Public University Fund Investment Policy Amendments

BACKGROUND

During its October 21, 2016 meeting, the Board of Trustees was presented with amendments to the Public University Fund (PUF) Investment Policy that would divest the fund of current fossil fuel-related securities and restrict future investment of fund assets into fossil fuel-related securities.

After much discussion, the Board voted to postpone until its January 2017 meeting action on amendments to the PUF policy and directed the Finance & Administration Committee to develop and recommend a framework to the Board to guide its consideration of requests for investment policy changes. On December 1, 2016, the Finance & Administration Committee met to consider and provided comment on a draft framework for considering requests for changes in the university's investment policies. A revised framework will be considered for a recommendation to the Board at its January meeting.

PROPOSED CHANGES TO THE PUF INVESTMENT POLICY

As presented in October, the amendments to the Public University Fund investment policy would divest current Fund assets of fossil fuel-related securities and restrict future investment of assets into fossil fuel-related securities, specifically, the Carbon Underground's list of 200 global oil, gas and coal companies (C.U. 200). Exhibit A of Attachment 1 presents the amended Public University Fund Investment Policy with changes highlighted in underlined and strikethrough text. The amendments reflect the fossil fuel-related investment restrictions, portfolio changes to incorporate the investment restrictions, modifications to active management parameters to reduce variances to the benchmark, and formatting revisions to streamline the policy.

Because the Oregon Intermediate-Term Pool and Long-Term Pool policies do not restrict investment into the C.U. 200, a new separately managed account would be established by the Treasury to fulfill the fossil fuel-free mandate. To meet the revised investment policy guidelines, the Treasury will transfer the Fund's proportional share of securities, now held in the Oregon Intermediate-Term and Long-Term Pools, into the new separately managed account. Cash will be received for any securities held that appear on the current C.U. 200 list and reinvested into securities from approved sectors. The investment strategy for the new account will blend the strategies from the Oregon Intermediate-Term and Long-Term Pools into one core investment account that incorporates the fossil fuel-free security restriction. The maturity target for the underlying securities is between three and seven years, heavily weighted towards the three- to five-year maturities.

The liquidity allocation will remain invested in the Oregon Short-Term Fund. The Oregon Short-Term Fund is the primary cash investment option for multiple state agencies banking with Treasury, which precludes any request to restrict fossil fuel investments from this specific fund. While the Oregon Short-Term Fund investment policy does not restrict investment into fossil fuel related securities, the Treasury's fixed-income investment team has indicated there are no plans to purchase new securities from the energy or coal sector. The Oregon Short-Term Fund currently holds a 1.1% allocation in securities from the C.U. 200 list, which are scheduled to mature over the next 18 months. The present expectation is for the Oregon Short-Term Fund's fossil fuel securities allocation to decline to zero by March 2018.

The recommended PUF investment strategy is designed to reduce total fossil fuel exposure from 1.7% to 0.4%, resulting in a 75% reduction upon creation. The strategy includes anticipated future divestment from the remaining fossil fuel securities over the following 18 months, lowers annual investment fees by 13%, and is estimated to return a net income yield of 1.6%, comparable to the present investment strategy, as summarized in the following table.

Summary	Market Value	Est. Annual Income	Est. Yield	Annual Mgmt Fees	Invest. Mgmt. Fee Rate	Est. Net Income	Est. Net Income Yield	Fossil Fuel Market Value	Fossil Fuel Alloc.
PUF Portfolio (Avg Balance)	$ 515,900,000	$7,984,900	1.57%	$ 140,084	0.027%	$7,633,816	1.50%	$8,817,600	1.71%
Recommended Portfolio (Avg Balance)	$ 515,900,000	$7,984,900	1.57%	$ 121,728	0.024%	$7,652,172	1.50%	$2,171,400	0.42%

Estimates based upon data available in May 2016

DRAFT RESOLUTION

When the Board postponed action on the amendments to the PUF investment policy, trustees requested that this agenda item be brought forward for action by the Board at its January 2017 meeting, regardless of the status of the framework development. Nevertheless, the resolution in Attachment 1 was drafted to address many of the considerations listed in the draft framework that will go to the Finance & Administration Committee in January (e.g., core values and other stated goals of the institution, impact on performance returns, stakeholder input). The draft resolution also touches on some of the points raised by trustees during the October 2016 deliberation of the PUF investment policy amendments (e.g., past actions by the Associated Students of ASOSU and the Faculty Senate).

It should also be noted that this action predates the process envisioned in the draft framework, so there are no written statements of positions from the boards of the participating PUF universities. However, the proposed amendments to the PUF Investment Policy were provided to the vice presidents for finance and administration of the participating universities prior to bringing the action to the OSU Board of Trustees in October 2016.

