

**ARKANSAS STATE UNIVERSITY FOUNDATION, INC.  
STATEMENT OF INVESTMENT POLICY**

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**I. DEFINITION AND FUNCTION**

The Arkansas State University Foundation, Inc. (The Foundation) is an Arkansas Corporation chartered March 7, 1977, for the primary purpose of advancing higher education, research and allied supportive activities of the Arkansas State University System through the promotion of private financial support. The organization is exempt from federal income tax under the provision of Internal Revenue Code Section 501(c)(3) and has nonprofit foundation status per section 170(b)(1)(A)(iv).

In recognition of its fiduciary responsibilities, the Board of Directors of the Arkansas State University Foundation, Inc. has adopted the following statement of investment policy. These guidelines relate to those gifts and donations in the form of endowments, with long term benefit objectives; those monies set aside and designated by the Board as quasi-endowment, and to those contributions received for the current benefit of the institution.

Investments will generally be limited to those firms and/or securities which adhere to the standards of these guidelines, and which meet prudent investment standards.

**II. PURPOSE OF STATEMENT**

The purpose of The Foundation is to support the Arkansas State University System and its mission over the long term. Accordingly, the purpose of this statement is to establish in a single document written procedures for the investment of endowment assets, and to instill confidence that the future growth of the endowment is sufficient to offset normal inflation plus reasonable spending, thereby preserving the constant dollar value and purchasing power of the endowment for future generations.

This statement will establish appropriate risk and return objectives in light of The Foundation's risk tolerance and investment time horizon. These objectives, as well as asset allocation guidelines, suitable investments, and responsibilities of the investment manager(s), are outlined below.

**III. OBJECTIVES OF THE ENDOWMENT FUND**

The objectives of the endowment fund shall be defined as follows: **Absolute**, which shall be measured in real (i.e. net of inflation) rate of return terms and shall have the longest time horizon for measurement; **Relative**, which shall be measured as time weighted rates

of return versus capital market indices; and **Comparative**, which shall be measured as performance of the investment manager(s) as compared to a universe of similar investment funds.

- A. Absolute** - The absolute objective of the endowment fund is to seek an average total annual real return of 5.0% or CPI plus 5%. This objective shall be measured over an annualized, rolling five and ten year time period. The intent of this objective is to preserve, over time, the principal value of assets as measured in real, inflation adjusted terms.
- B. Relative** - The relative objective of the endowment fund is to seek competitive investment performance versus appropriate or relative capital market measures, such as securities indices. This objective shall be measured primarily by comparing investment results over a moving annualized one, three and five year time period.
- C. Comparative** - The comparative performance objective of the endowment fund is to achieve a total rate of return that is above the median performance of the universe of similarly managed funds.

Endowment assets have a long term, indefinite time horizon that run concurrent with the existence of the institution, in perpetuity. As such, these funds can assume a time horizon that extends well beyond a normal market cycle, and can assume an above average level of risk as measured by the standard deviation of annual returns. It is expected, however, that both professional management and sufficient portfolio diversification will smooth volatility and help assure a reasonable consistency of return.

#### **IV. DESCRIPTION OF FUNDS**

The funds of The Foundation are divided into the following categories each having its own investment goals and objectives.

- A. University Unrestricted** - Funds available for use at the discretion of the Foundation CEO/President or Board of Directors when no specific purpose is designated by the donor.
- B. Restricted Discretionary** - Funds available for use at the discretion of an academic or administrative unit as designated by the donor.
- C. Restricted Scholarship** - Funds that are designated by donors for non-endowment scholarships.
- D. Endowments** - Funds received from a donor with the restriction that the principal either is not expendable or cannot be spent until a certain date or purpose is achieved.

- E. Quasi Endowment** - Funds established by the Foundation Board of Directors to function like an endowment fund but which may be totally expended at any time at the discretion of the Board.
- F. Agency** – Funds held and managed by the Foundation on behalf of Arkansas State University and its related entities.

## **V. RESPONSIBILITY**

The Joint Committee on University Investments (The Committee) is charged with the responsibility for the investment of the assets for all fund groups. The committee members shall discharge their duties solely in the interest of Arkansas State University and its related entities for the exclusive purposes of meeting the institution's financial needs. They shall discharge their duties with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of the enterprise of a like character and with like aims.

