

# **NC State Investment Fund, Inc. NC State Intermediate Term Fund Investment Policy**

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## I. Introduction

This Statement is issued by the Members Board of the NC State Investment Fund, Inc. (the “Fund”) for use by the Board of Directors of the NC State Investment Fund, Inc. (the “Board”) and for the guidance of its investment manager(s) in the investment of operating cash funds from the University and/or affiliated entities of North Carolina State University (the “Participants”).

The Fund is comprised of two separate pools. The Long-Term Investment Pool (the “LTIP”) and the Intermediate-Term Investment Pool (the “NC STATE ITF”). This document establishes the Investment Policy for the NC STATE ITF.

The NC STATE ITF Investment Policy (Policy) provides guiding principles for the Board to effectively supervise, monitor and evaluate the investment of intermediate-term assets and to optimize returns within appropriate risk parameters.

As a pooled fund for the collective investment of operating funds, the NC STATE ITF consists of excess balances of Participants. Excess balances are defined as funds not needed for normal operating purposes. Generally, NC STATE ITF will not include operating funds needed within the next year, endowed funds or those funds that are specifically excluded by law or contractual agreement.

## II. Governance and Oversight

### Board of Directors

The Board will establish investment policies, return objectives, risk tolerance, broad asset allocation ranges and monitor performance. In carrying out these duties, the Board has formed an NC STATE ITF Investment Committee (the “Investment Committee”) to assist in managing the assets of the NC STATE ITF. The Investment Committee’s role is to report to the Board on matters pertaining to the investment of the NC STATE ITF’s assets, performance and compliance with the Investment Policy.

### NC STATE ITF Investment Committee

The Investment Committee will consist of, at a minimum, two (2) members of the Fund’s Board, and three (3) ex officio officers which include the Assistant Treasurer, the Secretary, and the Assistant Secretary of the Fund.

Investment Committee responsibilities include the development of the NC STATE ITF Investment Policy, selection and termination of the master trustee/custodian, selection and termination of investment consultants and investment managers, monitoring performance of investment managers and the entire portfolio on a regular basis, maintaining sufficient knowledge about the portfolio and its managers so as to be reasonably assured of their compliance with the NC STATE ITF Investment Policy, and submitting periodic reports to the Fund’s Board.

The Investment Committee shall evaluate managers subject to, but not limited to, the following criteria:

1. Avoidance of material regulatory actions against the firm, its principals, owners or employees.
2. Adherence to the terms and conditions of the investment management agreement between the Fund and the manager.
3. Adherence to the stated philosophy and style of management at the time the investment manager was retained by the Fund.
4. Continuity of personnel and practices at the firm.
5. Ability to exceed the total return of the appropriate benchmark index.

The Investment Committee will review annually, at a minimum, the NC STATE ITF Investment Policy and make recommendations to the Members Board and Board of Directors as needed.

### Treasurer’s Office

The University Treasurer’s Office is responsible for managing NC STATE ITF investments in accordance with the NC STATE ITF Investment Policy under the direction of the Investment Committee.

The Treasurer’s Office is responsible for oversight and interactions with the investment managers, the preparation of analyses and materials for the Investment Committee, the execution of rebalancing actions within the stated bandwidths or pre-approved ranges, management of the custodial relationship, due diligence review of investment managers, performance reporting, performance monitoring, and accounting reconciliations.

The Treasurer's Office shall meet with the investment managers at least annually to review performance, their investment process, risk controls, and market outlook. Meetings may be held by teleconference.

The Treasurer's Office will immediately inform the Investment Committee of any material events that are discovered or reported during the ongoing due diligence process or that are required to be reported by the investment managers.

### **External Investment Managers**

External investment managers will invest NC STATE ITF assets in accordance with established guidelines but will apply their own judgment regarding security selection. External investment managers will be given full discretion, within established guidelines and policy limits, to select individual securities and diversify their portfolios. These responsibilities apply to managers of non-mutual and non-pooled funds, where the investment manager is able to construct a separate, discretionary account on behalf of the Fund. Although the Investment Committee cannot dictate policy to a pooled/mutual fund investment manager, it is the Investment Committee's intent to select and retain primarily pooled/mutual funds which in aggregate are similar to the investment policies of the NC State ITF. Each external investment manager shall:

1. Invest the assets of the NC STATE ITF with the care, skill, prudence and diligence that a prudent professional investment manager, familiar with such matters and acting in like capacity, would use in the investment of such assets, consistent with the guidelines outlined herein.
2. Adhere to the investment policies and guidelines prescribed by the NC STATE ITF and act in the best interest of the NC STATE ITF.
3. Have full investment discretion with regard to security selection, consistent with this policy and the manager's established guidelines.
4. Inform the Treasurer's Office about all significant matters pertaining to the investment of NC State ITF assets including but not limited to changes in investment strategy or portfolio structure; ownership, affiliations, or organizational structure; and any material regulatory actions being pursued or taken against the firm or any of its employees.
5. Report their performance on a monthly basis, and the reporting methodology must be in compliance with industry standards.
6. Meet with the Treasurer's Office and other investment staff on a regular basis, either in person or by teleconference.

