

# **TEXAS STATE UNIVERSITY SYSTEM**



## **Investment Policy for Operating Funds and Endowment Funds**

**Effective February 15, 2020**

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## **Texas State University System Investment Policy**

### I. PREFACE

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

Certain Operating Fund assets and all Endowment Fund assets are pooled and managed by the Investment Advisory Committee.

### II. POLICY AND OBJECTIVES

#### A. OPERATING FUNDS

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

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

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

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

- Current Funds (Unrestricted and Restricted);
- Loan Funds;
- Bond Funds;
- Plant Funds;
- Board-Designated Reserves; and
- Agency Funds

These funds may be held in investments authorized by this Policy (based on liquidity needs or bond covenants) or in authorized depositories as required for day-to-day operations within any fund group. The Investment Advisory Committee is not required to liquidate investments that were authorized investments at the time of purchase unless so directed by the Board. Funds held in banking institutions are covered by the TSUS *Depository Funds Policy*.

This Policy shall be reviewed annually and if necessary, updated and presented to the Board for adoption.

Operating funds covered under this Policy are classified as:

**Short-Intermediate Term Funds**

Funds needed to meet operating requirements (within the budget year) as well as funds not designated as Long-Term. These Funds may be used within the operating year and are typically invested in investments with high quality and ready access to liquidity.

**Long-Term Funds**

Funds that comprise a core holding that are not intended to be spent during any budget period. These funds are typically invested in a similar manner to Endowment Funds, with similar risk and reward metrics. Long-Term Funds may not exceed 60% of all Operating Funds exclusive of Bond Proceeds Funds; as determined annually based on the Ending Market Values as of August 31 of each year (fiscal year end).

**Bond Proceed Funds**

Funds obtained by the issuance of debt and commercial paper for a stated purpose. Bond proceeds may be invested in a manner consistent with the requirements and restrictions stated in the applicable Bond Covenants, but typically not longer than three years. Funds are to be invested following the same guidelines as Short-Intermediate Term Funds.

**B. ENDOWMENT FUNDS**

Endowment funds may include, but are not limited to, gifts of property, stock, and real assets, donated to TSUS to provide funding for scholarships, fellowships, professorships, academic chairs, and other uses as specified by the donors. It is the policy of TSUS to invest endowment funds in compliance with the Uniform Prudent Management of Institutional Funds Act (UPMIFA), Texas Property Code Chapter 163.

Funds functioning as endowments (commonly referred to as quasi-endowments) are resources that the governing board, rather than the donor, has determined are to be retained and managed like an endowment. Principal and income of these funds may be utilized at the discretion of the governing board. Resources that the governing board sets aside to function as an endowment may be unrestricted or restricted by an agent outside the institution.

Funds which by their nature are long term and have or potentially may have endowment qualities, for example Charitable Gift Annuities, may be invested with the endowment to the extent permitted by law and the individual charitable documents.

The endowment funds may be invested as authorized by this Policy and, for short periods, be placed in authorized TSUS depositories for the processing of receivables and disbursements.

This Policy is designed to fulfill the following objectives with respect to Endowment Funds:

- provide security of invested principal;
- provide for appreciation of principal;

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

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

### III. DELEGATION OF AUTHORITY AND RESPONSIBILITY

#### Board of Regents

The TSUS Board of Regents (Board) retains ultimate responsibility for investments as fiduciaries of TSUS assets regardless of who is investing those assets. The Board is required by the General Appropriations Act (Article III, Special Provisions, Section 6.5) to:

- A. Adopt and maintain a written Investment Policy for endowment funds, short-intermediate term operating funds, and long-term operating funds.
  1. Direct that a copy of the Investment Policy be filed with the State Auditor’s Office and the Legislative Budget Board no later than December 31<sup>st</sup> of each year.
- B. Direct that a report of all investment transactions for endowment funds, short-intermediate term operating funds, and long-term operating funds, and all other securities transactions be prepared annually in a method prescribed by the State Auditor’s Office, and that such report, or copies thereof:
  1. Be filed with:
    - a. The State Auditor
    - b. The Comptroller of Public Accounts
    - c. The Legislative Budget Board
    - d. The Office of Governor
  2. Shall be available for public inspection
- C. Direct that the Vice Chancellor/CFO, or designee, publish and maintain at least two years of quarterly consolidated investment reports on the System’s website. Each component should provide a link to this consolidated report on their websites.

#### TSUS Investment Advisory Committee

The TSUS Investment Advisory Committee (IAC) shall oversee pooled investments and shall initially comprise the System’s Vice Chancellor/CFO and chief financial officers of the component institutions, or their designees.

