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Office of the Chief Investment Officer

TO MEMBERS OF THE COMMITTEE ON INVESTMENTS:

ACTION ITEM

For Meeting of September 17, 2014

AUTHORIZATION TO ESTABLISH AN INVESTMENT VEHICLE TO INVEST IN THE UNIVERSITY'S INNOVATION ECONOMY

EXECUTIVE SUMMARY

The Chief Investment Officer seeks approval to participate in an investment vehicle referred to as "UC Ventures" consisting of (i) a venture fund entity to make and hold investments in innovative companies that are spun out from or associated with the University (collectively referred to as the "University ecosystem") on behalf of the investors in such entity (the "Fund") and (ii) possibly, an entity wholly owned by the University to hold the University's interest in the Fund (the "Holding Company"). The Fund would operate independently from the University and would seek to generate a commercially attractive return on capital first and foremost. The Office of the Chief Investment Officer believes UC Ventures will foster commercialization activity and research within the University ecosystem.

RECOMMENDATION

The Chief Investment Officer (CIO) recommends that the Committee on Investments recommend that the Regents:

1. Approve participation in an investment vehicle referred to herein as "UC Ventures" which would consist of:

    A. A venture fund entity (the "Fund") to make and hold investments in innovative companies that are spun out from or associated with the University (collectively referred to as the "University ecosystem") on behalf of the investors in such entity, which is to include the following:

        (1) The Fund will be created and managed on behalf of the University and other investors, if any, by an independent team (the "Team"). Team members will not be University employees, members of the Board of Regents, immediate family members of University employees, nor will members of the Team serve in a staff capacity for the University.

(2) Be subject to an investment strategy mandate to fund companies arising from the University ecosystem and have a goal to generate commercially attractive rates of return.

(3) Fund agreements to contain certain governance provisions such that the University, acting pursuant to its rights as an investor in the Fund, maintains certain limited control to ensure that the Fund's activities fit within the envisioned investment strategy and the University's interests are protected, including the ability of the CIO to:

a. Approve the business plan of the Fund.

b. Approve an annual dollar-based budget.

c. Terminate the Fund.

d. Meet customary information rights and reporting requirements as reasonably determined by the CIO.

e. Remove and replace the Team.

f. Approve any new Fund investors.

B. If determined at the discretion of the CIO to be beneficial, a Holding Company wholly owned by the University to hold the University's interest in the Fund.

2. Require that the CIO:

A. Present the detailed legal structure of UC Ventures to the Committee for informational purposes.

B. Submit regular reports no less than annually to the Committee on the Fund's status.

3. Authorize the CIO, after consultation with the Office of the General Counsel, to approve and execute: (i) any documents reasonably required to accomplish the above; and (ii) any modifications, addenda or amendments (collectively, "amendments") thereto; provided such amendments or other documents are materially consistent with the terms and conditions set forth above.

BACKGROUND

1. Introduction

At the Regents meeting in January 2012, then-Chairman Lansing established a working group on technology transfer (the "Regents' Working Group on Technology Transfer") to examine the current technology transfer operations and identify best practices to enhance the technology commercialization efforts across the University ecosystem. One of the key recommendations from the Regent's October 2012 Report of the Working Group on Technology Transfer concluded "...UC should establish a mechanism to invest in UC start-up companies, either through the establishment of or participation in a venture capital fund or funds.…"

The Office of the Chief Investment Officer (OCIO) is proposing to participate in a Fund that would be managed by, and formed with the participation of, an independent Team and would invest in commercial opportunities arising from the University ecosystem, which is one of the most vibrant in the world. Indeed, the rationale for setting up UC Ventures stems from a desire to capture a unique set of investment opportunities emerging from the ten leading research institutions, five medical centers, and three National Laboratories affiliated with the University. There are a number of incubators and accelerators across the University and entrepreneurial programs taking place throughout the University. With 233,000 students, 190,000 faculty and staff, and 1.7 million living alumni, the UC is expected to be a rich resource for the development of innovative companies and is already the target of venture capitalists globally.

