


MICHIGAN STATE
U N I V E R S I T Y

April 7, 2010

MEMORANDUM

To: Trustee Finance Committee

From: Fred L. Poston 

Subject: Revised Statement of Investment Objectives and Investment Guidelines

RECOMMENDATION

BE IT RESOLVED that the Trustee Finance Committee recommends that the Board of Trustees authorize the Administration to amend the Statement of Investment Objectives for Michigan State University's Pooled Cash Fund and Investment Guidelines, which are part of the University's Investment Policy, as set forth in the attachments hereto.

BACKGROUND

The purpose of the amendments to the Statement of Investment Objectives for the Pooled Cash Fund and Investment Guidelines, Exhibits B and C to the University's Investment Policy, are to revise the target amount for the Pooled Cash Fund. The Pooled Cash Fund would now consist of a Liquidity Pool equal to 30 days of operating cash and a Liquidity Reserve Pool equal to 45 days of operating cash. The target minimum amount for the combined Liquidity Pool and Liquidity Reserve Pool shall be the sum of (1) two times the Liquidity Pool's maximum historical net daily cash outflow, (2) three months of State appropriations, calculated using the sum of the University General Fund, Michigan Agricultural Experiment Station and MSU Extension appropriations from the State included in the University's Board-approved budget guidelines for that fiscal year, and (3) one-half of the total amount of tuition and fees collected for the most recently completed fall semester. Amounts in excess of the Pooled Cash Fund's targeted amount will be invested in the University's Common Investment Fund.

The current Statement of Investment Objectives was last revised December 5, 2008. The proposed Liquidity Pool and Liquidity Reserve Pool targets are based on the University's underlying operational liquidity needs instead of the former percentage of total allocation of the Overall Cash Pool.

Cambridge Associates and the Investment Advisory Subcommittee have reviewed and support the revisions.

cc: D. Brower, N. Carter, G. Klein, K. Lindahl



OFFICE OF THE
**VICE PRESIDENT
FOR FINANCE
AND OPERATIONS
AND TREASURER**

Fred L. Poston
Vice President

Michigan State University
412 Administration Building
East Lansing, MI
48824-1046

517/355-5014
FAX: 517/353-6772

Statement of Investment Objectives

Michigan State University's Pooled Cash Fund

Updated: (6/24/83, 2/3/89, 2/7/92, 6/10/94, 10/24/97, 12/8/00, 11/12/04, 12/5/08, 4/16/10)

INTRODUCTION

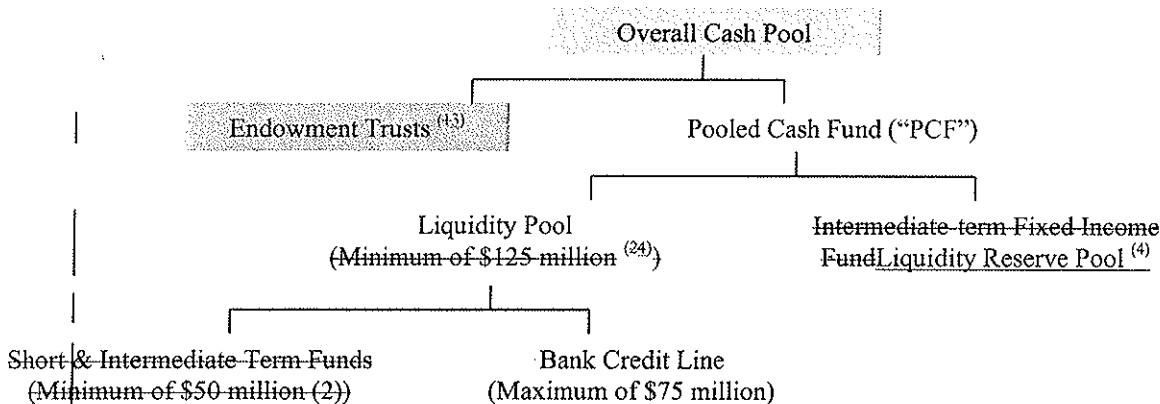
This statement sets forth the investment objectives of Michigan State University's Pooled Cash Fund ("PCF"), which is a subset of the University's overall cash pool. (See Figure No. 1.)

