**University of Arkansas System**

**Investment Policy – Operating Funds**

INTRODUCTION

The affairs of the University of Arkansas are controlled by the University’s Board of Trustees, which has designated investment authority to the University of Arkansas System Chief Financial Officer, who in turn will work with the Investment Advisory Committee as directed in Board of Trustees Policy 470.2.

The purpose of this Investment Policy (the "policy") is to set general guidelines to provide a clear understanding of the investment objectives for the System’s operating funds ("funds"). The policy shall be used as a guideline for the Investment Advisory Committee as well as for the external investment advisor and/or the investment managers and the custodial agents hired by the System.

INVESTMENT ADVISORY COMMITTEE

The Investment Advisory Committee will oversee and monitor management of operating funds of the System. The Investment Advisory Committee will be charged with the following responsibilities:

1. Review and update the policy as needed in response to changes in applicable laws, changing economic and market conditions, and current needs of the System.
2. Monitor the investment program to insure that proper controls are in place to ensure the integrity and security of the investment portfolios.
3. Assure that the investments are in compliance with the policy.
4. Meet periodically, but at least twice a year, to deliberate such topics as economic outlook, portfolio diversification, maturity structure, potential risks and the target rate of return on the investment portfolio.

The Committee may retain the services of an external investment advisor consistent with the UASP 310.1 to assist in performing its duties. The Committee members and those responsible for the management of the investment portfolio will perform their duties in a manner consistent with the standard of a “prudent investor.”

OBJECTIVES

The fund’s investment objectives, in order of priority, are the following:

1. Safety of Principal – Safety of principal is the foremost objective of the investment program. Investments shall be made in a manner that seeks to ensure the preservation of capital.
2. Maintenance of Liquidity – The funds shall remain sufficiently liquid to enable the System to meet all operating requirements which might be reasonably anticipated, including but not limited to payroll, accounts payable, capital projects, debt service and any other payments.
3. Return on Investment – The funds shall be managed with the objective of attaining a market rate of return (or higher) throughout the budgetary and economic cycles, taking into account the risk constraints and cash flow characteristics of the portfolio.

INVESTMENT PORTFOLIOS

Maintenance of adequate liquidity to meet the cash flow needs of the System is essential. Accordingly, to the extent possible, the funds will be structured in a manner that ensures sufficient cash is available to meet anticipated liquidity needs. Whenever practical, selection of investment maturities will be consistent with the known cash requirements in order to minimize the forced sale of securities prior to maturity.

Short Term Investment Fund

The Short Term investment fund provides a current return and stability of principal while affording a means of overnight liquidity for projected cash needs. The investment maturities in this fund will range between daily and two (2) years.

INVESTMENT OBJECTIVES

1. The primary investment objective shall be preservation of principal and current income consistent with permitted investments.
2. The secondary investment objective shall be to provide a competitive return on the short term funds of the System participants, while providing sufficient liquidity for periodic cash needs.
3. The portfolio shall be limited to domestic fixed income only and shall be well diversified as to issuer and maturity within the scope of permitted investments.
4. The overall character of the portfolio shall be of U.S. treasury and agency quality, possessing a minimal degree of credit risk.

GENERAL INVESTMENT GUIDELINES

1. The external investment adviser will give frequent and active attention to the portfolio to implement the System’s investment strategy.
2. The external investment adviser is authorized to make investment changes as deemed necessary on a discretionary basis, but only in accordance with the objectives and guidelines set forth in this document. The external investment adviser will meet regularly with the Investment Advisory Committee to review investment objectives, investment strategies and performance results.
3. All investments utilized in the Short Term investment fund will be highly liquid with readily determinable valuations. Generally, it is anticipated that liquidity needs will be met through maturities, portfolio structure and income.
4. For comparative purposes, the portfolio will be measured against the Barclays 9-12 month T-Bill Index.

