

2021

NC State University Associated Entity Operating Cash and Short-term Investments Policy Statement



Approved as of TBD

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I. Introduction

The purpose of this policy is to provide guidelines for the investment of operating cash and short-term operating investments for Associated Entities (Entity) at North Carolina State University. Specifically, this policy is directed to cash and short term operating investments that are held specifically for operating purposes and not invested in the long-term pool. This policy delegates responsibility for the execution of this investment policy to the University Treasurer who oversees the department, Foundations Accounting and Investments, which includes the two offices: Office of Investments and the Associated Entity Office. The policy establishes overall goals and objectives; identifies permitted investment securities/funds, and provides investment guidelines for the cash reserves. There are separate investment policies and guidelines for the NC State Investment Fund and the NC State Investment Fund's Intermediate Term Pool.

NC State's associated entities rely on operating cash to fund operations, pay continuing obligations, and build rainy day funds. Therefore, the investment of operating cash and short-term operating funds is focused on the most prudent methods of generating supplemental income while preserving principal. In this investment policy, we seek to balance these two objectives—invest in high credit quality instruments and generate income, while limiting duration, credit, sector, and counterparty risk. Limiting duration helps to reduce interest rate risk—the likelihood that movements in interest rates will affect the net asset value of investments in the program. To achieve the portfolio's objectives of protection and income, permitted investments may be moved among different investment types, while always maintaining cash sufficient for annual operations. It has been a long standing practice to ensure at least one year of operating reserves is in place for each Associated Entity.

II. Governance and Oversight

Governance

While this investment policy is approved by the governing board of the Associated Entity, or the specific committee authorized to act on behalf of the Board, the authority to manage the investments, in accordance with this investment policy, is delegated to each Entity's Treasurer or in cases where the University Treasurer is not the Associated Entity's Treasurer, to its Assistant Treasurer. The Treasurer, or Assistant Treasurer, approves investments based on staff recommendations, but further delegates the authority to execute and manage those investments in accordance with the procedures and permitted investments identified in, and consistent with, this policy. For clarity, the delegates include staff in the two offices under the Treasurer's direction: Office of Investments and the Associated Entity Office.

A. Role of the Associated Entity Board

The Associated Entity Board (or its relevant committee) is responsible for approving the Investment Policy and ensuring that management implements the policy. The Board, or its committee, is also responsible for approving subsequent amendments to the policy. The committee charged with monitoring investment results and adherence with the policy will ensure the policy and any amendments are clear and prudent with respect to the preservation of principal, and still allows for the possibility of reasonable returns. The Board is also responsible for attending meetings where investment information is presented, asking reasonable questions, and holding reasonable investment performance expectations.

The Board is responsible for regularly reviewing the investment performance of operating cash held for short-term investment, including the performance of Investment Manager(s) to assure the investment policy is being followed and progress is being made toward achieving the stated objectives.

B. Role of the Treasurer and Delegates

The following offices (delegates), under the direction of the University Treasurer, shall provide Investment Services and Administrative Services to the Associated Entities for the investment of operating cash and short-term investments for operations. These offices are the Office of Investments and the Associated Entity Office, and the services they provide to the Entities include without limitation:

1. The Office of Investments is responsible for the following investment services:

- a. Identifying and recommending new investment managers and opportunities to the Treasurer for consideration;
- b. Evaluating the performance of the Entity's operating cash and short-term investment managers, monitoring the assets under management and, from time to time recommending additional allocations to or withdrawals from managers;
- c. Engaging in regular, ongoing communications with external investment managers of operating cash investments in accordance with due diligence policies and procedures;
- d. Making recommendations to the Board, with respect to changes to investment objective and/or asset allocation guidelines;
- e. Conducting operational due diligence on new and existing investment managers;
- f. Ensuring legal due diligence is completed for new investment managers;
- g. Providing summarized quarterly performance reports from individual managers and providing quarterly investment reports for Board meetings;
- h. Reviewing monthly reports of the operating cash's performance and assets;
- i. Reporting in a timely manner any substantive developments that may affect the management of the assets.

2. The Associated Entities Office is responsible for the following administrative services:

- a. Performing a monthly cash analysis to determine the amount of operating cash available for each Entity to invest;
- b. Monitoring/recording/validating ownership and performance of the operating cash and short-term investment
- c. Establishing (and periodically reviewing and updating) accounting systems and internal controls relevant to operating cash holdings;
- d. Communicating with investment managers to obtain accurate and timely performance information;
- e. Retaining copies of manager performance reports, board reports, and accounting records in compliance with prudent record retention requirements;
- f. Executing and monitoring contracts for services with consultants, custodians, third party administrators, and investment managers;
- g. Preparing reports for the Associated Entity board or committee meetings;

In all investment decisions, including, without limitation, the purchase, sale, exchange or retention of assets, the determination of asset allocations, and the exercise of rights, options, and privileges incident to asset ownership, the Treasurer shall have full authority to act solely upon the direction and approval of the Board.

