SECTION 5.0 - INVESTMENTS

5.1 Introduction

This chapter defines funds permissible for investment and outlines the types of investment vehicles approved by the Board of Directors and the policies upon which dividends, interest, realized and unrealized market gains/losses earned on investments are distributed. The investments vehicles are consistent with those of the University of California as the College has contracted with the University to invest and manage its investible funds.

5.2 Investible Funds

All College funds are invested with the University of California Office of the Treasurer. Investments made outside of UC (i.e., proceeds from publicly issued debt) must be approved by the Board of Directors.

This policy does not apply to endowment assets held by others for the benefit of the College.

The investible funds of the College are as follows:

- tuition and miscellaneous revenues supporting the State-appropriation
- surplus scholarship monies
- surplus loan funds
- other surplus non-state funds
- all endowment funds
- funds of the 1066 Foundation

The funds are defined as surplus when the monies are not required for current (within one-year) expenditures. The level of surplus funds is determined by the Office of Fiscal Services as part of its cash management responsibilities. . These surplus funds are invested daily in the University of California's portfolio.

5.3 Philosophy Strategy

The College has adopted the investment philosophy of the University of California. As expressed by the University of California Treasurer, the "primary investment objective for the funds is to achieve above-average total rates of return over the long term carrying a level of risk that is appropriate to the individual fund characteristics and to the nature of the invested money." Further, the goals are to "preserve capital and the purchasing power of endowed projects."

The University of California philosophy statements outlines the overall strategy to be:

- "Strategically allocate assets between short- and long-term fixed income and equities, to adapt to fundamental changes in the long term economic outlook.
- Recognize the benefits of growing investment income to long-term portfolio performance.

- Tactically direct cash flow to purchase attractively priced, high quality securities."It further expresses the equity, fixed income, and short-term investment pool strategies to be:

a. Equity - "Emphasize long-term investment. Hold as long as the security continues to meet investment criteria and valuation remains reasonable.

Concentrate investments in a diversified yet relatively limited number of issues so that the benefits of superior stock selection are not diluted, while recognizing liquidity constraints.

The following criteria are used in determining the suitability of equity investments for inclusion in portfolios:

- Emphasis on shares of well-established companies with a stable and above average rate of earnings growth and ability to regularly increase dividends.
- Favorable return on invested capital and a high reinvestment rate.
- Proven and able management.
- High unit growth.
- Strong competitive position.
- Price leadership.
- Strong balance sheet and sound accounting.
- Substantial investment in the future as shown by research and development and marketing expenditures.
- Good corporate citizenship, defined as behavior generally acceptable by community standards."

b. Fixed Income - "Emphasize safety of principal, quality, and call protection.

Structure investment maturities to ensure investment income stability and to reflect changes in expected real rates of return.

Actively engage in "bond swaps" to improve quality, call protection, or yield, and take advantage of relative disparities among sectors of bonds."

c. Short Term Investment Pool - "Emphasize safety of principal, quality, liquidity, and cash flow requirements.

Structure investment maturities to ensure adequate flow of funds for University's cash needs.

Actively engage in "swaps" to improve yield while maintaining quality."

5.4 Investment Vehicles

The University of California investment contract offers an array of investment options. The College will allocate 100 percent of its invested endowment funds to General Endowment Pool (GEP).

5.4.1 General Endowment Pool (GEP)

The primary objective of this fund is to maximize real long-term total return (income plus capital appreciation) while assuming an appropriate level of risk. For this fund, the ability to preserve the capital and purchasing power of income is critical.

For the current contents of the GEP portfolio, the reader is referred to the Treasurer’s office website at: www.ucop.edu/treasurer/brochures/welcome.html

As of this writing, the Treasurer describes GEP as:

The General Endowment Pool (GEP), established in 1933, and unitized in 1958, is The Regents’ primary investment vehicle for endowed gift funds. GEP is a balanced portfolio of equities, fixed-income securities, and alternative investments that provides diversification and economies of scale in the investment process to participants. All endowment funds participate in GEP, unless higher payout needs require otherwise

5.4.2 Short Term Investment Pool (STIP)

This fund is a vehicle to invest excess operating cash until the monies are needed for current expenditures. The objective is to provide maximum returns consistent with "safety of principal liquidity and cash flow requirements." The STIP investments include money market and fixed income instruments with a maximum maturity of five years.

5.5 Reporting

Monthly, the College receives statements indicating the activity in the funds, the market values, and interest earned. Quarterly, the Chief Financial Officer provides a report to the Finance Committee showing the book and market values of the invested funds. Periodically, a representative from University of California Treasurer's Office reviews the performance of the funds and the economy in general with the College's Finance Committee members.

