

**NORTH CAROLINA DEPARTMENT OF STATE TREASURER**

**INVESTMENT POLICY  
PRIVATE EQUITY PROGRAM'S INNOVATION FUND**

**I. Background**

The North Carolina State Treasurer (“Treasurer”) hereby adopts the following supplementary Private Equity Investment Policy (the “Policy”) to guide the implementation of the Treasurer’s Innovation Fund (the “Innovation Fund”). The Innovation Fund, a subset of the Private Equity Investment Program (“PEIP”), is an Economically Targeted Investment (“ETI”) fund that is authorized to commit up to \$250 million over a period of three to five years in investment opportunities with significant operations in, or significant connections with North Carolina.

In order to meet the long-term performance objectives of the Alternative Investment Fund (the “AIF”) and the North Carolina Retirement Systems (the “NCRS”), the Innovation Fund may include a mix of direct portfolio investments and co-investments as well as customized and standardized fund-of-funds investments. In order to comply with statutory requirements of the AIF described below and to prevent the potential non-investment related pressures that may accompany and hinder successful “in-state” investment programs, specific investment decisions will be made by one or more qualified Program Manager(s) selected by the Treasurer in accordance with applicable fiduciary standards. The Treasurer’s office will retain the right to reject any investment selected by the Program Manager(s) prior to implementation if it is deemed to violate this Policy.

Under G.S. §147-69.2(b)9, investments in private limited partnerships and similar investment vehicles (“Alternative Investments”) that invest in public/private equity, corporate buyouts, venture capital; etc. are allowed, but in the aggregate may not exceed 5% of the total market value of NCRS investment assets. The Innovation Fund is part of the 5% total limit on Alternative Investments. Assets allocated to the credit bucket (G.S. §147-69.2(b)(6c)) and inflation protection bucket (G.S. §147-69.2(b)(9a)) may have similar investment structures but have their own separate percentage limitations.

In accordance with the above requirements, the Innovation Fund will be structured as one or more limited partnerships or limited liability companies, each of which is managed by a Program Manager as general partner or managing member. The Treasurer, on behalf of the NCRS, will make its capital commitments to these investment vehicles and, unless otherwise approved by the Treasurer, will be the sole limited partner or nonmanaging member of each such entity. The terms of each investment vehicle will be established consistent with the purpose of the Innovation Fund and the other provisions of this Policy.

## II. Purpose

This document sets forth the policy of the NCRS with respect to the Innovation Fund. The Treasurer has the fiduciary duty under G.S. §147-69.7 to invest and manage the entrusted funds in a manner consistent with statutes, regulations, policies, and is required to manage the program solely in the interest of the participants and beneficiaries of the NCRS. This statute also provides that, in discharging the Treasurer's fiduciary duties in managing the assets of the NCRS, the Treasurer may consider benefits created by the investment in addition to investment return only if the Treasurer determines that the investment providing these collateral benefits would be prudent even without collateral benefits.

The Investment Management Division of the Department of State Treasurer (the "IMD") evaluates investments in accordance with Alternative Investments Policies and Procedures ("Alternative Investment Procedures") which are designed to ensure that the standard of care for investments is met. These standards apply to all investments, including the Innovation Fund.

## III. Strategic Objectives

The Innovation Fund shall be managed to accomplish the following:

- A. **Primary Objective.** Competitive risk-adjusted rate of return consistent with the performance objective of the AIF.
- B. **Collateral Objective.** Support the economic well-being of the state of North Carolina.

## III. Roles and Responsibilities

### A. Treasurer's Roles and Responsibilities

- Approve this policy and any revisions thereto;
- Retain one or more qualified, experienced Program Manager(s) in accordance with appropriate fiduciary standards;
- Approve the capital commitment of the NCRS to and other terms of each limited partnership or limited liability company to be managed by a Program Manager;
- Develop preferred terms for Program Manager(s) to seek when making investments for the Innovation Fund;
- Reject any investment selected by a Program Manager prior to implementation if it is deemed to violate this Policy;
- Recommend statutory revisions.

