MICHIGAN STATE UNIVERSITY

BOARD OF TRUSTEES

Executive Action Summary

Committee Name: Budget & Finance **Date:** December 13, 2024

Agenda Item: Revisions to BOT 607, *Investment Policy*

☐ **Information** ☐ **Review** ☒ **Action**

Resolution:

BE IT RESOLVED that the Board of Trustees hereby approves the full restatement of BOT 607, *Investment Policy*, in whole as BOT 607, *Investment Policy Statement,* as indicated in Attachment A.

BE IT FURTHER RESOLVED that the Board of Trustees approves the recission of BOT 106, *Investment Advisory Subcommittee*.

BE IT FINALLY RESOLVED that the Board of Trustees establishes the Endowment Spending Rate at 4.8% starting fiscal year 2026.

Recommendation:

The Trustee Committee on Budget & Finance recommends that the Board of Trustees approve the restatement of BOT 607, *Investment Policy,* in whole as BOT *607, Investment Policy Statement*, indicated in Attachment A. Additionally, the Committee recommends the rescission of BOT 106, *Investment Advisory Subcommittee*. Last, the Trustee Committee on Budget & Finance recommends that the Endowment Spending Rate be set at 4.8%, an increase of 0.4% from its current 4.4%, starting fiscal year 2026.

Prior Action by BOT:

Board of Trustees Policy 607, *Investment Policy*, was last amended in September 2021.

Board of Trustees Policy 106, *Investment Advisory Subcommittee*, was last revised in September 2021.

Responsible Officers:

Philip Zecher, Chief Investment Officer

Lisa Frace, Senior Vice President, Chief Financial Officer and Treasurer

Summary:

Board of Trustees (BOT) Policy 607, *Investment Policy*, was previously revised in September 2021. The primary revisions to the policy that are being proposed are as follows:

- Raise the annual spending rate from the endowment to 4.8% from 4.4%, after eight years of strong investment performance;
- Improve Conflict of Interest protections;
- Restructure the investment advisory subcommittee to provide stronger, more flexible support to the President, CIO, and CFO;
- Align more with current institutional investment practices;
- Commit to implement a University committee of students, faculty and staff, appointed by the president, to hear concerns regarding particular investments. This process will serve as the formal mechanism by which the board will consider investment change requests for non-financial reasons. The committee will be established within a year.

The policy has also been put into the standard policy template approved by the board at its September 2023 meeting.

Additionally, the board is being asked to rescind BOT 106, *Investment Advisory Subcommittee.* The revisions to BOT 607 incorporate the composition and key responsibilities for an investment advisory committee, negating the need for a standalone policy. BOT 106 is therefore being rescinded due to being rendered obsolete by the proposed revisions to BOT 607.

Background Information:

Board of Trustees Policy 607, *Investment Policy*, was established in January 1979. The policy provides for how the University's investments are to be overseen and the roles and responsibilities of the board, investment managers, and key University leaders with respect to those investments. Additionally, the policy defines which assets are covered by the policy. When considering changes to the policy, benchmarking was conducted against several other higher education institutions.

Source of Funds:

Not applicable.

Resource Impact:

Not applicable.

Board of Trustees Policy

POLICY NUMBER: BOT 607

POLICY NAME: Investment Policy Statement

Effective Date:	January 26, 1979
Last Review Date:	December 13, 2024
Next Scheduled Review Date:	December 2029

I. POLICY STATEMENT

As stated in the Constitution of the State of Michigan and in the Bylaws of the Board of Trustees of Michigan State University (board), the board is responsible for the "control and direction of all expenditures from the institution's funds." In carrying out this responsibility with respect to the University's investments, the board has established a framework for active, professional investment management. This policy states the responsibilities of the parties involved in carrying out the investment program.

II. RESPONSIBLE OFFICE

Investment Office
Office of Finance

III. SCOPE

All endowments, which includes true endowments and quasi-endowments comprising institutional funds available for long-term investment, except for funds limited by law or by special donor restrictions, will be consolidated into the board's Common Investment Fund (CIF) and managed by the University's Investment Office. All institutional cash not available for long-term investment, except as otherwise required by contract or by another legal constraint, will be consolidated into the board's Pooled Cash Fund for investment purposes. The management of the Pooled Cash Fund is subject to Section V.3.B. of this policy.

IV. DEFINITIONS

None listed.

