

Memo

To: Members of the Investment Advisory Committee

Cc: Mr. Kevin SigRist
Chief Investment Officer, Investment Management Division

Ms. Jeanna Cullins
Fiduciary Services Practice Leader, Hewitt EnnisKnupp

From: Amy McDuffee, Associate Partner, Fiduciary Services Practice
Janet Callion, Consultant, Fiduciary Services Practice

Date: December 3, 2014

Re: Proposed Revisions to the Investment Advisory Committee Charter and Code of Ethics

In response to the request of Investment Management Division (IMD) staff, Hewitt EnnisKnupp (HEK) recently conducted a review of the Investment Advisory Committee (IAC) Charter and Code of Ethics. Both documents were created several years ago when the IAC was established. Now that the IAC has regularly met to conduct its business, it is important to revisit key governance documents to ensure each reflects actual practice and contemporary best practices. Additionally, conducting a periodic review and evaluation of the Charter and recommending appropriate adjustments is a stated responsibility of the IAC.

The purpose of this memo is to provide a high level summary of the proposed revisions to the IAC Charter and Code of Ethics for the IAC's consideration at its December 2014 meeting. The recommended revisions are based upon our evaluation of the documents and understanding of current IAC practices.

Proposed Revisions to the IAC Charter

The intent of the IAC Charter is to outline the IAC's purpose, primary responsibilities and authority, composition, relationships with professional staff, and meeting protocols. Based upon our review we found the Charter to be generally accurate; however, to better align with actual practice, we propose the following updates to the Charter.

1. Section II. C. Orientation

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Charge the IMD with sole responsibility for conducting the orientation. Currently the IMD and the General Counsel share joint responsibility. Staff from both areas has agreed that it is best for IMD to assume sole responsibility in order to better clarify accountability.

2. Section II. G. Secretary

Identify the IAC Secretary as the IMD Chief Operating Officer. Currently, the Charter specifies that the General Counsel serve as the Secretary, which is inconsistent with actual practice.

3. Section II. H. Legal Counsel

Add new language to outline the duties of Legal Counsel and its interaction with the IAC.

4. Section IV.B. IAC Self-Assessment

Adjust the required time period with respect to the self-assessment from annually to periodically, with the intent of at least biannually. This provides the requested flexibility given the IAC's quarterly meeting schedule.

5. Section IV. F. Review and Evaluate the Selection of Investment Managers

Clarify the IAC's responsibility to monitor compliance with the process used by staff.

6. Section IV. G. Review the Performance and Cost Reports

Clarify the IAC's responsibility to monitor the cost effectiveness of the investment program and advise the Treasurer on the reasonableness of benchmarks and universes used to measure performance.

7. Section IV. H and I. Reviewing and Evaluating Custodial Arrangements and Consultants

Adjust the review period requirement to specify a periodic versus annual review at the request of the Treasurer. Although these activities have not yet arisen in connection with the IAC's routine business, they could at some point in the future and therefore warrant continued inclusion.

HEK and IMD staff will be prepared to address specific questions regarding these updates during the IAC's December meeting.

Revisions to the Code of Ethics

We reviewed the IAC's Code of Ethics (Code) in light of industry best practices and the actual practices of the Department of State Treasurer and the IMD. Based upon our review, we found the current code to be in generally appropriate and only in need of some enhancements.

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The intent of the proposed revisions is to ensure documentation of the standards for ethics and transparency required by the Treasurer and achieve some consistency with the various policies applicable to IMD Staff. When considering the application of the Code, it is important to recognize that (1) IAC members, other than the State Treasurer, are by law not fiduciaries, (2) IAC members are not subject to State ethics laws unless expressly provided by positions they hold (i.e., State Treasurer, IAC members who are trustees of TSERS/LGERS¹ Board), and (3) IAC members include professionals and academics with relevant investment, banking and finance knowledge and expertise who are serving in the spirit of public service; therefore care should be taken to strike a balance of appropriate limitations while not unintentionally deterring those individuals from serving in the future.