The members of the IAC are designated as Investment Officers by the Board. Additional members of the IAC may be designated by the Chancellor.

The IAC shall have oversight of the pooled investments in the operating and endowment

portfolios and is responsible for investment management decisions and activities and all transactions undertaken, including the hiring/firing of Investment Manager(s). The IAC shall not engage in an investment transaction except as provided under terms of this Policy. No member of the IAC or employee of TSUS may accept anything of value from counter- parties or others in connection with investment transactions.

The IAC and any designated investment officer is responsible for managing the allocations of asset classes, investment products utilized, and providing individual investment guidelines to separately managed account investment managers so that the overall policy objectives as detailed for the Operating Short-Intermediate Term Funds, the Operating Long-Term Funds, and the Endowment Funds are met at the total portfolio level for each fund.

Each member of the IAC shall attend at least four hours of training per year that addresses the responsibilities of the investment officers. The training may include education in investment theory and practice, investment controls, security risks, strategy risks, market risks, and compliance with certain state statutes and this policy statement. Each investment officer must maintain the records of their training hours to show satisfaction of this requirement.

For certain operating funds not pooled, the chief financial officer of the respective component institution is designated as the Investment Officer by the Board. Additional Investment Officers may be designated by the Chancellor or President of the component, respectively.

#### Investment Officer Disclosures

The following reporting requirements apply:

1. An Investment Officer related within the second degree by affinity or consanguinity to an individual seeking to sell an investment to TSUS shall file a statement disclosing that relationship;
2. An Investment Officer having a business relationship of any nature with an individual seeking to sell an investment to TSUS shall file a statement disclosing that relationship;
3. The disclosure shall be filed with the Board and the Chancellor.

#### Investment Consultant

The IAC may contract with an Investment Consultant registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) to provide for investment oversight of the Operating and/or Endowment Funds. System Administration is responsible for the management of any investment consultant contract, including the solicitation and selection of the investment consultant. The initial contract may not be for a term exceeding six years and renewals or extensions of the contract must be made by order or resolution of the Board. The Investment Consultant must acknowledge in writing that they are a fiduciary to the Fund(s).

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

The Investment Consultant's responsibilities are to the System Administration and the IAC. Additionally, the Investment Consultant will:

- Assist in the development and implementation of investment policies, objectives, and guidelines to submit to the Board for approval at least annually.
- Review investment strategies and vehicles, including search, selection, and recommendation of investments to the IAC.
- Prepare and present performance evaluation reports in accordance to established investment standards.
- Review contracts and fees for both current and proposed Investment Managers.
- Communicate investment policies and objectives to Investment Managers, monitor those strategies, and notify the IAC of any significant changes in portfolio managers, litigation, or violation of securities regulations.

### Investment Manager(s)

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

For Investment Managers of commingled vehicles, registered Exchange Traded Funds, and Mutual funds: Investment Officers must collect a copy of commingled funds governing documents for each commingled fund investment, and collect a Mutual Fund prospectus for each mutual fund investment and collect a registered Exchange Traded Fund prospectus, or a Product Description if a Prospectus is not available, for each registered Exchange Traded Fund investment.

All Investment Managers have a fiduciary responsibility to make a good faith determination that commissions paid to a broker are reasonable and competitive. All Investment Managers shall treat the accounts they manage as discretionary accounts and have authority to act for Investment Officers. The Investment Managers have the authority to make investment decisions for the purpose of placing orders to effect any purchase, sale, exchange, liquidation or other investment of the assets in the accounts, within their asset class, and according to this Policy, without obtaining prior approval.

TSUS requests that all orders for transactions of account assets be placed in such markets and through such brokers as shall offer the most favorable price, execution and commission cost of each order (best execution). All such orders must also be in compliance with this investment policy.

TSUS acknowledges that Investment Managers may, in accordance with applicable law, pay commissions to brokers that are higher than those that might be obtainable elsewhere in order to obtain research and other services provided by such brokers in the expectation to enhance the long-term value of the account. The Investment Officers shall try to negotiate the contract without the use of these soft dollar arrangements. In the event that the soft dollar arrangements remain as part of the contract, the Investment Manager(s) will report to the Investment Consultant and the Investment Officers at least annually, the Investment Managers' soft dollar practices and any soft dollar purchases. In addition, Investment Managers must demonstrate how the soft dollars were used solely for the benefit of the account which generated the soft dollars.

The use of soft dollars by an Investment Manager in the portfolio must be disclosed as required by the State Auditor's Office.

