The Regents of the University of California

COMMITTEE ON FINANCE
COMMITTEE ON INVESTMENTS
COMMITTEE ON EDUCATIONAL POLICY

March 19, 1998

The Committees on Finance, Investments, and Educational Policy met jointly on the above date at UCSF - Laurel Heights, San Francisco.

Present: Representing the Committee on Finance: Regents Atkinson, Johnson, Khachigian, Lee, Levin, and McClymond; Advisory Member Miura

Representing the Committee on Investments: Regents Atkinson, Clark, Hotchkis, Khachigian, Leach, Lee, Levin, Montoya, Nakashima, and Parsky

Representing the Committee on Educational Policy: Regents Atkinson, Chandler, Hotchkis, Khachigian, Lee, Levin, McClymond, Montoya, and Soderquist; Advisory Member Miura

In attendance: Regents Davies and Ochoa, Regent-designate Espinoza, Faculty Representatives Dorr and Weiss, Secretary Trivette, General Counsel Holst, Treasurer Small, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Hershman, and Hopper, Chancellors Berdahl, Carnesale, Debas, Dynes, Greenwood, Vanderhoef, and Yang, and Recording Secretary Bryan

The meeting convened at 4 p.m. with Committee on Investments Chair Lee presiding.

The Committees discussed items 1 through 3 together.

1. **ADOPTION OF THE UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT**

The President and the Treasurer recommended that the Committee on Finance, with the concurrence of the Committee on Investments and the Committee on Educational Policy, recommend that The Regents adopt the Uniform Management of Institutional Funds Act (UMIFA), California Probate Code §18500 et seq.

The Committees were informed that the adoption of UMIFA would permit, but not require, the University to spend a portion of the realized or unrealized appreciation in the value of the endowment above historic cost, in addition to current income, subject to the continuing limitations of the "prudent person" standard of Probate Code §18506.

The Regents' current policy is to spend endowment income only when income is classically defined to include dividends, interest, rents, royalties, and the like. Under this policy, the realized and unrealized appreciation in the value of the endowment remains with the principal. It was recalled that the Regents had discussed the proposal to adopt UMIFA at the February 1998 meeting.

UMIFA was originally promulgated nationally to apply to all educational, religious, charitable, and eleemosynary institutions and to governmental organizations that hold funds for such purposes. California originally enacted the UMIFA in 1973 to apply only to certain accredited private schools and colleges. The revised UMIFA, supported by the University of California and effective in 1991, broadened the scope of the Act to apply to any public or private charity. The legislation prescribes the specific investment authority, the authority of governing boards to delegate day-to-day investment management, the standards of care and prudence in the operation of a nonprofit institution and, unless specifically prohibited, the release of donor-specified restrictions on the use or investment of endowed gifts.

It was noted that UMIFA has been adopted by the majority of American universities, as well as the nine University of California campus foundations.

2. ADOPTION OF A TOTAL RETURN EXPENDITURE POLICY ON REGENTS' GENERAL ENDOWMENT POOL ASSETS

The President and the Treasurer recommended that the Committee on Finance, with the concurrence of the Committee on Investments and the Committee on Educational Policy, recommend that The Regents adopt in principle a total return expenditure (spending) policy for eligible endowment gift assets in the General Endowment Pool.

The President and the Treasurer propose that The Regents adopt in principle a total return spending policy for the gift assets invested in the General Endowment Pool (GEP), as permitted under the Uniform Management of Institutional Funds Act. A total return spending policy permits the expenditure of income and a portion of the realized or unrealized appreciation in the value of the endowment above the historic cost. The methodology and procedures for the recommendation and adoption of a specific spending rate will be presented to The Regents at a future meeting. Following the adoption by The Regents of a specific spending rate, the Office of the President and the Office of the Treasurer would develop an implementation plan. The proposal for a total return spending policy is made to bring The Regents' spending policy into conformance with the practices of the majority of American universities and the nine University of California campus foundations.

The effect of the proposed policy would be to provide a similar level of expendable income as has been provided in the past for the beneficiaries of long-established endowments, while providing a slightly greater income to the beneficiaries of newly-established endowments. The General Counsel would direct the review of all gift terms for GEP endowments to determine their eligibility for a total return spending policy. All gift endowments that expressly prohibit a total return spending policy would continue to experience The Regents' existing spending policy of income and income growth.

3. **ADOPTION OF ENDOWMENT ADMINISTRATION COST RECOVERY POLICY FOR CAMPUSES ON REGENTS' ASSETS**

The President and the Treasurer recommended that the Committee on Finance, with the concurrence of the Committee on Investments and the Committee on Educational Policy, recommend that The Regents adopt a policy to recover reasonable and actual costs related to the administration of gift assets invested in the General Endowment Pool.

The President and the Treasurer recommend that The Regents adopt a policy to permit the recovery from the General Endowment Pool, as permitted by California trust law, of reasonable and actual administrative costs for gift assets invested in the GEP. Such costs include investment, accounting, compliance with gift terms, reporting, and the other related activities at the campuses and the Offices of the President, the General Counsel, and the Treasurer.

