The Regents of the University of California

COMMITTEE ON INVESTMENTS
INVESTMENT ADVISORY GROUP
February 24, 2009

The Committee on Investments and the Investment Advisory Group met jointly by teleconference on the above date at the following locations: 1111 Franklin Street, Room 12322, Oakland; 777 S. California Avenue, Palo Alto; and Covel Commons, Los Angeles Campus.

Members present: Representing the Committee on Investments: Regents Makarechian, Marcus, Schilling, and Wachter; Ex officio members Blum and Yudof; Advisory member Powell
Representing the Investment Advisory Group: Members Fong and Martin; Consultants Gilman, Hall, and Lehmann

In attendance: Regent Scorza, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Executive Vice President Lapp, and Recording Secretary Johns

The meeting convened at 1:30 p.m. with Committee Chair Wachter presiding.

1. **READING OF NOTICE OF MEETING**

For the record, it was confirmed that notice was given in compliance with the Bylaws and Standing Orders for a special meeting of the Committee on Investments to accommodate a location change and to consider an action item.

2. **PUBLIC COMMENT**

The following individual addressed the Committee:

UC Berkeley Professor Emeritus Charles Schwartz criticized changes in the style of reporting in the University's quarterly investment performance summary. He described the decision to use external managers for equity investments as a failure. He contested statements by President Yudof about the performance of the UC Retirement Plan, citing its relative performance as of September 30, 2008. He noted that projections for the funding ratio of the UCRP produced by the former Regents' actuary, Towers Perrin, included explicit consideration of the significant uncertainty inherent in stochastic calculations. The current actuary, the Segal Company, has abandoned this practice. Professor Schwartz stated that this was misleading both for the public and decision-makers and showed a lack of professionalism.

3. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Consultant Gilman requested that the minutes be amended to reflect that she was present at the last meeting. Upon motion duly made and seconded, the minutes of the meeting of November 12, 2008 were approved as amended, Regents Makarechian, Marcus, Schilling, Wachter, and Yudof (5) voting "aye." [1]

4. **DECEMBER QUARTER 2008 AND FISCAL YEAR TO DATE INVESTMENT PERFORMANCE SUMMARY**

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Chief Investment Officer Berggren began her presentation by noting double digit declines for the UC Retirement Plan (UCRP) and the General Endowment Pool (GEP) in the December quarter and the fiscal year to date. However, the UCRP outperformed the benchmark in both periods. The negative relative performance of the GEP was attributable to the negative relative performance of the absolute return portfolio, which uses a benchmark of Treasury bills + 450 basis points. Ms. Berggren opined that, if an appropriate benchmark had been used, the GEP would have performed above such a benchmark.

Financial assets suffered enormous losses in the quarter due to the global financial crisis, a slow economy, and deleveraging. Every asset class was affected. For the market, 2008 was the worst single calendar year since the Great Depression. In the UCRP portfolio, U.S. equity was down 23.26 percent, a reflection of deleveraging, increased risk premiums, earnings growth below expectation, a slower economy, and mass liquidation of stockholdings. The return on non-U.S. equity-developed was -20 percent, also a reflection of a weak economy and general lack of liquidity in many countries. Emerging markets were down 29 percent, a development which would not have been expected a year ago. Ms. Berggren cited a slowing down of those economies, inflation, and rising risk premiums as causes. Core fixed income and non-U.S. fixed income produced positive returns. The flight to quality and stability benefited core fixed income. Absolute return was down 9 percent, performing better than other equity asset classes. She noted that the economy was beginning to affect both real estate and private equity. Private equity was down 5.5 percent. Private real estate was down 8.5 percent.

All asset classes were within their policy range. U.S. equity was underweighted relative to the current policy allocation of 34.5 percent by 500 basis points. Core fixed income was overweighted relative to the current policy allocation of 12 percent by 500 basis points. Both of these asset allocation decisions benefited performance for the quarter.

[1] Roll call vote required by Bagley-Keene Open Meeting Act [Government Code §11123(b)(1)(D)] for all meetings held by teleconference.

In response to a question asked by Committee Chair Wachter, Ms. Berggren stated that these decisions were made in October 2008.

Ms. Berggren then turned to the University's assessment of risk in the UCRP portfolio. Risk rose to unprecedented levels in December 2008. The UCRP total risk was less than the policy benchmark total risk. However, the tracking error for the portfolio, at 143 basis points, was well below the 300 basis points targeted for this portfolio. The University has tried to maintain a lower risk in the portfolio than is allowed.

Committee Chair Wachter asked about the definition of risk. Ms. Berggren confirmed that risk was defined in this context as deviation from the index, not as risk inherent in the index.

Regent Marcus requested further discussion regarding the definition of risk.

Senior Managing Director Phillips referred to a chart displaying total risk, the risk inherent in the portfolio and the benchmark. A second chart displayed the risk of deviation from the benchmark, with a much lower scale. There was a 1.43 percent standard deviation from the benchmark in the portfolio, while the portfolio itself had a 10 percent standard deviation risk using this particular model.

Committee Chair Wachter referred to the first chart, regarding the risk inherent in investment in equities, and indicated that the portfolio had somewhat less than this level of risk or volatility. The second chart assumed that the index was accurate as a baseline and it showed the tracking error, or how much the portfolio deviated from the index. This chart indicated a fair amount of risk, but far less than is allowed under policy. Policy allows for 300 basis points or 3 percent above or below the index, and the portfolio's actual risk was about half of this, or approximately 1.5 percent. He emphasized that the essential risk was not how much the portfolio tracked the index, but the index itself. The University has suffered in the recent market and experienced significant risk, as have other entities with investments in equities.

Ms. Berggren observed that the fixed income allocation benefited the total portfolio with regard to its amount of risk during this period.

Committee Chair Wachter clarified that the charts being discussed referred to the total portfolio. Inherent risk and tracking error would be different in the equity portfolio considered by itself.

Investment Advisory Group Member Martin asked if a portion of the fixed income allocation was marked to model rather than marked to market, and if so, if this had an effect on volatility.

Ms. Berggren responded that it was all marked to market.

Mr. Phillips added that if the portion of this allocation which is not trading were marked to market, there would be less volatility, because there is no movement in the market.

Ms. Berggren then turned to UCRP factor exposures. The portfolio had a positive orientation toward government, credit, venture capital, and Treasury Inflation-Protected Securities (TIPS). It was underweighted in Large Value, Large Growth, and Europe-Asia.

The fixed income portfolio had a shorter duration, 6.6 years, than the Citicorp benchmark of 7.1. The average quality of the portfolio was AA, while the benchmark was AA+. Over 80 percent of the portfolio was rated A or better. The portfolio underperformed by 406 basis points. It was underweighted in Government and overweighted in Corporate and Mortgage, and this accounted for the negative return.

Committee Chair Wachter requested a presentation on fixed income at the next Committee meeting, with discussion about the duration of the portfolio, credit quality, and the types of securities in the portfolio. These would be important topics for the next year. He observed that benchmarks do not help the University to keep from losing money.

Consultant Lehmann asked if any of the University's mortgage bonds were marked to model rather than marked to market. Ms. Berggren responded in the negative. The pricing was the best available in the current market.

