

**NORTH CAROLINA DEPARTMENT OF STATE TREASURER
POLICIES AND PROCEDURES**

DST Reference:	IMD-POL-1013-IMD
Title:	Investment Manager and Vehicle Monitoring Policy
Chapter:	General Administration
Current Effective Date:	July 28, 2022
Original Effective Date:	August 14, 2015

I. Purpose

This policy sets forth the process that the Investment Management Division (IMD) shall follow when monitoring Investment Managers.

II. Background

The Treasurer of the State of North Carolina (the Treasurer) maintains the investment programs for the North Carolina Retirement Systems (NCRS), Short-Term Investment Fund, Escheat Fund, and Other Ancillary Funds. The Treasurer and the North Carolina Supplemental Retirement Board of Trustees provide oversight for the investment programs of the North Carolina Supplemental Retirement Plans (SRP), the Supplemental Retirement Income Plan of North Carolina, North Carolina Public Employee Deferred Compensation Plan, and North Carolina Public School Teachers' and Professional Educators' Investment Plan. The Treasurer and the North Carolina ABLE Program Board of Trustees provide oversight for the investment programs of the North Carolina ABLE Program Trust.

IMD is the primary operating division within the North Carolina Department of State Treasurer (DST) with responsibility for day-to-day oversight and management of various asset pools described in the Definitions section.

III. Key Definitions

“Alternative Investments” means private investment funds meeting the definition of an investment company under the provisions of the AICPA Audit and Accounting Guide Investment Companies, (*e.g.*, hedge funds, private equity funds, real estate funds, venture capital funds, commodity funds, offshore fund vehicles, and funds of funds), as well as bank common/collective trust funds. Alternative Investments may be structured as limited partnerships, limited liability companies, trusts, or corporations.

“Director” means the person holding the title of asset class director and, to the extent that the asset class director’s responsibilities described in this Policy are carried out with participation of IMD staff reporting to that asset class director, those employees as well.

“External Investment Manager” means any of the following non-DST persons or entities: investment managers for separate or commingled accounts; investment advisors to private market vehicles (*e.g.*, private equity, real estate, hedge funds); general partners or managing members of private market investments or funds; limited liability vehicles (separate or commingled); fund-of-funds; and other vehicles to which the DST or affiliated boards may commit capital or hire, as well as entities controlled by or under common control with an External Investment Manager.

“Internal Investment Manager” means any DST person in charge of a portfolio managed internally.

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“Investment Manager” means any of the following actors engaged in investment-related work for NCRS, SRP, Short-Term Investment Fund, Escheat Fund, or Other Ancillary Funds; External Investment Managers: Sponsors (or other lead entities such as investment advisors or general partners) for co-investments; and DST person in charge of internally managed portfolios.

“NCRS” means the North Carolina Retirement Systems including the Teachers’ and State Employees’ Retirement System, the Consolidated Judicial Retirement System, the Firemen’s and Rescue Workers’ Pension Fund, the Local Governmental Employees’ Retirement System, the Legislative Retirement System, the North Carolina National Guard Pension Fund, and the Retiree Health Benefit Fund.

“Other Ancillary Funds” means any monies invested by the Treasurer in the Bond Index Fund or Equity Index Fund.

“Performance” means industry standard measurements of rates of returns, risks, cost-effectiveness, and compliance with applicable law, regulation, and policy over various rolling and terminal time-periods.

IV. Policy Statement

The systematic monitoring of Investment Managers shall be carried out

1. in accordance with investment objectives, fiduciary standards, and approved procedures and criteria as set out in the Investment Policy Statement for NCRS, IMD-POL-1000-ALL, and other applicable policies and statutes,
2. with a predominant reliance on Directors’ and third-party experts’ regular evaluation of factors relevant to long-term expected Performance, and
3. in an impartial, consistent, and transparent manner to facilitate timely and effective management of evolving risks within and across asset classes and through diverse market environments.

V. Monitoring Guidelines

Directors shall follow an impartial and consistent framework for Investment Manager monitoring. Directors have discretion to develop customized approaches which satisfy the requirements set forth in this Policy.

Directors shall utilize an established diverse network of information sources for monitoring purposes, including Investment Managers, DST staff, databases and systems, limited partner advisory committee meetings, peer investment managers, other investors, consultants, legal counsel, regulators, auditors, investment banks, broker/dealers, and the press.

Directors or outside consultants shall conduct site visits at each Investment Manager’s office no less frequently than biennially for Investment Managers primarily investing in public market financial instruments, and no less than triennially for Investment Managers primarily investing in private market assets. Directors shall recommend the suspension of regular site visits for Investment Managers whose asset values the Director, in consultation with the Chief Risk and Operating Officer (CROO), determines are immaterial to the asset class Performance.

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Directors shall regularly review the types of information pertinent to assessing an Investment Manager’s historic and potential future Performance listed below. The frequency of the review shall be on such a schedule as the responsible Director determines is appropriate for the type of investment or the particular Investment Manager.

