The Regents of the University of California

COMMITTEE ON INVESTMENTS
INVESTMENT ADVISORY COMMITTEE
November 5, 2003

The Committee on Investments and the Investment Advisory Committee met jointly by teleconference on the above date at the James E. West Alumni Center, Los Angeles campus, Los Angeles; 1130 K Street, Suite 340, Sacramento; UCSF-Laurel Heights, San Francisco; 1111 Franklin Street, Room 5326, Oakland; and 2223 Avenida de la Playa, #220, La Jolla.

Members present: ***Representing the Committee on Investments:*** Regents Montoya, Parsky, Pattiz, Preuss and Saban; Advisory members Blumenthal and Ornellas

Representing the Investment Advisory Committee: Regent Parsky, Senior Vice President Mullinix representing President Dynes, Mr. Russell Gould, Mr. William Hambrecht, Mr. John Hotchkis, and Mr. Charles Martin; Consultants Beim, Cambon, Keller, and Lehmann

In attendance: Faculty Representative Pitts, Secretary Trivette, Associate Secretary Shaw, General Counsel Holst, Treasurer Russ, Associate Treasurer Stanton, and Recording Secretary Nietfeld

Representing the Campus Foundations: Mr. Mike Child, the UC Davis Foundation; Mr. Jim McCarthy, the UCLA Foundation; Mr. Lee Kolligian, the UC Merced Foundation; Mr. Mike Irwin, the UC San Francisco Foundation; Mr. Eric Sonquist, the UC Santa Barbara Foundation; and Mr. Art French, the UC Santa Cruz Foundation

The meeting convened at 1:40 p.m. with Committee on Investments and Investment Advisory Committee Chair Parsky presiding.

1. **APPROVAL OF THE MINUTES OF THE MEETING OF AUGUST 26, 2003**

Upon motion duly made and seconded, the minutes of the meeting of August 26, 2003 were approved, Regents Montoya, Parsky, Pattiz, Preuss, and Saban voting "aye."[1]

2. **DISCUSSION WITH UC CAMPUS FOUNDATION REPRESENTATIVES**

Regent Parsky welcomed the representatives from the campus foundations, noting that one of The Regents' objectives had been for the Treasurer's Office to become a service center for the University community. He invited the trustees to participate in the Committees' discussions.

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[1] Roll call vote required by State law for all meetings held by teleconference.

3. **QUARTERLY INVESTMENT PERFORMANCE SUMMARY REPORT**

Treasurer Russ presented the **Quarterly Investment Performance Summary Report** for the third quarter, the fiscal year to date, and the calendar year to date, noting that performance had been positive for all periods. The University of California Retirement Plan (UCRP) earned 2.5 percent in the third quarter versus the benchmark's earning of 2.6 percent. The Regents' U.S. equities are invested entirely in an index fund, and thus the return of 3.5 percent matched that of the benchmark. Bonds were hurt in the quarter by rising interest rates, resulting in a negative return of 0.9 percent, while Treasury Inflation Protected Securities (TIPS) matched the benchmark with a 0.3 percent return. Non-U.S. equity had a positive return of 9.1 percent and private equity returned 5.6 percent for the quarter ending June 30. The policy benchmark for the private equity program is the Russell 3000 plus 300 basis points. The underperformance of 11.2 percent relative to the benchmark had a negative impact on the portfolio; however, the long-term performance of private equity has been good. Treasurer Russ referred to a display of The Regents' portfolio market value changes for the third calendar quarter and the first fiscal quarter of 2003-04, noting that total assets had grown by $937 million.

Turning to the supplemental report on UCRP private equity performance, Mr. Russ observed that the chart goes into detail with respect to the comparison to various benchmarks. He emphasized the relative positive performance that had been earned by The Regents' investments. Regent Parsky stressed that in the area of private equity it was important to avoid valuations' being translated into returns. He did not attach great significance to the fact that the program had underperformed in the most recent quarter. He then called upon Mr. Steven Nesbitt of Wilshire Associates for his comments regarding the performance of the portfolios.