Ms. Berggren then turned to the U.S. public equity portfolio for the UCRP and GEP, which had characteristics similar to the benchmark. The portfolio had greater growth and volatility, was smaller in size, with less yield than the benchmark. In sector exposures, the portfolio was underweighted in consumer non-cyclicals, energy, industrials, and utilities. The energy sector performed better in the fourth quarter than previously.

The non-U.S. equity portfolio had a dividend yield, price earnings ratio, and price to book similar to the benchmark, but lower market capitalization. The biggest active exposures were sector, currency, and country. In regional exposures, the portfolio was underweight in Developed Asia, Japan, and Canada. In sector exposures, the portfolio was underweight in energy and finance, and overweighted in services. These orientations made a positive contribution to performance.

Committee Chair Wachter asked what percentage of the portfolio was actively managed, rather than passively. Senior Managing Director Coaker responded that 28 percent of the U.S. public equity portfolio was actively managed, while 32 percent of the non-U.S. equity portfolio was actively managed.

In response to a question asked by Regent Marcus, Committee Chair Wachter confirmed that active management meant not in an index fund.

President Yudof asked if there were differences, in aggregate, between the actively and passively managed parts of the portfolio. Ms. Berggren responded that the passively managed allocations would have performed in line with the market. The active U.S. public equity underperformed relative to the market, the active developed non-U.S. equity outperformed the market, and the active non-U.S. emerging market equity underperformed relative to the market. Developed non-U.S. equity was, relatively speaking, the best-performing asset class in the equity portfolio.

The private equity portfolio has performed about 966 basis points over its index. It has provided an absolute return of two times the invested capital. The total fund has returned 17.8 percent in the past ten years, relatively consistent since inception. Ms. Berggren concluded by noting that venture capital has been a positive contributor to the performance of the UCRP. The University has been closed out of a number of funds since 2002.

5. REVIEW OF ASSET ALLOCATION AND REBALANCING DURING RECENT MARKET EVENTS

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Chief Investment Officer Berggren began by discussing the rebalancing policy. This policy acknowledges that actual asset weights will periodically differ from policy asset weights. This is caused by market movements and portfolio performance. It can alter the expected return and risk to the UC Retirement Plan (UCRP) and the General Endowment Pool (GEP). For this reason, the Committee has authorized the Treasurer to rebalance these funds when necessary to ensure adherence to the investment policy. The intent is to rebalance in a timely and cost-effective manner. With the approval of the Committee Chair, the Treasurer can delay rebalancing when this is believed to be in the best interest of the funds. Results of rebalancing must be reported to the Committee at quarterly meetings.

In a conference call in October 2008, Committee Chair Wachter, before approving a widening of the allocation ranges on equity and fixed income to plus or minus ten percent, consulted Chairman Blum and President Yudof. If asset weights fall outside the new ranges, the Treasurer will rebalance to the new ranges or ask for authority from the Committee Chair to remain outside the ranges. This is consistent with the policy.

Ms. Berggren then discussed the downward trend in major markets, which continued through January 2009. In January, commodities led the cumulative decline and were down approximately 58 percent. Emerging markets were down 45 percent. International developed markets were down 39 percent. The S&P 500 index was down 35 percent. She noted that it was surprising that the U.S. market performed better than most other markets.

In early January, the Treasurer’s Office felt that the market was pricing extreme outcomes. Valuations seemed attractive, and the fiscal and monetary policies being undertaken appeared aggressive. At that time, the University carried out a modest rebalancing. In the UCRP, it increased U.S. equity by $1 billion, or three percent of the UCRP. The goal was to reduce the equity underweight to -5 percent. In the GEP, U.S. equity was increased by $100 million, or two percent of the fund. The goal was to reduce the equity underweight to -3.5 percent.

As of February 9, the UCRP was seven percent underweight in equity. The portfolio asset weight of 55.5 percent is well under the policy weight of 62.5 percent. Fixed income in the portfolio was overweight at 30 percent, at the upper end of the range. As a result of market movements, alternatives have risen to a total of about 14 percent of the total portfolio, at the upper end of the range.

In the GEP, total equity stood at 37.1 percent, which was 6.9 percent underweight. Fixed income stood at 23.2 percent, which was 2.7 percent overweight. The GEP has a higher target weight for alternatives, which are overweight by 3.8 percent.

Ms. Berggren then discussed the decision factors in asset allocation. She noted that senior staff in the Treasurer's Office meet weekly to discuss asset allocation.

Regent Marcus asked about the ability to move allocations in alternatives. Ms. Berggren responded that among alternatives, only absolute return had some flexibility. In real estate and private equity, the University makes commitments to which it is bound.

Regent Marcus remarked that it seemed unusual that the UC funds would be overweight in alternatives.

Committee Chair Wachter concurred that alternatives were overweighted, but added it might be better for the University if alternatives were even more overweighted. He recalled that about three years ago, the Treasurer's Office began to increase allocations in absolute returns and other alternatives, which were seen as mitigating risk. The current allocation to alternatives is much greater in the GEP than in the UCRP.

In response to a question asked by Committee Chair Wachter, Ms. Berggren noted that the GEP has 23.3 percent in absolute returns, very close to policy weight. It is by far the largest allocation to alternatives.

Committee Chair Wachter stated that absolute return strategies were in fact hedge funds. Although hedge funds have been criticized for not performing as they should, he opined that hedge funds provided better protection in the current market than equities alone. The overweight in alternatives has been good for the University.

Chairman Blum observed that the term "hedge funds" is sometimes used inappropriately for various funds; some have performed well, others not. It was essential to make wise allocation decisions.

Committee Chair Wachter noted that prior Committee members had concerns about avoiding bad hedge funds. He expressed confidence in the ability of the hedge fund and absolute return team in the Treasurer's Office to do so. He acknowledged that, if bad absolute return allocations had been made, UC's funds would be in worse condition than they would be with only equity.

Ms. Berggren stressed that the University has exercised great caution in this asset class through due diligence, long involvement with firms prior to investing with them, and ensuring that appropriate risk management policies were in place.

Committee Chair Wachter suggested that there be a report at the next meeting on the liquidity of hedge funds, their assets, and the concept of "gates."

Ms. Berggren responded that the University has invested in only one hedge fund with a temporary gate. This is a small proportion of the portfolio. This has not occurred with any other of the University's absolute return managers. In response to a question asked by Committee Chair Wachter, she stated that the underlying liquidity was strong.

Mr. Martin expressed confidence in the ability of the Treasurer's Office staff in regard to hedge fund manager selection.

Committee Chair Wachter found it interesting that the Treasurer's Office was comfortable using active managers in the absolute return area.

Regent Marcus suggested that, at a later point, the Committee might discuss how the relative risk of various asset categories is measured. He noted that the index concept is not applicable to judgments about various parts of the investment continuum.

