



## NORTH CAROLINA

OFFICE OF THE TREASURER

JANET COWELL, TREASURER

May 12, 2014

Speaker Thom Tillis  
North Carolina House of Representatives  
16 West Jones Street, Room 2304  
Raleigh, North Carolina 27601-1096

President Pro Tempore Phil Berger  
North Carolina Senate  
16 West Jones Street, Room 2008  
Raleigh, North Carolina 27601-2808

Dear Senator Berger and Speaker Tillis:

Enclosed with this letter is the final report of the Investment Fiduciary Governance Commission. Though our pension fund is one of the nation's strongest, and our investments have performed well, the basic investment governance structure for our State has not changed since 1979. Since that time, the world of investments has grown much more complex. When I formed the Commission, I asked the members to independently evaluate whether governance improvements should be made to North Carolina's pension investment program. The Commission consisted of eleven prominent legislators, industry experts, and Retirement System members.

The Commission has generated extraordinarily practical, thoughtful, and detailed work. On one important issue, whether North Carolina should move to a board structure for investment governance, the Commission was split. Based on initial feedback from legislators, legislation concerning a potential board will likely need to wait until the 2015 Long Session. On this issue, I hope the Commission's majority and minority reports can serve as a framework for discussion about whether the State should make this fundamental change.

Although Commission members differed on some issues, they reached unanimous consensus on four key points. In the 2014 Short Session, I look forward to working actively with the General Assembly to develop and pass laws enacting these unanimous Commission recommendations:

- Enhancing the State's existing audit by requiring financial statements, audited by a commercial independent third-party firm, for the Retirement Systems investment program
- A requirement that the Treasurer commission an independent performance review of the state's investment practices every four years, matching our Department's practice since 2009
- Expanded and modernized reporting for each Retirement Systems external investment, and clarification of public records laws pertaining to the investment program
- Additional resource flexibility, including greater ability to determine the size of the State's investment staff consistent with my fiduciary duties to the trust funds

These four unanimous Commission recommendations, when enacted into law, will be a significant step forward for the governance of our retirement investments.

Throughout the project, the members of the Commission took the initiative. They not only examined improvements to our existing system, but also visualized what kind of governance structure they would create if asked to build a new system from scratch today, in an increasingly complex world. The majority and minority reports take two different approaches to these foundational issues.

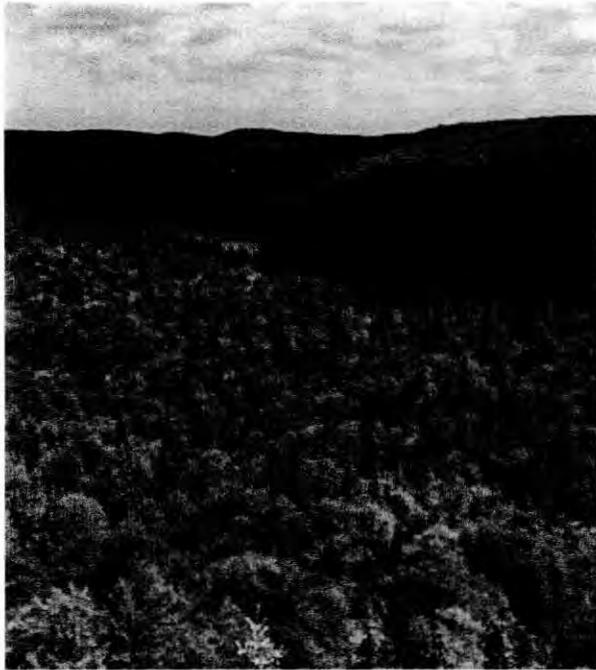
I look forward to working with you, during the upcoming Short Session, on the Commission's consensus recommendations, and I look forward to an active and vigorous discussion, prior to the 2015 Long Session, on further statutory changes that strengthen the governance of our retirement investments for the long term.

Sincerely,



Janet Cowell  
North Carolina State Treasurer

cc: Pat McCrory, Governor  
Rep. Nelson Dollar  
Rep. Rick Glazier  
Sen. Ralph Hise  
Sen. Floyd McKissick  
Beth Wood, State Auditor  
Roy Cooper, Attorney General  
Linda Combs, State Controller



NORTH CAROLINA  
INVESTMENT FIDUCIARY  
GOVERNANCE  
COMMISSION

April 30, 2014

REPORT TO THE  
STATE TREASURER

Prepared by Hewitt  
EnnisKnupp

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## TABLE OF CONTENTS

Executive Summary .....	1
About the Commission .....	3
Creation.....	3
Charter .....	3
Commission Members.....	4
Meeting Dates and Topics.....	5
Outcomes .....	7
Valued Principles in Governance and Management .....	7
Governance Model Recommendation.....	8
Recommendations for Key Governance and Management Features.....	10
Minority Report and Alternative Governance Model .....	29
Majority Response to the Minority Report and Areas of Universal Agreement.....	33
Majority Response to the Minority Report .....	33
Areas of Universal Agreement.....	33
Appendix.....	35
Investment Fiduciary Governance Commission Charter .....	37
Commission Member Biographies .....	43
List of Interviewees.....	55
List of Meeting Materials and Information Requests from Commission Members .....	57

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## Executive Summary

The North Carolina Investment Fiduciary Governance Commission (“Commission”) was established by Treasurer Janet Cowell in January 2014 to assess the current governance structure of the investment management function for all funds within the North Carolina Retirement Systems (NCRS) investment program. As a result, the Commission was to provide advice regarding the best features of an overall governance structure so that the Treasurer may achieve the following goals:

- Adopt best practices from the public, private, and nonprofit investment sectors;
- Enhance the ability to produce efficient long-term growth of retirement assets with reasonable contribution rate volatility;
- Improve the cost-effectiveness of investments and operational infrastructure;
- Enhance investment control, compliance, and risk environments;
- Maintain investment transparency and accountability; and
- Maintain a high-performing investment organization with access to best-in-class internal resources and external business partners.

Specifically, the Commission’s assignments were to:

- Evaluate the current sole investment trustee and investment advisory committee model versus an investment board of trustees and other models;
- Evaluate resourcing and investment fiduciary independence (including state laws applicable to personnel, procurement, open meetings, public records, and budget decisions); and
- Evaluate enhancements to external investment oversight, reporting, and monitoring.

Over the course of its meetings, the Commission discussed an array of institutional investment governance models and the practices of comparably sized peer investment programs from the public, private and non-profit sectors. The Commission acknowledged that:

- North Carolina is one of only four states in the nation that use a sole trustee model for the governance and management of its statewide pension fund investment program.
- The outcomes under the current NCRS sole trustee governance model have been generally favorable to date.
- The safeguards that the current Treasurer developed and adopted are beneficial to the NCRS investment program, but are policy-based; the next Treasurer is not legally required to maintain those safeguards.
- No empirical evidence exists to suggest that one specific governance model performs best under all circumstances and all economic environments.

As a result of the Commission’s discussions, and after thoroughly vetting applicable governance related issues, the Commission recommends that a shift be made to the governance of the

NCRS investment program from the current sole trustee model to a board of trustees model with the Treasurer serving as statutory Chair of the board. All trustees would share the same fiduciary responsibility.

While the Commission recommends the shift to a board of trustees model, it also underscores the importance that such a board can only properly carry out its function and meet its fiduciary responsibility if it is granted the necessary degree of autonomy. Therefore, a corresponding increase to the autonomy that the board has with respect to personnel, operating budget, and procurement matters should be granted so that its ability to adhere to high fiduciary standards is not artificially constrained.

Specifically, the board should have the ability to:

- Determine staff size, hire the staff necessary to administer the investment program, and compensate them in an appropriate manner without securing the approval of other State departments,
- Approve an operating budget for the NCRS investment program which should not require approval by the Legislature, but rather be submitted annually as an information item; and
- Establish a prudent, fair and competitive process to procure necessary goods and services for the proper administration of the NCRS investment program without requiring the involvement or approval of other State departments.

Existing safeguards relating to the NCRS investment program should be codified in law to make them more durable, including those pertaining to external oversight, reporting and monitoring. Furthermore, open meetings and public records laws specific to the NCRS investment program should be clarified.

This Report provides further detail and rationale with respect to the Commission's primary governance model recommendation and other related governance issues such as board size, board composition, how trustees on the board are appointed, frequency of meetings, scope of authority and more.

In summary, the Commission believes that adopting a board of trustees model, increasing the level of fiduciary independence, and codifying existing safeguards in law will best position the NCRS investment program in achieving the Treasurer's goals.

# About the Commission

## Creation

An independent, bipartisan Investment Fiduciary Governance Commission (“Commission”) was established by Treasurer Janet Cowell in January 2014 to examine and consider governance enhancements to the North Carolina Retirement Systems (“NCRS”) investment program and issue findings and recommendations to the Treasurer. The Commission met five times between January and April, 2014.

Hewitt EnnisKnupp (“HEK”), a national investment consulting firm with a dedicated governance practice, was selected through a competitive bid process to facilitate the Commission’s meetings and provide it with research and advice.

## Charter

The Commission’s mandate, set forth in a written charter, was to provide advice regarding the best features of an overall governance structure so that the Treasurer may achieve the following goals:

- Adopt best practices from the public, private, and nonprofit investment sectors;
- Enhance the ability to produce efficient long-term growth of retirement assets with reasonable contribution rate volatility;
- Improve the cost-effectiveness of investments and operational infrastructure;
- Enhance investment control, compliance, and risk environments;
- Maintain investment transparency and accountability; and
- Maintain a high-performing investment organization with access to best-in-class internal resources and external business partners.

