

COMMITTEE ON FINANCE

California State University Annual Investment Report and Establishment of the Investment Advisory Committee

Presentation By

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Summary

This item provides the annual investment report for fiscal year 2016-2017 pursuant to the California State University Investment Policy. The item also provides an update on the progress made in implementing the CSU's new investment authority signed into law in September, 2016 and effective January 1, 2017, including a request to the board to establish an investment advisory committee pursuant to the new investment authority.

Background

Most CSU funds are invested through the CSU Systemwide Investment Fund-Trust (SWIFT) investment portfolio, which was established in July 2007 for the purpose of enhancing centralized cash and investment management. On a daily basis, net investable cash from the Chancellor's Office and campus-controlled bank depository and disbursement accounts is pooled and moved into SWIFT for investment. All SWIFT cash and securities are held by US Bank, the custodian bank for SWIFT, and for investment management purposes, the SWIFT portfolio is divided equally between two investment management firms, US Bancorp Asset Management and Wells Capital Management. Neither state general fund nor CSU auxiliary funds are included in the SWIFT portfolio.

The State Treasurer also provides investment vehicles that may be used for CSU funds. The Surplus Money Investment Fund (SMIF) is used by the State Treasurer to invest state funds, or funds held by the state on behalf of state agencies, in a short-term pool. In order to facilitate certain expenditures, the CSU maintains small amounts of funds with the State that might otherwise be invested in the SWIFT portfolio. The Local Agency Investment Fund (LAIF) is used by the State Treasurer to invest local agency funds. Since 2009-2010, the CSU has not invested funds in LAIF.

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The year-end results for these two funds are reported in Attachment A. The State Treasurer also created the State Agency Investment Fund (SAIF) in 2011 to address liquidity needs created by the economic downturn at that time. The CSU moved funds out of its SWIFT portfolio into the SAIF to assist the State from September 2011 through April 2013, but no CSU funds have been in the SAIF since that time.

The California State University Investment Policy in effect during fiscal year 2016-2017 is included as Attachment B.

Investment Account Performance

As of June 30, 2017, the outstanding balance in the SWIFT portfolio totaled \$3.76 billion. The objective of SWIFT is to maximize current income while preserving and prioritizing asset safety and liquidity. Consistent with the California State University Investment Policy and state law, the portfolio is restricted to high quality, fixed income securities.

As of June 30, 2017, the SWIFT portfolio's holdings by asset type were as follows:

US Treasuries	22.36%
US Government Agencies	36.10%
Corporate Securities—Long Term	29.16%
Corporate Securities—Short Term	<u>12.38%</u>
	100.00%

The SWIFT portfolio provided a return of 0.55 percent during the 12 months ended June 30, 2017. This return was greater than the benchmark for the portfolio, which is a treasury based index.

	<u>SWIFT Portfolio</u>	<u>SWIFT Benchmark¹</u>	<u>LAIF²</u>
1 Month Return	0.03%	-0.01%	N/A
3 Months Return	0.29%	0.18%	0.23%
12 Months Return	0.55%	0.10%	0.75%
Annualized Return since SWIFT Inception	1.27%	1.59%	1.01%

For the year ended June 30, 2017, investment management and custodial fees totaled just under \$1.9 million, or about 0.048 percent (4.8 basis points) on average outstanding balances throughout the year.

¹ Bank of America Merrill Lynch 0-3 Year Treasury Index

² LAIF investment returns are provided as a benchmark since LAIF would be the primary investment alternative if the CSU did not invest funds in its own portfolio. LAIF outperformed the SWIFT portfolio for the twelve months ended June 30, 2017 due to the mix of securities in the portfolio and differences in the treatment of unrealized gains/losses.

Update on Implementation of the CSU's New Investment Authority

The CSU's new investment authority was signed into law in September of 2016 and became effective January 1, 2017. Key components of the new authority are:

1. Allows the CSU to invest in mutual funds, including equity mutual funds, subject to registration by, and under the regulatory authority of, the United States Securities and Exchange Commission and United States registered real estate investment trusts. Previously, the CSU had been restricted to investing in fixed income securities allowed under Government Code 16430.
2. Limits the amount of funds that the CSU may place in the new investment options and phases in such investment as follows:
 - In the fiscal year ending June 30, 2017, no more than 200,000,000.
 - In the fiscal year ending June 30, 2018, no more than 400,000,000.
 - In the fiscal year ending June 30, 2019, no more than 600,000,000.
 - In the fiscal year ending June 30, 2020, and each fiscal year thereafter, no more than 30 percent of all CSU investments.
3. Requires the board to establish an investment advisory committee to oversee investments. The committee must include a majority of members with investment expertise and who are not CSU employees. The State Treasurer has the option to serve, or appoint a deputy treasurer to serve, as a member of the committee.
4. Enhances investment reporting to the board and includes an annual reporting requirement to the legislature.
5. Restricts the use of earnings from the new investments to meet non-recurring capital needs, including deferred maintenance and critical infrastructure.
6. Prohibits the CSU from citing any losses associated with the new investments as justification for increases in student tuition or fees, and from seeking State general fund dollars to offset any losses associated with the new investments.

Investment Advisory Committee

As noted above, in order to take advantage of the new investment authority, the board needs to establish an investment advisory committee. This item requests the board to establish such investment advisory committee, hereafter referred to as the CSU Investment Advisory Committee or "IAC". Based upon review of a number of candidates and consultation with the Chair of the Committee on Finance of the Board of Trustees, staff proposes that the IAC membership be comprised of the following individuals:

- Ex Officio, the Chair, Committee on Finance of the CSU Board of Trustees. Peter J. Taylor currently serves in this position. This position will also serve as Chair of the IAC.

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- Ex Officio, the Executive Vice Chancellor and Chief Financial Officer of the California State University. Steve Relyea currently serves in this position. This position will also serve as Vice Chair of the IAC.
- Ex Officio, the Assistant Vice Chancellor, Financing, Treasury, and Risk Management, California State University. Robert Eaton currently serves in this position.
- David Bach – Principal, The Bach Group; former investment officer for the California Public Employees' Retirement System; board member for University Enterprises, Inc. at California State University, Sacramento.
- Leona M. Bridges – Director, San Francisco Municipal Transportation Agency; board member for the San Francisco State Foundation.
- Michael A. Lucki – Former Chief Financial Officer and member of the board of directors for CH2M Hill Companies, Ltd.; board member of the California State University Foundation.
- Irwin Rothenberg – Wealth Advisor, Buckingham Asset Management; board member for the Sonoma State University Foundation.

As noted above, the State Treasurer has the option to serve, or appoint a deputy treasurer to serve, as an ex officio member of the committee, and the State Treasurer's Office has indicated that the State Treasurer will exercise this option and appoint Timothy J. Schaefer, Deputy Treasurer for Public Finance, to serve on the IAC.

The basic charge of the IAC will be to oversee the portfolio of CSU investments that will be established under the new investment authority. The IAC will develop, periodically review, and amend, as needed, specific policies for the portfolio consistent with established investment policy of the board and state law; review and approve the retention or replacement of investment managers; monitor portfolio asset allocations, review rebalancing activities; and monitor performance to stated objectives. All actions of the IAC will be in the form of recommendations to the board for approval or to staff for implementation under delegated authority.

New Master Investment Policy

In light of the new investment authority and other investment goals of the CSU, the existing California State University Investment Policy (Attachment B) needs to be updated and enhanced. Staff is in the process of developing a new Master Investment Policy (MIP) for the CSU with the goal of presenting a final version of the MIP for approval by the board at a future meeting.

The MIP will be designed to provide a framework for the investment of CSU funds and will include the following key elements:

- The articulation of standards and expectations to be met by parties involved in the investment of CSU funds, such as compliance with law, adherence to policy, “prudent investor” rule, refraining from conflicts of interest, and the consideration of environmental, social, and governance factors in making investment decisions.
- Roles and responsibilities of the Board of Trustees, the chancellor and his staff, and the IAC, as fiduciaries for the investment of CSU funds, including delegations of authority from the Board of Trustees to the chancellor, staff, and the IAC to implement the provisions of the MIP.
- Investment objectives that shall govern CSU investments—safety of principal, liquidity needs of the CSU, and returns commensurate with acceptable levels of risk.
- Direction to the chancellor, staff, and the IAC to establish three investment portfolios, within acceptable allocation ranges and targets set by the board, each with their own investment objectives and policies.

The three portfolios and general purpose of each portfolio will be as follows:

Liquidity Fund (Systemwide Investment Fund—Trust or SWIFT)

The purpose of this portfolio will be to provide sufficient and immediate liquidity to meet the operating needs of the CSU. The existing SWIFT portfolio shall serve as the Liquidity Fund.

Intermediate Duration Fund

The purpose of this portfolio is to provide opportunity for modest, additional risk-adjusted returns on CSU funds not needed for immediate liquidity.

Total Return Fund

The purpose of this portfolio is to provide opportunity for additional risk-adjusted returns on CSU funds over a full market cycle. The Total Return Fund shall be the portfolio of investments that takes advantage of the new investment authority.

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Next Steps

Staff will continue working on the MIP with the goal of presenting it for approval at a future meeting of the board. Staff and the IAC will also work together on implementing the provisions of the investment authority, in particular, developing the policies and procedures for the Total Return Fund, with the goal of moving CSU funds into the portfolio in the first half of 2018. Staff and the IAC will report on implementation progress at future meetings of the board.

Recommendation

The following resolution is presented for approval:

RESOLVED, by the Board of Trustees of the California State University, that the Trustees hereby:

1. Establish the Investment Advisory Committee and approve the membership of the Investment Advisory Committee as presented in Agenda Item 4 of the September 19-20, 2017, meeting on the Committee on Finance;
2. Authorize the Chair of the Committee on Finance; the chancellor; the executive vice chancellor and chief financial officer; and the assistant vice chancellor, Financing, Treasury, and Risk Management; and their designees to take any and all actions necessary to implement this resolution.

Surplus Money Investment Fund (SMIF)

The Surplus Money Investment Fund (SMIF) is a vehicle used and managed by the State Treasurer to invest State funds, or funds held by the State on behalf of State agencies, in a short-term pool. Cash in this account is available on a daily basis. The portfolio's composition includes Certificates of Deposit and Time Deposits, U.S. Treasuries, Commercial Paper, Corporate Securities, and U.S. Government Agencies. As of fiscal year ended (FYE) June 30, 2017, the amount of CSU funds invested in SMIF was approximately \$93 million.

SMIF Performance

Apportionment Annualized Return

FYE 06/30/17 0.74%
FYE 06/30/16 0.42%

Quarterly Apportionment Yield Rate

FYE 06/30/07 - FYE 06/30/17

Average 1.00%
High 5.24%
Low 0.22%

Local Agency Investment Fund (LAIF)

The Local Agency Investment Fund (LAIF) is a vehicle used and managed by the State Treasurer to invest local agency funds. All investments are purchased at market, and market valuation is conducted quarterly. As of June 30, 2017 there were no CSU funds invested in LAIF.

LAIF Performance

Apportionment Annualized Return

FYE 06/30/17 0.75%
FYE 06/30/16 0.43%

Quarterly Apportionment Yield Rate

FYE 06/30/07 - FYE 06/30/17

Average 1.01%
High 5.25%
Low 0.23%

The California State University Investment Policy

The following investment guidelines have been developed for use when investing California State University funds.

Investment Policy Statement

The objective of the investment policy of the California State University (CSU) is to obtain the best possible return commensurate with the degree of risk that the CSU is willing to assume in obtaining such return. The Board of Trustees desires to provide the Chancellor and his designees with the greatest possible flexibility to maximize investment opportunities. However, as agents of the trustees, the chancellor and his designees must recognize the fiduciary responsibility of the trustees to conserve and protect the assets of the portfolios, and by prudent management prevent exposure to undue and unnecessary risk.

When investing CSU funds, the primary objective of the CSU shall be to safeguard the principal. The secondary objective shall be to meet the liquidity needs of the CSU. The third objective shall be to return an acceptable yield.

Investment Authority

The CSU may invest monies held in local trust accounts under Education Code Sections 89721 and 89724 in any of the securities authorized by Government Code Sections 16330 and 16430 and Education Code Section 89724 listed in Section A, subject to limitations described in Section B.

A. State Treasury investment options include:

- Surplus Money Investment Fund (SMIF)
- Local Agency Investment Fund (LAIF)
- State Agency Investment Fund (SAIF)

Eligible securities for investment outside the State Treasury, as authorized by Government Code Section 16430 and Education Code Section 89724, include:

- Bonds, notes or obligations with principal and interest secured by the full faith and credit of the United States;
- Bonds, notes or obligations with principal and interest guaranteed by a federal agency of the United States;

- Bonds or warrants of any county, city, water district, utility district or school district;
 - California State bonds, notes, or warrants, or bonds, notes, or warrants with principal and interest guaranteed by the full faith and credit of the State of California;
 - Various debt instruments issued by: (1) federal land banks, (2) Central Bank for Cooperatives, (3) Federal Home Loan Bank Bd., (4) Federal National Mortgage Association, (5) Federal Home Loan Mortgage Corporation, and (6) Tennessee Valley Authority;
 - Commercial paper exhibiting the following qualities: (1) “prime” rated, (2) less than 180 days maturity, (3) issued by a U.S. corporation with assets exceeding \$500,000,000, (4) approved by the PMIB. Investments must not exceed 10 percent of corporation’s outstanding paper, and total investments in commercial paper cannot exceed 30 percent of an investment pool;
 - Bankers’ acceptances eligible for purchase by the Federal Reserve System;
 - Certificates of deposit (insured by FDIC, FSLIC or appropriately collateralized);
 - Investment certificates or withdrawal shares in federal or state credit unions that are doing business in California and that have their accounts insured by the National Credit Union Administration;
 - Loans and obligations guaranteed by the United States Small Business Administration or the United States Farmers Home Administration;
 - Student loan notes insured by the Guaranteed Student Loan Program;
 - Debt issued, assumed, or guaranteed by the Inter-American Development Bank, Asian Development Bank or Puerto Rican Development Bank;
 - Bonds, notes or debentures issued by U.S. corporations rated within the top three ratings of a nationally recognized rating service;
- B. In addition to the restrictions established in Government Code Section 16430, the CSU restricts the use of leverage in CSU investment portfolios by limiting reverse repurchase agreements used to buy securities to no more than 20 percent of a portfolio.

Furthermore, the CSU:

- Prohibits securities purchased with the proceeds of a reverse repurchase from being used as collateral for another reverse repurchase while the original reverse repurchase is outstanding;
- Limits reverse repurchase agreements to unencumbered securities already held in the purchased with the proceeds of the repurchase (but in any event not more than one year) and;
- Limits reverse repurchase agreements to unencumbered securities already held in the portfolio.

Investment Reporting Requirements

Annually, the chancellor will provide to the Board of Trustees a written statement of investment policy in addition to a report containing a detailed description of the investment securities held by the CSU, including market values.

(Approved by the CSU Board of Trustees in January 1997; and as amended in September 2011 and November 2013)