Consultant Lehmann asked Ms. Berggren if she felt that private equity was accurately marked to market at 10.2 percent of the portfolio, and, if it were accurately marked, if it would reduce the overall allocation to alternatives. Ms. Berggren responded that it would reduce this allocation. The Treasurer's Office examines every major company in the private equity portfolio, by company rather than by fund, to gain an understanding of what the valuation should be. She anticipated that the performance of the private equity portfolio would come down in the next two quarters, perhaps as much as 13 percent in the next quarter. However, she stressed that the University does not have problematic investments. The Treasurer's Office examines company fundamentals and discusses assets and debt capacity with its managers every quarter.

Chairman Blum requested an in-depth presentation on the private equity portfolio. He noted that many private equity firms are experiencing covenant violations.

Ms. Berggren agreed that numerous real estate deals are now collapsing. She stated that she would gladly present and go over information on the major companies in the private equity portfolio.

6. **UNIVERSITY OF CALIFORNIA RETIREMENT PLAN ASSET LIABILITY STUDY INITIAL DISCUSSION**

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Mr. Terry Dennison of Mercer Investment Consulting informed the Committee that Mercer, together with the Regents’ actuary, the Segal Company, and the Treasurer’s Office have begun a triennial exercise to ensure that the UC Retirement Plan (UCRP) asset allocation, the principal determinant of investment performance, is appropriate in light of plan liabilities, funding requirements, and changes in capital markets over the last several years.

Mr. Dennison noted that it is helpful to Mercer to have the University identify risks about which it is most concerned, so that Mercer can work to minimize the impact of those risks. He observed that, while the future has always been uncertain, there was now an enormous degree of uncertainty. There was no visibility regarding the economic scenario for the immediate future. The current exercise would include a second level of probability analysis in response to the tremendous degree of uncertainty.

Asset liability modeling has been carried out for the UCRP about every three years since 1999, with increasing levels of sophistication. This modeling process is not for the purpose of determining funding policy. However, the analysis does make assumptions about contributions. Risk and return are related in the economic system. Modeling techniques can be used to attempt to quantify the level of risk for a given level of return. Mr. Dennison emphasized the conjectural nature of the results of the modeling. The UCRP liabilities, its promises to pay benefits in the future, are directly affected by interest rates and by inflation, which can alter the value of those benefits. Some asset classes are influenced by these same factors.

It is possible to model the relationship between assets and liabilities as they are affected by different interest rates and inflation in various economic scenarios in reasonably predictable ways. Liabilities are subject to other factors that would not be included in this analysis, such as benefit structures, payroll and workforce growth, and longevity. It would be important to consider low-probability, high-impact events in the analysis; numerous such events have occurred in the recent past. The analysis uses realistic assumptions of the probability of negative scenarios to model downside risk.

Mr. Dennison discussed a chart showing the UCRP long-term target allocation, current policy allocation, and allowable ranges. The objective of the exercise was to refine the allocation targets and ranges to suit UCRP liabilities and the forecast of economic assumptions.

Mr. Dennison then enumerated the phases of the process. One important factor was risk measurement. Almost any asset class has some exposure or degree of correlation with the equity market. Low-quality bonds are highly correlated with equity markets. Even the lower end of investment grade bonds has equity exposure. Private equity and real estate have the same economic sensitivity.

Mr. Dennison requested the Committee's guidance on the University's prioritization of risk. He distinguished between asset classes that are highly exposed to the behavior of interest rates and inflation and those less exposed. He stated that, at the May meeting, he would present several future policy asset allocation alternatives, taking into account liability and funding and using data from Segal.

Risk factors to be considered included the possibility of catastrophic losses, losses which would require massive capital infusions to ensure the long-term stability of the UCRP. In any pool of assets, if assets fall to a very low level, an extraordinarily high rate of return must be applied to that reduced asset base to restore the level of wealth needed. A related risk was insufficient asset growth to meet growing liabilities. This could endanger long-term viability. Another factor to consider was the volatility, magnitude, and variability of any contributions to the UCRP. Volatility in contributions affects the business model. Another risk was negative media attention due to unanticipated asset behavior. A final risk factor was the magnitude of inflation.

Regent Marcus opined that catastrophic loss was the most significant concern.

Committee Chair Wachter expressed the Committee's general agreement on this point. He expressed a low degree of concern about the risk of negative media attention. He opined that inflation is difficult to address in the equity portfolio, especially if the portfolio is 70 percent indexed. Contribution requirements are within the jurisdiction of the Committee on Finance. He described insufficient asset growth as a conclusion rather than a risk. He noted that there may be a temptation, in the current market conditions and in the face of great losses, to take greater risks in the hope of achieving higher returns. This consideration was part of the previously discussed rebalancing.

Chairman Blum expressed concern that the University might become too risk-averse. He recalled that, over the last 60 to 70 years, equity and real estate have provided good returns. The current scenario was an event that occurs once in a century. He cautioned that the University's investment profile might become so conservative that it would prevent the University from achieving its investment goals and taking necessary action when the market begins to recover.

Regent Marcus stated that he was comfortable with leaving the asset allocation as it currently stood. However, he cited the primary concern about possible catastrophic losses and expressed the wish that the University move toward a more conservative allocation. He suggested a general analysis of the top 20 pension funds, their allocations, and how they have fared, and that UC should move in that direction.

Chairman Blum observed that there was a mistaken impression of diversification, such that, if Asian markets collapsed, UC could make up the loss in Canada, or if private equity did not perform well, the loss would be made up in corporate bonds or commodities. The downside of globalization, or globalization in reverse, was unexpected. The University should learn what it could from the current situation. Half of existing hedge funds were now going out of business. However, he stressed that the University has exercised caution in its investments.

Investment Advisory Group Member Martin opined that it would be unproductive to focus on avoidance of catastrophic risk. He described risk as a spectrum; catastrophic risk always exists as an outside possibility. Converting the University's investments to cash would be just as unwise as taking unreasonable risks. He stated that the University should not try to adjust its risk exposure toward pension liabilities. The University's task was to make reasonable, good investment judgments. In spite of recent unusual events, the University should assume that the principles of economics will continue to apply and that diversification is a good tool for risk management. It should not be afraid of taking reasonable business risks.

Consultant Lehmann requested a report at the next meeting on the relative performance of the UCRP. He stated his view that its performance was probably good relative to peer institutions. He noted that it is possible to purchase insurance against price declines. It would have been possible to insure the passively managed part of the portfolio, but this would have entailed the cost of a premium. Investing in Treasury bills for a long period would be an unwise action. Mr. Lehmann cautioned against ignoring contribution risk, because the resumption of contributions to the UCRP would begin a new period, different from the historical experience of most Committee members. He asked about appropriate expected return targets for the portfolio relative to the funding rate, including liabilities.

Mr. Dennison responded that, for any defined benefit plan, the minimum return sought should be the asset growth assumed by the actuary. Establishing a target that underperforms that assumption would cause continuous erosion in the funding level of the plan. If it is not infeasible due to risk, the University should try to achieve more than that. This would reduce outside funding requirements, provide a certain cushion, and restore a desired funding level. He anticipated that it may be difficult in the next several years to find any creditable asset mix that would produce what the actuary assumes.

Mr. Lehmann observed that this would be an important topic of discussion for the Committee on Finance. These two concerns, the lack of contributions over an 18-year period, and the expected return of the portfolio, would be linked in ways they might not be in other settings.

