# Request for Proposals:
# **Investment Management**

Michigan Saves, a 501(c)(3) nonprofit, is seeking an established and well-respected investment management firm to provide investment management services.

## Organizational Description

Michigan Saves is a nonprofit dedicated to making energy improvements easier for all Michigan energy consumers. To accomplish this, Michigan Saves makes affordable financing and other incentives available through grants and partnerships with private sector lenders. We also authorize and monitor a network of contractors and recognize those with advanced training. Our current portfolio includes programs for residential, commercial, and municipal customers, and supports energy efficiency, geothermal, and solar PV projects.

### *Our Mission*

The mission of Michigan Saves is to stimulate and support investment in energy efficiency and renewable energy systems and measures in Michigan homes, businesses, and public buildings. Working through our industry and community partners, we offer a statewide network of authorized, professional building contractors with expertise in energy efficiency and on-site renewable energy systems; make innovative, affordable financing available for energy-focused building and equipment improvements; and accelerate demand for greater efficiency through education and communication.

### *How We Operate*

Michigan Saves was established in 2009 through a grant from the Michigan Public Service Commission (MPSC). The grant allowed a two-year period to establish the organization and an initial portfolio of programs to support energy installations. In September 2011, the organization became fully independent. Governed by a 15-member Board of Directors and a special policy adviser appointed by the MPSC, Michigan Saves has no employees, but is staffed via contract by Public Sector Consultants Inc. and the Delta Institute. Michigan Saves has been awarded several grants by State of Michigan agencies and by the U.S. Department of Energy to expand and enhance our programs.

We work hard to be good stewards of taxpayer dollars, and use them to appropriately leverage private investment. For every public dollar, an additional $20 in private funds are invested in energy improvements.

- Michigan Saves received its initial funding primarily through grants from state and federal agencies. Funding from the grants is available to be used long term to support credit enhancement and financing activities, primary through a loan loss reserve. Additional sources of revenue include contractor fees collected on each closed loan or lease, and program income. It is anticipated that additional grants from state and federal agencies, as well as from private foundations, will be secured in the future.

## Services Sought in this RFP

As of May 31, 2014, Michigan Saves has approximately $11.5 million of funds on hand, which are invested according to short- and long-term investment policy statements approved by the board.

This request seeks proposals from qualified firms to:

- Invest the restricted and unrestricted assets of the organization according to projected cash flow needs and schedules of future liabilities.
- Advise the executive director, treasurer, and accountants of the organization on cash management procedures and cash flow considerations.
- Assist the board's Finance Committee in reviewing the investment policy statements.
- Provide monthly reports to the executive director and Finance Committee on the value of investments.
- Attend (either in person or via teleconference) meetings of the Board of Directors on an as-needed basis.

The importance of the first two bullets above—investing the restricted and unrestricted assets of the organization and managing cash flow—cannot be overemphasized. Because the majority of funds held by Michigan Saves are in the form of a loan loss reserve pool, Michigan Saves, in many respects, behaves like an insurance company. At full operation, we will hold $10.1 million in assets—leveraged between 5:1 and 20:1—against a known pool of potential and capped losses. Each month, some of the losses are realized (loans default, converting potential liability to actual liability), new loans are written (therefore incurring new potential liabilities), and other loans are repaid (thereby removing all potential liability for that particular loan). (See attached internal management controls for section II for information on loan loss reserve business rules.) Investment earnings are expected to help fund ongoing operations and/or replace loan loss reserve funds as payments are made to lenders for loan or lease defaults. Maximizing investment earnings, while minimizing risk and the costs associated with management fees, is an important factor in evaluating potential investment management firms.

Michigan Saves is staffed by Public Sector Consultants Inc. and accounting services are provided by a third-party accounting firm. It is vital for the investment management firm to work in concert with our staff and our accountants to maintain the flow of both payments and receipts for these funds.

## Selection Criteria

1. **Company Information**
   a) Well-established (organization in existence at least 20 years, or principals of the firm with at least 20 years of prior direct experience as registered financial advisers)
   b) Financially stable

2. **Qualifications and Experience**
   a) Experience with nonprofits
   b) Experience providing financial management services for organizations of similar or larger size
   c) Appropriate qualifications and previous experience of staff assigned to work with Michigan Saves (both supervisory and day-to-day staff)
   d) Absence of conflicts of interest
   e) Satisfactory feedback from references

3. **Investment Policy**
   a) Demonstrated understanding of Michigan Saves' investment goals
   b) Satisfactory policy adherence controls

4. **Asset Allocation and Investment Management**
    a) Comprehensiveness and adequacy of the asset allocation development approach
    b) Management approach and style consistent with Michigan Saves' investment goals
    c) Portfolio performance of similar organizations
    d) Satisfactory reporting, portfolio evaluation, and review of accounts

5. **Fees**
    a) Feasibility of carrying out services given the proposed fees
    b) Satisfactory justification for proposed fees and costs

## Submission Requirements

To respond to this RFP, please submit a narrative of no more than 20 pages, with one-inch margins and 10-point type or larger, that addresses the following:

