The Regents of the University of California

COMMITTEE ON INVESTMENTS
INVESTMENT ADVISORY GROUP
November 7, 2007

The Committee on Investments and the Investment Advisory Group met jointly by teleconference on the above date at the following locations: James E. West Center, Los Angeles campus; 777 S. California Avenue, Palo Alto.

Members present: Representing the Committee on Investments: Regents Brewer, De La Peña, Marcus, Pattiz, Schilling, Wachter; Advisory member Croughan
Representing the Investment Advisory Group: Members Hotchkis and Martin; Consultants Behrle and Lehmann

In attendance: Regent Allen, Regent-designate Scorza, Associate Secretary Shaw, Chief Investment Officer Berggren, University Counsel Birnbaum, Recording Secretary Johns

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

1. **PUBLIC COMMENT PERIOD**

There were no speakers wishing to address the Regents.

2. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of September 11, 2007 were approved.

3. **APPROVAL OF TREASURER'S FY 2006-2007 ANNUAL REPORT**

[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.]

Upon motion duly made and seconded, the Treasurer's Annual Report for Fiscal Year 2006-2007 was approved.

4. **QUARTERLY 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 of the Quarterly Report on Investment Performance and Risk for the third quarter 2007 by calling attention to the positive UC Retirement Plan (UCRP) and General Endowment Pool (GEP) returns, relative and absolute, for the one-, three-, five-, and ten-year periods. UCRP outperformed the benchmark by 39, 42, 16, and 16 basis points for each period, respectively. The UCRP and GEP underperformed the benchmark for the recent quarter. The quarter was difficult across the board, shown by underperformance of the equity and bond portfolios. Ms. Berggren attributed the underperformance of the equity portfolio to security selection and sector allocation by UC managers. The largest contributor to the underperformance was emerging markets. She pointed out that half of UC's financial managers do not have representation in China, which was up 46 percent. The underperformance in the core fixed income portfolio came from the mortgage portfolio (its small, one percent position in AAA tranches of asset-backed securities) and the credit portfolio (UC is represented in high-quality, lower-end financial companies which have not performed well). The real estate portfolio performed well in the quarter.

Ms. Berggren summarized the performance of the UCRP. The annualized return over the past three and five years was 250 basis points over last quarter and exceeded the 7.5 percent actuarial rate. All asset classes were within guideline ranges. She pointed out the actual weights of equity allocations (70 percent, slightly higher than policy weight), fixed income (identical to policy weight), and alternatives (underweighted relative to policy). In response to a question asked by Committee Chair Wachter, she clarified that the equity figure represents combined equity. Turning to the factor analysis of the portfolio, Ms. Berggren noted that the portfolio was underweighted in high yield, large value, and mid-growth exposures. The largest contributors to risk in the portfolio were the underweighting in large value and mid growth.

The effective duration of the fixed income portfolio (7.3 years) was slightly lower than the benchmark (7.5 years), as was the average quality (AA, compared to AA+). The portfolio performance was hurt by negative returns in the corporate (negative 59 basis points) and mortgage sectors (negative 39 basis points).

Next Ms. Berggren discussed style exposure in the U.S. equity portfolio. She described the portfolio as having less currency orientation, smaller size, and smaller yield, and being oriented more toward earnings variability, growth, trading, and volatility. The portfolio is underweighted in the energy and financial sectors. Committee Chair Wachter recalled that underperformance was due to emerging markets. He believed that the University's slight overweighting in emerging markets is positive, and identified the source of the underperformance in the fact that, within its 4 percent emerging market allocation, the University was underweighted in China. Ms. Berggren responded that UC is overweighted in emerging markets because these markets have done so well. She explained that the University's financial managers are for the most part reluctant to invest in China. She reported that UC did once have a very small amount of investment in India.