Mr. Nesbitt recalled that the Investment Advisory Committee had been established three years ago, during which time a plan was developed to establish certain objectives for the Treasurer's Office and for each asset class. This plan has now been fully implemented. He observed that the purpose of the UCRP is to provide its members with future benefits. Unlike 80 percent of other pension funds, the UCRP is well funded in that its assets exceed its liabilities. On average, the Plan's liabilities have grown by eight to nine percent annually. As long as The Regents' investments return between 7.5 percent and 9.5 percent, the liabilities will continue to be funded in the future. As a result of the significant bear market, the UCRP saw returns of 4.4 percent for the most recent five-year period. As a result, the surplus of assets to liabilities has fallen. The benefits of having a diversified portfolio are clear when measured over a longer time period. Turning to the performance of the Treasurer, Mr. Nesbitt recalled that a policy benchmark had been established for each asset class in the portfolio. The results detailed in the report show that over intermediate and long time periods the performance has been good. The Office is in a transition period with respect to U.S. equities, which are currently invested in index funds. He noted that one intention of the asset allocation plan adopted by The Regents in 2000 had been to lower the risk in the fixed-income portfolio, which at the time had a long maturity and was invested heavily in non-U.S. bonds. Over the past three years, the Treasurer's Office has improved the quality and lowered the risk of the bond portfolio. Mr. Nesbitt continued that the performance of TIPS, a program which had been implemented at the request of the Treasurer, had exceeded that of all other asset classes over the five-quarter period during which it has been in the portfolio, adding $100 million. Non-U.S. equity is performing above its objectives. The only significant underperformance occurred in the private equity portfolio, which is measured against the performance of the U.S. equity market. It has done well when compared with the private equity universe, as demonstrated by the Treasurer.

Mr. Beim believed that The Regents should use a private equity benchmark to measure performance in this area because the use of the current benchmark distorts the fund's performance and does not show how the fund performs versus its peers in the industry.

Regent Parsky recalled that one of the reasons for adopting the Russell 3000 as the benchmark for private equity had been to demonstrate that this asset class, given its risk and illiquidity, could outperform the U.S. equity market and thus justify its inclusion in the portfolio. He agreed that it is also important to know how The Regents' private equity portfolio is performing in comparison with other portfolios and asked that the Treasurer think about how best to disclose to the public that element of the portfolio.

Consultant Lehmann commented that the intention in adopting the Russell 3000 as a benchmark for private equity had been to provide information on long-term performance. He agreed with Mr. Beim's observations, noting that the Russell 3000 plus 300 basis points had been intended as a place holder until there was a better benchmark. Mr. Martin concurred that the other benchmarks as displayed by the Treasurer were more helpful in measuring short-term performance.

Regent Parsky asked that the Treasurer and Wilshire think about a long-term benchmark for the five- and ten-year results and a different benchmark for the shorter term.

Treasurer Russ noted that the quarterly report on investment risk had been mailed to the Committees in advance of the meeting. The purpose of this report is to acquaint the Regents and the members of the Investment Advisory Committee with the ways in which the Treasurer's Office assesses the risk in the portfolio. Regent Parsky commended Treasurer Russ for implementing the risk assessment process.

(For speaker's comments, see the minutes of the November 5, 2003 meeting of the Committee of the Whole.)

4. **TREASURER'S ANNUAL REPORT, 2002-03**

The Treasurer recommended that the Committee on Investments forward the **Treasurer's Annual Report** for the fiscal year ended June 30, 2003 to The Regents.

> [The report was mailed to Committee members in advance of the meeting, and a copy is on file in the Office of the Secretary.]

The Committees were informed that the Bylaws require the Committee on Investments to report periodically to the Board concerning the investment operations of the University. The Treasurer's Annual Report goes into detail concerning these operations.

Upon motion duly made and seconded, the Treasurer's recommendation was approved, Regents Montoya, Parsky, Pattiz, Preuss, and Saban voting "aye."[2]

5. **PRIVATE EQUITY DISCLOSURE ISSUES**

The Committees were informed that, since its inception in 1979 through March 31, 2003, The Regents' private equity portfolio has consisted of $2.1 billion in commitments to 94 partnerships. As of March 31, 2003, the private equity portfolio has produced $2.1 billion in profits and a 2.4 multiple on contributed capital. The private equity portfolio has generated a total return of 25.6 percent for the ten-year period ended June 30, 2003.

Cambridge Associates has been retained by The Regents since 2001 to advise on the private equity portfolio and to calculate the net internal rate of return (IRR) for each partnership in the portfolio. Prior to the engagement of Cambridge, the Office of the Treasurer did not calculate IRRs for individual partnerships. The private equity portfolio was historically less than two percent of the total investment portfolio, and its performance was evaluated in the context of the total equity portfolio. Because investments in private equity are long term, the only relevant return measure is the amount returned at the end of the partnership compared to the capital invested. This has been the basis for investment decisions in the private equity asset class, and this long-term horizon has produced exceptional results.

