FUNCTION: Oregon University System
ACTIVITY: Funds Management Program

POLICY: Improve the earnings of cash balances held by the Oregon University System (OUS) by investing a portion into investments other than the Oregon Short-Term Investment Fund/Pool.

BACKGROUND: OUS cash balances have exceeded $400 million since July 1, 2005. These balances currently range between $650 million and $850 million. In order to improve investment returns, the “core” portion (up to $420 million) of these funds will be invested out longer.

PROCEDURES:

1. **Objective:** Provide adequate liquidity for the Oregon University System. Manage the portfolio to maximize total return within the desired risk parameters; trading, resulting in recognized losses, is discouraged.

2. **Portfolio Allocation:**
   - Long-Term Portion: cannot exceed $300 million dollars
   - Intermediate-Term Portion: cannot exceed $120 million dollars
   - Short-Term Portion: all remaining funds without limitation but no less than $200 million

3. **Risk Profile:**
   - Long-Term Portion: Primary objective is higher total return versus intermediate-term strategy over a market cycle
   - Intermediate-Term Portion: Primary objective is higher total return versus short-term strategy over a market cycle
   - Short-Term Portion: Primary objective is preservation of principal

4. **Permitted Holdings:**
   - Short-Term Portion:
     - The Oregon Short-Term Investment Fund/Pool as managed by the Oregon State Treasury in accordance with the terms approved by the Oregon Investment Council
   - Intermediate-Term Portion:
• Any holding permitted by the Short-Term Portion
• The Oregon Intermediate-Term Pool as managed by the Oregon State Treasury in accordance with the terms approved by the Oregon Investment Council (refer to OITP prospectus and portfolio rules for OIC-approved permitted holdings pending 4/28/10 OIC meeting/approval)

Longer-Term Portion:
• Any holding permitted by the Intermediate-Term Portion
• Fixed or floating rate bonds and notes issued, assumed, or guaranteed by the U.S. Government or its agencies (including student loans) with a weighted average maturity/life of less than 10.25 years
• Municipal debt (including Build America Bonds) with a minimum rating of A2/A-/A- at the time of purchase by Moody’s Investors Services, Standard & Poor’s, or Fitch, respectively, provided its final maturity is less than 10.25 years
• Corporate indebtedness with minimum long-term ratings of A3/A-/A- at the time of purchase by Moody’s Investors Services, Standard & Poor’s, or Fitch, respectively, provided its final maturity is less than 10.25 years
• Asset-backed securities rated AAA at the time of purchase with a weighted average maturity/life of less than 5.0 years
• Fixed or floating rate mortgage pools and mortgage related securities rated AAA at the time of purchase with a weighted average maturity/life of less than 5.0 years. Investments in Alt-A, sub-prime, limited documentation, or other “sub-prime” mortgage pools are not permitted.
• The portfolio’s modified duration shall not exceed 7.5 years

5. Diversification:
The portfolio should be adequately diversified to minimize various risks. The following specific limitations reflect, in part, the OIC’s current investment philosophy regarding diversification.
• No fixed income investment in any one issue shall be in excess of 5% of the outstanding fixed income obligations of the issuer.
• Not more than 5.0% of the total par value of any single portion shall be invested in any one issuer

These issuer level restrictions shall not apply to U.S. Government and Agency obligations including Agency backed mortgages.

These issuer level restrictions shall not apply to the Oregon Short-Term Fund/Pool or the Oregon Intermediate-Term Fund/Pool as managed by the Oregon State Treasury.

6. Counterparties:
A “counterparty” is any party involved in the management, reporting, and investment of OUS funds. There is risk that a particular counterparty will not be able to perform their expected duties in a timely professional manner. Examples of counterparties include investment brokers, custodial agents, servicing agents, etc… Each counterparty must be reviewed at least annually for financial strength and an assessment made of its ability to carry out the business of the Oregon State Treasury. A list of all counterparties will be provided to OUS annually along with this assessment.

7. **Strategy:**
   - Maintain an overall portfolio quality of at least “A” or higher using a rating to worst methodology
   - In the long-term portion, maintain an average bond duration level of +/-20% of the custom fixed income benchmark
   - Structure maturities to provide reinvestment opportunities that are staggered throughout the economic time horizon. No more than 15% of the portfolio can be reinvested in a single calendar quarter for the Longer-Term portion.

8. **Liquidity:**
   OUS will actively draw on the Short-Term portion of the portfolio. OUS may have occasional need to draw on the Intermediate-Term or Longer-Term portion of the portfolio. Prior to any such withdrawal, OUS will communicate its requirement in such a manner as to allow the greatest amount of time possible for planning purposes. At that time, this policy will be re-evaluated to determine the appropriate allocation of OUS funds to the three portions.

9. **Portfolio Restrictions:**
   - There shall be no investments in non-U.S. dollar denominated securities.
   - CDOs, CLOs, and Z-tranche investments are not permitted.
   - Any investment held that is downgraded by at least one rating agency to below investment grade requires a written action plan within 10 days of the downgrade. The plan may indicate why the investment should continue to be held and/or outline an exit strategy. The action plan will be shared with the OUS Finance and Administration Committee at its next regularly scheduled meeting.
   - There shall be no use of leverage in any fixed securities (excluding use of securities in a securities lending program). Securities such as ABS and CMBS shall not be considered as using leverage unless they are part of a broader structure, such as TARP funds, that explicitly use leverage.
   - The maximum allocation to each taxable fixed income sector shall be limited to a percentage of the total market value of each of the three portions (excluding mutual funds), as follows:
     
     | Sector                        | Limit |
     |-------------------------------|-------|
     | US Treasury Notes             | 100%  |
     | US Government Agencies        | 50%   |
Mortgage Backed Securities (Pass Though and CMO) 30%
Commercial Mortgage Backed Securities 10%
US Corporate indebtedness 50%
Asset Backed Securities 20%
Taxable Municipal Bonds 30%
Structured Securities (Combined MBS, CMBS, ABS) 50%

**Policy Compliance:** Any out of compliance issues with this policy, shall result in the external manager providing OST staff with a timely plan to achieve compliance.

10. **Performance Expectations/Reviews:** Over a market cycle of 3-5 years, the longer-term portion is expected to outperform the Merrill Lynch Global Bond Index B3B0. Quarterly investment review will take place focusing on:
   - Performance relative to objectives, and
   - Adherence to this policy.

   The Finance and Administration Committee of the State Board of Higher Education will review this policy every two years.

**SAMPLE FORMS, DOCUMENTS, OR REPORTS:**
None