UNIVERSITY OF CALIFORNIA
Office of the Treasurer

605 External Equity Manager Search Update

Committee on Investments/Investment Advisory Committee

February 15, 2005

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UC Asset Allocation Guidelines

- Domestic Equities:

  Passive Strategies-Indexed to the Russell 3000-TF

  Active Strategies-Benchmarked to the Russell 3000-TF

  - Structured to maximize potential out-performance at acceptable levels of risk
  - Styles and capitalizations will be complementary and varied

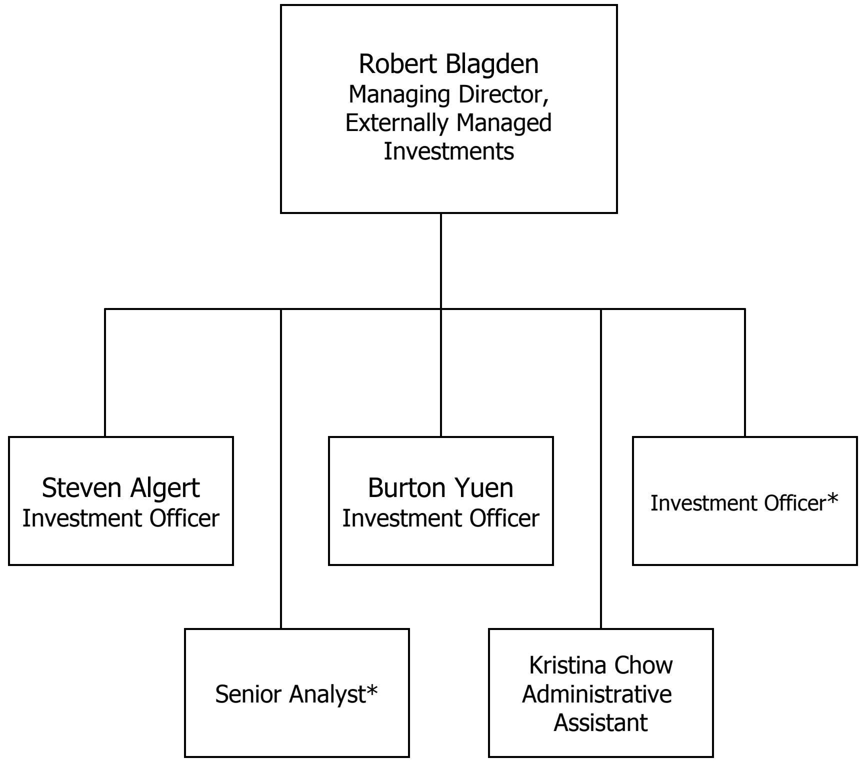
- International Equities:

  Passive Strategy-Indexed to the MSCI EAFE + Canada-TF

  Active Strategies-Benchmarked (including the passive) to MSCI All Country World Ex U.S.

