



North Carolina Department of State Treasurer Statutory Review of Governance, Operations & Investment Practices

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Investment advice and consulting services provided by Aon Investments USA Inc.

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A decorative background featuring various shades of green leaves and foliage, with some leaves appearing to float or fall. The overall tone is bright and natural.

I. Introduction

Introduction–Background

- The North Carolina Department of State Treasurer (“DST”) selected Aon Investments USA Inc. (“Aon”) to conduct a statutory review (“Review”) of the Investment Management Division’s (“IMD”) governance, operations and investment policies. North Carolina law requires that the DST engage an independent expert at least once every four years to conduct the Review and to make recommendations for improvements. North Carolina G.S. § 147-69.10(b). This is the first statutory Review for North Carolina DST.

- Scope of Work: Aon was engaged to review the following five areas for comparison to industry common and best practices and to make any recommendations for enhancements:
 1. Current Authority, Duties, Laws
 2. Policy and Process Review
 3. Compliance Process Review
 4. Transparency, Accountability, and Ethics
 5. Ethics Policy and Insider Trading Policy Review

Background–Methodology

- The development of this report progressed through several stages. These stages included document and information collection, interviews, discussions, research, analyses, and report drafting. Aon submitted a draft version of the report for IMD staff review and feedback. The final report took staff comments into consideration. The final report, however, reflects the independent work and professional judgment of Aon staff. This approach is consistent with the Aon review methodology used for the many other reviews it has performed.
- We appreciate the time and cooperation provided by IMD staff during the preparation of this Review.



II. Executive Summary

Executive Summary

Overall, we found the IMD governance, operations and investment policies to be in line with best practices. We have offered recommendations for enhancements as outlined in the report and in the Summary of Recommendations. We summarize our findings for each of the five scope of work areas below.

1. Current authority, duties and laws:

- The statutory language governing investment of North Carolina Retirement Systems' ("NCRS") assets reflects sound trust principles, parallels model laws, and is similar to laws in other states that establish public pension funds. The statutory framework provides for appropriate independence, oversight and reporting, transparency, accountability, and high ethical standards.
- The statutory creation of the Investment Advisory Committee and its membership is in line with best practices and consistent with other sole fiduciary states.
- The statutes granting the Treasurer independence regarding budgetary authority, personnel, and procurement comport with best practices and enable the Treasurer to prudently exercise his duties to act in the best interests of the participants and beneficiaries.
- The Treasurer's investments are subject to a legal list with thresholds. Although IMD staff has indicated it does not impede its ability to meet investment objectives, we recommend pursuing statutory changes to remove the legal list and corresponding thresholds limitations as they are contrary to the Prudent Investor Act standard of care and the modern portfolio theory.

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2. Policy and Process Review:

- The Investment Policy Statement (“IPS”) generally follows best practice and contains many of the components we believe that a well-structured IPS should have. We offer modest recommendations for enhancements to an already well-structured IPS.
- The Investment Manager and Vehicle Monitoring Policy and External Investment Manager and Vehicle Selection Policy generally align with best practice. We recommend codifying appropriate segregation of duties related to operational due diligence and having consistency between the two policies.

3. Compliance Process Review:

- The IMD has initiated a thoughtful approach to developing a “Conflict Wall” related to access to material nonpublic information (“MNPI”). We offer recommendations to supplement the approach with additional monitoring efforts, codification of a formal policy that is provided to staff and incorporated into compliance training, and creation and monitoring of a restricted list.
- IMD maintains comprehensive process documentation related to its internal equity trading efforts. IMD’s approach to internal equity trading process aligns with best practice regarding what processes are implemented. We recommend enhancements to the internal equity program to ensure appropriate segregation of duties, as well as codification of cross-trade policies and procedures.

Executive Summary

4. Transparency, Accountability and Ethics:

- The depth and breadth of information posted on the DST's website is in line with best practices, provides relevant investment policies and reports, as well as IAC meeting materials. Taken as a whole, the information demonstrates the commitment to transparency and accountability, compliance with fiduciary principles and a solid ethical framework.
- The retained authority and delegations by the Treasurer are generally consistent with other public pension funds as well as those of the sole fiduciaries in New York and Connecticut.

5. Ethics Policy and Insider Trading Policy Review:

- The Placement Agent, Political Contribution, and Connection Disclosure Policy is exceptionally comprehensive and consistent with best practices and the associated implementation and monitoring procedures are sound. The policy, procedures and posting of disclosures on the Treasurer's website evidence excellent transparency and accountability.
- The Ethics and Conduct Policies Tier 1 and Tier 2 are comprehensive, provide clear guidance to DST employees, and contain many best practice elements. The Treasurer is to be commended for applying state ethics law requirements of filing statements of economic interest and mandatory training on those employees not governed by the state ethics laws. The adoption of a Secondary Employment Policy is another recognition of potential conflicts and constitutes a best practice.
- The IMD Code of Ethics and Conduct Policy serves as an important supplemental policy. It recognizes that IMD employees have heightened responsibilities, addresses MNPI, and contains the expectation of adherence to professional standards.

Executive Summary

5. Ethics Policy and Insider Trading Policy Review (continued):

- The IAC Code of Conduct is in line with best practices in addressing ethical issues and conflicts of interests, clearly states ethical expectations, and promotes transparency and accountability. To further strengthen the goals of the policy, we recommend having IAC members file annual internal statements of economic interest for review by Compliance Counsel.
- The IMD Insider and Personal Trading policy contains many provisions that are in line with peers and best practices. The posting of the policy is a best practice and provides excellent transparency. We recommend revisions to the policy for enhancement and recommend that IMD review available software utilized by other public funds related to monitoring of trading. Finally, we recommend a dedicated compliance officer or counsel familiar with federal securities laws own the responsibility for ensuring safeguards and controls related to the prevention of illegal insider trading.