The Committee shall be comprised of four (4) representatives from the Foundation Board of Directors, three (3) representatives from Arkansas State University, one (1) representative from the Arkansas State University Indian Club, Inc., one (1) representative from the Arkansas State University Alumni Association Board of Directors The Treasurer of Arkansas State University and the Arkansas State University Foundation, Inc. shall attend all meetings and provide resources to the committee.

## **VI. DELEGATION OF AUTHORITY**

The Committee retains responsibility for policy making, but should delegate considerable responsibility for investment strategy and tactics. The Committee is authorized to engage the services of investment managers who possess the necessary specialized research facilities and skilled manpower to meet The Committee's investment guidelines and objectives. Policy guidelines will be fixed from time to time by The Committee after consideration of the advice and recommendations of the investment advisors and others. All modifications of the policy guidelines shall be in writing agreed to by The Committee and signed by the Chair of The Committee. The Committee also retains responsibility for monitoring and evaluating the investment manager's performance. The day to day supervision of such activities shall be the responsibility of the President/CEO and the Treasurer of The Foundation.

## VII. TARGET ASSET ALLOCATION

To achieve its investment objectives, the endowment pool shall be allocated among a number of asset classes. These asset classes include: domestic equity, domestic fixed income, international equity, international fixed income, alternative assets and cash. The purpose of allocating among fund asset classes is to ensure the proper level of diversification within the endowment pool.

The following target asset mix table defines The Committee's target asset allocation, and the minimum and maximum allocation limits of each asset class:

<u>Asset Class</u>	<u>Asset Allocation</u>		
	<u>Minimum</u>	<u>Target</u>	<u>Maximum</u>
Large Cap Equity	35%	40%	45%
Mid Cap Equity	5%	10%	15%
Small Cap Equity	5%	10%	15%
International Equity	5%	10%	15%
Bonds/Fixed Income	15%	20%	25%
Cash/cash Equivalents	0%	0%	5%
Alternative/Real Estate	5%	10%	15%

The general policy shall be to diversify investments among equity, fixed income and alternative asset securities so as to provide a balance that will enhance total return while avoiding undue risk concentration in any single asset class or investment category.

## VIII. ASSET ALLOCATION REBALANCING

Whenever a single asset class' allocation exceeds its minimum or maximum target asset allocation as identified in the table above, all assets will be rebalanced back to their target asset allocation. Rebalancing, if necessary, shall occur at least annually based on the fiscal year end June 30<sup>th</sup>.

Each manager who is responsible for more than one asset class shall be responsible for rebalancing its portion of the endowment pool as provided in the table above without reference to the assets held by other managers.

The Treasurer of The Foundation shall be responsible for rebalancing between managers.

## IX. INVESTMENT POLICIES

The investment policies, guidelines and restrictions presented in this policy statement serve as a framework to help The Committee and its investment manager(s) achieve the investment objectives at a level of risk deemed acceptable. The endowment pool will be

diversified by asset class and within asset classes. Within each asset class, securities will be diversified among economic sector, industry, quality, and size.

The purpose of diversification is to provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the performance of the total pool. As a result, the risk level associated with the portfolio investment is reduced.

Within the equity and fixed income asset classes, different investment styles will be employed. Diversification by investment style is also an important step in reducing the risk of The Foundation endowment pool portfolio.

#### **A. Equity Securities**

The purpose of equity investments, both domestic and international, in the endowment pool is to provide capital appreciation, growth of income, and current income, with the recognition that this asset class carries with it the assumption of greater market volatility and increased risk of loss. The investment manager(s) should maintain the equity portion of the pool at a risk level roughly equivalent to that of the equity market as a whole, over an annualized moving three and five year time period.

Investment styles within the equity asset class are defined as follows:

**Large Cap** – U.S. equity securities with primary exposure to companies exceeding a market capitalization of \$10 billion. Portfolio characteristics are similar to that of the S&P 500 Index, with the objective of adding value through long term capital appreciation.

**Mid Cap** – U.S. equity securities with primary exposure to companies with market capitalization between \$2 to \$10 billion.

**Small Cap**- Stocks of companies with relatively small market value capitalization. (Less than \$ 2 billion with an average market capitalization of approximately \$500 million.)

**International** - stocks of companies domiciled outside the United States.

Equity holdings shall generally be restricted to high quality, readily marketable securities or corporations that are actively traded on major stock exchanges. International equity investments of similar quality and marketability will be permitted up to 15% of the total equity portfolio.