Regent Schilling cautioned that the condition of the market was fragile and could become worse.

Committee Chair Wachter expressed agreement with statements by Chairman Blum and Regent Schilling. Recovery of losses would take a long time. On the other hand, there would be asset categories offering better returns than over the last five years, such as real estate. He anticipated that there would be tremendous distressed real estate opportunities and distressed debt opportunities. If the University failed to move into these areas itself, through outside managers or through funds, it would make recovery more difficult. These opportunities would be “return boosters” for recovery.

Mr. Martin stated that the current goal was not to recover earlier levels, but to do as well as possible from this point forward.

Chief Investment Officer Berggren recalled the significant liquidity needs of the UCRP. Almost $200 million are paid out every month. The UCRP is not comparable to other pension funds, which have been able to invest larger proportions of their portfolio in non-liquid assets. In response to a remark by Mr. Lehmann, she observed that the UCRP has very different assets than other pension funds.

Committee Chair Wachter noted that certain large endowments do not have enough liquidity to pay out even four or five percent annually.

Mr. Dennison then discussed subsequent steps. Mercer would devise a number of strategic asset allocation choices consistent with the assumptions and with the risk tolerance indicated by the University. Mercer would share the strategic asset allocation choices and underlying simulation data with Segal. The actuary would then use this data, combined with actuarial assumptions about the UCRP and about its liabilities and benefits, to develop the range of expected values of assets and liabilities and the expected funding levels.

Mr. Dennison stated that, at the next meeting in May, Mercer and Segal would provide candidate portfolios with results of economic simulations, actuarial results for each strategic asset allocation choice, and information on the impact on asset value and funding for various contribution levels. Mercer and Segal would also provide a recommendation for the most appropriate strategic asset allocation choice, using the Regents’ attitudes toward the various risks. They would seek an agreement with the Regents at this meeting on the appropriate strategic asset allocation choice.

Committee Chair Wachter stated his understanding that this recommendation might include, as examples, concrete recommendations about percentages allocated to real estate or about the width of ranges. Mercer’s role was to advise the Committee about topics on which the Committee advises the Treasurer’s Office. Mr. Dennison confirmed this.

Mr. Lehmann recalled that the last time an exercise of this nature was carried out, with the previous actuary Towers Perrin, the drivers in the simulation for liability and the drivers for assets were not closely related. The outcomes were not useful. He asked about how Mercer would work with Segal. Mr. Dennison responded that Mercer would provide Segal with trial-by-trial simulation results. The scenarios would be identical. Segal would carry out a simulation on the liability data using precisely the same set of stochastic trials. The study would be internally consistent.

Mr. Martin observed that this exercise would only be as good as the input assumptions. The quantification of risk and expected returns might vary.

Committee Chair Wachter asked Mercer to consider that, in the current environment, there might be opportunities in asset classes in which the University has not been traditionally active, such as distressed real estate, distressed real estate funds, distressed debt funds, and real assets.

Ms. Berggren emphasized that the current environment is not normal. The University was now starting in an unusual place, far below a trend line, and the study should thus focus on a short-term time horizon.

Committee Chair Wachter concurred that in order to be valuable, the study must take into account the fact that the present moment was very unusual.

7. **RECOMMENDATION TO CHANGE PERFORMANCE BENCHMARKS FOR ABSOLUTE RETURN STRATEGIES AND PRIVATE REAL ESTATE (OPEN ENDED FUNDS)**

The Regents' general investment consultant, Terry Dennison of Mercer Investment Consulting, with the concurrence of the absolute return strategies consultant and the real estate consultant, recommended that the performance benchmarks for the Absolute Return Strategies and Private Real Estate (Open-Ended Funds) be changed as indicated below, effective March 1, 2009.

Absolute Return Strategies performance measurement benchmark

- Currently: T Bills + 4.5 percent
- Proposed: ½ HFRX Absolute Returns Strategies Index + ½ HFRX Market Directional Index

Private Real Estate Benchmark for Open Ended Funds

- Currently: NCREIF Property Index ("NPI")
- Proposed: NCREIF Funds Open-Ended Core Diversified Equity Index ("NFI-ODCE")

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Mr. Terry Dennison of Mercer Investment Consulting explained that this item concerned the measurement of performance for reporting purposes. Benchmarks were used to measure performance. An organization called Hedge Fund Research, Inc. provides in-depth research on hedge funds and hedge fund performance. One of its activities is to measure the performance of a broad range of hedge funds broken down by appropriate categories. The Regents' absolute return guidelines suggest a "normal portfolio" of 50 percent low-volatility assets and 50 percent high-volatility assets. Mr. Dennison distinguished between the performance benchmark and the performance objective, which is a long-term view. The proposed performance benchmark would match those "normal portfolio" guidelines as closely as possible, using indices available from hedge fund research. There are two useful indices, the HFRX Absolute Return Index and the HFRX Market Directional Index. The advantages of this structure are that it is investible, it is an index portfolio against which active management can be evaluated, and it matches the "normal portfolio" guidelines. Mercer has reviewed the proposed benchmark change and recommended its adoption. If adopted, the benchmarks should be implemented at the first practicable month-end after approval.

Committee Chair Wachter recalled that the University's current hedge fund performance benchmark is Treasury bills plus 450 basis points. This benchmark reflected the view that hedge funds could provide returns in various market conditions. In fact, there are many different kinds of hedge funds and various risks in hedge funds. Among the positive aspects of hedge funds, good hedge funds can protect investors in a bad market. The University's benchmark was appropriate ten years ago, or when hedge funds first appeared. Today there is an index of hedge funds, and the University should use that index to measure performance.

In response to a question asked by Regent Marcus, Committee Chair Wachter stressed that the proposed benchmarks would be used only for purposes of reporting, not for compensation. When the news media or other outside entities examine the University's investment performance, they look at the University's benchmarks. One could compare UC to other institutions, but that would be problematic, because each institution has a different asset allocation and different needs. Or one could compare UC's performance to its own benchmarks. If the Treasurer's Office consistently underperformed relative to the hedge fund index, it would indicate that the hedge fund team was not doing an adequate job.

Regent Marcus responded that this would essentially be a qualitative judgment about the University's investment team. He expressed concern about the use of somewhat official guidelines which could alter the behavior of important executive staff. He opined that the University should develop a method of viewing this area of investment in a more innovative way. He reiterated his concern that the proposed benchmarks would send an inappropriate message to senior investment staff.

Committee Chair Wachter stated that the quality of benchmarks varies. He found that, while the proposed benchmarks and the hedge fund indices were not excellent, in the current down market, the proposed benchmarks were meaningful.

Regent Marcus asked that, in considering benchmarks for compensation, there be more flexibility.

Consultant Lehmann stated that the Treasury bills-plus-4.5 percent benchmark was not effective. He recalled that, ten years ago, the Treasurer's Office provided a nuanced report on portfolio performance, referring to a number of different benchmarks. A positive aspect of benchmarks is that they are difficult to move. A drawback is that they might be easy to manipulate. The proposed benchmarks might be hard to invest in, but not easy to manipulate. Mr. Lehmann felt that they would not send the wrong signal.

