

**BOARD OF REGENTS**  
EASTERN MICHIGAN UNIVERSITY

SECTION: 17
DATE:
September 22, 2009

**RECOMMENDATION**

**REVISIONS TO UNIVERSITY INVESTMENT POLICY**

**ACTION REQUESTED**

It is recommended that the Board of Regents approve revisions to Chapter 11.1.2 of the University's Policies, Rules, and Regulations regarding University investments. The recommended, revised investment policy (Att. 1) and the existing policy (Att. 2) are attached.

**STAFF SUMMARY**

The University's investment policy (Chapter 11.1.2) was last revised by the Board in March 2007. The policy covers the University's working capital and operating cash investments, but not the financial assets managed by the EMU Foundation. The EMU Foundation maintains a separate investment policy for the endowment and assets it manages.

On February 24, 2009, the Board authorized the University's engagement of an investment advisor (Fund Evaluation Group). The scope of the engagement included review of the University's investment policy. The recommended revisions reflect the outcome of that review and represent a consensus of Fund Evaluation Group and University administration.

The revised policy retains the basic structure of the investment policy adopted in 2007. There are three investment pools (short-term, intermediate-term, and long-term) with objectives and asset allocation guidelines and targets established for each pool. The recommended revisions to the policy are focused on providing clarification of the asset allocation targets and ranges, investments timeframes, the performance objectives that these investments will be benchmarked against, how the Investment Managers will be evaluated, and the responsibilities that are expected of the University's Investment Advisor.

Investment performance and adherence to policy guidelines will be reviewed with the Finance and Audit Committee of the Board at each meeting.

**FISCAL IMPLICATIONS**

None

**ADMINISTRATIVE RECOMMENDATION**

The proposed Board action has been reviewed and is recommended for Board approval.

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University Executive Officer

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Date

**Eastern Michigan University**  
**UNIVERSITY INVESTMENT POLICY**  
 (September 1, 2009 Draft)

**PURPOSE**

Eastern Michigan University's investment objective shall be to preserve investment principal while deriving a reasonable return consistent with the prevailing market and economic conditions. Investment decisions shall be based on specific guidelines which incorporate quality, safety, diversity and liquidity of funds.

**SCOPE**

The short-term investment pool guidelines are intended to cover the investment of University funds that are required for daily liquidity and expenditures of one year or less. The intermediate-term investment pool guidelines are intended to cover funds that are earmarked for use in the next one to three years. The remaining portion of the portfolio determined to be in excess of operational needs and not expected to be needed as working capital funds may be designated long-term in nature and allocated to the long term investment pool.

**GENERAL OBJECTIVES**

1. The **primary investment objective** for the **short-term investment pool accounts** will be to provide for preservation of capital with a secondary emphasis upon maximization of investment income without undue exposure to risk. *Funds needed for expenditures in less than one year will be considered short-term.*
2. The **primary investment objectives** for the **intermediate-term investment pool accounts** will be preservation of capital and maximization of income without undue exposure to risk within the parameters specified in this investment policy statement. *Funds needed for expenditures within one to three years will be considered intermediate-term.*
3. The **primary investment objectives** for the **long-term investment pool accounts** will be to provide for long-term growth of principal and income without undue exposure to risk. *Funds not needed for expenditures within three years will be considered long-term.*
4. Due to the inevitability of short-term market fluctuations that may cause variations in the investment performance, it is intended that the **performance objectives** will be achieved over a moving five-year period net of investment management fees and transaction costs. Nevertheless, the University reserves the right to evaluate and make any necessary changes regarding the investment managers/funds over a shorter-term using the criteria established in the "Evaluation of Investment Manager" section of this statement.

## **ASSET ALLOCATION**

### **Short-Term Investment Pool**

The short-term investment pool shall be managed by one or more short-term investment managers, each maintaining a portfolio with an average weighted maturity between one day and one year.

### **Intermediate-Term Investment Pool**

The intermediate-term investment pool shall be managed by one or more intermediate-term investment managers, each maintaining a portfolio with an average weighted maturity between one year and three years.

