

# COLLEGE OF MICRONESIA - FSM RESERVES FUND

## INVESTMENT POLICY STATEMENT



Adopted: February 2015

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## EXECUTIVE SUMMARY

Name of Fund                              College of Micronesia - FSM Reserves Fund

Current Market Value:                 \$2.92 Million (as of December 31, 2014)

Planning Time Horizon:                 Greater than 5 years.

Expected Return:                         Nominal rate of 5.60%.

Asset Allocation:

	<u>Lower Limit</u>	<b><u>Strategic Allocation</u></b>	<u>Upper Limit</u>
<u>U.S. Equities</u>	10%	<b>20%</b>	30%
<i>Large Value</i>		10%	
<i>Large Growth</i>		10%	
<u>Non-U.S. Equities</u>	0%	<b>10%</b>	20%
<i>Mature Markets</i>		10%	
<u>Fixed Income</u>	40%	<b>50%</b>	60%
<i>Core U.S. Bond</i>		50%	
<u>Cash &amp; Equivalents</u>	10%	<b>20%</b>	30%

Evaluation Benchmark:    10%    RUSSELL 1000 VALUE INDEX  
                                   10%    RUSSELL 1000 GROWTH INDEX  
                                   10%    MSCI EAFE INDEX  
                                   50%    BC INTERMEDIATE GOVT/CREDIT INDEX  
                                   20%    90-DAY TREASURY BILL

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## I. STATEMENT OF PURPOSE

The purpose of this Investment Policy Statement (IPS) is to assist the College of Micronesia - FSM Board of Regents (“Regents”) and its Investment Committee (“Committee”), in effectively supervising, monitoring and evaluating the investment of the College of Micronesia - FSM Reserve Fund (“Fund”). The Fund’s investment program is defined in the various sections of the IPS by:

- Stating in a written document the Regents’ attitudes, expectations, objectives and guidelines in the investment of all Fund assets.
- Setting forth an investment structure for managing all Fund assets. This structure includes various asset classes, investment management styles, asset allocation, and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return over the long-term.
- Providing guidelines for each investment portfolio that controls the level of overall risk and liquidity assumed in that portfolio so that all Fund assets are managed in accordance with stated objectives.
- Encouraging effective communications between the Regents, the Committee, the investment consultant (Consultant), and the investment managers.
- Establishing formalized criteria to monitor, evaluate and compare the performance results achieved by the investment managers on a regular basis.
- Complying with all fiduciary, prudence and due diligence standards that experienced investment professionals would be subject to.

This IPS has been arrived at upon consideration by the Regents of the financial implications of a wide range of policies, and describes the prudent investment process that the Regents deem appropriate.

## II. STATEMENT OF OBJECTIVES

The objectives of the Reserves Fund have been established in conjunction with a comprehensive review of the current and projected financial requirements. The objectives are:

- To defray the operational expenses and other special needs of COMFSM.
- To maximize return within reasonable and prudent levels of risk in order to minimize the dependency upon contributions.
- To exceed earnings assumptions as set forth in the IPS.
- To control costs of administering the Fund and managing the investments.

The Regents will carry out their duties as fiduciaries with the goal of achieving the established objectives with the realization that the Fund is faced with an uncertain funding stream, which may inhibit or delay the achievement of these objectives.

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### III. SPENDING POLICY/CASH FLOW EXPECTATIONS

The Board currently has no specific projected distribution requirements for the Fund. However, in anticipation of such an eventuality, the Fund will be invested in such a way that adequate funds can be made available within a short period of time should need arise.

### IV. SOCIAL RESPONSIBILITY POLICY

The College of Micronesia-FSM demonstrates its concern for preservation of the environment and other social causes through its programs and activities. However, no specific constraint in regards to social causes is to be placed on its investment portfolio at this time. Constraints can be added in the future as deemed advisable by the Regents.

### V. POLICY ON CONFLICTS OF INTEREST

Article V. Statement of Ethical Conduct in the Board of Regents Bylaws shall govern all decisions concerning investment of the College's Reserves Fund.

