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5-28-2019

## Operating Funds Guidelines

University of Maine System

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### Repository Citation

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**University of Maine System**  
**Executive Summary - Investment Guidelines and Objectives**  
**Operating Fund**  
**Approved by Investment Committee May 28, 2019**

**Type of Plan:** Operating Plan

**Minimum Long Term Return Assumption:** 4.00%

**Risk Tolerance:** Low to Moderate

<b>Asset Allocation:</b>	<b>PERMISSIBLE</b>	<b>TARGET</b>	
<b><u>ASSET CLASS</u></b>	<b><u>TARGET</u></b>	<b><u>RANGE %</u></b>	<b><u>BENCHMARK</u></b>
	<b>%</b>	<b>%</b>	
<b>Liquidity Pool</b>	<b>30%</b>	<b>5 - 100%</b>	FTSE T-Bill 3 Months
<b>Income Pool</b>	<b>47.5%</b>	<b>0 - 60%</b>	
Short-Term Bonds	26	15 - 35	BBgBarc US Govt/Credit 1-3Yr
Bank Loans	7	0 - 10	Custom Index*
Absolute Return Fixed Income	7	0 - 10	3-Month LIBOR
Core Bonds	7.5	0 - 10	BBgBarc US Aggregate
<b>Total Return Pool</b>	<b>22.5%</b>	<b>0 - 30%</b>	
Hedge Funds	5	0 - 10	Credit Suisse Long Short Equity
Global Asset Allocation	8	3 - 13	GAA Custom Index**
Global Equity	9.5	5 - 15	FTSE Global All Cap Index

\* Custom Index blends performance of "S&P/LSTA Leveraged Loan Index" before 9/1/2014 and "S&P/LSTA Leveraged BB Loan Index" after 9/1/2014.

\*\*GAA Custom Index: 50% (40% BC Aggregate, 30% BC U.S. TIPS 1-10YR, 10% S&P 500, 10% BC High Yield, 10% JPM EMBI+) and 50% (60% MSCI ACWI/40% BC Global Aggregate)

**Evaluation Benchmarks:**

Total return for the Fund shall be regularly compared to the Allocation Index\* and the Policy Index\*\*. While it is anticipated that there will be fluctuations in the Fund's value, the Fund assets should at a minimum produce a nominal long-term rate of return of 4.00%.

The investment performance of money managers shall be measured against the investment performance of other managers with similar investment styles (e.g., Large cap growth equity manager against other large cap growth managers). Furthermore, investment performance will also be measured against an appropriate index benchmark (e.g., small cap equity managers will be measured against the Russell 2000 Index).

\*Allocation Index: Calculated by taking the actual asset class weights, at the previous month end, multiplied by the return of the respective passive benchmark over the current month. Measures the effectiveness of deviating from target weights.

\*\*Policy Index: Calculated by taking the target asset class weights times the return of the respective passive benchmark (calculated monthly). Measures the effectiveness of Fund Structure.

**University of Maine System  
Operating Funds  
Statement of Investment Guidelines  
Approved by Investment Committee May 28, 2019**

## **INTRODUCTION**

The Statement of Investment Guidelines (the “Guidelines”) of the University of Maine System (the “UMS”) sets forth procedures and guidelines to assist in the day-to-day investment of the Operating Fund (the “Fund”). The purpose of these investment guidelines is to establish the objectives, responsibilities, permissible investments, risk tolerance, diversification requirements, and reporting requirements for the investment of the UMS Fund. This pool of funds excludes the assets of the managed investment pool (including endowments), planned giving funds and the defined benefit pension funds. The Board has delegated to the Treasurer responsibility for overseeing the Fund’s investment program in accordance with the provisions of these Guidelines.

## **STATEMENT OF GOALS AND OBJECTIVES**

These Guidelines are set forth to provide an appropriate set of goals and objectives for the Fund’s assets and to define guidelines from which the investment managers may formulate and execute their investment decisions.

Within the specific guidelines presented below, the investment managers shall exercise full investment discretion. However, assets must be managed with the care, skill, prudence and diligence that a prudent investment professional in similar circumstances would exercise. Investment practices must comply with applicable laws and regulations.

