Berea College
Learning, labor, & service

Investment Policy

Revised May, 2006

Contents

I. INTRODUCTION

The mission of Berea College is virtually unique in higher education in America. The College, founded in 1855, has a deeply rooted inclusive Christian heritage and educational philosophy expressed in “The Great Commitments of Berea College” which state:

The College, founded by ardent abolitionists and radical reformers, continues today as an educational institution still firmly rooted in its historic purpose “to promote the cause of Christ.” Adherence to the College’s spiritual foundation, “God has made of one blood all peoples of the earth,” shapes the College’s culture and programs so that students and staff alike can work toward both personal goals and vision of a world shaped by Christian values such as the power of love over hate, human dignity and equality, and peace with justice. This environment frees persons to be active learners, workers, and servers as members of the academic community and as citizens of the world. The Berea experience nurtures intellectual, physical, aesthetic, emotional, and spiritual potentials and with those the power to make meaningful commitments and translate them into action.

> To achieve this purpose, Berea College commits itself
>
> To provide an educational opportunity primarily for students from Appalachia, black and white, who have great promise and limited economic resources.
>
> To provide an education of high quality with a liberal arts foundation and outlook.
>
> To stimulate understanding of the Christian faith and its many expressions and to emphasize the Christian ethic and the motive of service to others.
>
> To provide all students, through the labor program, experiences for learning and serving in the community, and to demonstrate that labor, mental and manual, has dignity as well as utility.
>
> To assert the kinship of all people and to provide interracial education with a particular emphasis on understanding equality among blacks and whites.
>
> To create a democratic community dedicated to education and equality for women and men.
>
> To maintain a residential campus and to encourage in all members of the community a way of life characterized by plain living, pride in labor well done, zest for learning, high personal standards, and concern for the welfare of others.
>
> To serve the Appalachian region primarily through education but also by other appropriate services.

The investment of Berea’s endowment should be made with sensitivity to these Great Commitments, the ethical values they embody, and the significant dependence of the operating budget on endowment income.

Because the early students of Berea were freed slaves and poor Appalachian youth, the College stopped charging tuition in 1892 and continues that practice today. All students are expected to work in Berea’s Labor Program that allows students to earn some of their room and board costs. To finance this exceptional program of full tuition scholarships, Berea College established a policy in 1920 that places all unrestricted bequests into the College’s quasi endowment. This policy has led to more than 75% of the College’s educational and general (i.e., operations) budget being funded by income from the combined quasi and endowment pool. Unlike many colleges and universities, Berea’s endowment is the centerpiece of the funding strategy for its educational mission of learning, labor and service. In a real sense, Berea’s endowment is its “tuition replacement fund.” Consequently, Berea’s investment strategy must promote both real growth and acceptable levels of risk if the College is to maintain its no tuition policy.

This Investment Policy has been carefully considered and constitutes a series of guidelines for management in perpetuity of an investment program consistent with the objectives and important mission of Berea College. It is a living document that may be modified over time by the Investment Committee and approval by the Board of Trustees, but while in force, the Investment Committee, Board, and those who assist the College in managing and investing its endowment must comply with its terms. Consequently, current and prospective members of the

Investment Committee and those who assist the Investment Committee should thoroughly understand the Policy to ensure compliance and to establish a philosophical base from which all modifications are made.

This Investment Policy is strategic in nature and will be augmented by a written Investment Plan developed by the Chief Investment Officer and approved by the Investment Committee. The Investment Plan, a tactical document, will delineate specific allocation decisions and manager assignments and can be altered as often as necessary. The Investment Plan will always be in compliance with the Investment Policy. (The Investment Plan can be found in Appendix B.)

II. MISSION OF THE INVESTMENT COMMITTEE

Working within the spirit of the Great Commitments of Berea College, the Investment Committee, acting on behalf of the Board of Trustees, will design and supervise a long-term investment program for the College's *Endowment Fund*, hereafter referred to as the "Fund". The Berea College Investment Program (the "Investment Program") will seek three objectives:

1. Preserve the inflation-adjusted value, as defined by the CPI-U (non seasonally adjusted), of the Fund through investment performance and prudent spending formulas.
2. Produce a *total return* significantly in excess of inflation as defined by CPI-U (a real return greater than or equal to 5% per annum); and
3. Achieve competitive returns relative to appropriate benchmarks.

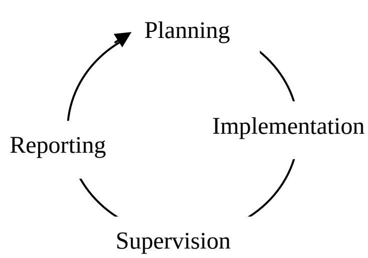
III. EXECUTION

The Investment Program will rely on close coordination between the Investment Committee, the Vice President for Finance and the Chief Investment Officer (CIO). The investment process includes four repeating steps (Figure One) that will be reviewed on a quarterly cycle.

The investment process begins with planning, development and subsequent maintenance of a written Investment Policy and Investment Plan – all approved by the Investment Committee. These documents will determine the allocation of funds among various asset classes and styles of management. Consequently, planning flows quickly into implementation where managers are selected and assignments are made.

Figure One

The Investment Process



Supervision involves an ongoing evaluation of manager conduct by the Chief Investment Officer to ensure the reasons a manager was engaged (i.e., key personnel, investment process and performance) remain intact. The Chief Investment Officer will deliver monthly progress reports to the Investment Committee and the Vice President for Finance concerning all aspects of the Investment Program with the Committee Chair reporting to the full Board of Trustees.