1. Investment Manager net of fee rates-of-returns and risk measurements, including relative to benchmarks and comparable peer universes over various time frames.
2. Characteristics of underlying investments held by the Investment Manager and related transaction and/or financing activity relative to expectations and guidelines.
3. Reports of compliance with law, regulations, and contract terms.
4. Ongoing fit of the Investment Manager and its strategy with aggregate portfolio construction and liquidity requirements.
5. “Key Operational Due Diligence” factors which shall include, but not be limited to
 - a. Investment Manager organization,
 - b. contractual terms and governance,
 - c. trading, allocation policy, cash controls, custody, financing, and counterparty management,
 - d. valuation and audited financial statements (including all investment vehicles within each fund),
 - e. material litigation, fraud, or conflicts of interest, and
 - f. infrastructure and business continuity.
6. Cost effectiveness of Investment Manager and its strategy.

Directors shall utilize external consultants or internal staff with subject matter expertise to assist with “Key Operational Due Diligence,” as appropriate.

Directors shall ensure that documentation of monitoring activity (*e.g.*, advisory committee activity, meeting notes, Investment Manager reports, consultant reports) is timely created and maintained within the CRM system (Backstop) Directors’ documentation of monitoring activity, which shall include follow-up and issue resolution and key word tagging by Investment Manager and subtopic.

VI. Reporting and Escalation

Each Director shall regularly communicate material information and conclusions developed through the Director’s monitoring efforts, and shall provide the following:

1. Periodic informal updates to the Chief Investment Officer (CIO), and other Directors whose assets classes have relationships with an Investment Manager’s affiliates, and when requested, other DST staff and the Treasurer;
2. Recommendations relating to Investment Manager rebalancing, termination, and contract amendments, as more fully described in Section VII of this Policy;
3. An annual report (the Annual Report) to the CIO and CROO that summarizes the Director’s view for each External Investment Manager, and shall include:
 - a. the Investment Manager’s performance versus expectations (*i.e.*, Too Early to be Meaningful/Below/Meets/Exceeds),

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- b. the Quality of the Investment Manager’s aggregate *Operational Due Diligence* factors relative to institutional industry practices (*i.e.*, Strong/Average/Weak/Materials Concerns), and
 - c. support for DST’s Alternative Investments fair value assertions, as more fully described in Appendix 1 (the Annual Valuation Report).
4. A report on Internal Investment Managers’ performance, prepared by the CROO, in consultation with the applicable Director(s), containing substantially the same information contained in the Annual Report on External Managers.
5. If a Director becomes aware of the actuality or the possibility of a material compliance violation, litigation, fraud, or conflict of interest, the Director shall promptly notify the CIO, the CROO, and the General Counsel. After receiving a Director’s report related to either a material compliance violation or a material litigation, fraud or conflict of interest matter, the CIO and the General Counsel shall determine if escalation to the Chief Financial Officer, and/or Treasurer is warranted.

The CIO may, in the CIO’s sole discretion, seek input from the IMD Investment Committee, made up of the CIO, CROO and asset class directors, or an independent third-party expert. A further review ordered by the CIO may consider any element of an Investment Manager’s performance or Operational Due Diligence factors.

VII. Approvals

Directors are responsible for submitting written recommendations for the CIO’s review and approval for the following:

1. Rebalancing among Investment Managers;
2. Termination of an investment agreement, limited partnership, or other primary governing agreement; or amendment to a termination provision of such agreement;
3. Removal of a general partner, managing member, or investment advisor of an Investment Manager;
4. Early termination of investment/commitment period;
5. Termination of a master agreement (or other primary governing agreement) with a managed account program provider; and
6. Recommendations for new tactical or opportunistic investment.

The CIO may reject any recommendation, requested changes, or provide other feedback to the Director, or forward the recommendation to the Treasurer, through the General Counsel, to receive approval and execution, as may be required under the Signatory Authority Policy and the relevant investment agreement.

VIII. Enforcement

The CIO is primarily responsible for ensuring compliance with this Policy. The CIO shall have authority to interpret and apply this Policy and authorize procedures which deviate from this Policy. If deviations

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are approved by the CIO they shall be documented. Otherwise, failure to comply with this Policy could result in disciplinary action, up to and including, dismissal.

Revision/Review History

Version	Date Approved	Description of Changes
1.0	8/14/2015	Initial version
1.1		Additional background information provided on investment programs managed by IMD; revisions to definition of 'Investment Manager'
2.0	7/19/2017	Update to background and key definitions
2.1	8/13/2018	Tech changes to change position title from Director of Risk Management to Chief Risk and Operating Officer, added investment opportunity recommendations to list of items presented to CIO for review and approval, other minor revisions
3.0	10/11/2019	Revised definition of "Director;" clarified the frequency of review of information related to investment manager performance; added the reporting of Internal Investment Managers' performance as part of the reporting requirements of the policy; added information on action to take if Directors become aware of material compliance violations, litigation, fraud or conflicts of interest; modified name of policy; other formatting changes
3.1	2/19/2021	Tech changes to clarify that directors shall utilize external consultants or internal staff with subject matter expertise to assist with "Key Operational Due Diligence" as appropriate; updated position titles; reviewed by Valuation Committee
3.2	7/28/2022	Added 'cost effectiveness considerations as an additional factor when reviewing investment manager performance; other minor revisions

Appendix

Appendix 1 – Support for Alternative Investment Fair Value Assertions

For questions or clarification on any of the information contained in this policy, please contact the policy owner or designated contact point: Christopher Morris, Co-Chief Investment Officer and Chief Risk and Operating Officer at Christopher.Morris@nctreasurer.com. For general questions about department-wide policies and procedures, contact the [DST Policy Coordinator](#).

