The Regents of the University of California

COMMITTEE ON INVESTMENTS
May 7, 2009

A special meeting of the Committee on Investments was held by teleconference on the above date at the following locations: UCSF–Mission Bay Community Center, 1675 Owens Street, San Francisco; International Room, Tom Bradley International Hall, Los Angeles Campus; Moss Cove A and B, Student Center, Irvine Campus; 355 Highlander Union Building, Riverside Campus; Ballroom B, Price Center, San Diego Campus; Chancellor's Conference Room, 5123 Cheadle Hall, Santa Barbara Campus; 501 S. Alta Avenue, Dinuba; 700 S. Flower Street, Los Angeles; 2220 Lodgepole Circle, Modesto; 777 California Avenue, Palo Alto; 3110 Main Street, Santa Monica; 12006 Bennett Flat Road, Truckee; Board Room, 1806 N. Nimitz Street, Victoria, Texas.

Members present: Regents De La Peña, Makarechian, Marcus, Schilling, and Wachter; Ex officio members Blum and Yudof; Advisory members Bernal, Nunn Gorman, Powell, and Stovitz

In attendance: Regents Cole, Gould, Island, Johnson, Kieffer, Lansing, Reiss, Ruiz, Scorza, Shewmake, Varner, and Zettel, Faculty Representative Croughan, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Interim Provost Pitts, Executive Vice Presidents Darling, Lapp, and Taylor, Senior Vice Presidents Dooley and Stobo, Vice Presidents Lenz and Sakaki, Chancellors Birgeneau, Bishop, Block, Blumenthal, Drake, Fox, Kang, Vanderhoef, White, and Yang, and Recording Secretary Johns

The meeting convened at 1:10 p.m. with Committee Chair Wachter presiding.

1. **READING OF NOTICE OF MEETING**

For the record, notice was given in compliance with the Bylaws and Standing Orders for a special meeting of the Committee on Investments to accommodate a scheduling change.

2. **UNIVERSITY OF CALIFORNIA RETIREMENT PLAN ASSET LIABILITY STUDY: RESULTS AND RECOMMENDATIONS**

The Chief Investment Officer and the Regents' investment consultant, Mercer Investment Consulting, recommended that the following changes to the University of California Retirement Plan (UCRP) Investment Policy Statement be adopted with an effective date of June 1, 2009.

A. Long-Term Policy asset class targets and "Current Policy" asset class targets as follows:

UCRP Asset Liability Study, May 2009

	Recommended Weights		Ranges vs. Current Policy Weights			
Asset Class	**Long-Term Policy**	**Current Policy**	**Lower Bound**	**Upper Bound**	**Lower Bound**	**Upper Bound**
US Equity	**23.0%**	**32.0%**	**27.0%**	**37.0%**	-5%	5%
Non US Eq Devel	**22.0%**	**22.0%**	**17.0%**	**27.0%**	-5%	5%
EM Equity	**5.0%**	**4.0%**	**2.0%**	**6.0%**	-2%	2%
Global Equity	**2.0%**	**2.0%**	**1.0%**	**3.0%**	-1%	1%
Mkt Bonds	**12.0%**	**12.0%**	**9.0%**	**15.0%**	-3%	3%
High Yield Debt	**2.5%**	**2.5%**	**1.5%**	**3.5%**	-1%	1%
EM Debt	**2.5%**	**2.5%**	**1.5%**	**3.5%**	-1%	1%
TIPS	**8.0%**	**8.0%**	**6.0%**	**10.0%**	-2%	2%
Real Estate	**7.0%**	**4.0%**	**1.0%**	**7.0%**	-3%	3%
Private Eq	**6.0%**	**6.0%**	**3.0%**	**9.0%**	-3%	3%
Hedge Funds	**10.0%**	**5.0%**	**0.0%**	**10.0%**	-5%	5%
Cash	**0.0%**	**0.0%**	**0.0%**	**10.0%**	0%	10%
Other	**0.0%**	**0.0%**				
TOTAL	**100.0%**	**100.0%**				
Equity	52.0%	60.0%	**50.0%**	**70.0%**	-10%	10%
Fixed Income	25.0%	25.0%	**20.0%**	**30.0%**	-5%	5%
Alternatives	23.0%	15.0%	**8.0%**	**22.0%**	-7%	7%
	100.0%	100.0%				

B. The performance benchmark for Core Fixed Income to be the Barclays Capital Aggregate Bond Index (effective July 1, 2009).

C. The investment guidelines for Treasury Inflation Protected Securities (TIPS) to be modified to allow active management of this asset class, with an active risk budget of 200 basis points (annualized standard deviation).

[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 by stating the objectives of the UC Retirement Plan (UCRP) asset liability study, which were to ensure that the strategic asset allocation is structured to best fund the University's growing pension liabilities and to estimate the impact of different portfolio choices on the UCRP's funded status. She pointed out that the study was the product of a joint effort by Mercer Investment

Consulting, the Segal Company, and the Treasurer's Office, and noted that Senior Managing Director Phillips made a significant contribution.

There are various Regents' policies which affect the health of the UCRP and which concern benefits, funding, or investment. The current discussion would focus solely on investment policies, but would assume baseline contributions as presented by Segal.

It was necessary to view the UCRP asset allocation in the context of the current environment. Ms. Berggren presented a chart showing that the past year has seen the worst market for risky assets since the 1930s. There has been a global recession, an unusual situation in which every economy in the world has been affected. Economic recovery could be expected, at best, in late 2009 or early 2010. The excesses resulting from the credit and property bubble may last longer than two years. While higher inflation is all but certain, Ms. Berggren opined that a situation like the Great Depression of the 1930s is unlikely to develop.

An environmental factor specific to the UCRP is its funded status. A sharp escalation in benefits, coupled with the lack of contributions since 1991, has caused the funded ratio to drop below 100 percent.

The process for asset allocation of the UCRP was adapted to this environment. The near-term outlook is now highly uncertain. Ms. Berggren emphasized the uncertainty about the economy, regulation, monetary and fiscal policy, and consumer behavior. There could be many different courses of action for the University. Asset markets are not in equilibrium. Adequate liquidity is critical to the UCRP and the General Endowment Pool. Downside risk is important in this environment, and asset allocation requires a flexible approach.

Ms. Berggren then presented a chart which detailed the selection process used for determining the "policy portfolio." Out of nine economic scenarios, the Treasurer's Office identified the five most likely, with their estimated returns, and focused on the "Rapid Recovery, Inflationary Growth" scenario. It chose candidate portfolios with optimal risk-return properties across all scenarios. Based on thousands of simulations, Segal estimated the impact on the funded ratio of various asset mixes. The outcome was the "policy portfolio" with the best performance and lowest downside risk in a range of likely economic scenarios. Ms. Berggren emphasized that the goal was to avoid adverse outcomes.

In order to find the best asset allocation, parameters for risk and return must be defined. The parameter for risk was determined to be the average loss in the worst five percent of outcomes. The target return was determined to be the median return. The recommended asset mix has an emphasis on downside risk of -4.6 percent. Ms. Berggren discussed a chart comparing this recommended portfolio with alternative risk levels from -1 percent to -5 percent. Percentages of equity decline in proportion to overall risk.

Segal analyzed the annual returns for all the candidate portfolios. Ms. Berggren presented a chart displaying the median funded ratio of 500 trials for six portfolios. Without further changes, the funded ratio will decline to 50 percent by the year 2013 under all scenarios.

The recommendations resulting from the study include reducing marketable equity by three percent and increasing hedged or opportunistic strategies by five percent. The hedged or opportunistic strategies maintain flexibility and reduce equity beta. Three further recommendations are intended to battle against inflation: there will be a two percent increase of Treasury Inflation-Protected Securities (TIPS), a reduction of the core fixed income duration, and a reduction of non-U.S. fixed income.

The recommendations before the Committee will maintain global equity market capitalization weights for U.S. equity, non-U.S. developed, and emerging markets. In addition, the benchmark for core fixed income will be changed to the Barclays Capital Aggregate Bond Index, eliminating the long-duration component, and the University will actively manage the TIPS allocation.

In the recommended policy portfolio, global equity will decrease from 55 percent to 52 percent; market bonds will increase from 8 percent to 12 percent; high yield and emerging market debt will decrease from 6 percent to 5 percent; non-U.S. fixed income will be eliminated; TIPS will increase from 6 percent to 8 percent; real estate and private equity will remain at their current levels; and hedge funds will increase from 5 percent to 10 percent. Of the asset class fund benchmarks, only the core fixed income benchmark will be changed. The asset class ranges will be ±10 percent for equity; ±5 percent for fixed income; and ±7 percent for alternatives.

The new policy will be effective June 1, 2009. The change in the fixed income benchmark will be effective July 1. The University will refine the ranges around the "Current Policy" weights to be consistent with the three percent active risk budget.

3. ADOPTION OF EXPENDITURE RATE FOR THE GENERAL ENDOWMENT POOL FOR FISCAL YEAR 2009-10

The President recommended that, with the concurrence of the Committee on Finance, the expenditure rate per unit of the General Endowment Pool (GEP) for expenditure in the 2009-10 fiscal year remain at a rate of 4.75 percent of a 60-month moving average of the market value of a unit invested in the GEP.

[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.]

Assistant Vice President O'Neill noted that this recommendation concerning the General Endowment Pool expenditure rate was identical to an item considered earlier that day by the Committee on Finance.

Upon motion duly made and seconded, the Committee approved the Chief Investment Officer's and the Regents' investment consultant's recommendation for changes to the UC Retirement Plan Investment Policy Statement and the President's recommendation for the expenditure rate per unit of the General Endowment Pool and voted to present them to the Board, Regents Blum, De La Peña, Makarechian, Marcus, Schilling, Wachter, and Yudof (7) voting "aye."[1]

The meeting adjourned at 1:25 p.m.

Attest:

Secretary and Chief of Staff

[1] Roll call vote required by the Bagley-Keene Open Meeting Act [Government Code §11123(b)(1)(D)] for all meetings held by teleconference.