

System-wide Policy: BT0020 - Investment Policies and Procedures	
Version: 2	Effective Date: 11/02/2018

BOARD OF TRUSTEES
INVESTMENT POLICIES AND PROCEDURES

I. INTRODUCTION AND SCOPE

The purpose of this document is to identify various policies and procedures that provide for a prudent and efficient investment program evidencing that the University's endowed assets are invested with care, skill, and diligence. Accordingly, it is intended that this policy cover all funds and investment activities for University of Tennessee funds subject to long-term investment. For purposes of this statement, University of Tennessee Foundation endowment accounts established after July 1, 2002 and invested as part of the Consolidated Investment Pool will be administered consistent with these policies. A separate Treasury Policy has been articulated for short-term investment of University operating funds. There are three categories of funds of The University of Tennessee which are subject to long-term investment, namely Endowment Funds, Quasi-Endowment Funds, and Life Income Funds. The definition and sources of such funds are as follows:

- A. Definition and Source of Endowment Funds: Endowment Funds are funds received by the University from gifts, grants, and bequests for which the donors have stipulated, as a condition of the gift, that the principal of the fund be maintained and invested for the purpose of producing income to be applied to uses as specified in the gift instrument.

- B. Definition and Source of Quasi-Endowment Funds: Quasi-Endowment Funds are funds which the Board of Trustees, rather than a donor, has determined are to be retained and invested. Since these funds are internally restricted, the Board retains the right to alter or amend such designation. Such funds primarily represent gifts or bequests to the University for which the donor(s) have not designated a specific use, or has specified optional uses, and which the Board has

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determined should be administered in the same manner as endowment funds.

- C. Definition and Source of Life Income Funds: Life Income Funds represent funds held in trust by the University under agreements with donors whereby designated beneficiaries receive specified interests in the annual income of such trusts. Upon the death of the beneficiaries or other termination of the trust, such trust assets then become available to the University for use as set forth in each agreement. These agreements usually take the form of charitable remainder unitrusts or charitable remainder annuity trusts.

II. INVESTMENT POLICY BACKGROUND

The charter of the Finance and Administration Committee, approved by the Board, provides that the Committee shall recommend to the Board, or to the Executive Committee when necessary between meetings of the Board, action or necessary policies relating to investment of University funds. Various statements of investment policies and procedures have been formalized and approved by the Board over time with this being the latest statement. A brief history of the development of investment policies includes the following summary points.

- The Finance and Administration Committee, with Board approval, delegated the administration of the investment program to the University Treasurer with support from an advisory group. Day-to-day investment authority has been delegated to the Treasurer who is charged with oversight of investment managers, security settlements, and security safekeeping.
- Investment objectives differ depending upon whether the funds invested are Life Income Funds or Endowment Funds and further whether the endowment funds are separately invested or part of the

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University Consolidated Investment Pool. In July 1954, the University adopted the policy of investing Endowment and Quasi-Endowment funds over which it had full investment discretion (on which the donor, the governing gift instrument or other considerations did not require or warrant separate investments) in the Consolidated Investment Pool. This pooling of investments affords closer supervision of the investment portfolio and makes available to all eligible Endowment and Quasi-Endowment Funds, regardless of size, the advantages of participation in a diversified portfolio of investments.

- The University of Tennessee as a state-supported institution, receives very few endowment funds on which donors designate the income for general operational support. The majority of endowment income is designated for scholarships, fellowships, and other academic support.
- In 1981, the University restructured the Consolidated Investment Pool portfolio to gain broader exposure to capital markets including non-traditional assets. Effective in late 1993, the University formally adopted the “total return” approach to investment management for the Consolidated Investment Pool which calls for the allocation of a prudent portion of realized endowment return to meet designated current year expenditures. A “total return” approach allows the investment portfolio to be structured for maximum return within accepted risk parameters but without current yield constraints.

III. INVESTMENT PROGRAM ADMINISTRATION

Jurisdiction of the investment of University funds is under the Finance and Administration Committee of the Board of Trustees, which makes recommendations to the Board on matters requiring Board action. Prior to each regularly scheduled Board meeting, the Finance and Administration Committee shall review the investment report provided by the Treasurer and

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recommend any actions as appropriate. The Finance and Administration Committee shall, at each regularly scheduled Board meeting, report its findings and recommendations, if any, to the Board for such actions as the Board deems appropriate.