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Appendix 1: Support for Alternative Investment Fair Value Assertions

DST management is responsible for the valuation of Alternative Investments, as presented in DST's financial statements and submissions to the Statewide Annual Comprehensive Financial Report (ACFR). Therefore, DST is responsible for the design, implementation, and maintenance of internal controls relevant to the valuation of Alternative Investments.

Although DST looks to the Investment Managers for the mechanics of valuation of Alternative Investments, Directors are responsible for evaluating whether the valuations, as reported by Investment Managers, are materially accurate. Within the *Three Lines of Defense* model, Directors are the first line of defense; *i.e.*, "the business and process owners whose activities create and/or manage the risks that can facilitate or prevent an organization's objectives from being achieved. This includes taking the right risks. The first line owns the risk and the design and execution of the organization's controls to respond to those risks."¹ IMD Risk Management and the Financial Operations Division (FOD) are the second line of defense "bringing expertise, process excellence, and management monitoring alongside the first line to help ensure that risk and control are effectively managed."² FOD's responsibilities for valuation and reporting controls are set out in a separate policy, Investment Valuation Policy and Procedure [FOD-POL-7070-MUL]. The third line of defense is audit activities.

Each Director has the discretion to apply a risk-based approach to the Director's review of Alternative Investments valuations, including utilizing third-party subject matter experts. In exercising this discretion, the Director shall conduct an assessment of the risk of material misstatement of DST's financial statements resulting from the valuation of the asset class being impacted by valuation methodologies or assumptions used by individual Investment Managers that are incorrect, incomplete, or otherwise unsatisfactory. The CROO and FOD shall provide annual consultation to the Directors to inform them of levels of materiality for the risk-based approach.

By August 31 of each year, each Director shall provide a summary report to the CIO and CROO indicating that the Director has obtained and reviewed audited financial statements. The Director's report shall note GAAP compliance, whether the opinion is qualified, the auditor, and any material concern that the Investment Manager valuation procedures or reported values do not represent fair value. Other factors the Directors should give consideration to include:

1. Any restatements of prior period official financial statements;
2. Delayed audit opinions;
3. Use of a non-nationally recognized auditor; and
4. Other internally developed valuation tools or analysis.

In addition to providing the summary report, by August 31 of each year, each Director also shall prepare a letter to the CIO and CROO containing the following representations related to the Alternative

¹ "Leveraging COSO Across the Three Lines of Defense," July 2015, Institute of Internal Auditors publication, <https://www.coso.org/Shared%20Documents/COSO-2015-3LOD.pdf>

² *Ibid.*

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Investments within the Director's asset class to the best of the Director's knowledge and belief, as of the date of the letter:

1. *We have conducted due diligence and monitoring in material compliance with the External Investment Manager and Vehicle Selection Policy and Procedures and the Investment Manager and Vehicle Monitoring Policy. We acknowledge that our compliance with these policies and procedures is essential to maintaining internal controls relevant to the financial statement reporting of the valuation of Alternative Investments.*
2. *We acknowledge that Investment Managers report Alternative Investments valuations at an estimated fair value. We have used a risk-based approach to develop an understanding of the characteristics of the underlying investments and the Investment Managers' valuation processes for Alternative Investments sufficient to mitigate the risk of material misstatement of DST's financial statements.*
3. *We acknowledge our responsibility for developing sufficient information and expertise to evaluate and, if necessary, independently challenge an Investment Manager's valuation. Where we deemed appropriate, in our professional judgment, we have independently challenged the methodology and/or techniques as well as the outcome of the Alternative Investments valuations provided to DST. These challenges have been discussed with the Chief Investment Officer or Chief Risk and Operating Officer.*
4. *As requested, we have worked with the Financial Operations Division (FOD) to assist with the reconciliation and roll forward of balances to transactions, fees, and Investment Manager statements including the audited financial statements. We acknowledge that FOD is responsible for the proper accounting and reporting of these assets and for performing certain monthly reconciliations that will verify transactions are accurate and complete in the custodian's accounting records.*
5. *The Investment Managers are in compliance, except to any extent stated below, with all laws, regulations, and provisions of contracts that would have a material effect on the determination of financial statement valuations.*
6. *No events, including instances of noncompliance, have occurred subsequent to the date of the Investment Managers' financial statements that have not been disclosed to the CIO and Chief Risk and Operating Officer.*

After review of the annual reporting required under this Policy, and making inquiries as reasonably necessary, the CIO and the CROO shall sign the Director's letter, communicate the findings to FOD, and shall review the results at a meeting of the DST Investment Valuation Committee. The final resolution, or decision to report issues to the Treasurer, shall be made by the Chief Financial Officer, as chair of the Investment Valuation Committee.