PCF ASSETS

The PCF has two components -- the Liquidity Pool and the ~~Intermediate-term Fixed Income Fund~~ Liquidity Reserve Pool. The Liquidity Pool shall be composed of short-term (less than one-year maturity) and intermediate-term (between one and three-year maturity, on average) commercially available funds and up to a \$75 million bank line of credit or its equivalent. (See Figure No. 1.) These funds shall be available on a daily basis. The target amount for the Liquidity Pool shall be 15% of the overall cash pool 30 days of operating cash ⁽¹⁾ (based on a 12-month average), subject to a minimum of \$125 million (12-month average). The minimum amount of short-term and intermediate-term funds in the Liquidity Pool shall be \$50 million (12-month average) with a \$75-million credit line.

The target amount for the Liquidity Reserve Pool shall be 45 days of operating cash ⁽¹⁾ (based on a 12-month average). ⁽²⁾ The minimum amount of the combined Liquidity Pool and Liquidity Reserve Pool shall be the sum of (1) two times the Liquidity Pool's maximum historical net daily cash outflow, (2) three months of State appropriations, calculated using the sum of the University General Fund, Michigan Agricultural Experiment Station and MSU Extension appropriations from the State included in the University's Board-approved budget guidelines for that fiscal year, and (3) one-half of the total amount of tuition and fees collected for the most recently completed fall semester.

**Figure No. 1
Structure of MSU's Overall Cash Pool**



(1) Operating cash equals operating expenses less depreciation as reported in MSU's Audited Financial Statements.
 (2) See also footnote 1 to Table No. 1 in the event the University employs a bank line of credit in the Liquidity Pool.
 (1)(3) Overall cash pool amounts in excess of the PCF targeted amount. Invested on a long-term basis with other Institutional Funds in the University's Common Investment Fund (CIF).
 (2) Minimum amounts are based on a 12-month average.

(4) The minimum amount of the combined Liquidity Pool and Liquidity Reserve Pool shall be the sum of (1) two times the Liquidity Pool's maximum historical net daily cash outflow, (2) three months of State appropriations, calculated using the sum of the University General Fund, Michigan Agricultural Experiment Station and MSU Extension appropriations from the State included in the University's Board-approved budget guidelines for that fiscal year, and (3) one-half of the total amount of tuition and fees collected for the most recently completed fall semester.

The target amount for the Intermediate-term Fixed-Income Fund shall be 25% of the overall cash pool (12-month average). Table No. 1 summarizes the target allocations for each component of the PCF.

Table No. 1 PCF Composition		
PCF Component	Target Allocation	
	Minimum Dollar Amount (\$ Millions)	(% of Overall Cash Pool) Target Amount
Liquidity Pool	<u>The sum of (1) two times the Liquidity Pool's maximum historical net daily cash outflow, (2) three months of State appropriations, calculated using the sum of the University General Fund, Michigan Agricultural Experiment Station and MSU Extension appropriations from the State included in the University's Board-approved budget guidelines for that fiscal year, and (3) one-half of the total amount of tuition and fees collected for the most recently completed fall semester.</u> \$125 ¹	15% ² 30 days of operating cash ⁽¹⁾
Intermediate-term Fixed-Income Fund Liquidity Reserve Pool	None Specified	25% 45 days of operating cash

1. Up to \$75 million of the \$125 million this amount may be represented by a bank line of credit, or its equivalent. Any Liquidity Pool target amount for which the bank line of credit would substitute would be retained in the PCF, thus increasing the Liquidity Reserve Pool target amount by the amount of the bank line of credit.
2. Subject to a minimum of \$125 million (\$50 million with a \$75 million credit line) in commercially available funds. Minimum amounts are based on a 12-month average.

INVESTMENT OBJECTIVES

The investment objectives for each component of the PCF are:

Liquidity Pool. The primary objective is to provide a liquid source of funds to meet the University's daily cash requirements. A secondary objective is to yield a competitive investment return while bearing minimal principal risk.