With these themes in mind, we propose the following updates to the IAC's Code.

1. Section II. Ethical Principles
Clarify that certain IAC members are not subject to State Ethics laws and align the definition of conflicts of interest with the standard that applies to IMD staff.
2. Section III. E. Prohibition of Receipt of Gifts
Add new language to specify a zero-gifts standard for IAC members. This is the same standard that applies to IMD staff.
3. Section III. F. Exception to Prohibition of Receipt of Gifts
Add new language to indicate permissible exceptions. The intent is to match the standard that currently applies to public servants under law (i.e., State Treasurer, IAC members who are trustees of the TSERS/LGERS Board).
4. Section V. Post Service Restriction
Adjust the language for readability while maintaining the two-year period noted in the current Code.
5. Section VI. Confidential Information
Align the definition of confidential information with the standard that applies to IMD staff.
6. Section VIII. Disclosure Requirement
Establish Compliance Counsel as the notification point for IAC members. Add language to require IAC members to immediately report certain suspected or actual fraudulent or unethical acts; this language reflects the same standard that applies to IMD staff.

¹ Teachers' and State Employees' Retirement System of North Carolina / Local Governmental Employees' Retirement System of North Carolina.

7. Section IX. Annual Ethics Session
Establish an annual requirement for IAC members to be refreshed on the provisions required by the Code. This amendment is consistent with best practice.
8. Section X. Acknowledgment
Add new language to establish an annual attestation requirement. This amendment is consistent with best practice.
9. Section XI. Violation of the Code of Ethics
Add new language to establish a mechanism for the State Treasurer to enforce the provisions of the Code.

Lastly, a second signature page template was added for the purpose of facilitating IAC members' annual recertification with the Code. HEK and IMD staff will be prepared to provide further detail upon request.

Focus of the December 2014 IAC Review

At the December IAC meeting, HEK will facilitate a discussion where the IAC will be asked to provide feedback on the proposed substantive revisions to the IAC Charter and Code of Ethics and convey any additional direction to HEK and IMD staff. If needed, revised documents will be provided to the IAC at its February 2015 for its further consideration.

It has been a pleasure to assist the IAC and IMD staff with this review. Should IAC members have questions regarding the revisions, please do not hesitate to contact us.

INVESTMENT ADVISORY COMMITTEE CHARTER

DRAFT – FOR DISCUSSION PURPOSES ONLY

DECEMBER 2014

I. Purpose

The General Assembly has established the Investment Advisory Committee ("IAC") to advise the State Treasurer with respect to investments of 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 "Retirement Systems")¹.

The statute states, "The committee shall have advisory powers only and membership shall not be deemed a public office within the meaning of Article VI, Section 9 of the Constitution of the North Carolina or G.S. 128-1.1." In order to help the IAC fulfill its advisory duties, the State Treasurer has adopted this Investment Advisory Committee Charter ("Charter"). The IAC shall periodically review and evaluate this Charter and make recommendations to the State Treasurer for changes it deems are appropriate.

II. Composition

The Treasurer's Governance and Transparency Act of 2009 amended N.C.G.S. section 147-69.2(b1) to authorize the State Treasurer to serve *as* chairman ex officio and to appoint six IAC members. Two members shall be selected among the members of the board of trustees of the Retirement Systems. Four public members must have experience in areas relevant to the administration of a large, diversified investment program, including but not limited to, investment management, securities law, real estate development, or absolute return strategies.

- A. Terms.** IAC 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 State Treasurer. Each IAC member shall serve as long as the State Treasurer who appointed them remains in office, unless such member is removed earlier or resigns.
- B. Standard of Care.** No IAC member shall owe any fiduciary, trust, or similar obligations in connection with his or her membership on the IAC other than the duty to act in good faith and as expressly set forth in this Charter and applicable law and policies.
- C. Orientation.** All IAC members must complete an orientation program within sixty days of the date of their appointment. The Investment Management

¹ N.C.G.S. § 147-69.2(b1).