RECOMMENDATION

Staff recommend that the Board approve the resolution and amendments to the Public University Fund Investment Policy as provided in Attachment 1, contingent on any necessary actions or approvals by the Oregon Investment Council.

ATTACHMENT 1

RESOLUTION NO. _____

Oregon State University
Amending the Public University Fund Investment Policy

BACKGROUND

Whereas, the Public University Fund Investment Policy was approved by the Board of Trustees (the "Board") of Oregon State University on October 17, 2014, and revised on October 16, 2015; and

Whereas, Oregon State University serves as the Designated University under the Agreement Regarding Administration of the Public University Fund (PUF); and

Whereas, the Oregon State University Investment Policy approved by the Board on October 17, 2014, and amended on October 21, 2016, identifies the policies for prudent investment of university funds with the primary objectives of safety, liquidity, and return on investment; and

Whereas, the Board recognizes that from time to time university stakeholders may request that the Board make specific investment policy changes due to environmental, social, or governance factors; and

Whereas, the Faculty Senate of OSU passed a resolution in December 2013 calling on the OSU Foundation to divest fossil fuel companies from its investment portfolio; and

Whereas, the Associated Students of OSU passed a resolution in March 2014 calling upon the OSU Foundation to cease new investments in fossil fuel companies and ensure that within five years none of its assets include holdings in these companies; and

Whereas, students and faculty from the group OSU Divest provided public testimony to the Board in May 2015, urging the university to remove its investments in fossil fuels; and

Whereas, as part of student elections in April 2016, 78% of students participating in the election voted in favor of a referendum for the OSU Foundation to divest from fossil fuels; and

Whereas, approximately 40 percent of the University funds in the PUF are from net tuition and fees paid by OSU students; and

Whereas, the Board may consider the consistency of investment decisions with the University's core value of social responsibility and its strategic goal to maintaining a rigorous focus on academic excellence, particularly in the science of sustainable earth ecosystems; and

Whereas, the University has established an institutional goal of carbon neutrality by 2025; and

Whereas, in September 2016, the Oregon State Treasury and the Oregon Investment Council worked with University staff to develop amendments to the Public University Fund Investment Policy to divest from current fossil fuel-related securities and restrict future investment of assets into fossil fuel-related securities, specifically, the Carbon Underground's list of 200 global oil, gas and coal companies (C.U. 200); and

Whereas, in September 2016 the Oregon State Treasury, the University's investment advisor PFM, and University Shared Services Enterprise staff designed a portfolio strategy to incorporate the fossil fuel restrictions while maintaining a low-cost, total return strategy similar to the present fund investment strategy; now, therefore, be it resolved that

The Board of Trustees hereby approves the amended Public University Fund Investment Policy, provided in Exhibit A.

This Resolution is effective January 20, 2017.

APPROVED by the Board of Trustees _____, 2017

_____ / /2017_____
Secretary to the Board Date

Exhibit A

Oregon State University
Public University Fund Investment Policy

OFFICE OF THE STATE TREASURER | Investment Manual

POLICY PROVISIONS

Definitions
None.

A. Policy Statements

1. Funds meeting OST requirements are eligible for segregated investment management by the OST Investment Division and its investment officers according to and within the guidelines established and approved by the OIC. Investments shall be authorized by an OST investment officer and documented in accordance with OST policies and procedures.

2. Funds shall be invested in accordance with the policies and procedures outlined in this policy and in accordance with statute established by HB 4018, section 7.

B. Compliance Application and Procedures

1. OST shall provide an investment compliance program to accomplish the following objectives: a) monitor and evaluate portfolios, asset classes, and other investment funds to determine compliance with OST policies and contractual obligations; b) identify instances of non-compliance and develop appropriate resolution strategies; c) provide relevant compliance information and reports to OST management and the OIC, as appropriate; and d) verify resolution by the appropriate individual or manager within the appropriate time frame.

2. **Resolution of Non-Compliance.** If PUF investments are found to be a) out of compliance with one or more adopted investment guidelines or b) managed inconsistently with governing policy and objectives, OST investment staff shall bring the investments into compliance as soon as is prudently feasible. Actions to bring the portfolio back into compliance and justification for such actions, including documentation of proposed and actual resolution strategies, shall be coordinated with the OST investment compliance program and communicated with the Designated University.

C. Portfolio Rules for the Public University Fund

1. Scope: These rules apply to the investment of funds from all eligible and approved PUF participants ~~in the Public University Fund ("PUF")~~, and are established under the

authority of, and shall not supersede, the requirements established under ORS Chapter 293 and HB 4018 of Oregon Laws 2014.

