Agendum
Oakland University
Board of Trustees Formal Session
April 7, 2010

ENDOWMENT MANAGEMENT AND INVESTMENT POLICY

1. Division and Department: Finance and Administration, Treasury Management

2. Introduction: The attached new Endowment Management and Investment Policy has been drafted to replace the current Investment Policy for Endowment, last modified and approved by the Board of Trustees (Board) on October 7, 2003. The reasons for this rewrite include the enactment of the Michigan Uniform Prudent Management of Institutional Funds Act (UPMIFA) in December 2009 and to address the full scope of investment alternatives now used by endowment investors to enhance returns and to improve diversification in the endowment portfolio.

UPMIFA introduced a number of significant changes from its predecessor legislation, the Uniform Management of Institutional Funds Act (UMIFA), including the following:

1. It eliminates the historical gift value consideration.
2. It introduces an inflation protection concept.
3. It sets the new underwater standard as "prudence".
4. It sets custodial standards in terms of Permanently Restricted Endowment Funds and Institutional Endowment Funds using donor intent as the standard.

3. Previous Board Action: The Board approved the current Investment Policy for Endowment on April 6, 1995, modified the integrated spending policy on December 4, 2002 and added a rebalancing requirement on October 7, 2003.

4. Budget Implications: Additional investment alternatives are expected to enhance returns which will provide funding increases for endowment spending.

5. Educational Implications: Scholarship endowments provide funding for students to continue their educational experiences.

6. Personnel Implications: None.

7. University Reviews/Approvals: This agendum has been prepared by Treasury Management and reviewed by UBS Financial Services, Oakland University's endowment investment advisor, the Vice President for Finance and Administration and the President. The new Endowment Management and Investment Policy was thoroughly reviewed by the Finance, Audit and Investment Committee (FAIC) on March 31, 2010. The FAIC supported the new policy and asked that it be brought forward for Board action at the next Formal Session of the Board.

8. Recommendation:

RESOLVED, that the Board of Trustees adopt the Endowment Management and Investment Policy, as presented in Attachment A.

9. <u>Attachments:</u>

A. Endowment Management and Investment Policy

Submitted to the President
on 4/1, 2010 by

John W. Beaghan
Vice President for Finance and Administration
and Treasurer to the Board of Trustees

Recommended on 4/2, 2010
to the Board of Trustees for Approval

Gary D. Russi
President

OAKLAND UNIVERSITY

ENDOWMENT MANAGEMENT AND INVESTMENT POLICY

GENERAL PHILOSOPHY

In recognition of its fiduciary responsibility, the Oakland University Board of Trustees (Board) has adopted the following investment and management policy for Oakland University (University) and the University's Endowment (Endowment Management and Investment Policy), which includes two principal categories: Permanently Restricted Endowment Funds (sometimes referred to as "true endowments" or "restricted endowments") and Institutional Endowment Funds (sometimes referred to as "term endowment funds", "funds functioning as endowment" or "quasi-endowment funds"). The University protects the intent of each donor with regard to the use of the endowment gift and to protect the perpetual nature of each individual Endowment Fund so that the benefits provided by the Endowment may be enjoyed by future generations. Endowment Fund investment and distribution shall be managed under this Endowment Management and Investment Policy according to the standards of prudence prescribed by the Michigan Uniform Prudent Management of Institutional Funds Act of 2009 as may be amended from time-to-time (UPMIFA), unless a higher standard of prudence is set forth by this Endowment Management and Investment Policy, in which case this Endowment Management and Investment Policy shall control.

DEFINITIONS

- **Accumulate** is the act of adding amounts to the Endowment Fund rather than Appropriate them. (Typically, investment earnings less Appropriations are Accumulations.)
- **Appropriate** is the act of making a portion of the Endowment Fund available for spending for the Endowment Fund's stated purpose.
- **Donor Restrictions** for an endowment gift are specified in the Endowment Agreement and, if and when accepted by the Board, are then binding upon the University both legally and ethically. Release or modification of donor restrictions is only possible as prescribed by UPMIFA.
- **Endowment** is the aggregate of all of the Endowment Funds of the University.
- **Endowment Agreement** is the formal written agreement executed by the University and a donor that specifies the donor's restrictions on the management, investment, or purpose of the endowment gift, if any. It may also be an instrument signed by the President or the President's designee that establishes the conditions for an Institutional Endowment Fund, if any.
- **Endowment Fund** refers to an individual endowment account within the Endowment Fund group in the University accounting system and may be either a Permanently Restricted Endowment Fund or an Institutional Endowment Fund.
- **Historical Gifts** are amounts given to the University by the donor and do not include investment earnings, Accumulations or Appropriations.
- **Inflation Protection** is the amount in an Endowment Fund that exceeds the Historical Gifts amount.