A. General Philosophy & Guidelines

The unique mission of Berea College is financially dependent, to a great degree, on the prudent management of the Fund. Consequently, the Investment Committee will rely on five investment maxims:

1. Diversification among and within asset classes is the key to prudent asset management. Diversification will be across global markets and different classes of publicly traded securities, and will also embrace so-called "alternative investments" that typically yield higher returns but also bear higher risks and liquidity restrictions.
2. Strategic decisions will greatly determine the variability in performance in diversified portfolios over time.
3. Although decisions concerning asset class assignments may vary slightly within a pre-designated range, dramatic "market-timing" changes in allocation are not appropriate.
4. Specialist managers are typically superior within their respective areas of specialization.
5. Active management strategies are most effective in least efficient market segments; efficient markets call for more passive, index-sensitive strategies.

B. Overall Investment Objectives

The Investment Program will seek three objectives:

1. <u>Preserve the inflation-adjusted value (as measured by the CPI-U Index – non seasonally adjusted) of the Fund.</u>

Although achieving a significant real return requires the acceptance of risk and portfolio volatility, the Berea College Investment Program will be diverse and designed such that the likelihood of its market value dropping below its three-year trailing average is low.

2. <u>Produce a total return significantly in excess of inflation in order to support the activities of the College through spendable endowment income.</u>

In order to achieve returns in excess of the sum of inflation and the College's spending policy, the Investment Program will emphasize equity securities. To minimize risk while pursuing these returns, the Investment Program will incorporate diversification among and within various asset classes and styles of equity management. A matrix of asset classes with corresponding levels of expected risk [standard deviation] and expected returns can be found in <u>Appendix A</u>. (The Berea College endowment spending formula & policy can also be found in <u>Appendix C</u>.)

3. <u>Achieve competitive returns relative to appropriate benchmarks.</u>

Investment indices and sub-indices will be selected to represent asset classes and management styles selected by the Investment Committee during the investment planning and asset allocation process. The idiosyncrasies of specific indices will be examined in detail for suitability and to better identify any investment style or bias inherent in the composition of the index. Independent management firms will be selected for each specific assignment based on relevant skill, experience and logic. Each manager will be expected to out-perform an appropriate benchmark and/or peer universe over the course of a market cycle. In general, the performance of each specialist manager will be evaluated over a minimum of five years or the appropriate market cycle for the particular asset class, which may be longer than five years. Active (non-index sensitive) equity managers are expected to outperform their appropriate benchmark by 100 basis points (1.00%) net of their fees, and active (non-index sensitive) fixed income managers are expected to outperform by 25 basis points (0.25%). Further, when active managers in any category are not exceeding benchmarks, they will be evaluated in the context of relevant peer groups.

C. Asset Allocation

The Fund's investments shall be diversified by asset class (i.e., equities, fixed income, alternative investments, etc.) and within asset classes (i.e., within equities by investment and economic sector, industry, size and financial characteristics). The purpose of asset allocation and rebalancing is to provide reasonable assurance that no single asset class will have a disproportionate impact on the Fund's aggregate results.

Rebalancing responds to the changes in the fund's actual allocation versus target allocations over time. The Chief Investment Officer will review the asset allocation with the Investment Committee at each meeting. Additionally, during extraordinary market volatility, the Chief Investment Officer and the Vice President for Finance may decide to call a conference call with the Investment Committee if they feel rebalancing should be considered. (Point allocations and rebalancing trigger values can be found in Appendix B.)

The Fund will be divided into four broad asset classes: publicly-traded equity, publicly-traded fixed income, alternative investments and derivatives.

1. Publicly-Traded Equity

The purpose of investments in publicly-traded equity (including domestic as well as international stocks) is to provide total return that significantly exceeds inflation and to maintain the real, inflation-adjusted purchasing power of the Fund after spending over time.

2. Publicly-Traded Fixed Income

The purpose of investments in publicly-traded fixed income is to reduce risk (volatility) and to provide a hedge against deflation. The percentage of total assets allocated to publicly-traded fixed income at any given time should be sufficient to ensure that the total value of the Fund does not decline by an intolerable amount. The publicly-traded fixed income asset class will consist of investment-grade, intermediate duration securities and when appropriate, opportunistic fixed income instruments (which may include high yield bonds defined as BBB and below), preferred stocks, convertible bonds, developed international bonds, emerging market bonds and Treasury Inflation Protection Securities (TIPS).

3. Alternative Investments

The purpose of participating in alternative investments is to increase the total expected return of the Fund. Alternative investments generally carry high levels of risk, are relatively illiquid compared to traditional investments and should be considered carefully. Given the risks that are involved with Alternative Investments, the Committee will employ diversified strategies and will work with the Chief Investment Officer (CIO) to conduct a high level of due diligence.

- Private Equity: Private equity investments are expected to provide a total return premium of 500 basis points (5.00%) above the S&P 500 Index. Private equity investments may include venture capital, buyouts, mezzanine, and distressed debt.

- Hedge Funds: Hedge funds are meant to provide the same return of the asset class they are replacing (equity or fixed income) with 50% of the volatility as measured by standard deviation.

- Real Assets: Real assets may be included in the portfolio to lessen the overall portfolio volatility, for income, for inflation protection, and increase the expected return. Real assets may include private equity real estate, public equity real estate (REITs), and energy and natural resources (oil, gas, timber, and commodities).