Intermediate-term Fixed-Income Fund Liquidity Reserve Pool. The primary objective is to provide a source of funds in the event the Liquidity Pool is insufficient to meet the University's cash needs. A secondary objective is to earn a higher investment return than the Liquidity Pool. Because of the very low likelihood that these funds would be needed to meet cash flow requirements, a greater degree of principal risk is acceptable in order to obtain a higher return.

SHORT-TERM PERFORMANCE GOALS

Short-term performance goals for each component of the PCF, and for individual managers, will be to outperform (if actively managed) net of fees appropriate market and peer benchmarks over rolling one, three

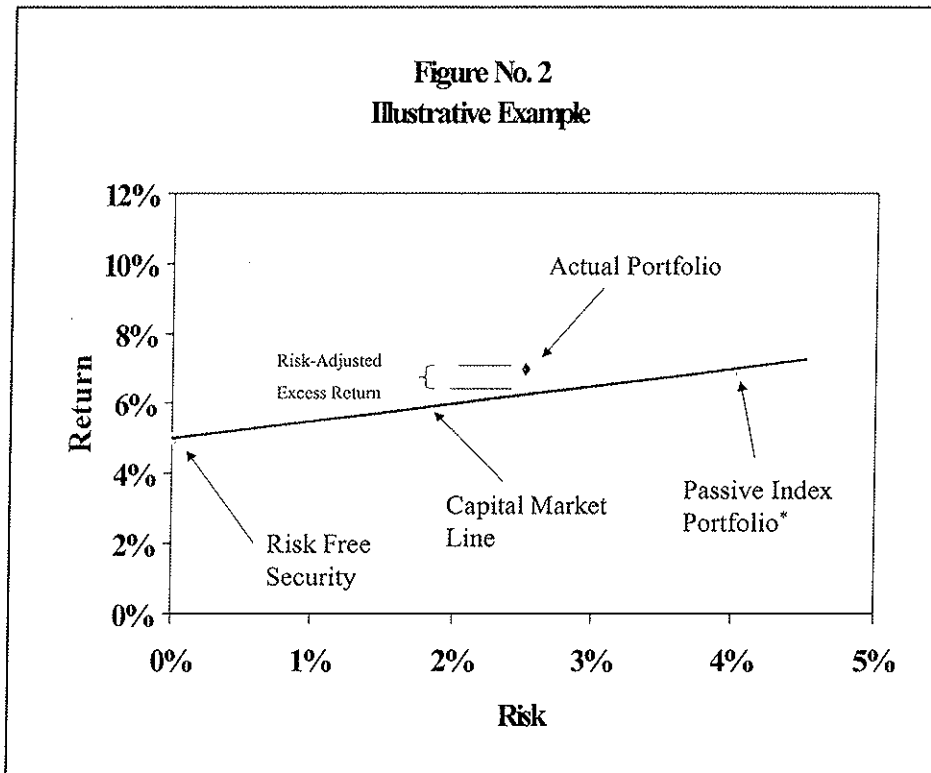
and five-year periods. Furthermore, adherence to the investment style for which individual managers were selected will also be monitored.

LONG-TERM PERFORMANCE GOALS

The following long-term performance goals of the PCF are expected to be achieved over a five-year period, measured on a five-year rolling basis.

- 1) A total annual return net of fees greater than the rate of inflation
 - a. plus 1.5% for the Liquidity Pool, and
 - b. plus 3.0% for the ~~Intermediate-term Fixed Income Fund~~ Liquidity Reserve Pool.
- 2) To the extent an actively managed strategy is used, a risk-adjusted, excess annual return net of fees greater than
 - a. -0.25% for the Liquidity Pool, and
 - b. 0.50% for the ~~Intermediate-term Fixed Income Fund~~ Liquidity Reserve Pool.

Risk-adjusted, excess return is defined as a portfolio's actual return less the capital market line return corresponding to the same risk level. (See Figure No. 2.)



*The passive index portfolio would be the appropriate fixed income benchmark index.