- **Institutional Endowment Fund** is an Endowment Fund that was established by the University of which none of the additions to the Institutional Endowment Fund are from donor restricted gifts or donor gifts accepted with an implied donor restriction.
- **Investment Advisor** is a firm or individual retained by the University to advise on investment strategy and investment management.
- **Investment Custodian** is typically a bank but may be another financial-type institution which has fiduciary custody of the Endowment and Endowment investments which are being managed by the Investment Manager or Investment Advisor.
- **Investment Manager** is a firm or individual that is retained by the University or Investment Advisor to direct investment in specific investment vehicles for the Endowment.
- **Permanently Restricted Endowment Fund** is an Endowment Fund which is based on a use restriction given by the donor or group of donors which restricts the management, investment, or purpose of the endowment gift, such as the purpose of the endowment gift being to Appropriate Endowment Funds only for scholarships or chairs.
- **Perpetual** or **Perpetuity** implies that the Endowment Fund is to be held indefinitely, usually forever, with the expectation that only its earnings may be spent in the future.
- **Spending** is the act of appropriating a portion of an Endowment Fund to be expended for the specific purpose stated in each Endowment Agreement.
- **Underwater Endowment Fund** is an Endowment Fund whose market value at the end of any calendar quarter is less than the sum of the Historical Gifts to that Endowment Fund plus Inflation Protection.

<u>ESTABLISHING AN ENDOWMENT FUND</u>

1. An Endowment Fund may be established in the University's Endowment only upon acceptance and approval by the Board of an Endowment Agreement.
2. Any Endowment Fund containing gifts by donors subject to Donor Restrictions shall be a Permanently Restricted Endowment Fund whether or not other monies in the Permanently Restricted Endowment Fund were placed there by the University.
3. No Endowment Fund will be established unless the Endowment Fund and its use are to be invested and remain in Perpetuity.
4. Any Endowment Fund established with unrestricted moneys set aside by the University will be an Institutional Endowment Fund, and may not include any donor gifts subject to Donor Restrictions. Donors may, however, contribute unrestricted gifts to an Institutional Endowment Fund.
5. No Endowment Fund shall be established unless it complies with the Board's gift acceptance policies or is an Institutional Endowment Fund.

<u>MAINTAINING THE ENDOWMENT</u>

1. Amounts within each individual Endowment Fund will be segregated into 1) Historical Gifts, and 2) Inflation Protection.

2. The purchasing power of an individual Endowment Fund is the sum of its Historical Gifts plus its Inflation Protection and Accumulations.
3. All investment earnings after fees in the Endowment are to be reinvested and allocated, whether positive or negative, to the individual Endowment Funds each calendar quarter in accordance with this Endowment Management and Investment Policy's Spending section.
4. All Endowment Funds shall be managed under this Endowment Management and Investment Policy according to the standards of prudence prescribed by UPMIFA, unless a higher standard of prudence is set forth by this Endowment Management and Investment Policy, in which case this Endowment Management and Investment Policy shall control.

INVESTING THE ENDOWMENT

Investments will be made only in those organizations and instruments which are consistent with policies of the University and that meet the prudence standards prescribed by UPMIFA.

I. INVESTMENT OBJECTIVE

The investment objectives for the management of the Endowment are to preserve the Endowment assets, to manage contributions in a manner that will maximize the benefit intended by the donor, to produce current income based on total rate of return, to support the objectives of the University and the donor, and to achieve growth of both principal value and income over time sufficient to preserve or increase the purchasing power of the assets, thus protecting the assets against inflation. The long-term investment objective is to maximize earnings after fees and expenses on the Endowment portfolio accepting only a prudent amount of risk for an endowment investment portfolio.

II. ASSET ALLOCATION

The policy shall generally be to diversify investments among asset classes to provide a strategic asset allocation that will enhance total return while avoiding undue risk concentration in any single asset class or investment category.

The long-term policy for asset allocation of the University Endowment is:

	Long-Term Objective	Range
Equity Investments	60%	50% - 80%
Structured Products 5% (of Equity Investments)		
Real Assets	5%	0%-10%
Fixed-income Investments	30%	15% - 40%
Structured Products 10% (of Fixed-income Investments)		
Alternative Investments	5%	0% - 7%

At the end of each calendar quarter the University's Treasury Management Department (TMD) along with the Investment Advisor and Investment Managers shall review the allocation of the assets representing the University's Endowment to measure the strategic asset allocation and tactical asset allocations on that date. If the strategic asset allocation is not within +(-) 3% of the target range asset allocation, the TMD and the Investment Advisor and Investment Managers shall take appropriate steps to bring the strategic asset allocation to within +(-) 1% of the targeted allocation ranges.