### VI. GUIDELINES AND INVESTMENT POLICY

#### **Time Horizon**

The investment guidelines are based upon an investment horizon of five years, so that interim fluctuations should be viewed with appropriate perspective. Similarly, the Fund's strategic asset allocation is based on this short-term perspective.

#### **Liquidity**

To minimize the possibility of a loss occasioned by the sale of a security forced by the need to meet a required payment, the Regents will periodically provide Investment Management Consultant with an estimate of expected net cash flow. The Regents will notify the Investment Management Consultant in a timely manner, to allow sufficient time to build up necessary liquid reserves.

To maintain the ability to deal with unplanned cash requirements that might arise, the Regents requires that a minimum of twenty (20) percent of Fund assets shall be maintained in cash or cash equivalents.

#### **Risk Tolerances**

The Regents recognize the difficulty of achieving the Fund's investment objectives in light of the uncertainties and complexities of contemporary investment markets. The Regents also recognize that some risk must be assumed to achieve the Fund's investment objectives. However, it is the intent to monitor the risk being assumed by each individual Investment Manager and by the Fund as a whole. To that end, risk will be evaluated by:

- Over a market cycle, risk associated with any Investment Managers portfolio, as measured by the variability of quarterly returns (standard deviation) must not exceed that of the Investment Manager's respective performance benchmark, without a commensurate increase in return.

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- Over a market cycle, risk associated with the total Fund, as measured by the variability of quarterly returns (standard deviation) must not exceed that of the blend of indices representing the strategic asset allocation of the Fund, without a commensurate increase in return.
  - During market cycles the risk measures, as indicated herein, will be reviewed at least annually by the Regents.

### **Performance Expectations**

The desired investment objective is a short-term nominal rate of return on assets that is at least equal to a 5.6% nominal rate of return after deducting for advisory, money management, and custodial fees as well as transaction costs (assumed to approximate 1%). The target rate of return for the Fund has been based upon the assumption that future real returns will approximate the long-run rates of return experienced for each asset class in the IPS.

It is acknowledged that the specified rate of return may not be achievable each and every year. It is the objective of the COMFSM Reserves Fund to meet this objective over a complete market cycle.

The investment objective of the Fund is to strive for positive real rates of return. As inflation statistics are more readily available for the United States than for the FSM, the U.S. Consumer Price Index (CPI) will be used when determining the real rate of return.

Each investment security utilized in the management of the Fund must have a competitive market rate of return if it is to be included in the Fund.

The Regents realize that market performance varies and that a 5.6% nominal rate of return may not be meaningful during some periods. Accordingly, relative performance benchmarks for the managers are set forth in Appendix B.

Over a complete market cycle, the Fund's overall annualized total return, after deducting all investment related costs, should perform above a customized index comprised of market indices weighted by the strategic asset allocation of the Fund.

### **Asset Allocation Constraints**

The Regents believe that the Fund's risk and liquidity posture are, in large part, a function of asset class mix. The Regents have reviewed the long-term performance characteristics of various asset classes, focusing on balancing the risks and rewards inherent in the marketplace.

Four asset classes were selected:

1. U.S. Equities
2. Non-U.S. Equities
3. U.S. Fixed Income
4. Cash & Equivalents

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Based on the Fund's time horizon, risk tolerances, performance expectations, and asset class preferences, an efficient or optimal portfolio was identified (Appendix A).

*Re-balancing of Strategic Allocation*

The percentage allocation to each broad-asset class may vary as much as plus or minus 10% of target.

When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation of the Fund. The allocation of the Fund will be reviewed quarterly.

If the Investment Committee upon review with the Consultant, judges cash flows to be insufficient to bring the Fund within the strategic allocation ranges, the Regents shall be promptly informed and an appropriate course of action recommended. The Regents will then determine the appropriate course of action to be taken. The investment managers will then be instructed to execute such action required to bring the strategic allocation within the pre-specified ranges.