Turning next to the non-U.S. equity portfolio, Ms. Berggren noted that the most active risk came from sector exposure. On a regional basis, the portfolio was overweighted in Europe and underweighted in developed Asia, Japan, and Canada. In sector exposures, the portfolio was underweighted in energy and finance and overweighted in capital equipment, consumer goods, and services. She concurred with Consultant Lehmann that the current investment in Japan represents a significant change compared to five years previously. In the private equity portfolio, the overall weighted excess return was 11.4 percent, with a 2.1 multiple of cost. Ms. Berggren described the overall 22.9 percent increase in the UCRP private equity portfolio as one of the better performances of most funds in the U.S. The GEP displayed good relative and absolute performance. Underperformance in the quarter was due to emerging markets and absolute returns. Ms. Berggren recalled that the absolute return portfolio is designed to perform not quite as well as the market when the market is up but should significantly outperform the market when the market goes down. She pointed out the excellent performance of the absolute return portfolio over a one-year period, with no major problem hedge funds in the third quarter. She finished her presentation by noting that the public market value of the Regents' portfolio gained $1.36 billion in the quarter and $6.6 billion in the year. Although the quarter performance was slightly below benchmark, there was still an excellent absolute return. The current strategy has been to cut back on emerging markets.

Consultant Lehmann asked about hedge funds in the next year. Ms. Berggren responded that the Treasurer's Office is considering moving into more non-U.S. hedge funds, ensuring that they are 50 percent high volume and 50 percent low volume. She emphasized the University's awareness of risk aspects and the significant amount of due diligence performed on its hedge fund managers. Regent De La Peña asked about the size of European investments and the impact of the dollar's performance versus the euro. Mr. Martin opined that the value of the dollar will continue to go down, accelerated by the movement of capital out of U.S. dollar assets, and that this trend will continue for at least a few years. Committee Chair Wachter concurred.

Regent Allen asked if the University has responded to Senate Concurrent Resolution (SCR) 52 by State Senator Yee, calling for shared governance of the UCRP. University Counsel Birnbaum responded in the negative.

Faculty Representative Croughan asked about a possible discussion of Short-Term Investment Pool (STIP) investments. Committee Chair Wachter responded that the Committee on Finance, rather than the Committee on Investments, would make any decision about major changes in STIP investment policy. Ms. Berggren explained that the Regents' current guidelines for the Committee on Investments are to manage the STIP as a money market fund. If there is a decision to change the management of the STIP, the Committee on Finance will determine this and present new guidelines to be approved by the Committee on Investments. The current value of the STIP stands at $8.2 billion.

5. **U.S. PUBLIC EQUITY STRATEGY**

[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 introduced Mr. Terry Dennison, worldwide partner of Mercer Investments. She explained that Mr. Dennison has been working with UC to review its U.S. public equity strategy and develop a proposal for major changes in the U.S. equity portfolio. Regent Marcus asked about the purpose of the changes. Ms. Berggren opined that the majority of return comes from one's perspective on segments of the market, and responded that one current objective is to position the portfolio in those areas with the largest undervaluation. She also observed that it is difficult for managers to produce alpha in many segments. Mr. Martin asked about the recruitment of a Managing Director of Public Equity. She responded that this search is still under way.

Ms. Berggren began with a short summary of the current strategy, which features active and passive allocations made separately, does not attempt to add value through passive allocations, does not use intentional market segment tilts, and presents a highly diversified portfolio with numerous active managers who replicate the Russell 3000. In the proposed strategy, active and passive decisions will be integrated, segments will be over- or underweighted relative to market weights, and there will be more concentrated use of active management. Mr. Lehmann asked about the place of security selection in this strategy. Ms. Berggren responded that security selection would be in the active segment of the portfolio. She outlined the differences in active and passive management in the current and proposed strategies. The proposal calls for passive index products to manage market segment exposure, minimal active representation in all areas for flexibility, and joint allocation of passive capital to attractive market segments and active capital to products with alpha potential. In segment tilts, the proposed strategy would allocate capital to market segments based on relative valuation (using a statistical model with four factors that determines undervaluation or overvaluation of the different segments). The strategy will be implemented with passive investment products (to be allocated through State Street) and will integrate passive and active managers. In active management, Ms. Berggren attributed the underperformance of the portfolio to fees paid to too many managers who replicate benchmarks. The proposed strategy would reduce the number of managers and dollars under management, focus on less benchmark-centric managers, and allocate assets to areas of greatest potential – the least efficient parts of the market.

Next Ms. Berggren described the investment process for the new strategy. The investment decision process would first examine the beta (market segment exposures) and then alpha (active management). The strategy would develop target beta and alpha portfolios. Managers selected would be those who fit strategy criteria. Mr. Lehmann asked if the target beta portfolios would be allocated through State Street. Ms. Berggren confirmed that the beta portfolios would be passive investment products. Market segmentation would use a framework dividing the market into analyzable segments with similar behavior. The market is arrayed along two dimensions – size (market capitalization) and style (growth in value) – and is divided into six segments, Mega Cap Growth and Value, Mid Cap Growth and Value, and Small Cap Growth and Value. Ms. Berggren outlined the principal recommendations, which regard segment tilts as the primary source of value and active management as a secondary source of value. In response to a question asked by Mr. Lehmann, she confirmed that performance evaluation of the segment tilts will be in relation to a neutral standard.

Regent Marcus asked what proprietary formula or theory indicates where UC investments should be tilted and how. Ms. Berggren explained that four factors or multiples have been examined: price to cash flow, price to free cash flow, price to sales, and price to earnings. This internal model has been developed and tested in the Treasurer's Office over the last nine months. Mr. Dennison explained that the model identifies six categories which are investable and indexable, and weights beta exposure. The model examines the four factors relative to their history and looks for "signals" falling outside a certain range. From this the model derives overweights and underweights, so that most money is made by using beta exposure, with the expectation for managers being only to add value through alpha generation. This model is consistent with financial theory. It takes advantage of the fact that, in size-specific and style-specific markets, areas like Mega Cap growth have been undervalued since the market decline in 2000-2002. Mr. Dennison believed that value can be added without the expectation that managers can generate alpha within that segment.

Committee Chair Wachter emphasized that few people have a good understanding of the concepts in the model discussed by Ms. Berggren and Mr. Dennison. He opined that the changes in the proposed strategy are significant (e. g., in passive and active management). He stated that he needs more time to review the proposal and will report back to the Committee and asked Ms. Berggren to outline the proposal in more accessible terms. Mr. Lehmann asked for confirmation that the alpha portfolio that will be the security selection portfolio. He identified as significant the fact that the proposal separates sector timing from the security selection aspect of the portfolio. Active managers will be hired for security selection only. Regent De La Peña asked about the potential risks of this proposed strategy. Mr. Martin praised the proposed strategy and encouraged the Committee members to review it carefully.

Ms. Berggren recalled that the Russell 3000 is segmented into different-sized categories (Russell 200, Large Cap, Mid Cap, Small Cap). The proposed model examines the relative valuations of each segment historically and relative to other segments. The model identifies segments within Russell 3000 which are more attractive today and should be overweighted. Monitoring would occur every quarter. Rather than paying active managers, the University might do better to examine relative valuations of the segments and use a passive approach. The Mega Cap currently looks attractive, so the model would suggest taking the passive part of the Mega Cap and increasing it relative to its weight in the Russell 3000. Ms. Berggren confirmed that asset allocation decisions would be made in the Treasurer's Office, which would use passive investment products. Regent Pattiz observed that the current UC investment ranges and strategies were designed to be flexible goals, to be adjusted by the Treasurer's Office as market conditions dictate. There is nothing unusual about the current proposal and discussion. Committee Chair Wachter noted that the Committee on Investments has not previously been involved with asset allocation at a "granular" level. He called attention to an important shift in the proposal of moving toward more passive than active management, a simple execution strategy, and that critical decisions would be made internally, at the Treasurer's Office. He emphasized the Committee's need to understand this shift.

Regent Marcus described the proposal as interesting and intriguing; he noted the significant shift toward increased responsibility at the Treasurer's Office. He opined that this shift should be justified by an increase in yield. Ms. Berggren responded that the Treasurer's Office has always had this responsibility, but has defaulted and passed it on to sometimes ineffective managers. In response to Regent Marcus, Committee Chair Wachter clarified that this issue will come back as a discussion item, not an action item. He noted as a future item for discussion the question of why UC's active managers have not outperformed their benchmarks and emphasized the importance of asset allocation activity. Mr. Martin suggested that this model be overlaid with a fundamentals-based model to see if the two match up. Mr. Lehmann described the proposed model as segregating market or sector timing from security selection. He observed that active managers perform well episodically, but not in market timing. The Treasurer's Office will outsource security selection, bringing segment or sector timing or timing of different groups in-house, where success or failure will be evident. He described this as a clean, mechanical segregation of work. Mr. Martin stated that UC's active managers have been "benchmark-huggers" in the past and that the proposed shift is to use active management where it can add value. Committee Chair Wachter raised the issue of engaging active managers who are not constrained or tied to a segment and stressed the need for further discussion. Regent De La Peña suggested that it would be helpful to use this model with data from the last six months, year, and three years, demonstrate what the results would have been, and compare them with actual results. Ms. Berggren stated that the model examines fundamental factors today and can explain returns three years into the future. Mr. Dennison stated that the proposed strategy relies on regression to the mean and described it as fail-safe, relying on the expectation that extreme conditions will return to normal. The risk involved is that extreme conditions might become more extreme.

6. **NON-U.S. PRIVATE EQUITY STRATEGY**

[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. Timothy Recker, Managing Director of Private Equity, presented the international private equity strategy. He began by noting that UC's private equity program has historically focused on U.S. partnerships. In May 2007 the private equity guidelines were changed, allowing a maximum of twenty percent investment in non-U.S. private equity, with a target of ten percent. Mr. Recker presented data showing increasing globalization of this asset class over the last five years. He outlined some potential benefits of international private equity (attractive returns, managers who would be additive and complementary to the current UC portfolio, the presence of high-quality managers in Europe with strong track records, diversification benefits, and attractive risk-adjusted returns). He noted that international private equity entails the same risks as any private equity investment in the U.S. There are additional country and regulatory risks (more acute in Asia than in Europe), cultural, network, and language barriers, and currency risk.

Mr. Recker outlined the portfolio construction goals for this program. He stressed the need for a cautious, measured approach over an appropriate time period. This would require focusing on developed private equity markets and assembling a diversified portfolio of top tier managers. The managers selected would be those with a track record across economic cycles, with deep domain knowledge and expertise, who focus on intrinsic value creation rather than momentum investing. The Treasurer's Office would rely on the same due diligence standards as in the U.S., but in fact the bar would be placed higher, due to the additional risks of investing outside the U.S. He also noted that a consultant would be engaged in the selection process. At Regent Schilling's request, he identified the consultant as Cambridge Associates. Mr. Recker presented a chart representing the investment process and continued with proposed international allocation targets. He estimated a necessary period of three to four years to achieve three-quarters of the ten percent exposure target on both a Net Asset Value (NAV) and outstanding commitment basis. He explained that this schedule represented a prudent approach given the current market conditions. The ten-percent allocation goal is $170 million NAV; the planned commitment of funds is $150 million in 2008, $175 million in 2009, and $175 million in 2010. Because managers require three to five years to draw down capital and convert it from a commitment to NAV, it will take three to four years to achieve the $170 million NAV target.

Mr. Recker presented a brief summary of the strategy, noting an emphasis on developed markets and a core portfolio focused on European buyouts. He explained this choice of focus in Europe by the many conditions necessary in the investing market and economic environment for a successful private equity market. Europe has proven itself over a long period as providing value. Asian private equity will be considered opportunistically, but there is a great deal of risk associated with investment in these marketplaces. Chief Investment Officer Berggren added that UC had invested in a number of funds that had entered the Asian market early; there has been much recent entry into this market, and it appears to be overheated. Mr. Recker informed the Committee that UC is not considering some other non-Asian emerging markets (Latin America, Turkey) because of their immaturity and high level of risk. The University will mitigate risks by joining a fund of funds in Europe. He briefly outlined the expected benefits of such a relationship and identified the extra layer of fees as the key challenge with a fund of funds manager.

Regent Schilling asked if there was to be a combination of direct private equity investment and use of a fund of funds. Mr. Recker clarified that the fund of funds would be used to gain additional knowledge and expertise, while the bulk of the investing would be done by Treasurer's Office staff. He noted that some of the best European financial managers exclude the fund of funds from their funds; for this reason, the University should not rely on a fund of funds for its strategy, but make use of it to augment its diligence and strategy. Regent Marcus asked about the historical yield of domestic private equity and the expected incremental yield in Europe. Mr. Recker responded that the expectation for the U.S. and Europe are the same by size and category. Regent Marcus questioned the value of this effort for a ten-percent allocation. He stressed that there are many risks in investment in other countries – risks which the University may not understand. Committee Chair Wachter noted that many domestic private equity firms have meaningful allocations in non-domestic private equity. He opined that the University should have global exposure in every category and that Europe presents very little additional risk other than currency risk. He felt that this is an important effort and a good beginning. Ms. Berggren recalled that the Treasurer's Office has made trips to Europe and Asia and concluded that it can match the "best of the best" in Europe with the "best of the best" in the U.S.

Mr. Martin inquired about Mr. Recker's background. Ms. Berggren informed the Committee that Mr. Recker has been working at the Treasurer's Office for seven months. He managed private equity and hedge funds for the State of Michigan, and before that worked at General Electric for many years, around the world. He has an MBA from the University of North Carolina and a Chartered Financial Analyst (CFA) designation.

Mr. Lehmann recalled the positive results of UC's early entry into the domestic private equity market. Since 1979, two percent of the UC portfolio has been in private equity, and it has generated eight percent of the return. He compared the incipient Asian private equity market to the domestic market in 1979, noting the value of getting into the market early, with good people.

Committee Chair Wachter asked if the private equity exposure would be focused on buyouts and traditional private equity rather than on venture capital. Mr. Recker responded in the affirmative and continued with a review of the expected segment allocations. He remarked that many U.S. managers have recently sought to increase their European exposure because of the attractiveness of European buyouts and strong returns. He outlined the projected allocations in large, middle, and small European market buyouts, and explained how these allocations will complement the global exposure UC currently has through its U.S. managers. The only venture capital investment being contemplated is less than five percent. He discussed the reasons for the attractiveness of European buyouts, such as first quartile buyout returns which have outperformed the U.S., a stable regulatory environment, and favorable business practices. He emphasized as most important the presence in Europe of high-quality managers with extensive depth and skill and proven ability to add value (currently lacking in Asia). Mr. Recker described Europe as a market presenting the least amount of risk. He then explained the reasons for the special attractiveness of European middle market buyouts and the planned fifty-to-sixty percent allocation in this segment, including the fact that this segment has outperformed the European large market buyouts by about 400 basis points over the last ten years, and that managers have used a lower level of leverage in their portfolios. In 2006, the middle market had 4.9 times leverage versus the large market, with 6.1 times leverage. Mr. Recker emphasized that this contributed to lower financial risk in the middle market.

Next Mr. Recker turned to currency considerations. Currencies exhibit volatility and are hard to predict; the proposed strategy recommends an un-hedged program. He outlined some of the risks of Asian private equity, including a rapidly changing regulatory environment (especially in China), questionable business practices, and a lack of skilled managers. He pointed out that many U.S. and European managers are moving into this space and that the University can get Asian exposure through its global managers. He concluded that the returns on Asian private equity would not compensate for the additional risks. He finished by presenting the efficient frontier, identifying the current target portfolio.

Associate Chief Investment Officer Stanton reported on the status of a request for proposals (RFP) issued by the Treasurer's Office on June 29 for custody, performance analytics, and securities and lending. He reported that four banks responded by the August 3 deadline: BNY Mellon, JPMorgan, Northern Trust, and State Street. During the week of September 12, these four banks visited the Treasurer's Office and made formal presentations to the evaluation committee. In early October the committee narrowed the group to three candidates, conducted reference calls, and during the week of October 22 the committee visited BNY Mellon, State Street, and Northern Trust. The evaluation committee will make a decision on a final candidate by the end of November, will notify the Committee on Investments, and will begin to negotiate a new contract or service-level agreement and prepare for conversion to a new provider if necessary.

Regent Schilling asked about the custodial relationship. Mr. Stanton explained that State Street, as the University's custodial bank, currently holds UC assets, provides investment accounting, clears trades, provides performance analytics on portfolios, serves as the official book of record, and serves as lender for a major portion of UC assets. There are also two third-party providers who manage a portion of UC assets.

Regent Marcus requested clarification on how items within the purview of the Treasurer's Office (private equity, domestic stock allocations) are implemented. Ms. Berggren explained that a proposed strategy is presented to the senior management group for discussion and possible recommendations, and then implemented. Regent Marcus asked if a strategy would be implemented even if the Committee on Investments were opposed. Ms. Berggren emphasized that she would carefully consider the counsel of all members of the Committee on Investments, and that their opinions matter in the decision-making process. Ms. Berggren and Mr. Lehmann both cited instances in the past when changes in investment policy such as international private equity exposure had been initiated not by the Treasurer's Office, but by Regent Parsky, when he was Chair of the Committee on Investments.

Regent-designate Scorza asked if the University knows what types of companies it is investing in as part of its private equity strategy, and what selection criteria it uses. Ms. Berggren replied that the University has complete information on every company it invests in. UC invests in a limited partnership fund with control over due diligence on the managers and choice of managers. The manager has total responsibility for choosing the best investments within a fund. Ms. Berggren underscored that this is an important legal consideration. Regent-designate Scorza recalled the Darfur divestment strategy and expressed the hope that the University will not in the future invest in those same or other companies doing business in Sudan. Ms. Berggren responded that the University does not select individual securities. Committee Chair Wachter clarified that it is possible to divest in the areas of public equity and bonds, but not in the area of private equity. He stated that it would be possible to research the investments made by managers and to discuss this with the Treasurer's Office. Faculty Representative Croughan noted a recent faculty request for socially responsible investing. Regent Pattiz recalled the Regents' recent action on Sudan and remarked that, in those areas where control can be exercised, control is being exercised, and that the position of the Regents has been made clear.

7. REGENTS' INVESTMENT POLICY FOR UC CAMPUS FOUNDATIONS

[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.]

Generalist Investment Consultant Tom Richards discussed a draft proposal to amend the Regents' Investment Policy for UC Campus Foundations, which is tied to the General Endowment Pool (GEP) investment policy. Mr. Richards recalled that the GEP investment policy was changed materially in May, and that the changes became effective in July. Thus it is appropriate to reexamine the policy and consider possible amendments.

Mr. Richards outlined the three asset classes defined in the policy. Equity asset classes are aggregated into a category of "public equity." Fixed income asset classes are aggregated into a category of "fixed income." Alternatives (real estate, private equity, and hedge funds) are aggregated into "alternatives." The Treasurer's Office has policy targets for the GEP for each of these asset classes. Previously, the public equity target was 57 percent, with an acceptable range of 42 to 72 percent; the fixed income target was 22 percent, with a range of 8 to 38 percent; the alternatives target had a range of 5 to 35 percent, with a midpoint of 20 percent. Campus foundations are asked to keep their policy allocations within these ranges. In the May 2007 changes to the GEP policy, which became effective in July, the asset classes no longer had this range of ± 15 percent. The ranges were changed to ± 7 percent for public equity and ± 5 percent for fixed income and alternatives. This represented a significant narrowing of the degree of freedom or operating room for the campus foundations.

Mr. Richards recalled the February 2007 meeting of the Committee on Investments and discussion with representatives of the campus foundations, which led to a consensus that the investment policy for campus foundations should be oriented toward long-term GEP policy rather than current asset allocation targets, and that the ranges for asset classes should be made wider and adjusted to ± 10 percent (with resulting ranges of 35 to 55 percent for equity, 5 to 25 percent for fixed income, and 30 to 50 percent for alternatives). The other aspects of the policy are unchanged (regarding monitoring of the campus foundations' investment processes).

Regent Brewer recalled that the campus foundations, when they were founded, were required to be separately incorporated as tax-exempt, 501(c)(3) organizations, with their own boards of directors with fiduciary duties. She enumerated the benefits of this separate incorporation for the Regents. The campus foundations have been able to advocate for and provide financial support for higher education bond measures, which the University is prohibited from doing. Private giving has grown enormously; she cited the growth of the UCLA endowment from less than $1.5 million in 1972 to almost $1 billion today. The campus capital campaigns are developed in cooperation with the campus foundations; she cited UCLA's $3.05 billion campaign, the largest ever in the history of higher education. Regent Brewer noted the great range in the size of endowments among the campuses. The revised version of the policy that was vetted by the campuses was changed at the November 2006 meeting of the Committee on Investments without advance notice to the foundations. Regent

Brewer described these changes as problematic and as a reason for the current discussion. She identified the essential issue as the question of the appropriate level of review for the Regents with regard to campus foundation investment policies. She underscored the fiduciary responsibility of the individual campus foundations. Regent Brewer opined that asking campus foundations to use GEP ranges, investment policies, and guidelines is to ignore the need for 501(c)(3) corporations to exercise independent judgment in their fiduciary responsibilities. The University should ensure that each campus foundation has appropriate investment expertise and rigorous controls in place. Regent Brewer recommended that the Committee either adopt the policy recommended by the investment consultants in July 2007 or that the most recent policy proposal be vetted with the campus foundations to create an acceptable policy. She recognized the importance of oversight by the Regents but cautioned against alienating campus support groups that are crucial to the funding of UC's academic enterprise.

Consultant Behrle stated that the UCLA Foundation was not in compliance with the policy when it was adopted, will not be in compliance under the current amended version, and will be outside the policy parameters when it achieves its allocation goals, particularly with respect to the alternative investment category. The UCLA Foundation had serious concerns when the policy was adopted and sought the opinion of its general counsel, an outside law firm. The resulting legal analysis has been shared with Assistant Vice President O'Neill and the Office of the General Counsel. Mr. Behrle summarized the legal advice to the UCLA Foundation as stating that the Foundation, as a separate 501(c)(3) organization, with its own fiduciary obligations, was obligated to make decisions itself, and not follow the dictates of an outside third party. The members of the Foundation Board would otherwise potentially be in violation of their fiduciary duties. Mr. Behrle reported that the Foundation was promised a written opinion by the Office of the General Counsel on this issue but has received none. He also reported that the Foundation's outside counsel examined formative documents and contracts signed between the University and the UCLA Foundation when the latter was created in 1983. He quoted a sentence from the agreement: "Campus foundations should make it clear to prospective donors that foundation Boards of Directors or Trustees assume full fiduciary responsibility for the investment of foundation funds including endowments." Citing the legal advice received by the UCLA Foundation and these contractual provisions, Mr. Behrle opined that directing allocations is micromanagement on the part of the Regents and conflicts with the Foundation's fiduciary duty. The UCLA Foundation has no disagreement with the proposed policy distributed as a discussion item at the July 2007 meeting, regarding review of the campus Foundations' process and policies.

Regent Pattiz described any actions that would put the Regents at odds with the campuses as a bad idea. He acknowledged that the campuses raise money more effectively. He requested an opinion from the Office of the General Counsel about the actual fiduciary responsibility of The Regents for the campus foundations and their responsibility for oversight. Assistant Vice President O'Neill responded that the Office of the General Counsel has never asserted that the campus foundations do not have a fiduciary responsibility. Because campus foundations are linked to the University as they are, their assets are dedicated irrevocably to The Regents, and can only be expended at the campus level. The Regents have responsibility over these assets as they do over assets held by alumni associations and support groups. Mr. Lehmann noted that this has been a longstanding question. He recalled that the Regents formerly exercised little oversight over the GEP and UCRS, but then discovered their fiduciary responsibility for many plans and campus foundations. He stated that he has never heard a clear definition of this fiduciary responsibility with respect to the campus foundations. Committee Chair Wachter responded that this question was discussed with the Office of the General Counsel last year and recalled that the essential issue was the indemnification that the University provides to the campus foundations. If a campus foundation were to forfeit this indemnification, it could then do as it pleased; however, campus foundations do not wish to give up this indemnification. The Regents do not wish to micromanage, but do have fiduciary obligations. Committee Chair Wachter opined that the position of the UCLA Foundation does not reflect common sense. He asserted that the proposed policy attempts to provide latitude while reflecting The Regents' fiduciary obligations. It allows for exceptions to be discussed. He described the ranges proposed (such as equity at 35 to 55 percent) as giant, and emphasized that there is a defined mechanism to exceed these boundaries. He opined that the proposed ranges would be adequate for most portfolios and that the Regents would most likely approve any requested exceptions.

Regent Marcus expressed agreement with Committee Chair Wachter, who anticipated that this issue will be further discussed and become an action item in the future.

Regent De La Peña asked if the UCLA Foundation is currently within the parameters of the policy. Mr. Behrle countered that the UCLA Foundation and three other campus foundations are outside these parameters, and that the UCLA Foundation will be outside the amended requirements. Mr. Behrle stated that the UCLA Foundation will not come to the Regents for approval for an exception, based on the legal advice it has received. The UCLA Foundation is seeking oversight by policy direction, not by setting standards for how it allocates its assets. Regent Pattiz described this as the UCLA Foundation's wish that the Regents exercise the business judgment rule (referring to a Delaware Supreme Court decision). Mr. Behrle confirmed this. Regent Pattiz asked why indemnification by the Regents is so important to the UCLA Foundation. Mr. Behrle cited financial considerations and reiterated his understanding that the UCLA Foundation is not to be directed as to its allocations. He stated that the Regents will have to wait for the Foundation's decision. Mr. Behrle stated that the Foundation will comply with any measure regarding disclosure of process or criticisms of process and procedures. He reaffirmed his view that asset allocation decisions should be made at the Foundation level.

Committee Chair Wachter stated that the UCLA position is clear and needs no further discussion. He concluded that The Regents need to seek the opinion of the Office of the General Counsel regarding their fiduciary obligations to the campus foundations, and perhaps an outside legal opinion as well. Regent Pattiz requested that the Office of the General Counsel inform The Regents about The Regents' obligation to indemnify the campus foundations. If there is no such obligation, a simple trade-off could resolve this issue. Committee Chair Wachter expressed his understanding of the conditions set at the time the campus foundations were established, which required that three essential elements (the foundations, oversight, and indemnification) be in place. The removal of indemnification or oversight would entail a change in the contract.

Regent De La Peña stressed that this is a legal issue. He suggested that the Office of the General Counsel explain what The Regents' legal obligation is, and that this should serve as the basis for a reasonable solution. Committee Chair Wachter expressed his conviction that the proposed investment policy is as broad, easy, and streamlined as possible, and in actual practice would not cause friction between the Regents and the UCLA Foundation. Mr. Lehmann repeated his request for a clear legal definition of The Regents' fiduciary responsibility from the General Counsel or outside counsel. Committee Chair Wachter concurred, but noted that a relevant formulation of the issue was produced at a Committee on Investments meeting in the previous year.

Mr. Martin noted that some of the smaller and younger campus foundations are not able to meet the minimum requirements for alternative investments. Committee Chair Wachter confirmed The Regents' ability to accommodate them by adjusting the timeline or in some other manner.

The meeting adjourned at 3:45 p.m.

Attest:

Secretary and Chief of Staff