### **Custodian**

If the investment vehicles utilized are mutual funds, NC State University will serve as the Custodian ("Custodian") for the NC STATE ITF investments and perform standard custodial functions and distribution of income to Participants. The University shall provide monthly account statements, performance reports, and other reports as requested. If separately managed account vehicles are utilized, a bank will be selected as the Custodian for the NC State ITF and perform standard custodial functions and distribution of income to Participants as well as provide monthly account statements, performance reports, and other reports as requested by the Treasurer's Office.

### **Ethics and Disclosures of Conflicts of Interest**

The Fund's Code of Ethics and Conflicts of Interest Policy applies to the Investment Committee and staff involved in the investment process. Disclosures shall be made of any significant interests that could directly or materially affect the NC STATE ITF investment activity and performance. These disclosures will be attested to on an annual basis.

### III. Investment Structure

#### Asset Allocation & Rebalancing

The percentage allocation to each type of investment may vary depending upon market conditions. The allocation table below documents the minimum, target, and maximum allocation weights. The Investment Team as delegated by the Treasurer's Office will use cash inflows/outflows in a manner consistent with the target allocation and allocation ranges as noted below. Allocations will be reviewed annually by the Investment Committee in conjunction with the annual Investment Policy review.

Type	Define	Minimum	Target	Maximum
<b>Cash &amp; Cash Equivalents</b>	Money Market Funds, Commercial paper, CD's, etc.	0%	0%	20%
<b>Core</b>	Short & Intermediate Term Fixed Income	60%	75%	100%
<b>Strategic</b>	Uncorrelated Strategies and NC State Investment Fund, Inc.	0%	25%	40%

### IV. Investment Objectives

The NC State ITF is designed to provide a margin of safety in the unlikely event that the short term operating cash pool is insufficient to meet any current or unplanned expenditure. A secondary objective is to provide enhanced financial flexibility during any unexpected market disruption when commingled funds can be susceptible to redemption risk. The investment of funds shall consider asset diversification, total return, suitability, and the experiences, quality and capability of external managers.

The primary investment objectives of NC STATE ITF are as follows:

#### Preservation of Capital

The primary objective is the preservation and safety of principal.

#### Liquidity

The NC State ITF shall remain sufficiently liquid to meet participants' cash flow requirements that may be reasonably anticipated for a 1-3 year timeframe. The Treasurer's Office will assess each Participant's need for liquidity by using a cash flow forecast to predict liquidity needs for any additions to or withdrawals from the NC State ITF portfolio.

#### Yield

The yield objective is to maximize the return that is consistent with liquidity needs with an acceptable level of risk.

#### Total Return

The Board adopted a Total Return concept which can offer the advantage of designing longer-term investment strategies as opposed to interest sensitive short-term policies and to optimize the fund between current income and capital appreciation. Participants in the NC State ITF are advised to only invest monies in this fund that are not needed for short term liquidity needs, as the fund can experience significant price volatility.

#### Reserve

Given the total return concept and pricing volatility, the Participants have established a policy to reserve 3% of the invested funds to protect the Net Asset Value (NAV) during times of extreme down market events.

#### Risk Management

The risk management investment philosophy and oversight for the Fund is to prevent any unnecessary portfolio concentration risk through the broad diversification of individual securities by security type, financial institutions, and corporations, while remaining consistent with the investment objectives for the Fund. In addition to security diversification, a risk management objective is to limit the probability to a 1% chance that a monthly loss could exceed -2% based on the conditional monthly VaR or CVaR 99%. The CVaR is derived by taking a weighted average between the value at risk and a loss exceeding the value at risk (tail risk). The portfolio's CVaR risk is not guaranteed.

## Performance Benchmarks

The NC State ITF will be measured against the Barclay's Capital Universal 1-5 Year Bond Index and the 1-3 Year U.S. Treasury Bond Index.

The total return goal for the NC State ITF is expected to match or exceed the performance of the appropriate benchmark index over a rolling three-year, or five year period given an appropriate level of risk. The performance of each investment manager will be evaluated against a comparable peer group and should rank above the median of that peer group over a rolling three-year period, or five-year period given an appropriate level of risk.

## V. Guidelines for Investments

This policy assumes that no broad list by category of investments can provide continuously adequate guidance for achieving investment objectives. Any such list is likely to be too inflexible to be suitable for all market environments in which investment decisions must be made. Therefore, the policy seeks to provide guidance as to the process by which investment strategies and decisions are developed, analyzed, adopted, implemented and monitored, and the overall manner in which investment risk is managed, which determines whether an appropriate standard of reasonableness, care, and prudence has been met for these investments.

### Credit Quality

80% of the portfolio should be at least Investment Grade or higher as rated by a Nationally Recognized Statistical Rating Organization (NRSRO).

### Duration

The portfolio's fixed income average effective duration will be less than five (5) years.

### Diversification

No single credit/corporate issuer should constitute more than 20% of the portfolio, except for U.S. Treasuries which may constitute up to 100%.

### Maximum Allocation by Permitted Investments

The following identifies the maximum exposure the portfolio may have relative to the identified permitted investment as defined in section VI:

Permitted Investments	Maximum Amount
Obligations of the U.S. Government	100%
Municipal Obligations	20%
Investment Grade Corporate Debt	80%
Cash & Cash Equivalents	20%
High Yield Debt	20%
Securitized Assets	40%
<b>Uncorrelated Assets:</b>	
NC State Investment Fund, Inc.	10%
Uncorrelated Strategies	30%

There may be periods where the maximum amount may be exceeded due to market fluctuations. If such periods exceed six months, the Investment Committee will determine the proper action to take. In addition, the fund may invest in Exchanged Traded Funds (ETF), Managed Accounts, or Mutual Funds. The use of pooled funds (e.g., ETF's, commingled funds, mutual funds, common trust funds, etc.) is permitted when it is deemed to be in the best

interest of the NC STATE ITF. These investment vehicles may have investment guidelines that are different than those described in the NC STATE ITF policy statement. Mutual Fund guidelines will supersede the guidelines of the NC State ITF policy statement.

## **VI. Permitted Investments**

The following list is indicative of the investment classes which are appropriate for intermediate term fixed income strategies based on return objectives and liquidity requirements. It should not be construed as an exhaustive list of “allowable” asset types. Security types and/or strategies not specifically enumerated, but which the Investment Committee determine are appropriate, may also be held. In addition, 80% of the total portfolio is to be invested in investment grade securities. The guidelines for the Cash and Cash Equivalents, Core, and Strategic styles listed below are written with the intent to provide investment managers sufficient flexibility to carry out their investment process:

### **Cash and Cash Equivalents**

Holdings of cash and cash equivalents may include the following:

- Money Market funds
- Commercial paper, negotiable certificates of deposit, and Bankers’ Acceptances rated at least A-1 by two NRSRO’s.
- Repurchase agreements for obligations of the United States or its agencies.
- Bank Loans
- Minimum P-1/A-1 rating or the equivalent from at least two NRSRO’s

### **Core**

#### **Obligations of the U.S. Government**

This category includes obligations issued by the U.S. Treasury, obligations guaranteed by the U.S. Government, or obligations issued or guaranteed by U.S. Federal Agencies, including but not limited to investments in Agency Mortgage-backed securities.

#### **Securitized Assets**

*Asset-Backed Securities (ABS)* - The investments in ABS shall be rated by an NRSRO at the time of purchase. These mortgage related securities are interests in pools of residential or commercial mortgage loans, including mortgage loans made by savings and loan institutions, mortgage bankers, commercial banks and others. Pools of mortgage loans are assembled as securities for sale to investors by various governmental, government-related and private organizations.

*Mortgage Backed Securities (MBS)* - A type of asset-backed security that is secured by a mortgage or collection of mortgages. These securities are grouped in one of the top two ratings as determined by an NRSRO and usually pay periodic payments that are similar to coupon payments.

*Collateralized Securities (CMO)* - Types of debt securities which are secured with collateral consisting of mortgage-related securities. A CMO is a debt obligation of a legal entity that is collateralized by mortgages and divided into classes. Similar to a bond, interest and prepaid principal is paid, in most cases, on a monthly basis. CMO’s may be collateralized by whole mortgage loans or private mortgage bonds, but are more typically collateralized by portfolios of mortgage pass-through securities guaranteed by GNMA, FHLMC, or FNMA, and their income streams.

#### **Investment Grade Corporate Debt**

Only debt issues that meet or exceed an Investment Grade Corporate rating from at least two NRSRO’s may be purchased. After purchase, any downgrade in rating below the stated credit rating standards must be reported to the Board of Directors. In addition, this asset class may invest up to 20% of its total assets in instruments that are to international and or emerging market countries.

(Denominated in US Dollars)

#### **High Yield Debt**

These securities are defined as 1) corporate bonds, with credit ratings below BBB- or Baa3 as determined by at least two NRSRO’s, or unrated with yields that correspond to other non-investment grade bonds, and 2) Bank Loans, secured senior floating rate financings made by banks and syndicated to investors.

#### **Municipal Obligations**

Bonds, notes, and other general obligations of a municipal authority organized within the United States upon which there is no default and having a rating of at least A+ as recognized by at least two NRSRO’s.



## **Derivatives**

Interest rate futures and options utilized to hedge the rate sensitivity and maturity of the portfolio are permitted. These instruments are to be used solely to mitigate risk at the portfolio level.

## **State Treasurers Short Term Investment Fund (STIF)**

A portfolio managed by the State Treasurer of North Carolina of highly liquid fixed income securities. These securities are primarily money market instruments and short- to intermediate-term U.S. Treasuries and Agencies. The primary consideration in making investments is safety and liquidity; the secondary consideration is income.

## **Strategic**

### **Uncorrelated Managers**

Unconstrained/Absolute Return fixed income products cover a wide range of approaches designed to produce positive absolute total returns across a variety of market environments. They tactically invest in a diverse set of risk factors, sectors and strategies within fixed income with an aim to maximize risk-adjusted total returns within a specific risk budget. By their nature, unconstrained managers have more flexible investment guidelines.

### **NC State Investment Fund, Inc. (Fund)**

A portfolio managed by the Treasurer's Office, based on direction from the Board, of broadly diversified assets allocated in a manner that is intended to achieve the return objective of inflation plus 5.5% (net of fees). Asset allocation guidelines reflect a diversified portfolio and emphasize equity-related investments to achieve the Fund's long-term return objective.

## **VII. Prohibited Investments**

This Policy prohibits the Investment Committee from engaging in any investment that would be considered speculative according to the principles of conservative investment management, whether or not that activity is specifically prohibited elsewhere in this Policy.

## **VIII. Selection of Investment Managers**

The Investment Committee will follow a process that embodies the principles of procedural due diligence in the selection of investment managers. The Committee may retain a "prudent expert" (a bank, insurance company, or investment advisor as defined by the Registered Investment Advisors Act of 1940) to facilitate this process. In addition, when selecting investment managers, the Investment Committee will:

1. Develop an investment manager candidate profile outlining the specific characteristics sought in the investment manager. Such criteria may include, but is not limited to:
  - a. Investment manager strategy and approach
  - b. Organizational Structure
  - c. Minimum and maximum assets under management
  - d. Client servicing capabilities
  - e. Performance criteria relative to an appropriate index and peer group
2. Analyze the investment manager candidates in terms of:
  - a. **Qualitative Characteristics**, such as key personnel, investment philosophy, investment strategy, research orientation, decision-making process, and risk controls.
  - b. **Quantitative Characteristics**, such as Global Investment Performance Standard -compliant composite return data, investment performance over multiple time periods, performance volatility, risk-adjusted rates of return (e.g., Information Ratio), and certain portfolio characteristics.
  - c. **Organizational Factors**, such as assets under management, ownership structure, client servicing capabilities, and fees.

The selection process shall conform to the requirements of the NC STATE ITF. The Investment Committee may utilize investment consultants or other professionals not responsible for the specific selection to assist in the development of the requirements, screening criteria, and analysis of the investment manager responses during the investment manager selection process.

## **IX. Guidance for Corrective Action**

Corrective action could be taken by the Investment Committee as a result of the on-going due diligence review process of the Investment Manager(s) by the Treasurer's Office. While there may be unusual occurrences at any time, the following are instances where corrective action or termination may be in order:

1. Major organizational changes at a firm may require a new contract and interview process. Failure on the part of the manager to notify the Board of such changes is grounds for termination. At all times, communication with the manager should be easy and informative.
2. Violation of terms of contract constitutes grounds for termination.
3. It is critical that the investment manager adhere to the original intent of the Board at the time they are engaged. Should either the Board or the Treasurer's Office staff ascertain that significant changes in investment approach have occurred, this may be grounds for termination.
4. The Board will not, as a rule, terminate the manager(s) on the basis of short-term performance. If the organization is sound and the firm is adhering to its style and approach, the Board will allow a sufficient interval of time, 12-18 months, over which to evaluate performance. The manager's performance will be viewed in light of the firm's particular style and approach, keeping in mind at all times the NC State ITF's diversification strategy, as well as the overall quality of the relationship.
5. Manager(s) may be replaced at any time as part of the overall restructuring of the NC State ITF.

## **X. Distribution Policy**

Net earnings of the NC STATE ITF shall be credited to the respective Participants on a quarterly basis. Net earnings would still be posted quarterly (even if reinvested) for each Participant to debit ITF and credit earnings. Net Earnings are defined as interest income, dividends, capital gains, less investment operation expenses. Withdrawals for an established spending policy will occur at least annually.

## **XI. Securities Lending**

With the exception of STIF, the Participants may not participate in a securities lending program.

## **XII. Periodic Review of Investment Policy**

The Board will review and, if necessary, update the NC STATE ITF investment policy statement at least on an annual basis.

## **XIII. Effective Date**

This investment policy statement was initially approved by the Fund's Members Board on 12/4/13, and last amended on X/XX/2015