By agreeing to manage assets on behalf of the Fund, an investment manager accepts the provisions of this Statement applicable to such investment manager and assets being managed by such investment manager.

The Fund’s primary investment goals are outlined below:

- To enable the UMS to meet its financial obligations
- Provide liquidity
- Preserve capital
- Produce an acceptable yield to meet budget goals
- Provide a total return opportunity set
- Build a Budget Stabilization Fund that enables UMS to smooth the financial impact of adverse markets, economic conditions, and address other financial challenges.

## INVESTMENT GUIDELINES

### *Asset Allocation*

The Fund will be diversified both by asset class (e.g. cash equivalents, diversified bonds, equities, global asset allocation and hedge funds of funds) and within asset classes (e.g., by industry, quality and size). The purpose of diversification is to minimize unsystematic risk, and to provide reasonable assurance that no single security or class of securities will have a disproportionate impact on the total Fund.

The Fund's assets will be invested primarily with external investment management firms, either via commingled funds, mutual funds or separately managed portfolios. These managers will be selected on the basis of many factors, including expertise with domestic and global fixed income and equity strategies, experience with the use of derivatives, scope of product offerings, asset allocation and consulting experience, performance, quality and experience of personnel, service, compliance procedures, references and fees.

In order to have a reasonable probability of consistently achieving the Fund's return objectives, the Committee has adopted the asset allocation policy outlined below.

If any asset class weighting is outside its respective permissible range at the end of any calendar quarter, the Investment Consultant will advise the Committee at the next Committee meeting. In addition, UMS Staff will bring the portfolio into compliance with these guidelines as promptly and prudently as possible.

The Fund will be stratified into a minimum of three separate pools. The pools reflect portfolios with different goals and objectives. The amounts invested in each pool will fluctuate based on liquidity needs and the seasonal fluctuations in the UMS cash balances.

1. Liquidity Pool: – The purpose of this pool is to meet the day-to-day obligations of the UMS, including payroll and accounts payable. It can consist of funds that are invested in a portfolio of highest quality short-term fixed-income securities (treasury obligations, agency securities, repurchase agreements, money market funds, commercial paper, short-term bond mutual funds) with adequate liquidity. The average quality of the pool will be rated at least "A-1" by Standard and Poor's (or equivalent).
2. Income Pool: – The purpose of this pool is to provide sufficient income (e.g., interest income) to meet budgetary goals and provide additional diversification to minimize downside risk. This pool can invest in a diversified portfolio, and may include items such as, but not limited to fixed income securities, FDIC insured or adequately collateralized CDs, or in unconstrained, short or intermediate term bond funds with a normal average duration of -2 to 7 years. The pool may invest in funds rated from BB to AAA quality. The overall average quality rating of this pool will be at least "A-" by Standard and Poor's (or equivalent).
3. Total Return Pool: – Expected to add diversification and growth to the Fund. Exists to provide a flow of financial support to the UMS' programs. The pool can invest in diversified assets made up of but not limited to equities, hedge funds, and global asset allocation mandates.

## POOL ALLOCATION

	<u>Minimum</u>	<u>Target</u>	<u>Maximum</u>	<u>Risk Tolerance</u>
Liquidity Pool	5%	30%	100%	Low
Income Pool Moderate	0%	47.5%	60%	Low-
Total Return Pool Moderate	0%	22.5%	30%	

## BUDGET STABILIZATION FUND

When net investment income exceeds budget, management may allocate the excess earnings to the budget stabilization fund. This fund will enable management to address fiscal challenges and priorities of the UMS, including supplementing the budget when the net performance of the operating cash fund does not meet budget.

The investment income budget is net of expenses related to UMS financing and investing activities. Such expenses include, but are not limited to, banking, manager, custodial, and consulting fees and expenses.

### ***Equities***

**Risk:** Return objectives should be achieved without assuming undue risk. The risk - as measured by the standard deviation of returns - and the risk-adjusted return of this portfolio will be compared to the same measures for an appropriate universe of Equity managers and that of the appropriate index.

**Diversification:** No more than 6% at cost and 8% of the equity portfolio's market value may be invested in one company. Deviations from this policy are allowed upon specific approval from the Committee. Care and consideration should be taken to ensure that the entire equity portfolio is adequately diversified by individual holdings and sector weights.

