications to Investment Policies and Practices

1. Statement of Investment Policy

Observations: An investment policy statement is a document that outlines formal investment policies and procedures. It can address numerous aspects of an investment fund, including asset allocation, administration, management, and selection and approval of investments. An investment policy statement also can define the roles and responsibilities of investment professionals to ensure that (i) all important functions are assigned to an investment professional, (ii) every professional clearly understands his or her responsibilities, and (iii) the roles and responsibilities of each position are maintained and preserved, even when investment staff experiences turnover. An investment policy statement of this nature seems particularly

important in a state like North Carolina that operates under a “sole fiduciary” model, because a sole fiduciary relies heavily on the decisions and practices of investment professionals. Indeed, the three other states that have a “sole fiduciary” model – Connecticut, Michigan, and New York – have already adopted investment policy statements.

The Treasurer’s Office presently has not adopted a formal statement of policies and procedures for investment selection, approval, management, or administration. However, we understand that the Treasurer’s Office has begun the process of drafting a Statement of Investment Policy, though that process is incomplete. For the reasons described above, we believe the Treasurer’s Office should finalize and adopt the Statement of Investment Policy. Moreover, in addition to realizing the benefits described above, the Statement of Investment Policy is an ideal vehicle for implementing some of the recommendations proposed below that relate specifically to placement agents.

Recommendation: Finalize and adopt a Statement of Investment Policy to provide clear guidelines and objectives for the selection, approval, management, administration, monitoring, and assessment of investments of NCRS assets. The Statement of Investment Policy should include clear descriptions of roles and responsibilities within the Treasurer’s Office related to the management of NCRS funds.

2. Contact of Placement Agents by the Treasurer’s Office

Observations: During the course of our review, we learned that, over the course of time, some investment professionals in the IMD have occasionally observed placement agents developing a track record of making sound investment suggestions to the Treasurer’s Office. Moreover, when those investment professionals have identified the need or desire for a particular type of investment that is missing from the NCRS portfolio, they have sometimes contacted such placement agents informally to seek their input regarding potential funds or fund managers that could fill the perceived gap in the portfolio. However, the Treasurer’s Office has not adopted guidelines or qualifications that a placement agent must have before being contacted by investment professionals in the IMD. Nor has the Treasurer’s Office developed any internal disclosure or recusal mechanisms to employ once IMD staff has contacted a placement agent. Direct contact between IMD investment professionals and placement agents has the potential to give rise to conflicts of interest, particularly when the monetary relationship is unclear. We urge the Treasurer’s Office to be mindful of the potential abuses that can arise under such circumstances.

In light of potential abuses and conflicts of interest that can arise with the use of placement agents, we believe the Treasurer’s Office should adopt guidelines and qualifications that a placement agent must have before being contacted by the Treasurer’s Office to ensure the integrity of its investment practices is not compromised. For the same reason, we also believe the Treasurer’s Office should adopt disclosure and recusal procedures that are triggered when IMD staff contacts a placement agent so that appropriate personnel in the IMD hierarchy know how the placement agent came to be involved in a potential investment and so that the IMD staff member who contacted the placement agent is not involved in any due diligence or investment approval that ultimately occurs as a result of such contact.

Recommendation: Amend Part IV.G of the draft Statement of Investment Policy to provide guidelines and qualifications that a placement agent must have in order to be contacted directly by the Treasurer's Office regarding potential new NCRS investments. Amend Part IV.G also to provide that, if the Treasurer's Office moves forward with a potential investment after contacting a placement agent, any IMD staff member who contacted the placement agent must disclose such contact internally and be recused from further involvement with the potential investment.

3. Repeat Use of Placement Agents by Existing Fund Managers

Observations: As described above, placement agents typically are engaged and compensated by fund managers to solicit and secure potential investors for the manager's fund(s). The premise of such engagement is that the placement agent is able to identify potential investors more readily and more effectively than the fund manager, typically because the placement agent has broad industry contacts that the fund manager may not have. However, when a fund manager already has an existing investment relationship with an investor, that premise does not apply and there should be no reason for the fund manager to employ a placement agent to identify that same investor for a new investment with that manager. During the course of our review, we learned of instances when a fund manager used a placement agent for a repeat investment with the Treasurer's Office. We believe the Treasurer's Office should take steps to ensure that a placement agent is not used and compensated in connection with NCRS investments with fund managers that already manage NCRS funds.

Recommendation: Amend Part IV.G of the draft Statement of Investment Policy and Part VI.A of the Placement Agent Policy to prohibit the Treasurer's Office from entering a new investment contract with an investment manager when (i) that manager has managed NCRS funds within the past 2 years, and (ii) the manager uses and compensates a placement agent in connection with obtaining the new investment contract with the Treasurer's Office. Provide notice of this provision to fund managers, and provide for a penalty (e.g., termination of existing investment agreement, and temporary ban on future investment relationship) that may be imposed for a violation of the provision or attempts to circumvent it.

4. Applicability of the Placement Agent Policy to Indirect Investments

Observations: Certain indirect investment vehicles involve entering into an investment contract after the terms of an underlying investment have been established. For example, a fund-of-funds is a multi-manager investment strategy of investing in a portfolio of investment funds, rather than investing in a single fund or other security. By further example, secondary transactions typically involve purchasing an existing private equity investment (and possibly assuming any unfunded obligations of the investment position). It is not clear how placement agents may be involved in such investments or to what extent the Placement Agent Policy, as currently formulated, applies to such investments. The Treasurer's Office should evaluate those issues and clarify how, if at all, the Placement Agent Policy should apply to such investments.

Recommendation: Evaluate to what extent, if any, the Placement Agent Policy should apply to investments in a fund-of-funds or a secondary transaction. Amend Part IV.G of the

draft Statement of Investment Policy and Part II of the Placement Agent Policy to reflect the results of that evaluation.

5. Placement Agents and the Innovation Fund

Observations: The North Carolina General Assembly has authorized the Treasurer, in investing and managing NCRS assets, to “consider benefits created by an investment in addition to investment return,” but “only if the Treasurer determines that the investment providing these collateral benefits would be prudent even without collateral benefits.” N.C. Gen. Stat. § 147-69.7(b)(5). One way that the Treasurer has implemented that authorization is the creation of the Innovation Fund, which is an economically targeted \$232.3 million diversified investment in companies with significant operations in or a nexus to North Carolina. Because the Innovation Fund seeks to invest in North Carolina businesses, the Treasurer has decided to outsource management of the Innovation Fund to a third-party investment manager in an effort to avoid potential conflicts of interest or improper contacts with local business interests. That change to policy strikes us as an appropriate commitment to sound investment practices and to avoiding potential conflicts of interest.

Because the operation of the Innovation Fund has prudently been made separate from and insulated from IMD operations in the Treasurer’s Office, it is not clear to what extent the Placement Agent Policy applies to Innovation Fund investments. The Treasurer has issued both an Investment Policy and Investment Guidelines for the Innovation Fund, but neither document discusses the extent to which the Placement Agent Policy applies to Innovation Fund investments; nor does the Placement Agent Policy address that issue. Moreover, because the Innovation Fund is managed by a third-party investment manager, it is possible that the manager itself (or some division thereof) could operate in a manner that falls within the definition of “Placement Agent” in Part VII.B of the Placement Policy, and thereby function as a placement agent for the manager’s own investment. We propose that the Placement Agent Policy and the Innovation Fund documents be modified to address these issues and that the Treasurer’s Office evaluate whether other policies should be extended to the Innovation Fund.

Recommendation: Amend Part IV of the Innovation Fund Investment Policy to include a new subpart C titled “Placement Agent and Political Contribution Policy,” and require that the Innovation Fund comply with the standards and procedures in the Placement Agent Policy. Amend the opening paragraph of Part VI of the Innovation Fund Investment Guidelines to provide that, in pursuing its investment objectives and asset allocation goals, the investment manager of the Innovation Fund will adhere to the Placement Agent Policy. In addition, create a new part VI.C that requires the manager to disclose to and receive approval from the Treasurer’s Office whenever the manager itself (or a division thereof) acts as a placement agent for an Innovation Fund investment. Amend Part II of the Placement Agent Policy to make clear that the policy applies to the Innovation Fund. Evaluate to what extent, if any, other policies of the Treasurer’s Office should apply to the Innovation Fund.

6. Modifying the “Sole Fiduciary” Model

Observations: Along with Connecticut, Michigan, and New York, North Carolina is one of only four states with a “sole fiduciary” model for managing the retirement assets of its public

servants. The vast majority of states vest the fiduciary duty to select and manage their retirement assets in a committee of qualified investment professionals, rather a single individual. We believe that one reason for such a strong consensus among states is that a committee of fiduciaries can enhance accountability and reduce the risk that the investment-making process could be compromised by a threat to the independence of a single individual. Indeed, even some “sole fiduciary” states have considered creating an investment committee to assist the sole fiduciary in the execution of his or her duties.

Our review suggests that there have been times, prior to Treasurer Cowell taking office, when the discretion granted to the Treasurer appears to have been unduly influenced by dealings with third parties. We believe that the involvement of an investment committee in the exercise of the Treasurer’s discretion could have reduced or eliminated such influences by increasing accountability. Accordingly, we believe that the North Carolina legislature should establish an Investment Committee comprised of experienced investment professionals to be involved in fiduciary decisions regarding the selection of investments for NCRS funds. Consistent with other states, we believe the Investment Committee should be vested with the fiduciary duty that currently is committed to the sole discretion of the Treasurer. If such a wholesale transition from a “sole fiduciary” model to an “investment committee” model cannot be accomplished, then at a minimum (and alternatively) the Investment Committee could be given authority to review and approve investment proposals before they are submitted to the Treasurer and to reject proposed investments without further review by the Treasurer.

The Investment Committee could be formed in a variety of ways, including members of the IAC or external investment professionals appointed by the Treasurer and others.³ Depending on the manner in which the Investment Committee is established, it is possible that it could be subject to North Carolina’s Open Meetings Law, N.C. Gen. Stat. § 143-318.10, requiring public disclosure of the Investment Committee’s deliberations. We believe that public disclosure of sensitive financial deliberations involving significant sums of money could threaten the independence of those deliberations and create a risk of adverse consequences to members of the Investment Committee and to third parties whose investments may be under consideration. Thus, regardless of the form or composition of the Investment Committee, we believe that its deliberations should be exempt from N.C. Gen. Stat. § 143-318.10.⁴

³ In addition, if the role of the Investment Committee were limited to reviewing and either recommending or rejecting proposed investments before they are submitted to the Treasurer, the committee could include internal senior investment professionals (such as the CIO and Directors), but should not include the Treasurer.

⁴ Although we have not conducted a 50-state survey, we have identified a number of states that exempt the deliberations of their investment committees from state open meetings laws. *See, e.g.*, Ga. Code § 50-14-3(b)(3); 5 Ill. Comp. Stat. 120/2(c)(7); Nev. Rev. Stat. § 286.150(2); Va. Code § 2.2-3711(A)(6); Wash. Rev. Code § 42.30.110(1)(k); Wis. Stat. § 19.85(1)(e). We also understand that the North Carolina Attorney General issued an advisory opinion in 2006, and the General Counsel of the Treasurer’s Office issued a legal memorandum in 2007, both of which interpret North Carolina’s Public Records Act as not requiring disclosure of certain investment-related information by the Treasurer’s Office.

Recommendation: (a) Propose amending Chapter 147, Article 6 of the North Carolina General Statutes to create an Investment Committee, chaired by the Treasurer, and vest fiduciary powers and responsibilities in the Investment Committee, rather than solely in the Treasurer. Amend Part II of the draft Statement of Investment Policy to identify the composition, roles, responsibilities, and procedures of the Investment Committee. Make harmonizing changes to existing statutes and policies to reflect that the Investment Committee, and not the Treasurer alone, is the fiduciary of NCRS funds. (b) In the alternative, propose amending Chapter 147, Article 6 of the North Carolina General Statutes to create an Investment Committee, the function of which should be to review and approve investment and allocation proposals before they are submitted to the Treasurer; a decision by the Investment Committee rejecting a proposed investment should be final. Amend Part II of the draft Statement of Investment Policy to identify the composition, roles, responsibilities, and procedures of the Investment Committee. In the case of *either* alternative (a) or (b) above, request that the General Assembly exempt from the Open Meetings Law, N.C. Gen. Stat. § 143-318.10, confidential deliberations of the Investment Committee about investment decisions.

B. Internal Conduct and Procedures of the Treasurer's Office

1. Evaluating Investments when Fund Manager or Placement Agent Has a Personal Relationship with IMD Staff

Observations: As explained below in Part III.C.4, it is important to require fund managers who seek to do business with the Treasurer's Office, and placement agents who do business with fund managers, to disclose any personal relationships or other connections they may have with members of the Treasurer's Office, particularly members of the IMD. However, the fact that a personal relationship or other connection may exist between someone in the Treasurer's Office and the fund manager or placement agent should not itself foreclose the investment of NCRS funds. Instead, once such disclosures occur, the Treasurer's Office should have a procedure for evaluating any potential investments without the involvement of any member of IMD staff who has a personal relationship or other connection and normally would be involved in such evaluation. During the course of our review, we learned that the informal practice of the Treasurer's Office in such circumstances is to involve a third party in the due diligence process. We believe that is an appropriate procedure and propose that it be formalized as part of the Standard Operating Procedures.

Recommendation: Amend Part III of the Standard Operating Procedures to require the hiring of a third party to assist with due diligence and any investment recommendation if the Disclosure Letter reveals that a fund manager or placement agent (i) has a personal relationship with a current or former employee of the Treasurer's Office, *or* (ii) was recommended by a current or former employee of the Treasurer's Office. To the extent the individual with the personal relationship or who made the recommendation is someone who otherwise would participate in consideration of the potential investment, that person should be recused from all consideration, and a suitable alternative employee should assume his or her role in consideration of the potential investment.

2. Approving Investments when Fund Manager or Placement Agent Has a Personal Relationship with the Treasurer

Observations: Just as the Treasurer’s Office should have a procedure for evaluating a potential investment when a fund manager or placement agent has a personal relationship or other connection with a member of the Treasurer’s Office, for all of the same reasons it also should have a procedure for approving a potential investment when a fund manager or placement agent has a personal relationship or other connection with the Treasurer. Such a procedure is important to ensure, on one hand, that a personal relationship of the Treasurer does not preclude the Treasurer’s Office from making good investments, and, on the other hand, that poor investments are not approved simply because of a personal relationship with the Treasurer.

Recommendation: Amend Part III of the Standard Operating Procedures to provide that if diligence suggests that an investment may be worth making, but the fund manager or placement agent disclosures reveal either (i) a personal relationship with the Treasurer, *or* (ii) that the Treasurer recommended the manager or placement agent, then the Treasurer shall be recused from the decision approving the investment and a panel (either an *ad hoc* panel or the Investment Committee recommended above in Part III.A.6) shall make the final decision whether to approve the investment. To the extent permitted by existing North Carolina statutes, *see, e.g.*, N.C. Gen. Stat. § 147-75, amend Part II of the draft Statement of Investment Policy to provide for the Treasurer to delegate authority to a panel that will have final authority regarding potential investments when the Treasurer is disqualified due to either (i) or (ii) above.⁵ To the extent such delegation is inconsistent with existing North Carolina statutes, recommend to the General Assembly that it enact such delegation authority.

3. Limiting Covered Persons from Seeking Employment with Fund Managers or Placement Agents Monitored by the Covered Person

Observations: The Treasurer’s Office implemented the Supplemental Ethics Policy on August 13, 2009. That policy, which applies to the Treasurer and her senior staff, currently prohibits such persons for 2 years after leaving the Treasurer’s Office from representing anyone before the Treasurer’s Office. Such “cooling off” laws are common for public servants and ensure, among other things, that (a) the public servant does not allow the prospect of particular future employment to interfere with his or her duties, and (b) other public servants are not unduly influenced by a former colleague who appears as an advocate shortly after leaving government employment.

In the course of our review, we learned that there may have been circumstances, prior to Treasurer Cowell taking office, when a member of the Treasurer’s Office may have used his or her official position to seek post-employment opportunities, such as by traveling to visit an existing fund manager to seek a post-employment opportunity from that fund manager. Such conduct is contrary to interest (a) above, and yet is beyond the scope of the existing Supplemental Ethics Policy, which concerns only *post*-employment activity. Thus, we believe it

⁵ If, consistent with Part III.A.6 above, the General Assembly abandons the “sole fiduciary” model and vests the fiduciary duty over NCRS funds in an Investment Committee, then the Treasurer’s Office should (a) require fund managers and placement agents to disclose personal relationships and other connections with members of the Investment Committee, and (b) provide for the recusal of any member of the Investment Committee who has a personal relationship with, or recommended the use of, a fund manager or placement agent under consideration.

would be appropriate to modify the Supplemental Ethics Policy to limit the ability of IMD investment professionals to *seek* employment with fund managers or placement agents who do business with the Treasurer's Office. We are mindful that a broad ban on interviewing with any fund manager or placement agent could unduly burden post-employment opportunities and thereby discourage otherwise qualified and interested applicants from taking a position with the Treasurer's Office in the first place. The interest to be served by a limitation (such as temporary recusal) would be to ensure that the investment professional does not allow future employment opportunities to impair the performance of his or her duties. Thus, we believe it would be appropriate to limit the Treasurer, CIO, and IMD investment professionals from seeking employment with fund managers or placement agents that are actively monitored by such persons and their subordinates.

Recommendation: Amend the Supplemental Ethics Policy to impose limitations on the ability of the Treasurer, CIO, and IMD investment professionals to interview with or solicit employment from fund managers that manage NCRS funds under the active direction of the individual or his or her subordinates and any placement agent such manager hired in connection with such funds. Provide notice of the amended policy to new and existing fund managers and placement agents, and provide for a penalty (e.g., termination of existing investment agreement, and temporary ban on future investment relationship) that may be imposed on those who violate the policy by interviewing or offering employment to any covered employees who monitor them.

4. Imposing Post-Employment Limitations on the Ability of Covered Persons To Interact with the Treasurer's Office

Observations: In recent years, as certain states have modified investment policies and practices in response to abuses that have come to light involving placement agents, some have also been revising their "cooling off" periods – like the one in the Supplemental Ethics Policy – to tailor such provisions more specifically to investment staff. For example, California has adopted a three-part, graduated framework that increases the length of the limitation on post-employment activity in relation to the risk of potential abuse that the activity presents to the California Public Employees Retirement System. *See* Cal. Gov't Code §§ 87408-87410. Although we are not aware of any specific past violations of the Supplemental Ethics Policy by members of the IMD, we believe it would be prudent to revise the policy to impose additional restrictions on the Treasurer, CIO, and IMD investment professionals and thereby diminish the risk of such persons exuding improper post-employment influence on the Treasurer's Office. Thus, we propose adopting post-employment restrictions structured similarly to those that California adopted.

Recommendation: Amend the Supplemental Ethics Policy to impose bans on the Treasurer, CIO, and IMD investment professionals from (i) working for anyone in connection with a Treasurer's Office contract for 2 years, (ii) representing anyone before the Treasurer's Office for 4 years, and (iii) serving as a placement agent in connection with an investment of NCRS funds for 6 years. Provide notice of the amended policy to new and existing fund managers and placement agents, and provide for a penalty (e.g., termination of existing investment agreement, and temporary ban on future investment relationship) that may be imposed on those who violate the policy.

5. Creating the Position of Ethics Counsel

Observations: No single person within the Treasurer’s Office has exclusive responsibility, with sufficient resources, to manage institutional risks, enforce ethics policies, and train staff regarding ethics issues. As relevant to issues involving placement agents, an attorney in the office of the General Counsel of the Treasurer’s Office currently is tasked with reviewing and approving completed Disclosure Letters, while also working collaboratively with investment staff – two roles that can be in tension with one another. To alleviate that tension and to give ethics issues the time and resources that they warrant, a position of special ethics officer should be established. Such centralized management of ethics issues within public investment bodies has been noted or implemented by other states, including Kentucky and Massachusetts. Indeed, California and New York specifically created special counsel positions after investigating the use of placement agents in their states.

Recommendation: Create the position of Ethics Counsel, whose role should be, among other things, to monitor and enforce the Placement Agent Policy, train staff regarding investment-specific ethics issues and compliance, and provide centralized supervision and enforcement of ethics issues.

6. Formal Training on Investment-Specific Ethics Issues

Observations: Members of the Treasurer’s Office receive state-mandated ethics training that includes various issues that apply broadly to all employees. *See generally* N.C. Gen. Stat. § 138A-15(g). However, the Treasurer’s Office does not provide formal training regarding the Placement Agent Policy or other investment-specific ethics issues that may be particularly important to members of the IMD in light of the substantial financial resources that they manage and the unique issues that their fiduciary positions entail.⁶ Moreover, our review has suggested varying levels of appreciation among IMD investment professionals for ethics issues related to placement agents. Accordingly, we propose that the Treasurer’s Office (and particularly the Ethics Counsel discussed above in Part III.B.5) create a formal ethics training program focused on investment-specific ethics issues and require completion and certification by IMD investment professionals.

Recommendation: Create an annual ethics training program (as contemplated by N.C. Gen. Stat. § 138A-15(g)) focused on investment-specific ethics issues and require completion and certification by IMD investment professionals. Ideally, such a program would be the responsibility of the Ethics Counsel proposed above in Part III.B.5.

7. Application of Policies to Consultants in IMD

Observations: From time to time, the Treasurer’s Office hires former employees as temporary consultants to serve as placeholders when there is a vacancy in a key position, such as Director or Portfolio Manager. However, it is not clear to what extent the ethics policies of the Treasurer’s Office apply to such non-employee consultants. If such consultants are not subject to, for example, the Supplemental Ethics Policy, this represents an ethics loophole that may

⁶ The Treasurer’s Office does provide training regarding insider trading.

result in consultants in key positions being outside the scope of important ethics requirements. Although our review has not yet uncovered any exploitation of this potential loophole, we believe steps should be taken to resolve it. Under N.C. Gen. Stat. §§ 138A-3(30)(f), (m) and 126-5(d)(2), “covered persons” under the State Government Ethics Act include “[i]ndividuals under contract with the State working in or against a position” that the Treasurer designates as an “exempt position[.]” The Treasurer’s Office should ensure that the Treasurer has properly designated all of the key positions in which consultants may be hired as “exempt positions” under the statute.

Recommendation: Amend existing policies to make clear that coverage extends to independent contractors hired by the Treasurer’s Office temporarily to fill vacancies in key positions.

8. Deadline for Completion of the Disclosure Letter

Observations: Neither the Placement Agent Policy, Standard Operating Procedures, nor the Disclosure Letter provides a timeframe or deadline for the fund manager to complete and return the Disclosure Letter. We understand that, in most cases, fund managers have returned the Disclosure Letter in a timely manner. However, in the course of our review, we discovered some circumstances in which the Disclosure Letter was not provided until the last minute. We do not believe that any of these circumstances resulted in violation of the spirit or the letter of the Placement Agent Policy. Nevertheless, the absence of a deadline can result in procrastination, which can cause more than a mere oversight in the completion of documentation. At worst, the failure to provide the Disclosure Letter in a timely manner could result in inertia for a particular investment that threatens the efficacy of the Placement Agent Policy; the parties may become so enamored with the potential transaction that a last-minute disclosure that raises potential issues may be treated differently than if it had been received when the transaction was in its early stages. Moreover, the timely receipt of a Disclosure Letter that reveals a deal-ending arrangement between fund manager and placement agent prevents the parties from wasting time and resources negotiating an investment arrangement that cannot be consummated. While we believe the Placement Agent Policy should be modified to include a deadline for return of the Disclosure Letter, we understand that some deals happen quickly, and the Treasurer therefore needs the flexibility to waive the deadline in special circumstances.