C. Ethics and Disclosures of Conflicts of Interest

The Code of Ethics and Conflicts of Interest Policy applies to the Treasurer, Board and staff involved in the investment and approval process in the selection and management of operating cash investments. Periodic disclosures shall be made about any significant interests that could directly or materially affect investment activity and performance.

Oversight

A. Selection of Investment Managers

The Treasurer and delegates will follow a process that embodies the principles of procedural due diligence in the selection of investment managers. They may retain a "prudent expert" (a bank, insurance company, or investment advisor as defined by the Registered Investment Advisors Act of 1940) to facilitate this process. In addition, when selecting investment managers, the Treasurer and delegates will:

1. Develop an investment manager candidate profile outlining the specific characteristics sought in the investment manager. Such criteria may include, but is not limited to:
 - a. Investment manager strategy and approach
 - b. Organizational Structure
 - c. Minimum and maximum assets under management
 - d. Client servicing capabilities
 - e. Performance criteria relative to an appropriate index and peer group
2. Analyze the investment manager candidates in terms of:
 - a. **Qualitative Characteristics**, such as key personnel, investment philosophy, investment strategy, research orientation, decision-making process, and risk controls.
 - b. **Quantitative Characteristics**, such as Global Investment Performance Standard - compliant composite return data, investment performance over multiple time periods, performance volatility, risk-adjusted rates of return (e.g., Information Ratio), and certain portfolio characteristics.
 - c. **Organizational Factors**, such as assets under management, ownership structure, client servicing capabilities, and fees.

The selection process shall conform to any specific requirements in this policy with a desire of achieving the required objectives of this policy. The Treasurer and delegates may use investment consultants or other professionals not responsible for the specific selection of managers to assist in the development of requirements, screening criteria, and analysis of potential investment manager responses to solicitations.

B. Guidance for Corrective Action

Corrective action may be taken by the Treasurer as a result of the on-going due diligence review process of the Investment Manager(s) and based on recommendations of the delegates responsible for overseeing individual managers. While there may be unusual occurrences at any time, the following are instances where corrective action or termination may be in order and any such changes will be reported back to the board at its next meeting:

1. Major organizational changes at a firm may require a new contract and interview process. Failure on the part of the manager to notify the Treasurer of such changes is grounds for termination. At all times, communication with the manager should be easy and informative.
2. Violation of terms of contract constitutes grounds for termination.
3. It is critical that the investment manager adhere to the original intent of the Treasurer at the time they are engaged. Should either the Treasurer or delegates ascertain that significant changes in investment approach or investment contract have occurred, this may be grounds for immediate termination.
4. The Treasurer will not, as a rule, terminate the manager(s) on the basis of short-term performance, unless such performance is inconsistent with similar market strategies. If the organization is sound and the firm is adhering to its style and approach, the Treasurer will allow a sufficient interval of time, six to 12 months, over which to evaluate performance. The manager's performance will be viewed in light of the firm's particular style and approach, keeping in mind at all times the investment program's diversification strategy, as well as the overall quality of the relationship.
5. Manager(s) may be replaced at any time as part of the overall restructuring of the portfolio.

III. Investment Objectives

Operating cash and short term investments held for operating purposes play a strategic role in the annual operations of an Associated Entity. Ensuring adequate liquidity is paramount, but the generation of additional income is also important in achieving key strategic initiatives. Key investment objectives are to:

1. Preserve capital
2. Provide liquidity for the Associated Entities annual operating budget
3. Provide increased levels of diversification
4. Optimize the use and investment of the Entities cash and short-term investments
5. Earn rates of return that consistently exceed money market rates of return over time to generate incremental resources for the Entity

IV. Risk Management

The primary risk management goal under this policy is to oversee an investment program that prevents investments loss of principal by predominantly investing in high quality investments with short maturities. Additionally, the investment program seeks broad diversification of individual securities by security type, financial institutions, and corporations, while remaining consistent with the investment objectives for the program.