Committee Chair Wachter recalled that there was a large universe of hedge funds. Thus, any index of hedge funds was somewhat meaningless. However, if the University outperformed the benchmark, this would be an indication that it had invested in the right hedge funds. Regent Marcus concurred.

Mr. Dennison explained that the second part of the recommendation concerned private real estate benchmarks. Like the first set of proposed benchmarks, these were not for compensation purposes, but purely for performance reporting purposes. There are two indices in real estate, one for property and another for funds. Real estate differs from other asset classes in that the underlying assets are unique. Each building is unique, while every share of a company is identical to every other share. The performance of investments in funds should be measured by the relative performance of funds, not individual assets. Many funds use the NCREIF Property Index. Mr. Dennison opined that this index is not desirable, because it measures the performance of individual real estate assets, which cannot be replicated. There is another index, the NCREIF Funds Open-Ended Core Diversified Equity Index (NFI-ODCE), which measures the performance of funds. Funds pay fees and employ leverage. In measuring the performance of real estate, this index would provide a like-for-like comparison. In response to a question asked by Committee Chair Wachter, he confirmed that this index would reflect the University's investment in real estate funds, not direct real estate investment.

Upon motion duly made and seconded, the Committee approved the recommendation of the Regents' general investment consultant, the absolute return strategies consultant, and the real estate consultant, and voted to present it to the Board, Regents Blum, Makarechian, Marcus, Schilling, Wachter, and Yudof (6) voting "aye."

8. **BENCHMARK STANDARDS FOR PRIVATE REAL ESTATE STAFF**

The President, with the concurrence of Mercer Investment Consulting, recommended that the following benchmark performance standards be adopted for fiscal year 2008-09 for the Office of the Treasurer Private Real Estate staff:

A. Entity Performance (10 to 20 percent)

B. Individual / Subjective (20 percent)

C. Asset Class / Sector Performance (60 to 70 percent)

   (1) Each segment (Real Estate Investment Trusts [REITS], Open End and Closed End Funds) is weighted by actual dollars invested, consistent with other asset classes in the Annual Incentive Plan (AIP).

(2) Performance hurdles over respective benchmarks for REITS and Open End Funds.

(3) For a transition period during which initial investments are made, performance for the Closed End Funds will be evaluated subjectively using a variety of quantitative and qualitative portfolio metrics.

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Executive Director Larsen explained that this item presented new performance benchmarks for private real estate staff in the Office of the Treasurer. These benchmarks would measure the staff's relative investment performance, which would be used to calculate the asset class performance awards under the Treasurer's Annual Incentive Plan (AIP). He introduced Ms. Susan Rowley of Mercer Investment Consulting.

Committee Chair Wachter noted that two different Mercer offices were reporting to the University regarding benchmarks and compensation, and that the necessary conflict protections were in place. These two offices do not communicate with each other about the University.

Ms. Rowley reiterated the purpose of the present discussion as described by Mr. Larsen. She emphasized that, while it concerned compensation, it was concerned with the development of benchmark standards, not with the payout function. She pointed out that this recommendation included qualitative factors, while all other aspects of the AIP were purely quantitative.

The real estate team is relatively new. The staff was hired in 2006. At that time, it was agreed to delay the implementation of incentive compensation metrics for the first two years. Fiscal year 2008-09 represents the third year of the real estate portfolio. Mercer was engaged by the Office of the President to develop benchmark standards.

Awards granted by the AIP are based on relative performance rather than absolute performance; therefore, benchmarks are very important. The current benchmark for the private real estate portfolio is the NCREIF Property Index (NPI), an unlevered, core property benchmark. Given the large allocation to non-core assets in the real estate portfolio, Mercer recommended that an alternative benchmark be considered.

In response to a question asked by Committee Chair Wachter, Ms. Rowley explained that "non-core" referred to enhanced, value-added, or opportunistic assets. This was related to changes at the property level, such as renovation or change in management.

Regent Marcus described this as yield tranching, or the risk yield continuum.

Committee Chair Wachter asked if this had to do with property ownership rather than investment in funds. Chief Investment Officer Berggren responded that this referred to fund investing. She distinguished between core open end real estate funds and funds that are considered enhanced and value-added.

Ms. Rowley then presented a chart showing the real estate investment guidelines. There were four segments in the real estate portfolio. Mercer recommended that each segment be measured against its appropriate benchmark. The real estate investment trusts (REITS) segment should be measured against an appropriate blended benchmark. Core and enhanced open end funds should be compared to the NCREIF NFI-ODCE Index. This index represents the fund level, not the property level. For non-core assets and closed end funds, Mercer recommended a combination of qualitative and quantitative factors.

The recommendation to consider qualitative factors was based on the J-curve nature of the closed end funds. In addition, because the real estate portfolio is still in its beginning years, returns at this time would most likely be negative, regardless of market conditions. Another reason for consideration of qualitative factors was the lack of industry peer group vintage year indices, such as those used for private equity. Private equity vintage year indices refer to a universe with over 1,000 funds; vintage year indices available for real estate contain about six or seven funds and are not robust enough to stand alone.

Committee Chair Wachter asked about the reason for negative returns. Ms. Berggren explained that, when an investor first invests in a fund, there are management fees, but there may be no investments. A management fee is being paid on the commitment.

Regent Marcus explained that, like a private equity fund, this fund is loaded up and then disposed of by a liquidity event.

Ms. Rowley then discussed the real estate staff compensation structure, which is mostly consistent with the AIP and other asset classes. Entity performance represents 10 to 20 percent of the award; individual/subjective performance represents 20 percent; asset class/sector performance represents 60 to 70 percent. The asset class/sector performance was being divided into three categories: REITS, open end funds, and non-core and closed end funds. The evaluation of the last category of non-core and closed end funds would include qualitative factors, and this would differ from other UC asset class incentive compensation.

In response to a question asked by Regent Marcus, Ms. Rowley recalled that individual/subjective performance accounted for 20 percent of the award. In the asset class/sector performance, 60 to 70 percent of the award, each of the three categories (REITS, open end funds, and non-core and closed end funds) was weighted by actual dollars invested. Currently, non-closed end funds make up 70 to 75 percent of the total portfolio.

Ms. Berggren noted that, when the University started its real estate portfolio, it felt that the core open end funds were overvalued, which turned out to be correct. The University did not invest in many core open end funds. Numerous open end funds are now in serious difficulty.

Ms. Rowley turned to the evaluation of closed end funds. Mercer recommended a combination of several factors, where each comparison was made subjectively rather than using formal hurdles. The first two factors were quantitative. Mercer recommended that the closed end funds' time-weighted returns be compared against the Townsend custom indices and that the closed end funds' internal rates of return be compared to vintage year data. Ms. Rowley next discussed the four qualitative factors. She emphasized that Mercer made an effort to develop goals that were subjective but measurable; these four were measurable. The first was compliance with established real estate investment guidelines; the second was comparison of the level of appreciation and depreciation in the UC portfolio with the Townsend custom indices; the third was managing the real estate funded exposure to allocation targets at the total fund level. For example, in the total portfolio, the real estate target allocation might be three percent. The fourth and last factor was the commitment of capital year by year in accordance with the approved real estate strategic plan.