Recommendation: Amend Part III.A of the Placement Agent Policy and Part III.B of the Standard Operating Procedures to require the Disclosure Letter to be completed within 30 calendar days of receipt, but no later than 10 calendar days prior to closing of the investment transaction. In the event of an accelerated closing, the minimum timing requirement of 10 calendar days may be waived by the Treasurer, so long as the Disclosure Letter is received and approved prior to closing of the investment transaction.

9. Prohibiting Use of Personal E-mail for Conducting State Business Related to the Investment of NCRS Funds

Observations: In the course of our review, we discovered isolated instances, prior to Treasurer Cowell taking office, when someone in the Treasurer’s Office used his or her personal e-mail address to contact a placement agent regarding investment of NCRS funds. Using a

personal e-mail address to contact anyone regarding the investment of NCRS funds – particularly a placement agent – seems to increase the threat of improper personal contact or influence. Accordingly, we propose that the Treasurer’s Office amend the Placement Agent Policy to prohibit the Treasurer, CIO, and IMD investment professionals from using personal e-mail addresses to communicate with fund managers and placement agents regarding state business related to the investment of NCRS funds. Moreover, because the use of other technologies for personal communication may pose similar risks in the future, we propose that the Treasurer’s Office consider whether additional limitations are appropriate.

Recommendation: Amend Part V of the Placement Agent Policy to prohibit the use of personal e-mail addresses by the Treasurer, CIO, and IMD investment professionals to communicate with fund managers and placement agents regarding state business related to the investment of NCRS funds. Evaluate to what extent, if any, the use of additional forms of personal communication should be limited.

C. Additional Disclosures from Third Parties

1. Additional Fund Manager Disclosures

Observations: As currently formulated, the first question on the Disclosure Letter asks a prospective fund manager to disclose whether or not a placement agent is involved with the proposed investment. If not, the Disclosure Letter informs the fund manager that “no further disclosures are necessary.” However, some disclosures from prospective fund managers are helpful and appropriate, even when a placement agent is not being used. In particular, fund managers should be required to disclose any relationships they may have with individuals in the Treasurer’s Office (question 6), information regarding lobbyist registrations held by principals at the fund manager (question 8), and any relevant political contributions that principals at the fund manager have made (question 9). Thus, the Disclosure Letter should be modified to require fund managers to disclose this information, even when a placement agent is not involved in the potential investment.

Recommendation: Modify the Disclosure Letter so that a fund manager must provide information responsive to questions 6, 8, and 9, even when the response to question 1 indicates that the fund manager is not using a placement agent. Require the fund manager to certify and sign its disclosures.

2. Placement Agent Disclosures by Fund Manager Employees

Observations: The Placement Agent Policy contains a very broad definition of “Placement Agent” in Part VII.B. That definition is so broad that, at times, it has swept within its scope internal employees of a fund manager who are compensated to assist “in securing investment commitments or other business” involving NCRS funds. In those circumstances, fund managers have strongly resisted providing all of the information that the Disclosure Letter – which is geared toward third-party placement agents – requires to be disclosed. Often, the Treasurer’s Office has been willing to accept less disclosure about, for example, placement agent compensation than it normally would, in light of the special circumstances presented by an employment relationship. In general, we believe that it is appropriate not to require fund

managers to make all of the disclosures required in the Disclosure Letter when the “placement agent” at issue is an employee of the fund manager. However, rather than treating such circumstances on an *ad hoc* basis, the Treasurer’s Office should amend the Placement Agent Policy and the Disclosure Letter to require appropriate information when the “placement agent” is a fund manager employee.

Recommendation: Modify Part III.A of the Placement Agent Policy to provide that, when a current employee of the fund manager functions as a placement agent, the manager must disclose (i) the employee’s role and responsibilities, (ii) the disclosures required by Part A.2 (resume), A.5 (government investigations), and A.6 (relationships with the Treasurer’s Office) of the Placement Agent Policy, and (iii) how a potential investment by the Treasurer’s Office is likely to affect the employee’s compensation. In light of the foregoing modification, delete “as well as employees of the Investment Manager” from Part III.A.3 of the Placement Agent Policy. Modify question 1 of the Disclosure Letter to require disclosure of (i) – (iii), above, when the placement agent being used is an employee of the fund manager.

3. Placement Agent Verification of Disclosure Letter

Observations: As currently formulated, the Disclosure Letter is provided to the fund manager, completed by the fund manager, and verified by the fund manager. However, the vast majority of the information in the Disclosure Letter concerns the placement agent. The placement agent is in the best position to provide the “true, correct, and complete” information required by the Disclosure Letter, and it also is best positioned to inform the Treasurer’s Office “of any material changes” to that information promptly when such changes occur. Thus, the placement agent should verify and sign the portion of the Disclosure Letter concerning information about the placement agent. In making this proposal, we do not suggest that the fund manager no longer verify and sign the portion of the Disclosure Letter concerning information about the placement agent. Because the fund manager is the entity that seeks to enter a long-term contractual relationship with the Treasurer’s Office, it has a strong incentive to ensure that the letter is completed accurately and updated promptly. Both the fund manager and the placement agent should sign the letter.

Recommendation: Modify the Disclosure Letter to require a certification and signature for a placement agent concerning the accuracy of its disclosures and its commitment to update the Treasurer’s Office promptly regarding any material changes to those disclosures.

4. Disclosure of All Relevant Relationships with the Treasurer’s Office

Observations: An important function of the Placement Agent Policy is to require fund managers and placement agents to disclose relationships they may have with the Treasurer’s Office that present potential conflicts of interest. Such relationships could be personal or professional. The Placement Agent Policy, however, may not inquire broadly about all personal or professional relationships with the Treasurer’s Office; rather, it can be read as inquiring only of “prior personal or professional relationships . . . with any current or former [employee of the Treasurer’s Office or their immediate family] *who suggested the retention of the Placement Agent.*” (emphasis added). For example, even if the placement agent were related to the CIO, the Placement Agent Policy could be read as not requiring that relationship to be disclosed unless

the CIO “suggested the retention of the Placement Agent.” Reading the requirement in that manner makes it far too narrow. And there is reason to believe that third parties have failed to disclose the existence of relevant relationships by reading the Placement Agent Policy narrowly. Thus, both the Placement Agent Policy and the Disclosure Letter should be modified to require disclosure of all relevant relationships, personal or professional, between the Treasurer’s Office and either the fund manager or the placement agent. Although prior professional relationships are less likely than personal relationships to present conflicts of interest, disclosure of professional relationships may help to ensure that no placement agent with a poor track record is used in connection with investments of the Treasurer’s Office. To encourage full disclosure, we recommend that the Placement Agent Policy make clear that, while all relevant relationships must be disclosed, that does not mean that all such relationships are problematic.

Recommendation: Amend Part III.A.6 of the Placement Agent Policy to require disclosures regarding (i) any professional relationships with current or former employees of the Treasurer’s Office or members of the IAC, (ii) any personal relationships with current or former employees of the Treasurer’s Office or members of the IAC, and (iii) the identity of any current or former employee in the Treasurer’s Office, member of the IAC, or immediate family thereof who suggested retention of the placement agent. Also make clear that, while all relevant relationships must be disclosed, not all are necessarily problematic. Modify question 6 of the Disclosure Letter to require disclosure of items (i) – (iii) above. To the extent there exists a relevant professional or personal relationship, require additional disclosure/explanation of the timing, nature, and scope of the relationship.

5. Defining “Personal Relationship” for Purposes of the Placement Agent Policy

Observations: The Placement Agent Policy presently does not define the type of “personal relationship” that requires disclosure and may result in recusal by a member of the IMD that otherwise would be involved in review and evaluation of the potential investment. Certainly immediate family relationships are “personal relationships.” But non-family relationships also can be sufficiently personal that disclosure and recusal would be appropriate. For example, our review suggests that, prior to Treasurer Cowell taking office, at least one individual within the Treasurer’s Office had close, personal, non-family relationships that may have created conflicts of interest but were not disclosed to anyone. Although it is difficult to devise a precise definition of non-family personal relationships, exact precision is unnecessary here because the purpose of the disclosure is to determine whether the relationship warrants recusal of a member of the IMD who normally would be involved in the review and evaluation of the potential investment. Thus, so long as the relationship is disclosed, the Ethics Counsel or other person within the Treasurer’s Office can discuss the relationship with the identified member of the Treasurer’s Office to determine whether recusal is appropriate.

Recommendation: Amend Part III.A.6 of the Placement Agent Policy and question 6 of the Disclosure Letter to define “personal relationship” as including (i) immediate family (i.e., mother, father, brother, sister, wife, husband, domestic partner, fiancé, or child); and (ii) a pre-existing relationship involving social contacts outside of business.

6. Disclosure of Relationships with the Treasurer

Observations: As currently formulated, the Placement Agent Policy and the Disclosure Letter require disclosure of relationships with a “Department of State Treasurer employee,” but not the Treasurer individually. Relationships with the Treasurer are among the most important that must be disclosed. Indeed, our review suggests that, prior to Treasurer Cowell taking office, there were circumstances when a placement agent had a personal relationship with a previous Treasurer that was not disclosed before the Treasurer’s Office entered into an investment contract that the placement agent helped arrange. The gap in the current documentation appears simply to have been an oversight in the original drafting of the documents.

Recommendation: Amend Part III.A.6 of the Placement Agent Policy and question 6 of the Disclosure Letter to require disclosure of any relationships with the Treasurer.

7. Disclosure of Relevant Political Contributions

Observations: Political contributions from fund managers or placement agents to the campaign of the Treasurer or those running for the office of Treasurer present a risk of improper influence. For this reason, Ennis Knupp recommended in 2010 that the Treasurer’s Office amend the Placement Agent Policy to require disclosure of political contributions and gifts to decision-makers by those doing and seeking to do business with the Treasurer’s Office. The Placement Agent Policy currently prohibits the Treasurer from transacting business with an investment manager when either the manager or its placement agent fails to comply with state and federal laws and policies regarding Political Contributions (as defined in the Placement Agent Policy); the Disclosure Letter requires the fund manager to certify such compliance. However, neither the Placement Agent Policy nor the Disclosure Letter requires fund managers and placement agents to disclose to the Treasurer’s Office relevant Political Contributions, though we understand that some do so voluntarily. Requiring such disclosures from all fund managers and placement agents will enhance transparency and reduce the risk of improper influence resulting from Political Contributions.

Recommendation: Amend Part VI.B of the Placement Agent Policy to require fund managers and placement agents to disclose Political Contributions made to, coordinated for, or solicited on behalf of the campaign of the Treasurer (regardless of the office for which the Treasurer is running) or any incumbent, nominee, candidate, or successful candidate for such elective office. Amend question 9 of the Disclosure Letter to require fund managers and placement agents to disclose such Political Contributions.

8. Treating Placement Agents as Lobbyists Under North Carolina Law

Observations: With the increasing scrutiny of placement agents across the country, states have begun requiring placement agents to comply with state lobbying laws, thereby subjecting placement agents to greater disclosure and reporting requirements. For example, California, Kentucky, and Ohio all have subjected placement agents to some level of regulation as lobbyists. North Carolina’s lobbying laws contain numerous registration, disclosure, periodic reporting, and financial limitations for registered lobbyists. Requiring placement agents to comply with

those requirements is consistent with the national trend towards increased regulation of placement agents and would enhance accountability and oversight within the State.

Recommendation: Propose amending N.C. Gen. Stat. § 120C-100(a)(10) (and other statutes, as necessary or appropriate) to provide that the term “lobbyist” includes anyone acting as a “placement agent” in connection with the investment of NCRS funds, where “placement agent” is defined in accordance with Part VII.B of the Placement Agent Policy.

9. Disclosure of Contract Terms Regarding Placement Agent

Observations: The Placement Agent Policy and the Disclosure Letter currently require a description of the terms of agreement between the fund manager and the placement agent regarding compensation of the placement agent and any obligation to pay a fee to or for the benefit of any placement agent. Understanding the compensation and fee terms in placement agent agreements is critical to enforcing the Placement Agent Policy, which provides in Part VI.A.6 that “no portion of any fee paid to the Investment Manager by the Treasurer [may be] offset by any fee paid the Placement Agent.” In addition, the Treasurer’s Office should fully understand the services that the placement agent is rendering in connection with its fee. Often, the compensation and fee terms can be complex. In light of the complexity and importance of those terms, the Treasurer’s Office should require fund managers to submit with the Disclosure Letter copies of the relevant terms from their contract(s) with the placement agent(s).⁷ This should include a detailed description of the services that the placement agent is performing in connection with any compensation or fee, and any contractual provisions regarding such services.

Recommendation: Modify Parts III.A.3 and 4 of the Placement Agent Policy and questions 3 and 4 of the Disclosure Letter to require a detailed description of the services (to be) provided by the placement agent, and to require submission of the actual contract terms concerning placement agent compensation, fee obligations, and services. Only permit a description of the terms if no written agreement exists (i.e., only an oral agreement).

10. Clarifying Ambiguities in the Placement Agent Policy and Disclosure Letter

Observations: Based on more than 2 years of experience with the Placement Agent Policy, the Treasurer’s Office has observed certain ambiguities in the policy and the Disclosure Letter that affect the responses that fund managers have provided. In particular, question 2(a) of the Disclosure Letter asks for the “name of the Placement Agent,” and numerous applicants have expressed confusion regarding whether they should provide the name of the entity or the name of the individual placement agent(s) involved. Likewise, questions 5 and 6 of the Disclosure Letter instruct the applicant to “check the appropriate box” regarding the existence of any government

⁷ We note that the placement agent policy in Massachusetts requires disclosure of “a written copy of *any and all agreements* between the manager and the placement agent.” Public Employee Retirement Administration Commission, Policy No. 11-1, Part II(1)(e) (emphasis added), available at <http://www.mass.gov/perac/11memos/PERAC%20Placement%20Agents%20Policy.pdf>.

investigations (question 5) and whether anyone in the Treasurer’s Office suggested the retention of the placement agent (question 6), yet applicants often write “N/A” instead of checking the box corresponding to a negative answer. Finally, because the definition of “Investment Manager” in Part VII.A of the Placement Agent Policy refers to the types of services provided without limitation to the IMD or the investment of NCRS funds, some applicants have been confused about whether the definition applies to services or advice provided to divisions of the Treasurer’s Office other than the IMD. To ensure full and adequate disclosure, these ambiguities should be eliminated.

Recommendation: Modify question 2(a) of the Disclosure Letter to require disclosure of the placement agent entity and the key individual(s) involved with the investment. Modify questions 5 and 6 of the Disclosure Letter to be “yes” or “no” questions, with an explanation required for a “yes” answer. Modify the definition of “Investment Manager” in Part VII.A of the Placement Agent Policy to make clear that it applies only to services and advice provided to the Treasurer or the IMD in connection with NCRS funds.

D. Additional Disclosures to Third Parties

1. Informing Third Parties of Relevant Policies of the Treasurer’s Office

Observations: The Treasurer’s Office is inconsistent in providing notice to third parties that may be affected by its internal policies. For example, the Placement Agent Policy indirectly regulates third-party conduct by limiting the circumstances when the Treasurer’s Office will contract with fund managers that use placement agents, and the policy provides for notice to be given to third parties about the policy. In contrast, the Supplemental Ethics, Charitable Donations, Prohibition of Gifts to State Employees, and Travel Policies also indirectly regulate third-party conduct,⁸ but none of those policies provides for notice to be given to third parties whose conduct is related to those policies. Each of those policies provides important protections to the integrity and independence of the Treasurer’s Office. Where third parties are in a position to cause a violation of a policy, informing them of the policy increases the likelihood of compliance. Thus, we believe that the policies of the Treasurer’s Office that indirectly regulate third-party conduct should be disclosed to those third parties.

Recommendation: Amend the Supplemental Ethics, Charitable Donations, Prohibition of Gifts to State Employees, and Travel Policies to provide for annual disclosure of the policies to new and existing third parties, including fund managers and placement agents who invest in or otherwise are involved with NCRS funds.

⁸ In particular, the Supplemental Ethics Policy limits the ability of third parties to hire (and, as proposed here, interview) covered employees for certain types of employment; the Charitable Donations and Prohibition of Gifts to State Employees Policies limit the ability of existing contractors to make direct or indirect gifts or donations to employees; and the Travel Policy limits the ability of contractors to reimburse or pay for travel or expenses of employees of the Treasurer’s Office.

E. Enhanced Transparency

1. Public Disclosure Regarding Placement Agents Used in Connection with Investments of the Treasurer's Office

Observations: In April 2010, Ennis Knupp authored a report regarding NCRS investment practices, part of which evaluated the role of placement agents in NCRS investments. To increase transparency and accountability, Ennis Knupp proposed that the Treasurer's Office include on its website an investment transactions report that disclosed to the public investment decisions of the Treasurer's Office, including placement agent usage, compensation, registration status, and political contributions or gifts given to decision-makers. Although our review indicates that the Treasurer's Office has implemented the vast majority of Ennis Knupp's recommendations from the April 2010 report, it does not appear to have implemented the recommendation regarding placement agent public disclosures. The Treasurer's Office makes various investment reports available on its website, but it does not disclose placement agent usage, compensation, registration status, or political contributions or gifts given to decision-makers. We agree with Ennis Knupp's recommendation and propose that the Treasurer's Office make greater public disclosures on its website regarding placement agent usage.

Recommendation: Disclose on the Treasurer's Office website placement agent usage, compensation, registration status, and political contributions or gifts given to decision-makers in connection with investments of the Treasurer's Office. To avoid any confusion over the roles for the Treasurer as political candidate and as fiduciary, which is a non-political role, the Treasurer's Office should consider segregating those disclosures.

2. Public Disclosure of the Disclosure Letter and Responses Thereto

Observations: Another recommendation from the April 2010 Ennis Knupp report was that the Treasurer's Office continue to post on the Treasurer's Office website, and update as needed, key documents related to governance and investment processes. Most of the policies of the Treasurer's Office discussed herein are maintained on the Treasurer's official website (<https://www.nctreasurer.com/Inside-The-Department/OpenGovernment/Pages/Department-Policies.aspx>). However, the website does not include the Disclosure Letter template or specific responses provided to the Treasurer's Office by fund managers and placement agents. We agree with Ennis Knupp's recommendation and believe that maintaining the Disclosure Letter template and specific third-party responses would be consistent with that recommendation and enhance transparency and accountability.

Recommendation: Maintain on the Treasurer's Office website the Disclosure Letter template and specific third-party responses to the Disclosure Letter.

F. Enhanced Investigative and Enforcement Measures

1. Enhanced Remedy for Violating the Placement Agent Policy

Observations: As currently formulated, the Placement Agent Policy has a relatively narrow remedy provision. The policy gives the Treasurer the option "to require the Investment

Manager to repay to the Treasurer the greater of (i) the aggregate amount of any management or advisory fees paid to the Investment Manager for the most recent two years in respect of the investments or business of the Treasurer, . . . or (ii) an amount equal to the amounts paid or promised to be paid to the Placement Agent with respect to investments or business with the Treasurer.” The policy also reserves “any other remedies that the Treasurer may be entitled to at law or in equity, by contract or otherwise.” Those remedies are incorporated into every new contract that the IMD enters into with an investment manager, which must represent that it “agrees to the remedies” in the Placement Agent Policy “for material omissions or inaccuracies” in the Disclosure Letter.

We believe that the express remedy provided in the Placement Agent Policy is good and appropriate; however, we do not believe that it goes far enough to deter fund managers from entering inappropriate contractual relationships with placement agents. Other states go further. The placement agent policy in Massachusetts, for example, provides that a violation gives the state “the authority to immediately terminate the investment management contract . . . without penalty, to withdraw without penalty from a limited partnership, limited liability company or other investment vehicle, or to cease making further capital contributions . . . to the limited partnership, limited liability company or other investment vehicle without penalty.” Public Employee Retirement Administration Commission, Policy No. 11-1, Part V(1)(b). We believe such a remedy provides a greater deterrent and incentive to fund managers and placement agents to provide accurate disclosures and to comply with the Placement Agent Policy. In addition, the policy could provide an even greater deterrent if it gave the Treasurer discretion to impose a temporary ban on future investments with the fund manager in the event of a willful violation of the Placement Agent Policy.

Recommendation: Amend Part IV of the Placement Agent Policy to allow the Treasurer’s Office both to terminate a contract if an investment manager fails to comply with the Placement Agent Policy and to impose a temporary ban on future investments with the investment manager in the event of a willful violation. Make harmonizing changes to the contractual representations required of investment managers regarding the remedies available to the Treasurer’s Office in the event of a violation of the Placement Agent Policy.

2. Criminalizing Material False Statements Made to State Officials

Observations: In the course of our review, we found that the scope and effectiveness of our review were limited by state law. For example, unlike the federal government, North Carolina does not have a statute that punishes material false statements made to government officials. *Compare* 18 U.S.C. § 1001. Without such a statute, there is little incentive for individuals who appear for voluntary interviews not to shade the truth in the hope of evading a broad investigation. In addition, a broadly worded statute could extend criminal liability for material false statements made in writing to state officials – such as the Disclosure Letter. We believe the Placement Agent Policy specifically, and the authority of the Treasurer’s Office more generally, would be enhanced with the passage of a statute criminalizing material false statements made to state officials.

Recommendation: Discuss with the NCDOJ the possibility of seeking to amend the obstruction of justice statutes, Chapter 14, Article 30 of the North Carolina General Statutes,

to include a statute similar to 18 U.S.C. § 1001, prohibiting material false statements to government officials.

3. Strengthening the State Bribery Statute

Observations: During the course of our review, we noted the possible narrowness of North Carolina's bribery statute. Under federal bribery law, a defendant can be convicted of bribery for improperly receiving benefits indirectly. *See* 18 U.S.C. § 666(a)(1)(B). However, under North Carolina law, the defendant arguably must receive the benefit personally in order to commit bribery. *See* N.C. Gen. Stat. § 14-217. As a result, North Carolina law can be read as permitting a state official to solicit things of value for the benefit of a third party (e.g., a family member) with the intent of influencing state business. We believe that the state bribery statute should be amended to be consistent with federal law.

Recommendation: Discuss with the NCDOJ the possibility of seeking to amend the bribery statute, N.C. Gen. Stat. § 14-217, to include a provision similar to 18 U.S.C. § 666(a)(1)(B), prohibiting state employees from soliciting or accepting anything of value with intent to influence state business, even when provided to a third party.

IV. Conclusion

We recognize the steps taken by the Treasurer's Office to address issues regarding placement agents in recent years, and we are pleased to have assisted the Treasurer's Office in developing important policy changes that respond to information developed during our review.

Appendix of Recommendations, Responses, and Resolutions

The formal written response below represents the efforts of the Department of State Treasurer (the “Department”) in considering and implementing the recommendations set forth in the Draft Preliminary Report of Kellogg, Huber, Hansen, Todd, Evans & Figel, P.L.L.C. (“Kellogg Huber”). We note that, while Kellogg Huber’s preliminary report envisioned that the Department would issue its response in early 2013, Kellogg Huber provided the Department with additional time so that the Department’s response could be informed by additional factual investigation and so that the new policies and procedures envisioned by the preliminary report could be adopted and implemented. We thank Kellogg Huber for extending the response time.