5.6 Distribution of Investment Earnings, Realized and Unrealized Market Gains/Losses

Quarterly, the dividends and interest earned along with the realized and unrealized market gains/losses are distributed to the designated, eligible College accounts. For invested endowments funds, the amount distributed is calculated based upon the annual spending rate percentage established by the Board of Directors for the fiscal year. Actual interest earned, realized and unrealized gain/ (loss) are credited to the endowment pool.

5.7 Spending Policy

Effective July 01, 2002, the College uses a Total Return spending policy for the General Endowment Pool (GEP) for the College's endowed funds consistent with that adopted by the Regents of the University of California. The Total Return spending policy establishes a spending rate that is expressed as a percentage based on a 12 quarter rolling average market value of the endowment pool for the period ending the previous December 31.

To facilitate its oversight of endowed funds, on an annual basis a recommendation is made to the Finance Committee on the proposed spending rate for the upcoming fiscal year. The Finance Committee determines whether the recommended spending rate in conjunction with anticipated inflation and market conditions sufficiently protects the endowment's purchasing power and whether the proposed rate provides sufficient funding to support activities supported by endowment funds.

5.8 Endowment Management

5.8.1 Definition

An "endowment fund" means an institutional fund or part thereof that, under the terms of a gift instrument, is not wholly expendable by the institution on a current basis. The term does not include assets that an institution designates as an endowment fund for its own use.

<u>True Endowments</u>
A true endowment is a fund created by a donor (or other external party) with the stipulation, as a condition of the gift instrument (or other directions), that the principal is to be maintained and invested in perpetuity to produce income, investment growth, or both. This type of endowment is also referred to as a permanent endowment. The stipulation that the endowment's principal be maintained in perpetuity is a time requirement. The institution should recognize assets and revenues when the gift is received because at that time the institution begins to comply with the time requirement. (In other works, the institution would not recognize a pledge to create an endowment fund because the time requirement cannot be met until the assets are received.) Because of the time requirement, true endowments are classified as restricted nonexpendable net assets.

Generally, income and/or realized and/or unrealized gain determine using a total return philosophy where funds from the endowment may be expended in conformity with the donor's specified restrictions. (Under the total return philosophy spending is not limited to cash yield—e.g., interest, dividends, and rents—but may include realized gains and market appreciation of endowment assets.)

Quasi Endowments
Quasi endowments permit principal and income to be expended. Quasi-endowments are individual endowment funds established at the direction of the Board of Directors. Because they are not established at the direction of a donor or other external party, quasi-endowments can be expended at any time the Board deems it desirable to do so. If unrestricted resources such as an unrestricted bequest or accumulated reserves are used to establish the endowment fund, it is considered an unrestricted quasi-endowment and the earnings can be used to support any organizational purposes. If restricted resources are used to establish the endowment, the earnings from the endowment must be used for the same purpose as was specified for the source funds.

Term Endowments
A term endowments is created when a donor (or other external party) specifies that the funds must be held and invested until the passage of a specified time or the occurrence of a specified event. The donor (or other external party) also specifies what is to be done with the income and investment growth during the specified period. In some cases those earnings are subject to a purpose restriction established in the gift instrument. However, it is not uncommon for the terms to require that those earnings be added to principal during the specified period. Term endowments are classified as restricted expendable net assets if the funds ultimately will be made available for spending. If the funds ultimately will be added to a true endowment, the term endowment is classified as restricted nonexpendable.

5.8.2 Purpose of the Hastings Endowment

The purpose of Hastings endowments is to support the college's activities in perpetuity while maintaining intergenerational equity. Over the years, the growth of the endowment has enabled the college to improve financial aid packages, build the faculty, launch programs and research efforts, and support a wide range of important needs.

5.8.3 Governing Authorities

Three authorities determine the College's rights and responsibilities in administering its endowment: legal, donor, and Board of Directors.

1. California Uniform Prudent Management of Institutional Funds Act (UPMIFA)

   The primary legal authority is the Uniform Prudent Management of Institutional Funds Act, adopted and enacted by the State of California in October 2008 as codified in California's Probate Code Section 18501-18510.

   This statute establishes the parameters, subject to any donor limitations, in which the College can maintain, invest, and spend its endowment and other institutional funds. Other legal regulations, doctrines, and considerations affect the procedures and policies of the College in its endowment administration.