III. EQUITY INVESTMENTS

The principal category of equity investments will be common stocks in all market capitalization segments. Primary emphasis will be on high quality stocks in companies that are financially sound and that have favorable prospects for earnings growth and capital appreciation. Diversification will be sought by investing in domestic, international, emerging market, and structured product securities.

Allocation Percentages and Ranges for Endowment Equity Investments are:

	Long-term Objective	Range
Domestic	35%	30% - 50%
International	17%	10% - 20%
Emerging Markets	3%	0% - 5%
Structured Products	5%	0% - 5%

IV. STRUCTURED PRODUCTS

1. Principal Protection Structured Products offer principal protection investments if held until maturity with returns commonly based on equities, commodities, interest rates, or currencies. These products are often considered a fixed income alternative but may offer greater potential than traditional bond investments.

   Investments in Principal Protection Structured Products are considered part of the fixed income portfolio. The underlying issuer must have a credit rating of A or better and no more than 1% of the fixed income portfolio can be invested with any one issuer. Investments in Principal Protection Structured Products may not exceed more than 10% of the fixed income portion of the Endowment portfolio.

2. Structured Products that are not principal protected are considered part of the equity portfolio. The underlying issuer must have a credit rating of A or better and no more than 1% of the equity portfolio can be invested with any one issuer. Investments in Structured Products that are not principal protected may not exceed more than 5% of the equity portion of the Endowment portfolio.

V. REAL ASSETS

The purpose of real assets is to achieve capital appreciation, current income, and to I invest in an asset-class that has low correlation to fixed income and equities.

1. Real Estate Investment Trusts - The Endowment portfolio may include equity real estate investments made through publicly traded real estate investment

trusts (REITs) and real estate operating companies. Such investments may not exceed 7% of total Endowment assets.

2. Commodities - The objective of investing in this asset class is to gain additional portfolio diversification, inflation protection and positive real returns.

The Endowment may be invested in Commodities and related derivatives through the use of Investment Managers, mutual funds, or Commodities based indices. Investments in commodities may not exceed 5% of the Endowment portfolio.

Investments in Real Assets may not exceed 10% of the Endowment Portfolio.

VI. FIXED-INCOME INVESTMENTS

1. General

Fixed income investments shall be invested in portfolios of high quality (primarily A to AAA rated) corporate bonds, U.S. Treasury and agency securities, issues of supranational organizations and foreign sovereigns. No more than 20% of the fixed income portfolio may be invested in securities rated less than BBB or in illiquid investments.

2. Derivative Investments

No more than 25% of the fixed income portfolio may be in derivative-type investments.

The Board's Investment Advisor shall report at least annually to the Board or the Board's designated committee (Board Committee) on the role of derivative investments in the overall fixed income portfolio and describe the risks and rewards associated with such investments. Investment Managers shall have a written policy on the use of derivative investments. A copy of such written policy shall be provided to the TMD and any subsequent revisions to the written policy shall be immediately communicated to the TMD.

VII. ALTERNATIVE INVESTMENTS

1. Private Capital Investments

The purpose of Private Capital Investments, which includes Venture Capital and Private Equity, is to provide long-term appreciation and diversification. Private Capital Investments are often illiquid in nature, are more susceptible than bonds and stock investments to extended periods of overvaluation and undervaluation, and returns are much more manager dependent than other forms of marketable securities. The main investment objective is to achieve long-term capital appreciation returns greater than those generally available in the public securities market.

Venture Capital - is generally considered to be start-up and early stage high growth companies. Venture Capitalists usually own a minority stake in such companies and are actively involved with the founders to develop strategy, secure financing and recruit management.

Private Equity - is investments in private companies for acquisition, leveraged buyouts, management buyouts, reorganizations, restructuring and spin-offs. Leverage is frequently used.

Private Capital Investments may not exceed more than 5% of the Endowment portfolio and any single investment may not exceed 25% of the total Private Capital Investments.

2. Hedge Funds

The purpose of Hedge Funds and Hedge Fund of Funds is to provide equity-like returns with less volatility over time. Additionally, Hedge Funds provide an additional benefit of portfolio diversification thereby lowering the probability for the Endowment to have large market value variations over short-term time horizons. Hedge Funds have limited liquidity and may invest in derivative instruments, employ leverage, and sell securities short. Common Hedge Fund strategies include: Long/Short Strategies, Relative Value Strategies, Event Driven Strategies, and Directional Strategies.

