

**University of Maine System
Operating Funds
Statement of Investment Guidelines
September 19, 2008**

INTRODUCTION

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 University of Maine System's (UMS) operating funds. This pool of funds excludes the assets of the endowment fund, planned giving funds and pension funds. The Board has delegated to the Treasurer responsibility for overseeing its operating funds investment program in accordance with the provisions of this policy.

OBJECTIVES

- To enable UMS to meet its financial obligations.
- To produce an annual income stream that will help offset the expenses associated with the unrestricted operating budget.
- To achieve investment returns that reflect the highest level of income and appreciation consistent with liquidity needs, minimum required returns, and preservation of capital. While total return is secondary to liquidity and safety, funds that do not need to be liquid, as determined by cash flow projections, may be invested to maximize overall portfolio returns within specific guidelines.

PROCEDURE

The portfolio's assets will be invested primarily with external investment management firms, either via commingled 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/consulting experience, performance, quality and experience of personnel, service, compliance procedures, references and fees.

The investment performance of the overall portfolio will be reported monthly by the Treasurer's staff and evaluated on a risk-adjusted basis relative to a blend of market indices that reflect the asset composition of the portfolio.

Quarterly and annual reports will also be provided to the Investment Committee that reviews the performance, current investment strategy, asset allocation and investment manager mix of the portfolio. At the discretion of the Treasurer, the portfolio or manager may be reviewed by the Investment Committee.

TEMPORARY INVESTMENT INCOME STABILIZATION FUND

The temporary investment income stabilization fund will help steady the fiscal resources of the UMS. When investment income exceeds budget, management will allocate a portion of the excess income to the stabilization fund at levels management feels is adequate. This fund will be used to maintain budgeted levels when the performance of the operating cash fund does not produce a sufficient annual income stream.

PORTFOLIO DIVERSIFICATION AND PERMISSIBLE INVESTMENTS

The operating cash investment portfolio will be stratified into a minimum of three separate tiers. The tiers reflect portfolios with different effective durations, sectors, credit quality and/or asset classes. The amounts invested in each pool will fluctuate based on liquidity needs and the seasonal fluctuations in UMS cash balances.

1. Tier 1: – The purpose of this pool is to meet the day-to-day obligations of the University, including payroll and accounts payable. It consists of funds that will be needed, at a minimum, within a one-month period, 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 daily to 3-day liquidity. The average quality of the portfolio will be at least “AA”.
2. Tier 2: – The purpose of this tier is to provide a secondary source of liquidity and additional return in the event the cash pool is insufficient to meet the University’s short-term needs. This pool consists of funds that will, in general, not be needed for 1-36 months, yet have the ability to transition into liquid assets with little to no forewarning. This tier is invested in a diversified portfolio, and includes items such as, but not limited to fixed income securities, FDIC insured or adequately collateralized CDs, or in short to intermediate term bond funds with a normal average duration of 1 to 3 years. The Intermediate pool may invest in securities or funds rated from B to Aaa quality, with a maximum of 10% below Baa and in private placements determined by the manager to be of similar credit quality. The overall average quality rating of this pool will be at least “A-”.
3. Tier 3 – Exists to provide a flow of financial support to University programs, and to provide a source of funds in the unlikely event the cash and intermediate pools are insufficient to meet the University’s day-to-day obligations. Consists of funds that will not be required for at least 36 months. Assets should be diversified both by asset class and within asset classes (e.g., by economic sector, industry, quality and size) in order 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.

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.

POOL ALLOCATION

	<u>Minimum</u>	<u>Target</u>	<u>Maximum</u>	<u>Risk Tolerance</u>
Tier 1	10%	25%	100%	Low
Tier 2	0%	35%	90%	Low-Moderate
Tier 3	0%	40%	60%	Moderate

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, the PIMCO Short-Term Fund Investment is benchmarked against the Citigroup 3-month T-bill 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 in all market conditions over the course of an interest rate cycle, while assuming benchmark-like risk.

Individual manager performance will normally be evaluated over an interest rate cycle, but 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 this statement of investment policy.
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:

- Produce periodic short-term and long-term cash flow forecasts.
- 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.
- Negotiate investment manager and custodial agreements, if applicable.
- Provide internal monthly reports on asset allocation and performance to the Treasurer. Provide quarterly and annual reporting to the Investment Committee. Monitor performance in relationship with benchmarks and investment guidelines.
- Gather and review research on appropriate investment opportunities.
- Rebalance as deemed prudent.

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.

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.

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.

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.

INTERNAL LOANS

A portion of the operating funds portfolio consists of loans to the universities in the System to fund large expenditures.