

COMMITTEE ON INVESTMENTS
September 16, 2010

TO THE REGENTS OF THE UNIVERSITY OF CALIFORNIA

1. ADOPTION OF EXPENDITURE RATE FOR TOTAL RETURN INVESTMENT POOL

The Committee recommends that the expenditure rate (payout rate) for the Total Return Investment Pool for the fiscal year 2010-11 be set at a maximum of six percent.

2. AMENDMENT OF UNIVERSITY OF CALIFORNIA RETIREMENT PLAN AND GENERAL ENDOWMENT POOL POLICIES FOR OPPORTUNISTIC ASSETS

The Committee recommends to the Regents that Regents Policy 6101: Investment Policy Statement for University of California Retirement Plan (UCRP) and Regents Policy 6102: Investment Policy Statement for General Endowment Pool (GEP) be amended as shown in Attachments 1 and 2.

**UNIVERSITY OF CALIFORNIA RETIREMENT PLAN
INVESTMENT POLICY STATEMENT**

APPENDIX 1Effective: ~~April 1, 2010~~ October 1, 2010Replaces Version Effective: April 1, 2010 ~~June 1, 2009~~

**ASSET ALLOCATION,
PERFORMANCE BENCHMARKS,
AND REBALANCING POLICY**

Based on the risk budget for the Retirement Fund, the Committee has adopted the following asset allocation policy, including asset class weights and ranges, benchmarks for each asset class, and the benchmark for the total Retirement Fund.

Criteria for including an asset class in the strategic policy include:

- Widely recognized and accepted among institutional investors
- Has low correlation with other accepted asset classes
- Has a meaningful performance history
- Involves a unique set of investors.

The Current Policy Allocation recognizes the current underinvestment in illiquid asset classes (real estate, real assets) and the corresponding need to set rebalancing ranges around this effective policy allocation until such time as long-term policy weights in these classes are achieved. The allowable ranges for each asset class and in total have been chosen to be consistent with budgets and ranges for total and active risk (see [Appendix 2](#)).

A. Strategic Asset Allocation and Ranges

| | Long-Term Target Allocation | Current Policy Allocation | Allowable Ranges | |
|---------------------------|--|--|-------------------------|----------------|
| | | | Minimum | Maximum |
| U.S. Equity | 23% | 31% | 26 | 36 |
| Developed Non US Equity | 22 | 22 | 17 | 27 |
| Emerging Mkt Equity | 5 | 4 | 2 | 6 |
| Global Equity | 2 | 2 | 1 | 3 |
| US Fixed Income | 12 | 12 | 9 | 15 |
| High Yield Fixed Income | 2.5 | 2.5 | 1.5 | 3.5 |
| Emerging Mkt Fixed Income | 2.5 | 2.5 | 1.5 | 3.5 |
| TIPS | 8 | 8 | 6 | 10 |
| Absolute Return Strategy | 6.5 | 5 | 0 | 10 |
| Real Assets | 3 | 0.5 | 0 | 1.5 |
| Opportunistic | 0.5 | 0.5 | 0 | 1.5 |
| Private Equity | 6 | 6 | 3 | 9 |
| Real Estate | 7 | 4 | 1 | 7 |
| Liquidity | 0 | 0 | 0 | 10 |
| | 100% | 100% | | |
| Combined Public Equity | 52 | 59 | 49 | 69 |
| Combined Fixed Income | 25 | 25 | 20 | 30 |
| Combined Alternatives | 23 | 16 | 9 | 23 |

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B. Asset Class Performance Benchmarks

The Committee has adopted the following performance benchmarks for each asset class. Criteria for selection of a benchmark include:

- Unambiguous: the names and weights of securities comprising the benchmark are clearly delineated
- Investable: the option is to forego active management and simply replicate the benchmark
- Measurable: it is possible to readily calculate the benchmark's return on a reasonably frequent basis
- Appropriate: the benchmark is consistent with the Committee's investment preferences or biases
- Specified in Advance: the benchmark is constructed prior to the start of an evaluation period
- Reflects Current Investment Opinion: investment professionals in the asset class should have views on the assets in the benchmark and incorporate those views in their portfolio construction