Specifically, UC Ventures will aim to maximize financial returns while leveraging the University's unique research and knowledge base, as well as the wider University community, to gain access to attractive opportunities emerging from the University's ecosystem. The OCIO will design UC Ventures to maximize alignment of interests, minimize costs, and provide a long-term investment horizon. The OCIO believes there is a compelling opportunity to generate attractive rates of return by selectively investing in early-, mid-, and late-stage companies arising from the UC ecosystem.

UC Ventures would be capitalized with an initial commitment from the University and may seek additional capital from the University and/or select third-party institutional investors. The Fund would be managed by a focused, independent team that will have a mandate to invest in companies arising from the UC ecosystem with a target to generate commercially attractive rates of return. The University would make sure that the Team is aware of applicable University policies regarding conflicts of interest and conflicts of commitment.

2. Objectives and Fit with the University's Technology Commercialization Initiative

Based on one of the key recommendations of the Regents' Working Group on Technology Transfer, the Fund would seek to invest in businesses affiliated with the UC ecosystem ("UC Startups"), which include companies associated with current or former students, faculty, staff, alumni, and/or other similar personnel attending, employed by, or in a similar relationship with the University.

UC Ventures would implement the Regents' recommendation and mission to provide a mechanism to further support the University ecosystem by providing capital to UC Startups. Potential ancillary benefits include, but are not limited to:

- Promoting the entrepreneurial culture at the University.
- Attracting talent (faculty and students) to the University.

- Creating future donors to the University.
- Increasing awareness of the University's innovation economy.

All of the above would serve to further the University's public and educational missions, and specifically would help to ensure that the University's academic research reaches the public at large.

3. Objectives and Fit with the Office of the Chief Investment Officer

The OCIO has been a long-term investor in venture capital and has invested over $2 billion externally in venture capital funds over the last 30 years. Several of the OCIO's external venture capital managers have actively invested in and generated attractive returns from UC Startups. The OCIO will aim to maximize alignment of interests between the University and the UC Ventures' Team, and minimize costs while providing a long-term investment horizon. The OCIO would monitor its investment in UC Ventures using the same processes and methodology currently employed in its existing venture capital portfolio.

4. The UC Ecosystem

The University is one of the premier research institutions in the world. University students, faculty, researchers, and alumni regularly develop new ideas and groundbreaking technologies that underpin the creation of successful companies. In fiscal year 2013, University researchers submitted 1,727 new inventions – an average of nearly five a day, 365 days a year – bringing the University's total portfolio to more than 11,500 inventions; entered into 427 new license and technology transfer agreements, providing industry access to University inventions; and generated $106.2 million in royalty and other license fee income. Over the last decade the University has generated approximately $1 billion in royalty and other license fee income.

As part of its due diligence (as further described in Section 9 below), the OCIO reviewed the University's historical track record of company development to better understand the potential investment pipeline for the Fund. The most robust available data is collected at the University's Technology Transfer Office (TTO), although it captures only a subset of UC Startups that went through the technology transfer process in order to use intellectual property that is licensed from the University. The following table details the number of new startup companies from University inventions from 2009 to 2013:

New Startup Companies formed from University Inventions, 2009-2013.[1]

Year	2009	2010	2011	2012	2013	TOTAL
# New Companies	53	78	60	62	71	324

[1] Technology Commercialization Report, 2013. University of California Innovation Alliances and Services.

The historical composition of UC Startups that pass through the TTO has been approximately 57 percent in life sciences, 22 percent in information technology, and 21 percent in materials, energy, and agricultural sectors.

5. UC Ventures Strategy

The UC Ventures strategy will selectively pursue multi-stage investment opportunities arising from or associated with the UC ecosystem. The UC Ventures' Fund will seek to invest in the most promising early-stage UC Startups identified by the Team through its relationships with local venture capital firms and personnel throughout the UC ecosystem, and will seek to selectively participate in mid- and later-stage rounds for companies that have demonstrated clear potential. Innovation is a local phenomenon; accordingly, the University's desire is to have the Team work closely with campuses and campus-affiliated accelerators, incubators, and entrepreneurial centers as well as the local venture capital community.