V. POLICY

1. INVESTMENT OBJECTIVES

The long-term objective for the CIF is to generate a consistent source of revenue while maintaining the purchasing power of the corpus, and to the extent possible, taking prudent investment risks to grow the CIF in real terms.

The primary objective of the Liquidity Pool is to provide a liquid source of funds to meet the University's daily cash requirements. A secondary objective is to yield a competitive investment return while bearing minimal principal risk.

The primary objective of the Liquidity Reserve Pool is to provide a source of funds in the event the Liquidity Pool is insufficient to meet the University's cash needs. A secondary objective is to earn a higher investment return than the Liquidity Pool.

2. DIVISION OF RESPONSIBILITY

A. Board of Trustees

i. Upon the recommendation of the Board of Trustee's Committee on Budget and Finance, approve investment policies which guide the management of the University's investment portfolios.
ii. The board, through its Budget and Finance committee, will review on a quarterly basis the performance and investment actions of the CIF and Pooled Cash Funds.

B. President
The board delegates to the president the general supervision of and responsibility for proper management of University investments, including the CIF and Liquidity Pools. The president is authorized and responsible for:

i. Appointing members of the Investment Advisory Committee (IAC) and any sub-committees which are charged with assisting the president, Chief Investment Officer (CIO), and Chief Financial Officer (CFO) in guiding the University's investment activity;
ii. Appointing chairs to the IAC and any sub-committees;
iii. Calling meetings of the IAC;
iv. Upon the recommendation of the IAC, the CIO, and CFO, establish investment objectives, guidelines, and benchmarks as University procedures (the "Investment Guidelines").

C. Chief Investment Officer (CIO)

The CIO will report directly to the president and will lead the University's investment staff responsible for the CIF. The CIO will direct the ongoing development and implementation of an investment strategy to meet the board's Investment Objectives subject to the Investment Principles as outlined in this Policy and the University's Investment Guidelines as adopted by the president upon the recommendation of the IAC. Leading the University's investment organization, the CIO's responsibilities will include the following:

i. Reporting quarterly to the president, CFO, and the board's Budget and Finance Committee, the total value of the CIF, the investment return for the quarter, comparisons to appropriate benchmarks as specified by the Investment Guidelines, and report any rebalancing transactions, new investments made, and investments redeemed,

ii. Developing and recommending to the IAC, an appropriate strategy to meet the board's long-term investment objectives including, but not be limited to, liquidity available for investments, performance goals, strategic asset allocation, and risk budgets for the CIF;

iii. Within the parameters of the Investment Guidelines, appointing new investment managers, terminating investments, reallocating assets, making follow-on investments with existing managers, and having the authority to allocate funds through use of a joint investment vehicle entity, such as a limited liability entity, and authority to take all actions and execute all documents in connection with the formation, management, operation, and dissolution of any such joint investment vehicle entity;

iv. Overseeing custody, depository, legal, and other operating functions;

v. Providing a monitoring and measurement program that will permit evaluation of the performance of the CIF portfolio and appropriate risk measures as prescribed by the University's Investment Guidelines;

vi. Providing the CFO with annual liquidity forecasts for the CIF to facilitate approval of long-term investments per section V.2.D.i.

D. Senior Vice President, Chief Financial Officer and Treasurer (CFO)

i. The CFO shall determine the availability of institutional funds that are available for long-term investment in the CIF and be responsible for establishing the appropriate documentation for such investments, including determination of reinvestment of earnings upon expiration of the investment vehicle.

ii. The CFO shall provide an annual review of the programmatic spending rate to the Committee on Budget and Finance and other members of the board stating the amount, if any, of the assessment for the following fiscal year and how it was determined.

iii. The CFO is responsible for managing and maintaining the appropriate levels of liquidity for the University; the CFO must concur on all CIF investments with redemption restrictions of greater than three years.

iv. The CFO is responsible for managing the investments in the liquidity pools, including selection and oversight of investment managers, and overseeing custody, depository, legal, and other operating functions for such funds.

v. The CFO is responsible for reporting quarterly to the president, CIO, and the board's Committee on Budget and Finance, the total value of the Liquidity Pools, the investment return for the quarter, and comparisons to appropriate benchmarks as specified by the University's Investment Guidelines.
vi. The CFO is responsible for developing and recommending to the president, upon consultation with the CIO and IAC, an appropriate strategy to manage the University's Liquidity Pools, including appropriate benchmarks.