### Investment Custodians

The Investment Custodians are responsible for the safekeeping of the Operating and Endowment Funds' assets. Their responsibilities are to:



- Provide timely (defined as within 6 business days of month end) and accurate reports detailing investment holdings, including, on a Trade Date accrual basis:
  - Statement of all securities and other assets held,
  - Statement of all receipts, sales, redemptions, and principal payments,
  - Statement of all distributions, expenses paid, purchases, and
  - Statement of all income, and
  - Establishing and maintaining separate accounts for each Investment Manager.
  
- Provide all normal custodian functions, including but not limited to:
  - Security safekeeping,
  - Collection of income,
  - Settlement of trades,
  - Collection of proceeds of maturing securities, and
  - Daily investment of available cash.

System Administration is responsible for the management of any investment custodian contract, including the solicitation and selection of the investment custodian(s).

#### Financial Advisors and Service Providers Disclosure

Financial Advisors and Service Providers as defined by Texas Government Code Section 2263.002 shall comply with disclosure requirements contained in Texas Government Code Section 2263.004.

#### IV. STANDARD OF CARE

Pursuant to Texas Education Code §51.0031(d), the “Prudent Person Standard” shall be the standard used in all investment functions and shall be applied in the context of individual transactions as well as management of the overall portfolio. Accordingly, all investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, emphasizing the probable safety of their capital as well as the expected income to be derived.

All investments shall be consistent with this Policy. As long as investments made were in accordance with this Policy at the time of purchase, no individual will be held personally liable.

#### V. INSTITUTIONAL INVESTMENT PROCEDURES

The IAC shall establish written procedures supporting this Policy when necessary and promoting internal control. The procedures shall be directed towards preventing loss of funds due to fraud, employee error, misrepresentation, or imprudent actions.

The IAC shall establish and maintain (a) written administrative procedures and guidelines in support of this Policy, (b) distribution formulae(s)/procedures for the funds, and (c) internal controls in support of this Policy.

The IAC shall ensure the following specific controls, as further defined by this Policy, are incorporated into their operating procedures or the operating procedures of the Investment Managers.

- All securities will be settled delivery versus payment (DVP) into the component's depository or custodian bank,
- Excluding accounts used for Gift Acceptance, no securities will be safe-kept with a broker/dealer,
- Pooled Operating funds cash flow will be reviewed at least annually to determine investment strategy impact and projections,
- Every transaction will be documented for accounting information and security description,
- All transaction documentation will be completed within five business days of receipt,
- An investment ledger will be maintained for reconciliation with the general ledger, bank reports, and trade confirmations on a monthly basis, at a minimum,
- Market values for private capital strategies with drawdown structures will be recorded for performance measures using estimates and will begin with the investment managers' reported fair market value from the past quarter and make adjustments for interim cash flows (calls and distributions).
- A monthly reconciliation of transactions and income will be made,
- A review of the portfolio will be made by all Investment Officers at least quarterly,
- Designated levels of signatory approval will be set,
- Investment reporting will be completed quarterly, and
- Internal control, oversight and/or separation of responsibilities will be maintained over all transactions.

The IAC may pursue an active portfolio management strategy for Endowment Funds with investments diversified by asset class and style. All investment securities must be held under a custodial agreement and all Investment Managers must provide statements to the IAC on a monthly basis for all investment activities during the preceding month (or quarterly basis for diversifying assets). The IAC, with the assistance of the Investment Consultant, will regularly monitor the contents of the portfolio, the available markets, and the relative value of competing instruments to adjust the portfolio in response to market conditions. Quarterly reviews of performance shall be made by the IAC.

## VI. INVESTMENT STRATEGIES AND OBJECTIVES

### A. OPERATING FUNDS

Operating funds may be commingled for investment purposes but will address the unique characteristics and needs of each fund group and classification of funds represented in the portfolio. Operating funds are constricted by expenditure plans and can serve a fiscal year or multiple year purposes.

The investment strategy for operating funds has as its primary objective assurance that anticipated liabilities are matched and adequate investment liquidity provided. The secondary objective is to create a portfolio structure which will experience minimal volatility while generating income and/or capital growth.

The intention is to match investments with projected cash flow and liquidity needs. The IAC may pursue an active and/or a passive portfolio management strategy. That is, securities may be sold before they mature if market conditions present an opportunity for a net positive horizon fiscal benefit from the trade, or to manage a market downturn.

The IAC and/or Investment Consultant will continuously monitor the contents of the portfolio, the available markets, and the relative value of all authorized, competing instruments to adjust the portfolio in response to market conditions.

