

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2013

H.B. 1209
May 27, 2014
HOUSE PRINCIPAL CLERK

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HOUSE DRH10543-LL-215 (05/15)

Short Title: Retirement Investment Accountability. (Public)

Sponsors: Representatives Dollar, Collins, and S. Ross (Primary Sponsors).

Referred to:

1 A BILL TO BE ENTITLED
2 AN ACT TO ENHANCE THE ACCOUNTABILITY AND TRANSPARENCY OF THE
3 STATE RETIREMENT SYSTEMS' INVESTMENT PROGRAMS BY PROVIDING FOR
4 AUDITED FINANCIAL STATEMENTS, PERFORMANCE REVIEWS, EXPANDED
5 AND MODERNIZED REPORTING, A SUNSET ON THE CONFIDENTIALITY OF
6 PROPRIETARY INFORMATION, RESOURCE FLEXIBILITY FOR THE
7 INVESTMENT MANAGEMENT DIVISION, AND OTHER MEASURES.

8 The General Assembly of North Carolina enacts:

9 SECTION 1.(a) Article 6 of Chapter 147 of the General Statutes is amended by
10 adding a new section to read:

11 "**§ 147-69.9. Third-party audit of Retirement Systems investment programs.**

12 (a) In addition to all other audits and reports required by law, the State Treasurer shall
13 prepare and issue, as of the end of each fiscal year, a set of financial statements regarding the
14 investment programs for the Retirement Systems enumerated in G.S. 147-69.2(b)(8). These
15 financial statements shall be audited by a commercial independent third-party audit firm
16 selected and engaged by the State Auditor based upon selection criteria developed by the State
17 Auditor in consultation with the State Treasurer. The audit firm's report and the financial
18 statements shall be provided to the General Assembly within six months after the close of the
19 reporting period.

20 (b) Supplementary information accompanying the financial statements required by
21 subsection (a) of this section shall include a discussion of the Retirement Systems' risk and
22 returns compared to benchmarks, total management fees and incentives paid, and comparisons
23 to peer cost benchmarks.

24 (c) Any associated costs of the audit required by this section shall be subject to the
25 provisions of G.S. 147-69.3(f) and do not require appropriations to either the State Auditor or
26 the State Treasurer in the Current Operations Appropriations Act."

27 SECTION 1.(b) This section becomes effective for audits and reports relating to
28 the 2014-2015 fiscal year. For the 2014-2015 fiscal year, the requirements stated by subsection
29 (a) of this section shall be met by an independent review of the Retirement Systems' pro forma
30 financial statements. For the 2015-2016 fiscal year and thereafter, the audit requirement stated
31 by this section shall take the form of an independent opinion concerning the Retirement
32 Systems' initial financial statements. In order to allow for an opinion to be offered for the
33 2015-2016 fiscal year, the State Auditor shall select an audit firm no later than January 1, 2015,
34 and by June 30, 2015, the Treasurer shall separately account for any Retirement Systems
35 investment portfolios that are commingled with the Treasurer's other investment programs.



1 SECTION 2. Article 6 of Chapter 147 of the General Statutes is amended by
2 adding a new section to read:

3 **"§ 147-69.10. Performance review of Retirement Systems investment programs.**

4 At least once every four years, the State Treasurer shall engage a commercial independent
5 expert firm pursuant to G.S. 147-69.3(g) to evaluate the governance, operations, and
6 investment practices of the State Treasurer in order to develop recommendations for
7 improvement. The report of the expert firm shall be provided to the General Assembly when
8 complete."