### **Long-Term Investment Pool**

Deliberate management of the asset mix among classes of investments is both a necessary and desirable responsibility. In the allocation of assets, diversification of investments among asset classes that are not similarly affected by economic, political, or social developments is a highly desirable objective. The University's general policy shall be to diversify investments within both equity and fixed income securities so as to provide a balance that will enhance total return, while avoiding undue risk concentrations in any single asset class or investment category. The diversification does not necessarily depend upon the number of industries or companies in a portfolio or their particular location, but rather upon the broad nature of such investments and of the factors that may influence them.

In making asset allocation judgments, the University is not expected to seek to "time" subtle changes in financial markets, or to make frequent or minor adjustments. Instead, the University is expected to develop and adopt expressed guidelines for broad allocations on a long-term basis, in light of current and projected investment environments.

To ensure broad diversification in the long-term investment pool among the major categories of investments, asset allocation, as a percent of the total market value of the total long-term portfolio, will be set with the following target percentage and within the following ranges:

<u>Type of Securities</u>	<u>Overall Fund</u>	
	<u>Target</u>	<u>Range</u>
Domestic Equity	25%	10% - 40 %
Domestic Large Cap	20%	5% -35%
Domestic Mid Cap	0%	0% - 20%
Domestic Small Cap	5%	0% - 10%
International Equity	5%	0% - 10%
Fixed Income	70%	50% - 90%
Cash	0%	0% - 60%

### **REBALANCING ASSET ALLOCATION**

The University representatives will monitor the asset allocation structure of the long-term investment pool and will attempt to stay within the ranges allowed for each asset class. If the portfolio becomes overweighed or exceeds the range of percentage for that asset class, the University representatives will develop a plan of action, either for immediate rebalancing of the portfolio or a rebalancing that will occur over the subsequent few months.

### **TIME HORIZON**

Due to the inevitability of short-term market fluctuations, the University intends that the following Performance Objectives will be achieved by the investment manager(s) over a **5-year moving period, net of investment management fees**. Nonetheless, the University reserves the right to evaluate and make any necessary changes regarding the investment manager over a shorter term using the criteria established in the "Evaluation of Investment Managers" section of this statement.

### **PERFORMANCE OBJECTIVES**

#### **1. Market Benchmark**

- a. The total return for the **short-term investment pool** and for each **short-term investment manager** shall exceed the rate of return on 3-month U.S. Treasury Bills.
- b. The total return for the **intermediate-term investment pool** and for each **intermediate-term investment manager** shall exceed the Merrill Lynch 1-3 Year Government Bond Index.
- c. The total return for the **long-term investment pool** shall exceed a target Balanced Index composed of: 20 % of the S & P 500 Index, 5 % of the Russell 2000 Index,

5 % of the MSCI EAFE Index and 70 % of the Barclays Aggregate Bond Index. Furthermore, the total return for each **long-term investment manager** shall exceed the relevant benchmark (*Domestic Large Cap - S&P 500 Index; Domestic Mid Cap - S&P MidCap 400 Index; Domestic Small Cap - Russell 2000 Index; Core International - EAFE Index; and Fixed Income - Barclays Aggregate Bond Index*).

## 2. Variability

- a. The standard deviation for each **short-term investment manager** shall not exceed the standard deviation of the 52-week Treasury Bills.
- b. The standard deviation for each **intermediate-term investment manager** shall not exceed 1.2 times the standard deviation of the Merrill Lynch 1-3 Year Government Bond Index or the Barclays Intermediate Bond Index.
- c. The beta (volatility) for each **long-term equity investment manager** shall not exceed 1.2 times that of the relevant equity benchmark. Furthermore, each equity investment manager is expected to achieve a positive alpha (risk-adjusted return). The standard deviation for each **long-term fixed income investment manager** shall not exceed 1.2 times the standard deviation of the Barclays Aggregate Bond Index.

## 3. Peer Group Ranking

- a. The total return for each **intermediate-term investment manager** shall rank in the top half of the Intermediate-Term Fixed Income Universe.
- b. The total return for each **long-term investment manager** shall rank in the top half of the appropriate universe (*Large Cap Equity, Small Cap Equity, Small Cap Growth, Small Cap Value, International Equity, and Fixed Income*).