## **VII. SECURITIES GUIDELINES**

Every investment manager selected to manage Fund assets must adhere to the following guidelines.

**General:**

- Any pertinent restrictions existing under the laws of the Federated States of Micronesia with respect to the Fund, that may exist now or in the future, will be the governing restriction.
- U.S. and Non-U.S. equities, ADRs (American Depository Receipts), convertible bonds, preferred stocks, fixed-income securities, mutual funds and short-term securities are permissible investments.
- No individual security of any issuer, other than that of the United States Government, shall constitute more than 10% (at cost) of the Total Fund or any Investment Manager's portfolio.
- Holdings of any issuer shall constitute no more than 5% of the outstanding securities of such issuer.
- Investments in a registered mutual fund managed by the Investment Manager are subject to the prior approval of the Regents.
- The following securities and transactions are not authorized: letter stock and other unregistered securities; and, non-negotiable securities. Commodities or other commodity contracts; short sales; margin transactions; options; and, futures are restricted, except by petition to the Regents for approval.

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**Equities:**

- Consistent with the desire to maintain broad diversification, allocations to any economic or industry sector should not be excessive.
- Equity holdings shall be restricted to readily marketable securities of corporations that are actively traded on the major exchanges and over the counter.
- The investment managers shall have the discretion to invest a portion of the assets in cash reserves when they deem appropriate. However, the investment managers will be evaluated against their peers on the performance of the total funds under their direct management.
- Common stock and preferred stock of any institution or entity created or existing under the laws of the United States or any other country are permissible investments.

**Fixed Income:**

- All fixed income securities held in the portfolio shall have a Moody's, Standard & Poor's and/or a Fitch's credit quality rating of no less than "BBB". U.S. Treasury and U.S. Government agencies, which are unrated securities, are qualified for inclusion in the portfolio and will be considered to be of the highest rating.
- Total portfolio quality (capitalization weighted) shall maintain an "A" minimum rating.

**Cash/Cash Equivalents:**

- Cash equivalent reserves shall consist of cash instruments having a quality rating of A-1, P-1 or their equivalent. U.S. Treasury and Agency securities, Bankers Acceptances, Certificates of Deposit, and Collateralized Repurchase Agreements are also acceptable investment vehicles. Custodial Sweep Accounts must be, in the judgment of the investment managers, of credit quality equal or superior to the standards described above.
- In the case of Certificates of Deposit, they must be issued by FDIC insured institutions. Deposits in institutions with less than \$10,000,000 in assets may not be made in excess of \$100,000 (or prevailing FDIC insurance limit), unless the Deposit is fully collateralized by U.S. Treasury Securities.
- No single issue shall have a maturity of greater than two (2) years.
- Custodial Sweep Account portfolios must have an average maturity of less than one (1) year.

**VIII. SELECTION OF INVESTMENT MANAGERS**

The Regents, with the assistance of the Consultant, will select appropriate investment managers to manage Fund assets. Investment managers must meet the following minimum criteria:



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- Be a bank, insurance company, investment management company, or investment adviser as defined by the Investment Advisers Act of 1940.
  - Provide historical quarterly performance numbers calculated on a time-weighted basis, based on a composite of all fully discretionary accounts of similar investment.
  - Provide detailed information on the history of the firm, key personnel, key clients, fee schedule, and support personnel.
  - Clearly articulate the investment strategy that will be followed and document that the strategy has been successfully adhered to over time.
  - Must have been continuously engaged as an investment manager for five (5) or more years.
  - Must have least Two Hundred Million dollars under management.
  - Assets that are to be placed in an investment management organization shall not exceed 20% of the organization's total asset under management.
  - Selected firms shall have no outstanding legal judgments or past judgments, which may reflect negatively upon the firm.