9 SECTION 3.(a) Article 6 of Chapter 147 of the General Statutes is amended by
10 adding a new section to read:

11 **"§ 147-69.11. Reporting of Retirement Systems investments.**

12 (a) Definitions. – The following definitions apply in this section:

- 13 (1) External investment manager. – The State Treasurer's counterparty or its
14 affiliate given authority or discretion to make investment decisions
15 concerning the investments that are not managed internally by the State
16 Treasurer's staff.
- 17 (2) Incentive fees. – Any incentive compensation to an investment manager or
18 investment vehicle that the Retirement Systems incur directly or experience
19 indirectly as a reduction in distributions.
- 20 (3) Investment vehicle. – A limited partnership, limited liability company, trust,
21 or other legal entity through which the State Treasurer invests.
- 22 (4) Management Fees. – Compensation other than incentive fees paid to the
23 investment manager or investment vehicle to compensate it for its
24 management of funds that the Retirement Systems incur directly or
25 experience indirectly as a reduction in distributions.

26 (b) In addition to all other reports required by law, the State Treasurer shall prepare and
27 make public a report on the fees and performance of external investment managers engaged for
28 the Retirement Systems enumerated in G.S. 147-69.2(b)(8) as of the end of each fiscal year. A
29 copy of each report shall be submitted within nine months following the end of the fiscal year
30 to the State Auditor, the Joint Legislative Commission on Governmental Operations, the Chairs
31 of the House of Representatives Appropriations Subcommittee and Senate Appropriations
32 Committee, the Chairs of the House of Representatives and Senate Finance Committees, and
33 the Fiscal Research Division.

34 (c) The State Treasurer's report shall include all of the following that are applicable,
35 reported separately for each investment:

- 36 (1) The name, commitment amount, statutory classification, inception year, and,
37 as applicable, either a statement that the investment is managed internally by
38 the staff of the State Treasurer or the names of the external investment
39 manager and the investment vehicle for that investment.
- 40 (2) The value of the State Treasurer's investment as of the fiscal year end.
- 41 (3) For each investment made pursuant to subdivisions (1) through (6) of
42 G.S. 147-69.2(b) or sub-subdivisions a. and c. of G.S. 147-69.2(b)(8), the
43 periodic net annualized time-weighted rate of return for that fiscal year and,
44 since inception, reported net of fees.
- 45 (4) For each investment other than those described in subdivision (3) of this
46 subsection, the net annualized internal rate of return and investment multiple
47 for that fiscal year and, since inception, reported net of fees.
- 48 (5) For each investment other than those described in subdivision (3) of this
49 subsection, the total cash contributions or other investments made and the
50 total distribution received with respect to that investment for that fiscal year
51 and since inception.

- 1 (6) The dollar amount of the management fees and incentive fees incurred by
2 the State Treasurer and paid to the external investment manager.
3 (7) For any fund-of-fund investment vehicles, the aggregate management fees
4 and incentive fees for the underlying investment managers or investment
5 vehicles used by the external investment manager.
6 (8) If any placement agent fees relating to the investment were directly or
7 indirectly borne by the Retirement Systems, a list of the amount and type of
8 those fees.

9 Portfolios of investments managed internally by the staff of the State Treasurer shall be
10 reported on a portfolio-by-portfolio basis."

11 **SECTION 3.(b)** Chapter 132 of the General Statutes is amended by adding a new
12 section to read:

13 "§ 132-1.14. Public records for Treasurer's investment programs.

14 (a) Definitions. – The following definitions apply in this section:

- 15 (1) External investment manager. – The State Treasurer's counterparty or its
16 affiliate given authority or discretion to make investment decisions
17 concerning Treasurer investments that are not managed internally by the
18 State Treasurer's staff.
19 (2) Incentive fees. – Any incentive compensation to an investment manager or
20 investment vehicle that the Retirement Systems incur directly or experience
21 indirectly as a reduction in distributions.
22 (3) Investment vehicle. – A limited partnership, limited liability company, trust,
23 or other legal entity through which the State Treasurer invests.
24 (4) Management Fees. – Compensation other than incentive fees paid to the
25 investment manager or investment vehicle to compensate it for its
26 management of funds that the Retirement Systems incur directly or
27 experience indirectly as a reduction in distributions.
28 (5) Person. – An individual, corporation, business trust, partnership, association,
29 joint venture, or any other legal or commercial entity.
30 (6) Treasurer investment. – An investment for one or more of the investment
31 programs established, managed, or operated by the State Treasurer pursuant
32 to G.S. 147-69.3.