| <u>Asset Class</u> | <u>Benchmark</u> |
|---------------------------|--|
| U.S. Equity | Russell 3000 Tobacco Free Index |
| Developed Non US Equity | MSCI World ex-US (Net Dividends) Tobacco Free |
| Emerging Mkt Equity | MSCI Emerging Market Free (Net Dividends) |
| Global Equity | MSCI All Country World Index Net – IMI – Tobacco Free |
| Fixed Income | Barclays Capital US Aggregate Index |
| High Yield Fixed Income | Merrill Lynch High Yield Cash Pay Index |
| Emg Mkt Fixed Income | 33% times JP Morgan Emerging Market Bond Index – Global Diversified, plus 67% times the JP Morgan Global Bond Index – Emerging Markets – Global Diversified |
| TIPS | Barclays Capital USTIPS Index |
| Absolute Return Strategy | 50% x HFRX Absolute Return Index + 50% HFRX Market Directional Index |
| Real Assets | Commodities: S&PGSCI Reduced Energy Index All Other: N/A (see below note 4) |
| <u>Opportunistic</u> | <u>See below note 5</u> |
| Private Equity | N/A (see below note 2) |
| Real Estate | <u>Public</u> : 50% times the FTSE EPRA NAREIT US Index plus 50% times the FTSE EPRA NAREIT Global ex-US Index <u>Private (core strategies)</u> : NCREIF Funds Index – Open end Diversified Core Equity, lagged 3 months <u>Private (non-core strategies)</u> : N/A (see below note 3) |

Notes on asset class benchmarks:

1. Global Equity: The Treasurer will determine what constitutes a tobacco company based on standard industry classification of the major index providers (e.g., Russell, MSCI) and communicate this list to investment managers annually and whenever changes occur.

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2. Private Equity: *Long-term* portfolio returns will be compared to investable public equity alternatives as well as non-investable peer group indices. There is no appropriate market benchmark to use for *short-term* performance evaluation or decision making.

3. Private Real Estate (non-core strategies only): similar to Private Equity

4. Real Assets (all strategies ex-commodities): similar to Private Equity

5. Opportunistic: By their nature, unique or limited opportunity investments are difficult to benchmark, and there will not be a “one size fits all” benchmark for this category. The Regents’ general investment consultant will establish the appropriate individual benchmark after the investment is chosen but before funding the investment. For any asset whose size at initial or subsequent purchase is greater than ½ of one percent of the total fund market value, the benchmark will be approved by the Chair of the Committee on Investments based on recommendation of the Regents’ general investment consultant.

C. Total Retirement Fund Performance Benchmark

This is the composition of the total Fund performance benchmark referred to in the Investment Policy Statement, Part 4(d). The percentages below add to 100%.

Percentage Benchmark

| | |
|-------------|---|
| 31% | × Russell 3000 Tobacco Free Index |
| 22% | × MSCI World ex-US (Net Dividends) Tobacco Free |
| 4% | × MSCI Emerging Market Free (Net Dividends) |
| 2% | × MSCI All Country World Index Net – IMI – Tobacco Free |
| 12% | × Barclays Capital US Aggregate Index |
| 2.5% | × Merrill Lynch High Yield Cash Pay Index |
| 2.5% | × 33% times JP Morgan Emerging Market Bond Index – Global Diversified, plus 67% times the JP Morgan Global Bond Index – Emerging Markets – Global Diversified |
| 8% | × Barclays Capital US TIPS Index |
| 5% | × 50% x HFRX Absolute Return Index + 50% HFRX Market Directional Index |
| 0.5% | × Aggregate Real Assets benchmark (see section B, with components weighted by their actual weights within the total real assets portfolio) |
| <u>0.5%</u> | <u>× Aggregate Opportunistic benchmark (see section B, with components weighted by their actual weights within the total opportunistic portfolio)</u> |
| 6% | × Actual return of private equity portfolio |
| 4% | × Aggregate Real Estate benchmark (see section B, with components weighted by their actual weights within the total real estate portfolio) |

Notes on total fund benchmark:

1. The benchmark for private equity is replaced by the private equity portfolio’s actual performance. This has the effect of neutralizing the active performance of this class for purposes of total fund performance evaluation. Similar comments apply to private real estate – non-core strategies (closed end funds) and Real Assets (all strategies ex commodities).

2. The calculation of the total fund benchmark will assume a monthly rebalancing methodology.

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3. In the event of a significant change in asset allocation, The Regents' generalist consultant may specify an alternative weighting scheme to be used during a transition period.

D. Rebalancing Policy

There will be periodic deviations in actual asset weights from the long-term/current policy asset weights specified above. Causes for periodic deviations are market movements, cash flows, and varying portfolio performance. Significant movements from the asset class policy weights will alter the intended expected return and risk of the Fund. Accordingly, the Investment Committee authorizes the Treasurer to rebalance the Fund when necessary to ensure adherence to the Investment Policy.