The Department agrees with Kellogg Huber’s observations that the agency can do more to provide both Department employees and investment managers better guidance on the role of placement agents. We believe the implementation of Kellogg Huber’s recommendations continues the Department’s emphasis on transparency, accountability, and ethics, beginning with the independent and comprehensive review of the Investment Management Division (“IMD”) conducted by Ennis Knupp starting in June 2009.

The Department took action, or is in the process of taking action, in response to all the Kellogg Huber recommendations. These actions include:

- New restrictions on when placement agents can be used, expanded disclosures required from placement agents and fund managers, and the posting of those disclosures on the Department’s website. More broadly, the Department now requires industry-leading disclosures of connections or relationships between Department personnel and fund managers or their placement agents. The Department retained outside Compliance Counsel to oversee the revised Placement Agent Policy.
- Additional policies and procedures, going beyond the recommendations in the Kellogg Huber preliminary report, to make the Department’s investment decision-making processes more clear and methodical. Specifically, the Department has adopted new procedures that set out a standard process to be used each time the Department hires an external investment manager. Staff now complete a detailed Investment Recommendation Memorandum in connection with each transaction.
- The soon-to-be-announced Governance Commission that will evaluate the way the North Carolina Retirement Systems manage the pension funds, including additional internal controls.

Responses follow to each of Kellogg Huber’s specific recommendations. We have also enclosed copies of the seven new policies adopted or revised by the Department over the last 12 months to make the Department’s investment decision-making processes more clear and methodical. These new or revised policies are the Placement Agent, Political Contribution, and Connection Disclosure Policy, revised November 19, 2013 (the “Placement Agent Policy”); the Investment Management Division Code of Ethics and Conduct, adopted June 5, 2013 (the “IMD Code of Ethics”); the External Investment Manager and Vehicle Selection Policy and

Procedures, adopted June 5, 2013 (the “Selection Policy”); the External Investment Management Conflict of Interest Certification, adopted June 5, 2013 (the “Certification”); the IMD Investment Committee Charter, adopted June 5, 2013 (the “Internal Investment Committee Charter”); the form Report on N.C.G.S. § 114-8.3(b1) Review of Proposed Contract, adopted October 4, 2013 (the “In-House Attorney Contract Review Form”); and the Investment Policy Statement for North Carolina Retirement Systems, adopted November 26, 2012 (the “Investment Policy Statement”). In the next few days, the Department expects to revise the Selection Policy; the Supplemental Ethics Policy for State Treasurer, Senior Executive Staff and Investment Division (the “Supplemental Ethics Policy”); the Signatory Authority Policy (the “Signatory Policy”); the North Carolina Innovation Fund Investment Policy (the “Innovation Fund Investment Policy”); and the Investment Guidelines for the North Carolina Innovation Fund (the “Innovation Fund Investment Guidelines”). We will send Kellogg Huber the final versions of each of these policies when they are officially adopted.

A. Modifications to Investment Policies and Practices

1. ***Kellogg Huber Recommendation:*** Finalize and adopt a Statement of Investment Policy to provide clear guidelines and objectives for the selection, approval, management, administration, monitoring, and assessment of investments of the North Carolina Retirement Systems (“NCRS”) assets. The Statement of Investment Policy should include clear descriptions of roles and responsibilities within the Treasurer’s Office related to the management of NCRS funds.

Response: The Department has taken the recommended action. On November 26, 2012, the State Treasurer adopted the Investment Policy Statement for NCRS. The Investment Policy Statement incorporates several features that address Kellogg Huber recommendations. First, the Investment Policy Statement discusses objectives and guidelines for the selection of new investments in each of the NCRS asset classes. *See* Investment Policy Statement, Provisions for Particular Asset Classes, §§ II-IV for each portfolio. Second, it sets out detailed procedures for the administration, monitoring, and assessment of existing NCRS investments. *See* Investment Policy Statement, pp. 5-7; Provisions for Particular Asset Classes, § V. Third, it establishes the day-to-day division of responsibilities among the Treasurer, the Investment Advisory Committee, and the Investment Management Division. *See* Investment Policy Statement, pp. 3-4.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

2. ***Kellogg Huber Recommendation:*** Amend Part IV.G of the draft Statement of Investment Policy to provide guidelines and qualifications that a placement agent must have in order to be contacted directly by the Treasurer’s Office regarding potential new NCRS investments. Amend Part IV.G also to provide that, if the Treasurer’s Office moves forward with a potential investment after contacting a placement agent, any IMD staff member who contacted the placement agent must

disclose such contact internally and be recused from further involvement with the potential investment.

Response: The Department acknowledges the importance of the recommendation and has taken a slightly different approach to achieve the same purpose. IMD personnel contact persons across the industry seeking out new investment opportunities. Occasionally, IMD personnel contact someone who has a marketing role for an investment fund and therefore falls within the Placement Agent Policy's broad definition of "Placement Agent." In response to Kellogg Huber's recommendation, the Department has amended the Placement Agent Policy to provide qualifications that a placement agent must have in order to be contacted directly by the Investment Management Division as part of a search for investment opportunities. *See* Placement Agent Policy, Part VII(D)(2). The Department has established new policies that require disclosure in the Investment Recommendation Memorandum of the source of an investment opportunity and of any third-party placement agents that contact the Department before execution. *See* Selection Policy, Part VI; Placement Agent Policy, Part III(E). The Placement Agent Policy has been amended to require disclosure and evaluation of any connections or relationships between the placement agent and Department personnel. *See* Placement Agent Policy, Part IX. The Compliance Counsel will review the Investment Recommendation Memorandum and Disclosure Letters, determining whether recusal is appropriate. *See* Placement Agent Policy, Parts VI, VIII; Selection Policy, Part VII.

Kellogg Huber Resolution: It is not clear that the Department's Response adequately addresses the Recommendation in two ways. First, with respect to the qualifications required of placement agents contacted by Department staff, we understand that the Department applied some of the qualifications already applicable to placement agents retained by fund managers to the new context of placement agents contacted directly by Department staff members. The Placement Agent Policy now provides that Department staff "shall not ... [m]ake an initial call or contact to a Placement Agent about an investment opportunity," Placement Agent Policy, Part VII(D)(2), unless the placement agent is both "registered with either the Securities and Exchange Commission or the Financial Industry Regulatory Authority" and is "in the habitual, systematized business of acting as a Placement Agent," *id.* Parts VII(B)(1), (B)(3). We recognize the Department's effort to develop qualifications for placement agents contacted by Department staff, but it is not clear whether the standards adopted are sufficient. In particular, the effectiveness of the policy may depend on the application of the requirement that a placement agent be "in the habitual, systematized business of acting as a Placement Agent." Accordingly, we recommend that a further review be conducted by independent counsel or some other third party in 12 to 18 months to evaluate the application and effectiveness this aspect of the Department's Response.

Second, the Response departs from Kellogg Huber’s Recommendation by making recusal discretionary at the recommendation of the Compliance Counsel on the basis of the Investment Recommendation Memorandum and the Disclosure Letters. This discretionary policy raises two concerns. It could permit investments that are tainted by direct contact by IMD staff of placement agents. In addition, because the decision to impose a recusal would be made on the basis of information in the Investment Recommendation Memorandum, such recusals could take place too late in the due diligence process to be effective.

We understand Part VI of the Selection Policy and Part III(E) of the Placement Agent Policy to require that the Investment Recommendation Memorandum disclose whether the source of an investment opportunity was contact between an IMD staff member and a third-party marketer or placement agent, and whether that contact was initiated by the IMD staff member. We also understand that Part VII of the Selection Policy requires the Compliance Counsel to evaluate whether the recommendation of an investment was “unduly influenced” by “direct or indirect personal interest,” but it is not clear how that determination will take into account the situation at issue in this recommendation. Finally, we understand that Part VII of the Selection Policy authorizes the Department to take steps to “remediate” undue influence, including terminating the potential investment. These policies, if rigorously applied, could ensure that no potentially problematic investments are made because the Chief Investment Officer can terminate any investments tainted by contact with placement agents.

We understand the Department’s Response to be animated, in part, by concerns that its small staff makes recusals potentially problematic. The adequacy of the Department’s Response, therefore, will depend upon its execution. Accordingly, we recommend that a further review be conducted by independent counsel or some other third party in 12 to 18 months to evaluate the application and effectiveness of this aspect of the Department’s Response.

3. ***Kellogg Huber Recommendation:*** Amend Part IV.G of the draft Statement of Investment Policy and Part VI.A of the Placement Agent Policy to prohibit the Treasurer’s Office from entering a new investment contract with an investment manager when (i) that manager has managed NCRS funds within the past 2 years, and (ii) the manager uses and compensates a placement agent in connection with obtaining the new investment contract with the Treasurer’s Office. Provide notice of this provision to fund managers, and provide for a penalty (e.g., termination of existing investment agreement, and temporary ban on future investment relationship) that may be imposed for a violation of the provision or attempts to circumvent it.

Response: The Department has taken the recommended action. In response to the Kellogg Huber recommendation, the State Treasurer has amended the Placement Agent Policy, which now bars the compensation of any third-party placement agent if the investment manager has managed investments for the

Department within the past two years.¹ See Placement Agent Policy, Part VII(C). Notice is provided to investment managers. See Investment Manager Disclosure Letter, Question 2.4. The remedy in Part IV(A) of the Placement Agent Policy will apply if this provision is violated.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

4. **Kellogg Huber Recommendation:** Evaluate to what extent, if any, the Placement Agent Policy should apply to investments in a fund-of-funds or a secondary transaction. Amend Part IV.G of the draft Statement of Investment Policy and Part II of the Placement Agent Policy to reflect the results of that evaluation.

Response: The Department has taken the recommended action. See Placement Agent Policy, Part X(B). In response to the Kellogg Huber recommendation, the State Treasurer has amended the Placement Agent Policy to apply to fund-of-funds. See *id.*, Part X(B)(1). The policy was not made applicable to secondary market transactions, in which the Department would be buying from another investor an existing equity interest in an established fund. See *id.*, Part X(B)(2). In these circumstances, the concept of a “placement agent” for an investment manager is not truly applicable, because the fund’s manager ordinarily has little or no involvement in the transaction.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

5. **Kellogg Huber Recommendation:** Amend Part IV of the Innovation Fund Investment Policy to include a new subpart C titled “Placement Agent and Political Contribution Policy,” and require that the Innovation Fund comply with the standards and procedures in the Placement Agent Policy. Amend the opening paragraph of Part VI of the Innovation Fund Investment Guidelines to provide that, in pursuing its investment objectives and asset allocation goals, the investment manager of the Innovation Fund will adhere to the Placement Agent Policy. In addition, create a new part VI.C that requires the manager to disclose to and receive approval from the Treasurer’s Office whenever the manager itself (or a division thereof) acts as a placement agent for an Innovation Fund investment. Amend Part II of the Placement Agent Policy to make clear that the policy applies to the Innovation Fund. Evaluate to what extent, if any, other policies of the Treasurer’s Office should apply to the Innovation Fund.

Response: The Department has taken the recommended action. In response to the Kellogg Huber recommendation, the State Treasurer has amended the Placement Agent Policy to apply to the Innovation Fund. See Placement Agent

¹ The investment manager may continue to use internal employees or employees of its affiliates for marketing purposes. Any such use of internal employees must comply with the Placement Agent Policy.

Policy, Part X(B)(1). The Department commits to make conforming changes to the Innovation Fund Investment Policy and Investment Guidelines.

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation, provided the Department makes the conforming changes to the Innovation Fund Investment Policy and Investment Guidelines.

6. **Kellogg Huber Recommendation:** (a) Propose amending Chapter 147, Article 6 of the North Carolina General Statutes to create an Investment Committee, chaired by the Treasurer, and vest fiduciary powers and responsibilities in the Investment Committee, rather than solely in the Treasurer. Amend Part II of the draft Statement of Investment Policy to identify the composition, roles, responsibilities, and procedures of the Investment Committee. Make harmonizing changes to existing statutes and policies to reflect that the Investment Committee, and not the Treasurer alone, is the fiduciary of NCRS funds.

(b) In the alternative, propose amending Chapter 147, Article 6 of the North Carolina General Statutes to create an Investment Committee, the function of which should be to review and approve investment and allocation proposals before they are submitted to the Treasurer; a decision by the Investment Committee rejecting a proposed investment should be final. Amend Part II of the draft Statement of Investment Policy to identify the composition, roles, responsibilities, and procedures of the Investment Committee.

In the case of *either* alternative (a) or (b) above, request that the General Assembly exempt from the Open Meetings Law, N.C. Gen. Stat. § 143-318.10, confidential deliberations of the Investment Committee about investment decisions.

Response: The Department acknowledges the importance of the recommendation and is in the process of developing the Treasurer's proposal to the General Assembly. The Chief Investment Officer and State Treasurer discussed with the Investment Advisory Committee, at the Committee's May 2013 and September 2013 meetings, the need to review the impact of the governance structure and operating model on attainment of long-term investment objectives. As a result, the State Treasurer plans to announce by the end of the year the formal creation of a Governance Commission (the "Commission") comprised of financial sector experts, legislators, and beneficiaries. The Commission will be charged with reviewing and recommending a governance structure and operating model, including the need for additional internal controls.

In addition, in November 2013, the General Assembly announced the creation of a Legislative Study Committee on Treasurer Investment Targets and State Employee Retirement Options to review whether laws regarding the management of the pension funds need updating. The Committee will be chaired by Representatives Jeff Collins and Stephen Ross. The Department intends to

coordinate the Commission and Committee work. Both reviews will be completed prior to the next session of the General Assembly with the goal of amending the appropriate statutes if necessary.

Supplementing these forthcoming reviews, the State Treasurer has already taken several steps to improve the accountability and transparency on investment policy and practices. First, in 2009, the State Treasurer successfully pushed the General Assembly to expand the Investment Advisory Committee from five to seven members, increasing the number of financial experts available to the State Treasurer. *See* N.C.G.S. § 147-69.2(b1)(2009). Second, in 2010, the State Treasurer adopted a Charter and Code of Ethics for the Investment Advisory Committee to set out the duties and standards of conduct for Committee members. *See* Investment Advisory Committee Charter and Investment Advisory Committee Code of Ethics. Third, in 2013, the State Treasurer adopted an Investment Management Division Committee Charter that provides oversight over the NCRS funds under the Investment Policy Statement. Specifically, the scope of oversight includes, but is not limited to, investment policies, risk and compliance standards, and investment managers. *See* Internal Investment Committee Charter, Part II.

Kellogg Huber Resolution: The Department's Response represents an important first step towards addressing the Recommendation. Kellogg Huber encourages the Department to pursue diligently reformation of its existing sole fiduciary model, whether through the contemplated Governance Commission or otherwise.

B. Internal Conduct and Procedures of the Treasurer's Office

1. ***Kellogg Huber Recommendation:*** Amend Part III of the Standard Operating Procedures to require the hiring of a third party to assist with due diligence and any investment recommendation if the Disclosure Letter reveals that a fund manager or placement agent (i) has a personal relationship with a current or former employee of the Treasurer's Office, *or* (ii) was recommended by a current or former employee of the Treasurer's Office. To the extent the individual with the personal relationship or who made the recommendation is someone who otherwise would participate in consideration of the potential investment, that person should be recused from all consideration, and a suitable alternative employee should assume his or her role in consideration of the potential investment.

Response: The Department acknowledges the importance of the recommendation and has taken a slightly different approach to achieve the same purpose. Concerning subpart (i) of this recommendation, please see the Department's response to recommendation (C)(4) below, which deals with this subject in greater detail. Concerning subpart (ii), the Placement Agent Policy has been amended to strictly bar any recommendation of a placement agent by current Department employees, Investment Management Division contractors or

consultants, the Treasurer, or Investment Advisory Committee members. *See* Placement Agent Policy, Part VII(D)(1). If such a person nonetheless recommends a placement agent to the investment manager or the Department's investment staff, the transaction is barred if the placement agent was then retained by the investment manager. If the investment manager rejected the suggestion, recusal and mandatory third-party due diligence are required. *See id.*, Part VIII(C)(2)(a). If a suggestion was made by former employees, the Compliance Counsel will evaluate whether a ban on the transaction, mandatory third-party due diligence, or recusal is appropriate based on the likelihood that the suggestion resulted in a conflict of interest. *See id.*, Part VIII(C)(2)(b). If a Department employee recommended a potential investment with a fund manager to the Treasurer or Department staff for further due diligence, that will be disclosed in the Investment Recommendation Memorandum, which will be reviewed by the Compliance Counsel. *See* Placement Agent Policy, Parts III(E), VI; Selection Policy, Parts VI, VII.

Kellogg Huber Resolution: It is not clear that the Department's Response adequately addresses the Recommendation in several respects. First, the Response departs from the Recommendation to require an independent third-party evaluation of any potential investment when a fund manager has a personal relationship with a current or former Department employee, or when a current or former employee recommended a fund manager or placement agent. The Response instead requires an independent third-party evaluation only when a transaction proceeded despite the non-recusal of an employee with a family relationship with a fund manager or placement agent, or if the Compliance Counsel determines that decision-making in the Department was "unduly influenced" by a conflicted relationship. This approach risks permitting transactions tainted by personal and professional relationships to proceed without securing an independent third-party evaluation of the investment.

Second, the Response also departs from the Recommendation by requiring recusal of Department staff only if that staff member has a "family relationship" with a fund manager or placement agent. The response vests Compliance Counsel with discretionary authority to determine "whether the decision-making of the Department appears to have been unduly influenced by" a non-family relationship and to determine whether a Department employee should be recused. Such recusals could take place too late in the due diligence process to be effective.

Third, the Response departs from the Recommendation by banning a transaction only when a current employee recommends that a fund manager retain a placement agent, and the fund manager then retains that placement agent. The Response would make a ban on a transaction discretionary, rather than mandatory, when the fund manager declines to retain the recommended placement agent or when the recommendation to retain the placement agent is made by a former Department employee. Permitting a transaction to proceed when a person affiliated with the Department recommended that the fund

manager retain a particular placement agent risks the appearance of a lack of impartiality, even if the fund manager does not retain the placement agent and even if the recommendation was made by a former employee. Because we understand that Part VII of the Selection Policy authorizes the Department to take steps to “remediate” undue influence, including terminating the potential investment, these discretionary policies could prove adequate if rigorously applied.

We also recommend that the Department adopt a formal policy regarding the meaning and requirements of a “recusal.” A formal policy would provide clear guidance to the Department, its staff, and third parties of acceptable conduct when a Department staff member is recused. Such a formal policy could be modeled on the recusal policy adopted by the United States Office of Government Ethics.

The adequacy of the Department’s Response depends on its execution. Accordingly, we recommend that a further review be conducted by independent counsel or other third party in 12 to 18 months to evaluate the application and effectiveness of the Department’s Response.

2. ***Kellogg Huber Recommendation:*** Amend Part III of the Standard Operating Procedures to provide that if diligence suggests that an investment may be worth making, but the fund manager or placement agent disclosures reveal either (i) a personal relationship with the Treasurer, *or* (ii) that the Treasurer recommended the manager or placement agent, then the Treasurer shall be recused from the decision approving the investment and a panel (either an *ad hoc* panel or the Investment Committee in Recommendation A.6) shall make the final decision whether to approve the investment. To the extent permitted by existing North Carolina statutes, *see, e.g.*, N.C. Gen. Stat. § 147-75, amend Part II of the draft Statement of Investment Policy to provide for the Treasurer to delegate authority to a panel that will have final authority regarding potential investments when the Treasurer is disqualified due to either (i) or (ii) above.² To the extent such delegation is inconsistent with existing North Carolina statutes, recommend to the General Assembly that it enact such delegation authority.

Response: The Department acknowledges the importance of the recommendation and has taken a slightly different approach to achieve the same purpose. The Signatory Policy will be amended to provide for the Chief Investment Officer to make investment decisions in any situation where the Treasurer is recused.

² If, consistent with Recommendation A.6 above, the General Assembly abandons the “sole fiduciary” model and vests the fiduciary duty over NCRS funds in an Investment Committee, then the Treasurer’s Office should (a) require fund managers and placement agents to disclose personal relationships and other connections with members of the Investment Committee, and (b) provide for the recusal of any member of the Investment Committee who has a personal relationship with, or recommended the use of, a fund manager or placement agent under consideration.

Concerning the situations where the Treasurer or other personnel should be recused, see the Department's response to recommendation (C)(4) below, which deals with this subject in greater detail. If a Treasurer recommended a placement agent to the fund manager, the transaction would be prohibited or (if the fund manager did not retain the placement agent) recusal and mandatory third-party due diligence would be required. *See* Placement Agent Policy, Part VIII(C)(2)(a). If the Treasurer recommended a potential investment with a fund manager to Department staff for further due diligence, that will be disclosed in the Investment Recommendation Memorandum, which will be reviewed by the Compliance Counsel. *See id.*, Parts III(E), VI; Selection Policy, Parts VI, VII. If the disclosure letters indicate a personal relationship with the Treasurer, recusal of the Treasurer will be required if the personal relationship is a family relationship. *See* Placement Agent Policy, Part VIII(D)(2). If the personal relationship is a prior working relationship or a social connection (a pre-existing relationship involving social contacts outside of business), the Compliance Counsel will recommend, based on whether the relationship appears to be significant and long-lasting, whether recusal or an independent evaluation of the transaction by a neutral third party should be provided. *See id.*, Parts VIII(F), VIII(G)(2).

Kellogg Huber Resolution: It is not clear that the Department's Response adequately addresses the Recommendation. The Response departs from the Recommendation by vesting the Chief Investment Officer (CIO) with final decision-making authority over investments when the Treasurer is recused. However, because the CIO is a subordinate of the Treasurer who may be subject to discipline or termination by the Treasurer, this process may not adequately ensure that decisions regarding such investments are free from undue influence. We suggest that the implementation of the Department's Response be evaluated by independent counsel or a third party in 12 to 18 months to determine whether it is adequate to address the potential appearance issues identified in the review.

3. ***Kellogg Huber Recommendation:*** Amend the Supplemental Ethics Policy to impose limitations on the ability of the Treasurer, CIO, and IMD investment professionals to interview with or solicit employment from fund managers that manage NCRS funds under the active direction of the individual or his or her subordinates and any placement agent such manager hired in connection with such funds. Provide notice of the amended policy to new and existing fund managers and placement agents, and provide for a penalty (e.g., termination of existing investment agreement, and temporary ban on future investment relationship) that may be imposed on those who violate the policy by interviewing or offering employment to any covered employees who monitor them.

Response: The Department will take the recommended action. The Supplemental Ethics Policy will be amended to limit solicitations or interviews for employment between fund managers (or their placement agents) and the Treasurer, CIO, or IMD investment professionals. Direct solicitations or requests for employment will be barred under the revised policy if made during the

evaluation process for a potential investment or within two years thereafter. Our IMD staff members have told us that they are commonly approached by third-party “headhunters” who ask whether they might be interested in a position with an identified or unidentified firm. If a third-party “headhunter” approaches the Treasurer, CIO, or an IMD investment professional with an offer from an IMD fund manager, the revised policy will require disclosure to the Compliance Counsel and recusal of that DST employee until he or she rejects the offer. Investment managers will receive notice of these provisions and of the penalty for violation of the Supplemental Ethics Policy. The Department also now asks, as part of the Conflict of Interest Certification, for personnel who played key roles in any proposed investment transaction to certify that they have not sought employment or discussed potential employment with the investment manager. See Certification, statement 4.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

4. ***Kellogg Huber Recommendation:*** Amend the Supplemental Ethics Policy to impose bans on the Treasurer, CIO, and IMD investment professionals from (i) working for anyone in connection with a Treasurer’s Office contract for 2 years, (ii) representing anyone before the Treasurer’s Office for 4 years, and (iii) serving as a placement agent in connection with an investment of NCRS funds for 6 years. Provide notice of the amended policy to new and existing fund managers and placement agents, and provide for a penalty (e.g., termination of existing investment agreement, and temporary ban on future investment relationship) that may be imposed on those who violate the policy.