#### **IX. SELECTION OF CONSULTANT**

The Regents will select an appropriate investment management consulting firm to assist in the prudent investment and monitoring of the Fund. The Consultant must meet the following minimum criteria:

- The Consultant must be a Registered Investment Advisor (RIA) registered with the Securities Exchange Commission.
- Consultants must be recognized as expert in investment management consulting, with an emphasis in institutional/endowment funds.
- Consultant must be able to provide unbiased fiduciary and financial advice to the Fund. Consultant must be willing to acknowledge, in writing, its fiduciary capacity and liabilities associated with it.
- Consultants must demonstrate experience in the breadth and depth of their professional staff. The specific individual providing advice to the Fund must provide evidence of specialized training in the field of Investment Management Consulting, such as the Certified Investment Management Analyst (CIMA) designation, or its equivalent.
- The specific individual providing advice to the Fund shall not have any awards or judgments against him or her either by the Securities Exchange Commission (SEC) or the National Association of Securities Dealers (NASD).
- Consultant must maintain its own independent investment manager database and have its own investment manager due diligence capabilities, as well as its own investment performance monitoring system to ensure quality and accuracy of data and which tasks should not have to be either subcontracted out or purchased from third party vendors.

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## X. CONTROL PROCEDURES

### **Duties and Responsibilities of the Investment Managers**

The duties and responsibilities of each investment manager retained by Regents include the following:

- Exercising investment discretion over the Fund assets under its care, custody and/or control in accordance with the IPS objectives and guidelines set forth herein.
- Promptly informing the Regents in writing regarding all significant and/or material matters and changes pertaining to the investment of Fund assets, including, but not limited to:
  - a. Investment strategy
  - b. Portfolio Structure
  - c. Tactical approaches
  - d. Ownership
  - e. Organizational structure
  - f. Financial condition
  - g. Professional staff
  - h. Recommendations for guideline changes
  - i. All material, legal, SEC and other regulatory agency proceedings affecting the firm.
- Promptly voting all proxies and related actions in a manner consistent with the long-term interests and objectives of the Fund set forth herein.
- Utilize the same care, skill, prudence and due diligence under the circumstances then prevailing that experienced, investment professionals acting in a like capacity and fully familiar with such matters would use in like activities for like reserve funds with like aims in accordance and compliance with all applicable laws, rules and regulations from local, state and federal and international political entities as it pertains to fiduciary duties and responsibilities.

### **Duties and Responsibilities of the Consultant**

The duties and responsibilities of the consultant retained by the Regents include, but are not limited to, the following:

- Assist in the development of investment strategies for Fund's assets;
- Analyze existing investments;
- Assist with asset allocation;
- Assist in the IPS development/ongoing review;
- Provide investment manager search services;
- Monitor the performance of Fund assets, and investment managers;
- Provide educational forms, as requested;
- Provide quarterly on-site reviews;
- Assist with special projects.

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## **Performance Objectives**

Investment performance will be reviewed at least quarterly to determine the continued feasibility of achieving the investment objectives and the appropriateness of the IPS for achieving those objectives.

It is not expected that the IPS will change frequently. In particular, short-term changes in the financial markets should not require adjustments to the IPS.

## **Monitoring of Investment Managers**

On a timely basis, but not less than four times a year, the Regents will meet to focus on:

- Investment manager's adherence to the IPS guidelines;
- Material changes in the investment managers' organization, investment philosophy and/or personnel; and,
- Comparisons of investment manager performance to appropriate benchmarks.

The appropriate benchmarks in which to compare the investment managers' results are detailed under each investment manager's specific objectives and guidelines as presented in the Appendix B.

### *Performance Measurement Periods*

The measurement period for complete evaluation will be cumulative annual periods and complete market cycles. Market cycles will be loosely defined as periods of at least two consecutive quarters of rising stock prices/interest rates and two consecutive quarters of declining stock prices/interest rates.

Quarterly performance will be evaluated to test progress toward the attainment of longer-term targets. It is understood that there are likely to be short-term periods during which performance deviates from market indices. During such times, greater emphasis shall be placed on *peer*-performance comparisons with investment managers employing similar styles.

The Regents will utilize the services of an independent third party consulting firm to assist in their evaluation and complete performance measurement duties.