Division shall be responsible for conducting the orientation program.

- D. Ethics.** Upon accepting his or her appointment and annually thereafter, each IAC member shall be required to sign and submit to Compliance Counsel an affirmation pledging to uphold both the letter and the spirit of the Code of Ethics.
- E. Chair.** Pursuant to the statute, the State Treasurer shall be the chairman ex officio. These duties include but are not limited to: (1) calling special or emergency meetings, when necessary; (2) enforcing the governing charter and policies of the IAC; (3) appointing or removing IAC members, the IAC Vice-Chair and staff to serve the IAC; (4) appointing a designee to assume the Chair's responsibilities for the IAC, when necessary and (5) conducting the IAC meetings in an efficient and effective manner.
- F. Vice-Chair.** The Vice-Chair's duties include but are not limited to: (1) working constructively with all IAC members and staff; and (2) assuming the Chair's responsibilities for the IAC if specifically requested to do so by the Chair.
- G. Secretary.** The Secretary shall be the Chief Operating Officer of the Investment Management Division unless otherwise appointed by the State Treasurer. The Secretary's duties include but are not limited to: (1) maintaining a current list of IAC members; (2) notifying the IAC and the public of meetings; (3) coordinating and disseminating information to the IAC; (4) maintaining official minutes and records of all proceedings from IAC meetings; (5) preparing as directed by the State Treasurer prior to each meeting an agenda for the meeting,; and (6) facilitating the scheduling of each meeting and notifying the IAC members thereof.
- H. Legal Counsel.** The General Counsel to the State Treasurer shall serve as Legal Counsel to the IAC. Legal Counsel's duties include but are not limited to: (1) responding to requests under North Carolina public records laws; (2) ensuring compliance with open meetings laws; (3) facilitating the IAC's access to Compliance Counsel; and (4) monitoring IAC members' compliance with the Code of Ethics.

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.** Each year, the IAC will set, publish, and post on the State Treasurer's website an annual schedule showing the time and location of regular meetings. The IAC will meet at least quarterly and may convene more often if called by the State Treasurer or a majority of the IAC members.

- C. **Attendance Policy.** IAC members are to attend meetings in person. In urgent situations where personal attendance is not possible IAC members may attend by teleconference or by videoconference. The IAC 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.

IV. Responsibilities

The IAC shall be responsible for advising and assisting the State Treasurer in the areas set forth below. In addition, the IAC will perform any activities related to this Charter as directed by the State Treasurer.

- A. **Assist in Selection and Evaluation of the Chief Investment Officer.** If requested by the State Treasurer, when the Chief Investment Officer ("CIO") position is vacant or is scheduled to become vacant, the IAC will assist in the recruiting process, interview candidates, and/or provide input on the candidates. The IAC may also be asked to provide input to the State Treasurer during the annual evaluation of the CIO.
- B. **Self-Assessment of the IAC.** In order to ensure the IAC is functioning as effectively and efficiently as possible, the IAC will periodically assess its own performance and make appropriate changes with the intent that the assessment will occur at least biannually. During such assessment, it will also determine if the responsibilities in this Charter have been carried out.
- C. **Review and Recommend Investment Policies.** The IAC will assist and advise the State Treasurer on the establishment of the investment policies and any relevant investment guidelines. The IAC will periodically review the existing policies and guidelines and make recommendations as necessary regarding modifications and enhancements.
- D. **Review Asset Allocations.** The IAC will review information presented to it and advise the State Treasurer about the suitability and proper use of the current and any proposed asset classes. The IAC will review asset/liability studies and asset allocation studies for the Retirement Systems. The IAC will analyze and comment on diversification, risk control, asset class targets and ranges, and liquidity within of the stated investment objectives.
- E. **Review and Comment on Investment Management Structure.** The IAC will review and comment on the investment management structure of the Retirement Systems at least annually. The review will include the use of internal and external management, the number and types of managers in each class, the use of active and passive strategies, and correlations among portfolios.