Response: The Department will take the recommended action. The recommended time limits will be applied to the Treasurer, Chief Investment Officer, IMD investment professionals at the Director level or above, any in-house Compliance Counsel, the DST Chief of Staff, DST General Counsel, and DST in-house legal staff with responsibility for IMD transactions. Investment managers will receive notice of these provisions and of the penalty for violation of the Supplemental Ethics Policy.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

5. ***Kellogg Huber Recommendation:*** Create the position of Ethics Counsel, whose role should be, among other things, to monitor and enforce the Placement Agent Policy, train staff regarding investment-specific ethics issues and compliance, and provide centralized supervision and enforcement of ethics issues.

Response: The Department acknowledges the importance of the recommendation and has taken a slightly different approach to achieve the same purpose. In November 2013, the Department retained Cohen Milstein Sellers & Toll, P.L.L.C. after receiving approval from the Attorney General’s Office and the Governor’s

Office. The firm includes the former General Counsel and former Special Counsel for Ethics to the New York State Comptroller, the sole trustee of the third largest pension plan in the country. The firm currently serves as outside compliance counsel to the Connecticut State Treasurer and has provided ethics counsel to the California State Teachers' Retirement System.

Ideally, this Ethics and Compliance Counsel position would be an in-house attorney. However, the Department has been unsuccessful in gaining approval for the position for the past two years. In February 2012, the Department requested this Counsel position in its budget expansion request for Fiscal Year 2012-2013. In October 2012, the Department again made such a request as part of its budget request for Fiscal Year 2013-2015. In both instances, the Office of State Budget and Management did not include the provision in the Recommended Budget. In February 2013, the North Carolina Department of Justice ("NCDOJ") through its statutory authority established a Special Deputy Attorney General position with a focus on such issues. This occurred at the time there was uncertainty about whether certain NCDOJ positions would be transferred to other state agencies, and the position was not approved by the Office of State Budget and Management.

Kellogg Huber Resolution: It is not clear that the Department's Response adequately addresses the Recommendation. The Response departs from the Recommendation by retaining a private law firm as Compliance Counsel rather than creating the position of Ethics Counsel within the Department. We understand that budgetary issues may have prevented the creation of a new position within the Department. However, North Carolina should make it a priority to approve funding for hiring an in-house Ethics Counsel to protect the retirement assets of the State's public servants. We note that such an allocation of public resources is likely to be more cost-effective with greater internal accountability than delegating this important function to an outside law firm.

6. ***Kellogg Huber Recommendation:*** Create an annual ethics training program (as contemplated by N.C. Gen. Stat. § 138A-15(g)) focused on investment-specific ethics issues and require completion and certification by IMD investment professionals. Ideally, such a program would be the responsibility of the Ethics Counsel proposed above in Recommendation B.5.

Response: The Department will take the recommended action. Staff education and training will be an annual program as part of the outside Compliance Counsel duties.

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation.

7. ***Kellogg Huber Recommendation:*** Amend existing policies to make clear that coverage extends to independent contractors hired by the Treasurer's Office temporarily to fill vacancies in key positions.

Response: The Department has taken the recommended action. See Placement Agent Policy, Parts IV(B), XI(D). The Supplemental Ethics Policy will also be amended to apply to any contractors filling vacant positions.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

8. **Kellogg Huber Recommendation:** Amend Part III.A of the Placement Agent Policy and Part III.B of the Standard Operating Procedures to require the Disclosure Letter to be completed within 30 calendar days of receipt, but no later than 10 calendar days prior to closing of the investment transaction. In the event of an accelerated closing, the minimum timing requirement of 10 calendar days may be waived by the Treasurer, so long as the Disclosure Letter is received and approved prior to closing of the investment transaction.

Response: The Department has taken the recommended action. See Placement Agent Policy, Part V(B).

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

9. **Kellogg Huber Recommendation:** Amend Part V of the Placement Agent Policy to prohibit the use of personal e-mail addresses by the Treasurer, CIO, and IMD investment professionals to communicate with fund managers and placement agents regarding state business related to the investment of NCRS funds. Evaluate to what extent, if any, the use of additional forms of personal communication should be limited.

Response: The Department will take the recommended action by amending a different policy. This change will be made to the Selection Policy’s External Communication Protocol, which sets out a series of policy provisions governing correspondence and conversations between fund managers (or their agents) and Department personnel. See Selection Policy, Part XI.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation, provided the Department makes appropriate changes to the Selection Policy’s External Communication Protocol.

C. Additional Disclosures from Third Parties

1. **Kellogg Huber Recommendation:** Modify the Disclosure Letter so that a fund manager must provide information responsive to questions 6, 8, and 9, even when the response to question 1 indicates that the fund manager is not using a placement agent. Require the fund manager to certify and sign its disclosures.

Response: The Department has taken the recommended action. The Disclosure Letter’s question order was reorganized to facilitate this change. Former Question

6 was split into Questions 3.1 through 3.6. Former Question 8 was renumbered as Question 4. Former Question 9 was renumbered as Question 5.1. These questions must be answered by the investment manager even if it is not using a placement agent.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

2. ***Kellogg Huber Recommendation:*** Modify Part III.A of the Placement Agent Policy to provide that, when a current employee of the fund manager functions as a placement agent, the manager must disclose (i) the employee’s role and responsibilities, (ii) the disclosures required by Part A.2 (resume), A.5 (government investigations), and A.6 (relationships with the Treasurer’s Office) of the Placement Agent Policy, and (iii) how a potential investment by the Treasurer’s Office is likely to affect the employee’s compensation. In light of the foregoing modification, delete “as well as employees of the Investment Manager” from Part III.A.3 of the Placement Agent Policy. Modify question 1 of the Disclosure Letter to require disclosure of (i) – (iii), above, when the placement agent being used is an employee of the fund manager.

Response: The Department has taken the recommended action. The text quoted by Kellogg Huber has been deleted from the relevant Placement Agent Policy subpart, which is now numbered III(B)(4). The recommended treatment of investment manager employees has been added to the end of that subpart. For the sake of clarity, the recommended disclosures have been added to Question 2.6 of the Disclosure Letters instead of Question 1.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

3. ***Kellogg Huber Recommendation:*** Modify the Disclosure Letter to require a certification and signature for a placement agent concerning the accuracy of its disclosures and its commitment to update the Treasurer’s Office promptly regarding any material changes to those disclosures.

Response: The Department has taken the recommended action. The placement agent must now complete its own Placement Agent Disclosure Letter. That Disclosure Letter contains a certification and signature, along with a commitment to update. See Placement Agent Policy, Parts III(C), III(D).

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

4. ***Kellogg Huber Recommendation:*** Amend Part III.A.6 of the Placement Agent Policy to require disclosures regarding (i) any professional relationships with current or former employees of the Treasurer’s Office or members of the IAC, (ii) any personal relationships with current or former employees of the Treasurer’s

Office or members of the IAC, and (iii) the identity of any current or former employee in the Treasurer's Office, member of the IAC, or immediate family thereof who suggested retention of the placement agent. Also make clear that, while all relevant relationships must be disclosed, not all are necessarily problematic. Modify question 6 of the Disclosure Letter to require disclosure of items (i) – (iii) above. To the extent there exists a relevant professional or personal relationship, require additional disclosure/explanation of the timing, nature, and scope of the relationship.

Response: The Department acknowledges the importance of the recommendation and has taken a slightly different approach to achieve the same purpose. As noted by Kellogg Huber, the former policy's Question 6 inquired about two subjects in one yes/no question: first, the existence of any personal or professional relationships, and, second, whether Department-affiliated persons suggested the retention of any placement agent. To reduce confusion, we have split former Question 6 and former Placement Agent Policy Part III(A)(6). Whether Department-affiliated persons suggested placement agent retention is now covered by revised Question 3.2 and VIII(C) of the Disclosure Policy.³ The subject of personal or professional relationships is now covered by Questions 3.3 to 3.6 and Parts VIII(D) to (G) of the revised Placement Agent Policy.

As Kellogg Huber's preliminary report suggested, professional or personal relationships are not necessarily problematic. Kellogg Huber has suggested defining "personal relationship" to include both immediate family and social contacts; we think it is more helpful to discuss family relationships and social relationships as separate types of connections.

Parts VIII(D) to (G) of the revised Placement Agent Policy set out a framework under which the Compliance Counsel will evaluate family relationships, former professional interactions, and social relationships. We agree that disclosure of all these types of connections is appropriate. As set out below, we believe the kind of response required from the Compliance Counsel will depend upon the type of relationship that is disclosed. More broadly, the Department's response to any relationship or connection should depend on the strength of the connection, as it becomes apparent from the facts. Social connections could indicate a very strong relationship or could show that two people are mere acquaintances. For very strong friends, recusal may be appropriate; for acquaintances, recusal would be unnecessary.

Part VIII(D) and Question 3.3 cover the subject of family relationships between Department-affiliated persons and the personnel at the investment manager or any placement agent who are involved in the transaction. If such a connection is disclosed, the Compliance Counsel will require recusal. If recusal is not practical, or if the transaction has proceeded without recusal, the Compliance Counsel will

³ Question 3.2 is discussed above in our response to Kellogg Huber recommendation (B)(1).

require an independent evaluation of the transaction by a neutral third party. *See* Placement Agent Policy, Part VIII(D)(2).

Part VIII(E) and Question 3.4 cover instances in which personnel of the investment manager or placement agent are former Department-affiliated persons.⁴ The Compliance Counsel will ensure that the Chief Investment Officer, General Counsel, and Treasurer are notified in writing of any such connection, then will determine whether the decision-making of the Department appears to have been unduly influenced by the presence of these former employees. *See id.*, Part VIII(E)(2). Based on this determination, the Compliance Counsel may recuse Department personnel or engage a neutral third party to perform an independent evaluation of the transaction. *See id.*, Part VIII(A) (last sentence).

Part VIII(F) and Question 3.5 discuss prior professional relationships between key Investment Management Division or Department staff and the personnel at the investment manager or any placement agent who are involved in the transaction. The Compliance Counsel will determine whether the decision-making of the Department appears to have been unduly influenced by the prior professional relationship. *See id.*, Part VIII(F)(2). Based on this determination, the Compliance Counsel may recuse Department personnel or engage a neutral third party to perform an independent evaluation of the transaction. *See id.*, Part VIII(A) (last sentence).

Part VIII(G) and Question 3.6 discuss personal relationships, defined as pre-existing relationships involving social contacts outside of business, between key Investment Management Division or Department staff and the personnel at the investment manager or any placement agent who are involved in the transaction. The Compliance Counsel will ensure that the Chief Investment Officer, General Counsel, and Treasurer are notified in writing of any social relationship that appears to be a significant, long-lasting relationship. More broadly, the Compliance Counsel will determine whether the decision-making of the Department appears to have been unduly influenced by the social connection or personal relationship. *See id.*, Part VIII(G)(2). Based on this determination, the Compliance Counsel may recuse Department personnel or engage a neutral third party to perform an independent evaluation of the transaction. *See id.*, Part VIII(A) (last sentence).

Kellogg Huber Resolution: The Department's Response regarding the disclosure of personal and professional relationships between Department staff and placement agents or fund managers adequately addresses the Recommendation. The Department's Response regarding the recusal policy regarding such relationships is addressed in the resolution to Recommendation B.1.

⁴ If personnel are current Department-affiliated persons, those persons must have been effectively recused, or the transaction is barred. *See* Placement Agent Policy, Part VIII(B).

5. ***Kellogg Huber Recommendation:*** Amend Part III.A.6 of the Placement Agent Policy and question 6 of the Disclosure Letter to define “personal relationship” as including (i) immediate family (i.e., mother, father, brother, sister, wife, husband, domestic partner, fiancé, or child); and (ii) a pre-existing relationship involving social contacts outside of business.

Response: The Department has taken the recommended action. See the definition of “Immediate Family” in Part XI(G) of the Placement Agent Policy and the request for information concerning “pre-existing relationships involving social contacts outside of business” in Question 3.6 of each Disclosure Letter.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

6. ***Kellogg Huber Recommendation:*** Amend Part III.A.6 of the Placement Agent Policy and question 6 of the Disclosure Letter to require disclosure of any relationships with the Treasurer.

Response: The Department has taken the recommended action. Part III.A.6 of the prior Policy has been renumbered as Part III(B)(7); that part has been modified to eliminate any doubt that the State Treasurer is within the part’s scope. More broadly, relationships with a Treasurer must be disclosed on the Disclosure Letters as required by new Part VIII of the Placement Agent Policy. *See* Disclosure Letter, Questions 3.1 to 3.6.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

7. ***Kellogg Huber Recommendation:*** Amend Part VI.B of the Placement Agent Policy to require fund managers and placement agents to disclose all political contributions made to, coordinated for, or solicited on behalf of the campaign of the Treasurer (regardless of the office for which the Treasurer is running) or any incumbent, nominee, candidate, or successful candidate for such elective office. Amend question 9 of the Disclosure Letter to require fund managers and placement agents to disclose all such political contributions.

Response: The Department has taken the recommended action. *See* Placement Agent Policy, Part IX(B); Disclosure Letter, Question 5.2.

Kellogg Huber Resolution: The Department’s Response adequately addresses the Recommendation.

8. ***Kellogg Huber Recommendation:*** Propose amending N.C. Gen. Stat. § 120C-100(a)(10) (and other statutes, as necessary or appropriate) to provide that the term “lobbyist” includes anyone acting as a “placement agent” in connection with the investment of NCRS funds, where “placement agent” is defined in accordance with Part VII.B of the Placement Agent Policy.

Response: The Department will make this proposal as part of its legislative agenda for 2014 session of the General Assembly. We note that under existing law, under certain circumstances, placement agents may be required to register as lobbyists under the North Carolina General Statutes.

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation, provided the Department makes an appropriate proposal regarding the status of Placement Agents as "lobbyists" under N.C. Gen. Stat. § 120C-100(a)(10).

9. **Kellogg Huber Recommendation:** Modify Parts III.A.3 and 4 of the Placement Agent Policy and questions 3 and 4 of the Disclosure Letter to require a detailed description of the services (to be) provided by the placement agent, and to require submission of the actual contract terms concerning placement agent compensation, fee obligations, and services. Only permit a description of the terms if no written agreement exists (i.e., only an oral agreement).

Response: The Department has taken the recommended action. See Placement Agent Policy, Part III(B)(3); Disclosure Letter, Question 2.6.

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation.

10. **Kellogg Huber Recommendation:** Modify question 2(a) of the Disclosure Letter to require disclosure of the placement agent entity and the key individual(s) involved with the investment. Modify questions 5 and 6 of the Disclosure Letter to be "yes" or "no" questions, with an explanation required for a "yes" answer. Modify the definition of "Investment Manager" in Part VII.A of the Placement Agent Policy to make clear that it applies only to services and advice provided to the Treasurer or the IMD in connection with NCRS funds.

Response: The Department has taken the recommended actions. Concerning disclosure of individuals as well as the placement agent entity, see Question 2.3 of each Disclosure Letter. The former Disclosure Letter's Question 5 has been modified as recommended; it is now renumbered as Question 2.7. The former Disclosure Letter's Question 6 has been modified as recommended; it is now renumbered as Question 3.2. The Department has chosen to apply the Placement Agent Policy not only to NCRS funds, but also to all other funds managed by the Treasurer.

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation.

D. Additional Disclosures to Third Parties

1. **Kellogg Huber Recommendation:** Amend the Supplemental Ethics, Charitable Donations, Prohibition of Gifts to State Employees, and Travel Policies to provide

for annual disclosure of the policies to new and existing third parties, including fund managers and placement agents who invest in or otherwise are involved with NCRS funds.

Response: The Department has taken the recommended action. The Placement Agent Policy has been amended to require annual disclosure of the Supplemental Ethics Policy, Charitable Donations Policy, Gift Prohibition, and Travel Policy as well as disclosure of the Placement Agent Policy itself. *See* Placement Agent Policy, Part V(A).

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation.

E. Enhanced Transparency

1. **Kellogg Huber Recommendation:** Disclose on the Treasurer's Office website placement agent usage, compensation, registration status, and political contributions or gifts given to decision-makers in connection with investments of the Treasurer's Office. To avoid any confusion over the roles for the Treasurer as political candidate and as fiduciary, which is a non-political role, the Treasurer's Office should consider segregating those disclosures.

Response: The Department has amended its policies to take the recommended action. *See* Placement Agent Policy, Part III(F). Effective December 10, the Department will post placement agent information online.

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation.

2. **Kellogg Huber Recommendation:** Maintain on the Treasurer's Office website the Disclosure Letter template and specific third-party responses to the Disclosure Letter.

Response: The Department has amended its policies to take the recommended action. *See* Placement Agent Policy, Part III(F). Effective December 10, the Department will post placement agent information online. The disclosure letter template is posted on the Department's website.

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation.

F. Enhanced Investigative and Enforcement Measures

1. **Kellogg Huber Recommendation:** Amend Part IV of the Placement Agent Policy to allow the Treasurer's Office both to terminate a contract if an investment manager fails to comply with the Placement Agent Policy and to impose a temporary ban on future investments with the investment manager in the event of

a willful violation. Make harmonizing changes to the contractual representations required of investment managers regarding the remedies available to the Treasurer's Office in the event of a violation of the Placement Agent Policy.

Response: The Department has amended its policies to take the recommended action. The Department will seek this language in its contracts. *See* Placement Agent Policy, Part IV(A)(4). The Treasurer now has express authority to impose a ban on future investments. *See id.*, Part IV(A)(5).

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation.

2. **Kellogg Huber Recommendation:** Discuss with the NCDOJ the possibility of seeking to amend the obstruction of justice statutes, Chapter 14, Article 30 of the North Carolina General Statutes, to include a statute similar to 18 U.S.C. § 1001, prohibiting material false statements to government officials.

Response: The Department has communicated with the NCDOJ. We agree that 18 U.S.C. § 1001 is model legislation and should be incorporated into the General Statutes to supplement internal controls implemented by the Department.

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation.

3. **Kellogg Huber Recommendation:** Discuss with the NCDOJ the possibility of seeking to amend the bribery statute, N.C. Gen. Stat. § 14-217, to include a provision similar to 18 U.S.C. § 666(a)(1)(B), prohibiting state employees from soliciting or accepting anything of value with intent to influence state business, even when provided to a third party.

Response: The Department has communicated with the NCDOJ. We agree that 18 U.S.C. § 666(a)(1)(B) is model legislation and should be incorporated into the General Statutes to supplement internal controls implemented by the Department.

Kellogg Huber Resolution: The Department's Response adequately addresses the Recommendation.

Tab 4: **New and Revised Policies**

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**NORTH CAROLINA DEPARTMENT OF STATE TREASURER
INVESTMENT MANAGEMENT DIVISION**

Placement Agent, Political Contribution, and Connection Disclosure Policy

I. Purpose

A. Background. The North Carolina State Treasurer (the “Treasurer”) and the North Carolina Department of State Treasurer (the “Department”) strive to model excellence in state government through accountability and prudent investment of entrusted assets. The Treasurer maintains the investment program for the North Carolina Retirement Systems defined in N.C.G.S. § 147-69.2(b)(8) and other investment funds (collectively, the “NC Funds”). The Investment Management Division (“IMD”) serves as the investment arm of the State Treasurer. Because IMD is limited in the number of staff it can hire and the Department lacks legal authority to invest directly in certain asset classes, outside Investment Managers (as hereinafter defined)¹ manage a majority of the investments made on behalf of the NC Funds.

Since the first version of this Policy was adopted in 2009, the Treasurer and the Department have adopted several policies and procedures that govern the selection of outside Investment Managers. Among these policies are the Investment Policy Statement, the External Investment Manager and Vehicle Selection Policy and Procedure (the “Selection Policy”), the Code of Ethics and Conduct, the IMD Investment Committee Charter, and the External Investment Management Conflict of Interest Certification. The Treasurer’s overarching goal, in adopting this set of policies, has been to develop the best possible procedures for selecting investments and to maintain high ethical standards.

B. Role of Placement Agents. A Placement Agent is, in essence, a marketing specialist hired by an outside Investment Manager. Placement Agents often serve a valuable function by exposing new and emerging Investment Managers to investment funds which might otherwise have not received information about those Investment Managers’ opportunities. Placement Agents can help smaller managers learn how to market themselves as effectively as their larger counterparts. The Securities and Exchange Commission noted the helpful functions of Placement Agents in 2010, determining that it was prudent to allow Investment Managers to continue hiring Placement Agents so long as those Placement Agents are registered and regulated by an organization such as FINRA. *See* Release on SEC Rule, 75 Fed. Reg. 41,017 at 41,038 and 41,041 (July 14, 2010).

As the SEC observed, however, Placement Agents have been implicated in improper conduct affecting several public pension funds. If an Investment Manager hires a Placement Agent to utilize a pre-existing relationship between the Placement Agent and the public pension fund’s staff, the Placement Agent does not serve any useful function, and instead could cause a fund to make decisions on factors other than the potential investment’s strategy and expected performance.

C. Goals of this Policy. In this Policy, the Treasurer has chosen to impose limitations on Investment Managers’ use of Placement Agents to ensure that Placement Agents will play only a proper role in marketing investment opportunities. More broadly, the Policy seeks disclosures of connections or relationships between Investment Managers, Placement Agents, and persons affiliated with the Department. The Policy has three basic features:

¹ Capitalized terms not otherwise defined in the text of this Policy have the meanings stated in Section XI herein.

- First, the Policy requires comprehensive disclosures from the Investment Manager and Placement Agent.
- Second, the Policy provides for attorney review of the disclosed information to ensure that any Placement Agent or Investment Manager was hired for professional expertise, not for his or her connections to the Treasurer, board members, or staff. The Treasurer's Compliance Counsel will also evaluate any relationships to determine appropriate action, such as recusal.
- Third, the Policy restricts Investment Managers from using and compensating Placement Agents unless the Placement Agent is providing an introduction for an Investment Manager who has not managed any investments for the NC Funds within the last two years. *See* Section VII(C).

II. Application

This Policy applies to all Investment Transactions and Substantive Amendments entered into by the Treasurer on or after September 29, 2009. Revised requirements of this version of the Policy shall apply to agreements entered into or modified pursuant to a Substantive Amendment on or after December 1, 2013.

For purposes of agreements with Investment Managers entered into prior to September 29, 2009, when a Substantive Amendment is made with the consent of the Treasurer to such agreement, this Policy shall apply prospectively to the amended agreement and not to the original agreement. As to pre-2009 Investment Managers to whom this Policy does not apply pursuant to the foregoing, the Treasurer has previously requested that each such Investment Manager voluntarily comply with this policy.

This Policy applies whenever the Treasurer is seeking to engage, hire, invest with or commit to invest, or to do business with an Investment Manager, whether the applicable agreement is directly with the Investment Manager or with an investment vehicle affiliated with the Investment Manager. Investment Managers should note that, although Placement Agents' services are generally considered more applicable to the general partners, managers, and sponsors of private equity, real estate, absolute return, and other private market investment funds, this Policy also applies to public market Investment Managers.

