The Regents of the University of California

COMMITTEE ON INVESTMENTS
June 17, 1999

The Committee on Investments met on the above date at UCSF-Laurel Heights, San Francisco.

Members present: Regents Atkinson, Bagley, Davies, Lee, Parsky, Preuss, and Sayles

In attendance: Regents Connerly, Espinoza, Hopkinson, S. Johnson, Kozberg, Lansing, Miura, Montoya, and Willmon, Regents-designate Pannor, Taylor, and Vining, Faculty Representatives Coleman and Dorr, Secretary Trivette, General Counsel Holst, Treasurer Small, Assistant Treasurer Stanton, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Hershman, and Hopper, Chancellors Carnesale, Dynes, Orbach, Vanderhoef, and Yang, Provost Christ representing Chancellor Berdahl, Vice Chancellor Bainton representing Chancellor Bishop, Executive Vice Chancellor Lillyman representing Chancellor Cicerone, and Recording Secretary Nietfeld

The meeting convened at 4:30 p.m. with Committee Chair Parsky presiding.

REPORT OF THE ACTIVITY TO DATE OF THE COMMISSION ON THE OFFICE OF THE TREASURER

Committee Chair Parsky informed the Committee that the purpose of today's meeting was to bring the Regents up to date on the work of a commission that was established to review certain aspects of the University's investment program managed by the Office of the Treasurer. Because the Office of the Treasurer reports directly to The Regents, it was deemed appropriate to review its operations. A further reason for the review was a recent request from the Treasurer to make certain types of investments that previously had not been made. These investments technically have not been authorized by The Regents. For instance, within the investment category of private equity, historically the Office of the Treasurer had invested in venture capital but had not invested in buy-out funds, mezzanine debt financing, or bond-type funds, and there was no authorization to do so.

Regent Parsky continued that a third reason for the review was the relationship between the Treasurer and the Committee on Investments. At present, the Treasurer makes a quarterly presentation to the Committee of the entire investment portfolio. This session typically lasts for an hour and is scheduled to begin late in the afternoon. This formula is not consistent with the way in which a number of other institutions carry out this fiduciary responsibility. For each meeting, the Treasurer has supplied the Regents with a great deal of information concerning investment matters, and there is concern that some Regents may not be fully aware of the content of this material.

In response to the need for a review, in November the Chairman appointed a commission initially consisting of Regents Parsky and Leach and former Regent Gould, who has been replaced by Regent Hopkinson, Ms. Kathryn Hall of Laurel Management Company, Mr. Laurie Hoagland of Stanford Management Company, Mr. Joseph Maurer of Levi Strauss, and Ms. Gail Seneca of Seneca Capital. These individuals either have direct experience in managing resources or experience in overseeing investment management. The charter for the commission was to review the investment policies of the Office in relationship to various asset classes and how the policies are being implemented; review the decision-making process in order to advise the Regents regarding asset allocation; review the staffing needs of the Treasurer's Office; examine the appropriateness of monitoring the performance of the Office; assess how the function is integrated into the overall financial management of the University; and examine the proxy policy. Chairman Davies had originally asked that the work of the commission be completed by March 1. The commission agreed to complete its review by June or July, given the intense nature of its task.

The commission sought the assistance of an independent consultant to conduct the review and, through a request for proposal process, selected the firm of Wilshire Associates. The commission has worked closely with the Office of the Treasurer throughout the review process. Wilshire Associates has had several meetings with the Treasurer and her staff, and the commission has met twice with the Treasurer and her senior staff.