SPECIFIC INVESTMENT GUIDELINES

1. Investments in the Short Term investment fund shall be limited to securities permitted for investment under Arkansas Code Section 19-4-805.
2. Permitted investments shall include:
	* US Treasury bonds, bills and notes;
	* Obligations (including mortgage obligations) of subsidiary corporations of the US Federal Government including, but not limited to, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association;
	* Repurchase agreements collateralized by obligations of the US Treasury and subsidiary corporations of the US Federal Government. The market value of the collateral shall be 102% of the repurchase agreement investment.
	* U.S. dollar denominated commercial paper issued or guaranteed by a domestic or foreign corporation, company, financial institution, trust or other entity.
	* Bankers’ acceptances issued, drawn on or guaranteed by a U.S. bank or U.S. branch of a foreign bank.
	* Interest bearing time certificates of deposit, savings accounts, or deposit accounts fully insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA), or collateralized in accordance with State of Arkansas laws.
	* Shares in open-end and no-load money market funds, provided such funds are registered under the Investment Company Act of 1940 and operate in accordance with Rule 2a-7. Before investing in any mutual fund, the university shall obtain a copy of the fund’s prospectus and review permitted investments, fees and management structure. At no time shall the System own more than 20% of the total net assets of the mutual fund series.
	* Shares in open-end and no-load fixed-income mutual funds or exchange-traded funds (ETFs) whose underlying investments would be permitted for purchase under this policy and all its restrictions.
3. The average duration of the portfolio will range from 0.3 to 1.25 years and will typically average 0.75 to 1 year.
4. The maximum maturity (average life) of any individual holding shall not exceed 3 years.

PORTFOLIO DIVERSIFICATION

The System’s funds shall be diversified to avoid incurring unreasonable risks inherent in over-investing in specific instruments, individual financial institutions or maturities. The maximum percentage of the System’s funds permitted in each eligible security based on book value at the date of acquisition shall be as follows:

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| --- | --- | --- | --- | --- |
| **Sector** | **Sector Maximum (%)** | **Per Issuer Maximum (%)** | **Minimum Ratings Requirement1** | **Maximum Maturity** |
| U.S. Treasury | 100% | 100% | N/A | 10 Years(10 year avg. life4 for GNMA)  |
| Federal Agency / Government Sponsored Enterprise | 100% | 35%3 | Highest short-term4 or one of the two highest long-term rating categories(A-1/P-1, AA-/Aa3 or equivalent)  | 10 Years |
| Commercial Paper | 35% | 5%2 | Highest short-term rating category4(A-1/P-1, or equivalent)  | 270 Days |
| Bankers’ Acceptances | 10% | 5%2 | Highest short-term rating category4(A-1/P-1, or equivalent)  | 180 Days |
| Negotiable Certificates of Deposits | 25% | 5%2 | Highest short-term4 or one of the three highest long-term rating categories(A-1/P-1, A-/A3 or equivalent)  | 5 Years |
| Collateralized Bank Deposits | 50% | 25% | None, if fully insured or collateralized. | 2 Years |
| Insured Bank Deposits | 25% | FDIC limit for insurance | None, if fully FDIC-insured. | 2 Years |
| Repurchase Agreements | 50% | 50% | Counterparty (or if the counterparty is not rated by a Nationally Recognized Statistical Rating Organization "NRSRO", then the counterparty’s parent) must be rated in the highest short-term rating category(A-1/P-1, or equivalent)  | 90 days |
| Money Market Funds | 75% | 50% | AAAm | N/A |
| Fixed-Income Mutual Funds & ETFs | 40% | 20% | N/A | N/A |

Notes:
1 Denotes minimum rating by at least two SEC-registered Nationally Recognized Statistical Rating Organization ("NRSRO"), unless otherwise noted.
2 Maximum across all non-government permitted investment sectors (excluding treasuries, U.S. federal agencies and government sponsored enterprises) is 5% combined per issuer.
3 Maximum exposure to any one federal agency is 35%.
4 Short-term ratings apply to securities with maturities of under one year.