Private equity partnerships are subject to a J-curve effect, meaning that returns are often low or negative during the first several years. Most of the fully realized partnerships that demonstrate strong returns on invested capital had previously demonstrated significantly negative IRRs. Private equity partnerships represent long-term commitments, typically of 10 to 13 years. The majority of capital commitments are contributed to each partnership during the initial five- to six-year period when the general partners are actively making new investments. Differences in the investment pace of each partnership have a significant effect

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[2] Roll call vote required by State law for all meetings held by teleconference.

on the investment multiple and net IRR calculations. Because fees and expenses are paid on a regular schedule, partnerships with a relatively slower investment pace will tend to produce lower investment multiple and net IRR figures. In addition, each general partner uses different valuation policies to determine the net asset value of the partnership, as no industry standard exists. Conservatism often results in early write-downs for underperforming investments. In addition, write-ups are typically limited to an independent valuation such as third-party financing or an initial public offering. All of these issues contribute to the J-curve effect and limit the comparability of returns across partnerships.

Treasurer Russ recalled that on July 24, 2003, the Alameda Superior Court had ruled for the plaintiffs in *Coalition of University Employees, et al. v. The Regents.* In its ruling, the court ordered The Regents to disclose fund-level internal rates of return under the California Public Records Act. To be consistent with the disclosure provided by other California-based institutional limited partners subject to the public records act, The Regents is disclosing detailed fund-level performance information for the most recent period available. This information should allow for more meaningful interpretation of fund performance than IRR information alone.

A number of general partners have informed Cambridge that performance information will no longer be provided as a result of the court's ruling. Consequently, it is uncertain whether or not The Regents will be able to provide IRRs for all partnerships in the private equity portfolio in future periods. Mr. Russ noted that the background information that had been provided to the Committee contained a display of The Regents' alternative investments as of March 31, 2003.

In a response to a question from Regent Parsky, Mr. Russ reported The Regents had invested approximately $225 million in Kleiner Perkins and Sequoia Capital; the investment returned $1.5 billion. The Regents has been removed from Sequoia's most recent fund as a result of the ruling in the lawsuit and its shares have been reallocated to other partners. The University has also been asked to sell existing partnerships in Sequoia Capital; the partners have been informed that the University does not intend to do so.

Regent Parsky observed that The Regents' investments in private equity had historically been heavily weighted toward venture capital, with extremely positive results. The effect of these investments on the retirement plan has been significant, and thus it appears odd that Plan members who benefit from these investments chose to pursue a strategy that resulted in the University's not being able to participate in these partnerships in the future. The partners view disclosure as disruptive to the investment program they are pursuing. Regent Parsky stressed that the overall performance of The Regents' portfolio would be damaged as a result of the court's decision.

University Counsel Patti confirmed that all appeals in *Coalition of University Employees, et al. v. The Regents* had been exhausted.

Consultant Lehmann commented that, although The Regents' investments in private equity had historically not been a large part of the portfolio, the returns these investments had generated were impressive, with less than two percent of the portfolio producing more than eight percent of the returns. He did not feel that it was conceivable that the parties in the lawsuit could have believed that private equity was performing poorly for the University.

Regent Pattiz asked for further comment on why the partners were reluctant to release the requested information. Treasurer Russ confirmed that they believe these data to be proprietary. Regent Parsky continued that these companies operate in a highly competitive environment. Some members of the venture capital community view their investments over the long term and do not believe that recitation of the IRRs is an accurate reflection of their assets.

Mr. Hambrecht commented that he had had numerous conversations with managers from the funds which intend to no longer include The Regents. All of the funds feel that they do a good job of disclosing to the limited partners, but they resist the concept of being rated on a quarterly basis, which would result in significant distortions of their performance.

Mr. Martin drew the Committees' attention to the list of The Regents' investments in private equity, noting that the only meaningful information was for funds that are mature. People in the venture community are concerned that these types of data would be misconstrued by those outside of the industry. He asked what steps might be taken to mitigate the court's decision and suggested that the Treasurer's Office would need to undertake a survey of the top tier of venture capital partners to see where the University stands with respect to future investments. A determination should be made of whether or not the University will be able to limit its disclosures to the internal rates of return.

Regent Parsky invited the members of the Committees as well as the foundation trustees to discuss with Treasurer Russ the level of due diligence that occurs in conjunction with Cambridge Associates for this asset class.

