

Minnesota State University Mankato Foundation

STATEMENT OF INVESTMENT POLICY

REVISION DATE: DECEMBER 2006

Statement of Investment Policy for the Minnesota State University Mankato Foundation

INTRODUCTION AND PURPOSE

This Statement of Investment Policy is set forth to:

1. Define the investment policies, guidelines and objectives of the Foundation.
2. Create a framework from which the Investment Committee can evaluate performance, explore new opportunities and make recommendations to the Board of Trustees to enhance the investment portfolio.
3. Provide guidance for, expectation of and limitation on all parties bearing investment responsibilities with the Foundation.

The intent of this Statement is to design an investment environment with specific parameters that reflects the philosophy of the Investment Committee, thereby providing Investment Managers with clearly defined policies and objectives. Although these policies and objectives are intended to govern the investment activity, they are designed to be sufficiently flexible in order to be practical.

INVESTMENT RESPONSIBILITIES

The Foundation is organized exclusively for scientific, literary, charitable, and educational purposes, within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1954. The investment program is managed in compliance with all applicable fiduciary, prudence, and due diligence requirements that experienced investment professionals would utilize, and with all relevant laws, rules, and regulations issued by local, state, federal and international political entities that apply to the Foundation.

Board of Directors

The Board of Directors (“Board”) bears the overall fiduciary responsibility for the Foundation. As such, the Board is ultimately responsible for making the decisions that affect the Foundation’s Investment Policy, Portfolio Objectives, Policy Asset Allocation, and Consultant. They must act prudently, avoid self-dealing and conflicts of interest, and for the best long-term interest of the Foundation. The Board has created the Investment Committee, a working committee of the Board, to coordinate the activities of Investment Managers, the Consultant and Custodian, study issues pertinent to the Foundation portfolio, and report and make recommendations back to the Board.

Investment Committee

The Investment Committee (“Committee”) is charged by the Board with the responsibility of overseeing the management of assets of the Foundation available for investment. The Committee has the responsibility to ensure that the assets of the Foundation are managed in a manner which is consistent with the policies and objectives of the Foundation. In this regard, the Committee also has oversight responsibility for full compliance with all applicable laws.

The Committee Members shall discharge their duties solely in the interest of the Foundation and for the exclusive purpose of meeting the financial needs of the Foundation. The Committee is authorized and permitted to engage the services of registered Investment Managers who possess the necessary specialized research facilities and skill to meet the investment objectives and guidelines of the Foundation. Accordingly, the Committee will require the Investment Managers to adhere to any policies adopted by the Committee.

In carrying out its responsibilities a quorum of the Committee must be present, either in person or by teleconference. Each member shall be entitled to one vote and each decision of the Committee shall require the assent of a majority of those present.

The Investment Committee's responsibilities include:

1. Recommending investment policy guidelines and reviewing their compliance;
2. Recommending policy asset allocation ranges;
3. Assessing and recommending investment objectives, rebalancing strategies, and performance measurement standards which are consistent with the financial needs of the Foundation;
4. Reviewing and evaluating investment results in the context of predetermined performance standards and implementing corrective action as needed; and
5. Reporting to the Board regarding the Foundation's account balance, asset allocation, performance, and other pertinent items.

Investment Consultant

The Investment Committee may recommend the engagement of an independent investment consulting firm (“Consultant”) to assist the Foundation in the attainment of its objectives and monitor compliance with the stated investment policies. The Consultant’s responsibilities are:

1. Assisting in the development and implementation of investment policies, objectives and guidelines,
2. Preparation of an asset allocation analysis and recommendation of an asset allocation strategy with respect to the Foundation’s objectives,
3. Searching for, reviewing, and selecting Investment Managers and Custodian.
4. Preparing and presenting performance evaluation reports in accordance with Association of Investment Management and Research promulgated standards,
5. Attending Committee meetings to present evaluation reports on a regular basis,
6. Reviewing of contracts and fees for both current and proposed Investment Managers and Mutual Fund Investments,
7. Reviewing and developing special investment strategies that complement existing asset classes or strategies to be considered by the Finance/Investment Committee,
8. Communicating investment policies and objectives to the managers, monitoring their adherence to such policies and reporting all violations,
9. Notifying the Committee of any changes in key personnel or ownership of the consulting firm, as well as satisfactory explanation for such changes,
10. Assisting the Committee in special tasks,
11. Notifying the Committee immediately of any litigation or violation of securities regulations in which any Investment Manager is involved, and
12. Notifying the Committee of any significant changes in portfolio managers, personnel or ownership of any investment management or mutual fund firm.