- A. Investment Advisory Council: The University Investment Advisory Council (IAC) shall consist of no more than eight (8) members, with four (4) being ex-officio members based upon positions held and the other four appointed by the Chair of the Finance and Administration Committee of the Board of Trustees for three-year staggered terms and one renewal. The ex-officio members are (1) Chair of the Finance and Administration Committee of the Board of Trustees or a Committee member designated by the Committee Chair, in which case the designated Committee member shall serve as, or appoint, the Chair of the Investment Advisory Council; (2) the University Treasurer, (3) the University Chief Financial Officer; and (4) the Chair of the Board of Directors of the UT Foundation or designee. The Investment Advisory Council shall serve as an advisory group to the University President and staff for the investment program, its policies and investment strategy, including asset allocation and risk tolerance. The appointed members of the Investment Advisory Council should have a sound understanding of the financial concepts, familiarity with the challenges facing institutional investment portfolios, and experience guiding long-term investment policies and strategy in public and private markets. The Investment Advisory Council will adopt a charter that establishes a clear understanding of the philosophy and the investment objectives of the University of Tennessee consolidated investment pool. This document will further describe the duties and the standards that will be utilized by the Investment Advisory Council in developing, maintaining and monitoring investment performance criteria.
- B. Investment Objectives: While investment objectives for funds subject to long-term investment vary widely depending upon the type of fund,

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in most instances, objectives are based upon an extended time horizon and set over a full market cycle or rolling ten-year period. Intergenerational equity is the term most often used to articulate the investment objective of perpetual-styled funds, meaning that the real value of those funds are not diminished with the passage of time or generations. Summarized below are the investment objectives for each type of funds.

Life Income Funds -- Each Life Income Agreement is a separately invested entity requiring detailed accounting to reflect specific compliance with terms of the trust and applicable federal regulations. The investment objectives as reflected in such agreements vary widely since they are affected by the age, income levels, and needs of the beneficiaries as well as the motives and objectives of the donor. Trusts that require a periodic payment of an annuity, set dollar amount or percentage of market value at defined measurement dates, are invested for total return. Total return consists of two elements: current yield and capital appreciation. For these trusts, asset allocation and portfolio risk are determined after considering the investment time horizon, required payout, and ability to preserve and enhance the real value of trust corpus. Other trusts, usually "net income trusts", are invested to maximize current yield so as to satisfy, to the extent possible, trust income requirements.

Separately Invested Endowments -- The University is obligated to observe scrupulously any investment requirements or limitations imposed by donors of a fund, to the extent it is legal to do so. In such instances, the Treasurer has limited investment discretion and to meet the specified obligations, handles each such fund as a separately invested entity with unique investment objectives. Some endowments are funded with illiquid assets that cannot be pooled. The practice in those instances is to treat them as separately invested until such time as the asset can be sold and the proceeds pooled.

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Consolidated Investment Pool -- The basic investment objectives of the University’s Consolidated Investment Pool are to (1) preserve the principal of the funds, (2) achieve a moderate growth in the principal of funds to offset to some extent the effects of inflation, and (3) produce a reasonable current income return. Within these objectives, the investment performance goals for management of the Consolidated Investment Pool, as measured by a rolling ten-year time period, are to earn a compound annual return equal to or greater than spending + inflation + administrative fees (CPI+5.5%); have component asset classes outperform comparable indices; and outperform similar funds average nominal returns. Moderate volatility in the principal value of the portfolio will not significantly impact the current income distributions, and therefore the portfolio should be designed to emphasize the total return of the fund. It is recognized that returns are cyclical and will vary by assets depending on economic, political, and monetary conditions. To capture the highest level of return with an acceptable level of risk, the investment portfolio shall be balanced to include a wide range of qualified assets. Accordingly, the University has formally adopted a “total return” approach to investment management which calls for the distribution of a prudent portion of realized investment gains in addition to current income.

