

MINUTES
UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS
ENDOWMENT MANAGEMENT COMMITTEE

February 9, 2010

The Chair of the Committee, Jarvis V. Hollingsworth, convened the Endowment Management Committee of the University of Houston System Board of Regents at the University of Houston, in the Athletics/Alumni Center, Melcher Board Room 100B, 3100 Cullen Boulevard, Houston, Texas on Tuesday, February 9, 2010 at 2:07 p.m. The following committee members were in attendance: Jarvis V. Hollingsworth, Chair; Carroll Robertson Ray, Vice Chair; Welcome W. Wilson, Sr., Ex Officio; Michael J. Cemo and J. Christopher Jones, Advisory Members. Regent Jim P. Wise was unable to attend the meeting.

Regent Hollingsworth opened the meeting and then turned it over to Dr. Carl Carlucci, Executive Vice Chancellor for Administration and Finance. Dr. Carlucci stated the committee would hear a status report and recommendations regarding endowed and non-endowed assets from Mr. Hamilton Lee and Mr. Jeff Blazek, consultants from Cambridge Associates. This agenda represented the results of a long deliberation, said Dr. Carlucci. The committee had decided over the last couple of years to change the way it had been doing business: (1) it brought on Cambridge Associates; (2) it changed the asset allocation; and (3) at this committee meeting it would consider a series of additional changes that would be based on the committee's concerns for timeliness of the process. Dr. Carlucci then turned the meeting over to Mr. Hamilton Lee for his report.

Mr. Lee introduced two new members of his team: Philip Fiske and Mark Dalton. A new reporting format to the committee was introduced. This new format will help guide the discussion on investment topics, as well as provide streamlined structure to the overall investment plan for the coming months and years.

Numerous issues were addressed by Mr. Lee as he gave an overview of the new layout of the discussion materials: (1) Executive Summary; (2) Market Commentary; (3) Performance; (4) U.S. Equity Manager Structure; (5) Manager Recommendations; (6) Sourcing Cash; (7) Work Plan 2010; (8) Investment Chronology; (9) Manager Watch List; and (10) Appendix.

Mr. Lee gave a manager update concerning the watch list. Mr. Hollingsworth asked if criteria had been put in place for the consultants whereby the board and Cambridge Associates develop a process to keep each other informed in this regard. Mr. Lee stated that criteria was previously approved by the Committee. Mr. Lee stated that this information would be included, along with the watch list, in the discussion materials at each committee meeting.

Asset allocation as of the end of the year was closely aligned with interim targets. Total assets for the quarter-to-date were up 3.1% and for the year ending December 31, 2009, the Endowment posted a 20.2% return, with solid performance in excess of Benchmarks A and B by +450bps and +140 bps, respectively. Regent Hollingsworth made a recommendation to add a

column to the summary page which would address the actual asset size/dollar amount to each asset class for further clarification. The committee concurred with this recommendation. Mr. Jeff Blazek, Cambridge Associate, gave an equities market update and performance review. S&P 500 was up 6% in the 4th quarter ending 12/31/09 and 26.5% for 2009. International equities, particularly for the full year, were significant outperformers. Treasuries were down -3.6% but corporate bonds were up 18.7%. Unfortunately, 2009 was not nearly as historical as 2008, said Mr. Blazek, and to put it into context, even with the high 20% gain in the stock market, it was only the best return we have seen since 2003. In 2008, there was a 39% decline in the stock market which was the worst decline since the Great Depression; and U.S. stocks' annualized returns by decade was the worst performance in history. Lower quality names outperformed larger quality names making it a difficult time for investment managers.

Mr. Blazek reviewed the different types of potential manager structures, a spectrum that spans from complete passive indexing to exclusive use of satellite managers. These suggestions set the stage for recommendations to completely revamp the Endowment's U.S. equity manager structure.

Small cap funds outperformed large cap; the Endowment's international equity funds performed the best with international managers up 35% for the year vs. 32% for the MSCI EAFE Index, said Mr. Lee. Cambridge Associates recommended the termination of Smith Asset Management. This will also facilitate a review of the broader U.S. equity portfolio. Cambridge advocated the use of a more streamlined and risk-efficient manager structure. This would also allow more resources and time to be directed toward building the direct marketable alternatives program (with higher alpha potential).

Mr. Mark Dalton was introduced to the committee. Mr. Dalton is a Senior Investment Consultant and a Hedge Fund Specialist in Cambridge Associates. Mr. Dalton introduced his associate, Mr. Gene Lohmeyer, who is an Investment Consultant and Hedge Fund Specialist with Cambridge Associates. These two gentlemen will be, focused on our Hedge Fund Program. The Hedge Fund Investment Philosophy will be to:

- Diversity systematic and organizational risk by using a variety of strategies and managers, but avoid over-diversification;
- Emphasize qualitative evaluation of managers;
- Discourage the use of significant financial leverage; and
- Avoid strategies that are trading oriented, highly complex or quantitatively driven.

Mr. Dalton stated the structure of the existing Hedge Fund Program would change. They would build the program to include between 15-20 managers which will provide proper diversification between strategy, style and geography. The University of Houston System currently has \$100 million in hedge funds with some in direct fund investments. Moving forward, Mr. Dalton recommended a proposed \$100 million Hedge Fund Program that would have 15-20 direct investments. Regent Ray asked whether the liquidity and fee structure would change. Mr. Dalton stated the average fees would roughly be 1½ % management fee and 20% incentive.

Mr. Philip Fiske was introduced to the committee. He is a Managing Director and Specialist Consultant with Cambridge Associated in the Boston office. Mr. Fiske discussed venture and

private equity. Private equity has historically outperformed public equities in slow economic environments. It takes a long time to build a private equity fund, typically five – seven years, said Mr. Fiske. The three areas from a timing perspective that are particularly attractive in today's market are: (1) secondaries; (2) distressed for control players; and (3) lower middle market of private equity.

After the discussion with Cambridge Associates, Regent Hollingsworth turned the meeting over to Dr. Carlucci, who introduced the following four items from the agenda, Approval to modify Board of Regents Bylaws Section 5 (Committee to the Board); Approval to modify Board of Regents Policies 55.01.1(D); 55.01.1(E); and 55.01.1(F); Approval to modify the UH System Endowment Fund Statement of Investment Objectives and Policies; and the Approval to modify the UH System Investment Policy for Non-Endowed Funds. These changes would represent the areas of implementation for the Endowment Management Committee. The four major areas addressed were: (1) Asset Allocation; (2) Hiring Managers; (3) Terminating Managers; and (4) Rebalance Assets within Existing Managers and Asset Classes.

1. Approval was requested to modify Board of Regents Bylaws Section 5.2.1 and 5.4 and add a new Section 5.7, and renumber 5.7 and 5.8.
 - (a) The revision to 5.2.1 adds the Endowment Management Committee as a standing committee of the Board;
 - (b) The revision to Section 5.4 deletes the oversight responsibility for investment policies and performance from the Finance and Administration Committee; and
 - (c) A new Section 5.7 was added that defines the oversight responsibilities of the Endowment Management Committee including responsibility for investment policies and performance. The following change to the proposed charge of the Endowment Management Committee was proposed below. The verbiage in bold italics was deleted from the charge.

5.7 – Endowment Management Committee – The endowment management committee has oversight of all investment assets and activities, outside investment managers, investment consultants, and any other matters pertaining to endowed and non-endowed assets for the System. It also provides oversight of investment policies and performance. The chair of the Finance and Administration Committee shall be a member of this committee ***and if the same regent serves both positions, the vice chair of the Finance and Administration Committee will be a member.***

Regent Ray moved committee approval of the above action item with the recommended change to Section 5.7 as described above. Regent Wilson seconded the motion and the committee concurred. This item will be placed on the agenda for the February 16, 2010 Board of Regents meeting for final approval.

2. Approval was requested to modify Board of Regents policies 55.01.1(D); 55.01.1(E); and 55.01.1(F). These changes would exclude investment agreements from Board approval and the approval of investment agreements would be part of the Endowment Management Committee's responsibilities.

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Regent Ray moved committee approval of this action item as presented. Regent Wilson seconded the motion and the committee concurred. This item will be placed on the agenda for the February 16, 2010 Board of Regents meeting for final approval.

3. Approval was requested to modify the UH System Endowment Fund Statement of Investment Objectives and Policies to be consistent with changes to Section 5 of the Board bylaws and Section 55.01.1 of the Board policies. The Preface section was amended to include a statement that the Endowment Management Committee had been established as a standing committee to assist the Board in fulfilling its fiduciary responsibilities and this section lists the responsibilities of the Endowment Management Committee. The Investment Manager section of the Endowment Investment Policy was modified to be consistent with the changes to Board policy 55.01.1.
4. Approval was requested to modify the UH System Investment Policy for Non-Endowed Funds to be consistent with changes to Section 5 of the Board bylaws and Section 55.01.1 of the Board policies. The Investment Reporting and Performance Evaluation section of this investment policy had been changed to clarify that investment reporting and performance evaluation reports were provided to the Endowment Management Committee. There was also a change to the Review and Modification of Policy section that provides flexibility in determining when and to whom Board approved changes to this policy should be communicated.

Regent Ray moved that further review of these two Board policies be conducted and recommended this review be delegated to Ms. Dona Cornell, General Counsel, and Dr. Carl Carlucci, Executive Vice Chancellor, Administration and Finance, for final edits and when completed the recommended changes be placed on the Board agenda for the Board of Regents meeting scheduled on February 16, 2010 for final approval. Regent Wilson seconded the motion and the committee concurred.

The last action item for consideration by the committee was Item G, Approve the FY10 University Advancement Endowment Assessment Rate of 1.5%. Approval was requested to continue assessing the UH System Endowment at a rate of 1.5% for FY 2010 to fund the University Advancement fee. This represents the annual approval by the Board of this assessment.

Regent Ray moved committee approval of this item as presented. Regent Wilson seconded the motion and the committee concurred. This item will be placed on the Board agenda for the Board of Regents meeting on February 16, 2010 for final approval.

The last item on the agenda for information, Item H, FY10 Endowment Payout Rate, was not discussed.

There being no further business to come before the Committee, the meeting adjourned at 3:52 p.m.

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All documentation submitted to the Committee in support of the foregoing action items, including but not limited to “Passed” agenda items and supporting documentation presented to the Committee, is incorporated herein and made a part of these minutes for all purposes; however, this does not constitute a waiver of any privileges contained herein.

Others Present:

Carl Carlucci
John Antel
Dona Cornell
Grover Campbell
Mike Cemo
J. Christopher Jones
Gerry Mathisen

Hamilton Lee
Jeff Blazek
Mark Dalton
Philip Fiske
Terry Dike
Nzinga Tchameni

Eli Cipriano
Tom Ehardt
Joe Hernandez
Raymond Bartlett
Marquette Hobbs
Ed Jones