Investment Managers

Each Investment Manager is expected to pursue their own investment strategy within the performance guidelines created for individual managers. Coordination of the guidelines for the individual managers assures the combined efforts of the managers will be consistent with the overall investment objectives of the Foundation.

The Investment Managers' responsibilities are as follows:

1. Investing assets under their management in accordance with the guidelines and restrictions formulated by the Committee;
2. Exercising discretionary authority over the assets entrusted to them, subject to these guidelines and restrictions;
3. Providing written documentation of portfolio activity, portfolio valuations, performance data, and portfolio characteristics on a quarterly basis in addition to other information as requested by the Committee or Investment Consultant;
4. Voting proxies vigorously in the best interest of the Foundation; and,
5. Where applicable, annually providing a copy of the SEC investment advisors disclosure form ADV Part II.

Investment Custodian

The custodians are responsible for the safekeeping of the Foundation's assets. Their duties and responsibilities are as follows:

1. Providing timely reports detailing investment holdings and account transactions monthly and an annual report summarizing the following to be submitted to the Foundation and the Consultant within 21 days following each fiscal year end.
2. The reports will include the following:
 - a. Statement of all property on hand,
 - b. Statement of all property received representing contributions to the accounts,
 - c. Statement of all sales, redemptions, and principal payments,
 - d. Statement of all distributions from the account,
 - e. Statement of all expenses paid,
 - f. Statement of all purchases, and
 - g. Statement of all income.
3. Establishing and maintaining an account(s) for Investment Manager(s) employed or Mutual Fund(s) held by the Foundation,
4. Providing all normal custodial functions including security safekeeping, collection of income, settlement of trades, collection of proceeds of maturing securities, daily investment of uninvested cash, etc., and
5. Preparing additional accounting reports as requested by the Committee or Consultant.

INVESTMENT POLICIES AND OBJECTIVES

General Investment Philosophy

Objectives:

1. **Return:** The long term objective of the Foundation is to earn a return sufficient to preserve the purchasing power of the Foundation for generations to come, as well as to provide for current needs. As a result, the annual return should at least equal the annual sum of distributions, inflation, administrative costs, and net of management fees. The Foundation portfolio has adopted a “total return” investment approach; current income is considered a secondary consideration.
2. **Risk:** The Foundation’s portfolio will be permitted to experience an overall level of risk consistent with the risk generally associated with the policy asset allocation. Permissible ranges for policy asset allocation are set forth in **Appendix B**.

Constraints:

1. **Liquidity:** The portfolio must offer sufficient liquidity to meet payments of philanthropic endeavors and operating expenses, as well as principal and interest payments due on (any) outstanding debt.
2. **Time Horizon:** The Foundation’s intent is to remain in perpetuity, and as such, the portfolio should support this goal.
3. **Taxes:** The Foundation pays taxes according to IRS Section 501(c)(3) for exempt private foundations.

Return Measurement Objectives

The investment objectives of the Foundation are based upon a long term investment horizon allowing interim fluctuations to be viewed in an appropriate perspective. While there cannot be complete assurance that the defined objectives will be realized, it is believed that the likelihood of their realization is enhanced by the Investment Policy Statement of the Foundation.

Over time, the Foundation will aim to achieve the total fund return goal while maintaining acceptable risk levels. To accomplish this goal, the fund will diversify its assets among several asset classes. **Appendix A** provides permissible asset classes and appropriate index measures of these classes. Active managers will be expected to provide returns greater than or equal to their appropriate benchmark while utilizing acceptable risk levels.