Treasurer Russ stressed the fact that the returns received from investing in private equity had been recycled back into The Regents' portfolio, thus postponing the time when contributions to the UCRP would be required. He noted the enormous contributions to the State's economy by venture capital firms such as Sequoia and Kleiner Perkins.

In response to a comment by Mr. Hotchkis, Regent Parsky noted that it is the University's position that it cannot be forced to divest from those partnerships with which it has invested funds, even when requested to do so.

Speaking from the perspective of a foundation trustee, Mr. Beim explained that the Berkeley campus had committed to a private equity fund offered by the Office of the Treasurer. It was his understanding that removal of the top-tier performers would result in returns that more closely approximate public U.S. equities. Mr. Martin reiterated his belief that the Treasurer would need to determine which top-tier funds would no longer offer investment opportunities to The Regents.

Mr. Gould pointed out that the University is not the only institution being challenged and suggested the need to develop a protocol of reporting that would be acceptable to the venture capital partners. Treasurer Russ agreed to look into this suggestion. He continued that there is pending legislation in several states to exclude this type of information from public records requests. The University of Michigan, which was required to release IRRs for its private equity investments, has been asked to withdraw from Sequoia's Fund XI.

Mr. Martin suggested that the six to eight public universities that have access to this type of private equity investments should work together on setting up such a standard for disclosure.

Regent Parsky noted that the Regents would need the advice of both General Counsel Holst and outside counsel as to how much information the University might be required to disclose. General Counsel Holst assured the Committees that he would provide a full report at the Closed Session of the Committee on Finance.

(For speaker's comments, see the minutes of the November 5, 2003 meeting of the Committee of the Whole.)

6. **REVIEW OF ENDOWMENT SPENDING POLICY**

Treasurer Russ recalled that in November 2002 The Regents had approved an expenditure rate per unit of the General Endowment Pool for expenditure in the 2003-04 fiscal year of 4.5 percent of a 60-month moving average of the market value of a unit invested in the GEP. The long-term target rate is 4.75 percent.

Assistant Vice President Barber explained that many of the campus foundations are reconsidering their own endowment expenditure formulas; this meeting seemed to be an appropriate opportunity to present to foundation trustees the report on endowment spending policy.

Mr. Matt Lincoln of Cambridge Associates reported that the study he had performed first addressed spending policies in general and then looked at the University's spending policy for the GEP. He noted that at the January 2004 meeting The Regents would be asked whether the pay-out rate should be increased by 5 basis points or more for the 2004-05 fiscal year. Basing his remarks on the document **Spending Policy Study** which had been distributed to the Committees, Mr. Lincoln explained that the objectives of an endowment spending policy are to provide university programs with a source of revenue that is perpetual, that is growing at least as fast as inflation, and that is predictable. The second major objective is to preserve the purchasing power of the endowment, net of annual spending distributions. Finally, the spending policy should balance the needs of current programs against those of future generations. Mr. Lincoln continued that spending policies tend to have two components, the spending rate and the smoothing formula. The spending rate is defined as the percent of unit value distributed to programs each year, typically between four percent and six percent. He recalled that The Regents had set a range of 4.35 percent to 4.75 percent. A lower spending rate reduces the risk that the real value of distributions or the real value of the endowment will decline. However, a lower spending rate also increases the probability that the spending policy will favor future generations. The smoothing formula is used to mediate the volatility of the market and to provide more predictable revenues to programs. Very stable distribution policies have the highest risk of eroding the endowment's real value, while policies that protect the endowment's value typically result in a more volatile stream of revenues to programs. Mr. Lincoln stressed that no one spending policy would be able to achieve each of the objectives perfectly; trustees must weigh the trade-offs between the three major objectives of a spending policy.

Mr. Lincoln outlined the three most common types of spending policy, the first of which is the one used by the University and is based on a moving average. The second is a constant growth formula which increases per unit distributions by the inflation rate each year, usually subject to a floor and a ceiling. A hybrid of these two methods blends constant growth with a moving average. Mr. Lincoln presented a summary of the spending policies employed by large universities which indicated that two-thirds of those surveyed had a spending rate between 4.5 percent and 5 percent as the policy targets. Approximately half use a moving-average spending rate, while 13.6 percent have a discretionary range similar to that used by The Regents. He then outlined spending policy trends at these universities, noting that two-thirds of the group reported no changes to policy over the past three years, while others have made or are considering changes in their spending policies. The conclusion to be drawn from these data is that there is a growing movement from a moving average towards either a constant growth or a hybrid policy. Mr. Lincoln presented an analysis of the three policies on an indexed portfolio from 1926 to 2002, all of which increased the real value of the distributions over this time period. The primary driving force for universities to increase the diversification of their portfolios was the steep decline in the stock market between 1966 and 1983. A second analysis using Monte Carlo simulations was used to calculate the range of returns and how they would impact spending decisions, given The Regents' current asset allocation. Over twenty years, the constant growth formula produces a much lower probability of a decline in spending. However, the moving average formula produces significantly less risk to the endowment. Further analysis demonstrated how the second major variable of a spending policy, the payout rate, affects the endowment.

