

TEXAS STATE UNIVERSITY SYSTEM



Investment Policy for Operating Funds and Endowment Funds November 2016

Table of Contents

I.	PREFACE	3
II.		

Texas State University System Investment Policy

I. PREFACE

This Policy is the approved Investment Policy for Operating Funds and Endowment Funds of the Texas State University System. Texas State University System ("TSUS") refers to System Administration, Lamar University, Sam Houston State University, Sul Ross State University, Texas State University, Lamar Institute of Technology, Lamar State College-Orange, Lamar State College- Port Arthur, and Sul Ross State University - Rio Grande College.

II. POLICY AND OBJECTIVES

A. OPERATING FUNDS

It is the policy of TSUS to invest operating funds in compliance with the "Prudent Person Standard" as defined by Texas Education Code §51.0031(d). The Investment Policy for Operating Funds and Endowment Funds ("Policy") of TSUS is designed to fulfill the following objectives with respect to Operating Funds:

- ~ Provide security of invested principal;
- ~ Provide liquidity for operating requirements which may be reasonably anticipated;
- ~ Manage interest-rate and market risk;
- ~ Maximize total return within established risk constraints; and
- ~ Provide for diversification of investment assets.

To meet these objectives, TSUS will base investment decisions on short-term, intermediate-term, and long-term needs dictated by cash flow analyses of present and anticipated future financial requirements.

This Policy applies to the following operating funds held by TSUS:

- ~ Current Funds (Unrestricted and Restricted);
- ~ Loan Funds;
- ~ Bond Funds;
- ~ Plant Funds;

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TexPool) with which the component conducts investment transactions. Such entities will be required to acknowledge in writing receipt of the Policy and to attest that they have implemented reasonable procedures and internal controls to comply with provisions contained within the Policy. The Vice Chancellor for Finance will distribute the Policy to and obtain the acknowledgement from TexPool on behalf of the Texas State University System and its components and will do likewise for any entity, including investment advisors, conducting investment transactions on behalf of the System Office.

Operating funds covered under this Policy are classified as:

Short-

- provide for appreciation of principal;
- provide a continuing and dependable cash payout within market constraints;
- provide for planned liquidity for anticipated cash flow purposes;
- manage market risks;
- maximize overall total return within the established risk constraints; and
- provide for diversification of investment assets.

The long term objective of an endowment is to preserve the intergenerational equity of the endowment while providing an appropriate current spending policy. All endowment funds will be managed by the “Prudent Person Standard”.

III. DELEGATION OF AUTHORITY AND RESPONSIBILITY

Board of Regents

The TSUS Board of Regents (the “Board”) retains ultimate responsibility for investments as fiduciaries of TSUS assets regardless of who is investing those assets. The Board is statutorily required to:

- Designate Investment Officers, at least annually, review and adopt this Policy, at least annually, review and adopt a list of qualified broker/dealers authorized to engage in investment transactions with TSUS,
- At least quarterly, receive and review investment reports prepared in accordance with this Policy, and
- Attend at least one training session as regards to Board responsibilities under the Act within six (6) months of assuming office as provided by the Higher Education Coordinating Board.

Investment Officers

The Chief Financial Officer (CFO) for System Administration and the CFO for each component are designated as Investment Officers for their respective entities by the Board. Additional Investment Officers may be designated by the Chancellor or the President of the component.

Investment Officers are responsible for investment management decisions and activities and all transactions undertaken, including the hiring/firing of Investment Manager(s) recommended by the Investment Consultants, and banking relationships. No officer or designee may engage in an investment transaction except as provided under terms of this Policy. No Investment Officer or

termination clause with a maximum 30 days' notice provision and may not be for a term longer than two years. A renewal or extension of the contract must be approved by the Board.

The Investment Manager(s) must certify to the receipt and review of this Policy; it will act in accordance with the Policy; and it will provide a copy of its most current Form ADV and ADV brochure as filed with the Securities and Exchange Commission to the CFO(s) for the component(s) that it advises (see Exhibit 1).

All Investment Managers have a fiduciary responsibility to make a good faith determination that commissions paid to a broker are reasonable and competitive

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- Provide all normal custodian functions, including but not limited to:
 - Security safekeeping,
 - Collection of income,
 - Settlement of trades,
 - Collection of proceeds of maturing securities, and
 - Daily investment of available cash.

IV. STANDARD OF CARE

Pursuant to Texas Education Code §51.00311

System Administration and each component may pursue an active portfolio management strategy for Endowment Funds with investments diversified by asset class and style. All Endowment Fund investment securities must be held under a custodial agreement and all Investment Managers must provide monthly statements to the Investment Officer. The Investment Officer and/or Investment Consultant will regularly monitor the contents of the componentM(t)-6.6(m

The cash payout requirement for Endowment Funds is significant and continuous. The portfolio shall be diversified to diminish risks associated with particular securities, market sectors, or industries with an excessive impact on the funds.

VII. INVESTMENT GUIDELINES

A. OPERATING SHORT-INTERMEDIATE TERM FUNDS

Refer to APPENDIX 1 for Investment Guidelines for Operating Short-Term portfolios. This includes Diversification parameters, approved allocation ranges, and Prohibited Investments.

B. OPERATING LONG-TERM FUNDS

Refer to APPENDIX 2 for Investment Guidelines for Operating Long-Term portfolios. This includes Diversification parameters, approved allocation ranges, and Prohibited Investments.

C. ENDOWMENT FUNDS

Refer to APPENDIX 3 for Investment Guidelines for Endowment portfolios. This includes Diversification parameters, approved allocation ranges, and Prohibited Investments.

VIII. REBALANCING

Since asset allocation is a critical component of Investment Portfolio returns, it is desirable to review the investment portfolio as follows:

Operating Funds: At least quarterly, more frequently as necessary

Endowment: At least annually, more frequently if necessary.

In the event any individual asset class falls outside the allocation range specified in the appropriate Appendix, rebalancing should be performed in a prudent manner.

The appropriateness of Asset Allocation ranges will be reviewed annually.

IX. SAFEKEEPING

All securities, including collateral bought under a repurchase agreement, but excluding investment pool funds, certificates of deposit, and mutual funds, shall be settled on a delivery versus payment (DVP) basis. All securities shall be held by System Administration's or the component's depository bank, as applicable, or an independent third party custodian approved by the System Office. All securities will be held in the name of System Administration or the component, as applicable. No broker/dealer shall be used for safekeeping purposes.

The third party custodian of TSUS-owned assets shall be required to issue an original safekeeping trust statement to the System Administration or the component, as applicable, on a timely basis describing the specific instrument, coupon, maturity, par, CUSIP, and other pertinent information. The safekeeping receipt shall clearly identify ownership by System

3. Agreed to provide to the component, the System Office, and the Investment Consultant retained by the System Office (if any) all monthly data and schedules

APPENDIX 1
INVESTMENT GUIDELINES FOR OPERATING SHORT-INTERMEDIATE TERM FUNDS

A. LIQUIDITY

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The intention of the Operating Short-Intermediate Term Funds portfolio is to provide
necessary Liquidity to operations. A minimum of

The following are prohibited transactions and securities for TSUS components. Any change in this list shall require amendment of this Policy and adoption by the Board.

- i. TSUS may not purchase or sell financial futures, options, interest rate swaps, or forward rate agreements.
- ii. TSUS may not engage in adjusted trading or short sales.
- iii. TSUS may not purchase residual interests in CMOs/REMICs or mortgages servicing rights. Specific securities that may not be purchased are:
 1. Inverse CMO floaters
 2. Principal only CMOs
 3. Interest only CMOs
- iv. TSUS may not purchase 144-A or other private placement securities not registered with the SEC.
- v. Non-US Dollar denominated securities are prohibited in Operating Short-Intermediate Fund portfolios. Foreign securities issued and priced in US. Dollars are allowed.
- vi. The use of Margin or leverage in Operating Short-Intermediate Term Funds Portfolios is prohibited.
- vii. The purchase of Equities in Operating Short-Intermediate Term Funds Portfolios is prohibited.

INVESTMENT GUIDELINES **APPENDIX 2**

All terms specified in sections B, C, and D of Appendix 3 **apply in this Appendix**, with the following additional limitations and prohibitions:

Prohibitions:

1. Non-US Dollar denominated bonds are prohibited
2. The direct or indirect use of derivatives, short sales, futures, options, private placements, limited partnerships, and otherwise illiquid investments is prohibited.

Additional Limitations:

1. No more than **20%** of the **Income Portfolio** may be rated below Investment Grade.
2. No more than **10%** of the

**APPENDIX 3
INVESTMENT GUIDELINES FOR ENDOWMENT FUNDS**

Policy asset allocation is the most single important decision for the Endowment Funds portfolio. A significant proportion of a portfolio investment behavior can be attributed to the asset classes/styles and the weighting of each asset class/style.

TSUS recognizes that investment risks can result from issuer defaults, market price changes, or various technical complications leading to temporary illiquidity. This risk is controlled through portfolio diversification. Investment Officer(s) shall diversify the portfolio(s) by market sector and maturity to minimize market risks.

A. DIVERSIFICATION

Diversification shall be considered within major market sectors so that various industries, maturities, markets, domestic and international factors are considered within the portfolio.

Asset Allocation is to be determined by each component as a result of their Required Rate of Return for the portfolio as defined by:

$$\text{Required Rate of Return} = \text{Spending Rate} + \text{Inflation} + \text{Endowment Expense rate.}$$

This Policy recognizes two main Categories which Investments may be allocated: the Appreciation/Dividend Category and the Income Category.

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B. The following requirements are applied at the **Manager/Mutual Fund/Asset Class level**:

- i. A Minimum of **20** securities are to be held in a Portfolio or Fund.
- ii. If Soft Dollars are used in the account, a Quarterly report of Soft Dollar usage is required to be delivered to the Component Investment Officer.
- iii. EQUITY MANAGERS
 - 1. A Maximum of **40%** in any one **sector** UNLESS waived by the Component Investment Officer in writing.
 - 2. A Maximum of **10%** ownership of shares outstanding of a single Stock.
- iv. FIXED INCOME MANAGERS
 - 1. For International/Global Fixed Income managers, a Maximum of **40%** in any One Non-US Country.

C. The following requirements are applied at the **Total Portfolio level**:

- i. A Maximum of **20%** of the Total Portfolio may be held in Emerging/Frontier Market securities (Regardless of asset type)
- ii. Excluding Pooled funds, Mutual Funds, or Managed Accounts which are Multi-Strategy and Multi-Manager products, no more than **40%** of the Portfolio may be invested in a **single** Mutual Fund or Manager
- iii. FIXED INCOME

EXHIBIT 2