The College will manage its endowment pursuant to California's UPMIFA which provides guidance and authority to charitable organizations concerning the management and investment of funds held by those organizations, and imposes additional duties on those who manage and invest charitable funds. These duties provide additional protections for charities and also protect the interests of donors who want to see their contributions used wisely.

Additionally, UPMIFA, which replaces the Uniform Management of Institutional Funds Act (UMIFA), modernizes the rules governing expenditures from endowment funds, both to provide stricter guidelines on spending from endowment funds and to give institutions the ability to more easily cope with fluctuations in the value of the endowment. UPMIFA removes the requirement to maintain the historic dollar value of the endowment in perpetuity. In making a determination to appropriate or accumulate, the institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and shall consider, if relevant, all of the following factors:

(1) The duration and preservation of the endowment fund.
(2) The purposes of the institution and the endowment fund.
(3) General economic conditions.
(4) The possible effect of inflation or deflation.
(5) The expected total return from income and the appreciation of investments.
(6) Other resources of the institution.
(7) The investment policy of the institution.

Refer to Exhibit AB for the full text of California's UPMIFA.

2. Donor Authority

To the extent accepted by the Board of Directors, the donor can restrict the terms of an endowment by means of a "gift instrument," a document signed by the donor and the College that states the donor's intent. The donor can intend a true or term endowment, and may either restrict the distribution of that endowment to a specific purpose or allow the Board of Directors to direct the distribution for purposes determined at the College's discretion.

Refer to the College's Development Policy and Administration Manual for specific guidance and information on the acceptance of endowment and other restricted gifts to the College.

3. Board of Directors

The third authority is the Board of Directors. The Board has ultimate authority over the acceptance and maintenance of gifts, endowments, and investments. The Board of Directors authorizes the Finance Committee of the Board, the Chancellor and Dean, and the Chief Financial Officer to oversee the administration and investment of the endowment.

5.8.4 Duties and Responsibilities Related to the Endowment

1. Board of Directors

The Board of Directors of the College has ultimate authority over the investment, management and administration of the College's endowment.

Specifically, the Board of Directors approves all additions and modifications to the College's policies related to the acceptance, management and administration of the endowment including the Development Policy and Administration Manual and the Financial Operations Policies and Procedure Manual.

Further, the Board of Directors annually approves the endowment spending rate as set forth in Section 5.7 Spending Policy.

The overall objective of the spending rate is to provide resources that can be used to fulfill the purpose for which an endowment was created, while also achieving intergenerational equity. Intergenerational equity requires that a balance be struck between the needs of current versus future beneficiaries. Intergenerational equity is achieved when both current and future beneficiaries are treated equitably. Establishing too high a spending rate—though advantageous for current beneficiaries—depletes the endowment fund and adversely affects future beneficiaries. Establishing too low a rate preserves more of the endowment—thereby creating the potential for enhanced treatment of future beneficiaries—but adversely affects current beneficiaries. Intergenerational equity is achieved by establishing a reasonable spending rate that fulfills current objectives while simultaneously reinvesting to grow the endowment.

Another objective for the spending rate is to ensure a reasonably predictable level of support that is responsive to market changes. Two major factors must be considered when determining the rate: a desire for steadily increasing support over time and responsiveness to market conditions. This is accomplished by basing the spending rate on market values that are averaged over time.

2. University of California Office of the Treasurer (UC)

As set forth in Section 5.2 Investible Funds, all endowment funds under the control of the College shall be invested with the University of California Office of the Treasurer. The duties and responsibilities of UC are outlined in the Agreement between the Regents of the University of California and Hastings College of the Law executed on November 30, 1992.

3. Management and Staff

Alumni Center Staff - Responsibilities of the Alumni Center staff include:

- Solicits and accepts endowment gifts in accordance with the College's established policies and procedures;
- Prepares the initial endowment agreements;
- Receives and deposits endowment gifts in the College's bank account as designated by Fiscal Services;
- Timely reports the receipt of endowment funds to the Office of Fiscal Services;
- Maintains donor giving and other records necessary to reflect the receipt of endowment gifts;
- Prepares and issues acknowledgement letters to the donor in accordance with established policies and procedures;
- Manages all donor relations and correspondence related to the management of the endowment. This includes working with College staff at the department level which the endowment is supporting to ensure the terms and conditions of the endowment are being met.

Office of General Counsel - Responsibilities of the Office of General Counsel include:

- Reviews all endowment agreements and presents them to the Board of Directors for their acceptance and approval;
- Circulates Board approved resolutions to interested parties of the College;
- Coordinating any changes to endowment terms and conditions as they are warranted;
- Is the official repository for all endowment agreements, Board resolutions accepting endowments and other legal documents related to the endowment.