- F. Review and Evaluate the Selection and Monitoring of Investment Managers.** The IAC will review the process used by staff and consultants in the selection and monitoring of investment managers made for the Retirement Systems, and compliance with such process. The IAC has no independent responsibility for the selection or monitoring of specific managers.
- G. Review Performance and Cost Reports.** The IAC will review the performance of the total investment portfolio of the Retirement Systems, each asset class, outside investment managers, and internal managers at least annually along with the cost-effectiveness of the investment program. Performance and costs will be compared to established benchmarks and universes. The IAC will advise the State Treasurer on the reasonableness of the benchmarks and universes.
- H. Review and Evaluate the Custodian Arrangement.** The IAC will periodically review information prepared by the staff and consultants about the quality of the services and the reasonableness of the fees for the custodian. If requested by the State Treasurer, the IAC will evaluate and discuss fees and services proposals and offer observations about the strengths and weaknesses of candidates for custodial and related services.
- I. Evaluate the Selection of Consultants.** If requested by the Treasurer, the IAC will evaluate proposals and offer observations about the strengths and weaknesses of any candidates considered for general or specialized consulting services for the Retirement Systems.

V. Authority

The IAC has the authority to review background data, historical information, staff reports, consultants' reports, and any other documents it deems reasonably necessary to form an opinion on the capabilities of the staff, investment managers, custodian banks, investment consultants, and other service providers to the Retirement Systems. Furthermore, the IAC is authorized to ask any questions of individuals that are relevant to the services they perform on behalf of the Retirement Systems.

The IAC also has the authority to call upon the Department of State Treasurer's Chief of Staff, CIO, General Counsel, investment consultant(s), actuary, and auditor to assist it in carrying out its responsibilities; however, any request for assistance from outside service providers that might result in additional fees must have the prior approval of the State Treasurer.

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

The IAC does not have the authority to sign contracts, obligate the State Treasurer, or spend any portion of the operating budget that has not been designated for IAC purposes.

VI. Expectations

IAC members are not expected to find investment opportunities, analyze individual investments or investment managers, and engage in the types of day-to-day investment activities performed in the Investment Management Division.

Individual IAC members are expected to: (1) be informed about the Retirement Systems' investment policies and practices; (2) work constructively with other IAC members to review investment activities; (3) interact appropriately with the State Treasurer, the staff, and outside service providers; (4) be prepared for all IAC meetings by reviewing agendas and supporting materials prior to the meetings; (5) attend IAC meetings, share expertise, and actively participate in the discussions; (6) respect open meetings laws by not convening meetings with fellow IAC members to discuss business of the Retirement Systems outside the properly noticed meetings; (7) follow conflict of interest, disclosure, and confidentiality rules and policies; (8) discharge duties solely in the interest of the members and beneficiaries and for their exclusive benefit; (9) incur only reasonable expenses in carrying out duties as an IAC member, consistent with the operating budget of the IAC; (10) live up to high ethical standards and avoid the appearance of impropriety; (11) attend an orientation session and on-going education opportunities, as appropriate; and (12) refrain from making individual time-consuming requests to staff without a directive of the full IAC.

VII. Compensation

The IAC members will serve without compensation but shall receive reimbursements for expenses and allowances consistent with those granted to members of other State boards. IAC members will be reimbursed 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 CIO of the Department of State Treasurer's Investment Management Division will attend and staff all IAC meetings. The CIO shall ensure appropriate internal staff members are assigned to assist the IAC and support the IAC's activities by preparing meeting materials, performing research, and rendering other types of assistance as reasonably requested by the IAC.

Adopted by State Treasurer Janet Cowell on _____, 201_.