E. Investment Advisory Committee (IAC)

The IAC is an external advisory board that:

i. Advises the president, CIO, and CFO on matters relating to the management of the University's investment portfolios;
ii. Develop and recommend to the president the University's Investment Guidelines, as prescribed in section V.3. Annually review the Investment and recommend any changes to the president for adoption;
iii. Advises the president on the programmatic spending rate;
iv. Advises the president on compensation of investment staff and other administrative matters.

The IAC will not oversee manager selection, termination, or specific investments.

The IAC will consist of five (5) to nine (9) external members, appointed by the president and serving such terms as the president determines appropriate. Terms are not to exceed five (5) years, but multiple terms are allowed.

The IAC should meet no less than twice a year. All appointed members of the IAC shall have appropriate credentials in institutional investing or other related corporate financial backgrounds.

The chair of the Committee on Budget and Finance Committee, or another trustee as selected by the board chair, will serve as ex-officio member of the IAC.

The president, CIO, and CFO will serve as ex-officio members of the IAC.

F. External Managers

The CIO is authorized to hire and delegate to external investment managers responsibility for managing investments held in the CIF on behalf of the University. The investment managers are required to invest in compliance with all applicable laws, the respective manager's individual investment management agreement(s), and as applicable, the University's Investment Guidelines as established by the president.

The CFO is authorized to hire and delegate to external investment managers responsibility for managing investments held in the Pooled Cash Funds on behalf of the University. The investment managers are required to invest in compliance with all applicable laws, the respective manager's individual investment management agreement(s), and as applicable, the University's Investment Guidelines as established by the president.

3. INVESTMENT PRINCIPLES

The Investment Guidelines, recommended by the IAC and adopted by the president, will specify the detailed implementation of University's investments, including, but not limited to, setting targets, benchmarks, and limitations on risk, and appropriate operational details. The Investment Guidelines shall work within the broad outlines of permissible investments and activities outlined below, by providing additional details for implementation and monitoring, and may restrict investments or activities otherwise allowed here.

A. <u>Common Investment Fund</u>

i. Risk Profile

The CIF is expected to generate a consistent income to unit holders while continuing to grow the inflation adjusted principal. This requires a diversified mix of investments that are predominately equity or equity-like. To achieve this, the CIF should strive to maintain both equity market exposure and volatility levels consistent with a portfolio with eighty percent (80%) exposure to equities and twenty percent (20%) exposure to diversifying strategies.

ii. Allowed Liquidity

It is expected that illiquid assets will earn a premium over public assets, therefore, the CIF may invest up to fifty percent (50%) of the CIF value in illiquid private assets. Sharp moves in a particular market may significantly affect the percent allocation, therefore, it is expected that the target allocation to illiquid investments will be below the 50% threshold. In the event the percentage of assets in private investments raises above 50% because of significant market events in an asset class, the Investment Office, on the advice of the IAC, has the latitude to remain above 50% for a reasonable amount of time before undertaking rebalancing and secondary sales.

iii. Investment Vehicles

The CIF may invest through any legally available vehicle not restricted by law that is appropriate for the strategy. Allowable investment vehicles include but are not limited to:

- mutual funds;
- collective bank trusts;
- Delaware Statutory Trusts; and
- domestic and foreign limited liability partnerships.

The CIF may utilize separately managed accounts held by the CIF's custody bank. The CIF may hold securities directly through either a securities broker or the CIF's custody bank. Any vehicle used to make investment by a third-party investment manager will be referred to as a "fund" and the third-party managers as "manager."

iv. Securities

Investments may be made into any security not restricted by law that has the return and risk expectations appropriate for the investment strategy of which they are a part. This will include, but not be limited to: public equities, either domestic or foreign; public fixed income, either domestic or foreign bonds with credit ratings appropriate for the strategy; cash held to manage liquidity needs of the CIF or for opportunistic investments; absolute return strategy, such as hedge funds, that use strategies to deliver returns uncorrelated to broad equities markets; private investments, including a broad ranges of strategies, such as buyout, venture, credit, secondaries, natural resources; and real estate.

v. Use of Derivatives

The CIF may employ funds that use derivatives, including futures, options, and swaps. Funds may also sell securities short. The use of derivatives by an investment manager trading on the University's separate accounts will be governed by their investment management agreement. The Investment Office may use derivatives for hedging, rebalancing, and risk management.

vi. Investment Concentration

The CIF should be a diversified pool of assets, and the underlying diversity of a fund should be considered when determining any limits imposed on the size of funds withing the CIF.

vii. Secondary Sales of Illiquid Assets

The Investment Office may undertake secondary sales of private investments to manage overall asset allocations and provide flexibility for management of the portfolio.

viii. Use of Leverage

It is expected that some funds will employ leverage as part of the strategy. The overall CIF should not employ direct leverage. The only exception is the use of a margin account for trading derivatives, in which case appropriate liquid assets must be identified and maintained for the full notional amount of the strategy being employed.