## B. ENDOWMENT FUNDS

The Endowment performance objective is to grow the market value of assets net of inflation, spending, and expenses, over a full market cycle (generally defined as a three to five year period) without undue exposure to risk. The Endowment is particularly risk-averse to the probability of not meeting the total return goal. Liquidity must be considered and sufficient to meet the spending needs and expenses.

The total return goal can be achieved while assuming acceptable risk levels commensurate with

“market volatility.” To achieve the total return goal, the endowment’s assets will be invested to generate appreciation and/or dividend and interest income.

The Endowment is expected to endure into perpetuity. Inflation is a key component in the performance objective. The long-term risk of not investing in equity securities outweighs the short-term volatility risk. As a result, the majority of assets should be invested in equity or equity-like securities. Fixed income and fixed income-like securities and Diversifying Strategies, may act to lower the short-term volatility of the portfolio and/or provide stability, especially during periods of weak or negative equity markets. Other asset classes are included to provide diversification and incremental total return.

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

## VII. INVESTMENT GUIDELINES

Operating Funds investment strategy, both Short-Intermediate and Long-Term funds, should match the investments with the liquidity needs and should be diversified. For the total Operating Funds portfolios (excluding bond funds), no more than 35% may be invested in a single product (ex. Mutual Fund, single ETF, commingled vehicle, separately managed account) except for cash management pools (TexPool or similar) and Fixed Income funds sponsored by organizations exempt from Federal Income taxation under Section 501 (f) Internal Revenue Code of 1986 (25 U.S.C. Section 501 (f)). These funds must meet the requirements outlined in the appropriate Appendixes.

### A. OPERATING SHORT-INTERMEDIATE TERM FUNDS

Refer to APPENDIX 1 for Investment Guidelines for Operating Short-Term portfolios.

This includes Diversification parameters, approved allocation ranges, and Prohibited Investments.

## B. OPERATING LONG-TERM FUNDS

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

## C. ENDOWMENT FUNDS

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

## VIII. REBALANCING

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

Operating Funds: At least quarterly, more frequently as necessary

Endowment: At least annually, more frequently if necessary.

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

The appropriateness of Asset Allocation ranges will be reviewed annually.

## IX. SAFEKEEPING

All securities, including collateral bought under a repurchase agreement, but excluding investment pool funds, certificates of deposit, commingled vehicles, registered Exchange Traded Funds, and mutual funds, shall be settled on a delivery versus payment (DVP) basis, where DVP is an available settlement option. All securities shall be held by System Administration's or the component's depository bank, as applicable, or an independent third party custodian, as applicable, approved by System Administration. All securities will be held in the name of System Administration or the component, as applicable. Excluding accounts used for Gift Acceptance, no securities will be safe-kept with a broker/dealer.

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

## X. SECURITIES LENDING

Participation in securities lending programs are prohibited under this Policy.

## XI. FINANCIAL DEALERS AND INSTITUTIONS

- A. If a business organization (including investment pools and investment management firms under contract) is not utilized, then the transaction requires the use of one or more broker/dealers.
- B. If investing directly, the IAC will maintain a list of the broker/dealers utilized, and maintain on file all certifications collected under sections XI. C and XI. D below.
- C. The IAC is responsible for confirming that all the broker/dealers they utilize conform with compliance requirements and procedures established by the Investment Policy to include the following:
- Brokers/dealers must complete a questionnaire (see Exhibit 2) supplying basic firm and broker contact and delivery information,
  - Brokers/dealers may be affiliated with a Texas bank, designated by the New York Federal Reserve Bank as "primary dealers" or qualify as regional dealers under the Securities and Exchange Commission's "Uniform Net Capital Rule",
  - Brokers/dealers must be FINRA (Financial Institutions Regulatory Authority),
  - Brokers/dealers must be registered with the Texas Securities Commission, and;
  - Brokers/dealers must provide the written certification detailed below.
- D. Certification: Upon request, System Administration shall present to any firm or person seeking to engage in an investment transaction with TSUS a written copy of this Policy. This includes business organizations, brokers/dealers, and banks. Mutual Funds (40-act funds), commingled vehicles, and registered Exchange Traded Funds are excluded from the certification process; the Investment Officer must obtain the fund prospectus for each Mutual Fund/ETF investment (or a Product Description for an ETF with no prospectus) and the investment documents for each commingled vehicle investment. The prospectus should be collected annually while the commingled investment documents are collected at the time the investment is made.