V. Performance Benchmarks

1. Earn a rate of return in excess of the State of North Carolina Treasurer's Short-Term Investment Fund ("STIF")
2. Earn a rate of return in excess of appropriate market-based indexes that represent the asset classes and duration of the underlying investments in a constructed portfolio

VI. Guidelines for Investments

To achieve the portfolio objectives, short-term investments may be moved among a three-tier investment structure, while always maintaining cash sufficient for annual operations. The percentage allocation to each type of investment may vary depending upon market conditions and the Entity's cash needs.

In addition, the investment program may invest in Exchange Traded Funds (ETF), Managed Accounts, or Mutual Funds. The use of pooled funds (e.g., ETF's, commingled funds, mutual funds, common trust funds, etc.) is permitted when it is deemed to be in the best interest of the Entity. These investment vehicles may have investment guidelines that are different than those described in this policy Statement. Mutual Fund guidelines will supersede the guidelines of this policy Statement.

Tier 1 assets

The primary investment objective of tier one investments is to be able to meet the daily operational needs of the Foundation(s) at an optimal yield while protecting the safety of the principal at an appropriate investment risk. Due to the difficulty inherent in accurately forecasting each Entities cash flow requirements, a portion of the investment program shall be continuously invested in readily available funds such as the State Treasurer's Short Term Investment Fund (STIF), other money market mutual fund, or bank deposits to ensure that appropriate liquidity is maintained to meet ongoing obligations. The Treasurer does not control the asset allocation policy, asset selection, or manager selection of the STIF, as that fund is directed solely under the Office of the State Treasurer.

Tier 2 assets

The investment objective of Tier 2 investments is to optimize yield and serve as a rainy day fund for Tier 1 funds as needed. These assets may be invested in longer duration investments, with low to moderate levels of risk while still protecting principal. Funds are generally placed in the Intermediate Term Fund if these reserves are not needed for operational purposes for three to five years. The asset allocation policy, asset selection, and manager selection of the Intermediate Term Fund is solely directed by the Board of Directors of the NC State Investment Fund. However, other permitted investments (outlined in the table below) include permitted investments outlined in the table below.

Tier 3 assets

A portion of operating assets may not be needed within a three to five year time horizon and can be considered to be long term assets of the entity. These assets may be invested as quasi-endowments in the NC State Investment Fund on a commingled basis with a primary goal of capital appreciation and are specific to each Entity. The asset allocation policy, asset selection, and manager selection of the NC State Investment Fund is solely directed by the Board of Directors of the NC State Investment Fund. These tier 3 assets produce spendable endowment income for the organization's annual operating budget.

VII. Permitted Investments

Permitted investments for tier 1 and 2 assets (not otherwise invested in the ITF or NCSIF) include direct investments in the following publicly traded securities listed below, or in the holdings of external managers hired to invest on behalf of the Entity. All investments should be denominated in U.S. dollars.

1. **United States Treasury & Government Guaranteed** – United States Treasury obligations, and obligations of which the principal and interest are backed or guaranteed by the full faith and credit of the United States Government.
2. **Federal Agency / Government Sponsored Enterprise (GSE) Debt** – Debt obligations, participations, or other instruments issued or fully guaranteed by any United States Federal agency, instrumentality, or GSE. Securities must be rated by a NRSRO in the highest short-term or one of the two highest long-term rating categories (at least A-1, AA- or equivalent).
3. **Foreign Government/Supranational Securities** – United States dollar denominated debt obligations issued or guaranteed by a foreign sovereign government or a multilateral organization of governments (supranational). Securities must be rated by a NRSRO in the highest long-term rating category (AAA or equivalent).
4. **Agency Mortgage-Backed Securities** – Mortgage-backed securities (MBS), backed by residential, multi-family, or commercial mortgages, that are issued or fully guaranteed as to principal and interest by a United States Federal agency or GSE. Securities must be rated by a NRSRO in the highest short-term or one of the two highest long-term rating categories (at least A-1, AA- or equivalent). MBS derivatives (IOs, POs, etc.) are specifically prohibited.
5. **Non-Agency Mortgage-Backed Securities** – MBS backed by residential, multi-family, or commercial mortgages. Securities must be rated by a NRSRO in the highest short-term or one of the two highest long-term rating categories (at least A-1, AA- or equivalent). MBS derivatives (IOs, POs, etc.) are specifically prohibited.
6. **Municipal Obligations** – Obligations issued or guaranteed by any state, territory, or possession of the United States, political subdivision, public corporation, authority, agency board, instrumentality, or other unit of local government of any United States state or territory. Securities must be rated by a NRSRO in the highest short-term or one of the three highest long-term rating categories (at least SP-1, A- or equivalent) or if longer term maturities in one of the three highest long term rating categories (AAA, AA, and A). For pre-refunded municipal obligations without a rating, the government rating will apply.
7. **Corporate Notes** – Corporate notes, bonds, or other debt obligations issued or guaranteed by a domestic or foreign corporation, financial institution, non-profit, or other entity. Securities must be rated by a NRSRO in one of the two highest short-term or one of the four highest long-term rating categories (at least A-2, BBB- or equivalent). Investment in corporate notes issued under Securities and Exchange Commission Rule 144A is permitted.
8. **Commercial Paper** – Commercial paper issued or guaranteed by a domestic or foreign corporation, company, financial institution, trust, or other entity. Securities must have a minimum rating of A-2 or the equivalent by a NRSRO. Investment in commercial paper issued under section 4(2) of the Securities Act of 1933 is permitted.
9. **Asset-Backed Securities (ABS)** – Obligations issued by bankruptcy-remote trusts, backed by regular cash flow payments from borrowings such as credit receivables, loans, and leases. Securities must be rated by a NRSRO in the highest short-term or the highest long-term rating categories (A-1, AAA or equivalent). Collateralized Debt Obligations are specifically prohibited.