1. **Company Information**
    a) Year organized
    b) Number of clients
    c) Type of clientele (defined by industry and size of portfolio)
    d) Number of staffers (i.e., investment-related staff only)
    e) Assets under management in 2008, 2009, and 2010
    f) Number of offices
    g) Location of corporate headquarters
    h) Affiliations with related institutions
    i) Discussion of any past or present litigation or regulatory actions against your firm
    j) Copy of the organization's most recent Form ADV as an appendix

2. **Qualifications and Experience**
    a) Qualifications of principals and professional staff (please specify the individuals directly responsible for this account)
    b) Number of years of experience in investment management
    c) Discussion of investment philosophy
    d) Discussion of customer service philosophy
    e) Qualifications and experience in providing investment management services for nonprofits, including organizations of comparable type and size to Michigan Saves
    f) Three specific references that we may contact (clients most similar to Michigan Saves in type, size, and services requested are recommended)
    g) Assurances that providing services to Michigan Saves under this RFP does not constitute a conflict of interest for your organization, Michigan Saves, or Public Sector Consultants Inc.

3. **Investment Policy**
    a) Assessment of existing investment policy, recommendations for improvement, rationale for recommendations, and effect on your fees, if any
    b) Approach to complying with Michigan Saves' investment policy, including controls and disciplines implemented

4. **Asset Allocation**
    a) Approach in formulating an asset allocation for Michigan Saves
    b) Frequency of allocation review

5. **Investment Management**
    a) Two alternative sample portfolios—one unrestricted portfolio and one portfolio focused on strategic sustainable investment strategies—you think will best accomplish Michigan Saves'

investment goals (as defined by the attached investment policy), including

i. Specific investment approaches you provide (U.S. equity, U.S. fixed income, international, non-traditional, etc.)
ii. Investment styles you implement (growth, value, market neutral, small capitalization, indexed, etc.)
iii. Performance results for one-, three-, five-, and 10-year periods, compared to the most applicable market index.
iv. Detailed and clear listing of all fees for the sample portfolio

b) Frequency of reporting to clients (e.g., monthly, quarterly)
c) Form of your reports (please provide sample)
d) Frequency of portfolio evaluation
e) Frequency of account review by your firm and willingness to meet with management to make recommendations and discuss performance

**6. Fees**

a) a. Indicate all fees involved for each of the services you are proposing to provide
b) Include a breakout of the initial and ongoing consulting fees and the custodial and management fees as a percentage of the dollar value of the assets
c) Does the fee schedule reflect a discount from your normal rates because of our nonprofit status?
d) Discuss how frequently such fees will be evaluated and the maximum amount of any increase to be expected

Proposals should provide a concise description of your organization's ability to meet the requirements of the RFP. You may submit the response by sending two hard copies to:

Anna Schroen
Project Assistant
230 N. Washington Square, Suite 300
Lansing, MI 48933

or by e-mailing a single copy in PDF format to aschroen@michigansaves.org.

The deadline for response is noon, July 15, 2014.

## Timeline

- Proposals due by July 15, 2014.
- Contract awarded by late August.

## Additional Information

Michigan Saves reserves the right to reject any and all proposals received as a result of this RFP, and is not liable for any cost incurred by your firm in responding to this opportunity.

Those firms whose proposals are selected for further consideration may be asked to make a personal presentation to us and/or answer questions in advance of our final selection.

**If you have any questions, you are welcome—and encouraged—to contact the executive director at any point between now and the RPF due date.** Mary Templeton, executive director, can be reached at (517) 371-7453 or mtempleton@michigansaves.org.

# ATTACHMENTS

Attachment A: Management of Trust Assets
Attachment B: Short-term Investment Policy
Attachment C: Long-term Investment Policy

# **Attachment A:**
# Management of Trust Assets Section of Internal Management Controls

## Investment of Assets

1. **Loan Loss Reserve Business Rule**

   The Michigan Saves Board of Directors has adopted a business rule to ensure adequate cash reserves are maintained for the organization's loan loss reserve (LLR) accounts. The executive director will maintain 1.5 times committed LLR balance or $500,000—whichever is less—in FDIC/NCUA-insured deposit accounts, 0.5 to 1.0 times committed LLR balance in cash-equivalent accounts with our investment advisor, and remaining, uncommitted funds according to our investment policy statements. The executive director can use his/her discretion based on projections of loans to be made in the next 12 months to annually set a written policy naming the multiplier.

2. **Investment Policy**

   The assets of Michigan Saves are invested according to investment policy statements for the short- and long-term portfolios adopted by the Board of Directors consistent with the provisions of the Michigan Saves bylaws and state law. Investment advice and brokerage services for Michigan Saves are provided by the fund investment manager, which will be a contracted, independent investment adviser.

3. **Approval of Equity and Bond Purchases**

   The fund investment manager makes trades and equity and bond purchases within the confines of the investment policy statements for each portfolio (long- and short-term), without first having to seek approval from Michigan Saves personnel.