For separate account fund holdings, System Administration must collect from the Qualified Representative of the business organization or the broker offering to engage in an investment transaction a signed certification (see Exhibit 1) to the effect that the business organization, registered principal, or broker has:

1. Received and reviewed this Policy.
2. Acknowledged that the business organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between TSUS and the organization that are not authorized by this Policy except to the extent that this authorization is dependent on an analysis of the makeup of the entire portfolio or requires an interpretation of subjective portfolio standards.
3. Agreed to provide to the IAC, and the Investment Consultant retained by System Administration (if any) all monthly data and schedules necessary to accurately prepare the required reporting to System Administration within 6 business days of month end.

Investment Officers may not acquire or otherwise obtain any separate account investment from a person, bank or firm that has not provided this certification.

Nothing in this section relieves the investing entity of the responsibility for monitoring the investments made by the investing entity to determine that they are in compliance with this Policy.

## XII. INVESTMENT REPORTING AND MONITORING

The IAC shall provide System Administration, no later than 45 days after each fiscal quarter end, with a signed written investment performance report listing the Operating and Endowment funds investments and performance.

Market prices used in the report are to be obtained from an independent, published source such as the Wall Street Journal, a custodian bank, a recognized financial website (such as Bloomberg), and/or through a contractual arrangement with a pricing service. Asset prices are not to be obtained from the broker/dealer having sold TSUS the asset being priced.

The report is to be submitted to the Vice Chancellor /CFO. The report must be provided in compliance with the requirements of Texas Education Code §51.0032 and the General Appropriations Act and describe in detail the investment position of the component, separated between Operating Investments and Endowment Investments, on the date of the report and:

1. Be signed by the chair of the IAC or designee;
2. Provide at the Total Portfolio Level and the Managed Account level (Separate Account/Mutual Fund/ETF/Commingled vehicle) using trade date accounting with interest income accruals:
  - a) Beginning Market Value (defined as trade date with interest income accruals) for the reporting period;
  - b) Ending Market Value (defined as trade date with interest income accruals) for the reporting period;
  - c) Beginning Book Value for the reporting period;
  - d) Ending Book Value for the reporting period;
  - e) Total return calculated net of investment management fees where applicable of the reporting quarter and the fiscal year to date. Investment returns are to be calculated net of fees, using the performance reporting methodology found in the Global Investment Performance Standards Handbook published under the guidance of the CFA Institute:

<http://www.cfainstitute.org/ethics/codes/gipsstandards/Pages/index.aspx>

*The Global Investment Performance Standards (GIPS Standards) is a set of standardized, industry-wide ethical principles that provides guidance on how to calculate and report investment results;*

- f) Provide a rate of return comparison to the established benchmarks as established by this Policy of each asset class (indicate each benchmark that is used), and a weighted benchmark based on the asset allocation for the entire portfolio. The benchmark for the Total Portfolio benchmark should have a footnote detailing the weights used to calculate that benchmark.
- g) For Operating Long-Term Funds and Endowment Funds, provide a comparison of the actual component's allocation with the allocation allowances under this Policy. State the compliance of the investment portfolio of the

- component as it relates to the investment strategy expressed in this Policy.
- h) Be posted on the TSUS website in accordance with SAO's Annual Tracking Report for Investment Reporting by Higher Education Institutions
  - i) Provide for each investment not held in a managed account (security purchased by the Investment Officer or designee, or not held in a Separately Managed Account/Mutual Fund/ETF/Commingled Vehicle), all the items enumerated in Section XII A 2. a-e above, categorized by asset class, the maturity date and current credit rating (by one of the top three rating agencies), if applicable.

### XIII. BENCHMARKS

The performance of each portfolio(s) will be measured against a customized blended index, developed and reviewed at least annually by the IAC , in consultation with the Consultant, if applicable. The IAC will annually review their portfolio(s) custom benchmark(s) for appropriateness. All performance returns shall be stated net of investment management fees. Other applicable indexes matching the specific allocation of the funds (for example international mutual funds or equities) shall be detailed in the IAC's procedures and included on all monthly and quarterly reporting as a benchmark for these investments.

**APPENDIX 1**  
**INVESTMENT GUIDELINES FOR OPERATING SHORT-INTERMEDIATE TERM FUNDS**

**A. LIQUIDITY**

The intention of the Operating Short-Intermediate Term Funds portfolio is to provide necessary Liquidity to operations. The Operating Short-Intermediate Term Fund portfolio is not envisioned to be pooled. A minimum of **5%** of the Operating Short-Intermediate Term Funds portfolio must have Daily Liquidity; additionally, a minimum of **20%** of the Operating Short-Intermediate Term Funds portfolio must be accessible within Trade Date plus 3 days. Components must meet these minimum requirements.