All return objectives described are understood to be net (after) of investment expense.

1. Total Foundation (portfolio) assets should attempt to return, over the Time Horizon, an annualized nominal rate of return greater than or equal to the long-term return objective, net after all fees and costs.
2. Total Foundation (portfolio) assets should attempt to return, over rolling twelve month periods, a nominal rate of return greater than or equal to a composite index created by combining various indices (**Appendix A**) in the same proportion as the Foundation’s target allocation (described in **Appendix B**).

3. Each investment manager should attempt to return, over rolling twelve month periods, a nominal rate of return greater than or equal to the appropriate market index for that investment manager (**Appendix A**), with not more than commensurate risk.

Volatility and Risk

The Foundation believes that the return objectives can be achieved while assuming acceptable risk levels commensurate with “market” volatility. “Market” volatility is defined as the trailing three year standard deviation of investment returns (based on monthly data) of the benchmark indices deemed appropriate.

The Foundation further believes that risk is defined as the probability of failing to meet the Foundation’s Objectives over the time horizon. Therefore, in order to minimize the probability of failure, thereby minimizing risk, the following variables should be considered in all aspects of the decision-making process with regards to the Foundation’s investable assets:

- Probability of Missing the Goal Return
- Inflation
- Asset/Style Allocation

Distribution Policy

Distribution Rate

The Foundation recognizes that authorizing a Distribution Rate equal to the Foundation’s total return each year will doom the Fund to declining real values, due to the effects of inflation and costs of investment management. At the same time, the Foundation is aware that it has come to rely upon a certain distribution amount in preparing its operating budgets. This amount is made available for the payments of grants, operating expenses, and investment management expense.

The Foundation feels that a Distribution Rate of up to 7% (5% for endowment purposes, and 0% to 2% for administrative costs) is appropriate to meet the needs of Foundation. Distributions for endowment purposes will take priority over administrative purposes. This Distribution Rate will be reviewed periodically in light of evolving trends with respect to investment returns and the rate of inflation. Adjustments will be made when appropriate.

In carrying out the Distribution Policy, the Foundation may find it necessary to distribute more in an individual year than was actually earned in the year where, for instance, the most recent four quarters experienced a loss. The policy will act to maintain a more stable distribution stream, whether total return is positive or negative in given years.

Distribution Amount Calculation

It shall be the policy of the Foundation to distribute an amount equal to the product of the Distribution Rate and the investment portfolio’s trailing three-year average market value, as of June 30th each year. This amount is then used for projecting the following years’ budget.

Total Return Policy

The Foundation's total return is comprised of both traditional "income" (e.g., dividend on stocks and interest on fixed-income securities) *plus* realized and unrealized net capital gains. In recognition of these facts the Foundation has determined to use a Total Return in conjunction with the Distribution Policy.

It shall be the policy of the Foundation when administering this Distribution Policy to consider the Foundation's total return from both income and net capital gains, both realized and unrealized. All earnings are to be reinvested rather than be paid in cash. When the distribution is made it will be withdrawn from the portfolio regardless of the portion of the total return that is from capital gains or from income.

Asset Allocation

The single most important decision made by the Foundation is the asset allocation decision. Investment research has determined that a significant portion of a fund's investment behavior can be attributed to (1) the asset classes/styles which are employed by the fund, and (2) the weighting of each asset class/style. It is the responsibility of the Committee of the Foundation to recommend to the Board the asset allocation that offers the highest probability of achieving the investment objectives. The Committee, with guidance and recommendations from their Consultant, should review the asset mix on an ongoing basis and recommend revisions as necessary. Current policy asset allocation guidelines and permissible ranges are set forth in **Appendix B**.

