

# Policies & Procedures

## **Texas State University-San Marcos Development Foundation** **STATEMENT OF INVESTMENT POLICY**

November 2007

### **INTRODUCTION AND PURPOSE**

The philosophy of the Texas State University San Marcos Development Foundation is to preserve, protect and enhance the corpus while providing a sustainable flow of funds to support the mission of the Foundation.

This Statement of Investment Policy is set forth to:

1. Define the investment policies, guidelines and objectives of the Texas State University — San Marcos Development Foundation ("Foundation").
2. Create a framework from which the Investment Committee ("Committee") can evaluate performance, explore new opportunities and make recommendations to the Board of Trustees ("Board") to enhance the investment portfolio.
3. Provide guidance for, expectation of, and limitation on, all parties bearing investment responsibilities with the Foundation.

The intent of this Statement is to design an investment environment with specific parameters that reflects the philosophy of the Committee, thereby providing Investment Manager(s) with clearly defined policies and objectives. Although these policies and objectives are intended to govern the investment activity, they are designed to be sufficiently flexible in order to be practical.

### **DELEGATION OF RESPONSIBILITIES**

The investment program is managed in compliance with all applicable fiduciary, prudence, and due diligence requirements that experienced investment professionals would utilize, and with all -relevant laws, rules, and regulations issued by local, state, federal and international political entities that apply to the Foundation. The investment function of the Foundation will adhere to the requirements of the Uniform Management of institutional Funds Act.

#### **Board of Trustees**

The Board of Trustees bears the overall fiduciary responsibility for the Foundation. It is the responsibility of the Board to approve and amend as appropriate the Investment Policy Statement, establishing strategic policy guidelines by which the Foundation is to be managed.

## **Investment Committee**

The Board has delegated to the Investment Committee the responsibility for all investable funds of the Foundation. The Committee has the responsibility to ensure that the assets of the Foundation are managed in a manner that is consistent with the policies and objectives of the Foundation. In so doing, the Committee will comply with all applicable laws.

The Committee members are required to discharge their duties solely in the interest of the University and for the exclusive purpose of meeting the financial needs of the University. The Committee is authorized to engage the services of Investment Manager(s) who possess the necessary specialized research capabilities and skill to meet the Investment Objectives and guidelines of the Foundation. The Committee will require the Investment Manager(s) to adhere to any policies adopted by the Board.

In carrying out its responsibilities a quorum of the Investment Committee must be present, either in person, by teleconference or by proxy. A quorum is at least fifty percent of the members of the Investment Committee. Each member shall be entitled to one vote and each decision of the Investment Committee shall require the ascent of a majority of those voting.

The Committee's responsibilities include:

1. Review, approve and submit for Board approval an Investment Policy for the Foundation which addresses asset allocation, spending guidelines, acceptable risk levels, and total return objectives.
2. Review, approve, and submit for Board approval investment guidelines relating to eligible investments, diversification and concentration restrictions, and performance objectives for specific managers or direct investments.
3. Select external investment consultant(s), professional investment manager(s), bank custodian(s) and other experts, as needed, and submit for Board approval.
4. Make direct investments where the selection of an external, professional investment manager is not appropriate.
5. Monitor the adherence to the Investment Policy and evaluate the performance based on achieving the stated objectives.
6. Evaluate the performance of the external investment consultant(s) and manager(s) and make changes if needed.
7. Examine which donated assets should be held for investment or liquidated.

## **Investment Consultant**

The Committee may recommend the engagement of an independent investment consulting firm to assist in the attainment of its objectives and monitor compliance with the stated investment policies. The

Consultant's responsibilities are:

1. Assisting in the development and implementation of investment policies, objectives and guidelines,
2. Preparation of an asset allocation analysis and recommendation of an asset allocation strategy with respect to the Foundation's objectives,
3. Reviewing investment Managers - including search, selection and recommendation,
4. Preparing and presenting performance evaluation reports in accordance with Association of Investment Management and Research promulgated standards,
5. Attending periodic meetings of the Committee to present evaluation reports (attendance at other meetings is on an "as needed" basis),
6. Reviewing of contracts and fees for both current and proposed Investment Managers,
7. Reviewing and developing special investment strategies that complement existing asset classes or strategies to be considered by the Committee,
8. Communicating investment policies and objectives to the managers, monitoring their adherence to such policies and reporting all violations,
9. Notifying the Committee of any changes in key personnel or ownership of the consulting firm, as well as satisfactory explanation for such changes,
10. Assisting the Committee in special tasks,
11. Notifying the Foundation Committee immediately of any litigation or violation of securities regulations in which any Investment Manager is involved,
12. Notifying the Committee of any significant changes in portfolio managers, personnel or ownership of any investment management firm, and
13. Serve as a fiduciary.

### **Investment Managers**

Each Investment Manager is expected to pursue their own investment strategy within the performance guidelines created for individual managers. Coordination of the guidelines for the

individual managers assures the combined efforts of the managers will be consistent with the overall investment objectives of the Foundation.

The Investment Managers' responsibilities are as follows:

1. Investing assets under their management in accordance with the guidelines and restrictions formulated by the Committee,
2. Exercising discretionary authority over the assets entrusted to them, subject to these guidelines and restrictions,
3. Providing written documentation of portfolio activity, portfolio valuations, performance data, and portfolio characteristics on a quarterly basis in addition to other information as requested by the Committee or Investment Consultant,
4. Voting proxies vigorously in the best interest of the Foundation and University, and
5. Where applicable, annually providing a copy of the SEC investment advisors disclosure Form ADV Part II.

### **Investment Custodian**

The custodians are responsible for the safekeeping of the Foundation's assets. Their duties and responsibilities are as follows:

1. Providing timely reports detailing investment holdings and account transactions monthly and an annual report summarizing the following to be submitted to the Foundation and the investment Consultant within a reasonable amount of time following each fiscal year end. Custodian may be subject to review and/or termination by the Committee if accuracy and timeliness of reporting falls below the Committee's expectations.
2. The reports will include the following:
  - a. Statement of all property on hand,
  - b. Statement of all property received representing contributions to the accounts,
  - c. Statement of all sales, redemptions, and principal payments,
  - d. Statement of all distributions from the account,
  - e. Statement of all expenses paid,
  - f. Statement of all purchases, and
  - g. Statement of all income.

3. Establishing and maintaining an account(s) for each Investment Manager of the Foundation,
4. Providing all normal custodial functions including security safekeeping, collection of income, settlement of trades, collection of proceeds of maturing securities, daily investment of uninvested cash, etc., and
5. Preparing additional accounting reports as requested by the Committee or Investment Consultant.

## INVESTMENT POLICIES AND OBJECTIVES

### General Investment Philosophy Objectives:

**1. Return:** The long term objective of the Foundation is to earn a return sufficient to preserve the purchasing power of the Foundation for generations to come, as well as to provide for current scholarship needs. As a result, the Return Goal shall consist of a spending rate, an assumed rate of inflation, investment management fees, and any desired real portfolio growth. As of the date of this Statement of Investment Policy, these items and their function in the overall return need are as below but may be modified in the future at the direction of the Committee and Board:

<b>Components of Return Goal</b>	
<b>Spending Rate</b>	3.00% -4.50%
<b>Inflation Rate</b>	2.50% -3.00% <i>1</i>
<b>Administrative Fees</b>	0.35% -1.00% <i>2</i>
<b>Real Portfolio Growth</b>	--
<b>Long-Term Return Goal (Net of Fees)</b>	5.85% -8.50%

[Administrative fees are based on a sliding scale. 1](#)

Includes 0.5% for Higher Education Price Index or "HEPI Index". *2*

**2. Risk:** The Committee will permit the Foundation's portfolio to experience an overall level of risk consistent with the risk generally associated with the Committee's policy asset allocation. The Foundation is particularly risk-adverse to the probability of not meeting the Return Goal.

### Constraints:

**1. Liquidity:** Income must be sufficient to meet spending needs and expenses.

**2. Time Horizon:** The Endowment has a long life and should be managed with a time horizon much longer than the normal investment cycle. A time horizon of thirty to fifty years is appropriate. Providing for the Endowment's needs over the time horizon is a high priority.

**3. Taxes:** The Foundation is a tax exempt organization.

### **Return Measurement Objectives**

To achieve the Return Goal, the Foundation's assets will be invested to generate appreciation and / or dividend and interest income. While there cannot be complete assurance that the defined goal will be realized, it is believed that likelihood of realization is enhanced by diversifying the assets of the Foundation. Over time, the Committee will aim to achieve the Return Goal while maintaining acceptable risk levels. To accomplish this goal, the Foundation will diversify assets among several asset classes. (See Section: Permissible Assets)

The following objectives are designed to support achievement of the Return Goal and are net of (after) investment expense:

1. Total Foundation assets should achieve an annualized nominal rate of return equal to or greater than that of the Goal.
2. Total Foundation assets should return, over trailing twelve month periods, a nominal rate of return greater than or equal to a composite index created by combining various indices in the same proportion as the Foundation's target allocation (as described in the Asset Allocation section of this document).
3. In general, active managers will be expected to provide returns greater than their appropriate benchmark, net after fees, while utilizing acceptable risk levels, over moving thirty-six-month periods. In contrast, index, or passive managers will be expected to provide returns nearly identical to the appropriate benchmark, before reasonable fees, with no more volatility than the benchmark.

### **Volatility and Risk**

The Return Goal can be achieved while assuming acceptable risk levels commensurate with "market" volatility. "Market" volatility is defined as the trailing three year standard deviation of investment returns (based on monthly data) of the benchmark indices deemed appropriate.

Risk is defined as the probability of failing to meet the Return Goal over the time horizon. Therefore, in order to minimize the probability of failure, thereby minimizing risk, the following variables should be considered in all aspects of the decision-making process with regards to the Foundation's investable assets:

- Probability of Missing the Return Goal
- Inflation
- Asset/Style Allocation

### **Spending Policy**

*Total Return Approach*

The Board has adopted a "total return" approach to calculating investment returns.

In recognition of these facts, the Committee will consider the Foundation's total return from both income and net realized and unrealized capital gains when recommending the Spending Policy. When distributions are made, they will be withdrawn from the Foundation regardless of the portion of the total return that is from capital gains or from income.

### *Spending Policy*

The distribution rate of endowment accounts is based on investment returns and is annually determined by the Audit Committee and approved by the Board of Directors. In an attempt to maintain inter-generational equity, the Foundation will take into account a rate of inflation when calculating the distribution rate. Generally, the distribution rate is applied to the estimated fair market value of each fund at the beginning of the fiscal year. The Foundation may review individual accounts determining if the approved distribution rate would reduce available amounts below prudent reserve thresholds and if so, reduce or freeze the approved distribution. The Foundation will attempt to maintain a consistent distribution annually. During the year the Executive Director may approve amounts in excess of the approved amounts providing there are sufficient funds in excess of corpus and a valid need presented in writing.

Periodically, a report should be provided to the committee that oversees the spending policy informing them of accounts approved for expenditure exceeding the distribution amount.

The Foundation receives designated gifts having permanent restriction on their use. Fluctuations in marketable investments are expected in the short term and the Foundation will use wise spending policy decisions to maintain funds in excess of the permanently restricted balance. If the value of the investment pool decreases to a point where the fund's share of the fair market value is below the permanently restricted amount, the Foundation will freeze spending until the balance is made whole.

### **Asset Allocation**

The single most important decision made by the Committee is the Policy Asset Allocation decision. Investment research has determined that a significant portion of a portfolio's investment behavior can be attributed to: (1) the asset classes/styles which are employed by the Foundation; and (2) the weighting of each asset class/style. It is the responsibility of the Committee to identify the Policy Asset Allocation that offers the highest probability of achieving the Foundation's investment objectives. The Committee, with guidance and recommendations from their Consultant(s), shall review the asset mix on an ongoing basis and recommend revisions as necessary.

The Policy Asset Allocation shall be determined based on a comprehensive asset allocation study completed by the Consultant(s) and reviewed from time to time by the Committee. The Policy Asset Allocation of the Foundation, as presented in **Appendix A**, is designed to give balance to the overall structure of the Foundation's investment program over the Time Horizon. However, many factors over time may necessitate an asset allocation review and possible rebalancing. These factors include an ongoing assessment by the Consultant and the Committee of the comparative intermediate or long-term outlook for all available types of asset classes and styles.

## **Permissible Investments**

The target asset allocation of the Foundation is expected to include a wide range of asset classes. These asset classes and their relative comparative indices are displayed in **Appendix B**. The permissible asset classes are as follows:

- Domestic Large-Capitalization Equity
- Domestic Mid-Capitalization Equity
- Domestic Small-Capitalization Equity
- International Large-Capitalization Equity
- International Small-Capitalization Equity
- International Emerging Markets Equity
- Private Equity
- Domestic Fixed Income
- Inflation-protected Fixed Income
- Global Fixed Income
- High Yield Fixed Income
- International Emerging Markets Fixed Income
- Real Estate (including REITs)
- Absolute Return Strategies (including hedge funds)
- Natural Resource and Commodity Investments
- Cash Equivalents

## **Portfolio Rebalancing**

Since asset allocation is the most critical component of the Foundation's returns, it is desirable to rebalance the Foundation's holdings periodically to minimize deviations from the Policy Asset Allocation mix.

The Committee may rebalance to achieve the Policy Asset Allocation at any time. However, rebalancing shall be done in the event any individual asset class (equity, alternatives, or fixed income) differs from policy by more than 20% of the target weight, but with a minimum deviation threshold of 2% of the total portfolio value. For example, if the Policy Asset Allocation for an asset class is 5% of the total portfolio, then the portfolio's actual allocation must either be below 3% or above 7% of the total portfolio before rebalancing is required. An actual allocation of 3.5% would have a deviation of 30% from the target weight but not meet the 2% minimum deviation threshold.

The Consultant(s) will inform both the Foundation Executive Director and the Investment Committee Chair at the close of any month in which rebalancing the Foundation is necessary. The Consultant(s), together with the Administration, will complete the rebalancing process and notify the Committee. The Consultant(s) will assist the Administration as needed in implementing such rebalancing.

## **Investment Policies and Performance Goals for Investment Managers**

The following are performance goals and constraint guidelines placed on individual managers within specific asset classes:

### *All Traditional Managers*

1. Each manager shall demonstrate a reasonable match, or "fit," with his comparative index, as measured by an acceptable R2 and tracking error. Tracking error is defined as the standard deviation of the excess returns.
2. Active managers may be terminated if tracking error is consistently out of policy and net performance is statistically indistinguishable from the benchmark return.
3. Index managers shall be terminated if tracking error is consistently out of policy.
4. The use of certain options and derivatives to reduce risk are acceptable with Committee approval. In addition, investment managers who have demonstrated an ability to add value with derivative securities (e.g., futures contracts) with appropriate levels of risk may purchase these securities with the prior written approval of the Committee.
5. Alternative investment managers typically must have significant latitude in the strategies and investments they make and the leverage they introduce into a portfolio. As a result, it is generally not feasible to impose guidelines and restrictions on such managers. Instead, the Committee may choose to terminate a manager, subject to the manager's liquidation policy, if they are dissatisfied with the manager and/or his strategy.

### *Other*

1. *Securities Lending:* Investment Managers (via contract with the University), may engage in securities lending, or the "loan" of the Foundation's securities in return for interest, to broker dealers as a means of enhancing income.
2. *Active vs. Passive Management:* The Committee shall continue to review the relative advantages of passive versus active investment management in the context of reduced management expenses, stable performance and constant, complete exposure to the particular asset class with regard to the excess return provided by the individual manager.
3. *Related Party Transaction:* The Foundation will not loan funds to related parties, defined as an officer, Committee member, employee, or donor, either current or prospective.

### **Investment Policies and Performance Goals for Investment Consultants**

Investment consultants will be reviewed on an annual basis and evaluated upon the following additional criteria:

1. Ability to meet or exceed the performance objectives as outlined in the Investment Policy Statement.
2. Adherence to the philosophy and style, which were articulated to Committee or Board at, or subsequent to, the time the investment consultants were retained.
3. Continuity of personnel and practices at the firm.

The Investment Consultant shall immediately notify the Committee or Administration in writing of any material changes in its investment outlook, strategy, portfolio-structure, ownership, or senior personnel.

### **Procedure for Revising the Statement of Investment Policy**

This Statement of Investment Policy will be reviewed at least annually and prior to the fall meeting by the Committee. The Board must approve material changes to the Statement. Any deviation from the Policy Asset Allocation of the combined asset sectors (i.e., total equities, total fixed income, or total alternative investments) would represent a material change and shall be approved by the Board.

### **Conflicts of Interest**

All persons responsible for investment decisions or who are involved in the management of the Foundation or who are consulting to, or providing any advice whatsoever to the Committee, shall disclose in writing at the beginning of any discussion or consideration by the Committee, any relationships, material beneficial ownership, or other material interest(s) which the person has or may reasonably be expected to have, with respect to any investment issue under consideration. The Committee may require such persons to remove themselves from the decision-making process.

Any members of the Committee responsible for investment decisions or who are involved in the management of the Foundation shall refuse any remuneration, commission, gift, favor, service or benefit that might reasonably tend to influence them in the discharge of their duties, except as disclosed in writing to and agreed upon in writing by the Committee. The intent of this provision is to eliminate conflicts of interest between committee membership and the Foundation. Failure to disclose any material benefit shall be grounds for immediate removal from the Committee. This provision shall not preclude the payment of ordinary fees and expenses to the Foundation's custodian(s), Investment Manager(s), or Consultant(s) in the course of their services on behalf of the Foundation.

## **APPENDIX A**

### **Part I**

#### **POLICY ASSET ALLOCATION**

<b>Total Equity</b>	50%
<b>Total Alternatives</b>	14%
<b>Total Fixed Income</b>	36%
<b>Total</b>	100%

### **Part II**

Within the above Policy Asset Allocation, the Investment Committee currently anticipates the following sub-allocations within a given asset class as stated below. However, the Committee may, from time to time, revise these sub-allocations.

#### **POLICY SUB-ALLOCATIONS**

Texas State University-San Marcos Development Foundation  
Growth Assets

US All-Cap Stocks	11%
US Large Growth Stocks	5%
US Large Quality Stocks	6%
<i>US Equity</i>	22%
Intl Large Stocks	21%
Intl Emerging Market Stocks	7%
<i>Intl Equity</i>	28%
<b>Total Growth Assets</b>	<b>50%</b>
Risk Reduction Assets	
US / Global Fixed Income	26%
Absolute Return	10%
<b>Total Risk Reduction Assets</b>	<b>36%</b>
Inflation Protection Assets	
US Inflation Protected Fixed	5%
Real Assets	9%
<b>Total Inflation Protection Assets</b>	<b>14%</b>
<b>Total</b>	<b>100%</b>

**APPENDIX B  
COMPARATIVE INDICES  
FOR TRADITIONAL INVESTMENT MANAGERS**

ASSET CLASS	COMPARATIVE INDEX
Equity	
Domestic Equity	
U.S. All-Cap Stocks	Wilshire 5000
U.S. Large Stocks	S&P 500
U.S. Large Value Stocks	Russell 1000 Value
U.S. Large Growth Stocks	Russell 1000 Growth
U.S. Mid Stocks	S&P MidCap 400
U.S. Small Stocks	Russell 2000
U.S. Small Value Stocks	Russell 2000 Value
International Equity	
Intl Large/Mid Stocks	MSCI EAFE
Intl Small Stocks	S&P Citigroup EMI-EPAC
Emerging Market Stocks	MSCI Emerging Markets Free
Private Equity	S&P 500 + 5%
Fixed Income	
Domestic Fixed Income	Lehman Aggregate Bond

Inflation-protected Fixed	Citigroup Inflation Linked Bond
High Yield Fixed Income	Citigroup High Yield
Global Fixed Income	Citigroup World Bond
Emerging Mkt Bonds	JPM Emerging Mkt Bond
Cash Equivalents	U.S. Treasury Bills
Absolute Return	HFR Fund of Funds Index
Real Estate (including REITs)	Dow Jones Wilshire REIT
Commodities	Dow Jones AIG Commodity Index
Natural Resources	Goldman Sachs Natural Resources Index