The performance of the Fund's investment managers will be monitored on an ongoing basis and it is at the Regents' discretion to take corrective action by replacing an investment manager if they deem it appropriate at any time.

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## College of Micronesia - FSM Reserves Fund - Appendix A

### Investment Manager Structure and Style Review

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Based on a formal asset allocation study initially conducted in 2014, the Regents and Committee, with the assistance from the Fund's Consultant, identified an optimal asset mix based on the Fund's time horizon, risk tolerances, performance expectations, and asset class preferences. The following strategic asset allocation for the Reserve Fund was selected:

The Regents further augmented the diversification of the Fund by implementing the strategic asset allocation with complementary styles of asset management. The Regents has reviewed the characteristics of various styles of investment management, focusing on balancing the risks and rewards of style behavior. The Regents specifically noted how investment styles go in and out of favor and the Regents understands the prudence of diversifying among several styles of investment management. The following strategic asset allocation and the specific investment manager structure for each broad asset class are listed below:

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	<u>Lower Limit</u>	<u>Strategic Allocation</u>	<u>Upper Limit</u>
<u>U.S. Equities</u>	10%	<b>20%</b>	30%
<i>Large Value</i>		10%	
<i>Large Growth</i>		10%	
<u>Non-U.S. Equities</u>	0%	<b>10%</b>	20%
<i>Mature Markets</i>		10%	
<u>Fixed Income</u>	40%	<b>50%</b>	60%
<i>Core U.S. Bond</i>		50%	
<u>Cash &amp; Equivalents</u>	10%	<b>20%</b>	30%

**College of Micronesia - FSM Reserves Fund-Appendix A (Continued)**  
**Investment Manager Structure and Style Review**

**STRATEGIC ASSET ALLOCATION - SUMMARY**

Report Prepared for COM-FSM Reserves

ASSET ALLOCATION SUMMARY					
	Current Portfolio	Proposal 1	Proposal 2	Proposal 3	Proposal 4
Cash	100.0%	30.0%	20.0%	10.0%	20.0%
<b>Total Cash</b>	<b>100.0%</b>	<b>30.0%</b>	<b>20.0%</b>	<b>10.0%</b>	<b>20.0%</b>
US Fixed Income		60.0%	50.0%	40.0%	20.0%
<b>Total Bonds</b>		<b>60.0%</b>	<b>50.0%</b>	<b>40.0%</b>	<b>20.0%</b>
US Large Cap Growth Equity		2.5%	10.0%	17.5%	15.0%
US Large Cap Value Equity		2.5%	10.0%	17.5%	15.0%
Developed International Equity		5.0%	10.0%	15.0%	30.0%
<b>Total Equities</b>		<b>10.0%</b>	<b>30.0%</b>	<b>50.0%</b>	<b>60.0%</b>
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

  

FORECASTED STATISTICS					
	Current Portfolio	Proposal 1	Proposal 2	Proposal 3	Proposal 4
Return	2.7%	4.4%	5.6%	6.8%	7.2%
Volatility	0.6%	2.8%	4.9%	7.6%	8.9%
Sharpe Ratio	0.00	0.60	0.59	0.54	0.51
Probability < 0%	0.0%	5.9%	12.5%	18.0%	20.4%
Yield	2.7%	3.6%	3.4%	3.2%	2.8%

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**College of Micronesia – FSM Reserves Fund – Appendix B**  
Investment Manager Performance Objectives

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*Management Style:*                    **Large Cap Value**

*Performance Benchmark:*        Russell 1000 Value Index

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*Manager Style:*                    **Large Cap Growth**

*Performance Benchmark*        Russell 1000 Growth Index

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*Management Style:*                **International Developed Markets Equity**

*Performance Benchmark:*        MSCI EAFE Index

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*Management Style:*                **Core Fixed Income**

*Performance Benchmark:*        BC Intermediate Government/Credit Index

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*Management Style:*                **Cash & Equivalents**

*Performance Benchmark:*        90-Day Treasury bill

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