**B. CREDIT QUALITY**

Unless specified elsewhere, Credit Ratings recognized by this policy may only be issued by the agencies of Standard and Poor's, Fitch, and/or Moody's. For definition purposes, Non Rated securities will be considered as Below Investment Grade.

The Average Credit Quality of the entire Short-Intermediate Term Funds Portfolio is to be greater than or equal to **A-**, as defined by S&P (**A-** by Fitch, **A3** by Moody's).

The Minimum Credit Quality of any diversified fund vehicle must be **Investment Grade** at the Time of Purchase.

**C. WEIGHTED AVERAGE MATURITY**

The Weighted Average Maturity of the entire Short-Intermediate Term Funds Portfolio is to be less than or equal to **36 Months**. There is no maximum Maturity of any single security.

**D. DIVERSIFICATION REQUIREMENTS**

- i. For Mutual Funds, commingled vehicles, and registered Exchange-Traded Funds (ETFs): Portfolio holding cannot represent more than **10%** of the total assets of a single Fund, commingled vehicle, or ETF.

**E. SOFT DOLLAR REPORTING**

If Soft Dollars are used in the account, a quarterly report of Soft Dollar usage is required to be delivered to the Component Investment Officer.

**F. PROHIBITED INVESTMENTS AND ACTIVITIES**

Investments and activities that are not expressly prohibited in this Appendix are considered allowable by this Policy.

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



- i. Portfolio(s) may not, outside of externally managed strategies, purchase or sell financial futures, options, interest rate swaps, or forward rate agreements.
- ii. Portfolio(s) may not engage in adjusted trading or short sales.
- iii. Portfolio(s) may not purchase funds or strategies primarily dedicated to residual interests in CMOs/REMICs or mortgages servicing rights. Specific strategies that may not be purchased are:
  - 1. Inverse CMO floaters
  - 2. Principal only CMOs
  - 3. Interest only CMOs
- iv. Portfolio(s) may not purchase 144-A or other private placement securities not registered with the SEC unless such securities have CUSIPs, are daily priced, and are publicly traded over the counter or on a US exchange.
- v. Non-US Dollar denominated securities are prohibited in Operating Short-Intermediate Fund portfolios. Foreign securities issued and priced in US. Dollars are allowed.
- vi. The use of Margin or leverage in Operating Short-Intermediate portfolios is prohibited.
- vii. The purchase of Equities in Operating Short-Intermediate portfolios is prohibited.

## APPENDIX 2 INVESTMENT GUIDELINES FOR OPERATING LONG-TERM FUNDS

Long-Term Funds are defined as up to **60%** of the market value of a components Total Operating Funds, exclusive of Bond Proceeds; the amount that a component may be allocate to Long-Term Funds is calculated annually based on the Ending Market Values as of August 31 of each year (fiscal year end). Long-Term Funds may be invested in Growth Equity, Fixed Income and Credit and Real Assets investments as outlined in this Appendix. Components are **not required** to participate in these Long-Term Funds Investment options and may elect to have no Operating Long-Term Funds.

Those components desiring to utilize Growth Equity or Real Assets investments in their Operating Long- Term portfolio must retain an Investment Consultant with oversight over the Operating Long- Term Assets, unless the component invests in an S&P 1500 and/or Russell 3000 Index Fund. No more than 20% of the allocated Operating Long Term funds may be invested in this strategy without consultant oversight.

Operating Long-Term funds are intended to be invested in a similar manner to Endowment funds, with additional restrictions in place. Consequently, this Appendix will refer to the Investment Guidelines for Endowment Funds, Appendix 3.

### A. DIVERSIFICATION

This Policy recognizes four main Categories which Investments may be allocated: the Global Equity Category, the Global Fixed Income and Credit Category, the Real Assets Category and the Diversifying Strategies Category.

#### **GLOBAL EQUITY**

Intended to be the primary source of long-term capital appreciation for the portfolio. While having higher expected returns than fixed income, they also have higher expected volatilities. Sub-categories include both public and private equities, as well as hedged equity mandates.

#### **GLOBAL FIXED INCOME/CREDIT**

Intended to offset the volatility of equities, particularly during market downturns, as well as provide deflation protection. These investments are comprised primarily of fixed income (debt) securities, and can be categorized as interest rate sensitive and credit sensitive. Sub-categories include both public and private debt.

#### **REAL ASSETS**

Intended to insulate the portfolio from inflation shocks and to provide a source of non-correlating returns with other asset categories. Includes both public and private investments in real estate, natural resources (e.g., energy, agriculture, timber, commodities), and infrastructure (e.g., power generation, mid-stream energy Master Limited Partnerships “MLPs”).