B. <u>Pooled Cash Funds</u>

The University's Pooled Cash Fund is a subset of the University's overall cash pool and includes two components – the Liquidity Pool and the Liquidity Reserve Pool. The Liquidity Pool will serve as the primary support for operational liquidity. The Liquidity Reserve Pool will consist of cash that is not required for immediate liquidity but does not meet the criteria for long-term investment in the CIF. The CFO will be responsible for determining the cash available for investment in each of the Funds.

Investment of institutional cash not otherwise invested in the CIF will be invested in fixed-income and related instruments, and any other instruments that may be permitted by statute. These include but are not limited to:

- US government and agency bonds;
- corporate debt and bonds;

- time deposits;
- certificates of deposit;
- asset and mortgage-backed securities; and
- repurchase or reverse repurchase agreements

The CFO will develop and propose to the president for approval, in consultation with the IAC, appropriate guidelines and benchmarks for managing pooled cash funds, including but not limited to:

- average portfolio credit quality;
- minimum credit quality for individual investments;
- average duration; and
- other such metrics as may be deemed appropriate

C. Consideration of Investment Change Requests for Non-Financial Reasons
The board is committed to ensuring academic freedom and freedom of speech for all the University's community. In keeping with the tenets of institutional restraint and in upholding its fiduciary duty to the institution and to the generous donors who have entrusted their legacy to the University, Michigan State University's investments will be based solely on financial considerations, such as their expected return, risk, and adherence to applicable laws. As the ultimate fiduciary for the University's financial assets, any decision to invest, divest, or exclude any investment for non-financial reason rests solely with the Board of Trustees. The board also retains the sole authority to create any committee to consider such proposed changes.

The board acknowledges that there may exist extraordinary circumstances in which the University may wish to consider investment changes for non-financial reasons. To make such a determination, the board will create, within a year of the initial adoption of this provision, a University committee of faculty, students, and staff, appointed by the president, to hear concerns regarding particular investments. The board will establish specific and objective instructions as to how to evaluate the merits of the request when establishing the committee. Any recommendation by the committee for investment, divestment, or exclusion from the University's investment pools, will be delivered to the president, upon whose discretion it may be forwarded to the board for consideration. The board will only consider requests that have followed this process.

4. Distribution and Withdrawals
The CIF contains various endowment funds in a unitized pool, with allowed contributions, distributions, and withdrawals on a quarterly basis when unit values are determined. The CIF contains true endowment funds received from donors with the commitment that the principal be invested in perpetuity to generate income for specific purposes outlined by the donor. The CIF also contains institutional funds as quasi-endowments and operating trusts.

The president is authorized to approve the establishment and dissolution of, and amendments to quasi- endowments that support departmental goals in amounts up to $5 million. All such vehicles worth more than $5 million require board approval.

Institutional funds invested in the CIF share the same long-term strategies as the true endowments and are therefore required to have a minimum five-year investment period. Withdrawals more than the approved programmatic spending rate, stewardship fee and expiration of operating trusts, will be subject to approval by the president, upon recommendation from the CFO and in consultation with the CIO.