**Use of Cash:** The manager is expected to be fully invested in equities. This notwithstanding, the Committee understands that some liquidity in the portfolio is necessary to facilitate trading, and does not place an explicit restriction on the holding of cash equivalents. The custodian bank's short term investment fund (STIF) is an allowed investment, as are other cash equivalents, provided they carry a Standard and Poor's rating of at least A-1 (or equivalent).

### ***Fixed Income***

**Risk:** Return objectives should be achieved without assuming undue risk. The risk - as measured by the standard deviation of returns - and the risk-adjusted return of this portfolio will be compared to the same measures for an appropriate universe of Fixed Income managers and that of the appropriate index.

**Diversification:** The securities of any issuer, excepting the U.S. government and U.S. government agencies, shall not constitute more than 5% of the portfolio at any time.

Up to 10% of the fund may be invested in international bonds and currency exposure may be hedged or unhedged at the manager's discretion.

**Duration:** The average effective duration of the fixed income portfolio may not differ by more than one year from the duration of the applicable benchmark. For example, a core bond fund will be evaluated against the Barclays Capital Aggregate index.

**Quality:** The overall quality rating of the fixed income portfolio will be at least one full quality rating within the applicable benchmarks quality rating as rated by Standard and Poor's (or equivalent). For example, if the Barclays Capital Aggregate has a credit rating of AA, a core bond fund should fall in the range of A to AAA.

**Use of Cash:** The manager is expected to be fully invested in fixed income securities. The custodian bank STIF is an allowed investment, as are other cash equivalents, provided they carry a Standard and Poor's rating of at least A-1 (or equivalent).

### ***Hedge Funds***

Investments in hedge funds are permitted. Hedge funds represent a broad set of mandates and strategies that focus primarily on the liquid equity, fixed income and derivatives markets, but they may also include allocations, to a smaller extent, to investments that are less liquid. These mandates may employ long strategies, short selling and derivatives to protect against market downturns and/or protect profits from anticipated market movements.

The primary objective of these strategies is to provide positive absolute return throughout a market cycle (cash return + incremental spread), as well as provide increased diversification to the portfolio.

Each investment should fall within the expected risk and return characteristics historically displayed by domestic fixed income and public domestic equity investments.

### ***Hedge Fund Guidelines***

- *Diversification* – investments should be made through diversified hedge fund programs.
- *Liquidity* – initial lock-up periods should not exceed one year; subsequent allowable redemption periods should not be less frequent than annual.
- *Transparency* – investments should be made only in funds that provide adequate transparency to the underlying securities/funds held by the fund.
- *Leverage* – funds may employ reasonable amounts of leverage (except for at the fund level as described in the excluded investments section) to the extent they adhere to targeted risk/return objectives.
- *Correlation* – funds added to the Fund in this asset class should exhibit low correlation with traditional stock and bond indices.
- *Reporting* – investments may only be made in funds that adhere to strict reporting guidelines that fall within that required by the Fund.

## ***Excluded Investments***

Certain investments are ineligible for inclusion within this Fund:

- *UBTI* – investments in transactions that would generate unrelated business taxable income (“UBTI”) to the Fund.
- *Self-dealing* – securities of the investment manager, their parent or subsidiary companies (excluding money market funds) or any other security that could be considered a self-dealing transaction.
- *Leverage* – when investing in fund of hedge funds (FOHF), the manager may not employ leverage at the master fund level
- *Unrelated Speculation* – Derivatives shall not be used to create exposures to securities, currencies, indices, or any other financial vehicle unless such exposures would be allowed by a portfolio’s investment guidelines if created with non-derivative securities.
- *Coal Companies* – separate account managers shall not invest in coal companies.

## **OTHER ASSET CLASSES, STRATEGIES, AND INVESTMENT MANAGERS**

From time to time the Treasurer may make additional diversifying investments in other asset classes or securities. The Treasurer shall approve any such investment prior to implementation and shall restrict these investments to specific investment managers.