## EVALUATION OF INVESTMENT MANAGERS

The investment managers will be reviewed on an ongoing basis and evaluated based upon the following additional criteria:

1. Ability to exceed the performance objectives stated in this Investment Policy Statement.
2. Adherence to the philosophy and style which were articulated to the University at, or subsequent to, the time the investment manager was retained.
3. Continuity of personnel and practices at the firm.

Each investment manager shall immediately notify the University representatives in writing of any material changes in its investment outlook, strategy, portfolio structure, ownership, or senior personnel.

## **INVESTMENT MANAGER REQUIREMENTS**

1. In today's rapidly changing and complex financial world, no list or types of categories of investments can provide continuously adequate guidance for achieving the investment objectives. Any such list is likely to be too inflexible to be suitable of the market environment in which investment decisions must be made. Therefore, it is 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.
2. Although there are no strict guidelines that will be utilized in selecting investment managers, the University will consider the length of time the firm has been in existence, its track record, assets under management, and the amount of assets the University already has invested with the firm.
3. The requirements stated below apply to investments in non-mutual and non-pooled funds, where the investment manager is able to construct a separate, discretionary account on behalf of the University. Although the University cannot dictate policy to pooled/mutual fund investment managers, the University's intent is to select and retain only pooled/mutual funds with policies that are similar to this policy statement. All managers (pooled/mutual and separate), however, are expected to achieve the performance objectives.
  - a. Each investment manager must satisfy the performance objectives and asset allocation guidelines.
  - b. Each investment manager shall have the full investment discretion with regard to market timing and security selection, consistent with this Investment Policy Statement.
  - c. The investment managers shall be evaluated on a quarterly basis and should be prepared to meet with the University at least annually.
  - d. Short-term investment managers must invest at least 50% of the portfolio in U.S. Government Securities and/or U.S. Government Agency issues.
  - e. No more than 10% of the portfolio, at cost, can be invested in any single issue, except the investments in U.S. Government Securities.

- f. The weighted average credit quality is to be no less than "AAA" (or its equivalent rating by two national rating agencies) for the **short-term investment pool accounts**, "AA" for the **intermediate-term investment pool accounts** and "A" for the **long-term investment pool accounts**. In addition, the minimum acceptable credit quality at the time of purchase for individual securities shall be "AA" for the **short-term pool accounts**, "BBB" for the **intermediate-term investment pool accounts**, and "B" for the **long-term investment pool accounts**.
- g. Portfolio holdings will be sufficiently liquid to ensure that 10% of the portfolio can be sold on a day's notice with no material impact on market value.
- h. Commercial paper must be, at the time of purchase, rated within the highest classification established by not less than two national rating services.
- i. The average weighted maturity for each **short-term investment manager** shall be between one day and one year. The average weighted maturity for each **intermediate-term investment manager** shall be between one year and three years. The duration for each **long-term fixed income investment manager** shall be no greater than  $\pm 20\%$  that of the Barclays Aggregate Bond Index.
- j. Bank Certificates of Deposit and Bankers' Acceptances are to be rated within the top two rating classifications by any one national rating service. Foreign bank issues are capped at 10% of the total investment in this category.
- k. There shall be no investments in non-marketable securities.
- l. Each equity and fixed income investment manager must assure that no position of any one issuer shall exceed 8% of the manager's portfolio at market value, with the exception of securities issued by the U.S. government and its agencies.
- m. The investment managers shall handle the voting of proxies and tendering of shares in a manner that is in the best interest of the University and consistent with the investment objectives contained herein.
- n. The equity and fixed income investment managers shall not effect a purchase, which would cause a position in the portfolio to exceed 5% of the issue outstanding at market value.
- o. The investment managers shall handle the voting of proxies and tendering of shares in a manner that is in the best interest of the University and consistent with the investment objectives contained herein.
- p. The investment managers shall not utilize derivative securities to increase the actual or potential risk posture of the accounts. Subject to other provisions in this Investment Policy Statement, the use of primary derivatives, including, but not

limited to, Structured Notes\*, lower class tranches\*\* of Collateralized Mortgage Obligations (CMOs), Principal Only (PO) or Interest Only (IO) Strips, Inverse Floating Securities, Futures Contracts, options, short sales, margin trading and such other specialized investment activity is prohibited.