10. **Bankers' Acceptances** – Bankers' acceptances issued, drawn on, or guaranteed by a United States bank or United States branch of a foreign bank. Securities must be rated by a NRSRO in the highest short-term rating category (A-1 or equivalent).
11. **Negotiable Certificates of Deposit and Bank Deposit Notes** – Negotiable certificates of deposit or bank deposit notes issued by banks organized under the laws of North Carolina or by national banks organized under the laws of the United States. Securities must be rated by a NRSRO in the highest short-term (for maturities of less than one (1) year) or one of the three highest long-term rating categories for maturities greater than one (1) year (at least A-1, A- or equivalent).
12. **Insured & Collateralized Bank Deposits & Local Banks** – Interest-bearing time certificates of deposit, money market deposit accounts, or demand deposit accounts, which are fully insured by the Federal Deposit Insurance Corporation (FDIC). Operating funds may be placed in local banks when the bank is the operating bank of the Entity.
13. **Repurchase Agreements** – Repurchase agreements that meet the following requirements:
 - a. Governed by a written SIFMA Master Repurchase Agreement which specifies securities eligible for purchase and resale, and which provides the unconditional right to liquidate the underlying securities should the counterparty default or fail to provide full timely repayment;
 - b. Counterparty is a Federal Reserve Bank, a primary dealer as designated by the Federal Reserve Bank of New York, a regional broker-dealer, or a nationally chartered commercial bank;
 - c. Counterparty is rated in one of the three highest long-term rating categories (at least A-1/P-1, A-/A3 or equivalent) by a NRSRO;
 - d. Securities underlying repurchase agreements are delivered to a third-party custodian under a written custodial agreement that must be deliverable or in tri-party form;
 - e. Acceptable underlying securities include only securities that are direct obligations of, or that are fully guaranteed by, the United States, an agency of the United States or a GSE, including United States Agency issued mortgage-backed securities;
 - f. Underlying securities must have an aggregate current market value, including accrued interest, of at least 102% of the purchase price plus current accrued price differential at the close of each business day;
 - g. The term of any repurchase agreement transaction will not exceed ninety (90) days.
14. **Government Money Market Funds** – Shares in open-end, no-load government 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 Entity or its investment manager shall obtain a copy of the fund's prospectus and review permitted investments, fees, and management structure. At no time shall the Entity own more than 10% of the total net assets of a mutual fund series.
15. **Fixed Income Mutual Funds and ETFs** – Shares in open-end, no-load fixed-income mutual funds or exchange-traded funds (ETFs) whose underlying investments would generally be permitted for purchase under this policy and all its restrictions. In such cases, the vehicles' prospectuses govern allowable investments.

VIII. Portfolio Diversification

The Entity's funds shall be diversified within and among permitted investments and issuers to avoid concentration, credit, interest rate, and duration risk. For US Government Agency MBS and CMOs, the maturity limit is thirty years; however, the weighted average life of the portfolio holdings of this sector allocation should not exceed ten years. The weighted-average (by market value) maturity of the entire portfolio (not including the NC State ITF fund) should, in general, not exceed three years, but other investments may have a duration of three to five years.

IX. Prohibited Investments

This Policy prohibits the Treasurer from engaging in any investment that would be considered speculative according to the principles of conservative investment management, whether or not that activity is specifically prohibited elsewhere in this Policy.

X. Securities Lending

With the exception of STIF, the Entities may not participate in a securities lending program.