Committee Chair Wachter asked about why a different incentive plan was proposed for real estate staff and asked about the subjective element in the plan. The objective part of the regular plan contained a subjective part. The objective part of the plan is in fact about 80 percent objective, based on numbers, but 20 percent subjective.

Ms. Berggren clarified that the subjective part of the AIP is linked to entity performance. The subjective elements just discussed applied only to the real estate asset class.

Ms. Rowley explained that 10 to 20 percent of the award for each real estate staff member would be determined by the entity performance.

Ms. Berggren pointed out that this award percentage was the same as for other Treasurer's Office staff, as was the percentage for individual/subjective performance. The real estate asset class was begun recently. It is difficult to determine quantitative measures to evaluate a portfolio that is only two years old.

Regent Marcus found that the indices for non-core funds were unreliable. For this reason, he expressed support for the inclusion of subjective factors.

Ms. Rowley added that there was no good benchmark comparison for closed end funds started three or even six years ago. This was the reason for including qualitative factors.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board, Regents Blum, Makarechian, Marcus, Schilling, Wachter, and Yudof (6) voting "aye."

9. **APPROVAL OF TREASURER'S FISCAL YEAR 2007-2008 ANNUAL ENDOWMENT REPORT**

The Chief Investment Officer recommended that the Annual Endowment Report for Fiscal Year 2008 be approved.

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

The Annual Endowment Report for Fiscal Year 2008 was submitted to the Committee. There was no discussion.

Upon motion duly made and seconded, the Committee approved the Chief Investment Officer's recommendation and voted to present it to the Board, Regents Blum, Makarechian, Marcus, Schilling, Wachter, and Yudof (6) voting "aye."

10. **AMENDMENT OF REGENTS' INVESTMENT POLICY FOR UNIVERSITY OF CALIFORNIA CAMPUS FOUNDATIONS AND MERGER WITH POLICY ON INVESTMENTS OF CAMPUS FOUNDATIONS**

The President recommended that the Committee:

A. Rescind the *Investment Policy for the UC Campus Foundations*.

B. Rescind the *Policy on Investments of Campus Foundations*.

C. Adopt the *Investment Policy for the University of California Campus Foundations*, which merges the former *Policy on Investments of Campus Foundations* into a new comprehensive investment policy for campus foundations, as shown in Attachment 1.

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Assistant Vice President O'Neill recalled that the University currently had two investment policies for the campus foundations. The first was adopted in 1981. It authorized the Committee to review the investment policies and practices of the campus foundations and discussed the presentation of the Annual Endowment Report. It also highlighted the condition that the services of the Treasurer's Office be made available to the campus foundations. This policy was being retained as the first paragraph of the proposed policy.

Consultant Gilman referred to the stated time frame for individual campus foundations to present their reports to the Regents. The proposed policy provided for 45 days. Ms. Gilman expressed concern that this might not allow sufficient time at the end of a fiscal year, because the campus foundations must await the Regents' report before compiling their own reports. She asked that the time period be increased from 45 days to 60 days. Committee Chair Wachter expressed approval.

Upon motion duly made and seconded, the Committee approved the President's recommendation as amended and voted to present it to the Board, Regents Blum, Makarechian, Marcus, Schilling, Wachter, and Yudof (6) voting "aye."

11. **AMENDMENT OF REGENTS' POLICY ON DIVESTMENT OF UNIVERSITY HOLDINGS IN COMPANIES WITH BUSINESS OPERATIONS IN SUDAN**

The Chief Investment Officer recommended that the *Policy on Divestment of University Holdings in Companies with Business Operations in Sudan* be amended, as shown in Attachment 2, to add the following four companies to the list of prohibited investments: CNPC Hong Kong, MISC Berhad (Petronas), Lundin Petroleum, and AREF Investment Group.

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Chief Investment Officer Berggren explained that this amendment would add four companies to those referenced in the original policy.

Upon motion duly made and seconded, the Committee approved the Chief Investment Officer's recommendation and voted to present it to the Board, Regents Blum, Makarechian, Marcus, Schilling, Wachter, and Yudof (6) voting "aye."

12. **PUBLIC EQUITY PROGRAM REVIEW**

[Background material was mailed to the Committee in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Senior Managing Director Coaker began his presentation by pointing out that, in calendar year 2008, the active U.S. equity portfolio underperformed its benchmark by 2.8 percent. The active international equity portfolio outperformed its benchmark by 2.2 percent. The emerging markets portfolio lagged the benchmark at -0.3 percent. Between January 1 and February 23, 2009, the U.S. equity portfolio outperformed the benchmark by 2.29 percent. In the same period, the international equity portfolio outperformed its benchmark by 1.1 percent, and the emerging markets portfolio outperformed by 2.47 percent. There has been meaningful improvement.

Mr. Coaker then discussed active equity returns from inception to date. The Large Cap return variance from the benchmark through February 23 was -1.6 percent. Small Cap variance was now 0.36 percent, and total U.S. equity variance was now -0.93 percent. International equity variance from the benchmark had improved to 0.85 percent.

Committee Chair Wachter requested clarification regarding the -2.7 percent benchmark for U.S. Large Cap. Mr. Coaker stated that this was the benchmark return. Chief Investment Officer Berggren and Consultant Lehmann confirmed that this represented -2.7 percent, annualized through the end of December 2008. UC performance for that period was -4.8 percent.

Mr. Coaker reiterated that, through February 23, the Large Cap variance was up to -1.6 percent. The portfolio had performed well over the past seven weeks, outperforming the benchmark by 2.3 percent. He then briefly noted that a number of market factors have influenced returns.

The active U.S. equity portfolio underperformed by 2.8 percent in 2008. It appeared that, especially during the period from September to November 2008, the securities of four Large Cap managers were affected by major deleveraging taking place among other leveraged investors. The University's hypothesis was that, after this severe selling, if this selling was not related to fundamental factors, the underlying securities of these managers would now be priced attractively relative to the investment opportunity set, and that the managers should be poised to outperform the benchmark. This has been the case, and since December, these four managers in aggregate have outperformed by 2.5 percent. One of them has outperformed by somewhat more than 7.5 percent.

Ms. Berggren stated that there was massive selling of very liquid securities, and fundamentals had little effect on managers' performance.

Mr. Lehmann asked if this demonstrates that returns have a low correlation to the benchmark.

Mr. Coaker responded that other leveraged investors were taking more idiosyncratic risks. He continued by observing that another factor that affected returns in 2008 was an overweight in technology of three percent, which underperformed for the year.

Committee Chair Wachter asked if this overweight in technology was intentional or by accident.

Mr. Coaker responded that the University has carefully considered the overall tilts of its managers. It is comfortable with the active managers' decisions. While the active managers' decisions are their own, the weighting scheme between those managers is decided by the University.

Mr. Lehmann added that Senior Managing Director Phillips had detailed knowledge of the University's positions for the entire portfolio, segment by segment.