33 (b) Notwithstanding any other provision of this section or any other provision of law,
34 all of the following information is a public record for each Treasurer investment:

- 35 (1) The name, commitment amount, statutory classification, inception year, and,
36 if applicable, the names of the external investment manager and the
37 investment vehicle for that investment.
38 (2) The value of the State Treasurer's investment as of the fiscal year end.
39 (3) For each investment made pursuant to subdivisions (1) through (6) of
40 G.S. 147-69.2(b) or sub-subdivisions a. and c. of G.S. 147-69.2(b)(8), the
41 periodic net annualized time-weighted rate of return for that fiscal year and,
42 since inception, reported net of fees.
43 (4) For each investment other than those described in subdivision (3) of this
44 subsection, the net annualized internal rate of return and investment multiple
45 for that fiscal year and, since inception, reported net of fees.
46 (5) For each investment other than those described in subdivision (3) of this
47 subsection, the total cash contributions or other investments made and the
48 total distribution received with respect to that investment for that fiscal year
49 and since inception.
50 (6) The dollar amount of the management fees and incentive fees incurred by
51 the State Treasurer to the external investment manager.

1 (7) For any fund-of-fund investment vehicles, the aggregate management fees
2 and incentive fees for the underlying investment managers or investment
3 vehicles used by the external investment manager.

4 (8) If any placement agent fees relating to the investment were directly or
5 indirectly borne by the Retirement Systems, a list of the amount and type of
6 those fees.

7 (c) In order to prevent other investment traders from utilizing knowledge of potential or
8 pending Treasurer investment trades for personal gain, all records relating to trades made
9 directly by the staff of the State Treasurer pursuant to G.S. 147-69.2(b)(6b) or the second
10 paragraph of G.S. 147-69.2(b)(8) are not public record until 90 days after the transaction has
11 closed.

12 (d) The following information shall not be public record until 10 years after the
13 termination of an investment vehicle in which the State Treasurer has made a Treasurer
14 investment:

15 (1) Information regarding the portfolio positions in which the investment
16 vehicle invests.

17 (2) Capital call and distribution notices to investors of the investment vehicle.

18 (3) Information concerning other investors in the investment vehicle.

19 (4) The investment's private placement memorandum and other offering and
20 marketing material, if marked confidential.

21 (5) The investment's contractual documents, to the extent stated in any clause
22 that places a duty of confidentiality upon the State Treasurer.

23 (6) Any other information that constitutes a "trade secret" as defined in
24 G.S. 66-152(3) and that was disclosed or furnished by an actual or potential
25 external investment manager in connection with an actual or potential
26 Treasurer investment.

27 The information described in this subsection shall be available to the General Assembly and
28 State Auditor at any time, even if not public record. The information shall become public
29 record beginning on the date of the 10th anniversary of the investment vehicle's termination."

30 **SECTION 4.(a)** G.S. 147-69.3(f) reads as rewritten:

31 "(f) The cost of administration, management, and operation of investment programs
32 established pursuant to this section shall be apportioned equitably among the programs in such
33 manner as may be prescribed by the State Treasurer, such costs to be paid from each ~~program,~~
34 ~~and to the extent not otherwise chargeable directly to the income or assets of the specific~~
35 ~~investment program or pooled investment vehicle, shall be deposited with the State Treasurer~~
36 ~~as a General Fund nontax revenue program.~~ The cost of administration, management, and
37 operation of investment programs established pursuant to this section ~~and not directly paid~~
38 ~~from the income or assets of such program shall be covered by an appropriation to the State~~
39 ~~Treasurer for this purpose in the Current Operations Appropriations Act shall be reported to the~~
40 ~~General Assembly by June 15 of each year, providing the actual costs incurred for the previous~~
41 ~~fiscal year, the estimated costs for the current fiscal year, and the estimated costs for the next~~
42 ~~fiscal year."~~

43 **SECTION 4.(b)** G.S. 147-69.3 is amended by adding a new subsection to read:

44 "(g1) The State Treasurer is authorized to appoint employees possessing specialized skills
45 or knowledge necessary for the proper administration of investment programs created pursuant
46 to this section. Notwithstanding the restrictions on the establishment of new employment
47 positions contained in G.S. 143C-6-6(a), the State Treasurer may create those positions
48 authorized under this subsection solely in the interest of the beneficiaries of the various
49 investments authorized under G.S. 147-69.1 and G.S. 147-69.2, incurring only costs that are
50 appropriate and reasonable."

51 **SECTION 4.(c)** G.S. 147-69.3(i2) reads as rewritten:

1 "(i2) In order to promote achievement of long-term investment objectives and to retain
2 key public employees in the Investment Division, with investment functions, the State Treasurer
3 is authorized to establish market-oriented compensation plans, including bonuses for the Chief
4 Investment Officer and Investment Directors salaries and performance-related bonuses, for
5 employees possessing specialized skills or knowledge necessary for the proper administration
6 of investment programs, who shall be exempt from the classification and compensation rules
7 established by the Office of State Human Resources. The ~~bonuses may design and~~
8 administration of those compensation plans shall be based on compensation studies conducted
9 by a nationally recognized firm specializing in public fund investment compensation and the
10 Pension Plan performance compensation. The ~~salaries compensation and other associated~~
11 employee benefits shall be apportioned directly from the investment program. The Treasurer
12 shall report the salaries and bonuses paid to the Joint Legislative Commission on Governmental
13 Operations annually."

14 **SECTION 4.(d)** G.S. 126-5(c1) reads as rewritten:

15 "(c1) Except as to the provisions of Articles 6 and 7 of this Chapter, the provisions of this
16 Chapter shall not apply to:

17 ...

18 (31) Employees of the Investment Management Division of the Department of
19 State Treasurer."

20 **SECTION 5.** Article 6 of Chapter 147 of the General Statutes is amended by
21 adding a new section to read:

22 "**§ 147-69.12. Placement agents.**

23 (a) Definitions. – The following definitions apply in this section:

24 (1) External investment manager. – The State Treasurer's counterparty or its
25 affiliate given authority or discretion to make investment decisions
26 concerning Treasurer investments that are not managed internally by the
27 State Treasurer's staff.

28 (2) Person. – An individual, corporation, business trust, partnership, association,
29 joint venture, or any other legal or commercial entity.

30 (3) Placement agent. – Any person or entity that is directly or indirectly hired,
31 used, engaged, retained, compensated, or otherwise given anything having
32 monetary value or benefit, tangible or intangible, by an external investment
33 manager to assist in securing investment commitments or other ongoing
34 investment management business from any Treasurer investment funds. The
35 term "placement agent" does not include employees of an external
36 investment manager, employees of affiliated entities that are under common
37 control with the external investment manager, or attorneys hired by an
38 external investment manager to negotiate contractual terms.

39 (4) Treasurer investment. – An investment for one or more of the investment
40 programs established, managed, or operated by the State Treasurer pursuant
41 to G.S. 147-69.3.

42 (b) A person shall not act as a placement agent in connection with any potential or
43 actual Treasurer investment unless that person is registered as a lobbyist in accordance with
44 Chapter 120C of the General Statutes, meeting the criteria set forth in G.S. 120C-100(a)(10)b."

45 **SECTION 6.(a)** G.S. 147-69.3 is amended by adding a new subsection to read:

46 "(h1) The State Treasurer shall adopt, publish, and regularly review investment policy
47 statements for each investment program created pursuant to this section."

48 **SECTION 6.(b)** G.S. 147-69.3(i) reads as rewritten:

49 "(i) The State Treasurer shall report at least twice a year to the General Assembly,
50 through the Finance Committees of the House of Representatives and the Senate, on the
51 investment programs created under this section. The Treasurer shall present the reports to a

1 joint meeting of the Finance Committees. The chairs of the Finance Committees may receive
2 the reports and call the meetings. The Finance Committees may meet during the interim as
3 necessary to hear the reports from the State Treasurer. The State Treasurer's report and
4 presentation to the Finance Committees shall include all of the following:

- 5 (1) A full and complete statement of all moneys invested by virtue of the
6 provisions of G.S. 147-69.1 and G.S. 147-69.2.
- 7 (2) The nature and character of the investments.
- 8 (3) The revenues derived from the investments.
- 9 (4) The costs of administering, managing, and operating the investment
10 programs, including the recapture of any investment commissions.
- 11 (5) A ~~statement~~summary of the investment policies for the revenues invested.
- 12 (6) Any other information that may be helpful in understanding the State
13 Treasurer's investment policies and investment results.
- 14 (7) Any other information requested by the Finance Committees."

15 **SECTION 6.(c)** G.S. 150B-2(8a) reads as rewritten:

16 "(8a) "Rule" means any agency regulation, standard, or statement of general
17 applicability that implements or interprets an enactment of the General
18 Assembly or Congress or a regulation adopted by a federal agency or that
19 describes the procedure or practice requirements of an agency. The term
20 includes the establishment of a fee and the amendment or repeal of a prior
21 rule. The term does not include the following:

- 22 a. Statements concerning only the internal management of an agency or
23 group of agencies within the same principal office or department
24 enumerated in G.S. 143A-11 or 143B-6, including policies and
25 procedures manuals, if the statement does not directly or
26 substantially affect the procedural or substantive rights or duties of a
27 person not employed by the agency or group of agencies.
- 28 b. Budgets and budget policies and procedures issued by the Director of
29 the Budget, by the head of a department, as defined by G.S. 143A-2
30 or G.S. 143B-3, by an occupational licensing board, as defined by
31 G.S. 93B-1, or by the State Board of Elections.
- 32 c. Nonbinding interpretative statements within the delegated authority
33 of an agency that merely define, interpret, or explain the meaning of
34 a statute or rule.
- 35 d. A form, the contents or substantive requirements of which are
36 prescribed by rule or statute.
- 37 e. Statements of agency policy made in the context of another
38 proceeding, including:
 - 39 1. Declaratory rulings under G.S. 150B-4.
 - 40 2. Orders establishing or fixing rates or tariffs.
- 41 f. Requirements, communicated to the public by the use of signs or
42 symbols, concerning the use of public roads, bridges, ferries,
43 buildings, or facilities.
- 44 g. Statements that set forth criteria or guidelines to be used by the staff
45 of an agency in performing audits, investigations, or inspections; in
46 settling financial disputes or negotiating financial arrangements; or in
47 the defense, prosecution, or settlement of cases.
- 48 h. Scientific, architectural, or engineering standards, forms, or
49 procedures, including design criteria and construction standards used
50 to construct or maintain highways, bridges, or ferries.

- 1 i. Job classification standards, job qualifications, and salaries
 2 established for positions under the jurisdiction of the State Human
 3 Resources Commission.
 4 j. Establishment of the interest rate that applies to tax assessments
 5 under G.S. 105-241.21 and the variable component of the excise tax
 6 on motor fuel under G.S. 105-449.80.
 7 k. The State Medical Facilities Plan, if the Plan has been prepared with
 8 public notice and hearing as provided in G.S. 131E-176(25),
 9 reviewed by the Commission for compliance with
 10 G.S. 131E-176(25), and approved by the Governor.
 11 l. Standards adopted by the Office of Information Technology Services
 12 applied to information technology as defined by G.S. 147-33.81.
 13 m. An investment policy statement adopted pursuant to
 14 G.S. 147-69.3(h1)."