SECURITY DOWNGRADES

In the event that any security held in the Short Term investment fund is downgraded below the minimum required credit rating for purchase, the Investment Advisory Committee shall require the external investment advisor to notify the Committee, in writing, within five business days after the security fails to meet the credit quality limitations.

PROHIBITED INVESTMENTS

The following are not permitted for investments without prior approval of the Investment Advisory Committee:

* Trading for speculation
* Derivatives (other than callables and traditional floating or variable-rate instruments)
* Mortgage-backed interest only structures (I/Os)
* Inverse or leverage floating-rate and variable-rate instruments
* Currency, equity, index, and event linked notes (e.g. range notes) or other structures that could return less than par at maturity
* Convertible, high yield and non-U.S. denominated debt
* Short sales
* Use of leverage
* Futures and options
* Equities, commodities, currencies and hard assets

**COLLATERALIZATION OF BANK DEPOSITS**

The System requires that all cash and other bank deposits maintained in any financial institution be either insured or collateralized, including bank deposits and non-negotiable certificates of deposit. All bank deposits of the System in excess of the amount protected by federal deposit insurance shall be collateralized in accordance with State of Arkansas laws and regulations.

REPORTING

The external investment advisor shall prepare a monthly portfolio report including: (i) a listing of the existing portfolios in terms of investment securities, amortized book value, maturity date, yield-on-cost, market value, credit ratings, and other features deemed relevant and (ii) a listing of all transactions executed during the month.

The external investment advisor shall prepare and submit to the Investment Advisory Committee a "Quarterly Investment Report" that summarizes (i) recent market conditions, economic developments, and anticipated investment conditions, (ii) the investment strategies employed in the most recent quarter, (iii) a description of all securities held in investment portfolios at month end, (iv) the total rate of return for the quarter and year-to date versus appropriate benchmarks, and (v) any areas of policy concern warranting possible revisions to current or planned investment strategies. The market values presented in these reports will be consistent with GASB account guidelines pertaining to the valuation of investments and the treatment of unrealized gains/losses.

GLOSSARY OF TERMS:

* + **Accrued Interest:** Interest earned, but which has not yet been paid or received.
	+ **Ask Price:** Price at which a broker/dealer offers to sell a security to an investor. Also known as "offered price."
	+ **Amortized Book Value:** The recorded amount of a security, adjusted for any applicable amortization of premium or discount. Eventually, once all amortization has been recorded, the amortized value of a security will equal its face value.
	+ **Arbitrage Rebate Regulations:** The Internal Revenue Code of 1986 requires that certain earnings on investments of tax-exempt bond proceeds be paid to the United States. The amount that must be rebated is based on the difference between the amount actually earned on investments and the amount that would have been earned if those investments had a yield equal to the yield on the issue.
	+ **Bankers’ Acceptance:** A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.
	+ **Benchmark:** A comparative base for measuring the performance or risk tolerance of the investment portfolio. A benchmark should represent a close correlation to the level of risk and the average duration of the portfolio’s investments.
	+ **Bid Price:** Price at which a broker/dealer offers to purchase a security from an investor.
	+ **Bond:** Financial obligation for which the issuer promises to pay the bondholder (the purchaser or owner of the bond) a specified stream of cash flows including periodic interest payments and a principal repayment.
	+ **Broker:** Brings buyers and sellers together for a commission.
	+ **Broker-Dealer:** A person or firm in the business of buying and selling securities, operating as both a broker and a dealer, depending on the transaction. A brokerage acts as a broker (or agent) when it executes orders on behalf of clients, whereas it acts as a dealer (or principal) when it trades for its own account.
	+ **Certificate of Deposit (CD):** A time deposit with a specific maturity evidenced by a Certificate. Large-denomination CDs are typically negotiable.
	+ **Collateral**: Securities, evidence of deposit or other property, which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.
	+ **Commercial Paper:** An unsecured promissory note with a fixed maturity no longer than 270 days. Public offerings are exempt from SEC regulation.
	+ **Corporate Notes:** Unsecured promissory notes issued by corporations to raise capital.
	+ **Counterparty:** The other party in a two party financial transaction.
	+ **Counterparty Risk**: Refers to the risk that the other party to a transaction will fail in its related obligations. For example, the bank or broker dealer in repurchase agreement.
	+ **Credit Risk:** Potential that a borrower or counterparty will fail to fulfill an obligation.
	+ **Custodial Bank:** A firm that holds securities and other assets in electronic or physical form for safekeeping so as to minimize the risk of their theft or loss.
	+ **Dealer:** A firm in the business of buying and selling securities for their own account. A dealer is defined by the fact that it acts as principal in trading for its own account, as opposed to a broker who acts as an agent in executing orders on behalf of its clients.
	+ **Delivery versus Payment:** Delivery of securities with an exchange of money for the securities.
	+ **Depository Bank:** A for-profit or non-profit financial organization that takes money from clients and places it in any of a variety of deposit or investment vehicles for the benefit of both the client and the organization.
	+ **Derivatives:** A contract between two or more parties whose value is based on an agreed-upon underlying financial asset, index or security such as bonds, commodities, currencies, interest rates, market indexes and stocks.
	+ **Diversification:** Allocation investment funds among a variety of securities offering independent returns.
	+ **Duration:** A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years.
	+ **Federal Agency:** Government sponsored/owned entity created by the U.S. Congress, generally for the purpose of acting as a financial intermediary by borrowing in the marketplace and directing proceeds to specific areas of the economy considered to otherwise have restricted access to credit markets, also referred to as government sponsored enterprises or GSEs. The largest are Ginnie Mae, Fannie Mae, Freddie Mac, Federal Home Loan Banks, Federal Farm Credit Bank and Tennessee Valley Authority.
	+ **Federal Deposit Insurance Cooperation (FDIC):** Federal agency that insures deposits at commercial banks, currently to a limit of $250,000 per depositor per bank.
	+ **Financial Industry Regulatory Authority (FINRA):** A self-regulatory organization under the Securities Exchange Act of 1934, which is responsible for regulatory oversight of all securities firms that do business with the public.
	+ **Floating Rate Security (FRN or "floater"):** A bond with an interest rate that is adjusted according to changes in an interest rate or index. Differs from variable-rate debt in that the changes to the rate take place immediately when the index changes, rather than on a predetermined schedule. See also "Variable Rate Security."
	+ **Foreign Notes:** A debt security issued by a national government denominated in a foreign currency or U. S. dollars.
	+ **Government Accounting Standards Board (GASB):** A non-profit organization that establishes generally accepted accounting principles (GAAP) for state and local governments in the United States.
	+ **Government Securities:** An obligation of the U.S. government, backed by the full faith and credit of the government. These securities are regarded as the highest quality of investment securities available in the U.S. securities market. See "Treasury Bills, Notes, and Bonds."
	+ **Government Sponsored Enterprise (GSE):** A financial services corporation created by the United States Congress. Their intended function is to enhance the flow of credit to targeted sectors of the economy and to make those segments of the capital market more efficient and transparent, and to reduce the risk to investors and other suppliers of capital.