Table No. 2 lists the benchmark indices and long-term performance goals for each PCF component. Similarly, the long-term performance goal for each individual manager will be for it to contribute a risk-adjusted return corresponding to its respective component of the PCF.

Table No. 2
Benchmarks & Long-Term Performance Goals

PCF Component	Benchmark	Long-Term Performance Goals
Liquidity Pool	Merrill Lynch 1-3 year Treasury Index	If passive, benchmark. If active, risk-adjusted excess return of 0.25% after fees
Intermediate term Fixed Income Fund Liquidity Reserve Pool	Lehman Brothers Barclays Aggregate	If passive, benchmark. If active, risk-adjusted excess return of 0.50% after fees

INVESTMENT GUIDELINES

- 1) Liquidity Pool - Investment guidelines are provided in Exhibit C.
- 2) ~~Intermediate-term Fixed Income Fund~~ Liquidity Reserve Pool – Investment guidelines are provided in Exhibit C.
- 3) Additional guidelines may be adopted by separate Board action. They will be communicated to the affected investment managers.

Investment Guidelines

<u>Liquidity Pool</u>	<u>Intermediate-term Fixed Income Liquidity Reserve Pool</u>	<u>Common Investment Fund</u>			
Separately Managed Funds					
Permitted Securities					
<p>Marketable fixed income securities such as: U.S. government and agency issues; corporate debt; certificates of deposit; time deposits; repurchase and reverse repurchase agreements; mortgage-backed; asset-backed; securities issued under Rule 144A; dollar denominated U.S. and foreign issuers; derivatives for hedging purposes and creating portfolio risk profiles that could otherwise have been achieved using fixed income instruments authorized in these guidelines; commingled and global funds that invest in securities authorized in these guidelines.</p>	<p>Marketable fixed income securities such as: U.S. government and agency issues; U.S and non-U.S. corporate debt; certificates of deposit; time deposits; repurchase and reverse repurchase agreements; inflation indexed bonds; mortgage-backed; asset-backed; securities issued under Rule 144A; obligations of state and local governments and non-U.S. government and agency issues; derivatives for hedging purposes and creating risk portfolio profiles that could otherwise have been achieved using fixed income instruments authorized in these guidelines.</p>	<p>Marketable securities. Non-marketable securities may be held in the Inflation Hedge, Non-Marketable Investments and Absolute Return asset classes.</p>			
Diversification:					
<p>No more than 15% of the portfolio's market value may be invested in dollar denominated foreign securities of developed countries. No more than 10% of the portfolio's market value will be invested in (1) Rule 144A securities or (2) securities of any single issuer, except those which are obligations of, or fully guaranteed as to both principal and interest by, the U.S. government or its agencies.</p>	<p>No more than 10% of the portfolio's market value may be invested in securities below BBB. No more than 30% of the portfolio's market value may be invested in securities denominated in foreign currencies. No more than 10% of the portfolio's market value will be invested in securities of any single issuer, except those which are obligations of, or fully guaranteed as to both principal and interest by, the U.S. government or its agencies.</p>	<p>In accordance with asset allocation guidelines.</p> <p>Individual investment managers' guidelines at time of manager appointment or as later amended by agreement of both parties.</p>			
Fixed Income:					
Minimum Quality:					
Portfolio:					
AA	AA	AA			
Security (at purchase):					
Short-term	Long-term	Short-term	Long-term	Short-term	Long-term
A1/P1	BBB	A2/P2	B	A2/P2	BB
Maturity/Duration:					
<p>10 year maximum maturity of any security.</p>	<p>No maximum maturity of any security.</p>	<p>No maximum maturity of any security.</p>			
<p>3 year maximum average duration of the portfolio.</p>	<p>6 year maximum average duration of the portfolio.</p>	<p>6 year maximum average duration of the portfolio.</p>			
Commingled Funds: Funds' investment guidelines at time of manager appointment prevail.					

Statement of Investment Objectives

Michigan State University's Pooled Cash Fund

Updated: (6/24/83, 2/3/89, 2/7/92, 6/10/94, 10/24/97, 12/8/00, 11/12/04, 12/5/08, 4/16/10)

INTRODUCTION

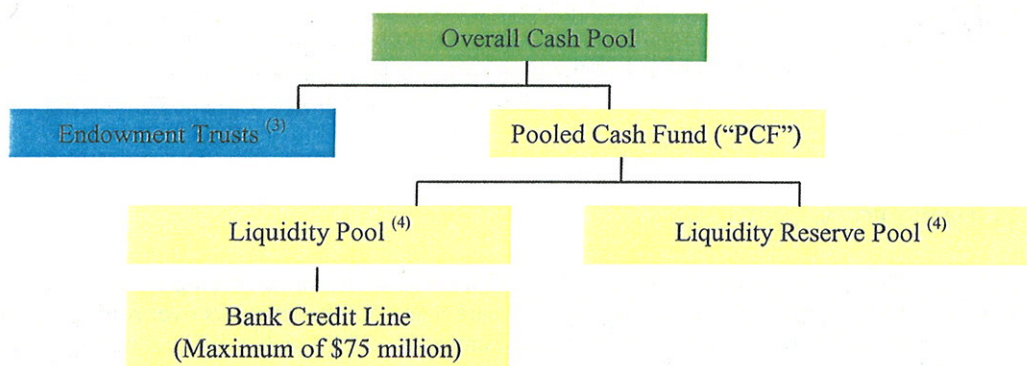
This statement sets forth the investment objectives of Michigan State University's Pooled Cash Fund ("PCF"), which is a subset of the University's overall cash pool. (See Figure No. 1.)

PCF ASSETS

The PCF has two components -- the Liquidity Pool and the Liquidity Reserve Pool. The Liquidity Pool shall be composed of short-term (less than one-year maturity) and intermediate-term (between one and three-year maturity, on average) commercially available funds and up to a \$75 million bank line of credit or its equivalent. (See Figure No. 1.) These funds shall be available on a daily basis. The target amount for the Liquidity Pool shall be 30 days of operating cash ⁽¹⁾ (based on a 12-month average).

The target amount for the Liquidity Reserve Pool shall be 45 days of operating cash ⁽¹⁾ (based on a 12-month average).⁽²⁾ The minimum amount of the combined Liquidity Pool and Liquidity Reserve Pool shall be the sum of (1) two times the Liquidity Pool's maximum historical net daily cash outflow, (2) three months of State appropriations, calculated using the sum of the University General Fund, Michigan Agricultural Experiment Station and MSU Extension appropriations from the State included in the University's Board-approved budget guidelines for that fiscal year, and (3) one-half of the total amount of tuition and fees collected for the most recently completed fall semester.

**Figure No. 1
Structure of MSU's Overall Cash Pool**



-
- (1) Operating cash equals operating expenses less depreciation as reported in MSU's Audited Financial Statements.
 - (2) See also footnote 1 to Table No. 1 in the event the University employs a bank line of credit in the Liquidity Pool.
 - (3) Overall cash pool amounts in excess of the PCF targeted amount. Invested on a long-term basis with other Institutional Funds in the University's Common Investment Fund (CIF).
 - (4) The minimum amount of the combined Liquidity Pool and Liquidity Reserve Pool shall be the sum of (1) two times the Liquidity Pool's maximum historical net daily cash outflow, (2) three months of State appropriations, calculated using the sum of the University General Fund, Michigan Agricultural Experiment Station and MSU Extension appropriations from the State included in the University's Board-approved budget guidelines for that fiscal year, and (3) one-half of the total amount of tuition and fees collected for the most recently completed fall semester.

Table No. 1 summarizes the target allocations for each component of the PCF.

Table No. 1 PCF Composition		
	Target Allocation	
	Minimum Amount	Target Amount
Liquidity Pool	The sum of (1) two times the Liquidity Pool's maximum historical net daily cash outflow, (2) three months of State appropriations, calculated using the sum of the University General Fund, Michigan Agricultural Experiment Station and MSU Extension appropriations from the State included in the University's Board-approved budget guidelines for that fiscal year, and (3) one-half of the total amount of tuition and fees collected for the most recently completed fall semester.	30 days of operating cash ⁽¹⁾
Liquidity Reserve Pool		45 days of operating cash

1. Up to \$75 million of this amount may be represented by a bank line of credit or its equivalent. Any Liquidity Pool target amount for which the bank line of credit would substitute would be retained in the PCF, thus increasing the Liquidity Reserve Pool target amount by the amount of the bank line of credit.