4. Derivative Investments

The purpose of participating in derivative investments is to increase the total expected return of the Fund and/or lower the volatility. Derivative investments can carry high levels of risk, but if done correctly, can also mitigate the risk of the portfolio. Derivative investments considered could include investment instruments such as structured notes and should be considered carefully.

D. Implementation

1. Manager Selection

The selection of specialist managers to implement the Investment Program will be carried out by the Investment Committee with assistance from the Chief Investment Officer in a thoughtful, deliberate, logical and explainable manner. Manager selection will be based not only on fundamental appeal, but also upon how the manager will complement other specialist managers employed by the College.

All specialist managers considered will exhibit strong ethical integrity and financial viability. The management team must be experienced, professional and properly motivated to stay and work together into the foreseeable future. The manager's degree of index sensitivity must be measured and deemed appropriate relative to the particular market segment and style of management for which the manager is being considered. Specific areas that should be considered include personnel, process, portfolio and performance. (Possible questions relative to manager selection can be found in Appendix D.)

2. Investment Objectives and Guidelines for Managers

a. Equity Managers

With the exception of indexed assets, the investment objective for managers of publicly-traded equity is to place in the top quartile of an appropriate peer universe and to out-perform an assigned index by 100 basis points (1.00%) net of fees over a minimum of five years or the appropriate market cycle for the particular style, which may be longer than five years. Further, managers are expected to control risk to be generally in line with their assigned index. Indexed assets are expected to perform in line with the appropriate index less expenses incurred to execute the strategy.

Decisions as to individual security selection, position size and quality, number of industries or holdings, current income levels, turnover, and the use of options or financial futures are left to broad manager discretion and subject to usual standards of fiduciary prudence. However, in no case (except mutual fund shares) shall a single security exceed 10% of the market value of the manager's Berea College portfolio and no option or financial future shall be used solely to leverage the manager's Berea College portfolio.

Equity managers will remain fully invested. The normal course of trading activity may occasionally place as much as 5% of the assets under the manager's supervision temporarily in short-term investment-grade securities. The quality of any cash equivalents utilized in the manager's Berea College portfolio will be governed by the guidelines set forth in Appendix E.

b. Fixed Income Managers

With the exception of indexed assets, the investment objective for managers of publicly-traded fixed income is to place in the top quartile of an appropriate peer universe and to out-perform an assigned index by 25 basis points (0.25%) net of fees over a minimum of five years or the appropriate market cycle for the particular style, which may be longer than five years. Further, managers are expected to control risk to be generally in line with their assigned index. Indexed assets are expected to perform in line with the appropriate index less expenses incurred to execute the strategy.

Money market instruments and bonds may be used in the managers' Berea College fixed income portfolios. Managers may employ active management techniques (such as interest rate anticipation and sector arbitrage) but changes in average duration should usually be moderate and incremental. Managers will strive to maintain an average duration in line with the assigned index. Managers may use derivatives to adjust the duration of the portfolio but not in a speculative manner.

The core of the managers of Berea College fixed income portfolios will be constructed of U.S. Government securities and corporate bonds rated "AA" or better by Moody's, Standard & Poors or the equivalent thereof and shall be well diversified with respect to type, industry, and issuer. The prospect of credit risk or risk of permanent loss will be avoided. Non-taxable issues of state governments or municipal agencies will not be purchased except in unusual circumstances. Obligations issued or guaranteed by the U.S. Government may be held without limitation. The quality of any cash equivalents utilized in the managers' Berea College portfolio will be governed by the guidelines set forth in Appendix E. When appropriate, opportunistic fixed income investments may be utilized, including high yield bonds (defined as BBB and below), preferred stocks, convertible bonds, developed international bonds, emerging market bonds and Treasury Inflation Protection Securities (TIPS).

c. Alternative Investments Managers

Private Equity: The investment objective for managers of private equity investments is to place in the top half of a representative peer universe by vintage year.

Hedge Funds: The investment objective for managers of the hedge fund portfolios is to exhibit half the volatility of the market (as measured by the Russell 3000 Index or Lehman Brothers Aggregate Bond Index) while matching the return of the market (as measured by the Russell 3000 Index or Lehman Brothers Aggregate Bond Index) over a minimum of five years.

Real Assets: The investment objective for managers of real assets is to generate returns in line with the appropriate index over a minimum of five years or the appropriate market cycle for the particular strategy, which may be longer than five years. Real assets may be utilized in the portfolio including Public or Private Real Estate investments, energy and natural resources (oil, gas, timber, and commodities.

d. Derivative Investments:

The investment objective for managers of the derivative investments will be to lower volatility and/or enhance returns. These investments will not be used in a speculative manner. Rather, they will be used to provide volatility management for Berea College.

e. Transactions

All transactions should be entered into on the basis of best execution (best-realized net price). Commissions may be designated for payment of services rendered in connection with management of the Fund.

E. Supervision & Reporting

1. Investment Program Supervision

Supervision of the Investment Program requires an ongoing evaluation of each manager's performance and conduct by the Chief Investment Officer. Ongoing evaluations will ensure that the manager remains fully invested and that the reasons the manager was initially engaged (key personnel, investment style and process, performance, etc.) remain intact. Asset allocation will also be monitored to ensure that the Investment Policy is not violated when an equity manager is released. (e.g., Funds under an outgoing manager's supervision must remain in the original asset class while a new manager is being selected.)

