The Regents of the University of California

COMMITTEE ON INVESTMENTS
May 18, 2000

The Committee on Investments met on the above date at Covel Commons, Los Angeles campus.

Members present: Regents Atkinson, Bagley, Davies, Hopkinson, Lansing, Moores, Parsky, and Taylor

In attendance: Regents Bustamante, Connerly, Khachigian, Kozberg, Montoya, Pannor, Preuss, Sayles, and Vining, Regents-designate Fong, Kohn, and Miura, Faculty Representatives Coleman and Cowan, Secretary Trivette, General Counsel Holst, Treasurer Small, Provost King, Senior Vice Presidents Darling and Kennedy, Vice Presidents Broome, Gomes, and Gurtner, Chancellors Carnesale, Cicerone, Dynes, Greenwood, and Yang, and Recording Secretary Nietfeld

The meeting convened at 12:15 p.m. with Committee Chair Parsky presiding. It was noted that a Special Meeting of the Committee was being convened concurrently with the regular meeting previously scheduled for this time and place for the purpose of receiving information on the implementation of the March 16, 2000 Regents= actions.

1. **PROPOSED ONE-YEAR AGREEMENT WITH WILSHIRE ASSOCIATES, INC. FOR GENERAL CONSULTANT SERVICES**

The Chair of the Committee recommended that the Officers of The Regents be authorized to execute an agreement with Wilshire Associates Incorporated for general consultant services in connection with implementation of the March 2000 Regents= action, *Adoption of Asset Allocation Plan*, for a term of one year at a fee of $350,000.

The Committee was informed that the services to be provided by Wilshire Associates in connection with the implementation of the asset allocation plan will include the following: ongoing advice on asset allocation, investment policy, manager selection/termination, performance measurement and reporting, and assistance in implementation of the asset allocation plan; participation in or direction of external investment manager searches, as requested by the University; development of recommendations for investment guidelines; special investment-related studies/projects as requested by the University; reports of quarterly performance calculations for Regents= investments; reports with respect to campus foundation investment performance using investment return data provided by the foundations; client education and other investment tasks related to the University=s investment program; and access for University representatives to Wilshire=s annual client seminar. Wilshire=s proposed fee for all services is $350,000 for the one-year period.

Regent Parsky recalled that Wilshire Associates had developed the asset allocation plan adopted by The Regents in March. Retention of Wilshire in the first year of the implementation of the plan will facilitate the process. The proposed contract with Wilshire includes a thirty-day cancellation clause.

Regent Bustamante observed that in the asset allocation plan Wilshire Associates had recommended that an outside consultant be hired, and he asked why, in light of that circumstance, the recommendation was being made to use Wilshire Associates as that outside consultant.

Regent Parsky recalled that when Wilshire Associates was originally retained to conduct an asset allocation study, the firm was chosen through a Request for Proposal (RFP) issued by the Office of the President. The proposed contract may be seen as an extension of this process. If the plan is fully implemented in less than a year, the contract may be terminated. Once the plan is implemented, retention of an ongoing consultant will take place through an RFP process. Regent Hopkinson added that the implementation of the plan would present a considerable learning curve for a new consultant.

In response to a question from Regent Taylor, Committee Chair Parsky explained that responsibility for terminating the contract with Wilshire and initiating the RFP process would rest with the Committee. The Committee will be kept up to date with respect to the implementation of the asset allocation plan.

Regent Parsky recalled for Regent Connerly the fact that the asset allocation plan had recommended that, in addition to the retention of a general consultant to provide ongoing advice on asset allocation, The Regents should select a U.S. equity index fund manager and a consultant for the private equity portfolio, all through the RFP process. Wilshire Associates will be excluded from bidding on either of the latter two contracts.

Regent Connerly suggested that the continued retention of Wilshire Associates would provide them with an advantage over other firms in bidding for the role of consultant. He suggested that other firms would be equally suited to assist in the implementation of the asset allocation plan. By recommending a consulting fee of $400,000 in the plan, Wilshire had effectively determined what its fee should be. Regent Connerly believed that The Regents should take the time to bid the contract in order to avoid future criticism. Regent Parsky pointed out that The Regents would have the option of excluding Wilshire Associates from bidding on the contract to serve as the general consultant.

In response to a comment by Regent Connerly, Regent Parsky confirmed that none of the work to be performed by Wilshire Associates in the implementation phase of the asset allocation plan was contained in the original RFP. Wilshire Associates= initial service for The Regents was the carrying out of an asset allocation study.

General Counsel Holst stated that the proposed contract with Wilshire Associates could be viewed as an amendment to the original contract. The statement of work will supercede the statement that was applicable for the previous contract. As indicated above, the scope of the work to be performed by Wilshire Associates is as follows:

$ Twenty percent will be devoted to the selection of the private equity index manager and the private equity consultant. The development of the RFP process is well under way by the Office of the President, with assistance from the Office of the Treasurer and Wilshire Associates.

$ Ten percent will be used to monitor the transition of existing assets to the plan adopted by The Regents.

$ Performance measurement will require approximately twenty percent of the firm=s overall effort. The provision of an independent evaluation of the Treasurer=s performance on a quarterly basis is recommended in the asset allocation plan.

$ A new element involving ten percent of the cost of the work would be access to Wilshires= investment research and client seminars by the Treasurer and the Investment Advisory Committee.