# Attachment B:
Short-term Investment Policy

# INVESTMENT POLICY STATEMENT

For

## Michigan Saves

## Short-Term Investment Account

December 2012

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# PURPOSE

The purpose of this Investment Policy Statement (IPS) is to assist the Finance Committee of Michigan Saves ("the Short-term Account") in establishing guidelines for managing the Short-term Account's Short-Term Investment account (the "Short-term Account") and to provide a framework for making consistent investment decisions in accordance with the stated objectives, risk tolerance, and time horizon of the Short-term Account. The Short-term Account's investment strategy is defined in the various sections of the IPS and Addendums by:

- Stating in a written document the Finance Committee's expectations, objectives, and guidelines with regard to the investment of Short-term Account assets.
- Setting forth a structure for managing the Short-term Account's investments. This structure includes an asset allocation policy that is expected to produce a sufficient level of overall diversification and total investment return over the investment time horizon.
- Providing guidelines for the level of overall risk and liquidity assumed in the portfolio, so that Short-term Account investments are managed in accordance with the stated objectives.
- Encouraging effective communications between the Investment Consultant and the Finance Committee.
- Establishing formalized criteria to monitor, evaluate, and compare the performance results achieved by the Investment Managers.
- Complying with all fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the Short-term Account's assets.

This IPS has been developed after consideration by the Finance Committee of the financial implications of a wide range of policies and describes the prudent investment process that the Investment Consultant and the Finance Committee deem appropriate.

The Short-term account is an asset of Michigan Saves, which is a non-profit corporation qualifying as a tax- exempt entity under Section 501 (c) (3) of the Internal Revenue Code of 1986, as amended. The specific and primary purpose of Michigan Saves is to implement a statewide program to help homeowners and commercial entities finance the cost of energy efficiency and renewable energy improvements. Michigan Saves receives its funding primarily through grants from state and federal agencies.

The Finance Committee is responsible for the charge and management of all assets of the Fund.

The Fund's current liquid assets, which consist of the Short-term Account and Long-term Account (covered under separate IPS), total approximately $10.0 million in market value and consist of cash and securities.

# RESPONSIBILITIES

**Finance Committee** – The Finance Committee has responsibility for the management of the Short-term Account assets. The Finance Committee shall discharge duties solely in the interest of the Short-term Account, with the care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character with like aims. The specific responsibilities of the Finance Committee relating to the investment management of the Short-term Account assets include, but are not limited to, the following:

1. Adhering to the guidelines as defined in all applicable regulations.
2. Determining the Short-term Account's risk tolerance and investment horizon and communicating these to the appropriate parties.
3. Establishing reasonable and consistent investment objectives, policies, and guidelines which will direct the investment of the Short-term Account's assets.
4. Prudently and diligently selecting qualified investment professionals, organizations including Investment Manager(s), Investment Consultant(s) and Custodian(s).
5. Regularly evaluating the performance of the Investment Managers to assure adherence to policy guidelines and monitor investment objective progress.
6. Developing and enacting proper control procedures: For example, replacing Investment Managers due to a fundamental change in investment process, or failure to comply with established guidelines.

As the Finance Committee is responsible for directing and monitoring the investment management of Short-term Account assets, it is authorized to delegate certain responsibilities to professional experts in various fields, as described below.

**Investment Consultant** – The Investment Consultant's role is that of a nondiscretionary advisor who will assist the Finance Committee in establishing investment policy, objectives and guidelines; selecting Investment Managers; reviewing such managers over time; measuring and evaluating investment performance and informing the Finance Committee regarding any qualitative change to the investment management organizations; selecting other diversified investment options for the Short-term Account, including but not limited to individual hedged strategies or fund of fund strategies, private equity, real estate, structured notes, etc.; and other tasks as deemed appropriate by the Finance Committee. The Investment Consultant's responsibilities are defined in a separate written agreement.

**Investment Manager(s)** - The Investment Managers have discretion to purchase, sell, or hold specific securities that will be used to meet the Short-term Account's investment objectives as provided by this IPS, or, in the case of a fund of fund strategy, hire or terminate individual managers and determine allocations to these managers and appropriate investment strategies. The Investment Manager(s) will be evaluated based on criteria established in this written IPS. Investment Manager(s) that may be hired include, but are not limited to, mutual funds, exchange traded funds (ETFs), separate account investment management firms, hedged strategies, private equity funds, real estate funds, fund of funds, and other specific investment strategies.

**Custodian** - The Custodian will maintain possession of securities owned by the Short-term Account, collect dividend and interest payments, redeem maturing securities, and effect receipt and delivery following purchases and sales. The Custodian may also perform regular accounting of all assets owned, purchased, or sold, as well as movement of assets into and out of the accounts.

Additional specialists such as attorneys, auditors, and others may be employed by the Finance Committee to assist in meeting its responsibilities and obligations to administer Short-term Account assets prudently.

If such experts employed are also deemed to be fiduciaries, they must acknowledge such in writing. All expenses for such experts must be customary and reasonable, and will be borne by the Short-term Account as deemed appropriate and necessary.