Decisions as to individual security selection, number of industries and holdings, current income levels and turnover are left to the broad manager discretion, subject to the standards of fiduciary prudence. However, no single major industry shall represent more than 20% of the total market value of the endowment pool,

and no single security shall represent more than 5% of the total market value of the endowment pool.

The investment managers are prohibited from selling securities short, buying securities on margin, borrowing money or pledging assets, or trading uncovered options, commodities or currencies without the advance written approval of The Committee.

Managers are also restricted from investing in private placements and restricted stock unless otherwise permitted in writing by The Committee. It is expected that no assets will be invested in securities whose issuers are or are reasonably expected to become insolvent, or who otherwise have filed a petition under any state or federal bankruptcy or similar statute.

Within the above guidelines and restrictions, the managers have complete discretion over the timing and selection of equity restrictions.

## **B. Fixed Income Securities**

The purpose of fixed income investments, both domestic and international, is to provide diversification, and is a predictable and dependent source of current income. It is expected that fixed income investments will be totally dedicated to the long term bond market, but will be flexibly allocated amongst maturities of different lengths according to interest rate prospects. Fixed instruments should reduce the overall volatility of the endowment pool's assets and provide a deflation hedge.

Investments in fixed income securities should be managed to pursue opportunities presented by changes in interest rates, credit ratings, and maturity premiums, with the objective of meeting or exceeding the results of the fixed income market as represented by the annualized returns of the Lehman Aggregate Bond Index, over an annualized moving three and five year time period.

Investment managers may select from appropriately liquid preferred stocks, corporate debt securities, and obligations of the U.S. Government and its agencies.

No issues may be purchased with more than 30 years maturity;

Investments of a single issuer, with the exception of the U.S. Government and its agencies, (including GNMA, FNMA and FHLMC) may not exceed 5% of the total market value of the endowment pool;

No more than 15% of the corporate debt securities in the fixed income portfolio may be rated below-investment grade.

Within the fixed income component, the investment managers are prohibited from investing in private placements, and fixed income or interest rate futures, without the prior written approval of the Committee.

Within the above guidelines and restrictions, the managers have complete discretion over the timing and selection of fixed income securities.

### **C. Cash and Equivalents**

The investment manager may invest in the highest quality commercial paper, repurchase agreements, Treasury Bills, certificates of deposit, and money market funds to provide income, liquidity for expense payments, and preservation of the endowment pool principal value. Commercial paper assets must be rated at least A1 or P-1 (by Moody's or S&P). No more than 5% of the total market value of the endowment pool's assets may be invested in the obligations of a single issuer, with the exception of the U.S. Government and its agencies.

Uninvested cash reserves shall be kept to a minimum; short term, cash equivalent securities are usually not considered an appropriate investment vehicle for the endowment assets. However, such vehicles are appropriate as depository for income distributions from long term endowment investments, or as needed for temporary placement of funds directed for future investment to the longer term capital markets. Also, such investments are the standard for contributions to the current fund or for current operating cash.

Within the above guidelines and restrictions, the managers have complete discretion over the timing and selection of cash and cash equivalent securities.

### **D. Alternative Assets**

Investments in the alternative assets category shall not exceed 15% of the total endowment pool assets and may include the following investment vehicles.

**Real Estate** – Real estate investments may include liquid funds that offer the benefits of a diversified real estate portfolio without the multi-year commitment typically associated with private real estate investments. This investment class will allocate its assets to managers who invest primarily in equity-oriented real estate investment trusts (REITs) and real estate operating companies (REOCs) that own and operate multi-family, commercial and retail properties, primarily in the United States.

Investments may also include private equity real estate, held in the form of professionally managed income producing commercial and residential property. Such investments may be made only through professionally managed pooled real

Estate investment funds, as offered by leading real estate managers with proven records of superior performance over time.

**Venture Capital and Other Private Equity Partnerships** – Investments may also include venture capital and private equity investments, held in the form of professionally managed pooled limited partnership investments. Such investments must be made through funds offered by professional investment managers with proven records of superior performance over time.

**Derivatives and Derivative Securities** – In general, the use of derivatives securities by investment managers shall be discouraged, unless the use of such securities provide substantial opportunity to increase investment returns at an appropriately equivalent level of risk to the remainder of the total portfolio. The approval and use of derivatives securities will not be allowed unless the Committee is confident that the investment manager(s) thoroughly understands the risks being taken, has demonstrated expertise in the use of such securities, and has guidelines in place for the use and monitoring of derivatives.