The Treasurer will monitor the actual asset allocation at least monthly. The Committee directs the Treasurer to take all actions necessary, within the requirement to act prudently, to rebalance assets to within the policy ranges in a timely and cost effective manner when actual weights are outside the prescribed ranges. The Treasurer may utilize derivative contracts (in accordance with Appendix 4) to rebalance the portfolio.

The Treasurer shall assess and manage the trade-off between the cost of rebalancing and the active risk associated with the deviation from policy asset weights. With approval from the Chair of the Committee, the Treasurer may delay a rebalancing program when the Treasurer believes the delay is in the best interest of the Plan. Results of rebalancing will be reported to the Committee at quarterly meetings.

**UNIVERSITY OF CALIFORNIA GENERAL ENDOWMENT POOL
INVESTMENT POLICY STATEMENT**

APPENDIX 1Effective: ~~April 1, 2010~~ [October 1, 2010](#)Replaces Version Effective: [April 1, 2010](#) ~~December 1, 2008~~

**ASSET ALLOCATION,
PERFORMANCE BENCHMARKS,
AND REBALANCING POLICY**

Based on the risk budget for the GEP, the Committee has adopted the following asset allocation policy, including asset class weights and ranges, benchmarks for each asset class, and the benchmark for the total GEP.

Criteria for including an asset class in the strategic policy include:

- Widely recognized and accepted among institutional investors
- Has low correlation with other accepted asset classes
- Has a meaningful performance history
- Involves a unique set of investors

The Current Policy Allocation recognizes the current under-investment in illiquid asset classes (real estate, real assets) and the corresponding need to set rebalancing ranges around this effective policy allocation until such time as long-term policy weights in these classes are achieved. The allowable ranges for each asset class and in total have been chosen to be consistent with budgets and ranges for total and active risk.

A. Strategic Asset Allocation and Ranges

| | Long-Term Target Allocation | Current Policy Allocation | <u>Allowable Ranges</u> | |
|---------------------------|--|--|--------------------------------|-----------------------|
| | | | <u>Minimum</u> | <u>Maximum</u> |
| U.S. Equity | 19% | 20% | 15 | 25 |
| Developed Non US Equity | 18 | 18.5 | 13.5 | 23.5 |
| Emerging Mkt Equity | 5 | 5 | 3 | 7 |
| Global Equity | 2 | 2 | 1 | 3 |
| US Fixed Income | 5 | 8 | 5 | 11 |
| High Yield Fixed Income | 2.5 | 3 | 2 | 4 |
| Emerging Mkt Fixed Income | 2.5 | 3 | 2 | 4 |
| TIPS | 2.5 | 4 | 2 | 6 |
| Absolute Return | 23.5 | 23.5 | 18.5 | 28.5 |
| Real Assets | 3.0 | 0.5 | 0 | 1.5 |
| Opportunistic | 0.5 | 0.5 | 0 | 1.5 |
| Private Equity | 9 | 7 | 4 | 10 |
| Real Estate | 7.5 | 5 | 2 | 8 |
| Liquidity | 0 | 0 | 0 | 10 |
| | 100% | 100% | | |
| Combined Public Equity | 44 | 45.5 | 35.5 | 55.5 |
| Combined Fixed Income | 12.5 | 18 | 13 | 23 |
| Combined Alternatives | 43.5 | 36.5 | 26.5 | 46.5 |

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INVESTMENT POLICY STATEMENT**

* Alternatives category including, but not limited to: Real Estate, Private Equity, and Absolute Return Strategies

B. Asset Class Performance Benchmarks

The Committee has adopted the following performance benchmarks for each asset class. Criteria for selection of a benchmark include:

- Unambiguous: the names and weights of securities comprising the benchmark are clearly delineated
- Investable: the option is to forego active management and simply replicate the benchmark
- Measurable: it is possible to readily calculate the benchmark's return on a reasonably frequent basis
- Appropriate: the benchmark is consistent with The Committee's investment preferences or biases
- Specified in Advance: the benchmark is constructed prior to the start of an evaluation period
- Reflecting Current Investment Opinion: investment professionals in the asset class should have views on the assets in the benchmark and incorporate those views in their portfolio construction