The target asset allocation has been determined by the Foundation based on a comprehensive allocation study completed by the Consultant. The target asset allocation of the Foundation is designed to give balance to the overall structure of the Foundation's investment program over a long time horizon. However, some factors may impact the target allocation, thereby requiring an asset allocation review and possible rebalancing. Some of these factors include:

1. The Committee's assessment of the intermediate or long term outlook for different types of asset classes and styles,
2. The Consultant's assessment of the intermediate or long term outlook for different types of asset classes and styles,
3. Divergence in the performance of the different asset classes and styles

Portfolio Rebalancing

Since asset allocation is the most critical component of the Foundation's returns, it is desirable to rebalance the portfolio periodically to minimize deviations from the Policy Asset Allocation mix.

The Committee or Consultant may rebalance the portfolio to achieve the Policy Asset Allocation at any time. However, the portfolio shall be rebalanced in the event any individual traditional asset class (equity, alternatives, or fixed income) differs from policy by more than 20% of the target weight, but with a minimum deviation threshold of 5% of the total portfolio value. The Consultant will complete the rebalancing process and notify the Committee.

Permissible Investments

The target asset allocation of the Foundation is expected to include a wide range of asset classes. These asset classes and their relative comparative indices are displayed in **Appendix A**. The permissible asset classes are as follows:

Maximum Allocation %	Asset Class
60	Domestic Large-Capitalization Equity
30	Domestic Large-Capitalization Value Equity
30	Domestic Large-Capitalization Growth Equity
40	Domestic Mid-Capitalization Equity
30	Domestic Small-Capitalization Equity
30	Domestic Small-Capitalization Value Equity
60	International Large-Capitalization Equity
30	International Small-Capitalization Equity
20	International Emerging Markets Equity
15	Private Equity
30	Domestic Fixed Income
30	Inflation-protected Fixed Income
15	Global Fixed Income
15	High Yield Fixed Income
15	International Emerging Markets Fixed Income
20	Real Estate (including REITs)
30	Absolute Return Strategies (including hedge funds)
15	Natural Resource and Commodity Funds
30	Cash Equivalents

Investment Policies & Performance Goals for Investment Managers and Mutual Funds

The following are performance goals and constraint guidelines placed on individual managers and mutual funds within specific asset classes:

All Managers

1. All managers shall demonstrate a reasonable match, or “fit”, with their respective index, as measured by acceptable R^2 and tracking error. R^2 ranges from 0 to 100 and reflects the percentage of a manager's movements that are explained by movements in its benchmark index.
2. Active managers shall be terminated if tracking error is consistently out of policy and net performance is statistically indistinguishable from the benchmark return.
3. Index managers shall be terminated if tracking error is consistently out of policy.
4. No traditional manager shall be permitted to use margin or to otherwise leverage the portfolio, without the prior written consent of the Committee. However, alternative managers are permitted to use margin or leverage the portfolio, without the Board's consent, so far as their use of margin and leverage is consistent with their mandate.

Domestic Equity

1. The maximum weighting (cost basis) in any one company for active managers is 10%. This weighting applies only to those funds managed by a particular manager.
2. The maximum allocation to cash, at any time, will be 5% unless written permission is communicated to the Consultant by the Committee.
3. Trading and Execution: Managers should execute trades on a competitive basis, considering both commission and market impact, as compared to relative size funds.

Domestic Fixed Income

1. The maximum weighting (cost basis) in any one security for active managers is 10%. This does not apply to U.S. government and agency issues.

International Equity and Fixed Income

1. The use of currency futures to enhance performance and/or hedge currency exposure by international and/or global managers is at the discretion of the manager, provided the hedging in any one currency will never exceed the market value of the assets in the currency. A detailed description of a manager's currency strategy must be submitted to the Investment Committee.

Other

- *Securities Lending:* Investment Managers may engage in securities lending to broker dealers as a means of enhancing the portfolio's income.
- *Active vs Passive Management Decision:* The Committee shall continue to review the relative advantages of passive versus active management in the context of reduced management expenses, stable performance and constant, complete exposure to the particular asset class with regard to the excess return provided by the individual manager.
- *Related Party Transaction:* The Foundation will not loan funds to related parties defined as an officer, director, Committee member, employee, or donor either current or prospective.