	+ **Instrumentality:** An organization that serves a public purpose and is closely tied to a federal and/or state government, but is not a government agency. Many instrumentalities are private companies, and some are chartered directly by state or federal government.
	+ **Investment Adviser:** A company that provides professional advice managing portfolios, investment recommendations and/or research in exchange for a management fee.
	+ **Investment Adviser’s Act of 1940:** Legislation passed by Congress in 1940 that requires all investment advisers to register with the Securities and Exchange Commission. The Act is designed to protect the public from fraud or misrepresentation by investment advisers.
	+ **Liquidity:** The ability of ease with which an asset can be converted into cash without a substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be transacted at those quotes.
	+ **Local Government Investment Program (LGIP):** An investment by local governments in which their money is pooled as a method for managing local funds.
	+ **Long-Term Credit Rating:** Probability factor of a security issuer going into default over a long time frame.
	+ **Market Value:** The price at which a security is trading and could presumably be purchased or sold.
	+ **Master Repurchase Agreement:** A written contract covering all future transactions between the parties to repurchase-reverse repurchase agreements that establishes each party’s rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller borrower.
	+ **Maturity:** The date upon which the principal or stated value of an investment becomes due and payable.
	+ **Money Market Fund:** An investment whose objective is to earn interest for shareholders while maintaining a net asset value (NAV) of $1 per share. A money market fund's portfolio is comprised of short-term (less than thirteen months to maturity) securities representing high-quality, liquid debt and monetary instruments. Rules related to the management of money market funds will change in 2016; subsequently, not all money market funds will maintain a NAV of $1.
	+ **Municipal Obligations:** A form of debt obligation issued by states, provinces, cities or towns, typically used to fund municipal and local projects.
	+ **Mutual Fund:** Portfolio of securities professionally managed by a registered investment company that issues shares to investors. Many different types of mutual funds exist (e.g., bond, equity, and money market funds); all except money market funds operate on a variable net asset value (NAV).
	+ **Nationally Recognized Statistical Rating Organization (NRSRO):** A credit rating agency which issues credit ratings that the U.S. Securities and Exchange Commission (SEC) permits other financial firms to use for certain regulatory purposes. Several examples include Moody’s Investor Service, Standard & Poor’s and Fitch Ratings.
	+ **Net Assets:** The total assets of a business minus its total liabilities.
	+ **No-Load:** A mutual fund which does not levy a sales charge on the purchase of its shares. Transaction fees will still apply.
	+ **Offer:** The price at which a seller is willing to sell a security.
	+ **Open End:** A type of mutual fund that does not have restrictions on the amount of shares the fund will issue. If demand is high enough, the fund will continue to issue shares no matter how many investors there are. Open-end funds also buy back shares when investors wish to sell.
	+ **Portfolio:** Collection of securities held by an investor.
	+ **Primary Dealer:** A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.
	+ **Prudent Investor Standard:** Standard that requires that when investing, reinvesting, purchasing, acquiring, exchanging, selling or managing public funds, a trustee shall act with care, skill, prudence and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. It is more stringent than the "prudent person" standard as it implies a level of knowledge commensurate with the responsibility at hand.
	+ **Rate of Return:** The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond or the current income return.
	+ **Repurchase Agreement (RP or Repo):** An agreement under which the holder of securities sells these securities to an investor with a commitment to repurchase the securities at a fixed price on a fixed date. The security’s "buyer" in effect lends the "seller" money for the period of the agreement, and the terms of the agreement are structured to compensate him for this.
	+ **Safekeeping:** A service rendered by banks for a fee whereby securities and valuables of all types and descriptions are held by the bank for protection.
	+ **SEC Rule 15C3-1:** See "Uniform Net Capital Rule."
	+ **Securities and Exchange Commission (SEC):** Agency created by Congress to protect investors in securities transactions by administering securities legislation.
	+ **Short Term Rating:** Probability factor of an issuer of debt going into default within a year.
	+ **Third-Party Safekeeping:** A custodial arrangement where investment securities are held by a firm that is not otherwise a party to the transaction (i.e. broker, dealer, portfolio manager) or affiliated with a party to the transaction.
	+ **Total Return:** Investment performance measured over a period of time that includes coupon interest, interest on interest, and both realized and unrealized gains or losses. Total return includes, therefore, any market value appreciation/depreciation on investments held at period end.
	+ **Treasury Bills:** A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months or one year.
	+ **Treasury Bonds:** Long-term, coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.
	+ **Treasury Notes:** Medium-term, coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.
	+ **Uniform Net Capital Rule:** Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.
	+ **Yield:** The rate of annual income return on an investment, expressed as a percentage. Income/current yield is obtained by dividing the current dollar income by the current market price for the security. Net yield or yield to maturity is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.