III. Required Disclosures

A. Disclosure Letters. For each Investment Transaction, prior to entering into an agreement or Substantive Amendment with the Treasurer, or at such time as provided in Section II above, an Investment Manager shall provide to the Treasurer's Compliance Counsel the following (collectively, the "Disclosure Letters"):

1. A disclosure from the Investment Manager substantially in the form of Appendix 1 to this Policy (an "Investment Manager Disclosure Letter"); and
2. If and only if there is a Placement Agent for the Investment Transaction, a disclosure from each Placement Agent substantially in the form of Appendix 2 to this Policy (a "Placement Agent Disclosure Letter").

For Substantive Amendments, whether or not any Disclosure Letter was provided at the time of the agreement's original execution under this Policy, Investment Managers and Placement Agents (if any) shall complete Disclosure Letters based on the circumstances surrounding the proposed Substantive Amendment, not the original agreement.

B. Content of Disclosure Letters. Each Disclosure Letter shall be in substantially the form of Appendix 1 or Appendix 2 to this Policy, as applicable, containing the following:

1. **Response 2.1.** A statement as to whether or not the Investment Manager (or any officer, partner, principal, or affiliate thereof) has elected to use or Compensate a Placement Agent to assist the Investment Manager in obtaining investments from, or business with, any of the NC Funds.

2. **Responses 2.2(e)-(f).** A statement confirming that (i) no Placement Agent is being, or will be, Compensated, directly or indirectly, to assist the Investment Manager in obtaining investments from (or business with) the NC Funds, except as disclosed in the Disclosure Letter and (ii) the Investment Manager, not the Treasurer or the NC Funds, shall bear the entire cost of the Placement Agent fees and expenses disclosed in the Disclosure Letter.

3. **Responses 2.3(a)-(g).** The name of the Placement Agent and a resume (or other summary) for all Placement Agent personnel who played a role in marketing or outreach for the Investment Transaction, all Placement Agent personnel who will receive Compensation as a result of the NC Funds' investment in the Investment Transaction, and each officer, partner, or principal of the Placement Agent. Such resume or other summary shall detail each person's education, work experience, and professional designations. If any such person is a current or former North Carolina Department of State Treasurer employee, IMD Contractor or Consultant, North Carolina State Treasurer, or Investment Advisory Committee member, or a member of the Immediate Family of any such person, this fact shall be specifically noted, and any financial benefit to such person from the Investment Transaction shall be identified.

4. **Response 2.6.** The terms of the agreement or arrangement (oral or written) with the Placement Agent that (i) describe any and all Compensation provided or agreed to be provided to a Placement Agent including the nature, timing, and value and (ii) create an obligation to pay a fee to or for the benefit of any Placement Agent. If the contract or agreement between the Investment Manager and Placement Agent is not written, the full extent of such agreement shall be written and summarized, succinctly describing the terms of such agreement or arrangement with the Placement Agent, including details of the nature, timing, and value of the Compensation or benefit provided. Where the Placement Agent is an employee of the Investment Manager,² Compliance Counsel may accept, in lieu of the detailed response described above, a general disclosure providing the employee's role and responsibilities and stating any known effect on the employee's Compensation directly attributable to the NC Funds' proposed investment.

5. **Response 2.7.** A statement as to whether the Placement Agent has been the subject of any actions or investigations by any federal, state, or local government agencies or regulatory bodies in the last ten (10) years and/or anticipates being the subject of such actions or investigations in the future.

6. **Responses 2.2(a)-(d) and 2.8.** A statement confirming that (i) the Placement Agent is registered with the Securities and Exchange Commission or the Financial Industry Regulatory Association; (ii) the individual officers, partners, principals, employees, or other representatives of the Placement Agent hold all required securities licenses (e.g. Series 7, 63);

² Note that Investment Manager employees are "Placement Agents" within the definition of this Policy only if subject to SEC or FINRA registration requirements. See this Policy's definition of "Placement Agent" in Section XI(K).

(iii) no placement fee has been or will be shared with any person or entity not so registered; and
 (iv) the Placement Agent is in the habitual systemized business of acting as a Placement Agent. In addition, the Placement Agent shall provide a statement that provides details of relevant persons' registrations, the number of years employed by the Placement Agent, and the number of years of experience directly related to such business.

7. **Response 3.2.** A statement as to whether a current or former North Carolina State Treasurer, Department of State Treasurer employee, IMD Contractor or Consultant, or Investment Advisory Committee member suggested the retention of the Placement Agent. If so, the name of such individual(s) shall be provided.

8. **Responses 3.1 to 3.5.** Disclosures of connections or relationships in accordance with Section VIII of this Policy.

9. **Response 4.** A statement indicating whether the Investment Manager or the Placement Agent (as applicable), or any of its officers, partners, principals or affiliates, is registered as a lobbyist with any state government and, if applicable, the name and positions of such persons and the registrations held.

10. **Responses 5.1 and 5.2.** Disclosures concerning Political Contributions in accordance with Section IX of this Policy.

C. Change of Information. The Investment Manager and Placement Agent shall provide a written update of any material changes to any of the information found in their Disclosure Letter within fourteen (14) days after such person or entity knew or should have known of the change in information.³

D. Representations and Warranties

1. **By Investment Manager.** In the Investment Manager Disclosure Letter, the Investment Manager shall represent and warrant that the statements found in the Investment Manager Disclosure Letter are true, correct, and complete in all material respects. The Investment Agreement shall contain substantially the same representation and warranty, and it shall provide for a remedy on breach consistent with § IV of this Policy.

2. **By Placement Agent.** The Placement Agent Disclosure Letter shall include a declaration under penalty of perjury that the Placement Agent Disclosure Letter is true, correct, and complete in all material respects.

E. Internal Disclosure in Investment Recommendation Memorandum. For certain IMD transactions, the Selection Policy requires staff to complete an Investment Recommendation Memorandum. In each Investment Recommendation Memorandum, the Asset Class Director will provide a brief statement that describes (1) the person or persons, if any, who initially suggested the investment opportunity to IMD and (2) any persons who appeared before IMD in the marketing or due diligence process on behalf of the Investment Manager and who were not employees of the Investment Manager or one of the Investment Manager's affiliates.

³ The Disclosure Letters ask several questions about social relationships, shared work history, and family or marital relationships. These answers to these questions will inevitably change over time. The Investment Manager and Placement Agent need not provide updates to Responses 3.3 to 3.6, but must update Responses 3.1(a), 3.1(b), or 3.2.

F. Website Posting. Disclosure Letters shall be public documents. Any designation by an Investment Manager or Placement Agent of Disclosure Letter text as a trade secret under N.C. Gen. Stat. § 132-1.2(1) shall be supported by a statement identifying how the text designated as a trade secret satisfies the test of N.C. Gen. Stat. §§ 66-152(3)(a),(b), and 132-1.2(1)(b)-(d.). On a quarterly basis, the Department shall electronically collate Disclosure Letters for all proposed Investment Transactions that were accepted and signed by the Treasurer and make such collations available through its website and other means.

IV. Failure to Comply – Remedies

A. By Investment Managers.

1. Each Investment Agreement shall include remedial provisions that apply in the event the Investment Manager (i) fails to comply with the Disclosure Letter requirements, (ii) makes a material misstatement or omission in its Disclosure Letter, (iii) fails to update a Disclosure Letter as required by Section § III(C) of this Policy, or (iv) otherwise materially violates this Policy (items (i) through (iv) collectively hereinafter, a “Violation of This Policy”).

2. All remedial actions for Violations of This Policy shall be at the Treasurer’s sole discretion, without liability by the Treasurer to the Investment Manager, and the Treasurer may choose not to exercise any such remedy if the Treasurer determines that such exercise may not be in the best interest of the NC Funds.

3. The remedial provisions for a Violation of This Policy shall provide that the Investment Manager shall repay to the Treasurer the greater of (a) the aggregate amount of any management or advisory fees paid to the Investment Manager for the most recent two years in respect of the investments or business of the Treasurer, whether paid directly by the Treasurer or an investment vehicle in which the Treasurer is an investor and without regard to any offset reducing such fees (e.g., for placement fees, special fees, fund expenses, etc.) or (b) an amount equal to the amounts paid or promised to be paid to the Placement Agent with respect to investments or business with the Treasurer.

4. The Treasurer shall also seek, in the remedial provisions in an Investment Agreement for a Violation of This Policy, language that allows for immediate termination of the Investment Agreement without penalty; or, for a limited partnership, limited liability company, or other investment vehicle, language that allows for an orderly withdrawal of the Treasurer from such investment vehicle without financial penalty to the Treasurer or the NC Funds.

5. The Treasurer may also impose a ban on future Investment Transactions with the Investment Manager.

6. The remedies set forth in this Section shall be in addition to any other remedies that the Treasurer may be entitled to at law or in equity, by contract or otherwise.

7. As to any existing Investment Manager voluntarily complying with the policy as described in Section II, the remedies described in this Section shall not apply to any use of a Placement Agent prior to the approval date of this policy that is described in the Disclosure Letter of the existing Investment Manager first submitted following such approval date, except to the extent the Disclosure Letter is not true, correct and complete in all material respects.

B. By Department Personnel. Failure to comply with this Policy by Department employees or IMD Contractors or Consultants may result in penalties up to and including termination.

V. Notification & Review Process

A. Notice. At the time that discussions are initiated with respect to a prospective Investment Transaction or Substantive Amendment, the Treasurer’s staff will provide the Investment Manager with a copy of this Policy along with the Supplemental Ethics Policy, the Charitable Donations Policy, the Prohibition of Gifts to State Employees Policy, and the Travel Policy. As applicable, the Director for each asset class, or his or her designee, will be responsible for sending such written notice.

B. Timing of Disclosure Letters. Unless exceptional circumstances exist, the Disclosure Letters shall be provided to the Compliance Counsel at least one month before the anticipated closing of the Investment Transaction.

C. Review before Closing. Before closing of the Investment Transaction and execution of contractual documents, the Compliance Counsel shall review Disclosure Letters in accordance with Section VI of this Policy.

D. Implementation. As part of the closing of an investment or engagement or any amendment thereto to which this Policy is applicable as described in Section II hereinabove, the Investment Manager will be required to (i) represent and warrant that its Disclosure Letter is, as of the date of closing, true, correct and complete in all material respects and (ii) confirm the Investment Manager’s agreement to the remedial provisions contained in Section IV.

VI. Evaluation of Disclosure Letters

A. Information Reviewed. The Compliance Counsel shall review the Disclosure Letter. When provided in the Selection Policy, the Compliance Counsel shall be provided with Investment Recommendation Memoranda or other documents related to the proposed transaction. The Compliance Counsel may contact Department personnel, the Investment Manager, or the Placement Agent to address questions.

B. Standard of Review. The Compliance Counsel shall determine whether in his or her view, based on the information reviewed:

1. The Disclosure Letters are responsive, complete, and sufficient in all material respects;
2. Whether there is a reasonable chance that any aspect of the Investment Transaction’s recommendation, negotiation, or approval may violate any law, regulation, or Department policy; and
3. Whether any aspect of the Investment Transaction’s recommendation, negotiation, or approval (a) creates a material risk that the professional judgment or actions of persons currently affiliated with the Department have been or will be unduly influenced by a direct or indirect personal interest; or (b) raises significant reputational risk concerns related to Conflicts of Interest.

Any approval by the Compliance Counsel will be made in writing. These criteria are intended to be identical to the criteria in Section VII of the Selection Policy, and the Compliance Counsel's review under this Policy and under the Selection Policy may be combined into one effort.

C. Corrective Procedures.

1. **For issues under § VI(B)(1).** If the Compliance Counsel determines that the test stated by Subsection (B)(1) above is not met, he or she shall contact the Investment Manager or Department staff to seek correction of the Disclosure Letters.

2. **For issues under § VI(B)(2) or (3).** If the Compliance Counsel determines that the test stated by Subsections (B)(2) or (B)(3) above may not be met, the Compliance Counsel will promptly notify the Chief Investment Officer and General Counsel. The issue will be jointly resolved following the procedures set out in Section VII of the Selection Policy. In accordance with Section VII(A) below, the Investment Agreement or Substantive Amendment may not be signed by the Treasurer without approval by the General Counsel or the General Counsel's attorney designee. The resolution of the issue raised by the Compliance Counsel will be documented in writing and provided to the Treasurer before execution.

VII. Prohibitions

A. Prohibition on Investment without Approval under This Policy. This Policy prohibits the Treasurer or Department personnel from entering into any Investment Transaction or Substantive Amendment unless, in compliance with Section VI above, it has been approved by either the Compliance Counsel, the General Counsel, or the attorney designated by the General Counsel to perform review of the contract under N.C.G.S. § 114-8.3(b1).

B. Eligibility Criteria for Placement Agent. The Treasurer will not transact business on behalf of any NC Funds with an Investment Manager that has elected to use a Placement Agent unless the following criteria are met in all material respects:

1. The Placement Agent must be registered with either the Securities and Exchange Commission or the Financial Industry Regulatory Authority.⁴

2. The placement fee must not be shared with a person or entity that does not meet the criteria in Subsection (B)(1) above.

3. The person or entity acting as the Placement Agent must be in the habitual, systematized business of acting as a Placement Agent.

4. The Investment Manager must represent and warrant in the Investment Agreement that the information disclosed is true, correct, and complete in all material respects, as set forth in Section III(D).

5. The Investment Manager must agree in the Investment Agreement to the remedies for material omission or inaccuracy in the Disclosure Letter, as set forth in Section IV.

6. The Investment Manager agrees in the Investment Agreement that the Investment

⁴ For international Investment Transactions, any Placement Agents outside the United States must have a substantially equivalent foreign registration.

Manager, not the Treasurer or the NC Funds, shall bear the entire cost of all Placement Agent fees and expenses.⁵

C. Prohibition on Use of Placement Agents if Investment Manager Currently Manages, or Recently Managed, North Carolina Investments.

1. **Prohibition.** The Treasurer shall not enter into an Investment Transaction if the Investment Manager (or its affiliate) currently manages an NC Funds investment or has managed an NC Funds investment within the last two years, but the Investment Manager has elected to use and Compensate a third-party Placement Agent with respect to the Investment Transaction. Such a transaction is not barred if the Investment Manager engages a Placement Agent, but the Placement Agent is not Compensated, directly or indirectly, for the NC Funds' investment.⁶

2. **Internal or Affiliated Placement Agents.** The ban on third-party Placement Agents set out in Subsection (C)(1) above does not restrict Investment Managers from utilizing Placement Agents who are employees or employees of an Investment Manager's affiliate, so long as Compensation to the Placement Agent is disclosed in accordance with Section III(B)(4) of this Policy.

3. **No Placement Agents to Promote or Market Amendments.** The Treasurer shall not enter into an amendment or consent to amend an existing contract if the Investment Manager hired a third-party Placement Agent to promote or market the amendment.

4. **No Tail Fees.** The Treasurer shall not enter into an Investment Transaction if a Placement Agent or other solicitor (a) is not utilized to promote the current Investment Transaction by the Investment Manager, (b) nonetheless, the Investment Manager would Compensate the Placement Agent based on the NC Funds' investment for the current transaction, and (c) such Compensation would be the result of the Placement Agent's status, in a prior investment transaction, as the Placement Agent to the NC Funds.

D. Prohibitions on Conduct of Department-Affiliated Personnel. The Treasurer, Department of State Treasurer staff, IMD Contractors or Consultants, and Investment Advisory Committee members ("Department-Affiliated Persons") shall not:

1. Suggest to an Investment Manager or the Department's investment staff that a Placement Agent be engaged with respect to an Investment Transaction or Substantive Amendment; or

2. Make an initial call or contact to a Placement Agent about an investment opportunity, unless that Placement Agent meets the standards of Subsections (B)(1) and (B)(3)

⁵ An investment vehicle in which the Treasurer is an investor may make a payment to the Placement Agent as an offset to the NC Funds' future fees or compensation to the Investment Manager if and only if (i) the terms of the management fee offset are fully disclosed, (ii) the Placement Agent and its Compensation are fully disclosed in approved Disclosure Letters under this Policy, and (iii) the NC Funds do not ultimately bear any Placement Agent fees and expenses.

⁶ In some situations, an Investment Manager hires a Placement Agent for a small flat fee to assist in preparing marketing materials for all potential investors in the fund. Subsection (C)(1) does not prohibit the Investment Transaction if the flat fee is not based on the size of the Investment Manager's fund, the flat fee is not based, directly or indirectly, on the size of the NC Funds' investment, and the Placement Agent does not appear personally in front of North Carolina.

above and the contact will be disclosed in the transaction's Investment Recommendation Memorandum and Disclosure Letters required under this Policy.

VIII. Disclosure and Evaluation of Connections or Relationships

A. General Principles. Each Disclosure Letter shall contain the statements requested in this section disclosing any connections or relationships that may exist between the Investment Manager or Placement Agent (as applicable) and Department-Affiliated Persons. The Investment Manager and Placement Agent must, in good faith, make their responses materially complete. In preparing their responses, the Investment Manager and Placement Agent may rely on lists provided by the Department of State Treasurer of current and past Department personnel and Investment Advisory Committee members.

The Compliance Counsel will evaluate the disclosures in accordance with the standard of review set out in Section VI(B) of this Policy, following the principles set out in this Section VIII. Some types of connections or relationships are the ordinary result of doing business. Based on the facts and the principles set out in this section of the Policy, the Treasurer's Compliance Counsel will determine what actions are required. It may be warranted, in the circumstances, to recuse Department personnel or engage a neutral third party to perform an independent evaluation of the proposed transaction.⁷

B. Responses 3.1(a) and (b): Financial Benefit or Current Employment

1. **Disclosure.** The Disclosure Letter shall list whether any current Department-Affiliated Persons or any member of their Immediate Family (i) are personnel, officers, directors, partners and/or principals of the Investment Manager or Placement Agent, or (ii) would receive a financial benefit to themselves derived from the Compensation provided to the Investment Manager or Placement Agent.

2. **Resolution.** If such a connection is disclosed, the Compliance Counsel shall ensure: (i) the affected Department-Affiliated Person shall be recused from the Investment Transaction and shall play no part in its consideration or approval; and (ii) if the Department-Affiliated Person has already played a substantive role in the consideration or approval of the Investment Transaction, the Investment Transaction shall be prohibited. The Chief Investment Officer, Department's General Counsel, and Treasurer shall be notified in writing of the connection.

C. Responses 3.2(a) and (b): Who Recommended Placement Agent

1. **Disclosure.** The Disclosure Letter shall list whether any current or former Department-Affiliated Person suggested to the Investment Manager or to the Department's investment staff that the Placement Agent be retained for the Investment Transaction.

2. **Resolution.** If such a suggestion is disclosed, the Compliance Counsel shall review the disclosure; notify the Chief Investment Officer, General Counsel, and Treasurer; and ensure that appropriate action is taken as prescribed by this subsection.

a. If a current Department-Affiliated Person suggested that a Placement Agent be retained with respect to a proposed Investment Transaction or Substantive

⁷ Any neutral third party engaged under this subsection shall be hired, compensated, and directed by the Department (not the Investment Manager or Placement Agent) and shall be paid on a basis that is not dependent on whether the transaction proceeds to closing.

Amendment, the Compliance Counsel will seek disciplinary action against the Department-Affiliated Person under Section VII(D)(1) of this Policy. Moreover, the proposed transaction or amendment shall be prohibited if the Investment Manager retained the suggested Placement Agent. If the Investment Manager did not retain the suggested Placement Agent, recusal of the Department-Affiliated Person and mandatory neutral third-party due diligence is required.

b. If a former Department-Affiliated Person suggested that a Placement Agent be retained, the Compliance Counsel shall determine whether recusal, a ban on the investment, or mandatory third-party due diligence is warranted based on the likelihood that the suggestion resulted in a Conflict of Interest.

D. Response 3.3: Family Relationships

1. **Disclosure.** The Disclosure Letter shall list any instance in which the current (i) Treasurer, (ii) Department of State Treasurer Senior Staff, (iii) Investment Advisory Committee members, (iv) Investment Management Division Senior Staff, or (v) IMD staff who played a role in due diligence for the Investment Transaction are Immediate Family members of either (a) principal members of the project team for the Treasurer's account at the Investment Manager or (b) Placement Agent officers, partners, or principals; Placement Agent personnel who played a role in marketing or outreach for the Investment Transaction; or Placement Agent personnel who will receive Compensation, directly, or indirectly for the Investment Transaction.

2. **Resolution.** If such a connection is disclosed, the Compliance Counsel shall ensure that (i) the Chief Investment Officer, General Counsel, and Treasurer are notified in writing of the connection and (ii) the Department-Affiliated Person with such a connection is recused from the Investment Transaction, has played no part in its consideration or approval, and will play no part in its consideration or approval. If recusal is not practical in the circumstances, or the Department-Affiliated Person has already played a role in the consideration or approval of the Investment Transaction, the Compliance Counsel may either designate the Investment Transaction as prohibited by this Policy or, at the option of the Compliance Counsel, allow the Investment Transaction to go forward if a neutral third party hired by the Department performs an independent evaluation of the proposed transaction and recommends it for investment.

E. Response 3.4: Former Department Personnel or Officials

1. **Disclosure.** The Disclosure Letter shall list any instance in which any personnel of the Investment Manager or Placement Agent (if applicable) are former Department-Affiliated Persons. Any financial benefit to such former personnel or officials shall be identified.

2. **Resolution.** If such a connection is disclosed, the Compliance Counsel shall ensure that (i) the Chief Investment Officer, General Counsel, and Treasurer are notified in writing of the connection; and (ii) the decision-making of the Department with respect to the Investment Transaction does not appear to have been unduly influenced by the presence of former Department-Affiliated Persons at the Investment Manager or Placement Agent.

F. Response 3.5: Prior Working Relationships

1. **Disclosure.** The Disclosure Letter shall list and describe any professional or working relationships that have existed in the past between persons who are now (i) IMD employees, (ii) IMD Contractors or Consultants, (iii) the State Treasurer, or (iv) Department of

State Treasurer Senior Staff, on the one hand, and, on the other hand, (a) the Investment Manager's project team for the Treasurer's account or (b) Placement Agent personnel who would receive Compensation (directly or indirectly) for the Investment Transaction or who played a role in marketing or outreach for the Investment Transaction. For purposes of this response, "professional or working relationships" includes occasions where persons worked together on the same projects at the same company, at the same fund, or as part of a client-consultant relationship; the term does not include prior engagements of the Investment Manager by the Department of State Treasurer or prior occasions in which the Placement Agent marketed a fund to the Department of State Treasurer.

2. **Resolution.** If such a connection is disclosed, the Compliance Counsel shall ensure that the decision-making of the Department with respect to the Investment Transaction does not appear to have been unduly influenced by the prior working relationship.

G. Response 3.6: Social Connections or Personal Relationships

1. **Disclosure.** The Disclosure Letter shall list and describe any pre-existing relationships involving social contacts outside of business between (i) IMD employees, (ii) IMD Contractors or Consultants, (iii) the State Treasurer, or (iv) Department of State Treasurer Senior Staff, on the one hand, and, on the other hand, (a) the Investment Manager's project team for the Treasurer's account or (b) Placement Agent personnel who would receive Compensation (directly or indirectly) for the Investment Transaction or who played a role in marketing or outreach for the Investment Transaction.

2. **Resolution.** If such a connection is disclosed, the Compliance Counsel shall ensure that the decision-making of the Department with respect to the Investment Transaction does not appear to have been unduly influenced by the social relationship. If the social relationship appears to be significant and long-lasting, the Compliance Counsel shall notify the Chief Investment Officer, General Counsel, and Treasurer in writing of the social relationship and suggest, based on the facts, whether recusal or an independent evaluation of the transaction by a neutral third party should be provided.