Certain criteria must be considered including, but not necessarily limited to, the following in evaluation of a Hedge Fund:

- Tenure and track record of management;
- Expertise in investment area; and
- Diversification relative to other hedge fund investments.

Single strategy, multi-strategy, and fund-of-funds investments are permitted.

Investments in Hedge Fund strategies may not comprise more than 5% of the Endowment portfolio. No investment with any single Hedge Fund manager may exceed 10% of the Hedge Fund portfolio. If using Hedge Fund of Funds, total assets with one manager are limited to 25% of the Hedge Fund portfolio.

When possible, Hedge Fund investments will be made in offshore limited partnerships in order to avoid unrelated business taxable income (UBTI).

Total allocation to the Alternative Investment Strategy may range from 0% to 7% of the overall Endowment portfolio. Allocation to any one area (Private Capital Investments and Hedge Funds) should not exceed 5% of the overall Alternative Investment Strategy portfolio.

INVESTMENT ADVISOR, INVESTMENT MANAGER AND INVESTMENT CUSTODIAN SELECTION

1. Generally, the University shall utilize professional management services for the investment of the Endowment portfolio. This does not preclude direct investment and ownership of securities by the University.

2. The Investment Advisor shall be appointed by the Board upon recommendation by the Treasurer and the appropriate Board Committee.
3. The Investment Managers may be appointed by the Treasurer upon advice of the Investment Advisor.
4. The Investment Custodian shall be appointed by the Treasurer.
5. No more than 50% of University equity and bond investments respectively shall be assigned to a single Investment Manager.

INVESTMENT MANAGER PERFORMANCE EVALUATION

Investment Managers and their performance will be measured over periods of the most recent quarter ending; one-year, three-year and five-year periods; and will be compared to appropriate market indices (benchmarks), peers and the performance of other endowments as published annually by the National Association of College and University Business Officers or other national reporting agencies. Market indices shall include indices that are appropriate for their specific portfolios. Risk-adjusted benchmarks shall be used when and where appropriate to measure performance. An Investment Manager whose performance falls below the first quartile over a five-year period, or below the median over the period of one year, shall be a candidate for replacement, absent a satisfactory explanation for the level of performance.

All Investment Managers must report their performance in writing each calendar quarter, and their portfolio holdings at least annually.

The University may utilize an independent performance evaluation service to ensure that all Investment Managers are competitive in the market and that their performance meets the needs and expectations of the University.

ROLE OF BOARD OF TRUSTEES

The Board:

1. Shall exercise its Endowment investment responsibilities with the assistance of its Board Committee(s).
2. Shall, upon the recommendation of its Board Committee(s), establish investment policies relating to the administration of the University's Endowment investment portfolio.
3. Shall, upon the recommendation of its Board Committee(s), establish investment objectives. (See I. Investment Objective)
4. Shall, upon the recommendation of its Board Committee(s), appoint an Investment Advisor or an Investment Manager(s) for the Endowment, and specify any investment restrictions deemed appropriate.
5. Shall, upon the recommendation of its Board Committee(s), establish the conditions and parameters under which the University may directly invest in and own securities independent of Investment Managers and may authorize such investment.
6. Shall receive periodic reports on investment results through its Board Committee(s).

ROLE OF BOARD COMMITTEES

The appropriate Board Committee(s):

1. Shall be responsible for the review of policies relating to the administration of the University's Endowment portfolio and, when appropriate, shall make recommendations to the Board.
2. Shall, in consultation with the Treasurer, recommend to the Board an Investment Advisor to advise and assist the appropriate Board Committee.
3. Shall, in consultation with the Treasurer, recommend to the Board an Investment Manager(s) when no Investment Advisor is used.
4. Shall, in consultation with the Investment Advisor and the Treasurer, annually review the investment objectives of the Endowment portfolio.
5. Shall receive periodic reports on the investment status of the portfolio(s) and shall transmit relevant information to the Board.
6. Shall meet with the Investment Advisor at least annually and shall evaluate the performance of the Endowment portfolio.

ROLE OF INVESTMENT ADVISOR

The Investment Advisor:

1. Shall annually develop and communicate to the Treasurer and the appropriate Board Committee(s) an appropriate strategy to meet the long-term Endowment management objectives.
2. Shall advise the Treasurer regarding searches for an Investment Manager(s) and an Investment Custodian(s).
3. Shall provide a monitoring and measurement program which will permit evaluation of the performance of the Investment Manager(s) in comparison with the investment markets and with other managers.
4. Shall provide such other information pertaining to the investment program as may reasonably be required.