## STATEMENT OF OBJECTIVES

The objectives of the Short-term Account have been established in conjunction with a comprehensive review of the Short-term Account's financial requirements, including the Finance Committee's attitudes, goals, expectations, and ability to tolerate risk, and the Short-term Account's investment time horizon, present investment allocation, and financial liquidity requirements. The investment objective is to maintain liquidity while achieving a return on capital. The return objective may be reduced by the Finance Committee if capital market conditions suggest a more conservative, lower risk approach is required to protect the Short-term Account's Principal. Further objectives are:

- To maintain the purchasing power of the current assets and all future contributions
- To maximize return within the risk tolerance parameters set by the Finance Committee, and to provide exposure to a wide range of investment opportunities in various markets while reducing risk exposure through prudent diversification as to asset classes (e.g. fixed income, and alternatives) and specific securities within each class in order to minimize contributions
- To maintain liquidity with stability of principal in the portfolio
- To control costs of administering the Short-term Account and managing Short-term Account investments
- To maintain adequate cash reserves and meet cash flow needs
- To monitor Short-term Account investments periodically in order to make timely decisions as to policy and strategy
- To minimize the Finance Committee's time commitment on day-to-day investment decisions by delegating this responsibility to advisors
- To safeguard Short-term Account assets by utilizing independent custodians. Investment results are the critical element in achieving the investment objectives

### Spending Policy

Based upon the organizations estimated operational expenses the targeted spending rate will be 3.0% of the Short-term Account's average 3-year market value. (The Short-term Account's average 3-year market value is calculated by averaging the previous 12 quarter market value as of the organization's calendar year end).

## GUIDELINES AND INVESTMENT POLICY

### Time Horizon

The investment guidelines are based upon an investment horizon of less than two years; therefore, total returns should be viewed with appropriate perspective. Similarly, the strategic asset allocation is based on a short-term perspective.

There is a requirement to maintain sufficient liquid reserves to provide for disbursements. The Finance Committee should notify the Investment Consultant and/or the Investment Manager(s) well in advance of the withdraw orders to allow sufficient time to build up necessary liquid reserves.

**Risk Tolerance**

It is important to recognize the difficulty in achieving the investment objectives in light of the uncertainties and complexities of contemporary investment markets. The Finance Committee recognizes and acknowledges that some risk must be assumed in order to achieve the investment objectives.

In establishing risk tolerance, the ability to withstand short and intermediate term variability was considered, leading the Finance Committee to conclude that risk tolerance is low. The Finance Committee desires a portfolio that emphasizes lower risk investments with lower price fluctuations and is willing to accept lower returns for this Short-term Account.

**Performance Expectations**

The Finance Committee has reviewed the actual historical long term return and risk characteristics of various asset allocation strategies, as well as modeled range of return expectations for the next 2 years for a portfolio with weightings similar to the target asset allocation policy as described in Exhibit 1 and summarized below. The Finance Committee realizes that the portfolio returns will depend on the future investment and economic environment, and that past historical performance may not be indicative of future results.

After review of the various items described above, the Finance Committee desires a portfolio that will most likely generate the following range of and average pre-tax returns:

| | |
|---|---|
| 1 year range | (1.1)% - 7.1% |
| 2 year range | 0.00% - 5.9% |
| Average compounded return | 3.0% |

**Asset Allocation**

This portfolio is designed to carry an average duration of no more than 3 years.

Fixed Income type assets may include, but are not limited to, individual bond securities, whether or not managed by an investment manager, bond mutual or exchange traded funds, and cash.

Alternative asset classes may be used in the portfolio in order to enhance returns and/or reduce the risk of the overall portfolio. Alternative assets may include, but are not limited to higher risk bond strategies and other "hybrid" strategies. When allocating a portion of the portfolio to alternative assets, the investment consultant will assist the Finance Committee in determining from which investment the assets will be taken. Due to the potential illiquid nature of many alternative assets, it is the Finance Committee's desire that the target allocation to Alternative Investment strategies not exceed 10% of the portfolio.

Changes to the strategic allocation specified above will warrant a new Investment Policy Statement. Addendum A includes a detailed breakdown of the strategic allocation at the sub-asset class level (e.g. core bonds, small cap equities, international equities, hedged strategies, etc.). Material changes at the sub-asset class level may result in a new Addendum A, which is also represented by the asset allocation schedule included in the quarterly investment report.

**Asset Allocation Constraints**

Rebalancing will be strongly considered when the actual percentage allocations to investments vary by 5 percentage points or more from the Neutral Strategic allocation. Subject to practical constraints, rebalancing will also be strongly considered when the actual percentage allocation of a sub-asset class utilized within the portfolio varies by more than 20% from the target allocation identified in Addendum A. When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation.

## IMPLEMENTATION GUIDELINES

The Finance Committee intends to implement the Short-term Account's policy with mutual funds, exchange traded funds (ETFs), and separate account investment management firms, or other investment choices that the Finance Committee desires, whether or not approved by the Investment Consultant. Each ETF and mutual fund selected is expected to adhere to the terms and conditions set forth in its prospectus.

Mutual funds and ETFs should meet the following minimum criteria:

(1) Funds should correspond to the sub-asset classes outlined in the investment report provided by the Investment Consultant.

(2) The fund's manager should have been in place for three years or more, or should have a long-term track record managing assets with a similar style at another mutual Short-term Account or investment management firm.

(3) The funds should have been following the same investment strategy for at least three years (or the fund manager should have been following the same strategy for at least three years).