INVESTMENT ADVISORY COMMITTEE CODE OF ETHICS

DRAFT – FOR DISCUSSION PURPOSES ONLY

DECEMBER 2014

I. Purpose

The General Assembly has established the Investment Advisory Committee (“IAC”) to advise the State Treasurer with duties related to the management of the investments of the Teachers’ and State Employees’ Retirement System, the Local Governmental 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 “Retirement System”).¹

II. Ethical Principles

Unless otherwise provided², IAC membership is not considered a public office under law³ subject to the oversight of the State Ethics Commission; however, IAC members should act with integrity, competence, diligence, respect, and in an ethical manner while performing their responsibilities as outlined in the IAC Charter. The advice of the IAC may influence the decision-making of the State Treasurer; therefore, the knowledge and expertise of the members on the IAC shall be applied solely for the benefit of the participants of the Retirement Systems. IAC members should not advance their personal interests or engage in behavior that appears to be a conflict of interest (“Conflict of Interest⁴”) with the Retirement System.

At the same time, it is important to recognize that IAC members volunteer their time in a spirit of public service and contribute their expertise without compensation. Accordingly, persons serving on the IAC should be free to pursue their personal and professional financial interests without limitation unless those interests would foreseeably result in a Conflict of Interest with the interests of the Retirement Systems or a restriction as defined in this Code of Ethics (“Code”).

¹ N.C.G.S. § 147-69.2(b1)

² The State Treasurer and the two IAC members selected from among the members of the boards of trustees of the Retirement Systems are subject to the oversight of the State Ethics Commission by virtue of their positions.

³ N.C.G.S. § 147-69.2(b1)

⁴ A Conflict of Interest shall mean circumstances that create a material risk that professional judgment or actions regarding advice or assistance given to the State Treasurer have been or will be unduly influenced by a direct or indirect personal interest.

III. **Restrictions on Transactions between the IAC Members and the Retirement Systems**

- A. Interested Party.** As used in this Policy, “interested party” shall mean: (1) an IAC member; (2) the spouse⁵ of an IAC member; (3) any partnership in which the IAC member or spouse is a general partner or owns ten percent of either the capital or profits interest of such partnership; and (4) any corporation in which the IAC member, or his or her spouse, individually or collectively, own or control ten percent or more of the outstanding stock.
- B. Prohibition on Transactions.** No interested party shall engage in a transaction if such transaction constitutes:
1. The sale, exchange, or lease of any property between the Retirement Systems and an interested party;
 2. The loan of money or other extension of credit between the Retirement Systems and an interested party;
 3. The furnishing of goods, services, or facilities between the Retirement Systems and an interested party; or
 4. The transfer of any assets of the Retirement Systems to, or the use of any assets of the Retirement Systems by or for the benefit of, an interested party.
- C. Prohibition as Broker-Agent.** An IAC member shall not, in his or her individual capacity or in any other capacity, act as a broker or agent for or otherwise represent any party in any transaction with the Retirement Systems.
- D. No Consideration.** No interested party shall receive any consideration from any party in connection with a transaction with the Retirement Systems.
- E. Prohibition of Receipt of Gifts.** No interested party may use their position to secure, solicit or accept things of value, including gifts, travel, meals and lodging, from parties doing or seeking to do business with the Department of State Treasurer Investment Management Division or interested in matters before the IAC.
- F. Exceptions to Prohibition of Receipt of Gifts.** This Code intends to be in harmony with the law⁶ with respect to gifts that a public servant is permitted to accept. This includes the gift and receipt of honorariums for participating in meetings, advertising items or souvenirs of nominal value, or meals furnished at banquets, as well as customary gifts or favors between employees or officers and

⁵ Spouse includes live-in domestic partners that are similar to marriage.

⁶ N.G.C.S. § 133-32 (d) and § 138A-32.

their friends and relatives where it is clear that it is the relationship rather than the business of the individual concerned which is the motivating factor for the gift or favor. However, all such gifts knowingly made or received are required to be reported by the IAC member to Compliance Counsel.

IV. Restrictions to Perform Certain Services or Evaluate or Vote on Certain Matters

If an IAC member is an officer, director, or employee of any entity which recommends, or seeks to engage in, a transaction not otherwise prohibited by this Code and the IAC member is required to evaluate or vote on such transaction, the IAC member shall notify in advance the IAC or his or her relationship to the entity and shall not participate in such an evaluation or vote. Further, such IAC member shall not knowingly perform services in connection with that transaction.