ROLE OF THE INVESTMENT MANAGER(S)

The Investment Manager(s):

1. Shall report their performance in writing each calendar quarter and their portfolio holdings at least annually to the Investment Advisor and the Treasurer.
2. Is authorized to execute investment transactions in conformity with this Endowment Management and Investment Policy, subject to any restrictions established by the Board or appropriate Board Committee(s).
3. Shall report immediately to the Treasurer and the Investment Advisor any major change in the manager's confidence regarding the securities markets or any decline in portfolio value in excess of 10% since the last reporting date.
4. Shall be reasonably expected to provide other necessary information for the development of interim reports and shall meet, as necessary, with the Investment Advisor and the Treasurer.

ROLE OF THE INVESTMENT CUSTODIAN(S)

Ordinarily, the Investment Manager(s) will utilize the services of an Investment Custodian and the University may not have a direct contractual relationship with such Investment Custodian(s). In the event the University requires the services of an Investment Custodian, (e.g., direct investment and ownership of securities by the University) the following procedures shall apply:

The Investment Custodian(s):

1. Shall hold all securities under management by the Investment Manager(s) in an agreed-upon nominee name and form.
2. Shall execute all transactions as directed by the Investment Manager(s).
3. Shall collect all income pertaining to the securities held, and shall temporarily invest such income in cash equivalents until reinvested or remitted to the University.
4. Shall periodically remit accumulated income to the University pursuant to instructions received from the University.
5. Shall provide a full monthly accounting of all transactions, together with a listing of all holdings at cost and market.
6. Shall vote all proxies in accordance with instructions received from the University.
7. Shall provide such other information pertaining to the portfolio as may reasonably be required.

ROLE OF THE UNIVERSITY ADMINISTRATION, THROUGH THE TREASURER

The University, through the Treasurer:

1. Is responsible for the continuous monitoring and review of: the Investment Advisors', Investment Managers' and Investment Custodians' reports, the actions of the Investment Manager(s), and the status of the University's Endowment portfolio.
2. Shall maintain communications, as appropriate, between the Board, the Board Committee(s), the Investment Advisor, the Investment Custodian and the Investment Manager(s).
3. Shall make recommendations to the appropriate Board Committee(s) concerning investment policies, structure, objectives and selection of Investment Advisor(s).
4. Shall periodically invest available additional funds with the Investment Managers in consultation with the Investment Advisor, if any, and within the allocation parameters established by this Endowment Management and Investment Policy.
5. Shall direct changes in existing allocations in consultation with the Investment Manager(s) as necessary to remain with the asset allocation parameters.
6. May, in consultation with the Investment Manager(s) and the Investment Advisor, and within the allocation parameters established by this Endowment Management and Investment Policy, direct the reallocation of endowment assets between the investment options and funds managed by the Investment Manager(s).

7. Shall appoint Investment Custodians, monitor their activity and receive, reconcile and account for remitted accumulated income.

GIFTS OF INVESTMENTS

Certain funds are obtained by the University through donor gifts subject to Donor Restrictions that restrict the form of investment, either directly by specifying qualifying investment vehicles or indirectly by stipulating a higher-than-normal spending rate (Gifts of Investments). Such Gifts of Investments will be accepted only with contractual provisions contained in the Endowment Agreement specifying that the Gift of Investment will be sold by the University at the first available opportunity and the proceeds of the sale be invested in the Endowment portfolio in accordance with the provisions of this Endowment Management and Investment Policy and spending will conform to the Spending section of this Endowment Management and Investment Policy.

SPENDING

In order to provide for stability in income growth together with preservation of purchasing power, Endowment Funds shall have Appropriations made available for Spending according to the following, except as the terms of a specific Board action shall otherwise require. A modified Spending plan for specific Institutional Endowment Funds may be ordered by the President.

Endowment Fund Appropriations shall be at an annual rate of four and one-half percent (4.5%) based upon the twelve quarter moving average market value of the Endowment Fund's value at the beginning of each quarter, with a one-quarter lag.

Should an Endowment Fund become an Underwater Endowment Fund, the President may declare a Spending from that Underwater Endowment Fund using a different calculation basis for the period of time to be specified by the President. Should the President take such action, the President must notify the Chair of the Board of the action taken and the rationale for the action. Appropriations from Underwater Endowment Funds may be made based on the prudence standards prescribed by UPMIFA, this Endowment Management and Investment Policy, and conditions contained within the Endowment Agreement that established the Endowment Fund that is underwater.