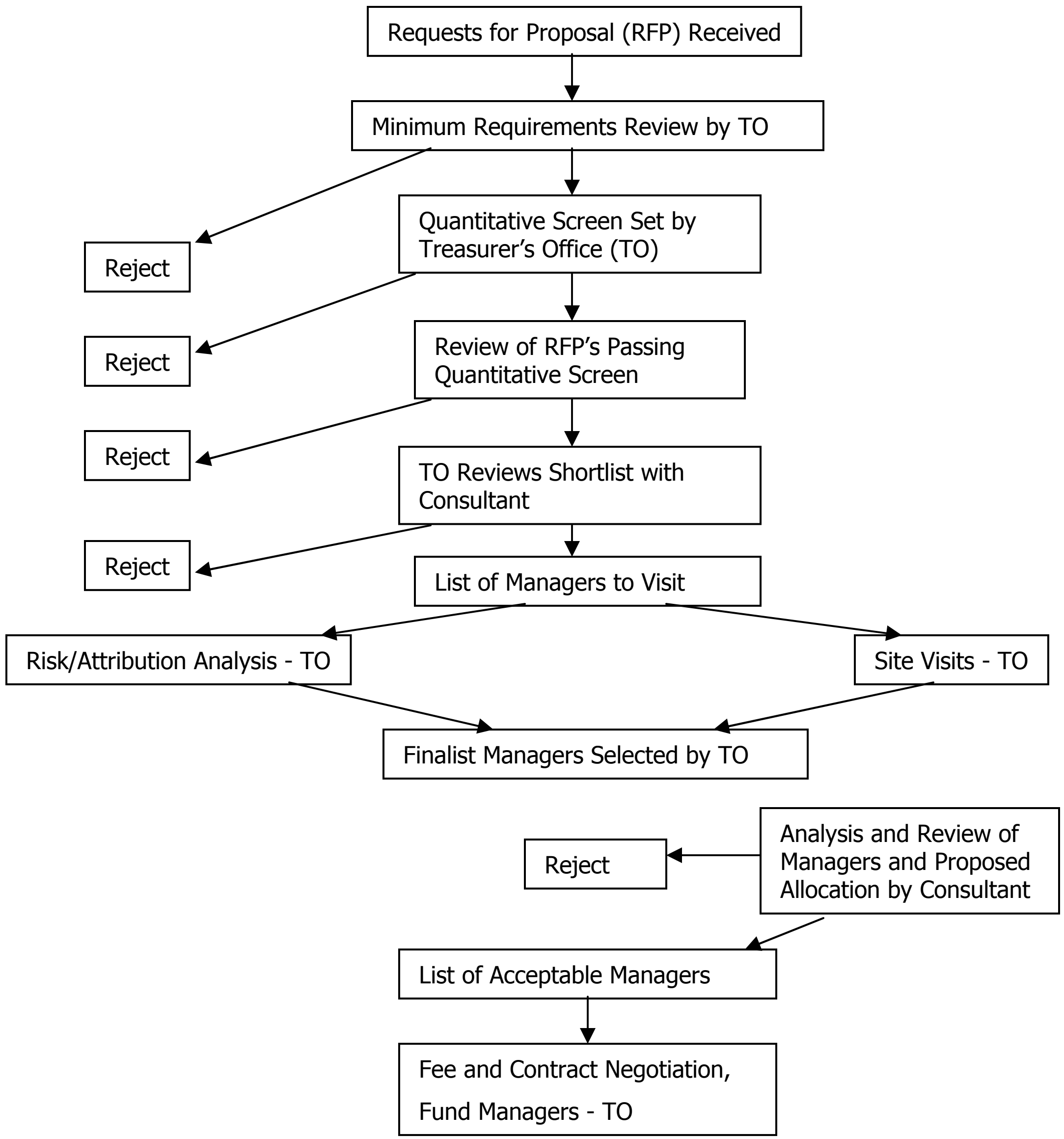
  - Structured to maximize potential out-performance at acceptable levels of risk
  - The allocation to existing emerging markets managers may be reduced after the funding of the developed markets managers.

Externally Managed Investments Group Organization Chart



* 2 positions open

External Manager Selection Process



Updated Timeline Projections: Request for Proposals

	RFP Posting		Managers Funding Date		Dollars Awarded		Number of Managers	
RFP Description	**8/03 Est.**	**Actual / Revised 2/05 Est.**	**8/03 Est.**	**Actual / Revised 2/05 Est.**	**8/03 Est.**	**Actual / Revised 2/05 Est.**	**8/03 Est.**	**Actual / Revised 2/05 Est.**
Small Cap Domestic Equity	Q3 – 2003	Sept. 2003	Q1/Q2 – 2004	Apr. 2004	$1.0 B	$1.0 B	5 - 8	9
Large Cap Domestic Equity	Q1 – 2004	Mar. 2004	Q2/Q3 – 2004	Oct. 2004	$5.2 B	$5.4 B	8 - 12	15
International Developed Equity	Q2 – 2004	Sept. 2004	Q3/Q4 – 2004	Q1/Q2 -2005	$1.6 B	$1.9 B	6 - 9	9-12