### ***Derivatives***

Where appropriate, investment managers may use derivative securities for the following reasons:

1. *Hedging*. To the extent that the portfolio is exposed to clearly defined risks and there are derivative contracts that can be used to reduce those risks, the investment managers are permitted to use such derivatives for hedging purposes, including cross-hedging of currency exposures.
2. *Creation of Market Exposures*. Investment managers are permitted to use derivatives to replicate the risk/return profile of an asset or asset class provided that the guidelines for the investment manager allow for such exposures to be created with the underlying assets themselves.
3. *Management of Country and Asset Allocation Exposure*. Managers charged with tactically changing the exposure of their portfolio to different countries and/or asset classes are permitted to use derivative contracts for this purpose.

By way of amplification, it is noted that the following two uses of derivatives are prohibited, unless otherwise approved:

1. *Leverage*: Derivatives shall not be used to magnify overall portfolio exposure to an asset, asset class, interest rate, or any other financial vehicle beyond that which would be allowed by a portfolio’s investment guidelines if derivatives were not used.

2. Unrelated Speculation: Derivatives shall not be used to create exposures to securities, currencies, indices, or any other financial vehicle unless such exposures would be allowed by a portfolio's investment guidelines if created with non-derivative securities.

### ***Distributions***

Investment managers should assume that withdrawals may be made from the Fund from time to time by the University of Maine System. Appropriate liquidity should be maintained to fund these withdrawals without impairing the investment process. UMS staff shall alert investment managers to anticipate liquidity needs of the Fund.

### ***Commingled Funds***

Assets of the Fund may be invested in commingled funds, in recognition of the benefits of commingled funds as investment vehicles (i.e., the ability to diversify more extensively than in a small, direct investment account and the lower costs which can be associated with these funds). The Committee and management recognize that they may not be permitted to give specific policy directives to a fund whose policies are already established; therefore, the Committee and management are relying on the Investment Consultant to assess and monitor the investment policies of such funds to ascertain whether they are appropriate.

## **BENCHMARKS**

Managers should produce returns that are commensurate with the degree of risk taken. Each manager's return and risk will be measured against the respective measures of an appropriate benchmark. For example, a core bond investment is benchmarked against the Barclays Capital Aggregate Index.

The total Fund's returns will be benchmarked against both the Consumer Price Index, and against the State of Maine Investment Pool returns.

## **PERFORMANCE STANDARDS AND EVALUATION**

Investment managers are expected to achieve the performance objectives that have been agreed to prior to engagement, in accordance with their investment guidelines. Performance comparisons will be made on a net of fees and risk-adjusted basis. Manager performance will be reviewed quarterly to ensure compliance with these standards.

Managers should match or exceed the return of their respective benchmarks over a complete market cycle, while assuming benchmark-like risk.

Individual manager performance will normally be evaluated over a full market cycle, but the UMS reserves the right to terminate a manager for any reason including the following:

1. Investment performance that is significantly less than anticipated given the discipline employed and the risk parameters established, or unacceptable justification of poor results.

2. Investment manager agreement/guideline violations.
3. Failure to adhere to any aspect of these Guidelines.
4. Significant qualitative changes to the investment management organization.

Investment managers will be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative factors that may impact their ability to achieve the desired investment results.

## RESPONSIBILITIES

**Internal Staff:** Staff duties include:

**Budget:** Produce periodic short-term and long-term cash flow forecasts.

**Standards:** Advise investment managers on income requirements over a long planning horizon and provide updates on unexpected cash flow changes. Work with investment managers on portfolio optimization/asset allocation. Establish and update written investment objectives and guidelines as appropriate.

**Manager Funding:** Negotiate investment manager and custodial agreements. Deploy existing assets and new monies to investment managers.

**Rebalancing:** Rebalance as deemed prudent.

**Appointments:** Evaluate, establish and terminate banking relationships, money market managers, and other relationships in the Liquidity Pool. Work with consultant to evaluate investment managers in the Income and Total Return Pools and bring recommendations to the Investment Committee.

**Corrective Action:** To take whatever action is deemed prudent and appropriate when the investment manager fails to meet mutually accepted performance standards or significantly violates the investment guidelines. When time permits, this action will be taken following consultation with the Investment Committee and approval of recommended action.

**Investment Committee:** The Trustees provide for the prudent investment of assets held in the UMS Operating Fund Portfolio. The Investment Committee routinely updates the Board of Trustees on investment policies and performance. The University of Maine System staff will assist the Committee in carrying out their duties.