2. Objective: Provide adequate liquidity for PUF participants' cash flow requirements. Manage the portfolio to maximize total return over a long-term horizon within ~~the~~ stipulated~~desired~~ risk parameters.

3. Portfolio Allocation and Risk Profile: Allocation parameters listed in the table below are intended as~~to be~~ general guidelines, not hard limits subject to OST Compliance monitoring.

~~Strategy Type~~	~~Name~~	~~Allocation~~	~~Objective~~	
~~Liquidity~~		~~Short-Term~~	~~The purpose of the short term portfolio is to assure adequate cash for operations. Investment management efforts shall be conducted to maintain an allocation to the short-term portfolio equivalent to not less than approximately six (6) months of average monthly operating expenses. This short term portfolio allocation may also be determined using the results of a cash flow analysis.~~	~~Principal preservation~~
~~Core~~		~~Intermediate Term~~	~~Investment management efforts shall be conducted to allocate to The intermediate term portfolio any cash balances in excess of those necessary to meet the requirements for the short-term portfolio. Funds allocated to the intermediate term portfolio should not exceed $300 million.~~	~~Exceed the Oregon Intermediate Term Pool benchmark's total return over a 3-year trailing period.~~
		~~Long Term~~	~~Investment management efforts shall be conducted to allocate to the long-term portfolio any cash balances in excess of those necessary to meet the requirements for the short-term portfolio. Funds allocated to the long-term portfolio should not exceed $120 million.~~	~~Exceed the benchmark's total return over a 5-year trailing period.~~

Portfolio	Objective	Allocation
Liquidity	Assure adequate cash for operations.	Short-Term Funds invested in the Oregon Short Term Fund (OSTF). Target allocation of funds based upon aggregated university participant annual cash flow forecasts. Absent of cash flow forecasts, the target allocation will be based upon a minimum of six months' estimated operating expenses.
Core	Actively managed to achieve a diversified portfolio of investment grade bonds invested over longer investment horizons than permittedavailable in the OSTF. Based on historical market performance, total returns generated over extended periods areit is anticipated that the total returns generated over extended periods willo be greater than returns realized in shorter-maturity vehiclesstrategies.	Intermediate Investments with a maturity or weighted average life from three years and above.

4. Permitted Holdings
   Short-Term Portfolio:

   - Securities eligible for inclusion or included in the designated performance benchmark(s) unless explicitly restricted in this policy.
   - The Oregon Short-Term Fund ("OSTF"), and
   - Any securities eligible for purchase in the OSTF. Underlying investments of the OSTF are excluded from restrictions in this policy. The OSTF is governed by the OIC and OST-adopted policies and guidelines as documented in OIC Policy INV 303.
   - Securities eligible for purchase by the OSTF unless explicitly excluded by this policy.

~~Intermediate-Term Portfolio:~~

- ~~Any holdings eligible for the Short-Term Portfolio;~~
- ~~The Oregon Intermediate-Term Pool (OITP); and~~
- ~~Any securities eligible for purchase in OITP which is governed by the OIC and OST-adopted policies and guidelines as documented in OIC Policy INV 404.~~

~~Long-Term Portfolio:~~

- ~~Any holdings eligible for the Intermediate-Term Portfolio;~~
- Obligations issued or guaranteed by the U.S. Treasury or by U.S. federal agencies and instrumentalities, including inflation-indexed obligations with stated maturities less than 15.25 years~~;~~
  - ~~Non-U.S. Government Securities and their Instrumentalities;~~
- Non-U.S. government securities and Instrumentalities with a minimum rating of one or more of Aa2/AA/AA by Moody's Investors Services, Standard & Poor's or Fitch, respectively, and with a stated maturity less than 15.25 years at the time of purchase.
- Municipal debt with a minimum rating of one or more of A3/A-/A- by Moody's Investors Services, Standard & Poor's or Fitch, respectively, and with a final maturity less than 15.25 years at the time of purchase~~;~~
- Corporate indebtedness with minimum investment grade ratings by one or more of Moody's Investors Services, Standard & Poor's or Fitch, respectively, and with a stated maturity less than 15.25 years at the time of purchase~~;~~
- Asset-backed securities rated AAA at the time of purchase~~, with a weighted average life of less than 5.25 years;~~
- Commercial mortgage-backed securities (CMBS) rated AAA at the time of purchase~~, with a weighted average life of less than 5.25 years; and~~
- U.S. agency residential mortgage-backed securities (MBS) and U.S. agency ~~residential mortgage-related securities~~commercial mortgage-backed obligations ("CMO") ~~with a weighted average life of less than 5.25 years~~.

