

October 7, 2009

MEMORANDUM

TO: State Board of Regents
FROM: William A. Sederburg
SUBJECT: SBR Policy R541, Management and Reporting of Institutional Investments

Issue

This revision would clarify the policy's investment allowances by restructuring the policy section order. Specifically, the policy revision would better clarify that a Regent-approved *institutional* investment policy supersedes the general guidelines of the Regents' policy R541. The request to revise this policy came from Mel Smith, Manager of Banking and Operational Investments, at the U of U.

In addition, Dixie State College is proposing clarifying language relative to the funds they have invested with the University of Utah, intent being to clearly state which investment policy is primary when one institution invests funds through another. The proposed addition to the policy is as follows:

6.3.5. Any institution that elects to invest their endowment funds with another institution may do so with prior approval from their Board of Trustees and the Board of Regents and shall adopt the investment guidelines of the institution receiving the funds in place of the guidelines outlined in 6.2-6.3.

Policy Change

Summary of Changes:

Note: the policy section references in this memo are the original section numbers and have a strikethrough in the attached policy document. Most of the sections in the revised policy have been renumbered.

The recommended changes would put policy R541, section 6, in a hierarchal order of handling endowment funds. This is accomplished by making section 4.6.1.2 the beginning paragraph because it deals with the disposition of received gifts, and then moving section 4.6.3 to be the second paragraph in order to then address policy for endowment funds investments.

Instructions regarding permissible investments in section 4.6.1.1. and 4.6.1.3 are clarified by adding the sentence, "In the absence of an investment policy that has been adopted by the Board of Trustees and approved by the Board of Regents, an institution's overall endowment portfolio shall be invested in accordance with the following allocation ranges:" This language is in response to a request by auditors for clarification regarding which allocation parameters govern particular situations.

The remaining changes include the following:

- Policy sections were renumbered for readability.
- Section 3.1 defines the word "Board."
- Section 4.6.2.1 was moved to be the introductory paragraph of 4.6.2 (now 6.3).
- 4.6.2.2. was changed to a new section 6.4.
- Section 4.8. is restructured into R541-8 and the original paragraph was broken into smaller sections, which include moving the definition of a conflict of interest to the beginning introductory paragraph followed by creating subsections 8.1.-8.2. The only new language added in section 8 was 8.1's heading which reads "Access Persons."

Commissioner's Recommendation

The Commissioner recommends that the Regents approve the proposed changes to policy R541.

William A. Sederburg
Commissioner of Higher Education

WAS/GLS/DAM
Attachment



R541, Management and Reporting of Institutional Investments¹

R541-1. Purpose: To provide for the implementation of the State Money Management Act, the rules of the State Money Management Council, and the Uniform Prudent Management of Institutional Funds Act; and the adoption of guidelines for the establishment of policy, process, and reporting of investments by institutions of the Utah System of Higher Education (USHE).

R541-2. References

- 2.1. Utah Code [§53B-2-106](#) (Duties and Responsibilities of the President)
- 2.2. Utah Code [Title 51, Chapter 7](#) (State Money Management Act)
- 2.3. Utah Administrative Code [Title R628](#) (Rules of the State Money Management Council)
- 2.4. Utah Code [Title 51, Chapter 08](#) (Uniform Prudent Management of Institutional Funds Act)

R541-3. Definitions

3.1. "The Board": The Utah State Board of Regents.

~~3.1~~ 3.2. Investments: All institutional funds addressed under provisions of the State Money Management Act or the Uniform Prudent Management of Institutional Funds Act.

~~3.2.~~ 3.3. Alternative Investments: Funds that derive returns primarily from high yield or distressed debt (hedged or non-hedged), private capital (including venture capital and private equity), natural resources, private real estate, or absolute return and long/short hedge funds.

R541-4. Policy

~~4.1.~~ R541-4. Delegation of Responsibility: The Board delegates to each institutional Board of Trustees full responsibility to manage and report institutional investments in compliance with this general policy.

~~4.2.~~ R541-5. Institutional Board of Trustees Responsibilities: Each institutional Board of Trustees shall adopt institutional policy and procedure regarding investments (including any changes in such policy and procedures), designate a public treasurer and approve the format of reports submitted for its review.

~~4.3.~~ 5.1. Periodic Review and Approval: Each institutional Board of Trustees shall receive and approve monthly investment reports.

