604
Investment Policy, Guideline, and Benchmark Review for UCRP and GEP

Committee on Investments
February 2006
INVESTMENT POLICY STATEMENT (IPS)

◆ Best practice for institutional funds
◆ IPS consolidates all Regents’ investment policies in one coherent framework
  - Focus is on principal investment risks and management/accountability for those risks
◆ IPS addresses
  - Governance and key responsibilities
  - Investment policies, including development of risk budget and strategic asset allocation
  - Fiduciary oversight procedures
  - Performance objectives
  - Investment guidelines for each asset class and general guidelines for all investment managers
PERIODIC REVIEW

◆ Committee’s principal fiduciary responsibility is to approve Investment Policy
  ■ “Operating Manual” for Treasurer’s Office
◆ Treasurer is charged with presenting annual review of policies and guidelines, and to propose changes
◆ Treasurer proposes to have annual review of Policy at each February Committee meeting
◆ Treasurer and Investment Consultant present the following joint recommendation for approval
◆ Previous Policies approved:
  ■ UCRP Policy Statement approved Nov 2004, amended May 2005
  ■ GEP Policy Statement approved Feb 2005, amended August 2005
PRINCIPAL CHANGES IN THIS VERSION

◆ Simplifies IPS Structure to facilitate revisions; separates IPS into:
  ▪ Plan-specific sections
    ◆ UCRP Policy
      - Includes asset allocation, risk budgets, and benchmarks
    ◆ GEP Policy
      - Includes asset allocation, risk budgets, and benchmarks
  ▪ Common sections apply to both plans
    ◆ Derivatives Policy
    ◆ Proxy Voting Policy
    ◆ Manager Retention Policy
    ◆ Asset class guidelines
    ◆ Definitions
PRINCIPAL CHANGES IN THIS VERSION

◆ Adds new asset class guidelines
  ◆ Developed Non-US Equity
  ◆ Emerging Market Equity
    ◆ Replaces Combined (Developed + Emerging) Non US Equity
  ◆ Core Fixed Income (for GEP)
    ◆ Renamed Fixed Income for UCRP to “Long Duration”
  ◆ Non US Dollar Fixed Income
  ◆ High Yield Debt
  ◆ Emerging Market Debt
  ◆ TIPS (Treasury Inflation Protected Securities)
Principal Changes in This Version

- Clarifies definition of economic leverage
  - Maintains prohibition, except for private equity, real estate, absolute return strategies, and securities lending
- Modifies Derivatives policy
  - Permits derivatives to implement arbitrage strategies
  - Revises/clarifies limits on derivative use in equity strategies
- Modifies Equity guidelines
  - Removes restriction on use of options and swaps, subject to limitations in Derivatives policy
  - Permits use of global strategies
- Proposes Risk Budgets for new asset classes
- Modifies Fixed Income guidelines
  - Permits Treasurer and Consultant to authorize use of new fixed income instruments, consistent with risk budget of fund
  - Replaces finite list of “permitted” instruments
Committee approves asset allocation and ranges ("strategic policy")
Committee approves benchmarks for asset classes
Committee approves investment guidelines for asset classes and Total Fund
Committee delegates implementation of policy to Treasurer
Committee appoints various consultants to assist in oversight or provide expertise
Treasurer selects investment managers, with the assistance of various consultants
Treasurer reports to Committee quarterly on investment performance and risk
The Committee has adopted the following performance benchmarks for each asset class. Criteria for selection of a benchmark include:

- **Unambiguous**: the names and weights of securities comprising the benchmark are clearly delineated.
- **Investable**: the option is to forego active management and simply replicate the benchmark.
- **Measurable**: it is possible to readily calculate the benchmark’s return on a reasonably frequent basis.
- **Appropriate**: the benchmark is consistent with the Committee’s investment preferences or biases.
- **Specified in Advance**: the benchmark is constructed prior to the start of an evaluation period.
- **Reflects Current Investment Opinion**: investment professionals in the asset class should have views on the assets in the benchmark and incorporate those views in their portfolio construction.
# Asset Class Benchmarks

## Marketable Equity
- **U.S. Market**
  - Benchmark: Russell 3000 Tobacco Free Index
- **Developed Non-US**
  - Benchmark: MSCI World ex US Tobacco Free Index
- **Emerging Markets**
  - Benchmark: MSCI Emerging Market Index

## Marketable Fixed Income
- **Core (UCEP)**
  - Benchmark: Citigroup Large Pension Fund Index
- **Core (GEP)**
  - Benchmark: Lehman Brothers Aggregate Index
- **Non US Dollar**
  - Benchmark: Citigroup World Gov’t Bond Index ex US
- **High Yield**
  - Benchmark: Merrill Lynch High Yield Cash Pay Index
- **Emerging Markets**
  - Benchmark: J.P. Morgan Emp. Mkt. Bond Index Plus

## Alternative Investments
- **Private Real Estate**
  - Benchmark: NCREIF Property Index (1 qtr lag)
- **Public Real Estate**
  - Benchmark: Dow Jones Wilshire REIT Index
- **Private Equity**
  - Benchmark: Actual Portfolio Return
- **Absolute Return**
  - Benchmark: One Month US T-Bill plus 2%
ALTERNATIVE INVESTMENT BENCHMARKS

◆ Private Equity

- The benchmark for private equity is replaced by the private equity portfolio’s actual performance.
- This has the effect of neutralizing the active performance of this class for purposes of total fund performance evaluation.
- Long-term portfolio returns will be compared to investable public equity alternatives as well as non-investable peer group indices.
- There is no appropriate market benchmark to use for short-term performance evaluation or decision making.
ALTERNATIVE INVESTMENT BENCHMARKS

◆ Absolute Return

■ Absence of permanent exposure to capital market risk justifies use of cash benchmark (One Month US T-Bill)

■ Additional risk (liquidity, leverage, operational, idiosyncratic manager plus security) justifies additional expected return, typically a fixed premium (2%-points, annualized)

◆ Currently results in 6.5% hurdle
ALTERNATIVE INVESTMENT BENCHMARKS

◆ Real Estate

- Propose benchmark change for non-core, private real estate, similar to private equity
- Applies to value added, opportunistic strategies only
- Typically implemented with closed-end funds
- Proposal:
  - The benchmark for non-core private real estate will be replaced by the real estate portfolio’s actual performance
  - Effective Date: April 1, 2006 (for both UCRP/GEP)
- No change to benchmark for core private real estate (open-end funds)
  - NC REIF Property Index (NPI) is reasonable for mature, investment quality portfolios