Program supervision also requires oversight of the master custodian to ensure that the cash management sweep function is operating smoothly, securities pricing is reasonable, performance measurement is accurate and custodial reports are produced in a timely manner.

2. Rebalancing

Rebalancing responds to the changes in the fund's actual allocation versus target allocations over time. The Chief Investment Officer will review the asset allocation with the Investment Committee at each meeting.

Additionally, during extraordinary market volatility, the Chief Investment Officer and the Vice President for Finance may decide to call a conference call with the Investment Committee if they feel rebalancing should be considered. (Point allocations and rebalancing trigger values can be found in Appendix B.) If a new investment manager is recommended as part of the rebalancing process, the new investment manager must be approved by the Investment Committee.

3. Performance Evaluation of Investment Managers

Every manager and asset class of the Fund will be measured against an appropriate index as well as a relevant peer group when available. Performance evaluation will be reported quarterly and will be aggregated to include one, three and five year perspectives.

4. Reporting

Quarterly investment reports will be presented by the Chief Investment Officer in accord with an annual calendar of delivery dates for reports based on the Board of Trustees meeting schedule and pre-approved by the Investment Committee.

The Chief Investment Officer will submit detailed monthly investment reports to the Investment Committee, the President, and the Vice President for Finance. The Investment Committee will report investment results and significant actions to the Board of Trustees at every Board of Trustees meeting.

IV. ADMINISTRATION

A. Responsibilities

1. The Board of Trustees

The Board of Trustees and its Investment Committee have a legal responsibility to manage the Fund in compliance with the requirements of Kentucky law, including, but not limited to, the provisions of the Kentucky Non-Profit Corporation Act and the Kentucky Uniform Management of Institutional Funds Act, both found in Chapter 273 of the Kentucky Revised Statutes. (The current text of the Kentucky Uniform Management of Institutional Funds Act can be found in Appendix F).

The College makes spending withdrawals from the Fund based on an endowment spending formula and policy. The Berea College endowment spending formula and policy is found in Appendix C. The Board of Trustees has a fiduciary responsibility to comply with the restrictions imposed by the donor of *restricted funds (true endowment funds)* to refrain from expending the principal of such funds and to expend only the income as and if directed by the donor. There are no similar legal requirements limiting the expenditure of the principal and/or income of the Berea College *quasi endowment funds (also referred to as Tuition Replacement Funds*). The *quasi endowment funds* are, however, subject to the same standards governing investment authority and standard of conduct for investment and management as pertain to true endowment funds.

2. The Investment Committee

The Investment Committee, within the broad framework of delegated responsibilities and policies established by the Board of Trustees, will have direct responsibility for the oversight and management of the Fund and for the establishment of investment policies, plans and procedures (Berea College By-laws Section 20.4). The Investment Committee, acting pursuant to authority delegated by the Board of Trustees, shall have the power to employ or discharge financial agents or advisors (Berea College By-laws Section 20.3). (Partial text of *Berea College Articles of Incorporation & By-laws* can be found in Appendix G.)

Specific responsibilities include:

- Selecting a Chief Investment Officer to implement the Investment Program under the direction and supervision of the Investment Committee;
- Developing a written Investment Policy, including objectives of risk and return and guidelines for asset allocation to be submitted to the Board of Trustees for approval;

- Selecting a master custodian to hold assets of the Fund in safekeeping;
- Selecting specialist managers to implement various strategies of the Investment Program;
- Monitoring investment performance to ensure the Investment Program is on track and in compliance with the Investment Policy;
- Performing an annual evaluation of the Chief Investment Officer and determining whether a Request for Proposal ("RFP") is to be issued ;
- Submitting an investment report at each Board of Trustees meeting; and
- Working closely with the Finance Committee of the Board of Trustees to ensure effective communication and coordination with the Investment Committee especially with respect to the investment goals and endowment spending policies of the College.

3. The Vice President for Finance

The Vice President for Finance is responsible for administrative support of the Investment Committee and for working closely with the Investment Committee and Chief Investment Officer to carry out the Investment Plan.

Specific responsibilities include:

- Carrying out the directions of the Investment Committee and acting as an authorized signatory on behalf of the College when entering into investment agreements and related documents, after appropriate legal review;
- Acting as liaison between Chief Investment Officer, the Office of Financial Affairs, and the Investment Committee;
- Maintaining detailed records for all endowment funds and investments;
- Calculating the unit value of the commingled Fund;
- Supervising receipt and disbursement of monies associated with the Fund;
- Being informed, on a continuing basis, of the activities of the Chief Investment Officer and the Investment Committee;
- Conducting periodic reviews of fees relating to the Chief Investment Officer and investment managers; and
- Executing the rebalancing recommendations of the Chief Investment Officer to rebalance within the investment plan ranges as necessary.

4. The Chief Investment Officer

The Chief Investment Officer is responsible to the College, for the development, implementation, supervision and reporting of the Investment Program.