Mr. Lincoln turned to the second section of his study, which was concerned with the spending policy of the University of California. He displayed a chart that summarized the historical distributions from the GEP in constant dollars from 1983 to 2003, noting that there had been an increase in the real value of distributions of 129 percent. The display also highlighted the year-to-year volatility, with a maximum real decline of distributions in 1994 of 7.7 percent. Distributions increased by over 15 percent in 1998, when the total return spending policy was adopted by The Regents. He discussed the historical simulation of the effect of a 4.25 percent and a 4.75 percent 20-quarter moving average on the General Endowment Pool from 1926 to 2002 and the implications of raising the current spending rate of 4.5 percent to 4.55 percent in fiscal year 2004. Assuming the long-term expected fund return of 7.45 percent, the 4.5 percent payout rate would result in a nominal decline in distributions, while increasing the payout rate to 4.55 percent would result in a 1.45 percent increase in distributions. From Cambridge's perspective, the full range of The Regents' spending policy is consistent with preserving the purchasing power of the fund and of distributions. The purpose of the range is to provide the University with the ability to offset declines in market value.

7. **AMENDMENT OF TAX-DEFERRED 403(b) PLAN AND DEFINED CONTRIBUTION PLAN RELATED TO UC-MANAGED FUNDS TO PROVIDE MORE INVESTMENT OPTIONS FOR EMPLOYEES**

Treasurer Russ informed the Committees that at the November meeting the President intends to recommend that the University of California Tax-Deferred 403(b) Plan and the University of California Defined Contribution Plan be amended as follows, effective April 1, 2004 or as soon as administratively possible:

- Revise the Multi-Asset Fund's asset allocation and rebalancing policy and change the Fund's name to the Balanced Growth Fund.

- Create a Treasury Inflation Protected Securities (TIPS) Fund.

- Merge the Money Market Fund into the Savings Fund.

- Delegate to the President the implementation of these amendments.

It was recalled that the Treasurer's Office offers six UC-managed investment funds to employees as options for 403(b) Plan and DC Plan contributions. The proposed changes to the UC-managed investment funds are designed to provide a more appropriate mix of investment options for employees saving towards retirement.

Multi-Asset Fund Changed to Balanced Growth Fund

The Multi-Asset Fund was created in 1990 in response to a need identified through a survey of participants in the 403(b) Plan and the After-Tax Contribution Plan. The fund's objective is to strike a balance between seeking current income with protection of principal and obtaining long-term growth through capital appreciation. The current conservative asset allocation of the Multi-Asset Fund is not appropriate for those participants with a longer time horizon seeking to maximize principal growth to fund retirement. The Treasurer's Office proposes adjusting the Multi-Asset Fund's asset allocation to mirror more closely the asset allocation program currently employed in the University of California Retirement Plan (UCRP). This proposal substantially increases the allocation to the Equity Fund, introduces use of a new asset class by implementing a TIPS Fund, and eliminates use of both the Savings Fund and the Money Market Fund in the allocation. In addition, it is proposed that the fund adopt a rebalancing process identical to the rebalancing process in place for UCRP. This would offer participants an investment alternative that reflects the asset allocation of the UCRP portfolio. To help participants become aware of and better understand this allocation change, the Multi-Asset Fund will be renamed the Balanced Growth Fund.

TIPS Fund

TIPS, a new fund proposed by the Treasurer's Office, would be composed of United States Treasury Bonds the principal of which is adjusted by the Consumer Price Index inflation value on a monthly basis. The use of TIPS within a fixed income allocation would serve as a hedge against inflation and would be an attractive investment choice for participants approaching retirement age who desire to protect their accumulations from inflation. TIPS would be a component of the Balanced Growth Fund as well as a "stand alone" investment option. The Regents approved the addition of TIPS to the UCRP asset allocation at the May 2002 meeting. There is significant interest in a TIPS Fund among faculty members.

