UNIVERSITY OF HOUSTON SYSTEM
Endowment Management Committee
February 14, 2012

AGENDA

UNIVERSITY OF HOUSTON SYSTEM
ENDOWMENT MANAGEMENT COMMITTEE MEETING

DATE: **Tuesday, February 14, 2012**

TIME: **1:30 p.m.**

PLACE: **Hilton University of Houston Hotel**
Waldorf Astoria Ballroom E, Second Floor
4800 Calhoun
Houston, Texas 77204

Chair: **Mica Mosbacher**
Vice Chair: **Jarvis V. Hollingsworth**
Members: **Jacob M. Monty**
Nelda Luce Blair, Ex Officio
Advisory Members: **Carroll Robertson Ray**
Jim P. Wise

ENDOWMENT MANAGEMENT COMMITTEE

A. Call to Order

B. Approval of Committee Minutes
- November 15, 2011, Endowment Management Committee Meeting

Action: Approval

C. Approve the FY 2012 University Advancement Endowment Assessment Rate of 1.5% – University of Houston System — EM-C-1

Action: Approval

D. Report and Recommendations from Cambridge Associates Regarding Endowed and Non-Endowed Assets – University of Houston System — EM-D-2

Action: Information and/or Approval

E. Approval to modify the UH System Endowment Fund Statement of Investment Objectives and Policies – University of Houston System — EM-E-3

Action: Approval

F. Annual review and approval of the UH System Investment Policy for Non-Endowed Funds – University of Houston EM-F-24

Action: Approval

G. Approval is requested to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of an investment manager for the University of Houston System Endowment Fund – University of Houston System EM-G-43

Action: Approval

H. Adjourn

UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA

COMMITTEE: Endowment Management

ITEM: Approve the FY12 University Advancement Endowment Assessment Rate of 1.5%

DATE PREVIOUSLY SUBMITTED: February 15, 2011

SUMMARY:
Approval is requested to continue assessing the UH System Endowment at a rate of 1.5% for FY12 (FY13 spending). This represents the annual approval by the Board of this assessment. The Endowment Statement of Investment Objectives and Policies permits the system to 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 investment policy also states that the Board shall annually review and approve the fee. The fee is based as a percentage of the fiscal year end market value averaged over rolling three-year periods for eligible endowments. If an endowment has been in existence less than three years, the average will be based on the number of years in existence.

SUPPORTING DOCUMENTATION: None

FISCAL NOTE: Estimated assessment for FY13 spending is $4.3 million, which is approximately $100k higher than the previous year.

RECOMMENDATION/ ACTION REQUESTED: Administration recommends approval of this item.

COMPONENT: University of Houston System

EXECUTIVE VICE CHANCELLOR Carl Carlucci **DATE** 1/27/2012

Renu Khator

CHANCELLOR Renu Khator **DATE** 1/31/12

UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA

COMMITTEE: Endowment Management

ITEM: Report and Recommendations from Cambridge Associates Regarding Endowed and Non-Endowed Assets

DATE PREVIOUSLY SUBMITTED:

SUMMARY:

(1) Approval is requested for a full redemption of our investment in Whippoorwill Offshore Distressed Opportunity Fund, Ltd. The justification for this recommendation will be presented by Cambridge Associates.

(2) Cambridge Associates will also present an overview of the market, the endowment's asset allocation and performance, and other analysis of the portfolio.

SUPPORTING DOCUMENTATION: Cambridge Associates discussion materials book (as to item 1, pages 89-90).

FISCAL NOTE: $4.6 million balance in Whippoorwill as of December 31, 2011.

RECOMMENDATION/ ACTION REQUESTED: Administration recommends approval of item1. Item 2 is information only.

COMPONENT: University of Houston System

EXECUTIVE VICE CHANCELLOR Carl Carlucci **DATE** 1/27/2012

CHANCELLOR Renu Khator **DATE** 1/31/12

UNIVERSITY OF HOUSTON SYSTEM ENDOWMENT FUND
STATEMENT OF INVESTMENT OBJECTIVES AND POLICIES
Approved by the Board of Regents February ~~16~~15, ~~2011~~2012

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. Pursuant to Board Bylaw, the Endowment Management Committee has been established as a standing committee to assist the Board in fulfilling its fiduciary responsibilities.

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 shall:

a) Review and recommend to the Board changes to investment policies;

b) Review and recommend to the Board the university advancement assessment rate;

c) Review and recommend to the Board asset allocation long-term targets and ranges;

d) Review and recommend to the Board external investment consultants;

e) Monitor, evaluate, hire or terminate external investment managers;

f) Establish investment manager guidelines;

g) Monitor and adjust the actual allocation of assets through additions and withdrawals of funds among managers and investment media to conform to the long-term targets insofar as practical; and

h) Oversee the results of the independent managers and report periodically to the Board 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 6% (which includes 4% 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 6.0% 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 university's peer group, as measured by the NACUBO-Commonfund Study of Endowments over rolling five-year time periods, as well as comparison annually to a peer group provided by an outside advisor. 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 consultants requires approval of the Board. Hiring of investment managers requires Endowment Management Committee approval except, when on the recommendation of the committee staff and the investment consultant, the chair of the Endowment Management Committee and the chair of the Finance and Administration Committee jointly determine that time is of the essence and

immediate action in lieu of a called committee meeting is necessary to hire or terminate an investment manager, the recommended change can then be made. The chair of the Endowment Management Committee will have the staff immediately report any such action taken to the members of the Endowment Management Committee and the Chairman of the Board of Regents after such action is taken.

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 Executive 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. 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:

	Long-Term Target	Range
Risk Controlling Assets	~~32~~37.5%	30 to 50%
Deflation Protection (high quality bonds)	15%	10 to 30%
Inflation Protection (real assets)	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~~12.5%	~~5~~ 7.5 to ~~15~~17.5%

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.

Cash	0%	0 to 10%
Drivers of Return	~~67~~62.5%	50 to 70%
Domestic Mid to Large Cap Equities	~~22.5~~17.5%	~~15~~ 12.5 to ~~35~~30%
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 (international equity)	~~20~~15%	~~15~~ 10 to ~~35~~30%
Emerging Market Equities	5%	2.5 to 7.5%
Long/Short Equity ~~Managers~~(hedged equity)	~~7.5~~12.5%	~~5~~ 7.5 ~~to15~~to 17.5%
Non Marketable Equity ~~Managers~~ (private equity)	10%	0 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.

Alternative Investment Risks

For the purposes of this section, "alternative investments" refers to investments in long/short equity, absolute return, private equity, private real estate and venture capital, as well as other investments employing leverage, short sales, or illiquid investment vehicles. The investments are made in the Endowment in order to improve diversification, reduce overall volatility, and enhance return, However, the Endowment Management Committee recognizes that these investments also present additional risks beyond those posed by investments in traditional marketable securities such as stocks and bonds. Among these risks are:

1. *Liquidity Risk:* most alternative investments impose restrictions on redemptions or require multi-year locks.

    a. This risk is mitigated by imposing restrictions on the amount of the Endowment that may be allocated to alternative investments as detailed above. In addition, the Endowment Management Committee will review at least annually the level of portfolio liquidity across all asset classes in order to ensure that there is sufficient liquidity to meet all obligations.

2. *Non-regulation risk:* Historically, alternative managers have been exempt from registration with the SEC, which has allowed them to employ strategies (such as short sales and use of leverage) forbidden by most traditional investment managers, as well as to avoid disclosing specific details of their investment practices or portfolio holdings.

    a. With the passage of the Dodd-Frank Act of 2010, almost all alternative investment managers will be required to register with the SEC under the Investment Advisers Act of 1940. This Act will require registered managers to file documents with the SEC and for public record describing the nature of the business, fees charged, types of clients, and details on compliance policies. It will also provide to investors a greater level of detail into portfolio strategy and investment.

    b. Venture capital managers will, however, remain exempt from the Investment Advisers Act and will therefore remain unregistered with the SEC.

        i. This risk will be mitigated by performing detailed due diligence on these managers and monitoring them regularly as described below, as well as by diversifying manager risk through multiple direct and fund-of-fund investments.

3. *Transparency Risk:* alternative managers are not required to disclose portfolio holding details to the same extent that traditional marketable managers are, and are often reluctant to do so in order to preserve their perceived advantage over other investors.

    a. This risk will be mitigated somewhat by the Dodd-Frank Act and the increased transparency provided by the requirement to file Form ADV with the SEC. Beyond that, however, the Endowment Management Committee, staff, and any outside advisors shall emphasize those managers who will provide at least the following level of detail into their investment portfolios:

        i. Number of short and long positions

        ii. The use of leverage

iii. Net market exposure

4. *Investment Strategy Risk:* alternatives often employ sophisticated and potentially riskier strategies, and may use leverage.

    a. This risk will be mitigated by intensive due diligence and monitoring of potential alternative managers described below. An emphasis will be placed on those managers who have extensive experience in employing these strategies, a demonstrated ability to consistently employ them effectively, and an established track record of superior performance.

5. *Foreign Currency Risk:* changes in exchange rates could adversely affect fair value of the Endowment Fund.

    a. The Endowment Management Committee recognizes that exposure to foreign currency acts as a hedge against a declining or collapsing dollar. In this way, such investments help to reduce risk in the portfolio. However, the Committee will review the level of exposure to foreign currencies periodically in order to ensure that there are no unintended risks in the portfolio.

The following principles shall guide the selection of alternative investment managers:

- Diversify across managers to mitigate systematic and organizational risk, but avoid over-diversification.
- Diversify by strategy and geography to decrease correlations within the program.
- Emphasize qualitative evaluation of managers, as a manager's quantitative characteristics may change over time and in different market conditions.
- Discourage the use of significant leverage, and emphasize managers with a demonstrated skill in generating returns on assets as opposed to returns on equity.
- Avoid strategies that are trading oriented, highly complex, or quantitatively driven.

In addition, the investment manager due diligence process shall include the following functions, to be performed by some combination of outside consultants/advisors and internal staff:

- Background checks
    - Reference checks
    - News searches
    - Industry consultation
- Review of vendor relationships
    - Prime brokers
    - Auditors
    - Fund administrators
    - Legal counsel
- Operational review
    - On site visits
    - Procedural

- Organizational

Monitoring of the overall program-level and manager-level exposures and investment results shall be administered in accordance with the following schedule by some combination of outside consultants/advisors and internal staff:

Monthly (For Long/Short Equity and Absolute Return Managers)
- Reports of performance and asset allocation.
- Proactive contact with investment managers whose performance falls outside of the expected range.

Quarterly or Semi-Annually
- Calls with investment managers.
- For long/short equity and absolute return managers, detailed performance reports and analysis providing information such as top long positions, net and gross exposures, exposure by strategy and geography, and organizational changes.

Annually
- On site meetings with managers and attendance at annual meetings.

The Endowment Management Committee reviews and recommends to the Board the above asset allocation long-term 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

The Committee recognizes the importance of periodically rebalancing the Endowment's asset allocation, namely to ensure that variation in returns among assets do not create outsized deviations from target allocations that cause Endowment performance to diverge from expected policy performance. To the extent possible, the Endowment will utilize naturally occurring cash movement opportunities to rebalance the Endowment portfolio. Such naturally occurring opportunities include:

- The sourcing of cash for spending needs (withdrawals)
- The infusion of cash (contributions) into the existing portfolio
- Manager changes (partial or complete subscriptions or redemptions)
- Other cash transactions (i.e., dividends, interest income, return on capital, etc.)

The Treasurer and Investment Consultant (if any) will monitor asset allocation and propose investment rebalancing recommendations (including a recommendation of no action if no rebalancing is needed) no less frequently than twice a year.

In addition to the rebalancing process described above, the Endowment should be rebalanced whenever an exposure is meaningfully overweight or underweight its target range (typically when extreme market circumstances may create significant dislocations

in actual allocation from target ranges). Between meetings of the Committee, should the exposure for any asset class reach a level of 5% or greater beyond the upper or lower 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 develop a plan to rebalance asset allocation back within target ranges. Such an allocation plan's timing will depend to some extent on the asset classes involved (for instance, rebalancing hedge funds would inherently take more time than rebalancing U.S. equities given vehicle/liquidity constraints). In such instances, the Treasurer and Investment Consultant will then communicate the rebalancing plan to the chair of the Endowment Management Committee and the Executive Vice Chancellor. Subsequent to this communication, the rebalancing plan will be executed as expeditiously as possible relative to market conditions and liquidity considerations. Any rebalancing actions taken by the Treasurer and Investment Consultant 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.

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, and if applicable monthly, 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

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.

PROXY VOTING

The University of Houston System has delegated proxy voting responsibility for separately managed accounts to its investment managers. Such separate account managers are to vote proxies in such a way as to maximize the value of related shares and in a manner consistent with the best interests of the University. It is noted in the case of commingled vehicles, voting rights on underlying company shares do not flow through to the System.

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 Executive 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 substantive modifications are made, they shall be promptly communicated to responsible parties.

UNIVERSITY OF HOUSTON SYSTEM ENDOWMENT FUND
STATEMENT OF INVESTMENT OBJECTIVES AND POLICIES
Approved by the Board of Regents February 15, 2012

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. Pursuant to Board Bylaw, the Endowment Management Committee has been established as a standing committee to assist the Board in fulfilling its fiduciary responsibilities.

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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

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UNIVERSITY ADVANCEMENT ASSESSMENT

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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:

	Long-Term Target	Range
Risk Controlling Assets	37.5%	30 to 50%
Deflation Protection (high quality bonds)	15%	10 to 30%
Inflation Protection (real assets)	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	12.5%	7.5 to 17.5%

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.

Cash	0%	0 to 10%
Drivers of Return	62.5%	50 to 70%
Domestic Mid to Large Cap Equities	17.5%	12.5 to 30%
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 (international equity)	15%	10 to 30%
Emerging Market Equities	5%	2.5 to 7.5%
Long/Short Equity (hedged equity)	12.5%	7.5 to 17.5%
Non Marketable Equity (private equity)	10%	0 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.

Alternative Investment Risks

For the purposes of this section, "alternative investments" refers to investments in long/short equity, absolute return, private equity, private real estate and venture capital, as well as other investments employing leverage, short sales, or illiquid investment vehicles. The investments are made in the Endowment in order to improve diversification, reduce overall volatility, and enhance return, However, the Endowment Management Committee recognizes that these investments also present additional risks beyond those posed by investments in traditional marketable securities such as stocks and bonds. Among these risks are:

1. *Liquidity Risk:* most alternative investments impose restrictions on redemptions or require multi-year locks.

    a. This risk is mitigated by imposing restrictions on the amount of the Endowment that may be allocated to alternative investments as detailed

above. In addition, the Endowment Management Committee will review at least annually the level of portfolio liquidity across all asset classes in order to ensure that there is sufficient liquidity to meet all obligations.

2. *Non-regulation risk:* Historically, alternative managers have been exempt from registration with the SEC, which has allowed them to employ strategies (such as short sales and use of leverage) forbidden by most traditional investment managers, as well as to avoid disclosing specific details of their investment practices or portfolio holdings.

    a. With the passage of the Dodd-Frank Act of 2010, almost all alternative investment managers will be required to register with the SEC under the Investment Advisers Act of 1940. This Act will require registered managers to file documents with the SEC and for public record describing the nature of the business, fees charged, types of clients, and details on compliance policies. It will also provide to investors a greater level of detail into portfolio strategy and investment.

    b. Venture capital managers will, however, remain exempt from the Investment Advisers Act and will therefore remain unregistered with the SEC.

        i. This risk will be mitigated by performing detailed due diligence on these managers and monitoring them regularly as described below, as well as by diversifying manager risk through multiple direct and fund-of-fund investments.

3. *Transparency Risk:* alternative managers are not required to disclose portfolio holding details to the same extent that traditional marketable managers are, and are often reluctant to do so in order to preserve their perceived advantage over other investors.

    a. This risk will be mitigated somewhat by the Dodd-Frank Act and the increased transparency provided by the requirement to file Form ADV with the SEC. Beyond that, however, the Endowment Management Committee, staff, and any outside advisors shall emphasize those managers who will provide at least the following level of detail into their investment portfolios:

        i. Number of short and long positions

        ii. The use of leverage

        iii. Net market exposure

4. *Investment Strategy Risk:* alternatives often employ sophisticated and potentially riskier strategies, and may use leverage.

a. This risk will be mitigated by intensive due diligence and monitoring of potential alternative managers described below. An emphasis will be placed on those managers who have extensive experience in employing these strategies, a demonstrated ability to consistently employ them effectively, and an established track record of superior performance.

5. *Foreign Currency Risk:* changes in exchange rates could adversely affect fair value of the Endowment Fund.

    a. The Endowment Management Committee recognizes that exposure to foreign currency acts as a hedge against a declining or collapsing dollar. In this way, such investments help to reduce risk in the portfolio. However, the Committee will review the level of exposure to foreign currencies periodically in order to ensure that there are no unintended risks in the portfolio.

The following principles shall guide the selection of alternative investment managers:

- Diversify across managers to mitigate systematic and organizational risk, but avoid over-diversification.
- Diversify by strategy and geography to decrease correlations within the program.
- Emphasize qualitative evaluation of managers, as a manager's quantitative characteristics may change over time and in different market conditions.
- Discourage the use of significant leverage, and emphasize managers with a demonstrated skill in generating returns on assets as opposed to returns on equity.
- Avoid strategies that are trading oriented, highly complex, or quantitatively driven.

In addition, the investment manager due diligence process shall include the following functions, to be performed by some combination of outside consultants/advisors and internal staff:

- Background checks
    - Reference checks
    - News searches
    - Industry consultation
- Review of vendor relationships
    - Prime brokers
    - Auditors
    - Fund administrators
    - Legal counsel
- Operational review
    - On site visits
    - Procedural
    - Organizational

Monitoring of the overall program-level and manager-level exposures and investment results shall be administered in accordance with the following schedule by some combination of outside consultants/advisors and internal staff:

Monthly (For Long/Short Equity and Absolute Return Managers)

- Reports of performance and asset allocation.
- Proactive contact with investment managers whose performance falls outside of the expected range.

Quarterly or Semi-Annually

- Calls with investment managers.
- For long/short equity and absolute return managers, detailed performance reports and analysis providing information such as top long positions, net and gross exposures, exposure by strategy and geography, and organizational changes.

Annually

- On site meetings with managers and attendance at annual meetings.

The Endowment Management Committee reviews and recommends to the Board the above asset allocation long-term 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

The Committee recognizes the importance of periodically rebalancing the Endowment's asset allocation, namely to ensure that variation in returns among assets do not create outsized deviations from target allocations that cause Endowment performance to diverge from expected policy performance. To the extent possible, the Endowment will utilize naturally occurring cash movement opportunities to rebalance the Endowment portfolio. Such naturally occurring opportunities include:

- The sourcing of cash for spending needs (withdrawals)
- The infusion of cash (contributions) into the existing portfolio
- Manager changes (partial or complete subscriptions or redemptions)
- Other cash transactions (i.e., dividends, interest income, return on capital, etc.)

The Treasurer and Investment Consultant (if any) will monitor asset allocation and propose investment rebalancing recommendations (including a recommendation of no action if no rebalancing is needed) no less frequently than twice a year.

In addition to the rebalancing process described above, the Endowment should be rebalanced whenever an exposure is meaningfully overweight or underweight its target range (typically when extreme market circumstances may create significant dislocations in actual allocation from target ranges). Between meetings of the Committee, should the exposure for any asset class reach a level of 5% or greater beyond the upper or lower 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 develop a plan to rebalance asset allocation back within target ranges. Such an allocation plan's timing will depend to some extent on the

asset classes involved (for instance, rebalancing hedge funds would inherently take more time than rebalancing U.S. equities given vehicle/liquidity constraints). In such instances, the Treasurer and Investment Consultant will then communicate the rebalancing plan to the chair of the Endowment Management Committee and the Executive Vice Chancellor. Subsequent to this communication, the rebalancing plan will be executed as expeditiously as possible relative to market conditions and liquidity considerations. Any rebalancing actions taken by the Treasurer and Investment Consultant 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.

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, and if applicable monthly, 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

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.

PROXY VOTING

The University of Houston System has delegated proxy voting responsibility for separately managed accounts to its investment managers. Such separate account managers are to vote proxies in such a way as to maximize the value of related shares and in a manner consistent with the best interests of the University. It is noted in the case of commingled vehicles, voting rights on underlying company shares do not flow through to the System.

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 Executive 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 substantive modifications are made, they shall be promptly communicated to responsible parties.

UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA

COMMITTEE: Endowment Management

ITEM: Annual review and approval of the UH System Investment Policy for Non-Endowed Funds

DATE PREVIOUSLY SUBMITTED: Last reviewed and approved on February 15, 2011

SUMMARY:
In accordance with section IX of the UH System Investment Policy for Non-Endowed Funds, the Endowment Management Committee shall review this policy at least once a year. There are no recommended changes to the policy.

SUPPORTING DOCUMENTATION: Redlined and clean copy of UH System Investment Policy for Non-Endowed Funds

FISCAL NOTE:

RECOMMENDATION/ ACTION REQUESTED: Administration recommends approval of this item.

COMPONENT: University of Houston System

EXECUTIVE VICE CHANCELLOR Carl Carlucci **DATE** 1/27/2012

CHANCELLOR Renu Khator **DATE** 1/31/12

UNIVERSITY OF HOUSTON SYSTEM
INVESTMENT POLICY FOR NON-ENDOWED FUNDS
Approved by the Board of Regents February 16, 2011
Reaffirmed by the Endowment Management Committee – February 14, 2012

I. INVESTMENT AUTHORITY AND SCOPE OF POLICY

A. 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.

B. 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 Endowment Management Committee 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

A. 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.

B. 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.

C. 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.

D. 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.

E. Investment Managers

Hiring of investment managers requires Endowment Management Committee approval except, when on the recommendation of the committee staff and the investment consultant, the chair of the Endowment Management Committee and the chair of the Finance and Administration Committee jointly determine that time is of the essence and immediate action in lieu of a called committee meeting is necessary to hire or terminate an investment manager, the recommended change can then be made. The chair of the Endowment Management Committee will have the staff immediately report any such action taken to the members of the Endowment Management Committee and the Chairman of the Board of Regents after such action is taken.

F. Asset Allocation

The non-endowed funds will be allocated into two 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. 50% 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. 50% 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 pool will be the BofA ML 1-5 Yr Govt/Corp Index and the BofA ML 1-5 Yr Govt/Corp Index AA and above.

A customized Total Portfolio Benchmark will be employed to measure the overall performance of the portfolio. This benchmark will blend the returns of the two 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	50%	40% to 100%
Liquidity Pool	50%	0% to 60%

G. Rebalancing

Given the substantial difference in expected return among these two pools, and the regular use of funds from the cash pool for operational purposes, these pools may need to be rebalanced occasionally. 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.

H. 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. AUTHORIZED INVESTMENT TYPES

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

A. Obligations of the United States or its agencies and instrumentalities;

B. Direct obligations of this state or its agencies or instrumentalities;

C. 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;

D. 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

E. 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.

F. 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, but excluding those mortgage backed

securities of the nature described as Prohibited Investment Instruments in this policy; or

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

G. 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 the 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.

H. 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.

I. 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.

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

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

   a. is registered with and regulated by the Securities and Exchange Commission;

   b. has a dollar-weighted average stated maturity of 90 days or fewer; and

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

2. A no-load mutual fund is authorized if it:

   a. is registered with the Securities and Exchange Commission;

   b. is Securities and Exchange Commission 2a-7 compliant;

   c. has an average weighted maturity of less than two years;

   d. is invested exclusively in obligations approved by this policy; and

   e. is continuously rated as to investment quality by the two nationally recognized statistical rating organizations that rate our debt of not less than AAA or its equivalent.

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.

K. 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.

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

M. 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 .

N. 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.

O. Any other investment types, other than prohibited investment instruments, not listed above as approved by the Endowment Management Committee.

IV. RISK CONTROL AND INVESTMENT LIMITS

In the interest of risk control and diversification, the following limits will be placed on allocation among allowable investments within the liquidity pool:

A. Types of issues permitted	Restrictions
(1) U.S. Government	No Limit
(2) Federal Agencies	20% per Agency (GNMA collateralized mortgages issued by FNMA or FHLMC count under U.S. Government limit)
(3) Municipal Obligations	5 % per issuer 30 % aggregate limit Rated A/A and above by S & P and Moody's (There is a 50% aggregate limit for corporate bonds and taxable municipal obligations.)
(4) Corporate Bonds	5% per issuer Rated AA and above by S&P or Moody's 25% per economic sector (There is a 50% aggregate limit for corporate bonds and taxable municipal obligations.)
(5) Mortgage Securities	30% aggregate limit Final maturity 10 years or less Average life less than 5 years
(6) SEC Registered Money Market Funds	
(7) Commercial Paper (under 270 day maturities)	5 % per issuer Rated A-1 / P-1 25 % limit per economic sector

B. Maturity Restrictions

Final Maturity	Percentage of Portfolio
Less than 1 year	0% to 100%
1 to 2 years	0% to 100%
2 to 5 years	0% to 75%

V. Prohibited Investment Instruments

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

A. Obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal

B. Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;

C. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years;

D. Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index; and

E. Any other security prohibited by the laws of the State of Texas. The Treasurer will inform investment managers of any such prohibitions on an ongoing basis.

VI. INVESTMENT RESPONSIBILITY AND CONTROL

A. 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, or their subsidiaries, domiciled in Texas that are insured by the FDIC;
3. Public funds investment pools;
4. Government securities brokers and dealers; or
5. Investment management firms registered under the Investment Advisers Act of 1940.

B. 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.

C. 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.

D. 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.

VII. INVESTMENT REPORTING AND PERFORMANCE EVALUATION

Not less than quarterly, the System shall submit to the Endowment Management Committee 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.

VIII. INVESTMENT COLLATERAL AND SAFEKEEPING

A. 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; or
2. Obligations of the United States or its agencies and instrumentalities.

B. 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.

C. Securities Lending

Securities owned by the System and held in custody by the System's custodian may only be lent to other parties through a contract between the System and the custodian pursuant to a written agreement approved by the Board of Regents. Neither custodians nor investment managers may enter into securities lending agreements without the consent of the Board of Regents. The System recognizes, however, that, for those investments placed in mutual funds, the Board cannot dictate whether or not the fund will engage in securities lending. Therefore, the System and its investment consultant (if any) shall make every effort either to avoid mutual funds that participate in securities lending, or to otherwise limit investment to those managers who will not engage in securities lending.

IX. 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 substantive modifications are made, they shall be promptly communicated to responsible parties.

UNIVERSITY OF HOUSTON SYSTEM
INVESTMENT POLICY FOR NON-ENDOWED FUNDS
Approved by the Board of Regents February 16, 2011
Reaffirmed by the Endowment Management Committee – February 14, 2012

I. INVESTMENT AUTHORITY AND SCOPE OF POLICY

A. 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.

B. 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 Endowment Management Committee 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

A. 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.

B. 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.

C. 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.

D. 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.

E. Investment Managers

Hiring of investment managers requires Endowment Management Committee approval except, when on the recommendation of the committee staff and the investment consultant, the chair of the Endowment Management Committee and the chair of the Finance and Administration Committee jointly determine that time is of the essence and immediate action in lieu of a called committee meeting is necessary to hire or terminate an investment manager, the recommended change can then be made. The chair of the Endowment Management Committee will have the staff immediately report any such action taken to the members of the Endowment Management Committee and the Chairman of the Board of Regents after such action is taken.

F. Asset Allocation

The non-endowed funds will be allocated into two 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. 50% 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. 50% 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 pool will be the BofA ML 1-5 Yr Govt/Corp Index and the BofA ML 1-5 Yr Govt/Corp Index AA and above.

A customized Total Portfolio Benchmark will be employed to measure the overall performance of the portfolio. This benchmark will blend the returns of the two 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	50%	40% to 100%
Liquidity Pool	50%	0% to 60%

G. Rebalancing

Given the substantial difference in expected return among these two pools, and the regular use of funds from the cash pool for operational purposes, these pools may need to be rebalanced occasionally. 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.

H. 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. AUTHORIZED INVESTMENT TYPES

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

A. Obligations of the United States or its agencies and instrumentalities;

B. Direct obligations of this state or its agencies or instrumentalities;

C. 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;

D. 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

E. 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.

F. 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, but excluding those mortgage backed securities of the nature described as Prohibited Investment Instruments in this policy; or

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

G. 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 the 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.

H. 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.

I. 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.

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

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

   a. is registered with and regulated by the Securities and Exchange Commission;

   b. has a dollar-weighted average stated maturity of 90 days or fewer; and

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

2. A no-load mutual fund is authorized if it:

   a. is registered with the Securities and Exchange Commission;

   b. is Securities and Exchange Commission 2a-7 compliant;

   c. has an average weighted maturity of less than two years;

   d. is invested exclusively in obligations approved by this policy; and

   e. is continuously rated as to investment quality by the two nationally recognized statistical rating organizations that rate our debt of not less than AAA or its equivalent.

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.

K. 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.

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

M. 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 .

N. 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.

O. Any other investment types, other than prohibited investment instruments, not listed above as approved by the Endowment Management Committee.

IV. RISK CONTROL AND INVESTMENT LIMITS

In the interest of risk control and diversification, the following limits will be placed on allocation among allowable investments within the liquidity pool:

A. Types of issues permitted	Restrictions
(1) U.S. Government	No Limit
(2) Federal Agencies	20% per Agency (GNMA collateralized mortgages issued by FNMA or FHLMC count under U.S. Government limit)
(3) Municipal Obligations	5 % per issuer 30 % aggregate limit Rated A/A and above by S & P and Moody's (There is a 50% aggregate limit for corporate bonds and taxable municipal obligations.)
(4) Corporate Bonds	5% per issuer Rated AA and above by S&P or Moody's 25% per economic sector (There is a 50% aggregate limit for corporate bonds and taxable municipal obligations.)
(5) Mortgage Securities	30% aggregate limit Final maturity 10 years or less Average life less than 5 years
(6) SEC Registered Money Market Funds	
(7) Commercial Paper (under 270 day maturities)	5 % per issuer Rated A-1 / P-1 25 % limit per economic sector

B. Maturity Restrictions

Final Maturity	Percentage of Portfolio
Less than 1 year	0% to 100%
1 to 2 years	0% to 100%
2 to 5 years	0% to 75%

V. Prohibited Investment Instruments

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

A. Obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal

B. Obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;

C. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years;

D. Collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index; and

E. Any other security prohibited by the laws of the State of Texas. The Treasurer will inform investment managers of any such prohibitions on an ongoing basis.

VI. INVESTMENT RESPONSIBILITY AND CONTROL

A. 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, or their subsidiaries, domiciled in Texas that are insured by the FDIC;
3. Public funds investment pools;
4. Government securities brokers and dealers; or
5. Investment management firms registered under the Investment Advisers Act of 1940.

B. 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.

C. 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.

D. **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.

VII. INVESTMENT REPORTING AND PERFORMANCE EVALUATION

Not less than quarterly, the System shall submit to the Endowment Management Committee 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.

VIII. INVESTMENT COLLATERAL AND SAFEKEEPING

A. **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; or
2. Obligations of the United States or its agencies and instrumentalities.

B. **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.

C. Securities Lending

Securities owned by the System and held in custody by the System's custodian may only be lent to other parties through a contract between the System and the custodian pursuant to a written agreement approved by the Board of Regents. Neither custodians nor investment managers may enter into securities lending agreements without the consent of the Board of Regents. The System recognizes, however, that, for those investments placed in mutual funds, the Board cannot dictate whether or not the fund will engage in securities lending. Therefore, the System and its investment consultant (if any) shall make every effort either to avoid mutual funds that participate in securities lending, or to otherwise limit investment to those managers who will not engage in securities lending.

IX. 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 substantive modifications are made, they shall be promptly communicated to responsible parties.

UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS AGENDA

COMMITTEE: Endowment Management

ITEM: Approval is requested to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of an investment manager for the University of Houston System Endowment Fund.

DATE PREVIOUSLY SUBMITTED:

SUMMARY:
Approval is requested to delegate authority to the Chancellor to negotiate and execute a contract for the hiring of an investment manager for the University of Houston System Endowment Fund. The Committee will receive a report from the System's investment consultant, Cambridge Associates, regarding their recommendation to invest in the third of this private equity fund of funds manager's private equity funds. The fund is expected to invest across Asia in growth capital (30-50%), venture capital (25-40%), and buyout (20-40%) focused private equity funds. Co-investments and secondaries may comprise up to 20% of the Fund. By geography, the Fund will be weighted toward managers investing in Mainland China (40-60%), India (15-25%), and Southeast Asia (5-15%), followed by those in Australia (5-10%), Japan (5-10%), South Korea (0-5%), Hong Kong/Taiwan (5-10%), and elsewhere in the region (0-5%).

SUPPORTING DOCUMENTATION: Details of the fund and the investment team are included in the Cambridge Associates discussion materials book (pages 77-81).

FISCAL NOTE: $4 million initial commitment. Management fee 1% per year during investment period; 5% carried interest with an 8% preferred return.

RECOMMENDATION/ ACTION REQUESTED: Administration recommends approval of this item.

COMPONENT: University of Houston System

EXECUTIVE VICE CHANCELLOR Carl Carlucci **DATE** 1/27/2012

CHANCELLOR Renu Khator **DATE** 1/31/12