Specific responsibilities include:

- Developing a written Investment Plan and assisting the Investment Committee in the periodic review and revision of the Investment Policy;
- Implementing the Investment Plan approved by the Investment Committee;
- Presenting strategic investment alternatives and identifying relative strengths and weaknesses of each alternative;
- Supervising the manager selection process and presenting manager alternatives to the Investment Committee in the form of specific recommendations;
- Performing due diligence and analysis of prospective investment managers recommended by members of the Investment Committee;
- Providing timely due diligence supporting its recommendations and appropriate documentation to the Investment Committee and the Vice President for Finance in order for review before an investment action is requested;
- Negotiating manager fees as well as those of other investment-related vendors involving services such as custody, commission recapture, and securities lending;
- Supervising manager conduct within the context of the Investment Policy and Investment Plan including reallocating assets among managers especially to rebalance the portfolio;
- Supervising investment-related functions of the master custodian including accuracy and timeliness of reporting;
- Responding to requests from the Vice President for Finance including requests to transfer funds from

investment portfolios to authorized Berea College bank accounts; and

- Preparing detailed monthly investment reports for the Investment Committee, the President, and the Vice President for Finance and distributing reports in accordance with an annual calendar of report delivery dates based on the Board of Trustees meeting schedule and pre-approved by the Investment Committee.

5. The Master Custodian

The master custodian, usually a major banking institution, will hold in safekeeping all liquid assets of the Fund in the name of Berea College. Independent managers supervising liquid, publicly-traded investments regardless of location will settle “delivery versus payment” with the master custodian. Illiquid assets, though not held by the master custodian, may be tracked for the purpose of consolidating reports.

Specific responsibilities include:

- Safeguarding all assets under custody;
- Transferring funds from a Berea College account to another pre-designated, pre-approved bank account in the name of Berea College, when properly requested by the Chief Investment Officer and authorized by a Berea College official having appropriate authority;
- Accounting for all stock splits and other corporate actions;
- Producing timely and accurate monthly reports listing all assets held by the Fund and reflecting current pricing for any transactions that have taken place during the reporting period;
- Producing timely and accurate quarterly reports that are in compliance with the requirements of the Association for Investment Management & Research; and
- Responding promptly and accurately to periodic reporting requests from the Chief Investment Officer or the Vice President for Finance;
- Producing monthly performance reports.

B. Procedures

1. Investment Plan

The Investment Plan, a tactical rather than strategic document, will be written to augment the Investment Policy. The Plan will be in the form of a spreadsheet detailing specific assignments by manager and style and may be modified as often as necessary with the approval of the Investment Committee.

While an Investment Plan is in effect, it defines the limits of the Chief Investment Officer’s discretion. (A sample Investment Plan may be found in Appendix B.)

2. Additions to The Fund

Additions to the Fund will be allocated to managers by the Chief Investment Officer as directed by the Investment Committee in the Investment Policy and written Investment Plan. Generally, additions will be used to rebalance the Fund in keeping with the current Investment Plan.

3. Managing Venture Capital and Private Equity Portfolio Holdings and Distributions

Assets committed to alternative equity investments but not yet called by the manager will be held in the appropriate surrogate for the asset to keep the overall portfolio asset allocation in line with the target. Assets deemed for private equity, as an example, will be kept invested in public equity markets.
Berea College is an investor in several venture capital and private equity funds, which make up a significant portion of the endowment’s alternative asset portfolio. From time to time, and at the sole discretion of the venture capital and private equity fund manager(s), securities of publicly traded companies are distributed to limited partners, including the Fund. When distributed securities are delivered to a Fund account at one or more brokerage firms, the Fund is free to decide whether to sell all shares received, some of the shares received, or to retain the entire position for some period of time.

Appendix H contains detailed guidelines that have been developed to provide specific direction for the College’s financial staff in managing distributions of stock from the alternative asset managers.

From time to time, and at the sole discretion of the venture capital and private equity fund manager(s), private equity investments are sold to the public via initial public offerings (IPO's). These IPO's create public equity exposures within these partnerships that, for various reasons can remain imbedded in them for a period of time that is indeterminate but can be as long as one year or more. These exposures can be very large relative to the College's investments in the partnerships, and have proven to be very volatile. The College has determined that it is prudent to reduce its risk profile with regard to these volatile securities positions prior to their distribution with hedging transactions whenever possible.

Appendix I contains detailed guidelines that have been developed to provide specific direction for the College's financial staff in managing hedging transactions of equities from or within the portfolios of alternative asset managers.

4. Commingling and Unitizing

The Fund will be commingled and unitized.

Exceptions to this policy include:

- A donor who specifically directs that a gift be separately invested; and
- A gift in a form that does not have a ready market, is illiquid or for other reasons that make the asset an unacceptable holding in the Fund.

Every addition to the Fund shall receive units in the Fund based upon the market value of the gift and the unit value of the Fund on the date the gift is added to the Fund.

5. Short-Term Allocation Guidelines

Allowable reserves consist of three parts:

- New monies added to the Fund will be allocated by the Chief Investment Officer to rebalance to established target asset allocations as directed by the Investment Policy and the current Investment Plan; and
- Publicly-traded equity managers will remain fully invested keeping cash balances at or below 5%. Cash balances will remain in the manager's Berea College equity portfolio under that manager's direction.

The Appendices that follow represent implementation policies and practices that the Investment Committee develops and may change as needed with the exception of the Endowment Spending Policy.

C. Conclusion

Through spendable endowment income, the perpetual pool of endowment investments provides tremendous operating budget support for the College. This policy is intended to help guide the College in the investment and management of its endowment in order to ensure that the College meets its objectives in carrying out its mission. The Board of Trustees, Investment Committee, and College financial staff – with assistance from the Chief Investment Officer – have the fiduciary responsibility to oversee the College endowment in a prudent manner through regular benchmarking and review of this policy and the Investment Plan to help maximize the overall benefits to the College within appropriate levels of risk.