$ Approximately twenty percent of the effort will be devoted to the refinement of the asset allocation plan implementation.

$ A final twenty percent will involve the elaboration of the investment policies, procedures, and guidelines incorporated in the asset allocation plan.

Regent Connerly expressed his strong objection to sole-source arrangements such as the one under consideration. Regent Hopkinson stated that, while this would normally be her position, as the new Chair of the Committee she would feel handicapped if the resources offered by Wilshire Associates were not available over the coming months.

Regent Parsky emphasized that an ongoing report would be presented to the Committee on the implementation of the asset allocation plan.

Upon motion duly made and seconded, the Committee approved the recommendation and voted to present it to the Board.

2. **IMPLEMENTATION OF THE MARCH 16, 2000 REGENTS= ACTIONS**

Treasurer Small reported that her Office had been working closely with Wilshire Associates on the implementation of the asset allocation plan, including the RFP process for the retention of outside consultants. A transition report was prepared at the request of Regent Parsky which was provided to Wilshire Associates and to several Regents on April 28. This report provided a detailed analysis of the work to be performed over the coming six- to nine-month period. Wilshire Associates has acknowledged the transition plan and will coordinate its implementation with the Treasurer=s Office. Some dates have been moved forward from the original recommendation.

Mr. Steve Nesbitt of Wilshire Associates commented on the three elements which are involved in implementation of the asset allocation plan. The first will be to bring the portfolio in line with the asset allocation targets adopted by The Regents at the March meeting. With one exception, Wilshire expects the portfolio to be in compliance with the new plan by December 31, 2000. The second element will involve the selection of outside managers for the U.S. equity index fund and the private equity portfolio through the RFP process. These RFPs will be issued shortly by the Office of the President, with the expectation of Regental action in the fall. Finally, the Treasurer=s Office is putting together a plan for moving assets to the equity index fund during the fourth quarter. The Treasurer has asked for a June 30, 2001 deadline to reduce the duration of the fixed-income portfolio to maximize the value of the investment strategy currently in place. Wilshire Associates has recommended that this exception be granted.

Committee Chair Parsky stated that it was the consensus of the Committee that this request be approved.

At the request of Regent Bustamante, Mr. Nesbitt outlined the elements of the asset allocation plan: the targeted U.S. equity allocation is 53 percent of the portfolio, with non-U.S. equity at 7 percent, for a total of 60 percent commonly traded stocks. Thirty-five percent of the portfolio will be invested in fixed income, and 5 percent will be invested in private equity.

Regent Parsky recalled that the Treasurer had raised the issue of additional investments in private equity during this transition period. He noted that, by adopting the asset allocation plan, The Regents had agreed to increase significantly the commitment to private equity. Implementation will involve a joint working relationship between a private equity consultant and the Office of the Treasurer. This consultant will have a direct reporting relationship to The Regents. The asset allocation plan which was adopted states specifically that any new private equity investments will be approved by The Regents following a joint recommendation by the consultant and the Treasurer. It appeared to Regent Parsky that no investments should be undertaken by the Treasurer in areas that do not fall under the category of venture capital partnerships. The question before the Committee is whether the Treasurer should have the ability to make new commitments to existing venture capital partnerships prior to the retention of a private equity consultant.

Regent Bagley suggested that a motion may be in order that would give the Treasurer the authority to expand or reduce present partnerships and that new partnerships may be entered into within the authorities of the Office of the Treasurer.

Regent Parsky was of the view that the Office should be permitted to continue its relationship with its current venture capital partnerships. Any new investments in this area which are believed by the Treasurer to be critical should be presented to the Investment Advisory Committee and to The Regents for approval.

General Counsel Holst suggested that, because there was no action item before the Committee on this matter, the sense of the Committee be developed for action on an interim basis in accordance with interim action procedures.

In response to a question from Regent Bustamante, Mr. Nesbitt recalled that the benchmark for the equity portfolio would be the Russell 3000, an index of the 3,000 largest stocks in the U.S. equity market which is developed and maintained by the Frank Russell Company. The Treasurer currently uses the S&P 500. The two indices are roughly comparable in terms of volatility. Larger institutions tend to feel that the S&P 500 is too narrow, with a concentration in large-cap technology stocks. The Russell index includes middle- and small-sized companies. The investment strategy which has been adopted seeks to control overall portfolio volatility by the allocation to investments in stock and in bonds rather than through investment in low-risk securities. The S&P 500 has been the best performing and lowest-risk index over the past ten years, but the industry believes in a strategy of maximizing diversification.

Treasurer Small confirmed that the use of a broader index as a benchmark will result in a diversified portfolio. Historically, under the direction of The Regents, the Treasurer's Office has invested in those stocks which it believed represented superior companies with consistent growth rates. The use of the Russell 3000 represents a different type of mandate from the Board.

Regent Bustamante asked whether the Treasurer agreed with the premise that use of the Russell 3000 would provide the portfolio with greater diversity and whether another benchmark might serve The Regents better. Treasurer Small tended not to put a great deal of faith in indices. Mr. Nesbitt recalled that the Treasurer had recommended the use of the Russell 3000. Endowments and pension funds across the country use this index. It will result in a solid investment for The Regents over a long period of time.

The meeting adjourned at 1:00 p.m.

Attest:

Secretary