~~4.4.~~ 5.2. Policy and Procedures Furnished to the Board: Each institution shall furnish the Board with a copy of its investment policies and procedures as approved by its institutional Board of Trustees. Such policy and procedures shall:

¹ Approved April 24, 1973, revised September 24, 1974, May 26, 1989, October 19, 1989, June 18, 1993, May 29, 1998, June 10, 2005, and December 14, 2007, and (tentative September 16, 2009).

~~4.4.1.~~ ~~5.2.1.~~ require institutional compliance with the State Money Management Act, Rules of the State Money Management Council, and Uniform Prudent Management of Institutional Funds Act; and

~~4.4.2.~~ ~~5.2.2.~~ specify criteria for appointment of a public treasurer, define the public treasurer's authority in making institutional investments within the overall operating responsibility of the chief executive officer, and establish criteria for supervisory approval of the public treasurer's investment decisions; and

~~4.4.3.~~ ~~5.2.3.~~ delineate specific procedures and required approvals for investment of institutional funds which provide for adequate internal controls, including an appropriate segregation of duties with respect to the authorization, custody, accounting and reporting of investment transactions; and

~~4.4.4.~~ ~~5.2.4.~~ specify the format and schedule for reporting to its institutional Board of Trustees.

~~4.5.~~ ~~5.3.~~ **Subsequent Changes:** Each institution shall submit to the Board all subsequent changes in investment policy.

4.6. R541-6. Endowment Funds: If any gift, devise, or bequest, whether outright or in trust, is made by a written instrument which contains directions as to investment thereof, the funds embodied within the gift shall be invested in accordance with those directions. Such gifts received by donation may be retained by an institution and shall be considered to be invested according to the terms of this policy. In the absence of a written instrument, non-qualifying investments shall be sold as soon as practical, not to exceed 30 days. The Commissioner may approve exceptions to the 30-day rule in the case of non-readily marketable investments.

6.1. In accordance with the Uniform Prudent Management of Institutional Funds Act, an institution's board of trustees may adopt its own endowment investment policy. All such policies (including any associated investment guidelines or other policy direction) must meet the requirements of the Uniform Prudent Management of Institutional Funds Act, and must be formally approved by the Board of Regents. Institutions are not authorized to apply their own policies until both of the foregoing conditions have been met. Institutions following a separate trustee adopted and Regent approved endowment investment policy will be considered to be investing in accordance with the terms of this policy. Revisions to institutional endowment investment policies (including revisions to any associated investment guidelines or other policy direction) must also receive both trustee and Regent approval.

~~4.6.1.~~ ~~6.2.~~ **Permissible Investments and Asset Allocations**

~~4.6.1.1.~~ ~~6.2.1.~~ In the absence of an investment policy that has been adopted by the Board of Trustees and approved by the Board of Regents, institutions are permitted to invest endowment funds in the following:

| | |
|---|----------|
| Mutual funds registered with the SEC | 0 - 100% |
| Investments sponsored by the Common Fund | 0 - 100% |
| Investments authorized by Utah Code §51-7-11 | 0 - 100% |
| Corporate stock listed on a major exchange (direct ownership) | 0 - 3% |

~~4.6.1.2.~~ If any gift, devise, or bequest, whether outright or in trust, is made by a written instrument which contains directions as to investment thereof, the funds embodied within the gift shall be invested in accordance with those directions. Such gifts received by donation may be retained by an institution and shall be considered to be invested according to the terms of this policy. In the absence of a written instrument, non-qualifying investments shall be sold as soon as practical, not to exceed 30 days. The Commissioner may approve exceptions to the 30-day rule in the case of non-readily marketable investments.

~~4.6.1.3.~~ **6.2.2.** In the absence of an investment policy that has been adopted by the Board of Trustees and approved by the Board of Regents, an ~~Each~~ institution's overall endowment portfolio shall be invested in accordance with the following allocation ranges:

| | |
|-----------------------------------|-----------|
| Fixed income and cash equivalents | 25 - 100% |
| Equity Investments | 0 - 75% |
| Alternative Investments | 0 - 30% |

~~4.6.1.4.~~ **6.2.3.** Each institution utilizing alternative investments must comply with the following criteria:

~~4.6.1.4.1.~~ **6.2.3.1.** Each institution with endowed funds in excess of \$100 million may invest up to 30% percent of its endowed funds in alternative investments.

~~4.6.1.4.2.~~ **6.2.3.2.** Each institution with endowed funds in excess of \$75 million but less than \$100 million may invest up to 25% percent of its endowed funds in alternative investments.

~~4.6.1.4.3.~~ **6.2.3.3.** Each institution with endowed funds in excess of \$50 million but less than \$75 million may invest up to 20% percent of its endowed funds in alternative investments.