Regent Parsky informed the Committee that the commission would submit an interim report within the next thirty days that will address several of the issues it was asked to consider. He thought it was important, however, to inform the Committee of certain preliminary issues in order to solicit questions and comments from the Regents. The primary conclusion is that the Investments Committee's oversight is not adequate. Second, the investment objectives and policies which are needed to control portfolio risk and assess performance should be improved. The commission believes that the present portfolio contains significant risk, although this may be risk that the Regents are willing to assume. The commission members feel that the nature of the risk is somewhat unusual for an institution such as the University of California. As an illustration, the bond portfolio contains a longer-than-normal maturity duration; the commission believes that this fact may not be fully understood by the Regents. A one percent increase in interest rates from the present level could have a 14 percent effect on the portfolio.

Under the broad heading of governance, the commission would like the Regents to consider several alternatives to the present system. Regent Parsky stated that he was not comfortable with the first option, which is to maintain the status quo, which consists of a report to the Committee by the Treasurer. One alternative that should be considered will be that the framework be maintained but that a consultant working on behalf of the Regents would conduct extensive due diligence and advise the Regents as the quarterly presentations are made. A third possibility would be to establish a body similar to the commission on a more permanent basis. This group could consist of Regents and outside individuals who would also meet on a quarterly basis for a longer session than the Committee and act as a board. This approach has been undertaken by many universities.

Regent Parsky reported that the Treasurer had recently requested expanded authority to engage in new areas of investment, including the private equity area. While the Committee may be willing to hear from the Treasurer concerning this request, its main objective should be to put into place a process that will assure that appropriate governance is being carried out.

Regent Connerly asked whether the Treasurer would be able to respond to the commission's report on a point-by-point basis, especially with regard to the risk factor in the portfolio. Regent Parsky believed that it would be important to hear directly from the Treasurer on any observations of the commission and confirmed for Regent Connerly that the Treasurer would be offered this opportunity. He stressed, however, the importance of the Committee's first addressing the issues of governance which he had outlined.

Regent Connerly suggested that the Regents would need to consider the magnitude of the problems involved with the governance structure in order to understand what changes need to be made. Regent Parsky noted that the performance of the portfolio had been excellent. The commission wishes the Committee to focus on the issue of whether or not the Office of the Treasurer should be investing in private equity or maintaining the current risk profile. A strong recommendation will be made that the current reporting format does not provide an adequate forum for the consideration of these matters.

Regent Connerly pointed out that if the Regents were to consider the retention of an outside consultant, it would be important for them to understand the investment capability within the Treasurer's Office and how it has affected the commission's view of the current governance system.
Regent Preuss observed that the commission had correctly focused on the proper execution of the Regents' fiduciary responsibilities. The Committee has now been informed that some experts do not consider that execution to be adequate, and therefore the Regents must decide whether to remain with the status quo or improve their oversight function.

Regent Lee asked whether the University, as a public institution, could legally embark upon a course which would involve an oversight board consisting in part of individuals who were not Regents. General Counsel Holst noted that, under Article IX, Section 9 of the California Constitution, the Board of Regents has broad powers with respect to organization and governance, including the full responsibility for investable assets. Without a precise proposal to comment on, Mr. Holst stated that there is a considerable amount of latitude in the way in which the oversight function and the Regents' role in that function could be organized. With respect to openness, while the Board of Regents is subject to the Bagley-Keene Open Meeting Law, a key exception permits the Regents to consider investment matters in Closed Session.

Regent-designate Taylor noted that any new oversight process or structure should be flexible enough to permit speedy action when indicated.

In response to a question from Regent Bagley, Regent Parsky confirmed that, technically speaking, unauthorized investments had been made in the area of private equity.

Regent-designate Vining stressed the need for the Regents to keep the focus of their fiduciary responsibilities on the governance structure and not become more involved in investment strategies. Regent Parsky confirmed that the commission did not wish to manage the investment program. A large number of institutions, however, perform a rigorous review with independent evaluation of the performance of the investment portfolio. The University is somewhat unique because policy is implemented within the Office of the Treasurer, and the evaluation of the performance is presented by the Treasurer.

The Committee went into Closed Session at 5:10 p.m.

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The meeting adjourned at 6:00 p.m.

Attest:

Secretary