Currently, actual corporate accounting and investment management expenses are recovered from the GEP. It is proposed that additional costs for actual endowment administrative activities at the campuses and in the Office of the President and the Office of the General Counsel would be recovered from the GEP.

In spring 1997, the General Counsel met with representatives of the Attorney General regarding the possibility of recouping endowment expenses from the endowment payout. The Attorney General's staff opined that this could be done if the actual costs were reasonable and directly related to the endowments' administration. Internal Audit and the Vice President--Financial Management, with the assistance of the General Counsel, would conduct the on-going review of the cost-recovery program to assure that the costs involved are reasonable and directly related to the endowments' administration.

With the passage of the proposed endowment administration cost recovery policy, Internal Audit would validate the allocation of the campuses' endowment administration costs for The Regents' endowment assets and conduct an analysis of fiscal year 1997 administration cost data. Internal Audit would also validate the endowment-related costs for the Offices of the President, the General Counsel, and the Treasurer.

The Office of the President and the Office of the Treasurer would work with Internal Audit to determine the specific recovery amounts from the GEP, as well as the process for allocation of the recovery amounts to the campuses. The Office of the President and the Office of the Treasurer would issue guidelines for campus submission for reimbursement of the actual endowment administration costs, which would have been audited in advance by

Internal Audit. The President and the Treasurer would report annually to the appropriate committees of The Regents on the total annual endowment administration costs and all cost recoveries.

The campus administrative activities supported by the endowment administrative cost recovery program would not be covered by other fees or recurring charges.

Upon motion duly made and seconded, the Committees on Investments and Educational Policy concurred, and the Committee on Finance approved the recommendations of the President and Treasurer contained in items 1, 2, and 3 and voted to present them to the Board.

[For speakers' comments, refer to the minutes of the afternoon session of the Committee of the Whole, March 19, 1998.]

Regent Lee commented that many Regents had expressed concern about the change in philosophy embodied by the recommendations. He noted that The Regents will be responsible for watching the returns on money donated to the University. He suggested examining the returns on investments every quarter and determining annually whether adjustments should be made. He hoped that future chairs of the Committee on Investment would keep a close watch on the relationship between the spending rate and the returns and be prepared to recommend to the Committee on Finance what the rate should be for each new year.

In response to a question from Regent Clark, Treasurer Small stated that her office was comfortable with having a total return spending policy on the endowed assets. She believed that the next step in the process will be to bring to the Committee on Investments a variety of options for protecting the endowed assets in perpetuity and for funding the University in the long term. Regent Clark asked whether she believed that the intent of the policy had been modified by providing that income only is to be spent. He wondered how the change will be explained to the University's donors. Ms. Small responded that an extensive review of the endowment funds within the General Endowment Pool will need to be undertaken in order to identify those endowment funds that can change from an income only policy. The General Counsel will ensure that there is proper disclosure on all the literature having to do with The Regents assets so that past, current, and future donors will understand the issue. Regent Clark noted that there are several broad California Probate Code sections involved, the effects of which must be taken into account. He noted also the necessity of operating within the "prudent person" rule. General Counsel Holst observed that endowments that are given with the stipulation that income only can be used may be affected by the change. His office is determining ways in which the new policy may be communicated effectively to prospective donors. The terms of individual endowment funds must be reviewed to make sure that no language therein could cause the University to restrict the application of the total return spending policy. He believed that in enacting the Uniform Management of Institutional Funds Act, the Legislature and Governor were aware that a reference to expenditure of income only might not be sufficient to override the application of the flexibility that is introduced by the act. Regent Clark noted that if the governing instrument refers to §18503 of the Probate Code, the income-only restriction will be binding.

Regent Parsky believed that adoption of the recommendations was a very positive decision consistent with the responsibilities of The Regents to establish what the spending policy of the institution should be. He suggested that in implementing these policy changes, the Special Committee on Regents' Procedures should bring forward a recommendation as to the process under which the rate would be established annually. He suggested that the establishment of the rate be initiated by the Committee on Investments, recommended to the Committee on Finance, and forwarded to the Board. He stressed the importance of establishing a process before establishing a rate. He believed it was important also for the President to establish a mechanism for reviewing the entire budget as part of the process. Such a review would make clear to the Regents what the rate will apply to in relation to the rest of the budget.

Referring to the third item, ***Adoption of Endowment Administration Cost Recovery Policy for Campuses on Regents' Assets***, Regent Parsky suggested that the President bring to The Regents a clear set of procedures for determining costs for recovery and for delineating how funds that will be available for development will be committed to development. The procedure should include a way to measure whether those funds are producing an adequate level of return in the form of increased private giving. President Atkinson responded that he had established a committee to examine a total funds budget and would be consulting with the Regents on how to proceed.

On behalf of the nine University of California Foundations, Mr. Roy Aaron, President of the UCLA Foundation, thanked the Regents and the President for working with the foundations to help increase private giving to the University.

The meeting adjourned at 4:20 p.m.

Attest:

Secretary