(4) In aggregate, the various share classes of the fund, as well as the separate account assets of the portfolio management firm sub-advising the mutual fund that are run under similar composite, should have at least $300 million under management.

The following securities and transactions are not authorized without receiving prior approval from the Finance Committee or authorized in a mutual fund's prospectus, separate managed account agreements, limited partnership agreements, or other investment implementation agreements. If authorized, such securities or transactions will only be implemented through the use of a qualified intermediary: antiques, coins, stamps, art work, precious metals, oil and gas interests, equipment leases, letter stock and other unregistered securities, securities lending, pledging or hypothecating securities, options and futures contracts.

# REPORTING AND MONITORING REQUIREMENTS

**Monitoring of Investment Managers**

Investment custodians should provide monthly statements of assets and transactions. Duplicate copies of these statements should be sent to the Investment Consultant by the custodians.

The Investment Consultant should prepare periodic investment reports that summarize the activity of the investments during the period reviewed, including investment performance and current asset allocation compared to desired asset allocation.

Quarterly performance will be evaluated to test progress toward the attainment of longer term targets. It is understood that there are likely to be short-term periods during which performance deviates from market indices. During such times, greater emphasis shall be placed on peer performance comparisons, with managers employing similar styles.

On a timely basis, but not less than once a year, the Finance Committee will meet with the Investment Consultant to focus on:

- Investment Manager's adherence to the IPS guidelines;
- Material changes in the manager's organization, investment philosophy and/or personnel; and,
- Comparisons of the Investment Manager's results to appropriate indices as found on Addendum A.

The 5 year risk associated with each Investment Manager's portfolio, as measured by the variability of quarterly returns (standard deviation), should not exceed that of the benchmark index and the peer group without a corresponding increase in performance above the benchmark and peer group.

In addition to the information covered during the quarterly reviews, the Finance Committee will meet with the Investment Consultant at least annually to focus on:

- The Investment Manager's performance relative to managers of like investment style or strategy. Each Investment Manager is expected to perform in the upper half of the manager's style universe over most annual periods.
- The Fund's investment performance results compared to the Investment Manager's overall composite performance figures to determine unaccounted for dispersion between the Investment Manager's reported results and the actual results over annual periods.

The Finance Committee is aware that the ongoing review and analysis of Investment Managers is just as important as the due diligence implemented during the manager selection process. Accordingly, a thorough **review and analysis** of an Investment Manager will be conducted, should:

- A manager performs in the bottom quartile (75th percentile) of their peer group over a quarterly or annual period.
- A manager falls into the southeast quadrant of the risk/return scatter-plot for a 5 year time-period.
- A manager has a 5 year risk adjusted return fall below that of the median manager within the appropriate peer group.

Furthermore, the following could be considered more serious indications of underperformance and may require the **replacement** of a manager:

- A manager performs below the median (50th percentile) of their peer group over the available rolling 3 year annual periods.
- A manager performs below the median (50th percentile) of their peer group over a 5 year period.
- A manager has a negative alpha for a 5 year time period.

Major organizational changes will also warrant immediate review of the manager, including:

- Significant change in professionals
- Significant account losses
- Significant growth of new business
- Significant change in ownership

The performance of the Investment Manager will be monitored as described above, and it is at the discretion of the Finance Committee to take corrective action by replacing a manager if deemed appropriate at any time.

In addition, the portfolio will be benchmarked against a "Broad Index," which shall consist of the following index, weighted in accordance with the current asset allocation policy:

| | |
|---|---|
| Barclays Capital 1-3 Year Government Index* | 100% |

(*or another index designed to measure the performance of this asset class)

In reviewing the longer term performance of the portfolio (net of fees) against the "Broad Index," the Finance Committee should be able to assess the effectiveness of the various recommendations provided by the Investment Consultant that Finance Committee implemented, and if, in aggregate, they added value. Decisions that will affect the performance of the portfolio when compared to this benchmark included, but are not limited to, sub-asset class allocations, Investment Managers hired, use of alternative investments, and periodic portfolio re-balancing.

Weightings to each component of the "Broad Index" will be updated if there is a material change in the relative allocations to these asset classes.

## STATEMENT REVIEW/AUTHORITY

This IPS should be reviewed by the Finance Committee/Trustee(s) at least annually and changed, as needed. It is not expected that the IPS will change frequently. In particular, short-term changes in financial markets should not require adjustments to the IPS. Changes to the IPS may only be made by the Finance Committee/Trustee(s).

| Prepared by: | Reviewed and Accepted: |
|---|---|
| ______________________________ | __________________________________ |

# **Attachment C:**
Long-term Investment Policy

# INVESTMENT POLICY STATEMENT

## For

## Michigan Saves

## Long-Term Investment Account

## July 2013

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# PURPOSE

The purpose of this Investment Policy Statement (IPS) is to assist the Finance Committee of Michigan Saves Long-Term Investment Account("the Fund") in establishing guidelines for managing the Fund investments and to provide a framework for making consistent investment decisions in accordance with the stated objectives, risk tolerance, and time horizon of the Fund. The Fund's investment strategy is defined in the various sections of the IPS by:

- Stating in a written document the Finance Committee's expectations, objectives, and guidelines with regard to the investment of Fund assets.
- Setting forth a structure for managing Fund investments. This structure includes an asset allocation policy that is expected to produce a sufficient level of overall diversification and total investment return over the investment time horizon.
- Providing guidelines for the level of overall risk and liquidity assumed in the portfolio, so that Fund investments are managed in accordance with the stated objectives.
- Encouraging effective communications between the Investment Consultant and the Finance Committee.
- Establishing formalized criteria to monitor, evaluate, and compare the performance results achieved by the Investment Managers.
- Complying with all fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, federal and international political entities that may impact Fund assets.