Appendix A

Capital Markets Intermediate-Term (7-10 Year) Assumptions (April 2006)

Asset Class	Expected Return	Expected Risk	Expected Correlation								
			US Large Cap	US Small Cap	Intl - Developed	Intl - Emerging	US Core Fixed Inc	High Yield	Private Equity	Real Estate	Cash
US Large Cap	7.9%	18.0%	1.00								
US Small Cap	7.2%	25.0%	0.80	1.00							
Intl - Developed	9.0%	25.0%	0.60	0.50	1.00						
Intl - Emerging	9.2%	40.0%	0.40	0.40	0.25	1.00					
US Core FI	4.4%	7.0%	0.30	0.30	0.10	0.10	1.00				
High Yield	6.5%	13.0%	0.60	0.60	0.60	0.10	0.60	1.00			
Private Equity	12.9%	50.0%	0.50	0.80	0.30	0.30	0.20	0.20	1.00		
Real Estate	4.7%	16.0%	0.60	0.60	0.40	0.20	0.40	0.40	0.00	1.00	
Cash	4.1%	1.0%	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.00

Appendix B

Berea College
Investment Plan – April, 2006

Asset Class	Benchmark	Policy Target	Ranges	Active Target
US Stocks – Large Cap	Russell 3000 Index	25.0%	20-50%	33%
US Stocks – Small Cap	Russell 2000 Index	5.0%	0-10%	5.5%
International Stocks – Developed	MSCI EAFE Index	15.0%	5-25%	16.5%
International Stocks – Emerging	MSCI Emerging Markets Free Index	5.0%	0-10%	5%
Hedge Funds - Equity	Russell 3000 Index	20.0%	10-30%	10%
Private Equity	S&P 500 + 500bps	10.0%	5-20%	10%
Real Estate	NCREIF Property Index	5%	0-10%	0%
Intermediate US Bonds	Lehman Aggregate	10.0%	10-20%	12%
High Yield Bonds	Merrill Lynch High Yield Master II Index	0.0%	0-5%	5%
TIPS		5.0%	0-10%	0%
Cash	Merrill Lynch 91 Day T-Bill	0.0%	0-5%	3%
Total		**100%**	**100%**	**100%**
Expected Return*		8.1%		
Expected Risk (Std Dev)*		13.9%		

*The expected return is forward-looking based on current capital market expectations as noted in the date above. It is not a guarantee. As with all forward-looking expected return data, it involves a high degree of uncertainty.

Appendix C

Endowment Spending Formula & Policy

I. Endowment Spending Policy

The spendable return for the commingled long-term pooled investments is calculated based on five percent (5%) of the prior twelve (12) quarter moving average of the market value of the pooled endowment funds. This income is allocated to the specific pooled endowment funds based on the respective number of units assigned to each of those funds.

Gains spent for any individual endowed fund cannot reduce the market value of such fund below its historic book value. Should the value of such a fund be reduced to its historic book value, then only actual income, and not calculated spendable income, may be utilized for such fund in accordance with the provision of KRS 273.520.

Spendable income for long term investment funds, which are not included in the investment pool and which are separately invested due to donor restrictions, being outside the control of the College, or other similar situations, shall be the actual income earned by those investments for those respective funds and spent in accordance to the restrictions of those funds.

II. Endowment Spending Formula

A. Overview

Spendable return for the pooled endowment funds shall be determined annually based on five percent (5%) of the prior twelve (12) quarter moving average of the market value of the long-term pooled investments. The purpose of this formula is to allow Berea College to have prudent and adequate annual support for its educational mission, as well as to preserve the principal and significant gains of the pooled endowment funds in an appropriate manner.

In any given year, if spendable income from this formula results in income in excess of the demonstrated operating budgetary needs of the College, then these excess funds are to be placed in reserve funds to be used for specific current or future capital project or program needs (e. g. TCERF and Capital and Plant reserves). Expenditures of these funds must be reported to and approved by the Board of Trustees. Realizing, too, that in any given year, spendable income from this formula could result in income which is not adequate to meet the College’s needs, there are provisions, with the approval of the Board of Trustees, for temporary suspension of this formula to allow for adequate income for support of the College.

B. Formula

The amount available for spending per unit from the pooled endowment funds shall be based on the calculation of five percent (5%) of the prior twelve (12) quarter moving average of the market value of the long-term investment pool, which would include the June 30th quarter of the most recent fiscal year. In each budget year the requested support for Educational and General Expenditures shall be justified through the budget approval process. In years where it is determined that the unrestricted spendable income from the endowment pool is in excess of the justified operational budgetary needs of the College, the excess funds shall be placed in appropriate reserve funds (e. g. TCERF and Capital and Plant reserves), to be utilized based on the recommendation of the Administration and with the approval of the Board of Trustees. In all years the restricted endowment funds shall be allocated their full allocations under the spending formula**.**

Appendix D

Possible Questions Relative to Manager Selection

Personnel

- Are the people who created the track record still on the job?
- Has organizational growth diluted the talent pool?
- Have there been any changes in compensation, ownership or organizational structure that may adversely affect performance?

Process and Philosophy

- Can the manager clearly articulate the securities selection process and does that process ring with compelling logic?
- Has the manager remained true to the style for which they are being considered, even when the style was out of favor?
- Does the manager have the administrative capacity required to support their process?

Portfolio

- Are there inconsistencies in the manager's portfolio?
- Have the relative characteristics of the portfolio changed over time?