Financial Services Staff - Responsibilities of the Financial Services staff include:

- Maintains an endowment file of pertinent documentation including fund terms, Board resolution; correspondence on spending decisions; reports to donors on endowment investment performance;
- Maintains and manages the accounting for endowment activity;
- Proposes the annual spending rate;
- Coordinates with departments to establish the expenditure budget of the annual payout;
- Works with departments to ensure the annual payout is spent;
- Quarterly distributes investment earnings to the endowment pool and realized and unrealized gains/(losses) to the endowments in the pool;

- Annually distributes the authorized annual spending amounts based upon the payout rate approved for the fiscal year by the Board of Directors;
- Maintains the principal (corpus) value of the endowment;
- Works with departments to ensure the allocated payout is spent timely and in accordance with the donor terms and conditions and if payout is carried forward with a spending plan, ensures Division Head authority is secured;
- Cash management of endowed funds;
- Provides endowment reports to donors and other interested parties.

Departments Administering the Endowment – Responsibilities of the Department administering the endowment include:

- Reviews the draft endowment agreement and fund terms;
- Ensures compliance with the terms and conditions of the endowment as specified by the donor and the Board of Directors;
- Provides timely reporting to the donor as they requested and that has been agreed to by the College;
- Establishes expenditure budgets for the annual payout amount;
- Ensures the annual payout amount is spent within the designated fiscal year and in compliance with the terms and conditions specified by the donor and approved by the Board of Directors;
- Coordinates information received by the donor with the Alumni Center, General Counsel and Controller.

5.8.5 Endowment Agreements

All endowments received and accepted by the College shall have an endowment agreement signed by the donor, the department which the endowment is supporting and the Chancellor and Dean. Endowment agreements outline the terms and conditions which the endowment earnings are to be spent and outline how the College will administer the endowment.

The Alumni Center staff is responsible for preparing the endowment agreement and working with the donor, the Chancellor, General Counsel, the department and the Controller to ensure agreement of the terms from all parties.

Endowment Agreement - The endowment agreement should include the following elements.

- The name of the endowment;
- The description and purpose of the endowment;
- Any criteria specified by the donor;
- A selection process of the recipient of the earnings as specified by the donor;
- The administration of the endowment including specifying that the endowment will be managed in accordance with College policies and procedures. This should also include future considerations including contingency language in case a program or department of College ceases to exist;

- Donor reporting requirements;
- The original gift amount or amount to be capitalized as the endowment's corpus.

A sample endowment agreement is reference in Exhibit AC.

It is the responsibility of the Alumni Center to secure the signatures of all parties and forward the executed, original document to General Counsel. The Alumni Center is also responsible for routing a copy of the signed agreement to the Chancellor, the department and the Controller.

5.8.6 New Gifts to Established Endowment Funds

It is the policy of the College that new gifts to already established endowment funds shall be made to the endowment's corpus unless otherwise specified by the donor to be a current use gift. If such specification is made, it is the responsibility of the Alumni Center to ensure the gift is properly credited to the current use fund and that the donor's intent is documented.

5.8.7 Investment Pool

Endowment gifts that are named and/or restricted by the donor(s) with a specific purpose are each recorded in a separate endowment account. Each endowment account participates in the College's general endowment pool, an investment account held with the University of California Office of the Treasurer.

5.8.8 Underwater Endowments

It is the policy of the College that all individual endowment accounts invested in the endowment pool as of December 31 will receive a payout. This will be true even if an individual endowment is underwater.

If at any time the endowment pool goes underwater, the CFO may suspend the payout until an evaluation of the endowment pool's status can be made and discussed with the Board of Directors and the Chancellor.

5.8.9 Cash Management

Annually, the College will liquate GEP investments to the level of the authorized endowment payout. The liquidated funds will be credited to the endowment pool and the funds deposited into the College's UC STIP account.

New endowed gifts are first deposited into the College's designated bank account. As soon as is practical the endowment gift is transferred to GEP.

5.8.10 Endowment Types, Thresholds and Naming Requirements

Endowment types, thresholds and naming requirements are set forth in the College's Development Policy and Administrative Manual.

5.8.11 New Endowments

Endowments must be in the endowment pool as of December 31st in order to receive a payout in the subsequent fiscal year.

For example, endowments received in January 2010 will be invested in the endowment pool as of December 31, 2010 for which a payout will be calculated. The first expenses can be incurred beginning on July 01, 2011.