This IPS has been developed after consideration by the Finance Committee of the financial implications of a wide range of policies and describes the prudent investment process that the Investment Consultant and the Finance Committee deem appropriate.

The Fund is an asset of Michigan Saves, which is a non-profit corporation qualifying as a tax-exempt entity under Section 501 (c) (3) of the Internal Revenue Code of 1986, as amended. The specific and primary purpose of Michigan Saves is to implement a statewide program to help homeowners and commercial entities finance the cost of energy efficiency and renewable energy improvements. Michigan Saves receives its funding primarily through grants from state and federal agencies.

The Finance Committee is responsible for the charge and management of all funds of the Fund.

The Fund's current liquid assets, which will fund the managed portfolio total approximately $10.0 million in market value and consist of cash and securities.

# RESPONSIBILITIES

**Finance Committee** – The Finance Committee has responsibility for the management of the Fund assets. The Finance Committee shall discharge duties solely in the interest of the Fund, with the care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character with like aims. The specific responsibilities of the Finance Committee relating to the investment management of the Fund assets include, but are not limited to, the following:

1. Adhering to the guidelines as defined in all applicable regulations.

2. Determining the Fund's risk tolerance and investment horizon and communicating these to the appropriate parties.
3. Establishing reasonable and consistent investment objectives, policies, and guidelines which will direct the investment of the Fund's assets.
4. Prudently and diligently selecting qualified investment professionals, organizations including Investment Manager(s), Investment Consultant(s) and Custodian(s).
5. Regularly evaluating the performance of the Investment Managers to assure adherence to policy guidelines and monitor investment objective progress.
6. Developing and enacting proper control procedures: For example, replacing Investment Managers due to a fundamental change in investment process, or failure to comply with established guidelines.

As the Finance Committee is responsible for directing and monitoring the investment management of Fund assets it is authorized to delegate certain responsibilities to professional experts in various fields, as described below.

**Investment Consultant** – The Investment Consultant's role is that of a discretionary advisor who will assist the Finance Committee in establishing investment policy, objectives and guidelines; selecting Investment Managers; reviewing such managers over time; measuring and evaluating investment performance and informing the Finance Committee regarding any qualitative change to the investment management organizations; selecting other diversified investment options for the Fund, including but not limited to individual hedged strategies or fund of funds strategies, private equity, real estate, structured notes, etc.; and other tasks as deemed appropriate by the Finance Committee. The Investment Consultant's responsibilities are defined in a separate written agreement.

**Investment Manager(s)-** The Investment Managers have discretion to purchase, sell, or hold specific securities that will be used to meet the Fund's investment objectives as provided by this IPS, or, in the case of a fund of funds strategy, hire or terminate individual managers and determine allocations to these managers and appropriate investment strategies. The Investment Manager(s) will be evaluated based on criteria established in this written IPS. Investment Manager(s) that may be hired include, but are not limited to, mutual funds, exchange traded funds (ETFs), separate account investment management firms, hedged strategies, private equity funds, real estate funds, fund of funds, and other specific investment strategies.

**Custodian** – The Custodian will maintain possession of securities owned by the Fund, collect dividend and interest payments, redeem maturing securities, and effect receipt and delivery following purchases and sales. The Custodian may also perform regular accounting of all assets owned, purchased, or sold, as well as movement of assets into and out of the accounts.

Additional specialists such as attorneys, auditors, and others may be employed by the Finance Committee to assist in meeting its responsibilities and obligations to administer Fund assets prudently.

If such experts employed are also deemed to be fiduciaries, they must acknowledge such in writing. All expenses for such experts must be customary and reasonable, and will be borne by the Fund as deemed appropriate and necessary.

## STATEMENT OF OBJECTIVES

The objectives of the Fund have been established in conjunction with a comprehensive review of the Fund's financial requirements, including the Finance Committee's attitudes, goals, expectations, and ability to tolerate risk, and the Fund's investment time horizon, present investment allocation, and financial liquidity requirements. The investment objective is to achieve a total rate of return (Income, appreciation and reinvested funds) providing a reasonable level of growth, generation of sufficient income and preservation of capital. The return objective may be reduced by the Finance Committee if capital market conditions suggest a more conservative, lower risk approach is required to protect the Fund's Principal. Further objectives are:

- To maintain the purchasing power of the current assets and all future contributions
- To maximize return within the risk tolerance parameters set by the Finance Committee, and to provide exposure to a wide range of investment opportunities in various markets while reducing risk exposure through prudent diversification as to asset classes (e.g. fixed income, equities, and alternatives) and specific securities within each class in order to minimize contributions
- To maintain balance between growth with inflation protection and income with stability of principal in the portfolio
- To control costs of administering the Fund and managing Fund investments
- To maintain adequate cash reserves and meet cash flow needs
- To monitor Fund investments periodically in order to make timely decisions as to policy and strategy
- To minimize the Finance Committee's time commitment on day-to-day investment decisions by delegating this responsibility to advisors
- To safeguard Fund assets by utilizing independent custodians.