Performance

- Has performance changed as the firm has grown?
- How has the manager performed in down markets?
- Can the manager explain clearly what happened to the portfolio?
- Is there significant return dispersion among accounts?
- How has the manager performed over time compared to appropriate benchmarks and peers?

Appendix E

Cash Equivalent Investments

BEREA COLLEGE
SHORT-TERM INVESTMENTS POLICY

1. Cash equivalent investments or short-term investments are generally defined as U.S. dollar-denominated fixed income instruments with remaining maturities of 397 days or less. The Commonfund Short Term Fund can have maturities of slightly more than 397 days since it is a common trust fund.

2. The goal of short term cash investing is to provide high current income consistent with stability of principal while maintaining liquidity by investing in a portfolio of high quality short-term debt instruments.

3. Short-term instruments are securities that present minimal credit risks and generally include securities that are rated by a major rating agency in the highest two rating categories for such securities. Permissible short-term investments include:

    a. Direct obligations of the United States.

    b. Obligations unconditionally guaranteed (principal and interest) by the United States government such as agency securities.

    c. Negotiable certificates of deposit, bankers' acceptances and floating rate notes issued by, or time deposits placed with, major domestic or foreign banks as well as commercial paper (A1/P1 or higher). Foreign government obligations are U.S. dollar-denominated obligations (commercial paper and notes) issued or guaranteed by a foreign government that maintains a short-term foreign currency rating in the highest short-term ratings category by the requisite number of Nationally Recognized Statistical Rating Organizations (NRSROs).

    d. Repurchase agreements collateralized by government obligations and issued by financial institutions such as banks and brokers-dealers.

    e. Money Market Funds of commercial banks and other major investment advisors such as the Commonfund.

Appendix F

Kentucky Uniform Management of Institutional Funds Act

273.510 Definitions.

In KRS 273.520 to 273.590, unless the context otherwise requires:

(1) "Institution" means an incorporated or unincorporated organization organized and operated exclusively for educational, religious, charitable, or other eleemosynary purposes, or a governmental organization to the extent that it holds funds exclusively for any of these purposes.

(2) "Institutional fund' means a fund held by an institution for its exclusive use, benefit, or purposes, but does not include:

(a) A fund held for an institution by a trustee that is not an institution; or (b) A fund in which a beneficiary that is not an institution has an interest, other than possible rights that could arise upon violation or failure of the purposes of the fund.

(3) "Endowment fund" means an institutional fund, or any part thereof, not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument.

(4) "Governing board" means the body responsible for the management of an institution or of an institutional fund.

(5) "Historic dollar value" means the aggregate fair value in dollars of:

(a) An endowment fund at the time it became an endowment fund;

(b) Each subsequent donation to the fund at the time it is made; and

(c) Each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund. The determination of historic dollar value made in good faith by the institution is conclusive.

(6) "Gift instrument" means a will, deed, grant, conveyance, agreement, memorandum, writing, or other governing document (including the terms of any institutional solicitations from which an institutional fund resulted) under which property is transferred to or held by an institution as an institutional fund.

273.520 Appropriation of net appreciation.

The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent under the standard established by KRS 273.560. This section does not limit the authority of the governing board to expend funds as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution.

273.530 Rule of construction.

KRS 273.520 does not apply if the applicable gift instrument indicates the donor's intention that net appreciation shall not be expended. A restriction upon the expenditure of net appreciation may not be implied from a designation of a gift as an endowment, or from a direction or authorization in the applicable gift instrument to use only "income," "interest," "dividends," or "rents, issues or profits," or "to preserve the principal intact," or a direction which contains other words of similar import. This rule of construction applies to gift instruments executed or in effect before or after June 19, 1976.

273.540 Investment authority.

In addition to an investment otherwise authorized by law or by the applicable gift instrument, and without restriction to investments a fiduciary may make, the governing board, subject to any specific limitations set forth in the applicable gift instrument or in the applicable law other than law relating to investments by a fiduciary, may:

(1) Invest and reinvest an institutional fund in any real or personal property deemed advisable by the governing board, whether or not it produces a current return, including mortgages, stocks, bonds, debentures, and other securities of profit or nonprofit corporations, shares in or obligations of associations, partnerships, individuals, and obligations of any government or subdivision or instrumentality thereof;
(2) Retain property contributed by a donor to an institutional fund for as long as the governing board deems advisable;
(3) Include all or any part of an institutional fund in any pooled or common fund maintained by the institution; and
(4) Invest all or any part of an institutional fund in any other pooled or common fund available for investment, including shares or interests in regulated investment companies, mutual funds, common trust funds, investment partnerships, real estate investment trusts, or similar organizations in which funds are commingled and investment determinations are made by persons other than the governing board.

273.550 Delegation of investment authority.

Except as otherwise provided by the applicable gift instrument or by applicable law relating to governmental institutions or funds, the governing board may:

(1) Delegate to its committees, officers or employees of the institution or the fund, or agents, including investment counsel, the authority to act in place of the board in investment and reinvestment of institutional funds;
(2) Contract with independent investment advisors, investment counsel or managers, banks, or trust companies, so to act; and
(3) Authorize the payment of compensation for investment advisory or management services.

273.560 Standard of conduct.

In the administration of the powers to appropriate appreciation, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision. In so doing they shall consider long and short-term needs of the institution in carrying out its educational, religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions.

273.570 Release of restrictions on use or investment.

(1) With the written consent of the donor, the governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund.