Procedure for Revising Guidelines

All investment policies and performance goals will be reviewed annually or when deemed necessary by the Committee. In order to facilitate timely adjustments and rebalancing to the Foundation's Policy Asset Allocation without undue delays, the Policy Asset Allocation may be revised with a majority vote of the Board.

Reporting Requirement

The Consultant will be responsible for the preparation of the reports concerning performance evaluation. These reports will comply with standards developed by the Association for

Investment Management and Research. While the assets will be monitored on a continuous basis, the Committee will focus primarily on the achievement of its objectives over a rolling three year time horizon. However, if any Investment Manager significantly changes management philosophy, personnel or ownership, a review will be conducted to determine if the Investment Manager remains appropriate for the Foundation's purpose. The format of the Foundation's performance evaluation reports shall be developed with input from the Committee.

Conflicts of Interest

All persons responsible for investment decisions or who are involved in the management of the Foundation or who are consulting to, or providing any advice whatsoever to the Committee, shall disclose in writing at the beginning of any discussion or consideration by the Committee, any relationships, material beneficial ownership, or other material interest(s) which the person has or may reasonably be expected to have, with respect to any investment issue under consideration. The Committee may require such persons to remove themselves from the decision-making process.

Any member(s) of the Committee responsible for investment decisions or who are involved in the management of the Foundation shall refuse any remuneration, commission, gift, favor, service or benefit that might reasonably tend to influence them in the discharge of their duties, except as disclosed in writing to and agreed upon in writing by the Committee. The intent of this provision is to eliminate conflicts of interest between committee membership and the Foundation. Failure to disclose any material benefit shall be grounds for immediate removal from the Committee. This provision shall not preclude the payment of ordinary fees and expenses to the Foundation's custodian(s), Investment Manager(s), or Consultant(s) in the course of their services on behalf of the Foundation.

APPENDIX A

**COMPARATIVE INDICES
FOR TRADITIONAL INVESTMENT MANAGERS**

ASSET CLASS	COMPARATIVE INDEX
Equity	
<i>Domestic Equity</i>	
U.S. All-Cap Stocks	Wilshire 5000
U.S. Large Stocks	S&P 500
U.S. Large Value Stocks	Russell 1000 Value
U.S. Large Growth Stocks	Russell 1000 Growth
U.S. Mid Stocks	S&P MidCap 400
U.S. Small Stocks	Russell 2000
U.S. Small Value Stocks	Russell 2000 Value
<i>International Equity</i>	
Int'l Large/Mid Stocks	MSCI EAFE
Int'l Small Stocks	S&P Citigroup EMI-EPAC
Emerging Market Stocks	MSCI Emerging Markets Free
<i>Private Equity</i>	S&P 500 + 5%
Fixed Income	
Domestic Fixed Income	Lehman Aggregate Bond
Inflation-protected Fixed	Citigroup Inflation Linked Bond
High Yield Fixed Income	Citigroup High Yield
Global Fixed Income	Citigroup World Bond
Emerging Mkt Bonds	JPM Emerging Mkt Bond
Cash Equivalents	U.S. Treasury Bills
Absolute Return	HFR Fund of Funds Index or CPI + 5%
Real Estate (including REITs)	Dow Jones Wilshire REIT
Commodity Funds	Dow Jones AIG Commodity Index
Natural Resources	Goldman Sachs Natural Resources Index

APPENDIX B**POLICY ASSET ALLOCATION PARAMETERS AND GUIDELINE RANGES**

Allocation Parameters	Allocation Range (%)
Growth Assets	50% to 75%
Risk Reduction Assets	10% to 40%
Inflation Protection	15% to 35%
Expected Return	8.0%
Standard Deviation	±10.5%

Portfolio Components		
Growth Assets	Risk Reduction	Inflation Protection
US Equities International Equities	Fixed Income Absolute Return	Real Assets Inflation Protected Bonds

Signatures:

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

This Investment Policy Statement must be reviewed by the Board of Directors at least once a year and confirmed as appropriate or amended as necessary at that time.

Approved by the Board of Directors on this _____ day of _____, 2006.