Mr. Coaker continued by remarking that technology has desirable attributes such as low debt and attractive valuations. Although the relative returns were poor during the previous year, there were some measures that were helpful. The University hired three managers early in the third quarter. All three have outperformed; the weighted average basis of their outperformance since hiring has been nine percent. There was also an overweight to small stocks that have outperformed.

Investment Advisory Group member Fong asked about the outperformance of the new managers, and if it was in fact around 1,000 basis points. Mr. Coaker responded that the three managers have outperformed by a weighted average basis of 900 basis points since being hired. He noted that the University hired one Mid Growth manager with high-quality attributes, very low debt, sustainable sales, and less sensitivity to the economy. This has paid off very well. Another manager that has performed well takes less systematic risk, with a beta of close to 0.5.

Ms. Berggren emphasized that the University pays close attention to the managers that it hires. This has shown itself to be a positive practice. Historically, this asset class has hurt the performance of the pension fund materially. Since Mr. Coaker was engaged about a year ago, a strategy for the group has been established, the University knows which managers it is investing in and why, and it carefully examines sectors and weights. This was a different way of investing in long managers than before.

Mr. Lehmann described this as a victory for benchmarking. Benchmarking made clear the problems and necessary corrective actions.

Mr. Coaker continued by reporting that the international equity portfolio outperformed by 2.2 percent the previous year. There was one manager with extra economic sensitivity, higher beta, and more exposure to emerging market stock. That manager hurt returns considerably, but overall, the portfolio was decidedly tilted toward high quality, low debt, less economic sensitivity, higher free cash flow, and higher sustainable sales. The University has attribution and risk metrics that allow it to ascertain and understand the active managers' decisions. The emerging market equity portfolio underperformed slightly in the previous year. There was a mix of factors that hurt and helped.

Turning to U.S. equity strategy, Mr. Coaker pointed out that, in the Large Cap space, the University emphasizes active management, because the amount of alpha there has historically been more temperate. The University uses more of its active budget in Small and Mid Cap managers, where alpha has been more robust and there is more cross-sectional volatility, less coverage, and a bigger universe. Satellite strategies would be considered. Managers with both top-down and bottom-up skills would be used. Macroeconomic skills may be more useful at this time than they otherwise would be. Quantitative and qualitative methods of evaluation would be used. The quantitative weighting scheme would depend on economic factors and crowding effects. The University did not have a strong view on growth as opposed to value. The portfolio had a slight growth tilt, but this was an outcome of metrics used to build the portfolio rather than the result of an intentional view.

In international equity strategy, active strategies would be used more than in U.S. equity. This was due to the larger universe and greater number of alpha sources. Satellite strategies would be considered here as well. Managers with both top-down and bottom-up skills would be used even more than in the U.S. equity strategy due to multiple-country and multiple-currency views. This portfolio might have a more persistent value tilt, because the value premium recognized in the U.S. has been even more robust internationally.

In emerging market strategy, active management was even more likely to be used, because indexing in emerging markets was particularly expensive. There were more possibilities in satellite strategies, with country managers, regional managers, and frontier markets. Top-down and bottom-up skills would be more important than in the U.S., due to country and currency volatility. This portfolio would also have a more persistent value tilt than the U.S. portfolio, but relative valuation and fundamentals, not only historical results, would be determining factors.

The University was developing a global equity strategy and was close to completing due diligence on global equity managers. It was in the middle stage of portfolio construction. Top-down and bottom-up skills would be particularly useful in this robust environment.

Mr. Coaker informed the Committee that the University has rebuilt its equity staff. The team was very thoughtful in its selection of managers, in portfolio construction, and in consideration of the economic environment in which the University invests. Their contributions have already been seen in improving returns. During the next 18 to 24 months, emphasis would be placed on companies able to survive. Cash and low debt were important. He pointed out some of the metrics considered in manager selection and portfolio construction.

In a more benign environment, macroeconomic skills would add less value. In periods of major disturbance, macroeconomic skills can be very important, concerning effects on sectors, countries, and currencies. The University was currently underweight in emerging markets, more underweight on a percentage basis than in other portfolios. This was due to the concern about emerging markets' access to capital. However, in the long term, emerging markets would present a favorable macroeconomic picture in savings, lower debt, and demographics. Mr. Coaker anticipated that there would be an overweight in emerging markets in the future. He concluded by noting that the University did not have a dedicated international Small Cap manager. This was an area that has generated robust alpha. When the economic environment becomes more benign and favorable, the University may invest in a dedicated international Small Cap manager. Due diligence for this has been completed.

Investment Advisory Group member Martin asked if it was reasonable to expect one manager in the international Small Cap arena to have global expertise, or if it would be better to find managers with zone- or country-specific expertise. Mr. Coaker responded that there were tradeoffs in this decision. Country- or region-specific managers would be able to identify inflection points and emerging companies earlier than a highly diversified manager would. On the other hand, if the fundamentals for that country or region were poor, the managers were locked into investing in them. Both approaches had advantages.

The University was inclined toward a diversified manager with a global research platform, in order to benefit from both skills.

Mr. Lehmann asked if good values were to be expected from high-quality, high free-cash-flow, low-debt companies, or if there would be overinvestment in these companies. Mr. Coaker responded that the portfolio has been tilted that way. This view was no longer controversial. If there was an improvement in economic fundamentals, the University would be watchful regarding an increase in its managers' economic sensitivity. He anticipated that in the short term and in the down market, this approach would still produce positive value.

The meeting adjourned at 3:45 p.m.

Attest:

Secretary and Chief of Staff

ATTACHMENT 1

Additions shown by underscoring; deletions shown by strikethrough

INVESTMENT POLICY FOR THE UNIVERSITY OF CALIFORNIA CAMPUS FOUNDATIONS

The Regents authorize the Committee on Investments to review the investment policies and practices of campus foundations and conduct an annual review of statements of investment policy and reports of investment performance in a format approved by the Committee on Investments, together with the annual financial reports of campus foundations as audited by certified public accountants. The Treasurer of The Regents is available to provide investment management services, without charge, for any campus foundation which requires such service.

Delegation to Campus Foundations and Statement of Policy.

The Administrative Guidelines for Campus Foundations provide that each Campus Foundation Board of Directors has the duty to develop an appropriate investment policy for such Foundation. It is the Policy of The Regents that each Campus Foundation shall develop and follow an appropriate investment policy, and shall act as a prudent investor in accordance with applicable law, using a portfolio approach in making investments and considering the risk and return objectives of the endowment funds. A Campus Foundation may hold and invest endowments and funds functioning as endowments on a long-term basis. All such investments must be consistent with the terms of the gift instrument. Investment operations shall be conducted in accordance with prudent, sound practices to ensure that gift assets are protected and enhanced and that a reasonable return is achieved, and with due regard for the fiduciary responsibilities of the Foundation's governing Board and the Regents. Financial activities of a Campus Foundation shall be administered and reported in accordance with prudent business practices and generally accepted accounting principles.

Reporting from Campus Foundations.

The Regents generalist investment consultant shall review investment procedures and results annually and report the findings to The Regents. The Administrative Guidelines for Campus Foundations require the following reports from the Campus Foundations to the generalist Investment Consultant:

- A Campus Foundation's enabling documents (e.g., articles of incorporation, bylaws, constitution) shall be provided, and any amendments shall be forwarded promptly following any revision.