An IAC member shall not participate in any evaluation of, discussion of any evaluation of, or vote on, any transaction if the investment manager or other organization under consideration employs an interested party or an entity of which he or she is an officer, director, or employee.

The provisions of this paragraph, however, shall not preclude an IAC member from evaluating or voting on an investment matter which the only relationship between the Retirement Systems and the entity is that of co-investors in limited partnerships or other investment structures where management responsibility is not vested in the entity.

V. Post-Service Restriction

An IAC member shall not, for a period of two-years after termination, make an unsolicited appearance before the IAC or any Investment Management Division staff for the purpose of influencing the actions of the Department of State Treasurer and/or the IAC.

VI. Confidential Information

IAC members may be provided or have access to confidential information, including material, nonpublic information. It is the duty of IAC members to use care and discretion in the handling of confidential information. No IAC member shall use or disclose confidential information which he or she has gained in the course of or by reason of his or her official position on the IAC for purposes of advancing his or her personal or financial interest.

VII. Interpretation and Meaning of this Code

When an IAC member has a doubt as to the application of any part of this Code to a particular situation, he or she may request the General Counsel or his or her designee for an

advisory opinion. The IAC member shall have the opportunity to present his or her interpretation of the facts at issue and of the applicability of provisions of this Code before such an advisory opinion is made. Such interpretations made by the General Counsel or his or her designee shall be binding upon the IAC and its members.

VIII. Disclosure Requirement

Each member of the IAC shall have an affirmative duty to proactively identify and promptly disclose to the Compliance Counsel any personal, social, employment or business activities and relationships that impact his or her objectivity, create potential Conflicts of Interest, impair his or her ability to make impartial decisions, or otherwise interfere with the proper performance of his or her responsibilities as a member. In addition, each member shall have a duty to report to Compliance Counsel, personal or professional investments that would foreseeably result in a Conflict of Interest with the interests of the Retirement Systems and receipts of gifts from vendors.

Each member of the IAC shall also have an affirmative duty to immediately report knowledge of any actual or suspected act by another IAC member or Department of State Treasurer staff directly to Compliance Counsel that constitutes: (1) fraud or misconduct, (2) a material error that adversely affects the Retirement Systems' assets or interests, (3) misrepresentation or omission of material information in reporting and communications, and/or (4) violations of laws, rules, or Department of State Treasurer policies.

IX. Annual Ethics Session

Each member of the IAC shall annually be required to participate in an ethics session that is arranged by the Department of State Treasurer.

X. Acknowledgment

The State Treasurer has approved this Code setting forth standards of conduct for members of the IAC. A copy of the Code shall be provided to each person upon appointment to the IAC and annually thereafter.

Each IAC member shall acknowledge that they have received and read the Code and agree to be bound by the provisions contained within, and the requirements to: (1) annually attest compliance with the Code, (2) to voluntarily disclose any potential lack of compliance with the Code, and (3) recertify acceptance of the Code.

XI. Violation of Code of Ethics

Any violation of this Code or failure to annually attest compliance by an IAC member may be grounds for removal with cause by the State Treasurer.

Adopted by State Treasurer Janet Cowell on _____, 201_.

ACKNOWLEDGMENT

My signature below indicates that I have read, understand and agree to be bound by the terms of the Investment Advisory Committee Code of Ethics. I affirm that I do not presently have any Conflicts of Interest as defined within this Code.

NAME (print)

SIGNATURE

DATE

ANNUAL RECERTIFICATION
INVESTMENT ADVISORY COMMITTEE
CODE OF ETHICS COMPLIANCE FORM

My signature below indicates that I certify that I presently am and have been in compliance with all requirements of the Investment Advisory Committee Code of Ethics for the time period indicated.

Applicable Time Period: _____
(Month/Day/Year – Month/Day/Year)

NAME (print)

SIGNATURE

DATE