#### **DIVERSIFYING STRATEGIES**

Intended to provide diversification from systematic market risk, with the primary determinant of returns typically derived from manager skill (alpha) rather than the market (beta). Sub-categories include both liquid and semi-liquid non-directional strategies that seek low correlations to the public equity and fixed income markets.

Below are the Category Allocation Ranges:

<u>ASSET CATEGORY</u>	<u>RANGE</u>
<b>GLOBAL EQUITY</b>	
<i>Public Equities</i>	
U.S.	0-75
International Developed	0-50
Emerging Markets	0-20
<i>Hedged Equity</i>	0
<i>Private Equity</i>	0
<b>GLOBAL FIXED INCOME/CREDIT</b>	
<i>Interest Rate Sensitive</i>	
Core (Investment Grade)	0-100
Inflation Protected (TIPS)	0-50
<i>Credit Sensitive</i>	0-100
<b>REAL ASSETS</b>	
<i>Public Real Estate</i>	0-70
<i>Public Natural Resources</i>	0-50
<i>Public Infrastructure</i>	0-50
<b>DIVERSIFYING STRATEGIES</b>	0-0

**B. INVESTMENTS, ACTIVITIES, PROHIBITIONS, AND EXCEPTIONS**

Investments and activities that are not expressly prohibited in this Appendix are considered allowable by this Policy.

All terms specified in sections B, C, and D (D2 refers to both Operating Short-Intermediate and Long-term combined) of Appendix 3 **apply in this Appendix**, with the following additional limitations and prohibitions:

Prohibitions:

1. Alternative Investments, defined as investments that are not publicly traded on the open markets, are illiquid, use leverage, or invest in: private placements, futures, options, short sales, are prohibited in Operating Long-Term portfolios
2. Portfolio(s) may not purchase 144-A or other private placement securities not registered with the SEC unless such securities have CUSIPs, are daily priced, and are publicly traded over the counter or on a US exchange.
3. The portfolio level use of derivatives, short sales, futures, options, private placements (except as allowed in 3. above), and otherwise illiquid investments is prohibited.

Additional Limitations:

1. No more than **20%** of the Global **Fixed Income and Credit** may be rated below Investment Grade.
2. No more than **15%** of the **Total Long Term Operating Portfolio** may be invested in Emerging/Frontier Markets, a sub-set of International.

Exceptions:

1. A maximum of 50% of the Long-Term Operating Fund portfolio may be invested in the Pooled Endowment Fund portfolio.

### **APPENDIX 3 INVESTMENT GUIDELINES FOR ENDOWMENT FUNDS**

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

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

#### **A. DIVERSIFICATION**

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

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

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

This Policy recognizes four main categories in which funds may be invested: the Global Equity Category, the Global Fixed Income and Credit Category, the Real Assets Category and the Diversifying Strategies Category.

Alternative Investments, defined as investments that are not publicly traded on the open markets, are illiquid, use leverage, or invest in: private placements, futures, options, short sales, can fall into any of the categories.

Below is the Category Allocation Range table:

<u>ASSET CATEGORY</u>	<u>RANGE</u>
<b>GLOBAL EQUITY</b>	<b>40-75%</b>
<i>Public Equities</i>	<b>35-75</b>
U.S.	10-50
International Developed	10-50
Emerging Markets	0-15
<i>Hedged Equity</i>	<b>0-10</b>
<i>Private Equity</i>	<b>0-15</b>
<b>GLOBAL FIXED INCOME/CREDIT</b>	<b>10-40</b>
<i>Interest Rate Sensitive</i>	<b>5-40</b>
Core (Investment Grade)	5-40
Inflation Protected (TIPS)	0-20
<i>Credit Sensitive</i>	<b>0-20</b>
Liquid	0-20
Private Debt	0-10
<b>REAL ASSETS</b>	<b>5-30</b>
<i>Real Estate</i>	<b>0-15</b>
REITs	0-10
Private Real Estate	0-5
<i>Natural Resources</i>	<b>0-10</b>
Commodities	0-10
Private Energy	0-5
<i>Infrastructure</i>	<b>0-10</b>
MLPs	0-10
Private Infrastructure	0-5
<b>DIVERSIFYING STRATEGIES</b>	<b>0-20</b>

## B. ALTERNATIVE INVESTMENTS REQUIREMENTS

Components who retain an Investment Consultant, as defined in this Policy, may invest with managers who utilize Alternative Investments:

1. Derivatives, short sales, futures, options, private placements, and otherwise prohibited investments (alternative investments) and instruments as outlined below, as long as the Endowment is a qualified investor for the product, the investment (as structured) does not expose the Endowment to risk of loss outside the actual invested amount, and the investments are supervised by an investment manager (no direct purchases).
2. Private Placements are allowed as long as the Endowment meets regulatory qualifications and no single issuer can represent more than 10% of the portfolio, with no single issue representing more than 5% of the portfolio
3. Where possible, pooled vehicles are the investment vehicles of choice for alternative investments as they can provide for more diversification and additional layers of oversight. These investments, in total cannot comprise more than 35% of the Endowment Portfolio.