~~4.6.1.4.4.~~ **6.2.3.4.** Each institution with endowed funds in excess of \$25 million but less than \$50 million may invest up to 15% percent of its endowed funds in alternative investments.

~~4.6.1.4.5.~~ **6.2.3.5.** Each institution with endowed funds in excess of \$5 million but less than \$25 million may invest up to 10% percent of its endowed funds in alternative investments.

~~4.6.1.4.6.~~ **6.2.3.6.** Institutions with endowed funds of less than \$5 million are not permitted to invest any of their endowed funds in alternative investments.

~~4.6.1.4.7.~~ **6.2.4.** Once an institution reaches an alternative investment threshold, it may retain the investment range authorized for that threshold as long as the market value of its endowed funds remains within 90% of the threshold.

~~4.6.1.5.~~ **6.2.5.** Pooled or commingled investment funds (e.g., mutual funds or Common Fund investments) are to be categorized and calculated into the asset mix according to the primary purpose of those investment funds.

~~4.6.1.6.~~ **6.2.6.** Pooled or commingled investment funds without a clear primary purpose (e.g., balanced funds) are to be categorized and calculated into the asset mix as equity investments.

~~4.6.1.7.~~ 6.2.7. Real estate investment trusts are to be categorized and calculated into the asset mix as equity investments.

~~4.6.1.8.~~ 6.2.8. The endowment portfolio shall be reviewed and rebalanced at the end of every quarter (rebalancing is only necessary if the permissible investment and/or asset allocation ranges are out of compliance). This action will constitute full compliance with the permissible investment and asset allocation provisions of this policy.

~~4.6.1.9.~~ 6.2.9. All calculations required to demonstrate compliance with section ~~4.6.1~~ 6.2 are to be based on market values.

~~4.6.2.~~ 6.3 **Investment Guidelines:** The foregoing asset allocation standards are meant to serve as a general guide. The institutions must use them in conjunction with appropriate due-diligence and prudence. The following standard of care shall apply to investments of endowed funds by institutions:

~~4.6.2.1.~~ The foregoing asset allocation standards are meant to serve as a general guide. The institutions must use them in conjunction with appropriate due-diligence and prudence. The following standard of care shall apply to investments of endowed funds by institutions:

~~4.6.2.1.1.~~ 6.3.1. An institution shall invest and manage endowment funds as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the endowment. In satisfying this standard, an institution shall exercise reasonable care, skill, and caution.

~~4.6.2.1.2.~~ 6.3.2. An institution's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the endowment portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the endowment.

~~4.6.2.1.3.~~ 6.3.3. Among circumstances that an institution shall consider in investing and managing endowment assets are the following which may be relevant to the endowment or its beneficiaries:

~~4.6.2.1.3.1.~~ 6.3.3.1. general economic conditions;

~~4.6.2.1.3.2.~~ 6.3.3.2. the possible effect of inflation or deflation;

~~4.6.2.1.3.3.~~ 6.3.3.3. the role that each investment or course of action plays within the overall endowment portfolio;

~~4.6.2.1.3.4.~~ 6.3.3.4. the expected total return from income and the appreciation of capital;

~~4.6.2.1.3.5.~~ 6.3.3.5. needs for liquidity, regularity of income, and preservation or appreciation of capital; and

~~4.6.2.1.3.6.~~ 6.3.3.6. an asset's special relationship or special value, if any, to the purposes of the endowment or to one or more of the beneficiaries.

~~4.6.2.1.4.~~ **6.3.4.** An institution shall make a reasonable effort to verify facts relevant to the investment and management of endowed assets.

6.3.5. Any institution that elects to invest their endowment funds with another institution may do so with prior approval from their Board of Trustees and the Board of Regents and shall adopt the investment guidelines of the institution receiving the funds in place of the guidelines outlined in 6.2-6.3.

~~4.6.2.2.~~ **6.4.** **Delegation to an Agent:** An institution may delegate investment and management functions that a prudent investor could properly delegate under the circumstances. ~~The institution shall exercise reasonable care, skill, and caution in:~~

6.4.1. The institution shall exercise reasonable care, skill, and caution in:

~~4.6.2.2.1.~~ **6.4.1.1.** selecting an agent;

~~4.6.2.2.2.~~ **6.4.1.2.** establishing the scope and terms of the delegation, consistent with the purposes and terms of the endowment; and

~~4.6.2.2.3.~~ **6.4.1.3.** periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

~~4.6.2.3.~~ **6.4.2.** In performing a delegated function, an agent owes a fiduciary duty to the endowment to exercise reasonable care to comply with the terms of the delegation. An institution that complies with the requirements of section 4.6.2.2 is not liable to the beneficiaries or to the endowment for the decisions or actions of the agent to whom the function was delegated.

~~4.6.2.4.~~ **6.4.3.** In investing and managing endowed funds, an institution may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the endowment, and the skills of the institution or agent to whom investment management functions were delegated.

~~4.6.3.~~ In accordance with the Uniform Prudent Management of Institutional Funds Act, an institution's board of trustees may adopt its own endowment investment policy. All such policies (including any associated investment guidelines or other policy direction) must meet the requirements of the Uniform Prudent Management of Institutional Funds Act, and must be formally approved by the Board of Regents. Institutions are not authorized to apply their own policies until both of the foregoing conditions have been met. Institutions following a separate [trustee adopted and Regent approved] endowment investment policy will be considered to be investing in accordance with the terms of this policy. Revisions to institutional endowment investment policies (including revisions to any associated investment guidelines or other policy direction) must also receive both trustee and Regent approval.

~~4.6.4.~~ **6.5.** **Exceptions:** The Board of Regents may approve exceptions to section 4-6 R541-6. Such exceptions must be immaterial to the endowment portfolio as a whole and must meet a compelling instructional, public service, or other institutional need.

4.7. R541-7. Operating and All Other Non-Endowment Funds: Operating and all other non-endowment funds shall be invested in accordance with the State Money Management Act and Rules of the State Money Management Council.

4.8. R541-8. Conflicts of Interest: Each institution's officers, directors, employees or members of an investment committee that are involved with the investment of endowment funds ("Access Persons"); have a duty to be free of conflicting interests that might influence their decisions when representing the institution. Consequently, as a general matter, an institution's Access Persons are not permitted to maintain any conflict of interest with the institution, and should make every effort to avoid even the appearance of any such conflict. A conflict of interest occurs when an individual's private interests interfere in any way—or even appear to interfere—with the institution's interests as a whole. A conflict of interest can arise when an Access Person takes actions or has interests that may make it difficult to perform his or her company work objectively and effectively, or when an Access Person or a member of his or her family receives any improper personal benefits as a result of his or her position with the institution. Any Access Person who believes that he or she may have a potential conflict of interest must immediately report concerns to the appropriate institutional representative, mechanism, or process (ethics committee, etc.). This general prohibition on conflicts of interest includes (but is not limited to) the following:

Conflicts of Interest: A conflict of interest occurs when an individual's private interests interfere in any way—or even appear to interfere—with the institution's interests as a whole.

8.1. Access Persons

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8.1.3. Any Access Person who believes that he or she may have a potential conflict of interest must immediately report concerns to the appropriate institutional representative, mechanism, or process (ethics committee, etc.).

8.2. This general prohibition on conflicts of interest includes (but is not limited to) the following:

4.8.1. 8.2.1. an institution's dealings with consultants, investment advisers, investment funds, and others shall be based solely on what is in the institution's best interest, without favor or preference to any third party, including close relatives; and

4.8.2. 8.2.2. Access Persons who deal with or influence decisions of individuals or organizations seeking to do business with an institution shall not own interests in or have other personal stakes in such organizations that might affect the decision-making process

and/or the objectivity of such employee, unless expressly authorized in writing by the investment committee and board of trustees of the institution, and only after the interest or personal stake has been disclosed.

4.9. ~~R541-9.~~ Reports to Institutional Boards of Trustees: In establishing reports to its Board of Trustees, each institution shall implement the following:

4.9.1. ~~9.1.~~ Reports: Each institution shall submit monthly investment reports to the secretary of the Board of Trustees within 60 days of the month's end. The secretary will place the reports on the agenda of the next regular trustee meeting.

4.9.2. ~~9.2.~~ Copies of Reports Submitted to the Board: Within 30 days of trustee approval, each institution shall submit to the Board of Regents a copy of the reports submitted to its board of trustees.

4.10. ~~R541-10.~~ Annual Report: Annually, each institution shall submit, on forms provided by the Commissioner of Higher Education, a report summarizing all investments under its jurisdiction.

4.11. ~~R541-11.~~ Audits: Each institution shall arrange for an audit of its annual report. The Office of the Commissioner will maintain an audit procedures guide to outline audit requirements and due dates.

4.12. ~~R541-12.~~ Annual Summary: The Board shall submit an annual report to the Governor and the Legislature summarizing all investments by institutions under its jurisdiction.