IX. Political Contributions

A. Prohibition. The Treasurer will not transact business with an Investment Manager if it has been determined that a Political Contribution to the Treasurer or any incumbent, nominee, or candidate for such elective office has been made, coordinated or solicited (i) in violation of applicable state or federal law or (ii) in a manner that would make it unlawful, under the SEC Rule, for the Investment Manager (or its affiliate) to seek Compensation for services to the Treasurer and/or the NC Funds.

B. Disclosure. Each Disclosure Letter shall contain a list of Political Contributions made, coordinated, or solicited by the Investment Manager and Placement Agent (as applicable) and their respective officers, partners, principals or affiliates for the campaign of (a) any incumbent, nominee, candidate, or successful candidate for North Carolina State Treasurer or (b) for the campaign of the current State Treasurer running for a different office.

C. Use of Disclosure. The Disclosure contemplated by Subsection (B) above shall not be used by the Treasurer or Department of State Treasurer staff for political purposes, but shall be used exclusively as a check on compliance with the SEC Rule and this Policy.

X. Interpretation of this Policy

A. Authority. Questions concerning the meaning of this Policy shall be resolved by the Department's General Counsel or by his or her designee.

B. Application of Policy to Particular Situations

To the extent any other text in this Policy conflicts with the more specific treatment of an issue in this Section X(B), the text in this section shall govern.

1. Fund of Funds. This Policy applies to the North Carolina Innovation Fund and all other investments (hereinafter, "Fund of Funds") in which the Treasurer selects an Investment Manager (a "First-Level Manager") who then selects several sub-Investment Managers ("Second-Level Managers"). For Fund of Funds, the First-Level Manager shall provide Disclosure Letters to the Treasurer when seeking the Treasurer's commitment to do business with the First-Level Manager. The Second-Level Managers shall provide Disclosure Letters if the Treasurer is asked to consent to the investment of funds with a Second-Level Manager.

2. Secondary Market. This Policy does not apply to "secondary market" and other similar transactions in which the Treasurer is acquiring an interest in an existing investment vehicle from a third party that is not affiliated with the Investment Manager in a transaction in which the Investment Manager is not materially involved (e.g., where the Investment Manager's only material involvement is consenting to the transaction).

3. Supplemental Retirement Plans. If this Policy is approved by the North Carolina Supplemental Retirement Board of Trustees, this Policy shall apply prospectively to all Investment Transactions and Substantive Amendments, entered into after the approval date, between the North Carolina Supplemental Retirement Board of Trustees and, directly or indirectly, its Investment Managers.

XI. Definitions

The following terms when used in this Policy shall have the meanings set forth below.

A. "Compensation": Compensation of any kind (including flat fees, contingent fees, or any other form of tangible or intangible compensation or benefit) provided as a result of the NC Funds' investment in the Investment Transaction. If a Placement Agent receives a flat fee based on the size of an Investment Manager's fund, the Placement Agent receives "Compensation" under this Policy if the NC Funds' investment is included in the fund size number that is used to calculate the Placement Agent's fee. A Placement Agent also receives "Compensation" under this Policy if the Investment Manager increases the Placement Agent's flat fee with the understanding, or in part because, direct payment to the Placement Agent based on the NC Funds' investment would be barred under this Policy. "Compensate" means to provide Compensation.

B. "Compliance Counsel": An attorney designated by the Department's General Counsel.

C. "Conflict of Interest": Circumstances that create a material risk that professional judgment or actions regarding the transaction's recommendation, approval, or execution have been or will be unduly influenced by a direct or indirect personal interest.

D. “IMD Contractor or Consultant”: A natural person engaged by the Department (whether directly or indirectly through a staffing agency, limited liability entity, or other organization) to consult and advise IMD on potential investment opportunities; *provided, however*, that the term “IMD Contractor or Consultant” shall not include (i) State of North Carolina employees, (ii) the Treasurer or members of governing boards for NC Funds, and (iii) persons given authority or discretion by the Treasurer to make decisions, such as Investment Managers.

E. “Department of State Treasurer Senior Staff”: The Department’s Chief of Staff, Deputy Chief of Staff, General Counsel, attorneys in the General Counsel’s Office with responsibility for IMD, Director of Communications, and the Treasurer’s Executive Assistant.

F. “Investment Agreement”: The final written agreement or contract between the Treasurer and the Investment Manager with respect to an Investment Transaction.

G. “Immediate Family”: 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 (grandparents, etc.); and lineal descendants (grandchildren, etc.).

H. “Investment Manager”: A person or entity, other than Department employees, given authority or discretion by the Treasurer to make decisions concerning the investment of NC Funds, the investment management of NC Funds, or the transfer or transition of invested NC Funds. In the case where the Treasurer invests in a limited partnership, limited liability company, or other similar investment vehicle, “Investment Manager” shall mean solely the general partner, manager, or other similar managing entity. This Policy is intended to apply broadly to all of the types of investment partners with whom the NC Funds does business, including the general partners, investment managers and sponsors of hedge funds, private equity funds, limited liability entities, and real estate funds, as well as investment managers (whether through a separate account or commingled trust) retained pursuant to a contract.

I. “Investment Transaction”: A business undertaking agreed upon between the Treasurer and an Investment Manager to invest NC Funds, to commit to invest NC Funds, to manage invested NC Funds, or to transfer or transition invested NC Funds.

J. “Investment Management Division Senior Staff”: Asset Class Directors, the Chief Administrative Officer, the Risk Officer, and the Chief Investment Officer.

K. “Placement Agent”: Any person or entity that is directly or indirectly hired, used, engaged, retained, Compensated, or otherwise given anything having monetary value or benefit, tangible or intangible, by an Investment Manager to assist the Investment Manager in securing investment commitments or other ongoing investment management business from any of the NC Funds. For purposes of this Policy, the term “Placement Agent” includes, but is not limited to, all placement agents, lobbyists, solicitors, brokers, meeting arrangers, “cap intro” firms, finders, third-party marketers, or any other entities or persons engaged by an Investment Manager and/or its affiliates, directly or indirectly, for the purpose of marketing and/or securing investor commitments or other ongoing investment management business from any of the NC Funds. Notwithstanding the foregoing, the term “Placement Agent” shall include natural persons who are employees, officers, directors or partners of an Investment Manager (or its affiliate) only if they are subject to registration requirements with the Securities and Exchange Commission or the Financial Industry Regulatory Authority.

L. “Political Contribution”: Any “Contribution” as defined under the SEC Rule or any other political or campaign contribution under any applicable state or federal law, including, without limitations, any gift, reward, promise of future employment or reward, subscription, loan, advance,

deposit of money, or anything of value furnished for the purpose of influencing an election for a federal, state or local office, including any payments for debts incurred in such an election and transition or inaugural expenses incurred by a successful candidate for office.

M. “SEC Rule”: The Securities and Exchange Commission rule on Political Contributions by Certain Investment Advisers, 75 Fed. Reg. 41,017 (July 14, 2010), amending 17 C.F.R. §§ 275.204-2, 275.206(4)-3, and 275.206(4)-5. Upon any future amendment to the SEC Rule, this reference shall automatically update to include those amendments.

N. “Substantive Amendment”: An amendment to, or consent to amend, an Investment Agreement which modifies the term, increases the commitment of funds by the Treasurer, materially changes the Investment Manager’s fees or Compensation, or otherwise materially amends the economic terms of the agreement. For clarification, the following are not Substantive Amendments and do not require the submission of Disclosure Letters: (i) consents or elections that solely diminish the Investment Manager’s fees, Compensation, rights to distributions or other economic rights, but do not otherwise materially amend the economic terms of the agreement; and (ii) consents of advisory committees, unless they materially amend the economic terms of the agreement.

O. Definition Cross-References

“Department,” “IMD,” “NC Funds,” “Selection Policy,” and “Treasurer” are defined in Section I of this Policy. “Disclosure Letter,” “Investment Manager Disclosure Letter,” and “Placement Agent Disclosure Letter” are defined in Section III(A) of this Policy. “Violation of This Policy” is defined in Section IV(A) of this Policy. “Department-Affiliated Persons” is defined in Section VII(D) of this Policy. “First-Level Manager,” “Fund of Funds,” and “Second-Level Managers” are defined in Section X(B) of this Policy.

XII. Revision History and Effective Date

| Version/Revision | Date Approved | Description of Changes |
|------------------|-------------------|---|
| 1 | Sep. 29, 2009 | Original version |
| 1.1 | Oct. 19, 2009 | Clarifications to Policy; voluntary compliance requested from all existing investment managers |
| 1.2 | March 14, 2011 | Clarifications to Policy; new section on political contributions |
| 2 | Date listed below | Clarifications to Policy and form Disclosure Letter; Disclosure Letters now required from Placement Agents; prohibition on compensation of Placement Agent if Investment Manager recently managed NC Funds; new section on connections or relationships |

Original Policy Approved by State Treasurer Janet Cowell on September 29, 2009

This Version of Policy Approved by State Treasurer Janet Cowell on November 19, 2013

North Carolina Department of State Treasurer Placement Agent,
Political Contribution, and Connection Disclosure Policy

Form Disclosure Letter for Investment Managers

From: The Investment Manager listed below

To: The Treasurer of the State of North Carolina
325 North Salisbury Street
Raleigh, North Carolina 27603-1385

Re: Disclosure Letter pursuant to Placement Agent and Political Contribution Policy

Ladies and Gentlemen:

Under the Placement Agent, Political Contribution, and Connection Disclosure Policy (the “Policy”) adopted by the Treasurer of the State of North Carolina (the “Treasurer”), the Treasurer requires Investment Managers and Placement Agents to make disclosures at certain times specified by the Policy. Pursuant to and in accordance with the Policy, the undersigned Investment Manager hereby makes the following disclosures. Capitalized terms not otherwise defined in this Disclosure Letter have the same meanings as specified in the Policy.

1. Basic Information

| | |
|-----------------------------|--|
| Name of Investment Manager: | |
|-----------------------------|--|

This letter is submitted in connection with the below-listed Investment Transaction.

List below the name of the fund in which the Treasurer is investing. For investment management agreements, list the name of the separate account or the name of the investment strategy.

- This form is submitted in connection with an amendment to the Investment Agreement or a proposed consent to amend the Investment Agreement. *If this box is checked, provide responses on this form based on the amendment, not based on the original contract.*
- This form is an update to a previously submitted disclosure letter.

2. Disclosures and Representations Concerning Placement Agent

2.1. Use of Placement Agent

Check the appropriate box.

The Investment Manager (or any officer, partner, principal, or affiliate thereof) has elected to use or Compensate a Placement Agent to assist the Investment Manager in obtaining investments from, or business with, any of the NC Funds.

See the definition of “Placement Agent” in Section XI of the Policy. Please be aware that this definition includes (without limitation) not only persons who hold themselves out as “placement agents,” but also lobbyists, solicitors, brokers, meeting arrangers, or any other entities or persons engaged for the purpose of obtaining investments from NC Funds.

No Placement Agent has been, or will be, used or Compensated by the Investment Manager (or any officer, partner, principal, or affiliate thereof) to assist in obtaining investments from, or business with, any of the NC Funds. *If this box is checked, proceed to question 3.1.*

2.2. Representations

The Investment Manager hereby confirms and represents:

- a. The Placement Agent is registered with the Securities and Exchange Commission or the Financial Industry Regulatory Association;
- b. The individual officers, partners, principals, employees, or other representatives of the Placement Agent hold all required securities licenses;
- c. No placement fee has been, or will be, shared with any person or entity not so registered;
- d. The Placement Agent is in the habitual systematized business of acting as a Placement Agent;
- e. Other than as disclosed in this document, no Placement Agent is being, or will be, Compensated, directly or indirectly, to assist the Investment Manager in obtaining investments from, or business with, any of the NC Funds; and
- f. The Investment Manager, not the Treasurer or the NC Funds, shall bear the entire cost of all Placement Agent fees and expenses disclosed in this document.

2.3. Placement Agent Information

- a. The name of the Placement Agent is:

- b. Is the Placement Agent an affiliate or employee of the Investment Manager?
 Yes No

Note that the definition of “Placement Agent” includes not only third parties, but also employees or affiliates of an Investment Manager who were used or Compensated to assist in obtaining North Carolina business and who were subject to registration with the Securities and Exchange Commission or the Financial Industry Regulatory Association.

- c. The names of the Placement Agent personnel who have played a role in marketing or outreach for the Investment Transaction are:

- d. The following Placement Agent personnel will receive Compensation, directly or indirectly, as a result of the NC Funds’ investment in the Investment Transaction:

Note that throughout this Disclosure Letter, “Compensation” to a Placement Agent is deemed to include a flat fee, contingent fee, or any other form of tangible or intangible compensation or benefit. See the Policy’s definitions for further details.

- e. To the Investment Manager’s knowledge, the officers, partners, or principals of the Placement Agent, not listed above, are:

- f. **Attached** is a resume (or other summary) for each person listed above detailing the person’s education, work experience and professional designations.

- g. Are any persons listed above, or any other Placement Agent officers, partners, and/or principals, current or former (i) North Carolina State Treasurers; (ii) Investment Advisory Committee members; (iii) North Carolina Department of State Treasurer employees, contractors, or consultants; or (iv) members of the Immediate Family of persons listed in (i) to (iii) above?

- Yes No

If your answer is “Yes,” list the persons and identify whether those persons would receive a financial benefit from the Investment Transaction.

2.4. Recent Management of North Carolina Investments by Investment Manager

- The Investment Manager (or its affiliate) currently manages an NC Funds investment or has managed an NC Funds investment within the last two years. *If this box is checked, Department policy bars the Compensation of any third-party Placement Agent (in other words, a Placement Agent who is not an employee or affiliate of the Investment Manager) in connection with the Treasurer’s investment in the Investment Transaction.*
- The Investment Manager (or its affiliate) has not managed an NC Funds investment within the last two years.

2.5. Whether Placement Agent is Being Compensated

- The Placement Agent is not being Compensated, directly or indirectly, as a result of the Treasurer’s investment in the Investment Transaction. *If this box is checked, skip question 2.6.*
- The Placement Agent is being Compensated, directly or indirectly, as a result of the Treasurer’s investment in the Investment Transaction.

2.6. Terms of Placement Agent Compensation and Placement Agent Agreement

Check one of the three boxes below. You may attach additional pages.

- Attached are the provisions of the Investment Manager’s contract with the Placement Agent that describe the Placement Agent’s Compensation and services. These provisions describe any and all Compensation of any kind provided or agreed to be provided to the Placement Agent.
- The contract or arrangement between the Investment Manager and the Placement Agent is oral, not written. Below is a description of the terms of that oral contract that create an obligation to pay a fee to or for the benefit of any Placement Agent, including but not limited to a description of all terms concerning Compensation of any kind provided or agreed to be provided to any Placement Agent. This description includes the nature, timing and value of such Compensation.

- The Placement Agent is an employee of the Investment Manager. Below is a general disclosure providing the employee’s role and responsibilities and stating any known effect on the employee’s Compensation that is directly attributable to the NC Funds’ proposed investment.

2.7. Actions and Investigations Involving Placement Agent

Check one of the two boxes below.

- a. Has the Placement Agent (or any officer, partner, principal or affiliate thereof) been the subject of a non-routine inquiry, action, or investigation by a federal, state, or local government agency or regulatory body in the last ten (10) years?

Yes No

If your answer is "Yes," describe any such actions or investigations. Attach additional pages as necessary.

- b. To the Investment Manager's knowledge, does the Placement Agent (or any officer, partner, principal or affiliate thereof) anticipate being the subject of such inquiries, actions or investigations in the future?

Yes No

If your answer is "Yes," describe any such actions or investigations. Attach additional pages as necessary.

3. Connections or Relationships

3.1. Conflicts

- a. Are any personnel, officers, directors, partners and/or principals of the Investment Manager current North Carolina Department of State Treasurer employees, persons who serve as consultants or contractors for the Department's Investment Management Division, or Investment Advisory Committee members?

Yes No

If the answer is "Yes," enclose a statement providing further information.

- b. Will any current North Carolina Department of State Treasurer employees, persons who serve as consultants or contractors for the Department's Investment Management Division, or Investment Advisory Committee members receive a financial benefit to themselves or to a member of their Immediate Family derived from the Compensation provided to the Investment Manager or Placement Agent for the Investment Transaction?

Yes No

If the answer is "Yes," enclose a statement providing further information.

3.2. Recommendations of Placement Agent

a. Did a current or former Treasurer, Department of State Treasurer employee, Investment Management Division contractor or consultant, or member of the Investment Advisory Committee suggest to the Investment Manager that it retain the Placement Agent?

- Yes No

If your answer is "Yes," list the person who suggested retention of the Placement Agent.

b. To the Investment Manager’s knowledge, did a current or former Treasurer, Department of State Treasurer employee, Investment Management Division contractor or consultant, or member of the Investment Advisory Committee suggest to the Department’s investment staff that the Placement Agent be retained for the Investment Transaction?

- Yes No

If your answer is "Yes," list the person who suggested retention of the Placement Agent.

3.3. Family Relationships

Are any of the persons listed in box (1) a member of the Immediate Family of a person listed in box (2)?

| Box (1) | Box (2) |
|--|--|
| <ul style="list-style-type: none"> • The State Treasurer • Department of State Treasurer Senior Staff • Members of the Investment Advisory Committee • Investment Management Division Senior Staff • Investment Management Division staff who played a role in due diligence for the Investment Transaction | <ul style="list-style-type: none"> • A principal member of the project team for the Treasurer’s account at the Investment Manager • Any person associated with the Placement Agent listed in the responses to Question 2.3 |

- Yes No

If your answer is "Yes," list the persons and describe the relationship.

The following questions ask about past or present connections, friendships, or relationships that may exist between the Treasurer’s staff and the Investment Manager’s staff. Some types of connections or relationships are the ordinary result of doing business. The Treasurer’s Compliance Counsel will evaluate this form to determine whether recusal, additional due diligence, or other actions are required.

3.4. Former Department Personnel or Officials

Are any Investment Manager personnel former North Carolina Department of State Treasurer employees or contractors, North Carolina State Treasurers, or Investment Advisory Committee members?

- Yes No

If your answer is “Yes,” list the persons and identify whether those persons would receive a financial benefit from the Investment Transaction.

3.5. Prior Working Relationships

List below any professional or working relationships that the Investment Manager’s project team for the Treasurer’s account have had in the past with persons who are now Investment Management Division personnel, Investment Management Division consultants or contractors, the State Treasurer, or Department of State Treasurer Senior Staff.

Please list in this section any occasions where persons worked together on the same projects at the same company, at the same fund, or as part of a client-consultant relationship. You need not list prior occasions in which the Investment Manager did business for the Department of State Treasurer.

3.6. Social Connections

List below any social connections or relationships between the Investment Manager’s project team for the Treasurer’s account and Investment Management Division personnel, Investment Management Division consultants or contractors, the State Treasurer, or Department of State Treasurer Senior Staff.

Please list in this section any pre-existing relationships involving social contacts outside of business.

4. Lobbying Information

Check one of the two boxes below.

The Investment Manager (and/or any officer, employee, partner, principal or affiliate thereof) is registered as a lobbyist with a state government. If this box is checked, the following are the names and positions of such persons and the registrations held (attach additional pages as necessary):

Neither the Investment Manager nor any officer, employee, partner, principal or affiliate thereof is registered as a lobbyist with any state government.

5. Political Contributions

5.1. Representation

The Investment Manager hereby confirms and represents that none of the Investment Manager and its respective officers, partners, principals or affiliates has made, coordinated or solicited any Political Contribution to the Treasurer or any incumbent, nominee, candidate or successful candidate for such elective office (i) in violation of applicable state or federal law or (ii) in a

manner that would make it unlawful, under the SEC Rule, for the Investment Manager (or its affiliate) to seek compensation for services to the Treasurer and/or the NC Funds.

5.2. Disclosure

During the last five years from the date of this letter, have the Investment Manager or its respective officers, partners, principals or affiliates made, coordinated, or solicited any Political Contributions for the campaign of (a) any incumbent, nominee, or candidate for North Carolina State Treasurer or (b) for the campaign of the current State Treasurer running for a different office?

Yes No

If your answer is "Yes," list applicable Political Contributions below.

| Date | Person or company making, coordinating, or soliciting | Person or entity receiving | Amount |
|------|---|----------------------------|--------|
| | | | |

[Signature Page Follows]

6. Signature

By signing below, the Investment Manager hereby (i) represents and warrants that the information found in this Disclosure Letter is true, correct, and complete in all material respects, and (ii) agrees that it shall provide the Treasurer with a written update of any material changes to any of the information in this Disclosure Letter within fourteen (14) days from the date the Investment Manager knew or should have known of the change of information.

Sincerely,

on behalf of the Investment Manager listed above

By: _____
 (print name)

Title: _____

Date: _____

North Carolina Department of State Treasurer Placement Agent,
Political Contribution, and Connection Disclosure Policy

Form Disclosure Letter for Placement Agents

From: The Placement Agent listed below

To: The Treasurer of the State of North Carolina
325 North Salisbury Street
Raleigh, North Carolina 27603-1385

Re: Disclosure Letter pursuant to Placement Agent and Political Contribution Policy

Ladies and Gentlemen:

Under the Placement Agent, Political Contribution, and Connection Disclosure Policy (the “Policy”) adopted by the Treasurer of the State of North Carolina (the “Treasurer”), the Treasurer requires Investment Managers and Placement Agents to make disclosures at certain times specified by the Policy. Pursuant to and in accordance with the Policy, the undersigned Placement Agent hereby makes the following disclosures. Capitalized terms not otherwise defined in this Disclosure Letter have the same meanings as specified in the Policy.

1. Basic Information

| | |
|-----------------------------|--|
| Name of Investment Manager: | |
|-----------------------------|--|

This letter is submitted in connection with the below-listed Investment Transaction.

List below the name of the fund in which the Treasurer is investing. For investment management agreements, list the name of the separate account or the name of the investment strategy.

- This form is submitted in connection with an amendment to the Investment Agreement or a proposed consent to amend the Investment Agreement. *If this box is checked, provide responses on this form based on the amendment, not based on the original contract.*
- This form is an update to a previously submitted disclosure letter.

2. Disclosures and Representations Concerning Placement Agent

2.1. Use of Placement Agent

The below-signed person or entity confirms that it is serving as a Placement Agent for the Investment Transaction listed above.

2.2. Representations

The Placement Agent hereby confirms and represents:

- a. The Placement Agent is registered with the Securities and Exchange Commission or the Financial Industry Regulatory Association;
- b. The individual officers, partners, principals, employees, or other representatives of the Placement Agent hold all required securities licenses; and
- c. The Placement Agent is in the habitual systematized business of acting as a Placement Agent.

The Placement Agent hereby confirms and represents, to the best of its knowledge:

- d. No placement fee has been, or will be, shared with any person or entity not so registered;
- e. Other than as disclosed in this document, no Placement Agent is being, or will be, compensated, directly or indirectly, to assist the Investment Manager in obtaining investments from, or business with, any of the NC Funds; and
- f. The Investment Manager, not the Treasurer or the NC Funds, shall bear the entire cost of all Placement Agent fees and expenses disclosed in this document.

2.3. Placement Agent Information

- a. The name of the Placement Agent is:

| |
|--|
| |
|--|

- b. Is the Placement Agent an affiliate or employee of the Investment Manager?

Yes No

Note that the definition of "Placement Agent" includes not only third parties, but also employees or affiliates of an Investment Manager who were used or compensated to assist in obtaining North Carolina business and who were subject to registration with the Securities and Exchange Commission or the Financial Industry Regulatory Association.