15 **SECTION 7.** G.S. 147-69.3(j) reads as rewritten:

16 "(j) Subject to the provisions of G.S. 147-69.1(d), the State Treasurer ~~shall~~may adopt
 17 any rules necessary to establish, operate, conduct, and carry out the provisions of all activities
 18 related to the investment programs established pursuant to this section."

19 **SECTION 8.(a)** G.S. 128-29.1 is repealed.

20 **SECTION 8.(b)** G.S. 147-69.2(b) reads as rewritten:

21 "(b) It shall be the duty of the State Treasurer to invest the cash of the funds enumerated
 22 in subsection (a) of this section in excess of the amount required to meet the current needs and
 23 demands on such funds. The State Treasurer may invest the funds as provided in this
 24 subsection. If an investment was authorized by this subsection at the time the investment was
 25 made or contractually committed to be made, then that investment shall continue to be
 26 authorized by this subsection, and none of the percentage or other limitation on investments set
 27 forth in this subsection shall be construed to require the State Treasurer to subsequently dispose
 28 of the investment or fail to honor any contractual commitments as a result of changes in market
 29 values, ratings, or other investment qualifications. For purposes of computing market values on
 30 which percentage limitations on investments in this subsection are based, all investments shall
 31 be valued as of the last date of the most recent fiscal quarter.

32 (1) Investments authorized by G.S. 147-69.1(c)(1)-(7).

33 (2) General obligations of other states of the United States.

34 (3) General obligations of cities, counties and special districts in North Carolina.

35 (4) Obligations of any company, other organization or legal entity incorporated
 36 or otherwise created or located within or outside the United States, including
 37 obligations that are convertible into equity securities, if the obligations bear
 38 one of the four highest ratings of at least one nationally recognized rating
 39 service when acquired.

40 (5) Repealed by Session Laws 2001-444, s. 2, effective October 1, 2001.

41 (6) Asset-backed securities (whether considered debt or equity) provided they
 42 bear ratings by nationally recognized rating services as provided in
 43 G.S. 147-69.2(b)(4).

44 (6a) In addition to the limitations and requirements with respect to the
 45 investments of the Retirement Systems set forth in this subsection, the State
 46 Treasurer shall select investments of the assets of the Retirement Systems
 47 such that investments made pursuant to subdivisions (b)(1) through (6) of
 48 this section shall at all times equal or exceed twenty percent (20%) of the
 49 market value of all invested assets of the Retirement Systems.

50 (6b) Investments pursuant to subdivisions (b)(1) through (6) of this section may
 51 be made directly by the State ~~Treasurer~~Treasurer, through investment

1 companies registered under the Investment Company Act of 1940,
2 individual, common, or collective trust funds of banks and trust companies,
3 group trusts and limited partnerships, limited liability companies or other
4 limited liability investment vehicles that invest primarily in investments
5 authorized by subdivisions (1) through (6) of this subsection, or through
6 contractual arrangements in which the investment manager has full and
7 complete discretion and authority to invest assets specified in such
8 arrangements in investments authorized by subdivisions (b)(1) through (6) of
9 this section, provided for each indirect investment, the investment manager
10 has assets under management of at least one hundred million dollars
11 (\$100,000,000).

12"

13 **SECTION 9.** Section 1 of this act becomes effective July 1, 2014, and applies as
14 provided in Section 1(b) of this act. Section 3 of this act becomes effective July 1, 2014, and
15 the reporting requirements required by that section apply to the reports for the 2013-2014 fiscal
16 year. Section 6 of this act becomes effective July 1, 2014, for the Retirement Systems
17 enumerated in G.S. 147-69.2(b)(8) and becomes effective July 1, 2015, for the other investment
18 programs created pursuant to G.S. 147-69.3. The remainder of this act becomes effective July
19 1, 2014.