- C. Operation of the Consolidated Investment Pool: To provide more efficient and effective managerial review and control of the investment portfolio and to make available to all eligible endowment and quasi-endowments, regardless of size, the advantages of participation in a diversified portfolio of investments; the University maintains the Consolidated Investment Pool (Pool) in which each contributing endowment participates in the income and capital appreciation of the Pool on a per-share basis commensurate with its contribution.
 - 1. Procedures: The usual procedure is for new funds available for investment to be admitted to the Pool at the end of each month.

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The assets of the Pool are valued at current market prices as of the month-end valuation date and the current per-share value of the Pool determined. New endowments or additions to existing endowments, which are added to the Pool, are based on the number of shares represented by the transaction amount divided by the current per-share value. This number of shares increases the total number of shares of the Consolidated Investment Pool. Appropriate adjustments are made for shares outstanding only a fractional part of the quarter. Quarterly, deficits resulting from spending plan distributions in excess of dividend and interest income are funded from realized investment gains in the Pool. Portfolio investment management fees, consulting fees, custodial and safekeeping fees, and a University administrative fee are considered costs of the Pool and accordingly covered by annual transfers from the Pool. The administrative fee charged to the Pool for accounting and development activities will be one hundred basis points of the previous calendar year-end Pool market value.

2. Eligible Securities: The following types of securities will be eligible investments for inclusion in the Pool:
 - a. Global common and preferred stocks and convertible securities, including pooled investments in these securities;
 - b. Stock and bond options and future contracts that are used exclusively as hedging tools or to facilitate effective cash management;
 - c. Private capital partnerships (international or domestic), hedge fund partnerships, or other similarly focused private capital funds;
 - d. Global fixed-income or other debt securities;

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- e. Real estate investments (pooled and direct);

Not more than five percent of the portfolio (at cost) should be invested in the securities of any one issuer with the exception of the U.S. treasury and government agencies.

IV. CUSTODY AND TRANSFER OF SECURITIES

- A. Custody: The Treasurer is charged with the responsibilities of receipt, custody and proper handling of securities and other University funds in accordance with policies established by the Board of Trustees. In order to provide efficient handling of security transactions, the Board of Trustees has authorized the appointment of custodian bank(s) for keeping safely all University securities entrusted to its care by the Treasurer of the University, and appointed said bank(s) as attorney-in-fact to render certain service functions in connection with said securities. It is standard practice for custodians of securities owned by institutional investors to utilize the services of securities depositories. Such practice simplifies the settlement process for securities transactions, improves the timeliness of income collection, and provides other efficiencies to the securities custodian function. The contractual arrangements for custodial services permit custodians of University securities to utilize such depository services.

- B. Transfer of Securities: Securities held by custodian banks may be transferred upon instructions of the University Treasurer's Office in compliance with transfer specifications approved by the Treasurer. Direct transfer of ownership of securities standing in the name of the University shall be accomplished by delivery of such securities accompanied by a stock power or bond power assignment form executed by the Treasurer or General Counsel of the University. Such assignment form shall bear the corporate seal of the University (if required) and to which must be attached a certification of corporate

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authorization to transfer executed by the Secretary of the University bearing the same date as the assignment form.

V. INVESTMENT RECORDS AND REPORTS

The Treasurer shall be responsible for maintaining or causing to be maintained the following investment records of all University investments.

- A. Detailed Investment Records: The Treasurer's Office shall maintain or cause to be maintained for the current fiscal year and six prior years, detailed records of all University investments and investment transactions. Quarterly reports will be prepared reflecting detailed fiscal year-to-date transactions and ending book and market value balances on each investment by asset and fund classification including separately invested funds. An inventory report will be maintained detailing where each investment asset of the University is safe kept.
- B. Treasurer's Annual Report: The annual financial report of the Treasurer for each fiscal year shall contain detailed schedules of all stocks and bonds owned by the University. These schedules shall set forth the number of shares or face amount, book value of the investments, and the market or appraised value of the investments as of the report date.
- C. Treasurer's Investment Report: The Treasurer shall prepare an annual report on the University's investment program for the Finance and Administration Committee. This report will include detailed information on the overall investment program with comparative investment performance results for the year.

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