INVESTMENT OBJECTIVES

The investment objectives for each component of the PCF are:

Liquidity Pool. The primary objective is to provide a liquid source of funds to meet the University's daily cash requirements. A secondary objective is to yield a competitive investment return while bearing minimal principal risk.

Liquidity Reserve Pool. The primary objective is to provide a source of funds in the event the Liquidity Pool is insufficient to meet the University's cash needs. A secondary objective is to earn a higher investment return than the Liquidity Pool. Because of the very low likelihood that these funds would be needed to meet cash flow requirements, a greater degree of principal risk is acceptable in order to obtain a higher return.

SHORT-TERM PERFORMANCE GOALS

Short-term performance goals for each component of the PCF, and for individual managers, will be to outperform (if actively managed) net of fees appropriate market and peer benchmarks over rolling one, three and five-year periods. Furthermore, adherence to the investment style for which individual managers were selected will also be monitored.

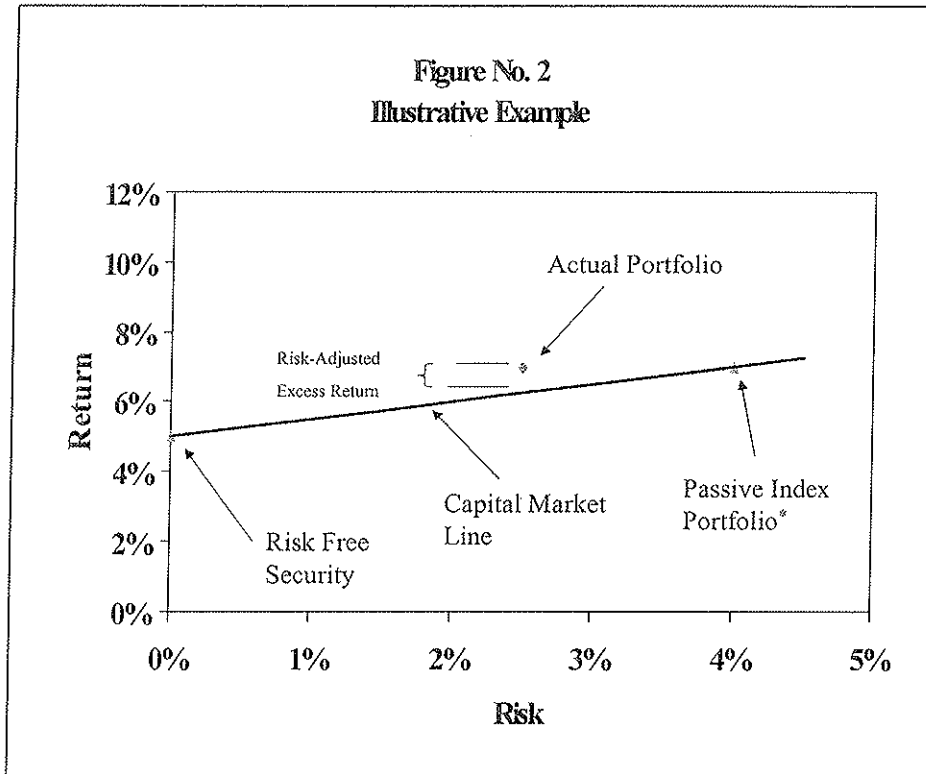
LONG-TERM PERFORMANCE GOALS

The following long-term performance goals of the PCF are expected to be achieved over a five-year period, measured on a five-year rolling basis.

- 1) A total annual return net of fees greater than the rate of inflation
 - a. plus 1.5% for the Liquidity Pool, and
 - b. plus 3.0% for the Liquidity Reserve Pool.