- c. The names of the Placement Agent personnel who have played a role in marketing or outreach for the Investment Transaction are:

- d. The following Placement Agent personnel will receive Compensation, directly or indirectly, as a result of the NC Funds' investment in the Investment Transaction:

Note that throughout this Disclosure Letter, "Compensation" to a Placement Agent is deemed to include a flat fee, contingent fee, or any other form of tangible or intangible compensation or benefit. See the Policy's definitions for further details.

- e. The officers, partners, or principals of the Placement Agent, not listed above, are:

- f. **Attached** is a resume (or other summary) for each person listed above detailing the person's education, work experience and professional designations.

- g. Are any persons listed above, or any other Placement Agent officers, partners, and/or principals, current or former (i) North Carolina State Treasurers; (ii) Investment Advisory Committee members; (iii) North Carolina Department of State Treasurer employees, contractors, or consultants; or (iv) members of the Immediate Family of persons listed in (i) to (iii) above?

Yes No

If your answer is "Yes," list the persons and identify whether those persons would receive a financial benefit from the Investment Transaction.

2.4. Recent Management of North Carolina Investments by Investment Manager

- To the Placement Agent’s knowledge, the Investment Manager (or its affiliate) currently manages an NC Funds investment or has managed an NC Funds investment within the last two years. *If this box is checked, Department policy bars the Compensation of any third-party Placement Agent (in other words, a Placement Agent who is not an employee or affiliate of the Investment Manager) in connection with the Treasurer’s investment in the Investment Transaction.*
- To the Placement Agent’s knowledge, the Investment Manager (or its affiliate) has not managed an NC Funds investment within the last two years.

2.5. Whether Placement Agent is Being Compensated

- The Placement Agent is not being Compensated, directly or indirectly, as a result of the Treasurer’s investment in the Investment Transaction. *If this box is checked, skip question 2.6.*
- The Placement Agent is being Compensated, directly or indirectly, as a result of the Treasurer’s investment in the Investment Transaction.

2.6. Terms of Placement Agent Compensation and Placement Agent Agreement

Check one of the three boxes below. You may attach additional pages.

- Attached are the provisions of the Investment Manager’s contract with the Placement Agent that describe the Placement Agent’s Compensation and services. These provisions describe any and all Compensation of any kind provided or agreed to be provided to the Placement Agent.
- The contract or arrangement between the Investment Manager and the Placement Agent is oral, not written. Below is a description of the terms of that oral contract that create an obligation to pay a fee to or for the benefit of any Placement Agent, including but not limited to a description of all terms concerning Compensation of any kind provided or agreed to be provided to any Placement Agent. This description includes the nature, timing and value of such Compensation.

- The Placement Agent is an employee of the Investment Manager. Below is a general disclosure providing the employee’s role and responsibilities and stating any known effect on the employee’s Compensation that is directly attributable to the NC Funds’ proposed investment.

2.7. Actions and Investigations Involving Placement Agent

Check one of the two boxes below.

- a. Has the Placement Agent (or any officer, partner, principal or affiliate thereof) been the subject of a non-routine inquiry, action, or investigation by a federal, state, or local government agency or regulatory body in the last ten (10) years?

Yes No

If your answer is "Yes," describe any such actions or investigations. Attach additional pages as necessary.

- b. Does the Placement Agent (or any officer, partner, principal or affiliate thereof) anticipate being the subject of such inquiries, actions or investigations in the future?

Yes No

If your answer is "Yes," describe any such actions or investigations. Attach additional pages as necessary.

2.8. Registration of Placement Agent and Licensing of Placement Agent Representatives

- a. The Placement Agent's registration details are as follows:

- b. For each individual officer, partner, principal, employee and other representative of the Placement Agent, the registrations, number of years of employment by the Placement Agent and the number of years of experience directly related to such business are as follows (attach additional pages as necessary):

3. Connections or Relationships

3.1. Conflicts

- a. Are any personnel, officers, directors, partners and/or principals of the Placement Agent current North Carolina Department of State Treasurer employees, persons who serve as consultants or contractors for the Department’s Investment Management Division, or Investment Advisory Committee members?

Yes No

If the answer is “Yes,” enclose a statement providing further information.

- b. Will any current North Carolina Department of State Treasurer employees, persons who serve as consultants or contractors for the Department’s Investment Management Division, or Investment Advisory Committee members receive a financial benefit to themselves or to a member of their Immediate Family derived from the Compensation provided to the Placement Agent for the Investment Transaction?

Yes No

If the answer is “Yes,” enclose a statement providing further information.

3.2. Recommendations of Placement Agent

- a. To the Placement Agent’s knowledge, did a current or former Treasurer, Department of State Treasurer employee, Investment Management Division contractor or consultant, or member of the Investment Advisory Committee suggest to the Investment Manager that it retain the Placement Agent?

Yes No

If your answer is “Yes,” list the person who suggested retention of the Placement Agent.

- b. To the Placement Agent’s knowledge, did a current or former Treasurer, Department of State Treasurer employee, Investment Management Division contractor or consultant, or member of the Investment Advisory Committee suggest to the Department’s investment staff that the Placement Agent be retained for the Investment Transaction?

Yes No

If your answer is “Yes,” list the person who suggested retention of the Placement Agent.

3.3. Family Relationships

Are any of the persons listed in box (1) a member of the Immediate Family of a person listed in box (2)?

| Box (1) | Box (2) |
|--|--|
| <ul style="list-style-type: none"> • The State Treasurer • Department of State Treasurer Senior Staff • Members of the Investment Advisory Committee • Investment Management Division Senior Staff • Investment Management Division staff who played a role in due diligence for the Investment Transaction | <ul style="list-style-type: none"> • Any person associated with the Placement Agent listed in the responses to Question 2.3 |

Yes No

If your answer is “Yes,” list the persons and describe the relationship.

The following questions ask about past or present connections, friendships, or relationships that may exist between the Treasurer’s staff and the staff of any Placement Agent. Some types of connections or relationships are the ordinary result of doing business. The Treasurer’s Compliance Counsel will evaluate this form to determine whether recusal, additional due diligence, or other actions are required.

3.4. Former Department Personnel or Officials

Are any Placement Agent personnel former North Carolina Department of State Treasurer employees or contractors, North Carolina State Treasurers, or Investment Advisory Committee members?

Yes No

If your answer is “Yes,” list the persons and identify whether those persons would receive a financial benefit from the Investment Transaction.

3.5. Prior Working Relationships

List below any professional or working relationships that Placement Agent personnel listed in the responses to Questions 2.3(c) or (d) have had in the past with persons who are now Investment Management Division personnel, Investment Management Division consultants or contractors, the State Treasurer, or Department of State Treasurer Senior Staff.

Please list in this section any occasions where persons worked together on the same projects at the same company, at the same fund, or as part of a client-consultant relationship. You need not list prior occasions in which an Investment Manager utilized the Placement Agent to market a potential investment to the Department of State Treasurer.

3.6. Social Connections

List below any social connections or relationships between Placement Agent personnel listed in the responses to Questions 2.3(c)-(d) and Investment Management Division personnel, Investment Management Division consultants or contractors, the State Treasurer, or Department of State Treasurer Senior Staff.

Please list in this section any pre-existing relationships involving social contacts outside of business.

4. Lobbying Information

Check one of the two boxes below.

The Placement Agent (and/or any officer, employee, partner, principal or affiliate thereof) is registered as a lobbyist with a state government. If this box is checked, the following are the names and positions of such persons and the registrations held (attach additional pages as necessary):

| |
|--|
| |
|--|

Neither the Placement Agent nor any officer, employee, partner, principal or affiliate thereof is registered as a lobbyist with any state government.

5. Political Contributions

5.1. Representation

The Placement Agent hereby confirms and represents that none of the Placement Agent and its respective officers, partners, principals or affiliates has made, coordinated or solicited any Political Contribution to the Treasurer or any incumbent, nominee, candidate or successful candidate for such elective office (i) in violation of applicable state or federal law or (ii) in a manner that would make it unlawful, under the SEC Rule, for the Investment Manager (or its affiliate) to seek compensation for services to the Treasurer and/or the NC Funds.

5.2. Disclosure

During the last five years from the date of this letter, have the Placement Agent or its respective officers, partners, principals or affiliates made, coordinated, or solicited any Political Contributions for the campaign of (a) any incumbent, nominee, or candidate for North Carolina State Treasurer or (b) for the campaign of the current State Treasurer running for a different office?

Yes No

If your answer is "Yes," list applicable Political Contributions below.

| Date | Person or company making, coordinating, or soliciting | Person or entity receiving | Amount |
|------|---|----------------------------|--------|
| | | | |

[Signature Page Follows]

6. Signature

I declare under penalty of perjury that the foregoing is true and correct. I shall provide the Treasurer with a written update of any material changes to any of the information in this Disclosure Letter within fourteen (14) days from the date I knew or should have known of the change of information.

Sincerely,

_____,
on behalf of the Placement Agent listed above

By: _____
(print name)

Title: _____

Date: _____

NORTH CAROLINA DEPARTMENT OF STATE TREASURER INVESTMENT MANAGEMENT DIVISION

Code of Ethics and Conduct

- I. Employees of the Department of State Treasurer, Investment Management Division (“IMD”) hold a public trust that obligates them to endeavor to act consistent with certain principles described within this Code of Ethics and Conduct (the “Code”). As an employee, I shall:
- Be familiar with and comply with applicable policies and state and federal laws and shall not knowingly be a party to, or condone, any illegal or improper activity.
 - Agree that the following policies specifically contain ethical conduct requirements and are incorporated into this document by reference:
 - [State Government Ethics Act](#) (N.C.G.S. § 138A)
 - [Prohibition of Gifts to State Employees Policy](#)
 - [Supplemental Ethics Policy for State Treasurer, Senior Executive Staff and Investment Division](#)
 - [Charitable Donations Policy](#)
 - [Insider and Personal Trading Policy](#)
 - [Placement Agent, Political Contribution, and Connection Disclosure Policy](#)
 - [Use of State Property Policy](#)¹
 - Act with integrity, competence, diligence, respect, and in an ethical manner in dealings with the beneficiaries and stakeholders defined by applicable statutes, and in dealings with other participants in the global capital markets.
 - Owe a duty of loyalty to beneficiaries and act for their exclusive benefit.
 - Exercise prudence consistent with the Treasurer’s fiduciary duties under G.S. Section 147-69.7 and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other related activities.
 - Have an affirmative duty to proactively identify and promptly disclose to the Compliance Counsel any personal, social, employment or business activities and relationships that:
 - impact my objectivity
 - create potential Conflicts of Interest²
 - impair my ability to make impartial decisions
 - otherwise interfere with my proper performance of official duties

¹ For easy reference to each of these policies, you may click on the hyperlinks in the electronic version of this file.

² A Conflict of Interest is defined as circumstances that create a material risk that professional judgment or actions regarding a transaction’s recommendation, approval, or execution have been or will be unduly influenced by a direct or indirect personal interest.

- Use care and discretion in the handling of confidential information and not disclose or use such information for personal gain or private advantage.
- Not falsify or fail to record proper entries on any books or records, electronic or otherwise, or knowingly sign or permit the issuance of any statement or report which contains any misstatement or which omits any material fact necessary to make any statement made therein not misleading.
- Abide by the approved practices and recommended standards of professional associations and standard setting organizations of which I am a member (e.g., CFA Institute, AICPA, etc.), to the extent they do not conflict with the requirements of this Code, other policies, or law.
- Have an affirmative duty to immediately report directly to the Compliance Counsel any actual or suspected:
 - employee or contractual party fraud or misconduct
 - employee or contractual party material error that adversely affects IMD or client assets or interests
 - misrepresentation or omission of material information in internal or external reporting and client communications
 - violations of laws, rules, or IMD policies

I agree that the Compliance Counsel shall investigate any such report upon first being made aware of the alleged fraud, misconduct, misrepresentation, error or omission under this provision. The Compliance Counsel will advise the General Counsel and IMD management as appropriate.

- II. I have read the Code and understand that I will be annually required to attest to my compliance with the Code, voluntarily disclose any potential lack of compliance with the Code, and recertify my acceptance of the Code. I further understand that violating this code or failing to annually attest to my compliance with this Code may be grounds for immediate disciplinary action, up to and including dismissal.
- III. I have been in compliance with the Code for the previous 12 months.

Name/Date

- IV. I hereby acknowledge that I have read the Code and that I understand it and shall comply with its terms.

Name/Date

NORTH CAROLINA DEPARTMENT OF STATE TREASURER INVESTMENT MANAGEMENT DIVISION

External Investment Manager and Vehicle Selection Policy and Procedures

I. Background

The North Carolina Retirement Systems include the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, the North Carolina National Guard Pension Fund, and the Retiree Health Benefit Fund (collectively, the "Retirement Systems" or the "NCRS"). The Treasurer of the State of North Carolina ("Treasurer") maintains the investment program for the Retirement Systems (the "Fund" or "Pension Fund Program"). The Investment Management Division (the "IMD") of the North Carolina Department of State Treasurer (the "DST") serves as the investment arm of the State Treasurer. Under the direction of the Treasurer, IMD manages the Fund and other investments.

For a variety of reasons, IMD periodically recommends hiring external investment managers and adding to its portfolios new commitments to private market investment vehicles permitted by statute.¹ This policy sets forth the process that IMD will follow when hiring new external investment managers or making a new commitment to any of the aforementioned entities for the NCRS or another IMD managed fund. This policy does not apply to internally managed portfolios, individual co-investments periodically presented to staff, or managers, funds or other vehicles that receive allocations within a fund-of-fund vehicle.² On a case-by-case basis, the Chief Investment Officer may authorize procedures that deviate from this policy, but IMD shall note any material deviation from this policy in the contract recommendation memorandum provided to the Treasurer.

II. Policy Statement

The selection of a new portfolio commitment shall be carried out:

1. In accordance with investment objectives, fiduciary standards, and approved procedures and criteria as set out in the *Investment Policy Statement for North Carolina Retirement Systems* and other applicable policies and statutes
2. With a predominant reliance on asset class Director and third party experts' comparative evaluation of opportunities within a defined due diligence process
3. In a fair and consistent manner with a structured external communication protocol designed to

¹ The term "External Investment Manager" means any of the following: investment managers for separate or commingled accounts, investment advisors to private market vehicles (e.g., private equity, real estate, hedge funds, etc.), general partners or managing members of private market investments, or the funds, limited liability vehicles (separate or commingled), fund-of-funds, and other vehicles to which the IMD may commit capital. The term "External Investment Manager" also includes such organizations' wholly-owned affiliates and any entities controlled by or under common control with the External Investment Manager.

² Staff directed rebalancing between direct fund investments or incremental funding to such vehicles will be evaluated on a case-by-case basis by the Chief Investment Officer to determine what updated due diligence and recommendation memorandum are required.

facilitate transparency and efficiency of process for IMD and external parties

III. Identifying Investment Opportunities

IMD will typically utilize either a “Request for Information Search” or a “Work Plan and Opportunistic Search” to identify investment opportunities and ultimately recommend investment managers, advisors, fund-of-fund managers, separate account or commingled limited liability vehicles, and other investment vehicles permitted by statute. While IMD will be neutral regarding the sourcing or identification of investment opportunities, both approaches defined below are designed to focus scarce IMD resources on the highest potential value-added investment opportunities and relationships given IMD’s evolving portfolio needs. To that end, every effort should be made to promptly refer investment opportunities to Directors for inclusion in one of the processes described below.

A. Request for Information Searches

It is the responsibility of the Director³ of the applicable asset class or individual mandate to develop and propose the:

1. Rationale for conducting a search
2. Role of staff and any consultant in that search
3. Search criteria that define broad parameters that ultimately determine the universe of eligible investment managers, funds, etc.

Once the foregoing three items are approved by the Chief Investment Officer, the Director will use the following process:

1. **First-Level Screen.** Consultant and third-party databases, peer information, and internal files will be screened to identify a universe of managers that meet the specific investment criteria. A short-form questionnaire may be sent. The purpose of these initial steps are to eliminate managers early in the process that would not be seriously considered due to size, experience, or focus, then prioritize attractive candidates. The Director will approve a list of managers to be sent Requests for Information (typically 3 or more managers).
2. **Requests for Information (RFI).** Managers remaining under consideration will be requested to provide comprehensive information regarding performance, portfolio composition, personnel, organizational history and structure, proposed fees, and any other information deemed necessary to make an informed decision.
3. **Additional Screen after Requests for Information.** After receipt of the remaining managers’ responses, the Director will evaluate risk-adjusted investment performance, investment processes and organizational issues to identify the target firms that will be interviewed for the assignment.
4. **Preliminary Conference Call.** The Director will coordinate with the target firms and IMD representatives to discuss preliminary issues involving the investment, including administrative details, operational concerns, risk and compliance issues, potential conflicts of interest, and

³ For convenience, the term “Director” is used to mean both the Director and all staff within their span of control. It is understood that the Directors’ responsibilities described in this policy will be carried out with active participation of the asset class staff.

manager's willingness to accept NCRS preferred terms. Informal reference calls to peers and industry contacts may be made. Additional managers may be eliminated as a result of these discussions.

5. **Manager Interviews.** The Director will develop and distribute interview materials and schedule interviews with the finalists. The Director should invite the Chief Investment Officer, IMD risk and operations personnel, and the Director of Risk Management & Asset Allocation. Other DST personnel may also attend interviews. Additional cuts may be made as a result of these interviews.

The remainder of the investment manager diligence, recommendation, negotiation, and approval process is described starting in Section IV below.

B. Work Plan and Opportunistic Searches

The intent of Work Plan and Opportunistic Searches is to utilize a prudent process to maximize long-term access to attractive risk-adjusted investment opportunities through use of business partners. Desirable characteristics of such business partners include:

1. Financial, operational, and investment expertise and resources
2. Alignment of interests
3. Transparency and repeatability of investment process
4. Controls on leverage

Work Plan and Opportunistic Searches are typically used for Private Equity, Credit, Inflation Protection, and Real Estate asset classes and direct hedged equity or opportunistic investment grade strategies. In each of these areas, the limited window of opportunity to commit capital in certain vehicles and strategies calls for a blend of proactive and opportunistic approaches. Non-marketable and marketable alternative strategies typically will be structured as limited partnerships with very specific offering periods that cycle on average every 4-6 years. Hedge funds may have periodic openings and closings to new investors. On the opportunistic front, strategies that intend to exploit capital market dislocations due to supply/demand imbalances, regulatory changes, or other events can be transitory in nature. Finally, IMD periodically approaches best-in-class managers to execute a targeted strategy customized to the NCRS portfolio structure.

Phase I - Annual Portfolio Evaluation

Each year, Directors will produce an Annual Investment Work Plan for each asset class. Portfolio and market analysis, cash flow forecasting, availabilities of various vehicles and targeted asset class allocation will be considered to determine the annual capital commitment pace and other fundings for the asset class, although market opportunities will play an important role in determining interim allocations. The Annual Investment Work Plans will be submitted to the Chief Investment Officer for concurrence, then the Treasurer for approval.

Phase II - Fund Sourcing

Directors will proactively identify a broad universe of relevant offerings in the market from consultants, other investors, and direct outreach from general partners or their placement agents. Directors will

proactively build strong relationships and communicate with market participants to access competitive/oversubscribed/soft-closed vehicles that may not be widely marketed or open for only limited periods of time.

In order to effectively track the various opportunities in the market, Directors will maintain a database of potential investment vehicles. This “Opportunity Database” will provide summary descriptive information about each investment opportunity and be used at regular internal asset class staff meetings as the basis for screening the various vehicles. The following procedures shall be used:

1. When staff identifies a viable investment opportunity, the contact and source of the contact will be logged into the Opportunity Database (e.g., CRM).
2. As additional contacts are made concerning the investment opportunity, staff will log each such contact into the Opportunity Database entry for that potential investment.
3. The Opportunity Database should be updated as offering memoranda and other materials are received and reviewed by staff.

Phase III- Preliminary Fund Screen

Directors must choose from the potential opportunities in the Opportunity Database to identify the most attractive offerings and determining where due diligence resources will be deployed. Directors will choose based on various considerations, including but not limited to:

1. The fit within the Annual Investment Work Plan, overall portfolio construction, market opportunity, statutory classifications and limits, and competing offerings
2. IMD’s history with the firm
3. Prior funds or related investments performance, including co-investments and secondary investments
4. Research by consultants and other third parties on the offering
5. Professional judgment of IMD staff
6. Risk and operational considerations
7. Alignment and conflict of interest considerations
8. Willingness to accept NCRS preferred terms and ability to meet closing requirements

IV. Intensive Due Diligence

Upon selecting the most attractive investment opportunities under the processes identified in the Request for Information Searches (i.e., finalists) or Work Plan and Opportunistic Searches (i.e., opportunities from the Opportunity Database), Directors will conduct an intensive due diligence process for each investment opportunity, with the potential assistance of consultants and third-party research providers. The result of the process may be the recommendation to commit/invest capital in the offerings that are deemed most attractive by the Director.

The intensive due diligence process will include, but not be limited to:

1. Review of the Private Placement Memorandum and other related materials
2. Quantitative analysis of performance, fees, and incentives
3. Assessment of offering versus comparable or competing alternative offerings reasonably available in the market

4. Manager presentations to and/or onsite visit(s) to manager's office(s) by staff, Treasurer, and/or consultant
5. Reference checks with other investors, limited partners, consultants, and other industry contacts
6. Review of risk and operational considerations (identified by staff or consultant)
7. Review of alignment and conflict of interest considerations
8. Collection of the disclosure forms required by the Placement Agent Policy (To facilitate early collection of information and identification of potential issues, staff may ask investment managers and placement agents to submit these forms during the due diligence process as an unsigned draft. The final signed form will be due on the date specified in the Placement Agent Policy.)
9. Assessment of willingness to accept NCRS preferred terms and ability to meet closing requirements

At any point in the intensive due diligence process and during each of the following Sections, a Director, the Chief Investment Officer, or Treasurer may choose to reject the offering or table it for future consideration.

V. Forward Calendar and Coordination with Investment Committee

Directors are responsible for working proactively with the Chief Administrative Officer to help maintain an updated, consolidated, and accurate “Forward Calendar” for purposes of the IMD Investment Committee’s oversight of investment manager and vehicle selection. The Forward Calendar will contain the managers and/or vehicles that are deemed the most attractive by the Directors after screening available and potentially viable investment opportunities and, at a minimum, will include any that are the subject of Intensive Due Diligence.

Further, upon placing an entity on the Forward Calendar, Directors are responsible for closely and proactively coordinating with the Director of Risk Management and Asset Allocation, legal counsel, the Compliance Counsel, and the Chief Administrative Officer to manage obtaining materials and contacts at the entities in the event that an Investment Recommendation Memo is being drafted (see next section).

VI. Investment Recommendation Memorandum

Upon completing the intensive due diligence process, Directors shall prepare an Investment Recommendation Memo to the Chief Investment Officer in order to pursue the commitment of capital or other investment. This recommendation will include a “SWOT” analysis (i.e., Strengths, Weaknesses, Opportunities, Threats) considering fit within portfolio construction and statutory qualifications, background on the general partner/investment firm, historical returns, investment merits and risks, competitive analysis versus comparable or competing alternative offerings, operational assessment, liquidity provisions, expected contract terms and other relevant information. Consultants’ analysis and third-party research may be relied on to support the recommendation, if reasonable under the circumstances.

Documents to be requested prior to completion of the Investment Recommendation Memo include:

1. Disclosure forms required by Placement Agent Policy
2. Conflict of Interest Certification (*attached as Appendix 1*)

3. Code of Ethics
4. Compliance Manual Table of Contents
5. Organizational Chart
6. Valuation Policy
7. SSAE 16 Certification
8. Insurance Coverage
9. ADV Part I and II
10. Form 8 (Foreign) or Form 9 (U.S.)
11. Audited Financial Statements

The Investment Recommendation Memorandum will also include a statement by the Director, as required by the Placement Agent Policy, listing (1) the person or persons, if any, who initially suggested the investment opportunity to IMD and (2) any persons who appeared before IMD in the marketing or due diligence process on behalf of the proposed External Investment Manager and who were not employees of the proposed External Investment Manager or one of its affiliates. Investor and industry reference calls initiated by Directors may be described generically and without specific identifying information. The Investment Recommendation Memo will be provided for the concurrence of the Chief Investment Officer, through the Director of Risk Management and Asset Allocation and Compliance Counsel, and will be accompanied by:

1. Risk and operational due diligence reviews (by staff or consultant)
2. All Disclosure forms required by the Placement Agent Policy
3. Compliance and conflict of interest certification forms signed by Treasurer, IMD staff, consultant (as applicable), subject investment entity, and any related entities that participated in the process (as applicable)⁴

VII. Independent Review by Compliance Counsel

The Compliance Counsel will make an independent review of the Placement Agent Policy disclosure form, the Investment Recommendation Memorandum, and the supporting documents to the Investment Recommendation Memorandum listed above. Directors should ensure that these documents are provided to the Compliance Counsel as soon as possible. Placement Agent Policy disclosure letters shall be provided to the Compliance Counsel at least one month before the anticipated closing of the transaction. Based on these documents, the Compliance Counsel will complete a signed Compliance Review Form that includes the following:

1. The Compliance Counsel's approval of the disclosure forms under the Placement Agent Policy with respect to responsiveness and completeness
2. The Compliance Counsel's report concerning any aspect of the transaction's recommendation, negotiation, or approval that, in the view of the Compliance Counsel, may reasonably violate any law, regulation, or Department policy
3. The Compliance Counsel's report concerning any aspect of the transaction's recommendation, negotiation, or approval that, in the view of the Compliance Counsel, raises significant reputational risk concerns related to conflicts of interest; i.e., whether circumstances in fact exist that create a material risk that professional judgment or actions regarding the transaction's

⁴ External counsel conflict checks, and any required waivers granted, will be coordinated by General Counsel's Office.

recommendation, approval, or execution have been or will be unduly influenced by a direct or indirect personal interest⁵

Should the Compliance Counsel determine that the test stated by item (1) above is not met, he or she shall contact the External Investment Manager or Department staff to seek correction of the disclosure forms. Should the Compliance Counsel determine that the test stated by items (2) or (3) may not be met, the Compliance Counsel will promptly notify the Chief Investment Officer and General Counsel. The Chief Investment Officer has the authority to reject the offering or refer it to the Investment Committee to consider input from the Compliance Counsel and legal counsel on the materiality of the risk and recommended approaches to remediate the risk: recusal, third-party due diligence, etc.

The Compliance Counsel will forward the completed Compliance Review Form to the Chief Investment Officer.

If necessary because of a condensed time frame for the transaction, the following steps may take place simultaneously with the review of the transaction by the Compliance Counsel. However, the transaction **may not** be submitted to the Treasurer for execution without an Investment Memorandum and its attachment reviewed by the Chief Investment Officer (or delegate), conflict of interest certifications, and a final, signed Compliance Review Form based on review of the complete and finalized record by the Compliance Counsel.

VIII. Conditional Approval

The Chief Investment Officer is responsible for evaluating the Director's recommendation(s) including giving due consideration to input as received from the Investment Committee from time-to-time. The Chief Investment Officer may reject the recommendation, request changes or provide other feedback to the Director, or forward the recommendation to the Treasurer to receive conditional approval of the transaction. Unless otherwise expressly approved in writing by the Chief Investment Officer, conditional approval must be obtained before initiating the negotiation and contracting process described below. The Chief Investment Officer will regularly update the Treasurer on the Forward Calendar, including the status of pending and conditionally approved recommendations.

IX. Negotiations and Contracting

Upon approval of the recommendation, the Director and external legal counsel will negotiate contractual documents with the selected entity, with the Chief Investment Officer, DST in-house legal counsel, and the Compliance Counsel involved to the extent necessary.

X. Final Approval

The Chief Investment Officer will provide to the Treasurer each of the following:

1. The final contractual documents, ready for execution
2. Memo from external legal counsel concerning the final contractual documents, comparing actual terms to the NCRS preferred terms and addressing other items that were subject to

⁵ See Footnote 4.

- material negotiations
- 3. The final Investment Recommendation Memorandum
- 4. The final Compliance Review Form signed by the Compliance Counsel
- 5. Compliance and conflict of interest certification forms (*attached as Appendix 1*) signed by the relevant Director, the Compliance Counsel, the Chief Investment Officer, and the Treasurer

The Treasurer shall then execute the documents or reject the transaction.

XI. External Communication Protocol

This portion of the policy specifically applies the principles of DST's *No Contact Policy* to communications between DST and investment managers concerning potential new commitments or new relationships. In the event of any perceived conflict between this policy and the *No Contact Policy*, the more detailed text in this policy will govern the issue.

Except where necessary, IMD staff, the CIO, and the Treasurer shall not use personal e-mail addresses to communicate with fund managers or placement agents regarding state business related to the investment of funds. Personal e-mail addresses may be used only if the DST e-mail system is not functioning, the DST e-mail system is not available to the staff member, or an e-mail must be sent with an attachment which is too large for the DST e-mail system to transmit. Any DST documents sent using a personal e-mail account must be promptly copied by IMD staff onto the IMD shared drive.

Once either an investment opportunity has been referred to a Director *and* the Director has provided notice of this fact to the investment manager, or a Request For Information Search has been announced, the following procedures apply:

1. The Director (or designee) will be the point of contact for all communication with representatives of the investment manager. Communication between the Director and the investment manager's employees or registered placement agent is not limited under DST policy.
2. Participation by various IMD staff and the Treasurer in investment managers' presentations scheduled by the applicable Director will occur in the normal course of the diligence activities described in this policy.
3. The investment manager and its placement agent should not contact other DST staff, the Treasurer, or Investment Advisory Committee members regarding the merits of the investment manager, regarding whether IMD should retain the manager, or regarding whether IMD should make the investment commitment. Any such contact may be cause for rejection in the sole discretion of the Treasurer.
4. The investment manager may continue to contact DST, as normal, concerning other funds and day-to-day business interaction. Interactions at social events also are not prohibited. In either case, the topic of the potential new investment should not be discussed.
5. In the event that the investment manager or any other external parties feel it is necessary to escalate concerns about the adequacy of the IMD evaluation process, they may contact the Chief Investment Officer or the Treasurer to raise those concerns. Every effort should be made to direct those external parties first to the Chief Investment Officer.

This Policy contemplates that numerous investment opportunities will be identified, evaluated, rejected, or tabled for future consideration. Directors will be proactive in promptly communicating with investment managers, placement agents, etc. that have actively engaged with IMD on diligence but that

have been eliminated under a Request For Information Search or do not survive an "Initial Fund Screen" or subsequent evaluation, negotiation, or approval steps (as applicable).

XII. Revision History and Effective Date

This Policy is effective July 1, 2013. Revised requirements of this version 1.1 of the Policy are effective beginning on January 1, 2014.

| Version/Revision | Date Approved | Description of Changes |
|------------------|-------------------|--|
| 1 | June 5, 2013 | Original version |
| 1.1 | December 10, 2013 | Changes to conform with revised Placement Agent Policy; clarifications to role of Compliance Counsel |

SUBMISSION AND APPROVAL

Submitted:

Kevin SigRist
 Kevin SigRist
 Chief Investment Officer

Date: 12/10/13

Approved:

Janet Cowell
 Janet Cowell
 North Carolina State Treasurer

Date: 12/10/13

NORTH CAROLINA DEPARTMENT OF STATE TREASURER INVESTMENT MANAGEMENT DIVISION

External Investment Management Conflict of Interest Certification

When form is required. The Department of State Treasurer personnel listed below shall read, complete, and forward to the Compliance Officer this form for each:

- New commitment of funds to an External Investment Manager;
- Contract renewal or new contract with an External Investment Manager; or
- Contract amendment that alters the compensation due to an External Investment Manager.

Definitions. For the purposes of this form:

- “External Investment Manager” shall have the meaning provided in the *External Investment Manager and Vehicle Selection Policy and Procedures*.
- “Conflict of Interest” shall mean circumstances that create a material risk that professional judgment or actions regarding the transaction’s recommendation, approval, or execution have been or will be unduly influenced by a direct or indirect personal interest.
- “Family” shall mean immediate family (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 (grandparents, etc.); and lineal descendants (grandchildren, etc.).

Name of External Investment Manager and/or Fund: _____

I understand and have adhered to the Department of State Treasurer, Investment Management Division’s *Code of Ethics and Conduct* and other applicable policies in this recommendation, negotiation, and approval process and certify my participation in this process is not precluded, because to the best of my knowledge:

1. My Family and I have NO material financial interest (i.e., \$10,000 or more) in the External Investment Manager.
2. I am NOT a Family member of anyone who is employed by the External Investment Manager.
3. I have NOT been employed with the External Investment Manager within the past five (5) years.
4. I have NOT sought employment NOR discussed potential employment with the External Investment Manager.
5. I have NO Conflicts of Interest in the recommendation, negotiation, and/or approval of the External Investment Manager.
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 External Investment Manager. (If so, initial in the left margin and make any disclosure on attached sheets.)

Portfolio Manager: _____ **Date:** _____

Director: _____ **Date:** _____

Chief Investment Officer: _____ **Date:** _____

General Counsel (or designee): _____ **Date:** _____

State Treasurer: _____ **Date:** _____

NORTH CAROLINA DEPARTMENT OF STATE TREASURER INVESTMENT MANAGEMENT DIVISION

IMD INVESTMENT COMMITTEE CHARTER

I. Background

The North Carolina Retirement Systems include the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, the North Carolina National Guard Pension Fund, and the Retiree Health Benefit Fund (collectively, the "Retirement Systems" or the "NCRS"). The Treasurer of the State of North Carolina ("Treasurer") maintains the investment program for the Retirement Systems (the "Fund" or "Pension Fund Program"). The Investment Management Division (the "IMD") of the North Carolina Department of State Treasurer (the "DST") serves as the investment arm of the Treasurer. Under the direction of the Treasurer, the IMD manages the Fund and other investments.

II. Committee Purpose

The IMD Investment Committee (the "Committee") is created by the Treasurer to provide oversight and policy guidance related to the Fund investments within the parameters established by the Treasurer under the *Investment Policy Statement for North Carolina Retirement Systems*. The Committee will also periodically address other investments managed by IMD as requested by the Treasurer or other authorized person.

The Committee's scope of oversight includes, but is not limited, to the following:

1. Investment policies (e.g., Investment Policy Statement, rebalancing, risk budget, investment manager search)
2. Major investment research initiatives (e.g., cross-asset class initiatives, new asset classes and sub-classes, significant new asset class strategies)
3. Annual Investment Work Plans for individual asset classes
4. Tactical total fund activity (e.g., liquidity management, tilts, hedges, transitions)
5. Investment performance factors (e.g., returns and risk, fees and incentives, trade cost effectiveness)
6. Risk and compliance standards, reviews, exceptions, escalations, and related fiduciary issues to be addressed by the Treasurer or other authorized person
7. Investment managers/funds, including securities lenders
8. Investment-related service providers (e.g., consultants, custodian, broker/dealers) and operational processes
9. Proxy voting and other corporate governance guidelines (upon request of the General Counsel)
10. Any other investment policies and procedures, strategies, and tactics designated by the Chief Investment Officer

III. Committee Membership

The Committee consists of professional staff of the Department of State Treasurer:

1. Chief Investment Officer (Chair)
2. Chief Administrative Officer (Vice Chair and Staff Director)
3. Director of Equities
4. Director of Fixed Income
5. Director of Alternative Investments
6. Director of Real Estate
7. Director of Credit and Inflation Protection
8. Director of Risk Management and Asset Allocation
9. Compliance Officer (Ex Officio)

From time to time, the Chief Investment Officer may appoint other members of the IMD staff to the Committee and may form subcommittees to develop and submit analysis to the Committee. In the absence of the Chief Investment Officer, the Chief Administrative Officer will serve as the Chair's designee.

IV. Committee Member Duties

All Committee members shall proactively discharge the following duties in accordance with the applicable fiduciary standards of care as described in the *Investment Policy Statement for North Carolina Retirement Systems* and N.C. G.S. § 147-69.7:

1. Provide independent technical advice within their areas of expertise and span of control
2. Understand, evaluate, and advise on total fund and cross-functional investment issues
3. Engage in constructive, fair, open and critical deliberations within the Committee
4. Engage in a collaborative and cooperative consensus-building process that promotes excellence in the Department of State Treasurer's investment programs

V. Committee Responsibilities

1. The Committee will meet as needed and review the following items as regular business (i.e., typically on a monthly basis):
 - a. Projected liquidity assessments inclusive of net benefit payments, anticipated cash needs for capital calls/funding, transitions, and rebalancing
 - b. Performance and risk measures, particularly as they relate to current and anticipated economic and market conditions, positioning of the Fund and asset classes, and risk budget
 - c. Forward Calendar of funds and investment managers in various stages of due diligence, approval, negotiations, and closing
 - i) Individual funds and investment managers will be taken up by the Committee on an exception basis
 - ii) The Committee will particularly focus on the introduction of new strategies, new vehicles or products, new or elevated risk exposures, non-standard terms, potential compounding of risk exposures across the Fund, and deviations from the

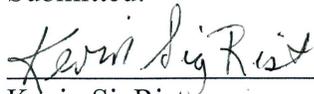
Annual Investment Work Plan

- d. Risk issues, compliance exceptions, or conflicts of interest deemed material by the Director of Risk Management and Asset Allocation, Compliance Officer, Internal Audit, or other control functions
- 2. On at least an annual basis, and prior to their submission as recommendations to the Treasurer or authorized person (as applicable), the Committee will review:
 - a. Investment Policy Statement
 - b. Risk budget and other total fund policies
 - c. Cost effectiveness measures for the Fund
 - d. Draft Annual Investment Work Plans
 - e. Potential investment process enhancements, including internal and external resourcing, and strategic initiatives
 - f. Legislative proposals
 - g. This charter and a member self-assessment of Committee effectiveness
- 3. The Chief Investment Officer approves final agendas, tabling of issues, requests for further study, and designation of sub-committees. The Chief Administrative Officer, as Staff Director, has the responsibility for preparing and distributing work papers, as necessary, prior to each scheduled meeting. The Staff Director, or their designee, shall develop minutes of the Committee meetings. Minutes may describe items taken up for discussion, open items requiring additional follow-up, and any Committee consensus, or lack thereof.
- 4. Notwithstanding the foregoing, the Chief Investment Officer, Chief Administrative Officer, Director of Risk Management and Asset Allocation, Compliance Officer, or internal legal counsel may request an ad hoc Committee meeting to consider risk issues, compliance exceptions, or conflicts of interest that they deem a material event requiring immediate review.
- 5. The Committee meetings will be a cooperative and collaborative venue for senior investment staff to develop consensus advice for the Chief Investment Officer and Treasurer. A majority of the members of the Committee will typically be present in order to develop a consensus. The Chair has the authority to formally poll the members on a specific issue or pending decision, but any such poll shall remain advisory in nature. The Committee's power is limited to making recommendations that would be adopted and implemented, or rejected, by the Treasurer or other authorized person. If a formal poll is taken, the results shall be noted in the minutes.

This Charter is effective July 1, 2013.

SUBMISSION AND APPROVAL

Submitted:



 Kevin SigRist
 Chief Investment Officer

Date: 6/5/13

Approved:



 Janet Cowell
 North Carolina State Treasurer

Date: 6/5/13

NORTH CAROLINA DEPARTMENT OF STATE TREASURER POLICIES AND PROCEDURES

| | |
|---------------------------------|---|
| DST Reference: | OST-POL-5011-ALL |
| Title: | Supplemental Ethics Policy for State Treasurer, Senior Executive Staff and Investment Division |
| Cross Reference: | |
| Chapter: | Legal |
| Current Effective Date: | December 10, 2013 |
| Revision History: | December 10, 2013 |
| Original Effective Date: | August 13, 2009 |

Applies to: NC Department of State Treasurer – Investment Management Division and Office of State Treasurer

Keywords: Supplemental ethics; post-employment restrictions; “revolving door” policies; solicitations for employment; “headhunters”

I. Background

In 2013, the Department of State Treasurer (“DST”) announced a new series of industry-leading ethics and transparency reforms. These reforms supplement measures previously put into place in 2009. This policy sets out in detail certain ethics restrictions applicable to the staff named in Section III below.

II. Purpose and Authority

The State Government Ethics Act (the “State Ethics Act”) permits heads of state agencies to develop and implement policies and procedures tailored to meet the agency’s particular needs for conflict identification and conflict avoidance. N.C.G.S. § 138A-15. In addition, the Act specifies that agencies such as DST are not prevented “from adopting additional or supplemental ethics standards applicable to” the agency’s operations. N.C.G.S. § 138A-41.

Consistent with the Act, the purpose of this supplemental ethics policy is to ensure that DST’s head and covered persons “exercise their authority honestly and fairly, free from impropriety, threats, favoritism, and undue influence.” N.C.G.S. § 138A-2.

III. Related Statutes, Rules, and Policies

The State Ethics Act (N.C.G.S. Chapter 138A); IMD Code of Ethics and Conduct (Policy # IMD-POL-1005-IMD); Supplemental Ethics Policy for Covered Persons except State Treasurer, Senior Executive Staff and Investment Division (Policy # DST-POL-5012-ALL)

IV. Policy

A. Restrictions During DST Employment

1. Coverage

This policy extends to the following persons (hereinafter, "Covered DST Individuals"): State Treasurer, Chief of Staff, Chief Investment Officer, the Investment Management Division ("IMD") Chief Administrative Officer, the IMD Director of Risk Management & Asset Allocation, all other IMD staff at the Director Level or above, the DST General Counsel, and all DST in-house compliance counsel and legal staff with responsibility for IMD transactions. The State Treasurer may deem additional DST positions to be covered by this policy; any such designations will be made in writing and appended as an exhibit to this policy.

In addition, this policy shall apply to any DST contractor, temporary employee, or permanent employee who is serving on a temporary or interim basis in one of the positions listed above.

2. Discussions with Vendors Concerning Post-Government Employment

Direct solicitations or requests for employment by Covered DST Individuals to current or proposed DST investment managers or service providers shall be barred.

After a Covered DST Individual leaves his or her employment with DST, he or she may discuss employment opportunities with DST investment managers or vendors. However, the restrictions stated in Section V(B) below shall apply to the Covered DST Individual's work at that vendor on DST matters.

3. Unsolicited Employment-Related Communications

Firms, including but not limited to third-party professional recruiters, or "head hunters," sometimes approach DST personnel unsolicited to ask whether they might be interested in a position with an identified or unidentified firm. If a Covered DST Individual is approached concerning employment with a current or proposed DST investment manager or vendor, the Covered DST Individual shall disclose the contact to the Compliance Counsel within two (2) business days. Until the Covered DST Individual has rejected the offer, the Covered DST Individual shall be recused from any and all matters involving the potential future employer, even if those conversations would be allowed under Section V(A)(2) above.

4. Applicable State Ethics Act provisions

The State Ethics Act provides that, unless an exception applies, a covered person shall not knowingly use the covered person's or legislative employee's public position in an official action that will result in financial benefit, direct or indirect, to the covered person, a member of the covered person's extended family, or business with which the covered person is associated. This subsection shall not apply to financial or other benefits derived by a covered person that the covered person would enjoy to an extent no greater than that which other citizens of the State would or could enjoy, or that are so remote, tenuous, insignificant, or speculative that a reasonable person would conclude under the circumstances that the covered person's ability to protect the public interest and perform the covered person's official duties would not be compromised. N.C.G.S. § 138A-31.

B. Post-Employment Restrictions

1. **Work “behind the scenes” on DST matters.** An individual who held a position designated in Section III of this policy shall not, for a period of **two (2) years** after leaving that position, render compensated services for any person, except for the State, in connection with a current or potential DST contract.

2. **Appearances before DST.** An individual who held a position designated in Section III of this policy shall not, for a period of **four (4) years** after leaving that position, render compensated services for any person, except for the State, by making any formal or informal appearance before DST or the Treasurer for marketing, advocacy, or other purposes.

3. **Appearances as placement agent.** An individual who held a position designated in Section III of this policy shall not, for a period of **six (6) years** after leaving that position, serve as a placement agent in connection with an investment of NCRS funds.

4. **Lobbying.** An individual who held a position designated in Section III of this policy shall not, for a period of six (6) months immediately after leaving that position, register as a lobbyist under N.C.G.S. § 120C. In addition, such covered individual shall not register as a lobbyist with the General Assembly for an additional six (6) months after leaving DST employment, except in situations under which it is clear that the individual’s lobbying activities will be completely unrelated to DST and to the individual’s prior office.

V. Failure to Comply – Remedies

Failure to comply with this policy by DST employees may result in penalties up to and including termination.

Failure to comply with this policy by investment managers or other DST vendors may result in the Treasurer, in his or her discretion, choosing to impose a ban on future investment transactions or other business with that vendor.

VI. Roles and Responsibilities; Notification; Implementation; Enforcement

Questions concerning the meaning of this policy shall be resolved by the Department’s General Counsel or by his or her designee, including without limitation DST’s Compliance Counsel. Questions concerning the meaning of the State Ethics Act shall be directed to the North Carolina Ethics Commission. DST staff will provide investment managers with a copy of this policy.

Immediately after the date of promulgation of this policy or upon hire, whichever is applicable, employees who fall under this coverage will be required to date and sign this policy in acknowledgment of its terms. The policy will be signed annually, ordinarily at the same time as IMD employees sign the IMD Code of Ethics and Conduct. The signed and dated form will be kept in each employee’s personnel file. Failure to comply with the above policy will be grounds for immediate disciplinary action, up to and including dismissal.

VII. Waiver

The State Treasurer, or his or her designee, in consultation with the State Treasurer’s General Counsel or his or her designee, may, in exceptional circumstances, grant to any current or former covered person a written waiver of any restrictions contained in the pledge signed by such covered person if, and to the extent that, the State Treasurer, or his or her designee, certifies in writing (i) that the literal application of the restriction is inconsistent with the purposes of the restriction, and (ii) that it is in the best interest of the members and beneficiaries of the Retirement Systems to grant the waiver. A waiver shall take effect when the State Treasurer or his or her designee signs the certification. The State Treasurer may not waive the policy for himself or herself.

VIII. Revision History

| Version/Revision | Date Approved | Description of Changes |
|------------------|-------------------|--|
| 1 | August 13, 2009 | First version of policy |
| 2 | December 10, 2013 | New express restrictions on soliciations; new procedure for response to unsolicited employment-related communications; revised periods of time for post-employment limitations |

For questions or clarification on any of the information contained in this policy, please contact the policy owner or designated contact point: [Jay Chaudhuri](#). For general questions about department-wide policies and procedures, contact the DST Policy Coordinator: [Sandra Johnson](#).

IX. Acknowledgement by DST Employee

“I hereby acknowledge that I have read the above policy and that I understand it and intend to comply with its terms. I acknowledge that failure to comply with the requirement that I sign this form could result in my dismissal.”

Printed Name: _____

Signature: _____

Date: _____