

# **ENDOWMENT FUND INVESTMENT BOARD**

## **Investment Policy**

**Date Established:** 2000  
**Last Reviewed:** November 2016  
**Last Revised:** November 2016

### **Background and Purpose**

#### **Statement of Philosophy**

This statement of investment policy is set forth by the EFIB to:

- Define and assign the responsibilities of all involved parties;
- Establish a clear understanding for all involved parties of the investment goals and objectives of Fund assets;
- Offer guidance and limitations to all involved parties regarding the investment of Fund assets;
- Establish a basis for evaluating investment results;
- Manage Fund assets according to prudent standards as established in common trust law; and,
- Establish the relevant investment horizon for which the Fund assets will be managed.

#### **Investment Objectives**

In order to meet its objectives, the investment strategy of the EFIB is to emphasize total return; that is, the aggregate return from capital appreciation, dividend and interest income. The primary objectives in the investment management for Endowment Fund assets shall be:

- *To maintain the purchasing power of the Fund* – In order to maintain fair and equitable inter-generational funding, state statute has mandated that the real value of the corpus be protected from inflation;
- *To maximize total return over time at an acceptable level of risk;*
- *To provide relatively smooth and predictable distributions to the beneficiaries*
- *Maintain sufficient liquidity for anticipated expenditures.*

#### **General Investment Principles**

- Investments shall be made solely in the interest of and for the beneficiaries of the Funds;
- The Funds shall be invested with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent expert acting in like capacity and familiar with such matters would use in the investment of a fund of like character and with like aims;
- Investment of the Funds shall be diversified as to minimize the risk of large permanent losses, unless under the circumstances it is clearly prudent not to do so;
- The EFIB will employ one or more investment managers of varying styles and philosophies to attain the Funds' objectives;

- Cash is to be employed productively at all times, by investment in short-term cash equivalents to provide safety, liquidity, and return; and,
- The investment manager(s) should, at all times, be guided by the principles of “best price and execution” and that the Funds’ best interests are the primary consideration.

### **Delegation of Authority**

The Manager of Investments (“MOI”) is a fiduciary to the EFIB. The MOI is responsible for directing and monitoring the investment management of Funds’ assets. As such, the MOI is authorized to delegate certain responsibilities to professional experts in various fields. These include, but are not limited to:

- *Investment Consultant.* The consultant will assist MOI and the EFIB in: 1) establishing investment policy; 2) designing objectives and guidelines; 3) selecting investment managers; 4) reviewing such managers over time; 5) measuring and evaluating investment performance; and, 6) other tasks as deemed appropriate. It is expected that the consultant will serve as a fiduciary with respect to the services it provides and will have the proper insurance to cover exposure to risk.
- *Investment Manager.* An investment manager hired by the EFIB must be registered with the Securities and Exchange Commission under the Investment Act of 1940, unless inapplicable, or in the case of a banking organization with the Office of the Comptroller of the Currency. The investment manager has discretion to purchase, sell, or hold the specific securities that will be used to meet the Funds’ investment objectives. This includes mutual fund or any collective fund portfolio managers.
- *Custodian.* Any custodian will maintain possession of securities owned by the Fund, collect dividend and interest payments, and redeem maturing securities, and effect receipt and delivery following purchases and sales. Any custodian will also perform regular accounting of all assets owned, purchased, or sold, as well as movement of assets into and out of the Fund accounts. Any custodian will provide at a minimum monthly reporting of assets and transactions to the MOI and provide the MOI with any additional data requests.
- Additional specialists may be employed by the MOI to assist in meeting its responsibilities and obligations to administer Fund assets prudently.

The MOI will not reserve any control over investment decisions, with the exception of specific limitations described in these statements. Managers will be held responsible and accountable to achieve the objectives outlined in their specific guidelines. While it is not believed that the limitations will hamper investment manager decisions, each manager should request in writing any modifications that they deem appropriate.

Any deemed fiduciaries must acknowledge such in writing. All expenses for such experts must be customary and reasonable, and will be borne by the Funds as deemed appropriate and necessary.

## **Assignment of Responsibility**

### *Responsibility of the MOI*

The MOI is empowered by the Board to make certain decisions and take appropriate action regarding investment of the Funds' assets. The responsibilities of the MOI include:

- Developing sound and consistent investment policy guidelines;
- Establishing reasonable investment objectives;
- Selecting qualified investment managers after consultation with the EFIB executive committee;
- Communicating the investment policy guidelines and objectives to the investment managers;
- Monitoring and evaluating performance results to assure that the policy guidelines are being met;
- Selecting and appointing custodian(s);
- Discharging investment managers after consultation with the EFIB executive committee; and,
- Taking any other appropriate actions.

### *Responsibility of the Investment Consultant(s)*

The investment consultant's role is that of a non-discretionary advisor to the EFIB. The consultant will offer investment advice concerning the investment management of the Funds' assets. The investment consultant will act as a fiduciary with respect to the services it provides. The advice will be consistent with the investment objectives, policies, guidelines and constraints as established in this statement. Specific responsibilities of the investment consultant include:

- Assisting in the development and on-going review of the investment policy, asset allocation strategy and performance of the investment managers;
- Supporting portfolio optimization and other investment techniques to optimize the return/risk characteristics of the Funds;
- Conducting investment manager searches when requested by the MOI;
- Monitoring the performance of the investment manager(s) to provide both the MOI and the Board with the ability to determine the progress toward the investment objectives;
- Communicating matters of policy, manager research, and manager performance to the MOI and the Board;
- Reviewing the Funds' investment history, historical capital markets performance and the contents of this investment policy statement with any newly appointed members of the Board.

### *Responsibility of the Investment Manager(s)*

As a signed fiduciary, each investment manager will have full discretion to make all investment decisions for the assets placed under its jurisdiction, while observing and operating within all policies, guidelines, constraints, and philosophies as outlined in this statement and in their specific Manager Guidelines.

## **Marketability of Assets**

Based on the Fund's long-term liquidity requirements, the EFIB desires securities with readily ascertainable market values that trade in liquid markets but recognizes that some allowable assets are valued less frequently by industry established appraisal methods.

## **Investment Guidelines**

### **Allowable Assets**

Cash Equivalents:	Treasury bills; money market funds; STIF funds; commercial paper; banker's acceptances; repurchase agreements; certificates of deposit.
Fixed Income:	US government and agency securities; corporate notes and bonds; mortgage backed bonds; fixed income securities of foreign governments and corporations; planned amortization class collateralized mortgage obligations; or other "early tranche" CMO's; asset backed securities; or any other fixed income security eligible for inclusion in the Barclays U.S. TIPS Index or Barclays Capital Aggregate Bond Index.
Equities:	Common stocks; convertible notes and bonds; convertible preferred stocks; preferred stocks; American depository receipts (ADR's); stocks of non-US companies (ordinary shares); non-investment grade bonds.
Real Estate	Domestic, private, open-end, core commingled funds
ETF's, Mutual or Collective Funds:	ETF's, Mutual Funds, Collective Funds may be used for the purposes of equitizing transactional cash. ETF's, Mutual Funds, Collective Funds which invest in securities as allowed in this statement are also permitted. In all cases, investment managers will advise the MOI of their intent to utilize ETFs prior to their purchase, what specific ETFs they intend to use and the purposes they serve.
Futures and Options:	As described in Futures and Options" section below.

## **Futures and Options**

The EFIB may approve the use of financial index futures and options in order to adjust the overall effective asset allocation of the entire portfolio and for use as hedges. For example, covered call options may be used to mitigate an expected decline in securities prices. However, futures and options positions are not to be used for speculation, and the EFIB must specifically approve the program for each type of use. No long or short futures or option positions may be established, unless the portfolio has sufficient cash reserves to either fund purchase or deliver securities under the contract.

## **Derivative Investments**

Derivative securities are defined as synthetic securities whose price and cash flow characteristics are based on the cash flows and price movements of other underlying securities. Most derivative securities are derived from equity or fixed income securities and are packaged in the form of options, futures, CMOs (PAC bonds, IOs, POs, residual bonds, etc.), and interest rate swaps, among others. The EFIB will take a conservative posture on derivative securities in order to maintain its risk adverse nature. Since it is anticipated that new derivative products will be created each year, it is not the intention of this document to list specific derivatives that are prohibited from investment, rather it will form a general policy on derivatives. Unless a specific type of derivative security is allowed in the Investment Manager Guidelines, the Investment Manager(s) must seek written permission from the EFIB to include derivative investments in the Fund's portfolio. The Investment Manager(s) must present detailed written information as to the expected return and risk characteristics of such investment vehicles.

## **Prohibited Assets**

Prohibited investments include, but are not limited to the following:

- Commodities
- Futures Contracts except as described in previous section “Futures and Options”;
- Naked Options;
- Interest-Only (IO), Principal-Only (PO), and Residual Tranche CMOs; and
- Purchases of securities on margin and short-sale transactions are prohibited.

## Asset Allocation Guidelines

Investment management of the assets of the Endowment Fund shall be in accordance with the following asset allocation guidelines:

- Aggregate Fund Asset Allocation Guidelines (at market value)

Asset Class	Range	Target	Rebalance Point	Benchmark
Equities Domestic Equities	63%-69% 37%-47%	66.0% 42.2%	+ -3% + -5%	MSCI All Country World Index Russell 3000 Index
Large Cap Growth Core Value	24%-34% 4%-7% 10%-14% 9%-13%	29.2% 5.5% 12.7% 11.0%	+/-5%	Russell 1000 Index Russell 1000 Growth Index S&P 500 Index Russell 1000 Value Index
Mid Cap Growth Value	4%-12% 2%-6% 2%-6%	8.4% 4.2% 4.2%	+/-4%	Russell Mid Cap Index Russell Mid Cap Growth Russell Mid Cap Value
Small Cap Growth Value	3%-7% 1.5%-3.5% 1.5%-3.5%	4.6% 2.3% 2.3%	+/-2%	Russell 2000 Index Russell 2000 Growth Index Russell 2000 Value Index
International Equities Developed Growth Developed Value Developed Markets Index Fund	11%-19% 5%-8% 5%-8% 1%-3%	15.2% 6.6% 6.6% 2.0%	+/-4%	MSCI ACWI EX US (ND) Index MSCI EAFE Growth (ND) Index MSCI EAFE Value (ND) Index MSCI EAFE Index
Global Equity	5%-13%	8.5%	+/-4%	MSCI All Country World Index
Real Estate	5%-12%	8.0%	+/-4%	NCREIF ODCE Index
Fixed Income Aggregate Bond US Tips	23%-29% 20%-24% 3%-5%	26.0% 22.0% 4.0%	+/-3%	Barclays Aggregate Bond Index Barclays Aggregate Bond Index Barclays US TIPS Index
Cash and Equivalents	0-5%	0%		3-month Treasury Bill Index

- The EFIB may employ investment managers whose investment disciplines lead to investments outside the established asset allocation guidelines. However, taken as a component of the aggregate Fund, such disciplines must fit within the overall asset allocation guidelines established in this statement. Such investment managers will receive written direction from the EFIB regarding specific objectives and guidelines. In the event that the above aggregate asset allocation guidelines are violated, for reasons including but not limited to market price fluctuations, the MOI will instruct the investment manager(s) to bring the portfolio(s) into compliance with these guidelines as promptly and prudently as possible. In the event that any individual investment manager's portfolio is in violation with its specific guidelines, for reasons including but not limited to market price fluctuations, the EFIB expects that the investment manager will bring the portfolio into compliance with these

guidelines as promptly and prudently as possible without instruction from the EFIB.

### **Rebalancing of Fund Assets**

Understanding that different asset classes will perform at different rates, the MOI and the investment consultant will closely monitor the asset allocation shifts caused by performance. Therefore:

- The MOI will review the relative market values of the asset classes whenever there is to be a net contribution to the Fund and will generally place the new monies under investment in the category(ies) which are furthest below the target allocation in this policy; and,
- The MOI and investment consultant will review the asset allocation quarterly and during periods of severe market change to assure that the target allocation is maintained. If an asset class is outside the allowable range, the MOI, with input from the investment consultant, will take appropriate action to redeploy assets taking into account timing, costs and other investment factors.

### **Guidelines for Fixed Income Investments and Cash Equivalents**

- Securities must be rated investment-grade (Baa3/BBB-/BBB- or higher) using the middle rating of Moody's, S&P and Fitch; when a rating from only two agencies is available, the lower is used; when only one agency rates a bond, that rating is used.
- Fund assets may be invested only in commercial paper rated A1 (or equivalent) or better.
- The fixed income weighted average portfolio maturity may not exceed that of the Fixed Income benchmark by more than .5 years.
- Money Market Funds selected shall contain securities whose credit rating at the absolute minimum would be rated investment grade by Standard and Poor's, and/or Moody's.

### **Investment Performance Review and Evaluation**

Performance reports generated by the investment consultant shall be compiled at least quarterly and communicated to the EFIB for review. The investment performance of the total Fund, as well as asset class components, will be measured against commonly accepted performance benchmarks. Consideration shall be given to the extent to which the investment results are consistent with the investment objectives, goals, and guidelines as set forth in this statement. The EFIB intends to evaluate the manager over at least a three-year period, but reserves the right to terminate a manager for any reason.

Each manager shall maintain a portfolio consistent with characteristics similar to those of the composite utilized for their retention. Investment performance will be measured on a total return basis, which is defined as dividend and interest income plus realized and unrealized capital gains. Each manager will be evaluated in part by regular comparison to a peer group of other managers employing statistically similar investment style characteristics. It is expected that each manager will perform above the peer group median and the appropriate index over rolling three-year periods with respect to both return and risk.

Investment managers shall be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative factors that may impact their ability to achieve the desired investment results.

### **Investment Policy Review**

To assure continued relevance of the guidelines, objectives, financial status and capital market expectations as established in this statement of investment policy, the EFIB will review the policy annually.

### **GASB 40 Reporting Requirements**

Purpose: The Governmental Accounting Standards Board has identified that state and local governments have deposits and investments which are exposed to risks that may result in losses. GASB Statement number 40 (GASB 40) is intended to inform users of the financial statements about the risks that could affect the ability of a government entity to meet its obligations. GASB 40 has identified general deposit and investment risks as credit risk, including concentration of credit risk and custodial credit risk, interest rate risk, and foreign currency risk and requires disclosures of these risks and of policies related to these risks. This portion of the Investment Policy addresses the monitoring and reporting of those risks.

In general, the risks identified in GASB 40, while present, are diminished when the entire portfolio is viewed as a whole. Specifically, the risks identified and the measurements required is poorly transferable, if at all, to portfolios like the EFIB, which is dominated by equity exposure.

It is the policy of the EFIB that the risks addressed in GASB 40 are to be monitored and addressed primarily through the guidelines agreed to by those managers, and by regular disclosures in reports by managers of levels of risks that may exceed expected limits for those portfolios.

- **Credit Risk:** The risk that an issuer or other counterparty to an investment will not fulfill its obligations to the EFIB. GASB 40 requires disclosure of credit quality ratings of investments in debt securities as described by nationally recognized statistical rating organizations.

Policy: The Investment Guidelines section of this Investment Policy provides credit quality and maturity guidelines for fixed income and cash equivalent investments. Managers are required to comply with the Investment Policies set forth by the EFIB.

- **Custodial Credit Risk:** The risk that in the event of a financial institution or bank failure, the Fund would not be able to recover the value of their deposits and investments that are in the possession of an outside party.

Policy: The EFIB minimizes exposure to custodial credit risk by requiring that investments, to the extent possible, be clearly marked as to the EFIB ownership and further to the extent possible, be held in the Fund' name.

- **Concentration of Credit Risk:** The risk of loss that may be attributed to the magnitude of a government's investment in a single issue.

Policy: Managers will provide the EFIB with expected concentration of credit risk exposures in their portfolio guidelines. If the concentration of credit risk exceeds expectations, managers are to be required to report these occurrences to Staff and these disclosures are to be made available to the Board. For the portfolio as a whole, staff will report to the Board at a regular Board meeting if the exposure to a non-US government guaranteed credit exceeds 5% of the total EFIB portfolio.

- **Interest Rate Risk:** The risk that changes interest rates will adversely affect the fair value of an investment. Interest rate risk to the EFIB's fixed income portfolio is monitored using the effective duration methodology. Effective duration measures the volatility of the price of a bond given a change in interest rates, taking into account the optional underlying bond.

Policy: Managers will provide the EFIB with the expected portfolio duration in their portfolio guidelines. If the duration of the portfolio differs from expectations, managers are to be required to report these occurrences to Staff and these disclosures are to be made available to the Board.

- **Foreign Currency Risk:** The risk that changes exchange rates will adversely impact the fair value of an investment. The EFIB's currency risk exposures, or exchange rate risk, primarily reside within the international equity investment holdings.

Policy: The EFIB permits investing up to 20% of total investments in international equities. No foreign fixed income securities are permitted except currency. The EFIB recognizes that international investments (equity or fixed income) will have a component of currency risk associated with it. The individual manager guidelines will outline the expected currency exposures (either specifically or through ranges of security exposures to particular currency areas) of the underlying portfolio and if the actual currency exposure differs from the expected, managers are to be required to report these occurrences to Staff and these disclosures are to be made available to the Board.