Money Market Fund

Along with the change in asset allocation, the renaming of the Multi-Asset Fund to the Balanced Growth Fund, and the creation of the TIPS Fund, the Treasurer's Office is proposing that the Money Market Fund be closed. Due to the low participation rate in the Money Market Fund outside of the Multi-Asset Fund and in anticipation of the drop in the fund's assets due to implementation of the proposed allocation adjustment, it is proposed that Money Market Fund shares be merged into the Savings Fund and that the Money Market Fund be closed. The UC-managed Savings Fund is an alternative investment option with a comparable historical rate of return.

Implementation

Multi-Asset Fund participants will receive ample notice that their shares are to be transferred into the Balanced Growth Fund on April 1, 2004, or as soon as administratively possible, unless they take action. Participants who wish to continue holding a higher percentage in fixed-income and short-term money market investments could achieve these allocations by contributing to the Bond Fund and the Savings Funds.

The TIPS Fund will begin operation on April 1, 2004 or as soon as administratively possible. The fund will be managed by the fixed-income staff in the Treasurer' Office, and the expense ratio will be the same as the other UC-managed funds at 0.15 percent annually. The objective of the TIPS Fund would be identical to the objective of UCRP's TIPS allocation of matching the performance of the Lehman TIPS Index.

Money Market Fund participants will also receive ample notice that their shares would be transferred into the Savings Fund with the closing of the Money Market Fund, unless they request that assets be transferred to a different fund.

8. **APPROVAL OF INCENTIVE PROGRAM ASSET CLASS INVESTMENT PERFORMANCE OBJECTIVES**

The President recommended that the incentive program asset class investment performance objectives be modified as indicated in the following Attachment C (page 11).

[Note: changes are highlighted, and the previous FY 2002-03 objectives are also attached (page 10) for reference.]

Treasurer Russ referred to the document prepared by Mercer Human Resources Consulting, **Recommendations to Modify Treasurer's Office Annual Incentive Plan**, which served as the basis for his presentation. He recalled that in March 2002 performance objectives had been established for each asset class managed within the Office of the Treasurer. With the transfer of U.S. equity management to an index fund, modifications of these objectives are necessary. Mr. Russ displayed the proposed performance objectives and benchmarks for fiscal year 2003-04, as shown in the Attachment.

Mercer and the Treasurer are recommending that asset class performance standards be developed for the new classes within the asset allocation plan, including TIPS, real estate, and absolute return strategies. The Treasurer recalled that there are two components to the incentive plan, the quantitative performance measures for asset class and entity and a qualitative set of performance objectives which is established for each individual.

Treasurer Russ outlined the new asset class performance standards. The first sector, government and agency bonds, was not included in the original incentive plan. The recommended performance targets are consistent with the fixed-income asset class and other sectors. In addition, the Savings Fund in the 403(b) plan was not included in the original incentive plan; the performance targets will be the same as those of the Short-Term Investment Pool. TIPS were added in May 2002; the goal is to replicate benchmark performance. He discussed relative benchmarks that will be used for absolute return strategies and for real estate. A further recommendation is to modify the asset class performance standards for mortgage bonds, as it is believed that the target was set unrealistically high. In addition, the STIP, 403(b) Savings, and Insurance Company

Contract benchmarks have been stated as yields, which is not an appropriate measure; rather, the evaluation will be based upon returns.

The entity performance standards will be changed to reflect the reduced opportunity for active management due to the elimination of the internal equity group and the subsequent transition to passive index management. At the time the annual incentive plan was adopted, 81 percent of the entity's assets were actively managed. Currently, only 46 percent is actively managed, 43 percent of which comes from active fixed income. Given the asset class policy weights and the percent of assets that are passively managed, it is mathematically impossible to outperform the benchmark without taking excessive risk. At the current policy weights, if all of the asset classes performed at target levels, entity performance would be 29 basis points, falling short of the target of 60 basis points that was set last year. The recommendation to reduce entity targets is for fiscal year 2003-04 only, as the intention is to move U.S. equities into active markets by June 2004. When the active equity program implementation is complete, performance targets will be raised.

Upon motion duly made and seconded, the Committee on Investments approved the President's recommendation, Regents Montoya, Parsky, Pattiz, Preuss, and Saban voting "aye."[3]

The Committees went into Closed Session at 3:40 p.m.

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The Committees went into Closed Session–Regents Only at 3:45 p.m.

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The meeting adjourned at 3:50 p.m.

Attest:

Associate Secretary

[3] Roll call vote required by State law for all meetings held by teleconference.