(2) If written consent of the donor cannot be obtained by reason of his death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution to the Circuit Court of the county in which the institution's principal office is located for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. The Attorney General shall be notified of the application and shall be given an opportunity to be heard. If the court finds that the restriction is obsolete, inappropriate, or impracticable, it may by order release the restriction in whole or in part. A release under this subsection may not change an endowment fund to a fund that is not an endowment fund.

(3) A release under this section may not allow a fund to be used for purposes other than the educational, religious, charitable, or other eleemosynary purposes of the institution affected.

(4) This section does not limit the application of the doctrine of cy pres.

273.580 Uniformity of application and construction.

KRS 273.510 to 273.580 shall be so applied and construed as to effectuate its general purpose to make uniform the law with respect to the subject of KRS 273.5 10 to 273.580 among those states which enact it.

273.590 Short title.

KRS 273.5 10 to 273.580 may be cited as the "Uniform Management of Institutional Funds Act."

Appendix G

Berea College Articles of Incorporation & By-laws (partial text)

Section 20.2

It shall supervise the investments of the College and shall have power to make and change investments, to sell, assign, and transfer any part of the stocks and securities held by the College or any rights or privileges appurtenant thereto, and to designate a person or persons to execute and deliver in the name and on behalf of the College instruments for the assignment and transfer of stocks and securities registered in its name. It shall have power on behalf of the College to enforce its rights under any stocks or securities held by it, to participate in the reorganization of the issuer of any stocks or securities, and to deposit any stocks or securities with a protective or reorganization committee on terms determined by the Committee. It shall have power to designate a person or persons to execute and deliver in the name of and on behalf of the College proxies to vote stock held by the College, to designate the person or persons named in such proxies to vote on behalf of the College, and to revoke any such proxy.

Section 20.3

If the Investment Committee wishes to employ or terminate the services of financial agents or investment advisors in furtherance of its duties set forth in Section 20.2 here of, it may do so, with such action being reported to the full Board at its next meeting.

Section 20.4

Within the broad framework of policy set by the Board, the Investment Committee shall have the power to issue specific instructions and guidelines to any agent or advisor employed in furtherance of its duties set forth in Section 20.2.

Appendix H

Managing Venture Capital and Private Equity Portfolio Distributions

Guidelines

1. In cases where Berea College has entered into a hedging transaction, the shares involved will be delivered to the counterparty's collateral account during the term of the hedge.

2. With the exception of shares previously hedged, distributed shares are to be sold within twenty (20) trading days from the day the securities are placed in a brokerage account in Berea's name.

3. The board empowers the financial staff to sell any public equity distributions that they receive immediately or as soon as practicable.

4. For securities that are subject to Rule 144 trading restrictions at the time of distribution, the financial staff will work within the above guidelines, but will also adjust trading activity for any restricted securities to reflect the applicable SEC guidelines.

5. The Investment Committee shall be notified by email or otherwise of all distributions.

Appendix I

Managing Venture Capital and Private Equity Portfolio Holdings

Guidelines

1. The Investment Committee has developed a list of the largest exposures within its private equity partnerships. Any name contained on this list is to be regarded as eligible for a hedging transaction.

2. As hedging opportunities are presented to the financial staff (VP Business and Administration, VP Finance, Controller), they are authorized to enter into transactions within the parameters outlined below.

3. Any name on the approved list can be hedged in an amount not to exceed 50% of the College's exposure.

4. The hedges will involve swaps into cash (LIBOR based). The terms of the transaction will vary, but the floating rate variable will not be greater than minus 3.00% and the termination penalty will not exceed 4.00% per year without prior approval from the Chair of the Investment Committee or the Chairman of the Board of Trustees. The term involved will not be less than two years.

5. The financial staff is authorized by the Investment Committee of the Board of Trustees to act under these guidelines without consulting the Investment Committee with one exception. Whenever a hedge has an aggregate value in excess of $10 million, a member of the financial staff should contact either the Chairman of the Board of Trustees or the Chair of the Investment Committee before issuing instructions to the brokerage firm to execute a hedge If for any reason neither of these individuals can be reached in a timely manner, the financial staff should operate on its own initiative with the policy framework outlined above.

6. To the extent that collateral is required or expected to be required in connection with these hedges, the staff is authorized to deliver such collateral to the counterparty. The maximum collateral level will not exceed the amount established by the Investment Committee.

7. The Investment Committee shall be notified by email or otherwise of all hedging transactions.

Glossary of Terms

Endowment Funds – All commingled, long-term investment funds including *restricted funds* and *Tuition Replacement Funds* excluding operating cash. Referred to as the "Fund".

Cash Reserves – Monies held for allocation and rebalancing as well as a small amount of monies committed to alternative investments but not yet called by managers.

Restricted Funds – Funds with a donor-imposed restriction that the funds are not to be expended but are to be invested for the purpose of producing real total return. Unless otherwise stated by the donor, the principal of the funds is to be maintained in perpetuity. The donor may also place restrictions on the purpose(s) for which income generated by the funds may be expended. Also referred to as ***True Endowment Funds***.

Total Return – The sum of capital appreciation (or loss) and current income achieved in the form of interest, dividends and rents. Real total return is total return adjusted for inflation as measured by the Consumer Price Index.

Trigger Value – Allocation percentage at which a particular asset class will be rebalanced to the appropriate point allocation.

Tuition Replacement Funds – Funds that the Berea College Board of Trustees have designated as restricted funds and are not to be expended but are to be invested for the purpose of producing real total return. Also referred to as ***Quasi-Endowment Funds***.