The Commission’s assignments were as follows:

- Evaluate the sole investment trustee and investment advisory committee model versus an investment board of trustees or other models;
- Examine investment fiduciary independence, including state laws that are applicable to personnel, procurement, and budget decisions; and
- Assess and consider enhancements to external investment oversight, reporting, and monitoring.

The Commission did not consider aspects of retirement plan design or matters such as the actuarially assumed rate of return. The charter the Commission adopted at its first meeting can be found in the Appendix.

## Commission Members

The Commission is comprised of eleven distinguished members with diverse viewpoints and backgrounds, including legislators, industry experts and members of the retirement systems:

- **Mr. Michael Kennedy, Chair**, Senior Client Partner of Korn/Ferry International, and Chair of the Federal Retirement Thrift Investment Board
- **Professor Rhoda Billings**, former Associate Justice and Chief Justice of the North Carolina Supreme Court (member of the Consolidated Judicial Retirement System)
- **Dr. Linda Combs**, former Controller of the United States
- **Representative Nelson Dollar**, State Representative from Wake (member of the Legislative Retirement System)
- **Mr. Greg Gaskins**, Chief Financial Officer, City of Charlotte (member of Local Governmental Employees' Retirement System)
- **Representative Rick Glazier**, State Representative from Cumberland (member of the Legislative Retirement System)
- **Senator Ralph Hise**, State Senator from Mitchell (member of the Legislative Retirement System)
- **Mr. Mark Jewell**, Vice President of the North Carolina Association of Educators (member of Teachers and State Employees' Retirement System)
- **Senator Floyd McKissick**, State Senator from Durham (member of the Legislative Retirement System)
- **Mr. Charles Perusse**, Chief Operating Officer, University of North Carolina (member of Teachers and State Employees' Retirement System)
- **Mr. Neal Triplett**, President and CEO of DUMAC Inc., Duke University's endowment and pension fund (member of the current Investment Advisory Committee)

Full biographies of the Commission members can be found in the Appendix.

## Meeting Dates and Topics

A total of five Commission meetings were held between January and April 2014. The objectives for each of the meetings are outlined below.

### January 23, 2014

- Introduce the charter for the Commission and meeting procedures
- Hear about the history of the current governance model and how it operates
- Review past performance under the current model
- Review various governance models used by others and hear about trends
- Develop a list of desired governance and management principles
- Determine a limited number of governance models for future study

### February 20, 2014

- Discuss the pros and cons of the governance models selected for future study
- Consider other fiduciary, governance and management matters and scope of authority
- Hear from an outside expert regarding strengths and weaknesses of different models , and issues related to fiduciary, governance and management matters and scope of authority

### March 25, 2014

- Hear from the Treasurer regarding the strengths and weaknesses of the sole trustee model, and issues related to fiduciary, governance and management matters and scope of authority
- Discuss the governance models and features in detail and make preliminary recommendations
- Determine what topics the Commission's recommendations will address its Report and what topics deserve further consideration after the Report is published
- Outline next steps for developing recommendations and give direction to consultants about the content and format of the draft Report

### April 10, 2014

- Hold the first reading of the draft Report
- Discuss the Commissioners' feedback as a group, and reach consensus on edits and revisions
- Give further direction to consultants about content and format of the draft Report
- Set timeline for reviewing the draft and process for giving feedback before the next meeting

**April 24, 2014**

- Hold the second reading of the draft Report
- Reach consensus on edits and revisions
- Finalize the Report and recommendations
- Decide if another draft is to be reviewed by all Commissioners
- Vote on the final Report

## Outcomes

### Valued Principles in Governance and Management

At its first meeting, the Commission reached consensus on the most important principles in the governance and management of public pension fund assets as follows:

- Continuity in policies and leadership
- Transparency in meetings and operations
- Confidentiality of certain investment information<sup>1</sup>
- Accountability for actions and decisions
- Disclosure of conflicts of interest
- Allocation of authority
- Speed of decision-making
- Optimal staff
- Efficiency in operations
- Sound internal controls
- An adequate level of autonomy or independence

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<sup>1</sup> Confidentiality of information within this context means specific investment related information such as investment strategy, investment transactions, fee schedule and terms, among others, that if were made public prior to or during the time that an investment is being made, would materially impact the competitive advantage of the NCRS investment program.

## Governance Model Recommendation

### Recommendation

The Commission recommends that a shift be made from the current sole trustee governance model to a board of trustees, with the Treasurer serving as statutory Chair. All trustees would share the same degree of fiduciary responsibility for the governance and oversight of the NCRS investment program and have full voting rights.

Additionally, the Commission recommends that the degree of statutory autonomy that the board and Treasurer have with respect to personnel, operating budget and procurement matters be increased so that constraints by non-fiduciaries will not impair the board's ability to execute the fiduciary responsibilities required. A corresponding increase to external investment oversight, reporting and monitoring should also be adopted. Existing safeguards should be codified in law to make them more durable, including those pertaining to external oversight, reporting and monitoring. Open meetings and public records laws pertaining to the NCRS investment program should be clarified.

### Rationale

Over the course of its meetings, the Commission discussed the strengths and weaknesses of various governance models in relation to the oversight of the NCRS investment program. Best practices from the public, private and non-profit institutional investment sectors were reviewed and studied along with examples of relevant, successful in-State models.

A common belief emerged that while the NCRS investment program has been served well by the current sole trustee governance model, simply maintaining the status quo is not likely to achieve the Treasurer's goals going forward of ensuring the NCRS investment program is efficient, cost-effective, transparent and poised for long-term growth.

The Commission acknowledged that the safeguards that presently exist in the governance model today, while desirable, are predominantly policy-based, meaning that the next Treasurer could choose whether to comply with the policies or adopt an entirely different approach.

As the Commission's meetings progressed, the following beliefs emerged from a majority of the Commission members:

- The institutional investment arena within which the NCRS investment program operates has rapidly evolved and will continue to become more complex in the future. Contributing factors include different types of asset classes, new investment strategies, more global investment opportunities, and different methods in evaluating risk, among others.
- As long as there are no required professional qualifications for the role of Treasurer, there needs to be a requirement that experts are involved in some meaningful way in the governance and oversight of the NCRS investment program.

- Even with a well-qualified future Treasurer, the increasing level of complexity in institutional investments is best addressed through requiring the involvement of individuals with different perspectives and the right mixture of professional expertise.
- A board of trustees, all of whom would have fiduciary responsibility, does not diminish the current level of accountability for the NCRS investment program. Fiduciaries are held to the strictest legal standards under North Carolina law.
- The potential for improper influence and potential conflicts of interest is reduced by having more than one trustee charged with investment responsibilities and stringent fiduciary standards.
- Structured correctly, a board of trustees model is as effective and efficient in investment decision-making as a sole trustee model.
- North Carolina's AAA bond rating is based in part upon its well-managed pension fund. A board of trustees model would further strengthen the oversight of the pension fund investment program.
- Regular reporting, audits and third-party reviews should be required for certain aspects of the NCRS investment program.
- As long as compensation disparity exists among positions in city governments, the private sector, and those in State government, there will be a risk of continued high turnover in the investment staff.
- Fiduciaries should have the flexibility and tools to do their job. Artificial constraints that impair them from being efficient and cost effective as they strive to achieve outcomes should be removed. With enhanced flexibility comes the need for additional transparency and accountability.
- A steep learning curve exists for trustees of any public pension fund governing entity. Comprehensive orientation and longer terms of service would help to mitigate risk associated with this.
- Going forward, the good governance practices and safeguards that have been developed and adopted by the current Treasurer should be codified in statute in order to reduce the risk of mistakes or mismanagement.

The Commission's recommendations regarding specific aspects of the proposed governance model, such as the size of the board, its composition, how trustees are appointed and more are discussed on the following pages.

## Recommendations for Key Governance and Management Features

The Commission discussed the following governance and management features in an effort to detail desired attributes of the recommended governance model.

- Board Size
- Board Composition
- Qualifications and Expertise
- Appointing Authorities
- Terms of Service
- Removal Process
- Compensation of Trustees
- Committees
- Fiduciary Responsibility
- Ethical Considerations and Disclosures
- Responsibilities, Authority and Functions
- Confidentiality of Information
- Frequency of Board Meetings
- Orientation and Continuing Education Requirements
- Staffing, Operating Budget, Procurement, and Required Reporting and Auditing

The resulting recommendations from the Commission's discussions are documented on the following pages.

## **Board Size**

### Recommendation

The Commission recommends a nine-member board of trustees.

### Rationale

The Commission's observation of industry practices was that there is no optimal size for governing boards of public pension funds. The Commission acknowledged that larger groups can be difficult to manage in terms of scheduling meetings and maintaining focus at meetings. They can, at times, slow down the decision-making process. Members of large committees and boards are sometimes less engaged than members of smaller entities.

The Commission observed that smaller entities can also have disadvantages. A governing body that is too small may be impaired by limited perspectives and opinions. In addition, it could be difficult to consistently achieve a quorum for meetings.

As a result of the discussion, the Commission reached consensus that an odd numbered entity of less than ten members would better facilitate speed in decision-making and foster engagement among its members.

## Board Composition

### Recommendation

The Commission recommends the following composition of the board:

- State Treasurer: Ex officio and Statutory Chair,
- Ex Officio: Director of Retirement Services Division,
- One appointed actively contributing or retired member of the NCRS, and
- Six appointed public members with specific professional expertise and experience.

Current legislators should not be eligible to serve as members of the board. The Commission further recommends that all trustees have full voting rights.

### Rationale

Constructing the most effective public pension fund governing body involves the careful consideration of many factors. The Commission observed that generally, state investment boards that handle only investments for large public pension funds have more appointed<sup>2</sup> and ex officio trustees than those who are elected by the members and/or beneficiaries of the pension plans. On the other hand, state retirement systems that handle both benefits administration and investments frequently have elected members and beneficiaries, as well as appointed and ex officio trustees on their boards.

As the complexity in the investment arena increases, requiring trustees with professional expertise and experience is critically important. In addition, the investment program exists to support the NCRS benefits. Therefore, the administration of the NCRS benefits should be considered in the investment of the assets. While the Treasurer reflects one such link, the Director of the Retirement Systems Division reinforces the concept, even as turnover occurs in the position of Treasurer. Lastly, it is important to consider the voice of the membership. Having an active or retired member on the board serves as a conduit for this perspective to be heard.

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<sup>2</sup> Those that are appointed by a governmental representative or body, such as the governor or legislature.

## Qualifications and Expertise

### Recommendation

The Commission recommends that members of the new board have a diversity of relevant expertise and skill sets. The Commission recommends that, in making appointments to the new board, the appointing authorities appoint individuals that have demonstrated experience and expertise in one or more of the following areas:

- Institutional investments
- Financial accounting or auditing
- Commercial transactions
- Risk management
- Technology
- General business management

Additionally, prior corporate or non-profit board or committee experience should be required. A preference should be given to those with professional accreditations such as the Chartered Financial Analyst (CFA) designation, Chartered Investment Counselor (CIC) designation, Certified Investment Management Analyst (CIMA) designation, Chartered Alternative Investment Analyst (CAIA), Certified Public Accountant (CPA) designation or those with a law degree (JD) or a master's degree in Business Administration (MBA).

In making appointments, each appointing authority should consult with the other appointing authorities prior to making appointments so that diverse experience is represented on the board of trustees.

### Rationale

The members of any public pension fund's governing body should have the time and be well qualified to handle the responsibilities. The current Investment Advisory Committee ("IAC") members are required by statute to have specific expertise in areas relevant to the administration of a large, diversified investment program and it was reported to the Commission that this requirement has been beneficial to the NCRS investment program.

Lastly, because no formal professional qualifications are required of candidates seeking the Office of Treasurer, it is possible that a candidate without the pertinent expertise and experience could be elected. As the complexity in the institutional investment arena continues to increase, the NCRS members and beneficiaries would continue to be well-served if the investment program is governed by trustees with the appropriate professional expertise.

## Appointing Authorities

### Recommendation

The Commission recommends that appointments of seven individuals<sup>3</sup> to the new board of trustees be allocated in the following manner:

- Governor receives one appointment
- Senate President Pro Tempore receives one appointment
- Speaker of the House of Representatives receives one appointment
- Treasurer receives one appointment
- The Board itself, once the aforementioned appointments are made, is vested with the authority to appoint the three other trustees

Vacancies on the board should be promptly filled by the respective appointing authority. The board should have the authority to appoint a qualified person if the seat is not filled by the respective appointing authority within ninety (90) days after receipt of notification of a vacancy by the board of trustees.

### Rationale

The Commission desires that the appointing authorities be a broad representation of the leadership of the State government. The stability of the board is critically important if thoughtful investment decisions are to be made. Any prolonged trustee vacancy would be disruptive to the business of the board. The Commission favored a corporate nominating committee concept whereby existing trustees appoint some of the trustees and also address vacancies that are not timely filled.

Should the appointment process be unexpectedly lengthy, vesting the board with the authority to fill a trustee seat mirrors the corporate practice and better ensures that the effectiveness of the board itself is not diminished.

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<sup>3</sup> Assuming a nine-member board of trustees, two, including the Treasurer would serve ex officio, and seven members would be appointed.

## Terms of Service

### Recommendation

Terms for appointed trustees should be four years in length, with the ability to serve a maximum of two consecutive terms. The terms should be staggered to ensure continuity. Initial terms should be different lengths so that the desired level of staggering can be established. If at all possible, terms of the members should not be conterminous with the respective appointing authority.

### Rationale

Because of the size and unique nature of the investment program, the learning curve for any member of the board of trustees is likely to be steep, regardless of whether they meet expertise and experience requirements. The Commission understands that other public pension fund trustees have reported that it takes approximately three years to become well-versed in institutional investments and a public pension fund's investment strategies. Therefore, terms should be of reasonable length with some term limits that allow for both continuity and periodic change. Staggering terms serves to further achieve stability. If possible, structuring terms that are not conterminous with the appointing authority's term would help to minimize undue political influence.

## Removal Process

### Recommendation

The Commission recommends that appointed trustees of the board must be removed by the respective appointing authority if any of the following apply:

- felony conviction of any type
- misdemeanor conviction involving misappropriation or misuse of funds
- conviction of a crime involving moral turpitude
- violation of State ethics laws and/or the board's ethics policy
- failure to comply with the orientation mandate in statute
- being absent for three consecutive meetings or for 75% percent of the meetings in any one calendar year, regardless of the reason

### Rationale

The responsibilities assigned to trustees are critically impactful, not only with respect to the fiduciary nature of the role, but to the lives of many members and beneficiaries that are citizens in the State. Accordingly, trustees must engender a certain level of public confidence.

The Commission would also like to emphasize the importance of trustees availing themselves to a prompt orientation and regularly attending board meetings.

## Compensation of Trustees

### Recommendation

The Commission recommends that the appointed trustees should receive \$100 per day for each day of board service, plus subsistence and travel expense reimbursement.

### Rationale

As a result of the discussions, the Commission believes that the compensation of trustees should be consistent with the standards for other boards and commissions in the State. It was acknowledged that while the role requires a deep level of engagement, a substantial commitment of time, and often transparency with regard to personal financial assets, those who tend to serve do so out of a desire for public service.

Although the Commission was in agreement that all expenses for travel and continuing education should be reimbursed, the Commission also agreed that that the board of trustees should establish prudent parameters to limit expenditures.

## **Committees**

### Recommendation

The new board of trustees may establish and disband committees as it deems appropriate. Its decision should be based upon ever-evolving best practices of governing boards of large, sophisticated public funds. Current best practice is for similar entities to have at least an audit committee. In addition, the Commission believes strongly that a sub-committee should be formed to address more time-sensitive investment issues as needed.

### Rationale

While the Commission acknowledged the potential need for specific committees in order to maximize effectiveness and efficiency, there was general agreement that the new governing entity would be in the best position to determine the use and purpose of specific committees or subcommittees. However, the Commission encourages the new board of trustees to establish an audit committee with at least one individual who is a financial expert and well-versed in audits who would meet standards that are similar to federal law (Sarbanes-Oxley) even though that law technically does not apply to state governmental entities.

## **Fiduciary Responsibility**

### Recommendation

The Commission recommends that the members of the board of trustees be fiduciaries for the general administration and proper operation of the NCRS investment program within the requirements and provisions of State statute.

A statutory limitation of liability should be established to grant trustees immunity from ordinary negligence, but not from gross negligence, willful and wanton misconduct, or acts that are undertaken for personal financial gain.

In addition, the board should be authorized to use the assets of the NCRS trust fund to acquire fidelity bonds, fiduciary insurance, directors' and officers' insurance, or errors and omissions coverage as it sees fit.

### Rationale

The Commission acknowledges the fiduciary nature of a trustee's position and that they are governed by the highest standards under the law. They are required to follow the duties of loyalty to the members and beneficiaries of the pension fund and prudence in all their decision-making.

The Commission believes that spreading the fiduciary responsibility for the oversight of the NCRS investment program across all trustees, including the Treasurer as chair, will serve to mitigate risk by introducing additional checks and balances into the investment process. Supplementing the Treasurer's leadership with additional fiduciary minds and voices better insulates the NCRS investment program from the long-term impact of ill-advised policy decisions, whether intentional or not. As the institutional investment industry evolves, even a well-qualified future Treasurer would be better served by engaging with those who are held to the same legal standard of care in the investment decision-making process.

Although the Commission acknowledges the challenge of attracting desirable candidates to serve in a fiduciary capacity where personal liability is at stake, particularly given the current asset size of NCRS, it is unlikely that the imposition of fiduciary standards would reduce the quality of the candidate pool to any significant degree.

## **Ethical Considerations and Disclosures**

### Recommendation

The Commission recommends that the members of the board of trustees be subject to the same State ethics laws and required financial disclosures of other boards and commissions.

### Rationale

The Commission advocated for the proactive identification of potential conflicts of interest. The personal disclosure requirements applicable under State ethics laws help to achieve that proactive stance. Although such disclosure may deter some otherwise attractive candidates from serving as a member of the board of trustees, the impact is not anticipated to be great. The NCRS investment program is the largest pool of assets in the State. More than anything else, it ought to be overseen by individuals with a high sensitivity to disclosures.

The Commission believes that the newly created board of trustees falls under the State Government Ethics Act. Therefore, each new trustee should be evaluated by the State Ethics Commission for potential or actual conflicts of interest.

## **Responsibilities, Authority and Functions**

### Recommendation

The Commission recommends that the board of trustees be responsible for all matters relating to the general administration and proper operation of the NCRS investment program within the requirements and provisions of State statutes. The board may delegate certain duties in a manner consistent with its fiduciary standard of care to those with the independence, objectivity and requisite expertise, but it retains the overall fiduciary responsibility.

Board approval should be required on the following responsibilities, at a minimum:

- Investment policy statement
- Asset allocation targets and ranges and risk tolerance
- Permissible asset classes that can be used
- Decisions about deviations from policies
- Internal versus external management
- Active versus passive management
- Selection of investment consultants
- Selection of the custodian bank
- Audit scope and outside auditors to use
- Operating budget for the NCRS investment program

The Treasurer and staff would continue to serve as administrators for the NCRS investment program, and the board of trustees, inclusive of the Treasurer, would be responsible as fiduciaries for overseeing the entire investment operation. The Treasurer would also retain the authority to appoint the Chief Investment Officer, but should be required to do so in consultation with the board.

To be prudent and to establish accountability, major delegations of duties should be documented by the new board through charters, staff job descriptions, investment policy statements, strategic plan goals and objectives, consultant and investment manager contracts, or other statements of delegation made at board meetings and documented in minutes. Compliance with the delegations should be verified and reported to the board by an independent source.

### Rationale

As the highest level fiduciary, the board, including the Treasurer, has the ultimate responsibility for the NCRS investment program. It should have the authority to be involved in any decision in which it deems its involvement is necessary. When a board involves itself in operational or management decisions, its role is that of a "working board." Some smaller endowments, foundations or corporate pension funds may have a working board. At times, public retirement system boards have become working boards involved in management details after a serious

problem has arisen, but generally this is not the case. Most large public retirement system and statewide investment boards operate at the policy level. "Policy boards" set the long-term direction of the organization, serve as a fresh perspective, and provide guidance to the key executives administering the program.

The aforementioned responsibilities outlined reflect the major policy and implementation related duties associated with the oversight of an institutional investment program such as NCRS.

## Confidentiality of Information

### Recommendation

The Commission recommends that the applicability of exemptions under North Carolina's open meetings and public records laws relating to the NCRS investment program information be clarified. In addition, the law should require that an independent expert conduct periodic assessments of the effectiveness of the investment program, including the related investment management fees and trading costs to ensure reasonableness with industry norms. A provision whereby the confidential information is disclosed after some period of time would serve to protect the short-term interests of the NCRS investment program while balancing the public's interest for all business related to the program to be conducted in an open format.

### Rationale

It serves the public interest for the Department of State Treasurer ("DST") to withhold the disclosure of proprietary and confidential investment manager related information. Disclosing it would put the NCRS fund at a competitive disadvantage relative to other institutional investors with whom it competes for the best investment opportunities. Confidentiality must be balanced with the need for transparency. A shared belief emerged that the DST should be periodically required to subject itself to an independent assessment of the effectiveness of the investment program, including investment management fees and costs, to ensure it is continually aligned with industry norms.

Although the Commission understands that the DST has been forward-thinking about how it currently reports specific investment manager related information, there is no legal requirement that the same level of information be reported in the future. Here, the Commission believes that codifying the current practice is warranted. Additionally, there is ambiguity in North Carolina's open meetings and public records laws as to what information is and is not considered confidential. All interested parties would be best served if the laws were clarified pertaining to these matters.

## **Frequency of Board Meetings**

### Recommendation

The Commission recommends that the new board be required by statute to meet at least quarterly, with the ability to convene more frequently if called by the Treasurer or the majority of the trustees.

### Rationale

Presently, the IAC meets quarterly; however, this practice is required by charter and not by statute. It was reported to the Commission that the current IAC meeting frequency serves the NCRS fund well in terms of providing an efficient forum to regularly conduct the IAC's business. Codifying meeting frequency in statute serves as a risk reducing measure and institutionalizes the current practice. The board itself will be in the best position to know if it should have more frequent meetings. It knows the work to be done.

## **Orientation and Continuing Education**

### Recommendation

The law should compel new trustees to promptly complete orientation upon appointment. The board of trustees can determine and establish by policy the curriculum and process, as well as the continuing education requirements for its members.

### Rationale

Current practice is that all members of the IAC are required to complete an orientation program within sixty days of their appointment. Here, too, such a requirement is based in the Committee's charter and is not mandated by statute. Codifying a requirement without being overly detailed will reduce the risk that someone will misunderstand their fiduciary responsibilities and will also reduce the chances that implementation of the investment program's strategic plan will be detrimentally delayed.

Regardless of background or expertise, becoming acquainted with the business of the NCRS is not easy and takes time. Prompt, comprehensive orientation can expedite the learning process and increase the likelihood of a new trustee making valuable contributions as soon as possible.

In addition, the institutional investment arena within which the NCRS investment program operates is rapidly evolving and is expected to continue to do so in the future. A continuing education requirement will aid members in staying current with the changing landscape of the industry's practices.

## Staffing, Operating Budget, Procurement, and Required Reporting and Auditing

### Recommendation

The degree of autonomy that the board has with respect to personnel, operating budget, and procurement matters should be increased so that it has the ability to meet its fiduciary obligations in the most efficient and cost-effective way possible. There is no need for non-fiduciaries to place cost constraints on the board, because it already has a legal duty to expend funds prudently. With increased autonomy there should be a corresponding increase in reporting.

Specifically, the board should have the ability to:

- Determine staff size, hire the staff<sup>4</sup> necessary to administer the investment program, and compensate them in an appropriate manner without securing the approval of other State departments<sup>5</sup>,
- approve an operating budget for the NCRS investment program; the operating budget should be submitted annually to the Legislature as an information item, but prior approval should not be required, and
- establish a prudent, fair and competitive process to procure necessary goods and services for the proper administration of the NCRS investment program without requiring the involvement or approval of other State departments<sup>6</sup>.

The current practice of regular reporting from the DST, coupled with external audits performed by unconflicted experts, should be required by law to ensure that the board is satisfying its fiduciary responsibilities. Specifically, the board and Treasurer should be required to make the following public at least annually:

- A description of the investment strategy, policies and controls pertaining to the NCRS investment program,
- A description of the global economic and financial environments' relationship with the performance of the NCRS investment program over historical time periods, including risk and returns versus benchmarks,
- The cost-effectiveness of the NCRS investment program, including comparisons to peer cost benchmarks,
- For each investment fund within the NCRS investment program, information pertaining to:

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<sup>4</sup> Here, staff is meant to include not only investment personnel, but those professional positions necessary to support the investment function, including the accounting and legal functions.

<sup>5</sup> Specifically, employees of the Investment Management Division should be exempt from the classification and compensation rules established by the State Human Resources Commission in a manner similar to the Office of the Commissioner of Banks.

<sup>6</sup> The exception to this recommendation was that information technology purchasing should continue to fall under the purview of the State's ITS Division.

- Who has delegated authority to manage the investment fund
- A description of how the assets are being managed
- The amounts being committed by the DST to each investment fund
- Contributions made, distributions received, ratio to paid-in capital and the amount of the remaining value of the investment fund assets attributable to the NCRS investment program
- Net annualized internal rate of return of each private market investment vehicle since inception
- Periodic net annualized time-weighted rates of return for public market investment funds and their applicable performance benchmarks
- Total management fees and incentives paid, and all placement fees and any other money management fees incurred by the NCRS investment program
- Financial statements for the NCRS investment program, reported to the Legislature, and audited by a commercial independent third-party audit firm,
- Periodic asset liability studies performed for the NCRS investment program, and
- Results of compensation studies relating to the NCRS investment program staff as conducted by a qualified, independent party.

### Rationale

By law<sup>7</sup>, the Treasurer is currently held to the highest standard of care as a fiduciary – the prudent expert standard – with respect to investing and managing the assets of the NCRS investment program. The prudent expert standard requires:

- A duty of loyalty to act solely in the interest of the trust beneficiaries,
- A duty of prudence to evaluate investment opportunities using a thorough and prudent process, and
- A duty to incur only appropriate and reasonable costs.

The Commission observed that although the position of Treasurer as the sole trustee is legally and personally liable to this standard, the DST does not always have the ability to do what the Treasurer believes is necessary to handle these responsibilities. Constraints exist in the ability to assemble the staff and resources needed to perform necessary investment functions in an efficient and cost-effective way. Current State laws give other entities and State departments authority over the DST budget, staff size, staff compensation, and procurement even though they have no fiduciary responsibility for the NCRS trust fund.

Shifting to a board of trustees model in itself would not solve these structural impediments; however, the Commission believes that vesting a board with approval authority for these matters offers the commensurate accountability needed to remove such constraints.

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<sup>7</sup> North Carolina General Statutes §147-69.7

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## Minority Report and Alternative Governance Model

Two primary governance models were given serious attention during the course of the Commission's meetings: the board of trustees model that reflects the majority recommendation and a strengthened sole trustee model with professional expertise guided by a codified, professional and diverse Investment Advisory Committee. For the reasons which follow, from the majority's determination, by a bare majority, to recommend the first model, we respectfully dissent.

As a starting point, there is much we agree with in the majority's thoughtful discussion of the interdependent issues of risk, transparency and sustainability. Indeed, the majority ably navigates many of the complex shoals the modern market and investment dynamic creates. In many respects, we differ from our shipmates only as to the final port of call. But, that difference is substantial. We strongly believe adopting a wholly new governance model introduces a risky, less nimble and transparent, and politically unwise level of change to the NCRS investment program that was not proven through the discussions to be needed at this point in time in North Carolina. Our assessment of the balance of the issues set forth above, which lead us to this different destination, follows seriatim.

First, the sole trustee governance model has been a most effective and efficient management system for the NCRS investment program. It has produced solid outcomes to date, indeed landing repeatedly in the top 5 in the nation in most objective return measures. So, in a sense we are truly looking to the future with this report as the present is being superbly navigated—meaning, no need to rush to a new model exists. The majority, however, recommends just that, and does so in large measure because of a fear of the future, not any present flaw it can truly identify which can not be incrementally improved; not because best practices nationwide strongly suggest a change in models for the evidence before this Commission establishes no best practice exists nationally; and not because either risk or transparency concerns impel movement away from a codified and strengthened sole trustee model, for in fact, as this dissent makes clear supra, those factors actually balance fairly strongly in favor of not moving to a new Board system lock, stock and barrel.

Second, the current Administration has developed and inculcated highly desirable investment and risk safeguards, as well as increasingly transparent mechanisms, through protocol, policy and practice, both within the Investment Advisory Committee and throughout the entire NCRS investment program. All of us on the Commission believe further protections could and would be achieved by codifying those policies and de facto practices as well as those suggested in the majority report regarding additional transparency disclosures.

Third, and importantly, an elected Treasurer serving as the sole trustee provides far more accountability to the NCRS investment program than will any appointed Board model. Under our current system, one supported by the unique history and culture of our state, the buck stops at one desk. There is one person, constitutionally elected, who is the final arbiter and decision-maker. No one can doubt who is accountable. A Board, of course, is fundamentally designed to

dilute that singular accountability. And, there are certainly times when a Board, through its more democratic and consensus-building processes, is the right choice to govern an institution or group. But, where nimbleness, agility, flexibility and speed in decision-making is vital and the failure to possess any of those functions can, in seconds, let alone hours, cost the NCRS and its beneficiaries tens of millions of dollars, democracy and consensus-building are not foundational building blocks of an investment system.

Today, more than ever, speed, professional expertise, and consolidated decision-making are crucial to investment practices. As the latest expose of firms seeking the advantage of processing their orders nanoseconds ahead of competitors through state of the art fiber optic systems on Wall Street establishes, he who delays, loses. A Board system, whatever its other advantages, is a more delayed system. When you need 6 votes to proceed, it will simply take more time to obtain than where 1 vote is dispositive. It is beyond cavil the sole trustee model provides for far greater speed in decision making. So, why move away from it? No reason, really, except fear—hardly, a basis upon which to uproot an entire system.

The majority report makes much of, and truth be told, is fundamentally premised on the concern over who the one decision- maker is (or might be in the future). So, because the citizens of our state might elect an aberrant Treasurer, though we never have, and that Treasurer might disregard all legislative, codified or IAC advice and direction, though that has not occurred, the majority recommends we upset the current applecart, move to an entirely new and untested system, with 9 decision-makers, several of whom would be appointed by the aberrant Treasurer they fear, thus creating the real potential for multiple aberrant Board members, with the remaining Board members to be selected from a purely and wholly political process, with the expectation that this system, which actually exists nowhere else in the nation in this form, will deliver a better professional product than has occurred throughout our storied investment history. To state the proposition articulates the reasons to oppose it.

There are certainly reasons to consider, and that the Treasurer and this State should, incrementally modify and strengthen the current system to ensure a diverse and highly professional IAC, to increase public confidence on issues of risk management, fee allocations, and investment strategy, and to provide all the necessary (and heretofore insufficiently allocated) staff and authority to the investment branch within the Treasurer's office. But, that is a far cry from creating, from scratch, an entirely new system, chock full of political appointees (regardless of their party affiliation) and appointees from the position of Treasurer, whom the majority fears could one day, perhaps, be a bad apple—as if such a Treasurer would then not fill his or her appointees with folks pre-determined to follow the Treasurer's lead, creating at best the enormous potential for a seriously divided Board. So, while the majority recommends the Board model out of fear of a future elected Treasurer, the model it creates is simply its political Frankenstein times nine! If the majority is asking the right question, and we respectfully suggest it is not, it definitely does not come up with the right answer.

Fourth, the increasing level of complexity in investment strategy and tactics is far more efficiently addressed by codifying a more diverse, but fully professional IAC, where conflict rules are less severe and current practitioners can provide full guidance, than with a Board, where current practitioners will likely be barred by conflicts and ethics rules, and where no matter the

statutory qualifications listed for political appointments to the Board, they are in the end, political appointments and modern appointments practice provides strong empirical evidence that statutory guidelines may well be observed only in the breach. As Senator Hise cogently summarized at the Commission's last meeting: "{h}aving diverse Board expertise is a poor substitute for professional staff expertise."

Fifth, North Carolina's AAA bond rating is based, in part, upon the strength of its strong executive framework and its well-funded, well-managed pension fund. We believe maintaining accountability through the Treasurer as guided by a strongly codified IAC and increased staff and administrative capacity is crucial to maintenance of this standing. Dilution of accountability, as the Board is designed to accomplish, limitations on professional advice and staffing, creating a politically appointed Board, and moving to an entirely new and untested system at a particularly heightened and politically charged moment in North Carolina's history is simply unwise, unnecessary, and ill-timed. Moving far more incrementally and vesting all internal and external stakeholders in that process, step by step, seems to us a significantly more conservative, and effective option, which still allows for increased transparency, substantially more assistance for the Treasurer through an expanded and codified IAC, and more resources and legislative flexibility for the Treasurer's investment staff.

Sixth, a strengthened sole trustee model will be just as effective in managing risk, if not better, than a Board model. Both depend on a strong statutory framework supporting transparency through regular reporting, monitoring and third party audits. The difference is the more fiduciary voices added to the mix, the more the opportunity for delay, division and conflicts.

Seventh, North Carolina has historically favored an incremental approach to legislative change. This tendency has served the state well and is wholly consistent with a conservative investment strategy, advocated from all quarters, for the NCRS. Stability and predictability are the highly valued currency here; not a forced march to change out of fear that the current system, which is working very well, might one day malfunction. Or that the investment process is becoming increasingly complex, which it is. This last point hardly suggests a move from 1 to 9 confused voting members! The key is providing whomever the decision maker is with the best possible professional investment advice and that is through a codified IAC, not a political Board.

Finally, it bears emphasis that NO empirical evidence exists to suggest one specific governance model outperforms another or is best under all circumstances. Indeed, our review establishes most systems have evolved over time in their states with an understanding of the history, politics, and investment culture of each state. No model will immunize the NCRS investment program from risk; none guarantees better outcomes.

In a very real sense, the majority and minority reports here are inverted. At our last Commission meeting, with perhaps only one limited dissenting voice, all of the Commissioners agreed they could support the strengthened sole fiduciary model that represents the core of this dissent. But, on a highly-divided vote for top choice, as if we were voting on what meal to serve our guests at a state dinner, the majority model barely won out with substantial opposition from most of us in dissent who indicated we had strong reservations with supporting the majority's

newly-minted model. If the task of this Commission was majority rule, this report is faithful to that result. If, however, the task was consensus recommendations, in fairness, it is not.

Conclusion

For the reasons stated, Commissioners Combs, Glazier, Hise and Perusse join in this dissent and minority report. We support an incremental approach to strengthen the sole trustee model. We prefer a clear line of accountability. We believe our recommendation best reflects the spirit of the history and law of our state, and provides the most direct link between the will of the people and the candidate they elect to the office of State Treasurer. Codifying in the law many of the suggested transparency and risk safeguards the majority report contains, but within the confines of North Carolina’s vastly successful sole trustee model preserves the approach that has served us well and will amply protect the state for the foreseeable future. However, because no Commission can see past the “foreseeable” future, we also concur in the recommendation that a Commission such as this be constituted five years from now, and periodically thereafter, to monitor progress and examine whether further changes are needed at that time. We conclude our report with many thanks to the expert leadership of the Chair, staff and of the Treasurer whose foresight constituted this Commission to thoughtfully consider these complex, but extraordinarily important issues,

Dr. Linda Combs

The Honorable Rick Glazier

The Honorable Ralph Hise

Mr. Charles Perusse

# Majority Response to the Minority Report and Areas of Universal Agreement

## Majority Response to the Minority Report

In response to the Minority Report, the majority of Commission members offer the following points of clarification;

- the driving force behind the recommendation for a board of trustees was not “fear,”
- the Commission’s charge was to evaluate governance from a fresh perspective, and recommend the best approach going forward without regard to what is currently in place, and
- a board of trustees model would best serve the investment program going forward because of increased complexity in the institutional investment arena.

## Areas of Universal Agreement

Regardless of the governance model established in the future, there was strong universal agreement among the Commissioners to increase the level of autonomy, consistent with fiduciary standards, relating to personnel positions, staff compensation, operating budget and procurement matters. Additionally there was agreement that existing policies and practices be codified to form a strong statutory framework that requires transparency through regular reporting, monitoring and third-party audits.

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# Appendix

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# Investment Fiduciary Governance Commission Charter

## I. Purpose

The State Treasurer has established the Investment Fiduciary Governance Commission ("IFGC") to assess the current governance structure of the investment management function for all funds under the State Treasurer's purview including the Teachers' and State Employees' Retirement System, the Local Government Employees' Retirement System, the Legislative Retirement System, the Firemen's and Rescue Workers' Pension Fund, the Consolidated Judicial Retirement System, and the North Carolina National Guard Pension Fund (hereinafter referred to collectively as the "Funds"), and advise the State Treasurer regarding the best features of an overall governance structure so that the State Treasurer may achieve the following goals:

- Adopt best practices from the public, private, and nonprofit investment sectors;
- Enhance the ability to produce efficient long-term growth of retirement assets with reasonable contribution rate volatility;
- Improve the cost-effectiveness of investments and operational infrastructure;
- Enhance investment control, compliance, and risk environments;
- Maintain investment transparency and accountability; and
- Maintain a high-performing investment organization with access to best-in-class internal resources and external business partners.

In order to help the IFGC fulfill its duties, the State Treasurer has adopted this Investment Fiduciary Governance Commission Charter ("Charter").

## II. Composition

For this endeavor, the State Treasurer shall call upon individuals (approximately eight to twelve) with diverse backgrounds who are knowledgeable of the statutory responsibilities, mindful of the high fiduciary standards required of the State Treasurer, and have a genuine interest in influencing sound public policy.

- A. Chair.** The State Treasurer shall appoint a Commission Chair, whose duties include, but are not limited to: (1) calling special or emergency meetings, when necessary; (2) recommending the appointment or removal of IFGC members; (3) recommending the appointment or removal of the Vice-Chair; (4) recommending the appointment or removal of staff to serve the IFGC; and (5) conducting the IFGC meetings in an efficient and effective manner.

- B. Vice-Chair.** The State Treasurer shall appoint a Vice-Chair. The Vice-Chair's duties include but are not limited to: (1) reviewing the minutes of the IFGC meetings prior to their distribution to the IFGC members; (2) working constructively with all IFGC members and staff; and (3) assuming the Chair's responsibilities for the IFGC if specifically requested to do so by the Chair.
- C. Terms.** IFGC members serve at will and their membership can end at any time upon written notice of removal with or without cause as determined by the Commission Chair. The expectation is that the term of service will span from January until May 2014. The Commission will evaluate its schedule at its third meeting and determine whether the term of service remains accurate.
- D. Standard of Care.** No IFGC member shall owe any fiduciary, trust, or similar obligations in connection with his or her membership on the IFGC other than the duty to act in good faith and act as expressly set forth in this Charter.

### III. Meetings

- A. Opening Meeting Laws.** All meetings will be held in compliance with North Carolina open meetings law, where applicable.
- B. Schedule of Meetings.** The IFGC will approve a schedule of meetings, times, and locations between January and May, 2014 and may convene more often if called by the State Treasurer or a majority of the IFGC members.
- C. Attendance Policy.** IFGC members are to attend meetings in person. In urgent situations where personal attendance is not possible IFGC members may attend by teleconference or by videoconference. The IFGC may require that staff, consultants, and other individuals attend the meetings to provide information as necessary.
- D. Public Comment.** At the end of each meeting, time will be reserved for public comment. Time for public comment may be limited by the Chair and will consist of no more than three minutes per speaker, unless the Chair determines otherwise. Members of the public may submit comments to the Chair, in writing, and have the comments noted in the official proceedings.

#### **IV. Responsibilities**

The IFGC shall be responsible for advising the State Treasurer in the areas set forth below.

- Evaluating the sole investment trustee and investment advisory committee model versus an investment board of trustees or other model;
- Evaluate resourcing and investment fiduciary independence (including state laws applicable to personnel, procurement, open meetings, public records, and budget decisions); and
- Evaluate enhancements to external investment oversight, reporting, and monitoring.

In addition, the IFGC shall perform any activities related to this Charter as requested by the State Treasurer.

The IFGC will not perform any activities related to the examination of the actuarially assumed rate of return used by the Funds or any aspects of retirement plan design.

#### **V. Authority**

The IFGC has the authority to review background data, historical information, staff reports, consultants' reports, and any other documents it deems reasonably necessary to form an independent opinion on the effectiveness and appropriateness of the current governance model. Furthermore, the IFGC is authorized to make reasonable requests of the consultants assigned to the Commission that are relevant to the Commission's responsibilities as set forth in this Charter.

The IFGC has the authority to call upon the Department of State Treasurer's Deputy Chief of Staff/Legal Counsel, CIO, General Counsel/Senior Policy Advisor, or outside experts including investment consultants, actuaries, and auditors for information relating to its responsibilities; however, any request for assistance from outside experts that might result in additional costs must have the prior approval of the State Treasurer.

The IFGC does not have the authority to convene meetings to discuss items of business outside of those agreed to by the State Treasurer.

The IFGC does not have the authority to sign contracts, obligate the State Treasurer, or incur expenses without the prior approval of the State Treasurer.

## **VI. Expectations**

Individual IFGC members are expected to: (1) be prepared for all IFGC meetings by reviewing agendas and supporting materials prior to the meetings; (2) attend IFGC meetings, share expertise, and actively participate in the discussions; (3) work constructively with other IFGC members; (4) interact appropriately with the State Treasurer, the staff, and outside experts; (5) respect open meetings laws by not convening meetings with fellow IFGC members to discuss business of the Commission outside the properly noticed meetings; (6) incur only reasonable expenses in carrying out duties as an IFGC member; (7) live up to high ethical standards and avoid the appearance of impropriety; (8) work through the Chair if requesting agenda items for IFGC meeting agendas; (9) refrain from making individual time-consuming requests to staff and consultants without a directive of the full IFGC; (10) discharge duties with the acknowledgment that the IFGC's advice and recommendations will be considered and potentially implemented by a fiduciary who must act solely in the interest of the members and beneficiaries and for their exclusive benefit; (11) direct any and all inquiries received from the media or public records requests to the Department's General Counsel for response.

## **VII. Compensation**

The IFGC members will serve without compensation but shall receive reimbursements for expenses incurred in the performance of their duties as long as they are reasonable, documented, and in compliance with the parameters set by the State Treasurer.

## **VIII. Staffing**

The Deputy Chief of Staff of the Department of State Treasurer shall have primary responsibility for all IFGC meetings and his duties shall include, but are not limited to (1) maintaining a current list of IFGC members; (2) notifying the IFGC and the public of meetings; (3) coordinating and disseminating information to the IFGC; (4) maintaining official minutes and records of all proceedings from IFGC meetings; (5) responding to requests under North Carolina public records laws; (6) accepting service of process on behalf of the IFGC; (7) preparing a meeting agenda as directed by the Chair, prior to each meeting; and (8) scheduling and notifying IFGC members of each meeting.

The General Counsel and Chief Investment Officer shall ensure appropriate internal staff members are assigned to assist the IFGC and support its activities by preparing meeting materials, performing research, and rendering other types of assistance as

reasonably requested by the IFGC.

**IX. Consultants**

The Treasurer shall appoint, through a competitive bid process, consultants who will be accountable to the IFGC. The consultants' duties shall include, but not be limited to: (1) providing independent advice regarding workable governance alternatives; (2) identifying and providing relevant research; (3) facilitating meetings; (4) assisting the IFGC with drafting the final assessment and recommendations; and (5) performing any duties relating to this Charter as directed by the IFGC.

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## Commission Member Biographies



### **Michael Kennedy, Chair**

Michael Kennedy is a Senior Client Partner in the Atlanta office of Korn/Ferry International and a member of the firm's Global Financial Services Market, specializing in commercial/investment banking, capital markets, and asset management searches. He has conducted senior-level searches in a wide array of pension funds and, in fact, developed and leads the public pension fund sector. He is also the co-leader of the firm's Diversity Center of Expertise.

Mr. Kennedy brings broad private equity and corporate finance experience to his executive recruiting. Prior to joining Korn/Ferry, Mr. Kennedy owned a venture capital consulting firm where he advised a Southeast-based private equity fund. Before founding his own firm, he was a vice president in the corporate finance group at GE Capital Corporation where he provided senior debt, mezzanine and equity financing to companies for recapitalizations, acquisitions and buyouts. Earlier, he was a vice president at the Wachovia Corporation in the U.S. Corporate Group. Mr. Kennedy started his financial services career in investment management at J.P. Morgan & Company in New York.

Mr. Kennedy was appointed by President Obama to serve as Chairman of the Federal Retirement Thrift Investment Board, the largest pension fund in the country, and has been confirmed by the U.S. Senate.

He previously served as a member of the Board of Trustees of the Georgia Employees Retirement System Pension Fund, and is the recent Chairman of the Board of Visitors at the University of North Carolina. He is also a past member of the Board of Trustees of the Phillips Exeter Academy in Exeter, New Hampshire. Mr. Kennedy is an active member of Leadership Atlanta, the Atlanta Venture Forum and the Harvard Business Club of Atlanta.

He received a master's degree in Business Administration from Harvard Business School and a bachelor of arts degree in History and Political Science (high honors) from the University of North Carolina at Chapel Hill.



### **Rhoda Billings**

A native of Wilkesboro, Billings has served the North Carolina Bar Association (NCBA) tirelessly throughout her distinguished career. In 1991, she became the first woman to serve as president of the NCBA. In 1981, she became the founding chair of the Criminal Justice Section. From 2008 through 2012, Justice Billings served as founding chair of the Judicial Performance Evaluation Committee. The Judicial Performance Evaluation Committee, composed of lawyers, laypersons and retired jurists, delivered North Carolina's first comprehensive statewide evaluation of trial court judges. The information obtained through the Committee's exhaustive efforts, combined with a subsequent evaluation of non-incumbent candidates compiled by the Administration of Justice Committee, is now being used by citizens of this state to evaluate candidates for the District Court and Superior Court. Billings served on the NCBA Board of Governors from 1982 through 1984.

Justice Billings earned her undergraduate degree in 1959 from Berea College in Berea, Ky., where she majored in English. The only woman in the Class of 1966 at the Wake Forest University School of Law, she graduated first in her class. She practiced law with her husband, Don Billings, from 1966 to 1968, and served as a U.S. Bankruptcy Chapter 13 Trustee from 1966 to 1967. When the District Court system was established in North Carolina in 1968, Justice Billings was one of five successful candidates and the only woman elected to serve in Forsyth County. She joined the law school faculty at Wake Forest in 1973, serving one year as an assistant professor of law, and from 1974 to 1979, as an associate professor of law. She held the rank of professor from 1980 to 2003.

While on leave from August 1984 to January 1987, Justice Billings practiced with Billings, Burns and Wells. She also chaired the North Carolina Parole Commission and served on the North Carolina Supreme Court from 1985 to 1986, serving as Chief Justice in 1986. Billings was the second woman to serve on the North Carolina Supreme Court, the second woman to serve as Chief Justice, and the second woman to receive the Judge John J. Parker Award.

Justice Billings and her husband, Don Billings, reside in Lewisville. They are the parents of Renee Crawford and Douglas Billings.



### **Linda Combs**

Dr. Linda Morrison Combs is a leading expert on what works in running and turning around large organizations with complex budgets and big challenges.

From 2005 to 2007, she was Controller of the United States. As Controller of the Executive Office of the President, Office of Management and Budget, she worked on the widest possible range of issues at the highest levels of government. Dr. Combs routinely briefed the President of the United States on the status of financial management in the federal departments, and frequently testified before numerous Congressional oversight committees. She led Sarbanes-Oxley compliance for the entire federal government. Dr. Combs headed the Chief Financial Officers Council for the entire Federal government and was responsible for establishing financial management policies and requirements for the Executive Branch of the federal government, totaling \$2.7 trillion in revenue.

Dr. Combs's key selected accomplishments as Controller of the United States included: reducing the audit completion time from five months to 45 days from end of the fiscal year for the entire federal government for the first time in history; reducing improper payments by \$9 billion; and disposing of \$4.5 billion of unneeded real property.

During Dr. Combs's career, she has worked for three U.S. Presidents, and has earned five Senate confirmations. In previous positions, she has been the Chief Financial Officer at the Environmental Protection Agency (\$8 billion in revenue) where she led that agency to obtain a clean audit opinion with no material weaknesses, and received the highest honor awarded---the prestigious Crystal Eagle Award from the President. As Assistant Secretary of the Department of Transportation (\$58 billion in revenue), she led that agency to be the first federal department to install a single core financial system department-wide, resulting in the Department of Transportation being designated a Federal Financial Center of Excellence. Dr. Combs also held Assistant Secretary or equivalent Chief Operating Officer roles at the Department of Treasury, Department of Veterans Affairs, and Department of Education.

Dr. Combs founded three successful companies and took their products to worldwide distribution. She also held line management positions with significant profit and loss responsibilities at a large southeastern bank.

Dr. Combs received a doctorate degree from Virginia Tech. She received a bachelor's degree and a master's degree from Appalachian State University, and is a graduate of the Program for Senior Managers at Harvard University.



**Nelson Dollar**

Representative Dollar is currently serving in his 5<sup>th</sup> term in the North Carolina General House of Representatives. He serves as the Senior Chair of the Appropriations Committee. Representative Dollar serves on a range of committees including Finance, Insurance, Commerce, Health and Human Services, Transportation, Public Utilities, Regulatory Reform and University Board of Governors Nominating. Representative Dollar also serves on a range of legislative oversight committees and special initiatives including the Medicaid Reform Advisory Group.

Representative Dollar is the principal with J. N. Dollar and Associates, a media and public relations firm. His past career included teaching at Wake Technical Community College, the North Carolina Department Commerce, and the Office of the North Carolina Governor.

Representative Dollar received a bachelor's degree and master's degree from Appalachian State University. He has been active with the Boy Scouts of America for forty years and is a leader with C.L.U.B. Youth Ministries. Representative Dollar is married to Lorrie Dollar and they have one son, Ian.



### **Greg Gaskins**

Greg Gaskins is currently serving as the Finance Director of the City of Charlotte North Carolina. As the Finance Director he plans and directs the activities of the Finance Department, including the Accounting, Revenue, Treasury, Risk Management and Finance Business Systems functions. Mr. Gaskins uses financial and legal expertise to support special city economic development initiatives. He also plans risk management policy and strategy and is responsible for the city's Comprehensive Annual Financial Report. He manages debt of over two billion dollars on behalf of the City's credit entities, and has the responsibility for all of the City's cash and investments. Additionally, Mr. Gaskins serves as trustee of the local Firefighter Retirement System.

Prior to his role with the City of Charlotte, he worked for the North Carolina Court of Appeals as a Prehearing Staff Attorney and the Department of State Treasurer as a Departmental Attorney and Counsel to the North Carolina Local Government Commission. In addition, Mr. Gaskins was Deputy Finance Director for the City of Charlotte.

Mr. Gaskins' accomplishments include being responsible for the formation of the Finance Risk Management Division, which is an agency jointly funded by the City of Charlotte, the County of Mecklenburg and the Charlotte/Mecklenburg schools to manage their risk, safety, insurance and claims processes. He was also the leader of the Finance Key Business Mission/Vision Teamwork process, and facilitated the sessions that led to their consensus vision. Mr. Gaskins has been a negotiator on a significant number of major public/private projects.

Mr. Gaskins received a bachelor's degree in Business Administration from Wake Forest University, a master's degree in Business Administration from the University of South Carolina, and a juris doctor degree from Wake Forest University. He also received a certificate in the Advanced Investments Program from the Wharton School and a certificate in the Pension Trustees Program from Harvard University Law School.



### **Rick Glazier**

Rick Glazier has been elected six times to the North Carolina General Assembly. He received his juris doctor degree from Wake Forest University in 1981. Attorney Glazier is a Visiting Professor in Criminal Justice at Fayetteville State University and has been teaching pre-trial law as well as trial and appellate advocacy at Campbell University School of Law for twenty-one years. In 1996, he was elected to the Cumberland County School Board and served for six years, two as Chairman. Attorney Glazier started his professional career in Fayetteville as Assistant Public Defender, then served five years as a law clerk to two federal judges, James C. Fox and Wallace Dixon, and spent fifteen years as a member of the Beaver, Holt law firm.

Attorney Glazier is widely recognized as a major leader on education and legal issues in the General Assembly. He currently serves on the following committees: Education Appropriations, IT Appropriations, Education, Judiciary, Banking and Insurance. He has served as Chair of the House Appropriations on Education, Chair of the House Education Committee (K-12), Chair and Vice Chair of several Judiciary Committees and, for five years, Co-Chair of the Joint Legislative Ethics Commission.

Attorney Glazier has spearheaded a number of legal and social justice bills at the legislature, including the School Violence Protection Act (the Anti-Bullying Bill), the Healthy Youth (Comprehensive Sex ED) Act, the North Carolina Actual Innocence Inquiry Commission Act, the Eyewitness Identification Reform Act, several DNA and biological evidence bills, the Uniform Military Child Custody Act, North Carolina's current special education laws, public health embargo and quarantine laws, as well as North Carolina's No Smoking in Restaurants bill.

Currently, Attorney Glazier serves on a number of state and national educational task forces on education and healthcare issues, including the North Carolina State Institute for Emerging Issues Forum on Creating an Outstanding 21st Century Teaching Work Force; the National Conference of State Legislators Education Committee; and the Millbanks Foundation Eastern United States Advisory Board. He is a former member of the Z Smith Reynolds Foundation Advisory Board, the UNC-TV Board of Trustees, the Chief Justice's Committee on the Future of the Business Courts in North Carolina, and the North Carolina Public School Forum Board of Directors.

Attorney Glazier and his wife, Lise, have two children, Megan and Philip.



### Ralph Hise

Senator Ralph Hise is serving his second term representing the 47<sup>th</sup> district in the North Carolina Senate.

Senator Hise co-chairs three standing Senate committees: Pensions & Retirement and Aging, Appropriations on Health and Human Services, and Health Care. He is also the Senate Chair for the Joint Legislative Oversight Committee on Health and Human Services, and for the Committee on Health Care Provider Practice Sustainability and Training/Additional Transparency in Health Care.

He is a member of the following standing Senate committees: Finance, Insurance, Redistricting, Rules and Operations of the Senate, and Transportation. He is also a member of the following non-standing committees: Joint Legislative Commission on Governmental Operations, Joint Legislative Oversight Committee on Information Technology, Committee on Market Based Solutions and Elimination of Anti-Competitive Practices in Health Care, Joint Legislative Program Evaluation Oversight Committee, and Joint Legislative Transportation Committee.

Senator Hise is a staff member at Mayland Community College in Spruce Pine. He is a statistician, and a graduate of Appalachian State University, where he received a bachelor of science in Statistics, and North Carolina State University, where he received a master's of education degree in Higher Education Administration.

Senator Hise is a native of Spruce Pine, where he previously served two terms as mayor. He attended Mitchell High School and graduated from the North Carolina School of Science and Mathematics.



### **Mark Jewell**

Mark Jewell is a 26-year veteran educator, with the majority of his teaching career occurring at the elementary level as a fourth- and fifth-grade teacher.

During his tenure, Mr. Jewell has been a strong advocate for children, young adults and educators. He spent ten years as a classroom teacher in West Virginia, and the last sixteen years with Guilford County Schools, serving at Oak Hill Elementary in High Point and Murphey Traditional Academy in Greensboro. He was honored to receive Teacher of the Year at both schools.

Most recently, Mr. Jewell served as a lateral-entry specialist for the Guilford County Schools' Human Resources Department, providing support for new teachers entering the profession through alternative licensure pathways. In addition, he has also contributed to many local and community boards: the Guilford County Council of PTAs, the Guilford Education Alliance, the Guilford Education Committee, the Guilford County Schools United Way Campaign, the High Point Student Human Relations Committee, Safe Schools NC Board of Directors, the North Carolina Public School Forum, and the Burroughs Wellcome Science, Math and Technology Council.

Mr. Jewell is a respected voice on public education policy, and a champion for all stakeholders at the local, state and national levels. He is the former president of the Guilford County Association of Educators, and served on the board of directors for both the North Carolina Association of Educators (NCAE) and the National Education Association. In April 2012, Mr. Jewell was elected as NCAE vice president, representing nearly 60,000 educators.

Mr. Jewell received both his bachelor's and master's degrees in Elementary Education from Marshall University.



### **Floyd McKissick**

Senator McKissick has served in the North Carolina State Senate since 2007. He has also served as a Deputy Minority Leader in Senate since 2011; Chair of the North Carolina Legislative Black Caucus from 2010 to 2012; Chair of the Durham County Democratic Party from 2005 to 2007; a Member of the Durham City Council from 1993 to 2001; a Former Member of the Durham Board of Adjustment and the Durham Planning Commission.

Senator McKissick currently serves as a member on the following legislative committees: Commerce, Finance, Health Care, Insurance, Judiciary II (Criminal), Program Evaluation, Redistricting, Subcommittee on Health and Human Services, and Transportation. He previously served on several Caucuses/Non-Legislative Committees for the North Carolina State Senate including the Education/Higher Education Committee.

In 2009, Senator McKissick was honored to receive the North Carolina Housing Coalition Legislative of the Year Award, the North Carolina Justice Center's Defender of Justice Award, the NAACP Political Trailblazer Award, the 2011 "Distinguished Leadership" Award from the North Carolina Division of the American Planning Association, the 2011 Medal of Valor for Excellence, the "Move" Award from the National Multiple Sclerosis Society, the 2011 Smart Growth America's Leadership Award and the 2013 Legislative of the Year Award for his exceptional leadership during the 2013 Legislative Session from the North Carolina Metropolitan Mayor's Coalition. He has also received national recognition as the primary sponsor of North Carolina's Racial Justice Act and for his leadership on sustainable development issues.

Since 1990, Senator McKissick has been a partner at McKissick and McKissick. Previously he was an associate at Dickstein, Shapiro and Morin in Washington, DC; and an associate at Faison, Brown, Fletcher and Broug in the Durham, North Carolina area. Senator McKissick is also an author.

Senator McKissick received his juris doctor degree from Duke University School of Law; his master's degree in Public Administration from Harvard University; his master's degree in Regional Planning from the University of North Carolina-Chapel Hill; and his undergraduate degree in Geography from Clark University. He has held leadership positions in the following organizations: Center of the Region Conference, Triangle J Council of Governments (Chair); Board of Directors, Hayti Heritage Center (Member); Lyon Park Advisory Board (Chair); Board of Directors, North Carolina Museum of Life and Science (Member); Research Triangle Park Foreign Trade Zone Board (Former Member).



### **Charles Perusse**

Charles Perusse has twenty years of statewide budget and financial management experience. He was appointed Chief Operating Officer (COO) for the University of North Carolina System on March 1, 2011. Mr. Perusse's COO portfolio includes managing budget and finance, human resources, information technology and development activities for a \$9 billion operation. Prior to that, Mr. Perusse served three years as State Budget Director and six years as Deputy Director of the Governor's Office of State Budget and Management. He spent eight years in the

General Assembly's Fiscal Research Division, serving three years as budget coordinator for the House of Representatives. Mr. Perusse has a thorough understanding of the entire North Carolina State budget and is a widely accepted expert in budget preparation and management activities. He has an excellent relationship with agency heads, legislative leaders, and bond rating staff. Mr. Perusse has considerable knowledge and application of government human resource practices and information technology programs.

Mr. Perusse's notable career accomplishments include: regaining North Carolina's AAA bond rating with Moody's; leading the development of the state's results-based budgeting initiative that emphasizes program performance and accountability; and assisting with the transition to a market and competency-based compensation program for state employees (career banding).

Mr. Perusse has received a master's degree in Public Administration from the University of North Carolina at Chapel Hill in 1994 and a bachelor of arts Degree in Political Science from North Carolina State University in 1992.

Mr. Perusse is married to Wendy Mills and they have two sons, Griffin and Keaton.



### **Neal F. Triplett**

Neal Triplett is President and CEO of DUMAC, Inc. (DUMAC), the investment arm of Duke University, where he oversees asset allocation, manager selection, manager performance evaluation and risk management. Located in Durham, North Carolina, the DUMAC investment staff manages approximately \$14 billion for Duke University and related entities.

In July 1999, Mr. Triplett joined DUMAC, initially working with public securities and hedged strategies before overseeing all of DUMAC's hedged investment strategies which at its peak represented over \$4 billion in assets. In January 2007, he was appointed President. During his tenure, Duke has consistently placed in the top quartile of performers for university endowments over longer-term time horizons.

Mr. Triplett holds a Bachelor of Arts Degree from Duke University where he majored in Public Policy and Religion. In 1999, he graduated with a master's degree in Business Administration from Duke University's Fuqua School of Business where he received the Fuqua Scholar Award. He also holds the Chartered Financial Analyst Designation. Prior to completing business school, Mr. Triplett was an Assistant Vice President and Credit Officer for Corporate and Real Estate Portfolios at Wachovia Bank.

In addition, Mr. Triplett serves on the boards and investments advisory committees of several organizations, including the North Carolina Department of State Treasurer, Brown Advisory Mutual Funds, MCNC, and Durham Academy.

Mr. Triplett's mother was a lifelong teacher in the North Carolina School System before retiring in 2003, and his wife taught in North Carolina for seven years. Along with his wife and two sons, he lives in Durham, North Carolina.

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## List of Interviewees

HEK interviewed all of the Commission members and the following stakeholders prior to the first Commission meeting in January to obtain various perspectives about the current governance model.

- Representative Stephen Ross
- Ms. Joyce Jarrett, Interim Executive Director, North Carolina Association of Educators
- Ms. Ann McColl, General Counsel, North Carolina Association of Educators
- Mr. David Vanderweide, Fiscal Analyst, Fiscal Research Division
- Mr. Mark Bondo, Fiscal Analyst, Fiscal Research Division

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## List of Meeting Materials and Information Requests from Commission Members

Commission members were provided a briefing book for each meeting that contained select readings for discussion. Over the course of the Commission's meetings various requests for research and further information arose. Questions from the Commission members are provided below. Responses to each specific question can be found on the State Treasurer's website at [www.NCTreasurer.com](http://www.NCTreasurer.com) under Divisions> Investment Management> Investment Fiduciary Governance Commission. The full briefing book for each Commission meeting is also available for viewing.

This archive will be available upon request through the Department of State Treasurer's Investment Management Division if the Commission specific pages on the site are ever removed.

### January 23, 2014 Meeting

1. Provide further detail on the history and evolution of the sole trustee model in the other states where it exists (New York, Michigan, and Connecticut).
2. Provide a summary of the inflows and outflows of the NCRS Fund on an annual basis over the past five year period.
3. Using the chart of peer systems (provided on page 24 of the briefing book), expand the chart to illustrate each system's:
  - a. Usage of internal management, external management and fund-of-funds,
  - b. 10-year performance history
  - c. Absolute risk assumed over the same 10-year time period
  - d. Unit cost (total cost / total assets managed)
4. Of the Top 25 public funds, identify the states that have a legal list (of permissible investments) or remnants of legal lists in their statutes. Highlight any connection between funds with legal lists and funds with statewide elected officials serving as board members.
5. Provide further detail relating to how the audit process works for the NCRS Fund. Include data on which of the Top 25 public funds that use an audit firm from the private sector versus the State Auditor's staff for independent audits of their financial statements.
6. Provide net performance data for the NCRS Fund on the following:
  - a. Internally and externally managed assets
  - b. Fund-of-funds

#### February 20, 2014 Meeting

7. Detail the expenses (staff time and costs) associated with performing external audits.
8. Provide an overview of the DST's internal policies that protect the interests of members and beneficiaries whose pension assets are under the responsibility of the Treasurer.
9. Provide the charter of the current Investment Advisory Committee, along with samples of charters from other public pension funds.
10. During the public comment period of the meeting, an audience member who is a Supplemental Retirement Plan Board Trustee suggested that a survey be conducted of the trustees of the Supplemental Retirement Plan Board and the State Health Plan Board to capture their views about what works well from a governance perspective.

#### March 25, 2014 Meeting

No additional research requested.

#### April 10, 2014 Meeting

11. Please provide a blank copy of the Statement of Economic Interest form in connection with the State Government Ethics Act.