Investment results are the critical element in achieving the investment objectives

### Spending Policy

Based upon the organizations estimated operational expenses the targeted spending rate will be 4.0 – 5.0% of the Fund's average 3-year market value. (The Fund's average 3-year market value is calculated by averaging the previous 12 quarter market value as of the organization's calendar year end).

## GUIDELINES AND INVESTMENT POLICY

### Time Horizon

The investment guidelines are based upon an investment horizon of greater than five years; therefore, cyclical fluctuations should be viewed with appropriate perspective. Similarly, the strategic asset allocation is based on a long-term perspective.

There is a requirement to maintain sufficient liquid reserves to provide for disbursements. The Finance Committee should notify the Investment Consultant and/or the Investment Manager(s) well in advance of the withdraw orders to allow sufficient time to build up necessary liquid reserves.

**Risk Tolerance**

It is important to recognize the difficulty in achieving the investment objectives in light of the uncertainties and complexities of contemporary investment markets. The Finance Committee recognizes and acknowledges that some risk must be assumed in order to achieve the long- term investment objectives.

In establishing risk tolerance, the ability to withstand short and intermediate term variability was considered, leading the Finance Committee to conclude that risk tolerance is moderate. The Finance Committee desires a portfolio that is balanced between lower risk investments with lower price fluctuations and more volatile investments with higher potential returns.

**Performance Expectations**

The Finance Committee has reviewed the actual historical long term return and risk characteristics of various asset allocation strategies, as well as modeled range of return expectations for the next 5 years for a portfolio with weightings similar to the long-term target asset allocation policy as described in Exhibit 1 and summarized below. The Finance Committee realizes that the portfolio returns will depend on the future investment and economic environment, and that past historical performance may not be indicative of future results.

After review of the various items described above, the Finance Committee desires a portfolio that will most likely generate the following range of and average pre-tax returns:

| | |
|---|---|
| 1 year range | (13.1)% -26.7% |
| 5 year range | (3.0)% - 14.9% |
| Average compounded return | 5.6% |

**Asset Allocation**

The Finance Committee has also reviewed the long-term performance of various asset classes, focusing on balancing the risks and rewards of market behavior. Based on the Fund's time horizon, and the Finance Committee's risk tolerance, performance expectations, and asset class preferences for the Fund, the following strategic asset allocation was constructed:

| | Policy Minimum | Neutral Allocation | Policy Maximum |
|---|---|---|---|
| Fixed Income | 35.0% | 45.0% | 55.0% |
| Equity | 25.0% | 45.0% | 65.0% |
| Alternative Investments | 0.0% | 10.0% | 20.0% |

Fixed Income type assets may include, but are not limited to, individual bond securities, whether or not managed by an investment manager, bond mutual or exchange traded funds, and cash.

Equity type assets may include, but are not limited to, domestic and foreign individual stock securities, whether or not managed by an investment manager, and domestic and foreign stock mutual or exchange traded funds.

Alternative asset classes may be used in the portfolio in order to enhance returns and/or reduce the risk of the overall portfolio. Alternative assets may include, but are not limited to, hedged strategies, private equity funds, direct real estate, commodities, global tactical asset allocation, high risk bond strategies, other hybrid strategies, and structured notes. When allocating a portion of the portfolio to alternative assets, the investment consultant will assist the Finance Committee in determining if these allocations should most appropriately be taken from the Fixed Income or Equity type assets in the strategic allocation. Due to the potential illiquid nature of many alternative assets, it is the Finance Committee's desire that the target allocation to Alternative Investment strategies not exceed 40% of the portfolio.

Changes to the strategic allocation specified above will warrant a new Investment Policy Statement. A detailed sub-asset class breakdown is provided by the asset allocation schedule included in the quarterly investment report. Changes to the sub-asset allocations within the context of the strategic allocation specified above will not warrant a new Investment Policy Statement.

### Asset Allocation Constraints

Rebalancing will be strongly considered when the actual percentage allocations to fixed income, equity or alternative investments vary by 5 percentage points or more from the Neutral Strategic allocation. Subject to practical constraints, rebalancing will also be strongly considered when the actual percentage allocation of a sub-asset class utilized within the portfolio varies by more than 20% from the target allocation identified in the quarterly reports. When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation.

## IMPLEMENTATION GUIDELINES

The Finance Committee intends to implement the Fund's policy with mutual funds, exchange traded funds (ETFs), separate account investment management firms, or other investment choices that the Finance Committee desires, whether or not approved by the Investment Consultant. Each ETF and mutual fund selected is expected to adhere to the terms and conditions set forth in its prospectus.