### B. Program Manager(s) Roles and Responsibilities

- Source and screen investment opportunities for inclusion in the Innovation Fund;

- Conduct due diligence using substantially the same thorough, comprehensive, and consistent due diligence process for all Innovation Fund investments as the IMD uses for all other PEIP investments;
- Work with counsel to prepare legal documentation required for program and investments;
- Make investment decisions using a prudent process focused on expected risk and return;
- Provide an estimation of the collateral benefits to the North Carolina economy, which should only be considered if the investment otherwise meets all of the requirements of this Policy;
- Semi-annually report on each investment's impact on the State of North Carolina's economy;
- Review the fit of an investment with Policy guidelines;
- Comply with the investment objectives and guidelines detailed in the Alternative Investment Procedures;
- Diversify the program across vintage years, opportunity types, investment styles, investment process;
- Monitor all investments on a regular and ongoing basis. Prepare investment evaluation reports at least quarterly;
- Maintain and periodically update the Treasurer on the pipeline of opportunities;
- Monitor cash flows, including capital calls and distributions, on a daily basis;
- Identify and resolve problem investments when they may arise;
- As appropriate, participating on the Advisory Boards of portfolio investments;
- Decision-making must be unbiased and free of influence from political agendas.

### **C. IMD Staff Roles and Responsibilities**

- Oversee the Program Manager(s) with regard to Innovation Fund implementation.
- Monitor the Program Manager(s)' implementation of the Innovation Fund and compliance with this Policy. This may include the use of special service providers for conducting legal review or other third party services.
- Monitor adherence to guidelines as set forth in this Policy.
- Monitor, evaluate, and report on program performance on a quarterly basis to the Investment Advisory Committee.
- Recommend statutory revisions.

## **IV. Investment Approaches and Parameters**

- A. Procedures and Limitations.** Invest according to the standards, procedures and limitations set forth in this Policy, the PEIP and the Alternative Investment Procedures. Such investments must be consistent with investment types found in approved sub-categories as noted in this Policy and the PEIP and comply with the investment and performance standards as set forth by the PEIP and the Alternative Investment Procedures.

- B. Prudent Investment Standards.** Select investments in accordance with its standards for prudent investments and its guiding principals as set forth in G.S. §147-69.7.
  - C. Asset Allocation Policy.** Conform to the Treasurer’s overall asset allocation policy. The Innovation Fund should be part of and consistent with the Treasurer’s strategy for the management of the entire portfolio of investments of the NCRS.
  - D. Classification.** Innovation Fund investments will be classified within the AIF asset allocation.
  - E. Period of Time.** Commit up to \$250 million over a period of three to five years, to one or more investment vehicles managed by a Program Manager(s) for investment in companies with significant operations in, or other significant connection with North Carolina that require additional capital to pursue growth strategies. These investment vehicles may make direct investments in such companies as well as indirect investments through other investment funds that invest primarily in such companies. Companies can be in a variety of industries including but not limited to pharmaceuticals, clean energy, technology and other sub-sectors of life sciences.
  - F. Based Investment Decisions.** Base investment decisions on a prudent process, focused on expected returns and risks; collateral benefits must not be included in expected return computations.
  - G. Opportunistic Partnering.** Consider customized strategies and opportunistic partnering (with public or private entities). Strategies that leverage Innovation Fund assets by bringing federal, state or other additional private investments to the State of North Carolina are encouraged.
  - H. Mitigate Manager Risk.** To mitigate manager specific risk, no more than 10% of the Treasurer’s capital commitment may be invested and/or committed for investment by a Program Manager in any one investment fund or direct investment, without the approval of the Treasurer.
  - I. Mitigate Vintage Year and Economic Cycle.** To mitigate vintage year/economic cycle/credit cycle risk, no more than 33% of the Treasurer’s capital commitment to any investment vehicle may be invested and/or committed for investment by a Program Manager during any single vintage year (defined as the year during which the first capital calls are made by such Program Manager), without the approval of the Treasurer.
- V. Performance Benchmark**
- A.** Generate returns greater than the Russell 3000 lagged 3 months plus 250 basis points, net of all fees and expenses. This is the same benchmark as non-Innovation Fund private equity investments.

- B. Generate returns competitive with those of similar private equity investments, as represented by the Venture Economics Total Index.
- C. It is expected that the returns generated by the Innovation Fund will be sufficient to compensate the NCRS for the long term and illiquid commitments associated with Private Equity investments. Recognizing the long-term nature of these investments, this relative performance will be measured over a period of multiple market cycles.

## **VI. Reporting**

The Program Manager(s) shall report on Innovation Fund performance, investments, concerns, material changes, and any violations of the Policy to the Treasurer and Investment Advisory Committee members on a quarterly basis.

## **VII. Policy Review**

The Treasurer shall review this policy at least once every year to ensure that it remains relevant and appropriate.