6. Governance, Management, and Operations

The UC Ventures' Fund would be established as a stand-alone, independent investment vehicle that would be structured to operate with a long-term investment horizon. The following proposed structure is subject to change based on negotiations with the Team and any prospective investors, consistent with the delegated authority provided to the CIO pursuant to the terms of this Action Item. The investment vehicle could consist of (i) the Fund, that would be managed by the independent UC Ventures Team on behalf of the University and other investors, if any and (ii) may also include a Holding Company, which would be owned and controlled solely by the University. Although initially recruited and selected by the OCIO, no members of the Team would be University employees while serving as members of the Team and the Team would not be supervised or controlled by the OCIO (other than as set forth in any limited approval rights maintained by the University in connection with its status as an investor in the Fund). The Team also would not serve in a staff capacity for the University.

If formed, the Holding Company would be owned and controlled solely by the University (with management authority delegated to the OCIO) at its sole-discretion. Such Holding Company would be the sole initial investor in the Fund, which is anticipated to be structured as a long-term or "evergreen" vehicle.

The Fund would be governed so that the University, acting pursuant to its rights as an investor in the Fund, has certain controls to ensure both that its activities fit within the envisioned investment strategy and the University's interests are protected, including but not limited to:

(i) Approval of an annual dollar-based budget;
(ii) Cessation of the Fund;
(iii) Removal and appointment of a new Team;
(iv) Approval of any new Fund investors;
(v) Considerable transparency and accountability to ensure public trust; and
(vi) Maintenance of customary information rights and reporting requirements.

7. Conflicts of Interest and Conflicts of Commitment

The University would make sure that the Team is aware of applicable University policies regarding conflicts of interest and conflicts of commitment. The University intends to have UC Ventures be mindful of the need to protect the academic freedom of UC students, faculty, and other researchers, including the right to publish their research. Finally, UC students, faculty, and other researchers would not be obligated to assist the Team in its investment endeavors.

8. Potential Benefits of the Investment Fund

The proposed vehicle is expected to have positive benefits for the University ecosystem including:

- Fostering innovation, research, and entrepreneurship throughout the UC ecosystem.
- Creating a stable overall structure that utilizes industry best-practices to promote a long-term investment and management horizon.
- Providing long-term aligned capital and related services to emerging companies arising within the University ecosystem.
- Helping to catalyze the University innovation ecosystem via increased awareness of, and investment in, UC Startups.

Importantly, all of the above would serve to further the objectives of UC Ventures from a commercial perspective, increasing the number and quality of investment opportunities.

9. Due Diligence

The OCIO conducted extensive due diligence with the following groups to better understand best practices in the venture capital industry:

- Interviews with university venture capital funds to better understand how other universities have structured similar initiatives and lessons learned from their experience.
- Interviews with more than 20 venture capital firms, corporate venture groups, incubators, and accelerators to inform the strategy and governance of the investment vehicle.
- Interviews with numerous internal stakeholders, including campuses, campus-affiliated incubators and accelerators, and members of the President’s Innovation Council.
- Legal review, including external legal consultation, to assess the risk/benefits of the structure of the investment vehicle.
- Financial assessments and modeling of operational costs and potential deal flow.

10. Mitigation of Risks

Although the OCIO has an extensive track record in venture capital investing, the participation in UC Ventures will represent a new model of investing for the OCIO. Several key takeaways from the due diligence discussions were the importance of the following:

- Recruiting and retaining a high quality team of venture capital investment professionals to conduct day-to-day investment management of the Fund.
- Establishing the Fund such that it is managed by an independent Team empowered to make investment decisions to minimize potential conflicts of interest and political pressures to invest.
- The University's holding certain key supermajority rights to facilitate proper governance.
- Creating a long-term investment vehicle to provide companies sufficient time to develop and remove pressures on the team to exit investments prematurely.
- Ensure the Team is aware of applicable University policies regarding conflicts of interest and conflicts of commitment as further described in Section 7 above.