External Equity Manager Hiring Timeline Update in Days

	August 2003 Estimate	Domestic Small Cap Actual	Domestic Large Cap Actual	International Developed Act/Est
Post RFP	28	32	25	23
Verify Minimum Requirement, Load Composite Returns	14	14	13	14
Quantitative Screening, Determine Managers to Visit	35	31	27	17
Visit Managers, Analysis of Representative Account Holdings and Returns	42	44	32	46
Determine Finalist Managers	14	18	21	7
Secure Affirmation from Consultant	7	2	60	38 – E
Contract, Negotiate Fees, Determine the Manager Combination	28	43	31	28 – E
Transition to the New Managers From the Legacy Portfolio	14	13	13	14 - 45 E
Total Days	182	197	222	187 – 218 E

Large Capitalization Managers Funded

Manager Name	Location	Style	Dollars	Fee Type
Ark Asset Management	New York, NY	Growth	$376,000,000	Asset Based
Capital Guardian Trust	Los Angeles, CA	Core	$377,000,000	Performance
Franklin Portfolio Associates	Boston, MA	Core	$486,000,000	Performance
Freeman Associates	San Diego, CA	Core	$269,000,000	Performance
Goldman Sachs Asset Management	Tampa, FL	Growth	$430,000,000	Performance
Harris Associates	Chicago, IL	Value	$377,000,000	Asset Based
Hotchkis & Wiley	Los Angeles, CA	Value	$432,000,000	Performance
INTECH	Palm Beach, FL	Growth	$434,000,000	Performance
LSV	Chicago, IL	Value	$270,000,000	Performance
NWQ	Los Angeles, CA	Value	$270,000,000	Performance
Pzena	New York, NY	Value	$375,000,000	Performance
Thornburg	Santa Fe, NM	Core	$376,000,000	Performance
Transamerica	San Francisco, CA	Growth	$325,000,000	Performance
Victory Capital	Cleveland, OH	Core	$270,000,000	Performance
Wellington Management	Boston, MA	Growth	$322,000,000	Asset Based
Total			**$5,389,000,000**	

Large Capitalization Investment Management Fees

Asset Based Fees for 3 of the 15 managers (20% of assets):

- Average fee is 36.7 basis points
- Account sizes vary from $322 million to $377 million

Performance Based Fees for 12 of the 15 managers (80% of assets):

- Average fee is a function of actual performance relative to benchmark:
- Performance fees range from 46% - 126% of average fee of asset based fee managers
  - The equivalent of the average asset based fee is earned when the gross out-performance of the benchmark is approximately 1.7%
  - The average performance fee is 31.6 basis points at the 1.7% level of gross out-performance
  - The average performance based fee may vary from a 47% reduction to a 46% increase to managers usual asset based fees, depending on performance
  - The average level of gross out-performance at which the maximum performance fee would be paid is approximately 4.0%
  - Performance fees earned are paid in two equal installments for the first 2 computations
  - Performance fees are based on a 3 year rolling performance history
- Account sizes vary from $269 million to $486 million

Appendix: The Large Capitalization Manager Selection Process – 2/15/05

THE PROCESS BY WHICH THE LARGE CAPITALIZATION DOMESTIC EQUITY MANAGERS WERE SELECTED BY THE OFFICE OF THE TREASURER'S EXTERNALLY MANAGED INVESTMENTS GROUP (EMG):