Mutual funds and ETFs should meet the following minimum criteria:

(1) Funds should correspond to the sub-asset classes outlined in the investment report provided by the Investment Consultant. For example, the domestic large capitalization equity component of the IPS should be implemented with a mutual fund invested primarily in that sub-asset class.

(2) The fund's manager should have been in place for three years or more, or should have a long-term track record managing assets with a similar style at another mutual fund or investment management firm.

(3) The funds should have been following the same investment strategy for at least three years (or the fund manager should have been following the same strategy for at least three years).

(4) In aggregate, the various share classes of the fund, as well as the separate account assets of the portfolio management firm sub-advising the mutual fund that are run under similar composite, should have at least $300 million under management.

The following securities and transactions are not authorized without receiving prior approval from the Finance Committee or authorized in a mutual fund's prospectus, separate managed account agreements, limited partnership agreements, or other investment implementation agreements. If authorized, such securities or transactions will only be implemented through the use of a qualified intermediary: antiques, coins, stamps, art work, precious metals, oil and gas interests, equipment leases, letter stock and other unregistered securities, securities lending, pledging or hypothecating securities, options and futures contracts.

# REPORTING AND MONITORING REQUIREMENTS

## Monitoring of Investment Managers

Investment custodians should provide monthly statements of assets and transactions. Duplicate copies of these statements should be sent to the Investment Consultant by the custodians.

The Investment Consultant should prepare periodic investment reports that summarize the activity of the investments during the period reviewed, including investment performance and current asset allocation compared to desired asset allocation.

Quarterly performance will be evaluated to test progress toward the attainment of longer term targets. It is understood that there are likely to be short-term periods during which performance deviates from market indices. During such times, greater emphasis shall be placed on peer-performance comparisons with managers employing similar styles.

On a timely basis, but not less than once a year, the Finance Committee will meet with the Investment Consultant to focus on:

- Investment Manager's adherence to the IPS guidelines;
- Material changes in the manager's organization, investment philosophy and/or personnel; and,
- Comparisons of the Investment Manager's results to appropriate indices as found on the quarterly report "Time Weighted Return" page

The 5 year risk associated with each Investment Manager's portfolio, as measured by the variability of quarterly returns (standard deviation), should not exceed that of the benchmark index and the peer group without a corresponding increase in performance above the benchmark and peer group.

In addition to the information covered during the quarterly reviews, the Finance Committee will meet with the Investment Consultant at least annually to focus on:

- The Investment Manager's performance relative to managers of like investment style or strategy. Each Investment Manager is expected to perform in the upper half of the manager's style universe over most annual periods.

- The Fund's investment performance results compared to the Investment Manager's overall composite performance figures to determine unaccounted for dispersion between the Investment Manager's reported results and the actual results over annual periods.

The Finance Committee is aware that the ongoing review and analysis of Investment Managers is just as important as the due diligence implemented during the manager selection process. Accordingly, a thorough review and analysis of an Investment Manager will be conducted, should:

- A manager perform in the bottom quartile (75th percentile) of their peer group over a quarterly or annual period.
- A manager fall into the southeast quadrant of the risk/return scatter-plot for a 5 year time-period.
- A manager have a 5 year risk adjusted return fall below that of the median manager within the appropriate peer group.

Furthermore, the following could be considered more serious indications of underperformance and may require the replacement of a manager:

- A manager performs below the median (50th percentile) of their peer group over% of the available rolling 3 year annual periods.
- A manager performs below the median (50th percentile) of their peer group over a 5 year period.
- A manager has a negative alpha for a 5 year time period.

Major organizational changes will also warrant immediate review of the manager, including:

- Significant change in professionals
- Significant account losses
- Significant growth of new business
- Significant change in ownership

The performance of the Investment Manager will be monitored as described above, and it is at the discretion of the Finance Committee to take corrective action by replacing a manager if deemed appropriate at any time.

In addition, the portfolio will be benchmarked against a "Broad Index," which shall consist of the following indices, weighted in accordance with the current asset allocation policy:

| | |
|---|---|
| U.S. Bond Market-Barclays Capital Aggregate* | 45% |
| U.S. Stock Market-Russell 3000* | 39% |
| International Stock Market- MSCI EAFE* | 16% |

(*or another index designed to measure the performance of this asset class)

In reviewing the longer term performance of the portfolio (net of fees) against the "Broad Index," the Finance Committee should be able to assess the effectiveness of the various recommendations provided by the Investment Consultant that Finance Committee implemented, and if, in aggregate, they added value. Decisions that will affect the performance of the portfolio when compared to this benchmark included, but are not limited to, sub-asset class allocations (e.g. small cap vs. large cap, opportunistic bond vs. core bond), style overweights (e.g. value vs. growth), Investment Managers hired, use of alternative investments, and periodic portfolio re-balancing.

Weightings to each component of the "Broad Index" would be updated if there is a material change in the relative allocations to these asset classes.

## STATEMENT REVIEW/AUTHORITY

This IPS should be reviewed by the Finance Committee/Trustee(s) at least annually and changed, as needed. It is not expected that the IPS will change frequently. In particular, short-term changes in financial markets should not require adjustments to the IPS. Changes to the IPS may only be made by the Finance Committee/Trustee(s).

Prepared by:

Reviewed and Accepted: