UNIVERSITY OF HOUSTON SYSTEM
Endowment Management Committee
Wednesday, August 12, 2009
1:00 p.m. – 3:00 p.m.

AGENDA

UNIVERSITY OF HOUSTON SYSTEM
ENDOWMENT MANAGEMENT COMMITTEE MEETING

DATE: **Wednesday, August 12, 2009**

TIME: **1:00 p.m.**

PLACE: **University of Houston**
Athletics/Alumni Center
Melcher Board Room 100B
3100 Cullen Boulevard
Houston, Texas 77204

Chair: **Carroll Robertson Ray**
Vice Chair: **Jim P. Wise**
Members: **Calvin W. Stephens**
Mica Mosbacher
Welcome W. Wilson, Sr., Ex Officio
Advisory Members: **Michael J. Cemo**
J. Christopher Jones

ENDOWMENT MANAGEMENT COMMITTEE

A. Call to Order

B. Report and Recommendations Regarding Endowed and Non-Endowed Assets – UH System — EM - 1

Action: Information and/or Approval

C. Approval of the UH System Endowment Fund Statement of Investment Objectives and Policies – UH System — EM - 2

Action: Approval

D. Approval of the UH System Investment Policy for Non-Endowed Funds – UH System — EM - 3

Action: Approval

E. Approve an Amendment to the existing contract with Cambridge Associates – UH System EM - 4

Action: Approval

F. Adjourn

UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA

COMMITTEE: Endowment Management

ITEM: Report and Recommendations Regarding Endowed and Non-Endowed Assets

DATE PREVIOUSLY SUBMITTED:

SUMMARY: The Committee will receive reports and recommendations from its investment consultant, Cambridge Associates, and discuss investment strategies for the System's Endowment Fund and Non-Endowed Funds.

FISCAL NOTE:

SUPPORTING DOCUMENTATION:

ACTION REQUESTED: Information and/or Approval

COMPONENT: University of Houston System

PRESIDENT		**DATE**
EXECUTIVE VICE CHANCELLOR	Carl Carlucci	7/30/09 **DATE**
CHANCELLOR	Renu Khator	8-4-09 **DATE**

UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA

COMMITTEE: Endowment Management

ITEM: Approval of the UH System Endowment Fund Statement of Investment Objectives and Policies.

DATE PREVIOUSLY SUBMITTED: May 15, 2008

SUMMARY: The Endowment Management Committee received a report from the System's investment consultant, Cambridge Associates, regarding the System endowment fund's investment policy. As a result of this report, the Committee is requesting approval to modify the investment policy.

FISCAL NOTE:

SUPPORTING DOCUMENTATION: Summary of Changes
Black-lined version of the policy

ACTION REQUESTED: Approval

COMPONENT: University of Houston System

PRESIDENT — **DATE**

EXECUTIVE VICE CHANCELLOR Carl Carlucci — **DATE** 7/30/09

CHANCELLOR Renu Khator — **DATE** 8-4-09

Endowment Management Committee
UH System Endowment Fund Statement of Investment Objectives and Policies
Summary of Changes

1. Delete text permitting a pro-rata payout on current fiscal year gifts. We eliminated this practice with the FY09 payout.
2. Cambridge is recommending changes to the asset allocation lower and upper ranges as follows:

Asset Class	Current Range	Proposed Range
Fixed Income	15-30%	10-30%
Mid to large cap equities	20-40%	15-35%
Non-US equities	10-30%	15-35%
Absolute Return	5-10%	5-15%
Long/Short equity managers	5-10%	5-15%
Non-marketable equity managers	0-10%	0-12%

The reasoning behind the change in these ranges is to open up more room for tactical positioning at the margin; in some cases this is to expand existing ranges to allow more room to over-or-under-weight the long-term target. In the case of fixed income, for example, the target is 15% while the bottom of the allowable range is also 15%. Therefore, Cambridge recommends broadening the fixed income range from 10-30%. In the public equity portfolio, following the trend toward a more balanced US-Global allocation, Cambridge recommends shifting the allowable ranges for both US and International equity to allow for more flexibility within each but also to bring the allowable ranges in line with each other. Cambridge also recommends broadening slightly the allowable ranges for hedged equity and absolute return, again to allow for a tactical over- or under-weight to long-term targets. Finally, Cambridge recommends slightly increasing the allowable range for the 10% target to private equity to 0 - 12%, so that the upper end of the allowable range is not the same as the target.

UNIVERSITY OF HOUSTON SYSTEM ENDOWMENT FUND
STATEMENT OF INVESTMENT OBJECTIVES AND POLICIES
Approved by the Board of Regents ~~May 17, 2007~~August 18, 2009

PREFACE

The University of Houston System Board of Regents is charged with the fiduciary responsibility for preserving and augmenting the value of the endowment, thereby sustaining its ability to generate support for both current and future generations of students. As part of a commitment to long-range financial equilibrium, the Regents have adopted the broad objective of investing endowment assets so as to preserve both their real value and the long-range purchasing power of endowment income so as to keep pace with inflation and evolving university needs, while generally performing above the average of the markets in which the assets are invested.

To achieve its investment objectives the University of Houston System retains independent investment managers each of whom plays a part in meeting the System's goals over a variety of capital market cycles. The Endowment Management Committee, Vice Chancellor for Administration and Finance (Vice Chancellor) or designee and Treasurer oversee the results of the independent managers and report periodically to the Board of Regents and the university community.

FORWARD

This policy is intended to be ongoing until the next review is completed. Comprehensive reviews are to be completed every five years.

It is the general practice of the University of Houston System to pool endowment resources. For investment purposes however, the assets are managed in separate endowment fund accounts. The following statement sets out explicit policies for the pooled endowment but would apply to non-pooled holdings as well. The Regents seek superior investment returns through professional management but not by assuming imprudent risks.

FINANCIAL OBJECTIVES

The primary long-term financial objective for the University endowment is to preserve the real (inflation-adjusted) purchasing power of endowment assets and income after accounting for endowment spending, inflation, and costs of portfolio management. Performance of the overall endowment against this objective is measured over rolling periods of at least ten years, which should encompass several market cycles.

INVESTMENT OBJECTIVES

In order to meet the financial objective stated above, the primary long-term investment objective of the endowment is to earn a total rate of return that exceeds the spending rate

plus the costs of managing the investment fund, and expressed in real (or inflation adjusted) terms. Given the current System spending rate of 7% (which includes 5% payout, 1.5% university advancement assessment, and 0.5% costs of managing the investment fund), the objective of this fund will be to earn a real (inflation adjusted) return of 7.0% when measured over rolling periods of at least five years. It is also understood that due to market conditions there may be five-year periods where this objective is exceeded and purchasing power is enhanced, as well as five-year periods where the objective is not met and purchasing power is diminished. The medium-term objective for the endowment is to outperform each of the capital markets in which assets are invested, measured over rolling periods of three to five years or complete market cycles, with emphasis on whichever measure is longer. In addition, the performance of the overall endowment is expected to be consistently in at least the second quartile of the NACUBO Annual Comparative Performance Survey of all educational endowments over rolling five-year time periods. Thus, the Endowment Management Committee is responsible for allocating assets to segments of the market and to managers who will provide superior performance when compared with both managers of other educational endowments and with capital markets generally.

Finally, the total return of the University's investment portfolio should be evaluated against the return of a composite index consisting of appropriate benchmarks weighted according to the Endowment Management Committee's asset allocation targets.

INVESTMENT MANAGERS

In accordance with Board policy, hiring of investment managers and investment advisors requires approval of the Board. Managers of marketable securities are expected to produce a cumulative annualized total return net of fees and commissions that exceeds an appropriate benchmark index over moving three to five-year periods, and should be above a median for active investment managers using similar investment philosophies over the same time periods. At their discretion, managers may hold cash reserves and fixed income securities up to 25% of portfolio market value with the understanding that their benchmark will not be adjusted to reflect cash holdings. Managers who wish to exceed these limits should secure prior approval from the Treasurer. The Treasurer, in turn, shall seek approval from the Vice Chancellor or designee.

ENDOWMENT PAYOUT POLICY

The Regents of the University of Houston System have established an endowment payout policy which attempts to balance the long-term objective of maintaining the purchasing power of the endowment with the goal of providing a reasonable, predictable, stable, and sustainable level of income to support current needs. Payout is derived from interest, dividends and realized gains, net of portfolio management fees. The historical rate of payout has been 4 to 5 percent. Going forward, the endowment will maintain a payout rate of approximately 4% to 5%, with any change to this range to be approved by the Board. The payout rate will be based as a percentage of the fiscal year end market value average over rolling three year periods. ~~plus a prorated amount for current fiscal year~~

~~gifts.~~ If an endowment has been in existence less than three years, the average will be based on the number of years in existence.

UNIVERSITY ADVANCEMENT ASSESSMENT

The System will annually assess a reasonable fee against the earnings of specified endowment funds to offset expenses associated with gift acquisition and fundraising at the component universities. The Board shall annually review and approve the fee. The fee will be based as a percentage of the fiscal year end market value averaged over rolling three year periods. If an endowment has been in existence less than three years, the average will be based on the number of years in existence.

ASSET SELECTION AND ALLOCATION

It is understood that ownership assets (or equities) are to be the dominant asset class in the Endowment due to the superior long-term return offered by such assets. As such, equity assets may be thought of as the drivers of long-term Endowment return.

Although the long-term return from equity assets is superior, they have three primary drawbacks that must be addressed. The first is that periods of prolonged economic contraction (deflation) can be catastrophic. Although such periods are rare, the results of such periods are severe enough to warrant holding a portion of the Endowment in assets (primarily intermediate to long-term high quality, non-callable fixed income securities), which are likely to appreciate in value during such periods. In this context, high quality shall mean a portfolio with an average credit quality of AA or better, although active managers may choose to hold select investment grade securities with lower ratings. The goal of such holdings would be to provide sufficient liquidity to the Endowment to meet payout needs over a three to five-year period without having to sell a significant portion of the equities at "fire-sale" prices. Adherence to this policy will keep equity holdings intact and allow the Endowment to reap the rewards of a return to a more normal economic environment.

The second drawback to a reliance on equity ownership is the effects of an unexpected rise in the rate of inflation. Such rises have traditionally been problematic for most types of equity assets, and given the System's stated goal of preserving purchasing power by achieving an attractive inflation adjusted return, some portion of the Endowment should be invested in assets that will appreciate in value during periods of unexpected inflation.

Lastly, equity assets are subject to greater degrees of risk. Risk takes many forms and is usually thought of in terms of volatility of investment returns. Volatile investment returns translate into a level of support for the System's programs that (even with the smoothing effect of the rolling three-year average market value payout rule) is variable over time. In order to control this variability to a tolerable level, some allocation is warranted to assets that produce attractive returns, but in a more absolute (or less variable) pattern. It is understood that such absolute return assets will invariably return less than equity assets, given rational markets.

After providing for the three broad categories noted above, the remainder of the Endowment should be invested in equity assets, broadly defined and broadly diversified. Broad diversification is required not only to further smooth the pattern of returns, but to protect the endowment from the risks associated with undue concentration in any one type of equity asset. Although other forms of diversification may be considered, it is understood that the Endowment's equity assets will be diversified by style (growth versus value), geography (domestic versus foreign), and market capitalization (large-cap versus small).

Current policy targets and ranges for the Endowment are as follows:

	Target	Range
Risk Controlling Assets	32.5%	30 to 50%
Deflation Protection (high quality bonds)	15%	~~15~~ 10 to 30%
Inflation Protection	10%	5 to15%

Assets to be considered for inclusion in this category include: Real Estate/REITs, TIPS (Treasury Inflation Protected Securities), and Energy or Commodities.

Absolute Return	7.5%	5 to ~~10~~15%

Assets to be considered for inclusion in this category would primarily include defensive arbitrage or absolute return funds. Bonds may also be held in some circumstances as absolute return vehicles, and in some circumstances a particular real estate manager may be viewed to qualify as such a holding as well.

Drivers of Return	67.5%	50 to 70%
Domestic Mid to Large Cap Equities	22.5%	~~20 to 40~~15 to 35%
Domestic Small-cap Equities	2.5%	0 to 10%

Large and mid-cap equities are defined as the 1000 largest companies traded in the United States, while small cap equities are considered to be the next 2000 stocks in terms of size. This characterization is compatible with the constitution of the Russell 1000, Russell 2000 and Russell 3000 Indexes.

Non U.S. Equities	25%	~~10 to 30~~15 to 35%
Long/Short Equity Managers	7.5%	5 ~~to10~~to15%

Non Marketable Equity Managers	10%	0 ~~to10~~to12%

Managers to be considered for inclusion in this category include private equity or venture capital managers, as well as real estate funds with comparable expected returns, and other funds subject to multi-year lock-ups.

The Endowment Management Committee sets the above asset allocation targets and ranges, and the actual allocation of assets will be adjusted through additions and withdrawals of funds among managers and investment media to conform to these targets insofar as practical.

REBALANCING

In addition to rebalancing through the deployment of cash flows, the Endowment Management Committee ("Committee") should consider rebalancing whenever an exposure is meaningfully overweight or underweight its target, and must rebalance to the upper range of the asset class once an exposure is 5% or more beyond the range specified for that asset class as measured at the end of the month.

Between meetings of the Committee, should the exposure for any asset class reach a level of 5% or more beyond the uppermost limit of the specified range as measured at the end of the month, the Treasurer shall consult with the System's Investment Consultant (if any) and make a recommendation to the Vice Chancellor or designee as to the appropriate rebalancing actions to take. By mutual agreement, those parties may then proceed either to take what rebalancing actions they deem to be reasonable and practical or, in the alternative, the Vice Chancellor may notify the Committee Chair who may call a special meeting of the Committee. Any rebalancing actions taken by the Treasurer, Vice Chancellor or designee, and Investment Consultant shall be communicated to the entire Committee by the Vice Chancellor in a timely matter but in any case, no later than the next Committee meeting.

Between meetings of the Committee, should the exposure of any asset class reach a level of 5% or more below the lower end of the specified range, as measured at the end of the month, or the System receives an inflow at any one time that is more than 3% of the total market value of the endowment, the Vice Chancellor shall notify the Committee Chair who shall convene a special meeting of the Committee to be held as soon as practical.

INVESTMENT MANAGEMENT

The endowment of the System will be managed primarily by external investment management organizations. Investment managers have discretion to manage the assets in each portfolio to best achieve the investment objectives, within the policies and requirements set forth in this statement, the investment manager agreement with the System including the guidelines for each investment manager, and subject to the usual standards of fiduciary prudence.

Each active investment manager with whom the System has a separate account will be provided with written statements of investment objectives and guidelines as part of the investment management contract that will govern his or her portfolio. These objectives shall describe the role the investment manager is expected to play within the manager structure, the objectives and comparative benchmarks that will be used to evaluate performance, and the allowable securities that can be used to achieve these objectives. Each manager will report performance quarterly consistent with these objectives and also indicate current annualized income and yield. These statements will be consistent with the Statement of Investment Objectives and Policies for the overall endowment as set forth herein. Investment managers will be provided with a copy of the Statement of Investment Objectives and Policies.

Additionally, each manager will be expected to use best efforts to realize the best execution price when trading securities and the settlement of all transactions (except investment pool funds and mutual funds) shall be done on a delivery versus payment basis.

SECURITIES LENDING

Managers may not enter into securities lending agreements. Securities owned by the endowment but held in custody by the endowment custodian may be lent to other parties through a contract between the University of Houston System and the custodian pursuant to a written agreement approved by the Board of Regents. Managers may not enter into securities lending agreements without the consent of the Board of Regents. The System recognizes, however, that for those investments placed in commingled vehicles, the Board cannot dictate whether or not the manager will engage in securities lending. Therefore, System and its investment consultant (if any) shall make every effort either to avoid commingled investments, or to otherwise limit investment to those managers who will not engage in securities lending. The limited partnerships of marketable and non-marketable alternative investments are excluded from this limitation.

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PROXY VOTING

Investment managers are responsible for voting proxies on behalf of the University of Houston System. When the manager is analyzing a proxy voting issue for the endowment and deciding how to vote, they should take into consideration the general positions of the Board of Regents as described in guidelines provided to each manager.

ADVISORY COMMITTEES

The Endowment Management Committee may establish advisory groups to provide general investment advice, as well as advice on special investments, to the Endowment Management Committee and the staff of the Vice Chancellor for Administration and Finance.

REVIEW PROCEDURES

A. Performance Measurement

The Endowment Management Committee intends to review quarterly the performance of the endowment and each investment manager's portfolio relative to the objectives and guidelines described herein. The investment performance review will include comparisons with unmanaged market indices and the Consumer Price Index. A time-weighted return formula (that minimizes the effect of contributions and withdrawals) will be utilized for the overall endowment, although it is understood that individual managers may be evaluated using a dollar-weighted methodology, where appropriate.

B. Review and Modification of Policy

The Endowment Management Committee shall review this Policy at least once a year to determine if modifications are necessary or desirable. If modifications are made, they shall be promptly communicated to the Investment Managers and other responsible parties.

UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA

COMMITTEE: Endowment Management

ITEM: Approval of the UH System Investment Policy for Non-Endowed Funds

DATE PREVIOUSLY SUBMITTED: May 15, 2008

SUMMARY: The Endowment Management Committee received a report from the System's investment consultant, Cambridge Associates, regarding the System's non-endowed investment policy. As a result of this report, the Committee is requesting approval to modify the investment policy.

FISCAL NOTE:

SUPPORTING DOCUMENTATION: Summary of Changes
Black-lined version of the policy

ACTION REQUESTED: Approval

COMPONENT: University of Houston System

PRESIDENT		**DATE**
EXECUTIVE VICE CHANCELLOR	Carl Carlucci	7/30/09 **DATE**
CHANCELLOR	Renu Khator	8-4-09 **DATE**

Endowment Management Committee
UH System Investment Policy for Non-Endowed Funds
Summary of Changes

1. Add additional language to the rebalancing section providing guidance to staff on rebalancing in between committee meetings should the upper or lower ranges of any investment pool (cash, liquidity, or core) be breached. This is similar language to what is in the rebalancing section of the endowment investment policy.
2. Add the following requirements
   a. Any money market fund or mutual fund must be SEC 2a-7 compliant. This is codifying in policy an existing practice.
   b. Any money market fund or mutual fund investment must be rated AAA or its equivalent by the two nationally recognized statistical rating organizations that rate our debt. Current language only requires one nationally recognized statistical rating organization. This is an important modification since the two organizations that currently rate our debt discount our liquidity if the mutual funds are not SEC 2a-7 compliant and rated AAA.
   c. Require a review of the investment policy at least once a year. This is best practice, and we are codifying in policy an existing practice.

UNIVERSITY OF HOUSTON SYSTEM
INVESTMENT POLICY FOR NON-ENDOWED FUNDS
Approved by the Board of Regents ~~May 15, 2008~~August 18, 2009

I. INVESTMENT AUTHORITY AND SCOPE OF POLICY

General Statement

All non-endowed financial assets of the University of Houston System are to be invested in a manner that will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the System and conforming to all state statutes governing investment of such funds. This investment policy applies to all non-endowed financial assets of all funds of the UH System at the present time and any funds to be created in the future.

Investment Officer

The System Treasurer may invest funds that are not immediately required to pay obligations of the System. The Board shall designate by resolution one or more additional officers or employees as investment officers. The Board may also appoint one or more investment managers to invest the System's funds under the terms of this policy.

If an investment officer has a personal business relationship with an entity or is related within the second degree by affinity or consanguinity to an individual seeking to sell an investment to the System, the investment officer must file a statement disclosing that personal business interest or relationship with the Texas Ethics Commission.

II. INVESTMENT OBJECTIVES

Safety and Maintenance of Adequate Liquidity

Safety of principal is a primary objective in any investment transaction involving non-endowed financial assets. The System's investment portfolio must be structured in conformance with an asset/liability management plan that provides for liquidity necessary to pay obligations as they become due.

Diversification

The System will diversify its portfolio to eliminate the risk of loss resulting from over concentration of assets in a specific maturity, a specific issuer or a specific class of investments.

Yield

The System seeks to earn the maximum rate of return allowed on its investments within constraints imposed by its safety and liquidity objectives, and state and federal law governing investment of public funds.

Maturity

Portfolio maturities will be structured to meet the obligations of the System first and then to achieve the highest return of interest. When the System has funds that will not be needed to meet current-year obligations, maturity restraints will be imposed based upon investment strategy.

Asset Allocation

The non-endowed funds will be allocated into three tiers of liquidity to better reflect the actual liquidity requirements of these assets. The approved liquidity tiers and target allocation to each tier is as follows:

1. 40% allocated to a cash pool with a one-year time horizon; designed to meet the annual operating needs of the system. This cash pool will be invested in money market funds in conformity with section III. The benchmark for this pool will be the Merrill Lynch 91-Day T-Bill Index.
2. 40% allocated to a liquidity pool with a horizon of one to five years, designed to serve as a margin of safety in the unlikely event that the cash pool is insufficient to meet spending needs. The liquidity pool will be invested in intermediate-term bonds in conformity with section III. The benchmark for this proposal will be the Lehman Brothers Intermediate-Term Government Bond Index.
3. 20% allocated to a core pool with an indefinite time horizon. This pool will be much more broadly diversified than either the cash pool or the liquidity pool and will be designed to generate a higher return over longer periods while remaining liquid enough to serve as a source of funds under extreme circumstances. The core pool may be invested in any asset classes as approved by the Endowment Management Committee. The benchmark for this pool will be the Dynamic Portfolio Benchmark used to measure the performance of the Endowment.

A customized Total Portfolio Benchmark will be employed to measure the overall performance of the portfolio. This benchmark will blend the returns of the three benchmarks specified above, weighted according to the target allocation for each respective tier.

Policy targets and allowable ranges for the Non-Endowed Funds are as follows:

	Target Allocation	Allowable Range
Cash Pool	40%	40 – 100%
Liquidity Pool	40%	0 – 50%
Core Pool	20%	0 -25%

Rebalancing

Given the substantial difference in expected return among these three pools, and the regular use of funds from the cash pool for operational purposes, it is expected that these pools will need to be rebalanced fairly frequently. The Endowment Management Committee should consider rebalancing a pool when it exceeds a five percent over-or-underweight relative to its allowable ranges.

Between meetings of the Committee, should the exposure for any pool reach a level of 5% or more beyond the uppermost limit or 5% below the lower end of the specified range as measured at the end of the month, the Treasurer shall consult with the System's Investment Consultant (if any) and make a recommendation to the Executive Vice Chancellor, or designee as to the appropriate rebalancing actions to take. By mutual agreement, those parties may then proceed to take what rebalancing actions they deem to be reasonable and practical. Any rebalancing actions taken shall be communicated to the entire Committee by the Executive Vice Chancellor, in a timely matter but in any case, no later than the next Committee meeting.

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Quality and Capability of Investment Management

The System will provide periodic training in investments for the System Investment Officers through courses and seminars offered by professional organizations and associations in order to insure the quality, capability and currency of the System Investment Officers in making investment decisions.

III. INVESTMENT TYPES

The System Investment Officer shall use any of the following authorized investment instruments consistent with this policy and governing law.

A. The following are authorized investments:

(1) obligations of the United States or its agencies and instrumentalities;

(2) direct obligations of this state or its agencies or instrumentalities;

(3) collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States;

(4) other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, this state or the United States or their respective agencies and instrumentalities; and

(5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent.

B. Certificates of deposit if issued by a state or national bank domiciled in this state or a savings and loan association domiciled in this state that are:

(1) guaranteed or insured by the Federal Deposit Insurance Corporation or its successor;

(2) secured by obligations that are described by Section 2256.009(a) of the Public Funds Investment Act, including mortgage backed securities directly issued by a federal agency or instrumentality that have a market value of not less than the principal amount of the certificates; or

(3) secured in any other manner and amount provided by law for deposits of the System.

C. A fully collateralized repurchase agreement or reverse repurchase agreement, as defined in the Public Funds Investment Act, if it:

(1) has a defined termination date;

(2) is secured by obligations described by Section 2256.009(a)(1) of the Public Funds Investment Act;

(3) requires the securities being purchased by the System to be pledged to the System, held in the System's name, and deposited at the time the investment is made with the System or with a third party selected and approved by the System; and

(4) is placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in this state.

Notwithstanding any law, the term of any reverse security repurchase agreement may not exceed 90 days after the date the reverse security repurchase agreement is delivered. Money received by a System under the terms of a reverse security repurchase agreement shall be used to acquire additional authorized investments, but the term of the authorized investments acquired must mature not later than the expiration date stated in the reverse security repurchase agreement.

D. A banker's acceptance if it:

(1) has a stated maturity of 270 days or fewer from the date of its issuance;

(2) will be, in accordance with its terms, liquidated in full at maturity;

(3) is eligible for collateral for borrowing from a Federal Reserve Bank; and

(4) is accepted by a bank organized and existing under the laws of the United States or any state, if the short-term obligations of the bank, or of a bank holding company of which the bank is the largest subsidiary, are rated not less than A-1 or P-1 or an equivalent rating by at least one nationally recognized credit rating agency.

E. Commercial paper if it:

(1) has a stated maturity of 270 days or fewer from the date of its issuance; and

(2) is rated not less than A-1 or P-1 or an equivalent rating by at least:

(A) two nationally recognized credit rating agencies; or

(B) one nationally recognized credit rating agency and is fully secured by an irrevocable letter of credit issued by a bank organized and existing under the laws of the United States or any state.

F. Mutual Funds and money market mutual funds with limitations described below:

A no-load money market mutual fund is authorized if it:

(1) is regulated by the Securities and Exchange Commission;

(2) has a dollar-weighted average stated maturity of 90 days or fewer; and

(3) includes in its investment objectives the maintenance of a stable net asset value of $1 for each share.

A no-load mutual fund is authorized if it:

(1) ~~(1)~~ is registered with the Securities and Exchange Commission;

(2) is Securities and Exchange Commission 2a-7 compliant;

(~~2~~3) has an average weighted maturity of less than two years;

(~~3~~4) is invested exclusively in obligations approved by this policy; and

(~~4~~5) is continuously rated as to investment quality by the two nationally recognized statistical rating organizations that rate our debt ~~at least one nationally recognized investment rating firm~~ of not less than AAA or its equivalent.

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The System may not invest its funds or funds under its control, including bond proceeds and reserves and other funds held for debt service, in any one mutual fund or money market mutual fund in an amount that exceeds 10 percent of the total assets of the mutual fund or money market mutual fund.

G. Eligible investment pools approved by the Board. An investment pool shall invest the funds it receives from entities in authorized investments permitted by the Public Funds Investment Act. The System by contract may delegate to an investment pool the authority to hold legal title as custodian of investments purchased with its local funds.

H. Cash management and fixed income funds sponsored by organizations exempt from federal income taxation under Section 501 (f), Internal Revenue Code of 1986.

I. Negotiable certificates of deposit issued by a bank that has a certificate of deposit rating of at least 1 or the equivalent by a nationally recognized credit rating agency or is associated with a holding company having a commercial paper rating of at least A-1, P-1, or the equivalent by a nationally recognized credit rating agency .

J. Corporate bonds, debentures, or similar debt obligations rated by a nationally recognized investment rating firm in one of the two highest long-term rating categories, without regard to gradation within those categories.

K. The purchase of units in the System Endowment Fund up to an amount not to exceed 20% of the non-endowed funds.

Prohibited Investment Instruments

The System Investment Officer or appointed investment management company has no authority to use any of the following investment instruments:

(1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal;

(2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;

(3) collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index;

(4) any security prohibited by the laws of the State of Texas. The Treasurer will inform investment managers of any such prohibitions on an ongoing basis.

IV. INVESTMENT RESPONSIBILITY AND CONTROL

Investment Institutions Defined

The System Investment Officer shall invest System funds with any or all of the following institutions or groups consistent with federal and state law and the current Depository Bank contract:

(1) Depository bank;

(2) Other state or national banks domiciled in Texas that are insured by the FDIC;

(3) Public funds investment pools; or

(4) Government securities brokers and dealers.

Standards of Operation

The System Investment Officer shall develop and maintain written administrative procedures for the operation of the investment program, consistent with this investment policy.

Delivery vs. Payment

All Treasury Bills, Notes and Bonds and Government Agencies' securities shall be purchased using the "Delivery vs. Payment" (DVP) method through the Federal Reserve System. By doing so, System funds are not released until the System has received, through the Federal Reserve wire, the securities purchased.

Standard of Care

Investments shall be made with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived. Investment of funds shall be governed by the following investment objectives, in order of priority: preservation and safety of principal; liquidity; and yield. In determining whether an investment officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration:

(1) the investment of all funds, or funds under the System's control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment; and

(2) whether the investment decision was consistent with the written investment policy of the System.

V. INVESTMENT REPORTING AND PERFORMANCE EVALUATION

Not less than quarterly, the System shall submit to the Board a written report of the System's investment transactions for the preceding reporting period. The report shall contain:

A. A summary statement of each pooled fund group that states the beginning market value for the reporting period, additions and changes to the market value during the period, and the ending market value for the period.

B. The book value and market value for each separately invested asset at the beginning and end of the reporting period by type of asset and fund type invested.

For purpose of this section:

"Pooled fund group" means an internally created fund in which one or more institutional accounts are invested; and "Separately invested asset" means an account that is not invested in a pooled fund group.

VI. INVESTMENT COLLATERAL AND SAFEKEEPING

Collateral or Insurance

The System Investment Officer shall ensure that all System funds are fully collateralized or insured consistent with federal and state law and the current Bank Depository Contract in one or more of the following manners:

(1) FDIC insurance coverage;

(2) Obligations of the United States or its agencies and instrumentalities.

Safekeeping

All purchased securities shall be held in safekeeping by the System, or a System account in a third party financial institution, or with the Federal Reserve Bank. All pledged securities by the Depository Bank shall be held in safekeeping by the System, or a System account in a third party financial institution, or with a Federal Reserve Bank.

Review and Modification of Policy

The Endowment Management Committee shall review this Policy at least once a year to determine if modifications are necessary or desirable. If modifications are made, they shall be promptly communicated to the Investment Managers and other responsible parties, if necessary.

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UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA

COMMITTEE: Endowment Management

ITEM: Approve an amendment to the existing contract with Cambridge Associates

DATE PREVIOUSLY SUBMITTED:

SUMMARY: Approval is requested to amend the existing contract with Cambridge Associates to increase their level of service offering from general investment consulting to comprehensive advisory services and modify the fee structure from a fixed price per year to basis points of total assets. Under the comprehensive advisory arrangement, the endowment would have unlimited access to Cambridge resources, and we would have a broader array of asset class consultants, researchers, and analysts at our disposal to build out direct investments in the marketable and non-marketable alternative asset classes. This arrangement would also save the endowment $91,750 based on the current allocation to alternative assets. When the alternative assets portfolio is built out to its target allocation under the comprehensive advisory arrangement, the endowment would save $441,750 per year compared to the existing cost structure. The savings are derived from the elimination of the fund-of-funds fee structure with the existing alternative assets portfolio.

FISCAL NOTE: Estimated annual fee: $795 thousand based on the June 30, 2009 MV of $397million. Cambridge annual fee equal to 20 bps of the market value of total assets for first $500 million; 16bps for the next $500 million; and negotiable beyond $1 billion; with a minimum annual fee of $200 thousand.

SUPPORTING DOCUMENTATION: Summary of existing level of service versus comprehensive advisory services and cost analysis

ACTION REQUESTED: Approval

COMPONENT: University of Houston System

PRESIDENT		**DATE**
		7/30/09
EXECUTIVE VICE CHANCELLOR	Carl Carlucci	**DATE**
Renu Khator		8-4-09
CHANCELLOR	Renu Khator	**DATE**

CAMBRIDGE ASSOCIATES PROPOSED SERVICE AGREEMENT

- In light of rapidly shifting market conditions and an increasingly uncertain economic environment, the Endowment Management Committee, along with Staff and Cambridge Associates, have recognized that more frequent and more proactive monitoring of the University's Endowment may be warranted in the current environment.
  - Furthermore, the Endowment Management Committee has made clear its desire to bring the allocation to non-marketable alternatives (or private equity, broadly defined) up to the long-term target of 10%.
  - It has also been noted that, given the recent run-up in valuations and the bleak economic outlook, the potential for strong returns from public equities may be diminished. It has been suggested that the Endowment may be better served by placing capital with managers that have a broader tool set, who can either preserve capital in difficult markets or even generate a modest profit regardless of market direction. This might include hedged equity or absolute return managers.

- *As currently designed*, however, the Cambridge Associates contract is somewhat restricted in the resources available to accomplish these goals as efficiently as possible. Under the terms of the current contract:
  - Manager searches are limited to either traditional asset classes such as equities or bonds, or to funds-of-funds for hedge funds and private equity managers. Funds-of-funds add an additional layer of fees on top of those charged by the underlying managers.
  - Performance measurement is limited to quarterly reporting.
  - Attendance by a team of one to two generalist consultants is limited to six meetings per year.
  - Consulting time outside of Endowment Management Committee meetings is limited to 12 hours per year.
- *Not* included in the current contract are:
  - Searches for and monitoring of individual alternative investment managers (hedge funds or private equity).
  - Monthly performance reporting.
  - Conference calls or any other meetings outside of regularly scheduled Endowment Management Committee meetings.
  - Administrative assistance with investment contracts and documentation.

- Consulting time beyond the 12-hour limit, which is exceeded each year.

- Over the past several months, Staff has been in discussions with Cambridge to determine what level of service would be necessary to facilitate more proactive management of the Endowment, including a more direct approach to building out private equity and hedge fund portfolios.

- Cambridge has suggested that the University convert to its Comprehensive Advisory Service, which will not only provide those resources but will in the end actually save the University money—net of any increase in fees—by eliminating the additional layer of fund-of-funds fees for alternative managers. Under the terms of the proposed service agreement, Cambridge would provide:
  - Unlimited access to all of the firm's resources, including:
    - A team of up to three generalist consultants, with attendance at an unlimited number of in-person meetings or conference calls.
    - Monthly and quarterly performance reporting.
    - Access to all Cambridge research, including extensive due diligence reports on select alternative managers.
    - Unlimited consulting time.
  - A dedicated Non-Marketable Alternative Specialist consultant. This Specialist will help build out the Endowment's 10% private equity allocation through direct investments in individual, top-quality managers, diversified by year, strategy, market, geography and manager. This will eliminate the need to pay an additional level of fund-of-fund fees, and will offer the University exposure to only the highest-quality managers.
  - A dedicated Marketable Alternative Specialist Consultant, who will help construct a customized hedge fund portfolio of direct investments in individual, top-flight hedge fund managers. Again, this will eliminate the fund-of-fund fees the University is currently paying, as well as control the quality of managers included in the program.
  - Administrative assistance with gathering and completing the necessary documents for all investments, as well as tracking document flow and monitoring the custodian's receipt and disbursement of cash with respect to new and terminated investments.
  - Upon request, CA will provide audit support materials relating to the University's alternative investment assets that describe CA's initial and ongoing due diligence process in detail and CA's

valuation tracking process for Marketable Alternative Investment Assets.

- The following pages illustrate the potential savings from eliminating fund of funds fees from both the hedge fund and private equity portfolios.
  - The top box represents the cost savings available to the University immediately, due to eliminating hedge fund-of-fund fees using the University's existing hedge fund portfolio and cost structure. Non-Marketable Alternative fund-of-fund fees are not taken into account here due to the small current allocation and to the fact that existing partnerships will not be wound down for a few years. Even excluding private equity fund-of-fund fees, the immediate net savings to the University is over $90,000.
  - The second box represents the net savings available to the University taking into account the private equity program. This analysis assumes a 10% allocation to private equity, and essentially compares the cost savings available by making direct investments in individual private equity managers through Cambridge's Comprehensive Advisory Service versus using funds-of-funds. Under this scenario, the total net savings to the University by converting to the Comprehensive Advisory Service is over $440,000.
- In sum, the proposed service agreement represents not only a substantial increase in personnel, time, research, and administrative support available to the University, but a net *reduction* in overall expenses due to the elimination of fund-of-fund fees. Staff recommends the Endowment Management Committee approve the proposed conversion to Cambridge Associates' Comprehensive Advisory Service.

CAMBRIDGE ASSOCIATES PROPOSED SERVICE AGREEMENT
COST-BENEFIT ANALYSIS

COMPREHENSIVE ADVISORY SERVICE

Immediate Increase/Decrease in Cost

Proposed Comprehensive Advisory Fees[1]	699,600
Current Service Contract	232,500
Current MALT Fund of Funds Fees[2]	559,250
Net Additional Cost (Savings)	**($92,150)**

COMPREHENSIVE ADVISORY SERVICE

Pro Forma Increase/Decrease in Cost
Assuming a 10% Allocation to Private Equity

Proposed Comprehensive Advisory Fees[1]	699,600
Current Service Contract	232,500
Current MALT Fund of Funds Fees[2]	559,250
Pro Forma NMAA Fund of Fund Fees [3]	350,000
Net Additional Cost (Savings)	**(442,150)**

[1] Based on annual fee of 20 bps and March 31 market value of total assets.

[2] Please see assumptions on following page. "MALT" refers to Marketable Alternatives, or hedge funds.

[3] Total Non-Marketable Alternative fund-of-funds fees assuming a 10% allocation. "NMAA" refers to Non-Marketable Alternative Assets, or private equity.

Assumptions

MALT Fund of Funds Mgr	Most Recent AUM	Fee	Annual Total
Crestline	10,900,000	1.25%	136,250
Barlow Partners	33,100,000	1.00%	331,000
Federal Street[1]	9,200,000	1.00%	92,000
TOTAL	53,200,000		559,250
NMAA FoF Mgrs (Full Allocation)			
10% of March 31 AUM	35,000,000	1.00%	350,000

[1]Federal Street was liquidated at year end 2008 due to manager concerns rather than a reduction in the allocation to MALT. The plan was to temporarily shift assets to cash but to eventually identify a replacement fund-of-funds.