5. Diversification

   The portfolio should be adequately diversified consistent with the following parameters:

   - No more than 3% of portfolio par value may be invested in a single security with the ~~notable~~ exception of obligations issued or guaranteed by the U.S. Treasury or by U.S. federal agencies and instrumentalities; and
   - No more than 5% of portfolio par value may be invested in the securities of a single issuer with the ~~notable~~ exception of obligations issued or guaranteed by the U.S. Treasury or by U.S. federal agencies and instrumentalities.
     - Maximum market value exposures shall be limited as follows:

- U.S. Treasury Obligations 100%
- U.S. Agency Obligations 50%
- U.S. Corporate Indebtedness 50%
- Municipal Indebtedness 30%
- Asset-backed Securities (ABS) 20%
- Mortgage-backed Securities (MBS) 40%
- Commercial Mortgage-backed Securities (CMBS) 10%
- Structured Securities (Combined ABS, MBS and CMBS) 50%

- Issuer~~-and~~, security, and sector~~-~~-level restrictions shall not apply to OSTF ~~or OITP~~ holdings.

6. Counterparties
   A list of all broker/dealer and custodian counterparties shall be provided ~~annually to the Designated University~~upon request.

7. Strategy
   - Maintain an average (measured by market value) credit rating in the Core allocation of A- or better~~at least A~~ ~~, excluding OSTF and OITP holdings~~. If a security is rated by more than one rating agency, the lowest rating is used to determine the average rating~~;~~
   - ~~In the Long-Term Portfolio,~~ Maintain an average modified duration level of +/- 120% of the custom ~~fixed income~~ benchmark ~~up to a maximum of 7.5 years; and~~.
   - ~~Structure maturities to provide reinvestment opportunities that are staggered. No more than 15% of the long-term portfolio should mature in a single, 3-month time period. This stipulation is intended to be a general guideline, not a hard limit subject to OST Compliance monitoring.~~

8. Investment Restrictions

- All investments will be in U.S. dollar denominated securities.
- All investments will be non-convertible to equity.
- Collateralized debt obligations (CDO), Collateralized Loan obligations (CLO) and Z-tranche investments are not permitted.
- Investments in Alt-A, sub-prime, limited documentation or other "sub-prime" residential mortgage pools are not permitted. There shall be no use of leverage in any investments (excluding use of securities in a securities lending program). Structured securities such as ABS, MBS and CMBS shall not be considered as using leverage.
- For newly issued securities with unassigned ratings, "expected ratings" may be used as a proxy for assigned ratings up to 30 business days after settlement date. and
- Investments in issuers identified by the Carbon Underground 200 published by the Fossil Free Indexes LLC ("FFI").
  - This restricted security list will be updated annually at calendar year-end and enforced for all new security purchases.
  - Exposures to issuers added to the Carbon Underground 200 subsequent to purchase may be held to maturity.
- Maximum market value exposures (excluding underlying holdings in OSTF and OITP) shall be limited as follows:

  - U.S. Treasury Obligations 100%

U.S. Agency Obligations	50%
U.S. Corporate Indebtedness	50%
Municipal Indebtedness	30%
Asset-backed Securities (ABS)	20%
Mortgage-backed Securities (MBS)	30%
Commercial Mortgage-backed Securities (CMBS)	10%
Structured Securities (Combined ABS, MBS and CMBS)	50%

9. Policy Compliance
   - OST Investment Staff will submit a written action plan to the Designated University regarding any investment downgraded by at least one rating agency to below investment grade within 10 days of the downgrade. The plan may indicate why the investment should continue to be held and/or outline an exit strategy. and.
   - OST Staff will consult with the Designated University, on a pre-trade basis, if an investment trade or trades will result in a cumulative net loss greater than 1% over 3 months prior to trade settlement date.

10. Performance Expectations/Reviews.
    - EOver a 5-year trailing period, the Long Term portfolioxcluding the short-term allocation, the Core allocation is expected to outperform in-line with the following custom benchmark:
      - 75% Bloomberg Barclays U.S. Aggregate 3-5 Year Index; and

- 25% Bloomberg Barclays U.S. Aggregate 5-7 Year Index.~~;~~
- OST will provide the Designated University with a monthly report of all non-passive compliance violations of this policy's guidelines.~~; and~~
- Investment reviews between OST investment staff and the Designated University will occur quarterly and focus on the following elements:
  - Performance relative to objectives;
  - Adherence to this policy; and
  - Trading activity.

Exceptions
None.

Failure to Comply
Failure to comply with this policy may be cause for disciplinary action up to and including dismissal.

Document History

- Adopted by the Board of Trustees October 17, 2014
- Amended October 16, 2015
- Amended _____