The Request For Proposals (RFP) was made available on the Treasurer's website on February 23, 2004. The Request For Proposals was advertised in *Pensions and Investments*. Submissions to the RFP were due as of the close of business on March 19, 2004. Responses were received from 63 different organizations. Per the RFP, copies of submissions were sent to Wilshire Associates (The Regents' Consultant) in order that Wilshire Associates could compare the data submitted in the RFP against the manager product composite data within Wilshire's Compass database and to allow composites submitted that were not in the database to be added to the database. The 63 investment management organizations submitted 100 individual proposals to the RFP. The assistance provided by Wilshire to the External Management Investments Group (EMG) facilitated the review by the EMG. The complete set of reviewed manager returns for all products submitted according to the RFP had been displayed within the Wilshire Compass database as of April 2, 2004. These manager product returns were electronically uploaded to the Office of the Treasurer for initial quantitative screening based on criteria determined by the EMG. The primary screening criterion used by the EMG was an Information Ratio relative to the manager's style benchmark that equaled or exceeded 0.5 on either a 3- year or a 5- year period (data permitting) ending December 31, 2003. Additional quantitative considerations noted by the EMG included the growth of manager assets under management, the length of the manager product history and the consistency of the investment approach, measured against the style benchmarks. Additional performance data subsequent to December was also reviewed.

After the 100 product submissions to the Request For Proposals had been divided into style groups of core, growth and value manager products, the information ratio criterion was applied to each style group in order to reduce the number of total products to approximately 40-50. The revised list included 30 organizations with 45 manager products. These were the managers/products that the EMG reviewed at the managers' offices, starting April 28, 2004 and ending May 28, 2004. All products submitted were discussed with the investment teams for any manager that the EMG visited.

During the site visits to 30 managers the EMG evaluated the individual product teams qualitatively, placing most emphasis on the manager's investment process, the financial strength and integrity of the firm, and the skills of the investment team implementing the investment process. From the managers visited within each style subgroup, the EMG determined those manager products that were deemed to be the most qualified from those products evaluated. This additional step reduced further the number of products deemed to be most qualified such that, as a group, their number exceeded the number likely to be funded by a factor of approximately one and one half times. During the time period of the manager site visits, the Regents decision to retain the investment consulting firm Richards and Tierney was announced. The EMG reviewed the findings of the manager evaluations with the Portfolio Management Group. The list was forwarded to Richard and Tierney for affirmation.

Appendix: The Large Capitalization Manager Selection Process – 2/15/05

A total of 22 managers deemed to be the most qualified by the EMG was forwarded to Richards and Tierney to be reviewed by Richards and Tierney and affirmed to the Treasurer. Although the EMG shared its tentative decision regarding which managers from the list of 22 sent to Richards and Tierney for affirmation seemed to represent the best combination to fund, the final manager names and weights were decided upon by the EMG. Richards and Tierney shared with the EMG a number of investment characteristics and returns attribution information relating to the managers chosen by the EMG from the affirmed list. The expected tracking error of the combination of managers to be funded was determined to be consistent with the risk budget of the active manager segment of domestic public equity. The EMG determined the combination of manager products that would produce an acceptable level of total expected active return net of fees/total expected active risk, relative to a Russell 1000 aggregate benchmark. The previous funding of the domestic small capitalization managers was taken into account when the EMG determined which large capitalization managers to fund.

After the Treasurer received affirmation from Richards and Tierney on August 17, 2004, the focus of the EMG switched to contracting and to the negotiation of performance-based fees with those managers willing to negotiate performance-based fees at a level and structure acceptable to the EMG, rather than managing the account under the traditional asset-based investment management fee schedules that had been proposed within the RFP submissions. When the manager contracts, including investment guidelines and management fee arrangements, had been signed on September 17, 2004, the EMG obtained target portfolios from the fifteen managers to be funded. These fifteen manager target portfolios were aggregated and then compared to the holdings of the legacy portfolio. A transition manager was engaged to oversee the funding of the active managers from the legacy portfolio. The transition occurred during the second half of September during a period of five consecutive trading days.

The new managers assumed management of the University Funds on October 1, 2004. Those organizations funded on October 1, 2004 will be identified to The Regents at the Committee On Investments (COI) meeting scheduled for February 15, 2005, according to the normal quarterly presentation format. The Regents will be informed of the amounts allocated to each manager as well as the range and structure of the investment management fees negotiated with the fifteen managers. The report to the COI will be available to the public on The Regents' website.