## C. GROWTH AND FIXED INCOME AND CREDIT MANAGERS

The following requirements are applied at the **Manager/Mutual Fund/ ETF/Commingled Vehicle Asset Class level**:

1. With the exception of Alternative Investments, a Minimum of **20%** of securities are to be held in a Portfolio/Fund/ETF/Commingled Vehicle.
2. If Soft Dollars are used in the account, a quarterly report of Soft Dollar usage is required to be delivered to the IAC.
3. GROWTH MANAGERS (for publicly traded holdings)
  - a) A Maximum of **40%** in any one **sector** unless:
    - i. waived by the IAC in writing.
    - ii. The investment is with a Sector Manager
  - b) A Maximum of **10%** ownership of shares outstanding of a single Stock.
4. FIXED INCOME AND CREDIT MANAGERS
  - a) For International/Global Fixed Income managers, a Maximum of **40%** in any One Non-US Country.

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

1. A Maximum of **20%** of the Total Portfolio may be held in Emerging/Frontier Market securities (Regardless of asset type)
2. Excluding Pooled Vehicles, Mutual Funds, ETF's, or Managed Accounts which are Multi-Strategy and Multi-Manager products, no more than **40%** of the Portfolio may be invested in a **single** Mutual Fund or Manager
3. A Maximum of **40%** of the Fixed **Income and credit Portfolio** may be invested below Investment Grade. For definition purposes, Non Rated securities will be considered as Below Investment Grade.

## E. PROHIBITED INVESTMENTS AND ACTIVITIES

1. Investments and activities that are not expressly prohibited in this Appendix are considered allowable by this Policy.

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

- a) At the portfolio level, may not directly purchase or sell financial futures, options, interest rate swaps, or forward rate agreements.
- b) At the portfolio level, may not engage directly in adjusted trading or short sales.
- c) Except as detailed in paragraph B. above, Portfolio(s) may not directly (at the portfolio level) purchase 144A or other private placement securities not registered with the SEC unless such securities have CUSIPs, are daily priced, and are publicly traded over the counter or on a US exchange.



EXHIBIT 1  
Texas State University System  
Investment Manager and Broker/Dealer Certification

This certification is executed on behalf of \_\_\_\_\_ (the Investor) and \_\_\_\_\_ (the Investment Manager or Broker/Dealer) as required by the Texas State University System Investment Policy (Investment Policy) in connection with investment transactions conducted between the Investor and the Investment Manager or Broker/Dealer.

The undersigned Qualified Representative of the Investment Manager or Broker/Dealer hereby certifies that:

1. The Investment Manager or Broker/Dealer Qualified Representative is duly authorized to execute this Certification on behalf of the Investment Manager or Broker/Dealer, and
2. The Investment Manager or Broker/Dealer Qualified Representative has received and reviewed the Investment Policy furnished by the Investor, and
3. The Investment Manager or Broker/Dealer will act in accordance with the Investment Policy, and has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the Investment Manager or Broker/Dealer and the Investor that are not authorized by the entity's investment policy, except to the extent that this authorization is dependent on an analysis of the makeup of the entity's entire portfolio or requires an interpretation of subjective investment standards.
4. For Investment Managers only—a copy of the most recent ADV and ADV brochure has been provided to the Investor.

Investment Manager or Broker/Dealer **Qualified Representative**

Signature \_\_\_\_\_

Name (Printed) \_\_\_\_\_

Title \_\_\_\_\_

Date \_\_\_\_\_

EXHIBIT 2

Texas State University System  
Broker/Dealer Questionnaire

Name of Texas State University System Component

Firm:

Date Established:

Main Office:

Representative:

Primary Dealer:

Qualified Historically Underutilized  
Business?

Seat on the NYSE?

Publicly Traded? Which Exchange?

Member NASD?

SIPC Insured?

Equity Position:

Annual Revenues:

Agency Selling Group  
Memberships:

Pertinent Rankings:

Representative Public Sector Clients:

Date of Investment Policy:

Date Certification Received by Component: