

MINUTES
UNIVERSITY OF HOUSTON SYSTEM
BOARD OF REGENTS
SPECIAL CALLED
ENDOWMENT MANAGEMENT COMMITTEE

February 16, 2010

The Vice Chair of the Committee, Carroll Robertson Ray, 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 16, 2010 at 8:15 a.m. The following committee members were in attendance: Jarvis V. Hollingsworth, Chair; Carroll Robertson Ray, Vice Chair; Jim P. Wise; Welcome W. Wilson, Sr., Ex Officio; J. Christopher Jones, Advisory Member. Mr. Michael J. Cemo, Advisory Member, was unable to attend. Regent Nandita V. Berry, Regent Nelda Luce Blair, and Regent Tilman J. Fertitta, attended the meeting as non-members of the committee.

Due to unforeseen circumstances in his arrival, the chair, Jarvis Hollingsworth asked the vice chair, Carroll Robertson Ray to call the meeting to order.

Regent Ray stated there were several approval items that would be presented to the committee and, if approved, would be presented to the board at the Board of Regents meeting scheduled later in the day.

Action Items:

1. Approval to modify the UH System Endowment Fund Statement of Investment Objectives and Policies – UH System;
2. Approval to modify the UH System Investment Policy for Non-Endowed Funds – UH System;
3. Report and Recommendations regarding Endowed and Non-Endowed Assets – UH System;
4. Approval is requested for delegation of authority to the Chancellor to negotiate and execute contracts associated with the hiring of one or more investment managers for the University of Houston System Endowment – UH System.

Regent Ray called on Dr. Carlucci, Executive Vice Chancellor for Administration and Finance to introduce these items.

Dr. Carlucci stated that at the Endowment Management Committee meeting held on Tuesday, February 9, 2010, the committee approved the modification of the changes to section 5 of the Board Bylaws and section 55.01.01 of the Board policies. Dr. Carlucci requested approval to modify the UH System Fund Statement of Investment Objectives and Policies and the approval to modify the UH System Investment Policy for Non-Endowed Funds to be consistent with these changes. These modifications delegate to the committee the ability to hire and fire managers. It also makes the provision for the Committee chair, with consultation by the Finance and

Administration Committee chair, when they 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. In addition, the last paragraph of the Asset Selection and Allocation section of the UH System Endowment Fund Statement of Investment Objectives and Policies has been changed to be consistent with the committee's responsibilities outlined in the Preface section. Other changes to this endowment policy were also noted, but were administrative in nature.

Regent Ray called for a motion of the first two action items as introduced. Regent Wise moved approval of these items as presented. Regent Wilson seconded the motion and the committee members concurred. These items will be brought forward for final board approval at the Board of Regents meeting later today.

Dr. Carlucci called on Hamilton Lee and Jeff Blazek, both with Cambridge Associates, to give their report and recommendations regarding endowed and non-endowed assets.

Mr. Lee addressed the potential manager structures from 100% passive indexing (low risk/low tracking error) to "The Doughnut" All Satellites (high risk/high tracking error).

The Complementary structure is index or active products based on style and capitalization and forms the building blocks of a diversified manager structure. The Complementary structure is the easiest approach to understand, implement, and monitor; management fees and other expenses are typically lower than for more active, satellite approaches; and since managers are typically more benchmark aware, and hence exhibit reduced tracking error, this approach helps protect against the behavioral mistake of buying high and selling low.

The Core/Satellite structure forms the foundation of a program that seeks both alpha and smoothing of returns through a constellation of satellite managers, while lowering fees and tracking error. Depending on the nature of the satellite managers and the size of the core, or indexed manager, there are typically four to eight satellites depending on the desired exposures; and sizing depends on conviction in the manager and tracking error tolerance. The core provides low-cost beta exposure and allows the institution to tailor its active risk exposure; the addition of weakly correlated active managers to a benchmark around the core tends to reduce total portfolio volatility; one avoids the muddy middle ground of high fees and index-like performance offered by many more diversified "active" managers; the selection of satellites, potentially including more focused index products, allows the client to express tactical views; and the core can serve as a ready source of liquidity to fund cash needs. Mr. Lee stressed that most top managers, from time to time, suffer periods of underperformance.

Mr. Blazek addressed the two manager structure recommendations with the committee. The two proposals discussed were: (1) the Complementary Structure and (2) the Core/Satellite Structure.

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Mr. Blazek reviewed the current University of Houston structure. Cambridge Associates believes a more streamlined and risk efficient structure is possible, which could then free up valuable time to orient towards areas of the portfolio where active management may have a greater impact on returns. We currently have seven managers under the current domestic equity structure. Smith Asset Management is currently listed in this group and Cambridge Associates has recommended their termination. If the committee approves the new structure, the remaining managers would be reviewed to see if they fit into the new proposed structure.

The Proposed Option 1: Complementary Structure was presented to the committee. Mr. Blazek said this was 100% active management. In this structure, there would be one growth large-cap manager, Jennison, and one value large-cap manager, Robeco (Boston Partners), both weighted at 45%. They are diversified companies holding 75-80 names, aware of the benchmarks, and complement each other well. They would be awarded \$45 million each. Cambridge also recommended Hoover and Luther King as the small cap managers in this proposed option.

Proposed Option 2: Core/Satellite Structure was addressed. Mr. Blazek stated that this structure funds three focused, concentrated large-cap managers that complement each other in differing market regimes, while investing 45% in a passive core index product. The resulting portfolio should result in lower risk (tracking error) than either our current structure or the complementary structure. State Street Russell 1000 Index would be the index product holding 45%. The satellite managers would be Mayo, a large-cap opportunistic manager; Columbia, a large-cap, concentrated growth manager, and ICAP, a value, concentrated manager would hold 15% each, with Luther King, a small cap, strong core manager holding the remaining 10%.

Mr. Blazek gave a report which highlighted the historical comparison analysis of the University of Houston manager structures: Current Structure, Complementary Structure, and Core/Satellite Structure ending December 31, 2009.

The Core/Satellite Structure was the proposed option recommended by Cambridge Associates. Mr. Blazek stated if the committee were to approve this recommendation, the transition would include taking approximately \$16 million from the endowment to meet the FY09 payout requirement; these funds coming from domestic equities, international equities, and cash. It would also include the termination of Fayez Sarofim, Smith Asset Management, Wellington U.S. Research Equity, Robeco-Boston Partners, Dodge & Cox, and Hoover Investment Management.

After hearing the recommendations from Cambridge Associates, Dr. Carlucci reiterated the committee would need to authorize the termination of six managers, hire four managers, rebalance, add to one, reduce two, and transfer \$5 million back into cash.

Regent Hollingsworth asked for a motion to adopt the Core/Satellite strategy as proposed by Cambridge Associates. Regent Wise moved the committee adopt this strategy. Regent Ray seconded the motion and the committee members concurred. The Core/Satellite strategy was approved by the committee.

Chairman Wilson asked Dr. Carlucci to investigate the difference between assets and net assets. Dr. Carlucci stated he would confirm with the Coordinating Board whether total assets include the endowed and non-endowed assets and are used as the National Standard by the Coordinating Endowment Management Committee Meeting
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Board. Regent Hollingsworth also stated the need to confirm that the Quasi Endowment Funds are included in the Endowment Funds.

A complete copy of the Cambridge Associates presentation has been filed in the Board office.

There being no further business to come before the Committee, the meeting adjourned at 8:57 a.m.

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:

Renu Khator
Carl Carlucci
John Antel
Dona Cornell
Grover Campbell
Elwyn Lee
Michael Rierson
Mike Cemo
J. Christopher Jones
William Flores
Bill Staples
Don Guyton
Wayne Beran
David Bell
Jeannie Kever
Ed Jones
Gerry Mathisen

Calvin W. Stephens
Dennis D. Golden
Hamilton Lee
Jeff Blazek
Monica McHenry
Barbara Stanley
Diane Murphy
Ed Hugetz
James Anderson
Michelle Dotter
Willie Munson
Don Bates
Richard Alderman
Claude Jacobs
Russell Lyman
Jon Aldrich

Raymond Bartlett
Elaine Charlson
David Bradley
Michelle Moosally
Dan Wells
Oscar Gutierrez
Tom Ehardt
Ed Apodaca
Katherine Peek
Carl Stockton
Mike Emery
Richard Bonnin
Randy Vivian
Daniel Arp
Dineta Frazier
Marquette Hobbs

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