Within 90 days of the close of each fiscal year, a Campus Foundation shall submit a detailed report comparing budgeted to actual administrative expenditures by fund source.

- Copies of the Foundation's report to the State Registry of Charitable Trusts, tax returns, and a current list of Foundation officers, directors or trustees, and legal counsel shall be provided promptly each year.

- The external auditor shall furnish a copy of the audit report, including the letter to management with management's response, promptly following the completion of the audit each year.

- A copy of each Foundation's investment policy shall be provided, and any amendments thereto shall be forwarded promptly following any revision.

- A copy of each investment performance report shall be provided [60] days following the close of each quarter.

Review by Investment Consultant.

The Regents' generalist investment consultant shall review, initially and at the time of any change, each Foundation's investment policy, asset allocation policy, and performance on an annual basis, including:

- Asset allocation relative to its policy, and

- Performance by asset class and relative to its benchmarks, and provide a report to the Committee on Investments annually on their findings.

- In addition, on an annual basis, beginning with the Fiscal Year 2006-2007, the Regents' investment consultant will review the written investment policies and governance structure of each Foundation to ensure that each set of written policies includes, at a minimum:

- Asset allocation target percentages,

- Ranges for each asset class,

- Policy benchmarks for each asset class and in total, and

- Investment guidelines for each asset class.

The Regents generalist investment consultant will raise any issues of concern with the campus foundations, and subsequently, if necessary, with the Committee on Investments.

If any Foundation approves changes to its investment policy (including but not limited to asset allocation targets and policy benchmarks), it must communicate such change to The Regents' generalist investment consultant prospectively before the effective date of such change.

Additions shown by underscoring; deletions shown by strikethrough

~~INVESTMENT POLICY FOR THE UC CAMPUS FOUNDATIONS~~
~~*Approved November 2006*~~

~~The Regents' generalist Investment Consultant shall conduct an annual review of each Campus Foundation's investment policy and performance on an annual basis, including:~~

~~.Asset allocation relative to its policy, and~~

~~.Performance by asset class and relative to its benchmarks, and provide a report to the Committee on Investments annually on their findings.In addition, on an annual basis, beginning with the Fiscal Year 2006-2007, the Regents' investmentconsultant will review the written investment policies and governance structure of each Foundationto ensure that each set of written policies includes, at a minimum:~~

~~.Asset allocation target percentages,~~

~~.Ranges for each asset class,~~

~~.Policy benchmarks for each asset class and in total, and~~

~~.Investment guidelines for each asset class.~~

~~Foundations should adopt the investment policies and guidelines of the GEP If any Foundation'spolicies differ materially from those of the GEP, the Foundation is required to explain thedifferences to The Regents' generalist investment consultant. The Regents' generalist investment consultant shall review, initially and at the time of any change, each Foundation's asset allocation policy. If a Foundation's target asset class weights are (or will be) outside the ranges currently setannually for the GEP for the next fiscal year, the Foundation is required to explain its rationale to The Regents' generalist investment consultant. The Regents' generalist investment consultant will then provide an assessment and recommendation to the Committee on Investments, at the next scheduled meeting of the Committee on Investments. Any exception to the Regents' Investment Policy must be approved by the Committee on Investments or the Foundation must immediately move to comply with the approved GEP Policies and demonstrate such compliance to the Committee on Investments.~~

~~If the Committee on Investments approves an exception to The Regents investment policies, it will be reevaluated by The Regents' Investment Consultant on an annual basis and brought back to theCommittee on Investments for approval each successive year.~~

~~If any Foundation makes changes to its policy (asset allocation percentages and/or benchmarks) that are outside the GEP guidelines, it must communicate such change to The Regents' generalist investment consultant and must be approved by the Committee on Investments before such change can be effective.~~

~~Beginning next fiscal year, the Committee on Investments will require the Foundations to also be in compliance with the GEP's risk budget, which will also be reviewed by the Consultant. The Treasurer's Office will work with the Foundations over the course of the next year to ensure that the Foundations are informed of the key assumptions underlying the risk budget.~~

Additions shown by underscoring; deletions shown by strikethrough

~~POLICY ON INVESTMENTS OF CAMPUS FOUNDATIONS~~

~~*Approved March 20, 1981 Amended September 22, 2005*~~

~~The Regents authorizes the Committee on Investments to review the investment policies and practices of campus foundations and conduct an annual review of statements of investment policy and reports of investment performance in a format approved by the Committee on Investments, together with the annual financial reports of campus foundations as audited by certified public accountants. The Treasurer of The Regents is available to provide investment management services, without charge, for any campus foundation which requires such service.~~

Additions shown by underscoring; deletions shown by strikethrough

I-9 Attachment

DIVESTMENT OF UNIVERSITY HOLDINGS IN COMPANIES WITH BUSINESS OPERATIONS IN SUDAN

In light of The Regents' decision of November 2005 to adopt a policy of divestment from a foreign government only when the United States government declares that a foreign regime is committing acts of genocide and The Regents' findings that the U.S. government has determined that there is ongoing genocide in the Darfur region of Sudan, it was recommended that The Regents:

A. Divest all shares of the following nine companies: Bharat Heavy Electricals Ltd., China Petroleum and Chemical Corp. (Sinopec), Oil & Natural Gas Co. Ltd., PECD Bhd., PetroChina Company Ltd., CNPC Hong Kong, MISC Berhad (Petronas), Lundin Petroleum, and AREF Investment Group held within separately managed equity portfolios of the University of California Retirement Plan (UCRP) and the General Endowment Pool (GEP). The proposed policy would apply to both indexed and actively managed, publicly-traded equity portfolios

B. Prohibit future purchase of shares in the above ~~five~~ nine companies until such time as the Office of the Treasurer reports to the Committee on Investment that either there is compelling information that a company has materially improved its operation and is no longer thought to be contributing to the suffering in the Darfur region of Sudan, or that the situation in the Darfur region has improved to such a point that the prohibition on investment is no longer thought to be in the best interests of the people of Sudan.

C. Condition implementation of the proposed divestment policy upon enactment by the California legislature and signature by the Governor of legislation providing indemnification for past, present, and future individual Regents, and the University, its officers, agents, and employees, for all costs and defense of any claim arising from the decision to divest.

D. Instruct the Office of the Treasurer to contact the management of several other companies identified by the Sudan Divestment Study Group to ask them to ensure that their business operations in Sudan, while providing beneficial effects for the people of Sudan, do not inadvertently contribute to the campaign of genocide.

E. Instruct the Office of the Treasurer to report on the status of this policy to the Committee on Investments as part of the annual review of the Investment Policies for the UCRP and GEP.

F. Divest all shares held in the nine companies within an 18-month period commencing once indemnification legislation has been enacted.

G. Communicate the decision to divest shares held in the nine companies to the managers of commingled accounts in which assets of the UCRP and GEP are invested, with a request that they consider the University's stand on this issue as they make their investment decisions.

H. Communicate the decision to divest shares held in the nine companies to the Investment Committees of the Campus Foundations so that they may consider adopting similar policies for their Funds.