A. Investments in the Endowment generate revenue that may be expended for the purposes for which endowments were established ("programmatic spending"). The board will establish a programmatic spending rate. The CFO shall develop and recommend to the president, in consultation with the CIO and IAC, any changes to the programmatic spending rate. This programmatic spending rate shall be reviewed annually by the board, and any changes made to the rate, upon the recommendation of the president to the Committee on Budget and Finance, shall be approved by the Board of Trustees.
B. Programmatic spending distributions will be made to the CIF unit holders on a periodic basis during the fiscal year. The CFO, in consultation with the CIO and president, will establish the necessary calculations and policies to affect the programmatic spending distributions. Such calculations and policies should utilize a moving quarterly average of up to twenty (20)-quarters average CIF unit value to help insulate the university from short-term market volatility.
C. The board authorizes the president, in consultation with the CIO and the CFO, to establish an annual assessment for endowment stewardship, including fund raising, against the endowments. The amount of the assessments must be reasonable and appropriate, particularly when considered in the context of the University's priorities for the use of the endowments. In any event, the amount assessed may not, without further board action, exceed one percent (1%) using the same methodology as used for the programmatic spending rate.
D. The board authorizes reasonable and appropriate costs to be charged to the endowments. These charges may include reasonable and appropriate costs of administering and managing the CIF, including internal and external investment costs.
E. If the University has accepted a gift to an endowment fund documented by a gift instrument in which the donor gives legally binding instructions for the investment of, or expenditures from, that fund which are inconsistent with the foregoing, the University will comply with those special instructions. The CFO shall calculate the annual programmatic spending distribution and assessment for each endowment fund which is not invested in the CIF in accordance with applicable law and report the programmatic spending rate and assessment amount for each such fund to the Committee on Budget and Finance. To the extent possible given each such fund's investments and the instructions of its donor, the priorities for the use of such funds should be the same as those for endowment funds invested in the CIF.

5. Conflict of Interest
All individuals involved in carrying out the University's investment program are expected to act with the highest ethical standards during all phases of the investment process. These individuals must comply with all applicable laws and regulations. Individuals that are employees of the University are subject to standard policies and procedures applicable to all employees of the University and to any additional standards and policies applicable to their specific University role, such as the Standards of Official Conduct for Senior University Administrators.

Conflicts of interest are more fully addressed in the Investment Office Conflict of Interest Policy, which provides more specific guidelines and procedures applicable to the Investment Office Staff, the members of the Investment Advisory Committee, and any other individuals or roles identified in the policy. The policy will be the responsibility of the CIO, CFO, and, ultimately, the president. The Committee on Budget and Finance will be consulted on any revisions to the policy.

The Investment Office also looks to those managing the University's investments to aid in avoiding inappropriate conflicts. During the initial onboarding of an investment, the Investment Office seeks certifications from the managers of that investment vehicle that no trustee, certain University senior administrators, or Investment Office staff, holds any inappropriate interest in the managers or will receive any undisclosed remuneration or thing of value in connection with the University's investment.

6. Non-Disclosure Policy
Investment Office staff, CFO and staff, and IAC members have a duty to use care and discretion in the handling of confidential information obtained in their Investment Office capacity. Any confidential information obtained through activities, meetings and discussions related to the Investment Office may not be used by Investment Office staff, CFO and staff, IAC members, or any staff with access to the information for personal gain, or disclosed to others outside the Investment Office, including family members. The foregoing prohibition includes any material, non-public information regarding a publicly traded company, which if used, would be considered prohibited insider trading.

7. Interpretation of Relevant Law and Accounting Standards
Investment Office staff and the CFO and staff are required to meet their fiduciary duties consistent with this IPS and applicable federal and state law, including, without limitation, the Uniform Prudent Management of Institutional Funds Act (MCL 451.921 through 451.931). With respect to the University's investment decisions, staff will act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and will consider, if relevant, the following factors:

(a) the duration and preservation of the endowment fund;
(b) the purposes of the institution and the endowment fund;
(c) general economic conditions;
(d) the possible effect of inflation or deflation;
(e) the expected total return from income and the appreciation of investments;
(f) other resources of the University; and
(g) this policy statement

The presentation of the financial statements, which upon acceptance of the audit by the Board of Trustees become the Audited Financial Statements (AFS), is the responsibility of the CFO. The Investment Office staff, members of the university controller's staff, and external experts may be called upon to provide input in the preparation of the statements.

VII. HISTORY

Enacted: January 26, 1979

Amended: April 15, 1983
June 8, 1884
February 6, 1987
October 14, 1988
December 6, 1991
April 10, 1998
September 22, 2000
June 5, 2003
May 7, 2004
November 12, 2004
May 18, 2007
December 5, 2008
April 24, 2009
April 16, 2010
September 17, 2010
December 10, 2010
October 21, 2011
December 14, 2012
January 25, 2013
April 12, 2013
June 21, 2013
September 11, 2015
December 18, 2015
April 15, 2016
October 28, 2016
October 27, 2017
December 14, 2018
September 10, 2021
December 13, 2024

Retired Policy No. 01-07-01