- 2) To the extent an actively managed strategy is used, a risk-adjusted, excess annual return net of fees greater than
- 0.25% for the Liquidity Pool, and
 - 0.50% for the Liquidity Reserve Pool.

Risk-adjusted, excess return is defined as a portfolio's actual return less the capital market line return corresponding to the same risk level. (See Figure No. 2.)



*The passive index portfolio would be the appropriate fixed income benchmark index.

Table No. 2 lists the benchmark indices and long-term performance goals for each PCF component. Similarly, the long-term performance goal for each individual manager will be for it to contribute a risk-adjusted return corresponding to its respective component of the PCF.

Table No. 2 Benchmarks & Long-Term Performance Goals		
PCF Component	Benchmark	Long-Term Performance Goals
Liquidity Pool	Merrill Lynch 1-3 year Treasury Index	If passive, benchmark. If active, risk-adjusted excess return of 0.25% after fees
Liquidity Reserve Pool	Barclays Aggregate	If passive, benchmark. If active, risk-adjusted excess return of 0.50% after fees

INVESTMENT GUIDELINES

- 1) Liquidity Pool - Investment guidelines are provided in Exhibit C.
- 2) Liquidity Reserve Pool -- Investment guidelines are provided in Exhibit C.
- 3) Additional guidelines may be adopted by separate Board action. They will be communicated to the affected investment managers.

Investment Guidelines

Exhibit C

<u>Liquidity Pool</u>	<u>Liquidity Reserve Pool</u>	<u>Common Investment Fund</u>			
Separately Managed Funds					
Permitted Securities					
<p>Marketable fixed income securities such as: U.S. government and agency issues; corporate debt; certificates of deposit; time deposits; repurchase and reverse repurchase agreements; mortgage-backed; asset-backed; securities issued under Rule 144A; dollar denominated U.S. and foreign issuers; derivatives for hedging purposes and creating portfolio risk profiles that could otherwise have been achieved using fixed income instruments authorized in these guidelines; commingled and global funds that invest in securities authorized in these guidelines.</p>	<p>Marketable fixed income securities such as: U.S. government and agency issues; U.S and non-U.S. corporate debt; certificates of deposit; time deposits; repurchase and reverse repurchase agreements; inflation indexed bonds; mortgage-backed; asset-backed; securities issued under Rule 144A; obligations of state and local governments and non-U.S. government and agency issues; derivatives for hedging purposes and creating risk portfolio profiles that could otherwise have been achieved using fixed income instruments authorized in these guidelines.</p>	<p>Marketable securities. Non-marketable securities may be held in the Inflation Hedge, Non-Marketable Investments and Absolute Return asset classes.</p>			
Diversification:					
<p>No more than 15% of the portfolio's market value may be invested in dollar denominated foreign securities of developed countries. No more than 10% of the portfolio's market value will be invested in (1) Rule 144A securities or (2) securities of any single issuer, except those which are obligations of, or fully guaranteed as to both principal and interest by, the U.S. government or its agencies.</p>	<p>No more than 10% of the portfolio's market value may be invested in securities below BBB. No more than 30% of the portfolio's market value may be invested in securities denominated in foreign currencies. No more than 10% of the portfolio's market value will be invested in securities of any single issuer, except those which are obligations of, or fully guaranteed as to both principal and interest by, the U.S. government or its agencies.</p>	<p>In accordance with asset allocation guidelines.</p> <p>Individual investment managers' guidelines at time of manager appointment or as later amended by agreement of both parties.</p>			
Fixed Income:					
Minimum Quality:					
Portfolio:					
AA	AA	AA			
Security (at purchase):					
Short-term	Long-term	Short-term	Long-term	Short-term	Long-term
A1/P1	BBB	A2/P2	B	A2/P2	BB
Maturity/Duration:					
<p>10 year maximum maturity of any security.</p>		<p>No maximum maturity of any security.</p>		<p>No maximum maturity of any security.</p>	
<p>3 year maximum average duration of the portfolio.</p>		<p>6 year maximum average duration of the portfolio.</p>		<p>6 year maximum average duration of the portfolio.</p>	
Commingled Funds: Funds' investment guidelines at time of manager appointment prevail.					