**Commodity Assets** – Investments may also include natural resource and commodity related investments to provide portfolio inflation protection. Such investments must be made through funds offered by managers with proven records of superior performance over time.

**Marketable Alternatives** – Investment in long/short hedge funds, risk arbitrage, distressed obligations and high yield bonds are allowed to provide portfolio return enhancement and volatility dampening. Such investments shall be made through specific accounts or funds with proven records of superior performance over time.

- E. Restrictions, Waivers and Modifications** – The Committee is authorized to waive or modify any of the restrictions in these guidelines in appropriate circumstances.  
Any such waiver or modification will be made only after a thorough review of the manager and the investment strategy involved. Documentation supporting all waivers and modifications will be maintained as part of the permanent records of the Committee. All waivers and modifications will be reported to the Board of Directors at the meeting immediately following the granting of the waiver modification.

## **X. COMMUNICATIONS**

Investment managers shall meet regularly, or as reasonably expected, with the interested parties representing the endowment pool. Investment policy shall be reviewed during such meetings and no less than annually.

- A. Managers Reporting and Evaluation** - It is expected that the investment managers responsible for the investment of endowment assets shall report monthly on the performance of the portfolio, including comparative gross returns for the funds and their respective benchmarks; also included will be a complete accounting for all transactions involving the endowment pool during the month, together with a statement of beginning market values, fees, capital appreciation, income and ending market value, for each account.

The Committee recognizes that market conditions may greatly influence the ability of a manager to meet year to year investment goals and objectives. Further, The Committee realizes that significant cash flow may also affect the ability of a manager to meet a specific short term objective. Accordingly, The Committee expects to monitor performance through absolute, relative, and comparative terms over annualized time periods. Absolute results will determine the rate of fund growth, while relative results will provide The Committee with a view of investment performance compared to the securities markets and comparative results will present performance as compared to other investment managers.

Review of portfolio results in absolute terms shall be made with consideration towards meeting and/or exceeding the expressed minimum real rate of return over a moving five and ten year time period.

Review of portfolio results in relative terms shall be accomplished primarily by comparing results, over a moving annualized three and five year time period, to assigned market indices.

Review of portfolio results in comparative terms shall be accomplished primarily through universe comparisons over moving annualized one, three and/or five year time periods.

## **XI. SPENDING POLICY**

Annual expenditures for support of University programs from the endowment pool should not exceed four and one half percent (4.5%) of the trailing five year average market value of the endowment pool as measured at December 31st. When an endowment has been in existence for less than five years, the spending limit will be calculated using the average market value over the life of the endowment. Endowments less than three years old are limited to spending actual cash yield (interest and dividend income.)

The Foundation is authorized to charge an endowment management fee of one half of one percent (.50%) of the market value of the endowment to be collected on a quarterly basis.

It is understood that the total return basis for calculating spending identified above is sanctioned by the Uniform Management of Institutional Funds Act (UMIFA).

In periods with no market value appreciation, spending may be limited to the actual current yield generated by the endowment pool assets. Actual yield will typically be defined as interest and dividend income.

## **XII. UNDERWATER ACCOUNTS**

**Definition** – An endowment account is deemed to be “underwater” when its current market value is less than its principal balance. Principal is defined as the historic gift value of the fund.

In the event any of the endowment accounts are underwater, the Joint Committee on University Investments (The Committee) shall meet and specifically approve any distributions. If the endowment memorandum of agreement (MOA) specifically prohibits distributions for any reason, including underwater situations, the MOA will prevail and the distributions will be eliminated or reduced in accordance with donor intent.

The Committee shall consider the following standards of prudence when determining distribution rates:

1. The duration and preservation of the endowment fund;
2. The purposes of the institution and the fund;
3. General economic conditions;
4. The possible effect of inflation and deflation;
5. The expected total return from income and appreciation of investments;
6. Other resources of the institution; and
7. The existing investment policy of the institution.

It is the philosophy of the Committee that stable and slowly growing cash distributions should be made available to account holders for the purposes originally mandated in the donor agreement. Distributions of this nature should be made available perpetually. Although distributions are dependent on investment returns, they should be insulated from severe market fluctuations as much as possible. Account holders should not make long-term commitments based solely on anticipated future endowment account distributions.