The Investment Committee is responsible for:

**Standards:** Approve written investment objectives and guidelines.

**Evaluation:** Monitor performance of the Fund.

**Appointments:** Approve investment managers for the Income and Total Return Pools.

**Compliance:** To comply with the provisions of all pertinent federal and state regulations and rulings.

**Communication:** To communicate investment goals, objectives, and standards to investment managers, including any material changes that may subsequently occur.

**Investment Manager:** In recognition of their role as investment managers of UMS funds, investment managers must assume the following responsibilities:

**Investment Responsibility:** To make investment decisions with respect to the assets under its management in accordance with investment manager agreements and guidelines or prospectuses. Investment managers are to make reasonable efforts to control risk, and will be evaluated regularly to ensure that the risk assumed is commensurate with the given investment style and objective.

**Compliance:** To comply with this statement and any other written instructions provided by UMS, and with all federal and state regulations pertaining to the investment of such assets.

**Notification of Changes:** To inform UMS of any material changes in the manager's outlook, policy, investment strategy and portfolio structure, or tactics or in the firm's structure including ownership, financial condition and changes in portfolio management personnel.

**Trading:** To comply with CFA Institute soft dollar standards. The investment manager recognizes that brokerage is the property of the client and that it has an ongoing duty to ensure the quality of transactions effected on behalf of its client. This includes, seeking to obtain best execution, minimizing transaction costs, and using client brokerage to benefit the client.

**Voting of Proxies:** Responsibility for the exercise of ownership rights through proxy voting shall rest solely with the investment managers, who shall exercise this responsibility strictly for the long-term economic benefit of the Fund, its participants and beneficiaries. Additionally, investment managers shall maintain a written annual report of the proxy votes for all shares of stock in companies held in the Fund's investment program. These reports shall specifically note and explain any instances where proxies were not voted in accordance with standing policy.

**Reporting:** To provide to the Committee and to its investment consultant quarterly reports that provide the total return net of commissions and fees, additions and withdrawals from the account, current holdings at cost and market value, and purchases and sales for the quarter. All reports are to comply with Global Investment Performance Standard (GIPS) performance presentation standards.

**Availability for Meetings:** To meet at least annually or at other such times as UMS may reasonably request to discuss investment outlook, performance, strategy and tactics, organizational and personnel changes, and other pertinent matters.

**Bonding:** The managers shall provide evidence of liability and fiduciary insurance and have its employees bonded unless otherwise exempted by law or governmental regulation.

**Investment Consultant:** The consultant will provide the Committee with objective advice. The responsibilities include:

**Reporting:** To provide performance evaluation reports to the Committee on a quarterly basis. Reports will include absolute and relative performance of each of the investment managers and the total fund. The consultant will utilize meaningful market indices for comparisons. Also, provide specialty reporting, and analysis of the overall program for portfolio risk.

**Consulting:** To provide proactive advice to the Committee on investment guidelines, asset allocation and manager structure. To assist in the selection of new investment managers and in the termination of managers. To alert the Committee of any adverse developments concerning the Fund and the performance of the managers. To report on market trends and external change (market intelligence). To provide research materials and educational seminars on different asset types, or topics, as requested.

**Availability for Meetings:** To meet at last quarterly for a formal performance review or at other such times as the Committee may reasonably request.

## **CONFLICT OF INTEREST**

It is the policy of the Trustees to avoid conflicts of interest in its operations and in the selection of investment managers or funds. Therefore, UMS administrative officers shall not have a significant financial relationship in any manager or fund being considered. No independent investment consultant that may be retained by UMS, or any entity in which such consultant may have an interest, shall have a significant financial or other interest in, any investment manager providing services to UMS or any fund in which UMS has an investment.

## **IMPLEMENTATION**

All new monies received by investment manager(s) after the adoption of this statement of Guidelines and Objectives shall conform to the Statement. To the extent that Fund assets are not currently managed in accordance with this Statement, the investment manager shall conform in all respects to this Statement within 60 days of its receipt hereof.

## **AMENDMENTS**

UMS reserves the right to amend this statement and/or to direct the investment managers to take any appropriate actions, whether or not consistent with this statement, if market conditions, liquidity needs or other circumstances so indicate.