Moreover, the investment managers are precluded from using derivatives to effect a leveraged portfolio structure (if options and futures are specifically approved by the University, such positions must be offset in their entirety by corresponding cash or securities).

The University must explicitly authorize the use of such derivative instruments, and shall consider certain criteria including, but not limited to, the following:

- i. Manager's proven expertise in such category,
- ii. Value added by engaging in derivatives,
- iii. Liquidity of instruments,
- iv. Actively traded by major exchanges (or for over-the-counter positions, executed with major dealers), and
- v. Managers internal procedures to evaluate derivatives, such as scenario and volatility analysis and duration constraints.

\* Permit investments in "conservative" structured notes which are principal guaranteed, unleveraged, and of short to intermediate maturity.

\*\* Lower class defined by Federal Financial Institutional Examination Council (FFIEC)

The investment manager shall immediately notify the University in writing of any material changes in its investment outlook, strategy, portfolio structure, ownership, or senior personnel.

### **CONSULTANT'S RESPONSIBILITIES**

The Investment Consultant is responsible for assisting the University in all aspects of managing and overseeing the investment portfolio. The consultant is the primary source of investment education and investment manager information. On an ongoing basis the consultant will:

1. Provide the University with quarterly performance reports within 45 days following the end of the quarter;



2. Meet with the University at least quarterly, or more frequently as needed;
3. Provide the University with an annual review of this Investment Policy Statement, including an assessment of the University's current asset allocation and investment objectives; and
4. Supply the University with other reports or information as reasonably requested.

**ACKNOWLEDGEMENT**

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Acknowledged on behalf of  
Eastern Michigan University


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Date

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Acknowledged on behalf of the  
Investment Manager

\_\_\_\_\_  
Date

\_\_\_\_\_  
Acknowledged on behalf of  
Fund Evaluation Group, Inc.

\_\_\_\_\_  
Date

<b>Effective Date</b>		<b>Date of Revision</b>		<b>Policies, Rules And Regulations</b>
1-10-66		3-20-07		
<b>Chapter Name</b>		<b>Chapter No.</b>	<b>Page</b>	
BUSINESS & FINANCIAL OPERATIONS		11.1.2	Page 1 of 4	
<b>Issue</b>				
INVESTMENTS				

**PURPOSE**

Eastern Michigan University's investment objective shall be to preserve investment principal while deriving a reasonable return consistent with the prevailing market and economic conditions. Investment decisions shall be based on specific guidelines which incorporate quality, safety, diversity and liquidity of funds.

**SCOPE**

The short-term investment pool guidelines are intended to cover the investment of university funds that are required for daily liquidity and normal operating needs. The intermediate-term investment pool guidelines are intended to cover funds that are earmarked for use in the next one to three years. Cash not expected to be needed for operational purposes will be designated for the long-term investment pool.

**GENERAL OBJECTIVES****Short-Term Investments**

The primary investment objective for the short-term investment pool accounts will be to provide for preservation of capital and liquidity with a secondary emphasis upon maximization of investment income without undue exposure to risk. Funds needed for normal operating expenditures will be considered short-term on a less than one-year basis.

**Intermediate-Term Investments**

The primary investment objectives for the intermediate-term investment pool accounts will be preservation of capital and maximization of income without undue exposure to risk within the parameters specified in this investment policy statement. Funds needed for expenditures within one to three years will be considered intermediate-term.

**Long-Term Investments**

The primary investment objectives for the long-term investment pool accounts will be to provide for long-term growth of principal and income without undue exposure to risk. Funds not needed for expenditures within three years will be considered long-term.

**ASSET ALLOCATION****Short-Term Investment Pool**

The short-term investment pool shall be managed to maintain a portfolio with an average weighted maturity between one day and one year.

Chapter Name	Chapter No.	Page
BUSINESS & FINANCIAL OPERATIONS	11.1.2	Page 2 of 4
<b>Issue</b>		
INVESTMENTS		

#### Intermediate -Term Investment Pool

The intermediate-term investment pool shall be managed to maintain a portfolio with an average weighted maturity between one year and three years.

#### Long-Term Investment Pool

Deliberate management of the asset mix among classes of investments is a necessary and desirable responsibility. In the allocation of assets, diversification of investments among asset classes that are not similarly affected by economic, political, or social developments is a highly desirable objective. The university's general policy shall be to diversify investments within both equity and fixed income securities so as to provide a balance that will enhance total return, while avoiding undue risk concentrations in any single asset class or investment category. The diversification does not necessarily depend upon the number of industries or companies in a portfolio or their particular location, but rather upon the broad nature of such investments and of the factors that may influence them.

In making asset allocation judgments, the university is not expected to seek to time subtle changes in financial markets, or to make frequent or minor adjustments. Instead, the university is expected to develop and adopt expressed guidelines for broad allocations on a long-term basis, in light of current and projected investment environments.

To ensure broad diversification in the long-term investment pool among the major categories of investments, asset allocation, as a percent of the total market value of the total long-term portfolio, will be set with the following target percentages and within the following ranges:

<u>Type of Securities</u>	<u>Overall Fund</u>	
	<u>Target</u>	<u>Range</u>
Equities	30%	15-45%
<i>Domestic Large Cap Equities</i>	15	10-30
<i>Domestic Mid Cap</i>	7	5-15
<i>Domestic Small Cap</i>	4	0-10
<i>Global/International</i>	4	0-10
Fixed Income	70%	55-85%
Cash	-	0-10%

#### **REBALANCING ASSET ALLOCATION**

The university representatives will monitor the asset allocation structure of the long-term investment pool and will attempt to stay within the ranges allowed for each asset class. If the portfolio becomes over weighted or exceeds the range of percentage for that asset class, the university representatives will develop a plan of action, either for immediate rebalancing of the portfolio or a rebalancing that will occur over the subsequent few months.

#### **MARKET BENCHMARK**

The total return for all investments shall be compared to consistent industry standard benchmarks appropriate for each investment pool.

Chapter Name	Chapter No.	Page
BUSINESS & FINANCIAL OPERATIONS	11.1.2	Page 3 of 4
Issue		
INVESTMENTS		

### INVESTMENT GUIDELINES

In today's rapidly changing and complex financial world, no list or types of categories of investments can provide continuously adequate guidance for achieving the investment objectives. Any such list is likely to be too inflexible to be suitable for the market environment in which investment decisions must be made. Therefore, it is 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.

Any investment manager and university representatives will use their best social conscience when investing.

### EVALUATION OF INVESTMENT MANAGERS

Any investment managers will be reviewed on an ongoing basis and evaluated based upon the following additional criteria:

- Ability to exceed the performance objectives stated in this investment policy statement.
- Adherence to the philosophy and style which were articulated to the university at, or subsequent to, the time the investment manager was retained.

Each investment manager that the University contracts with shall immediately notify the university representatives in writing of any material changes in its investment outlook, strategy, portfolio structure, ownership, or senior personnel.

### CONCLUSION

The investment performance will be reviewed on a quarterly basis and a report will be provided periodically, but not less than once a year, to the Board of Regents on the status of the investment program.

Authority for Creation or Revision
Minutes of the Board of Regents: January 10, 1966, para. 334M.
Minutes of the Board of Regents: March 15, 1972, para. .1086M and .1087M.
Minutes of the Board of Regents: May 17, 1978, para. .1941M.
Minutes of the Board of Regents: May 25, 1993; para. .4698M.
Minutes of the Board of Regents: September 15, 1998; para. .5412M.
Minutes of the Board of Regents March 20, 2007; para, .6709

Chapter Name	Chapter No.	Page
BUSINESS & FINANCIAL OPERATIONS	11.1.2	Page 4 of 4
<b>Issue</b>		
INVESTMENTS		

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