| <u>Asset Class</u> | <u>Benchmark</u> |
|-----------------------------|---|
| U.S. Equity | Russell 3000 Tobacco Free Index |
| Non US Eq. Devel. | MSCI World ex-US Net Tobacco Free |
| Emerging Mkt Eq | MSCI Emerging Market Free Net |
| Global Equity | MSCI All Country World Index Net – IMI – Tobacco Free |
| Fixed Income | Lehman Aggregate Bond Index |
| High Yield Fixed Income | Merrill Lynch High Yield Cash Pay Index |
| Emg Mkt Fixed Income | 33% times JP Morgan Emerging Market Bond Index – Global Diversified, plus 67% times the JP Morgan Global Bond Index – Emerging Markets – Global Diversified |
| TIPS | Lehman TIPS Index |
| Absolute Return | 50% x HFRX Absolute Return Index + 50% HFRX Market Directional Index |
| Real Assets | Commodities: S&PGSCI Reduced Energy Index All Other: N/A (see below note 4) |
| <u>Opportunistic</u> | <u>See below note 5</u> |
| Private Equity | N/A (see below note 2) |
| Real Estate | Public: 50% times the FTSE EPRA NAREIT US Index return plus 50% times the FTSE EPRA NAREIT Global ex-US Index return Private (core strategies): NCREIF Funds Index– Open end Diversified Core Equity, lagged 3 months Private (non-core strategies): N/A (see below note 3) |

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INVESTMENT POLICY STATEMENT**

Notes on asset class benchmarks:

1. Global Equity: The Treasurer will determine what constitutes a tobacco company based on standard industry classification of the major index providers (e.g., Russell, MSCI) and communicate this list to investment managers annually and whenever changes occur.
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5. Opportunistic: By their nature, unique or limited opportunity investments are difficult to benchmark, and there will not be a “one size fits all” benchmark for this category. The Regents’ general investment consultant will determine the appropriate individual benchmark after the investment is chosen but before funding the investment. The benchmark for any asset whose size at initial or subsequent purchase is greater than ½ of one percent of the total fund market value will be will be approved by the Chair of the Committee on Investments based on recommendation of the Regents’ general investment consultant.

C. Total GEP Performance Benchmark

This is the composition of the total GEP performance benchmark referred to in the Investment Policy Statement, Part 4(b). The percentages below add to 100%.

Percentage Benchmark

| | |
|-------------|---|
| 19% | × Russell 3000 Tobacco Free Index |
| 18% | × MSCI World ex-US Net Tobacco Free |
| 5% | × MSCI Emerging Market Free Net |
| 2% | × MSCI All Country World Index Net – IMI – Tobacco Free |
| 8% | × Lehman Aggregate Bond Index |
| 3% | × Merrill Lynch High Yield Cash Pay Index |
| 2.5% | × Citigroup World Government Bond Index ex-US |
| 3% | × 33% times JP Morgan Emerging Market Bond Index – Global Diversified, plus 67% times the JP Morgan Global Bond Index – Emerging Markets – Global Diversified |
| 4% | × Lehman TIPS Index |
| 23.5% | × 50% x HFRX Absolute Return Index + 50% HFRX Market Directional Index |
| 0.5% | × Aggregate Real Assets benchmark (see section B, with components weighted by their actual weights within the total real assets portfolio) |
| <u>0.5%</u> | <u>× Aggregate Opportunistic benchmark (see section B, with components weighted by their actual weights within the total opportunistic portfolio)</u> |
| 7% | × Actual return of private equity portfolio |
| 5% | × Aggregate Real Estate benchmark (see section B, with components weighted by their actual weights within the total real estate portfolio) |

Notes on Total Fund benchmark:

**UNIVERSITY OF CALIFORNIA GENERAL ENDOWMENT POOL
INVESTMENT POLICY STATEMENT**

1. The benchmark for private equity is replaced by the private equity portfolio's actual performance. This has the effect of neutralizing the active performance of this class for purposes of total fund performance evaluation.
2. The calculation of the Total Fund benchmark will assume a monthly rebalancing methodology.
3. In the event of a significant change in asset allocation, The Regents' generalist consultant may specify an alternative weighting scheme to be used during a transition period.

D. Rebalancing Policy

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The Treasurer will monitor the actual asset allocation at least monthly. The Committee directs the Treasurer to take all actions necessary, within the requirement to act prudently, to rebalance assets to within the policy ranges in a timely and cost effective manner when actual weights are outside the prescribed ranges. The Treasurer may utilize derivative contracts [in accordance with Appendix 4] to rebalance the portfolio.

The Treasurer shall assess and manage the trade-off between the cost of rebalancing and the active risk associated with the deviation from policy asset weights. With approval from the Chair of the Committee, the Treasurer may delay a rebalancing program when the Treasurer believes the delay is in the best interest of the GEP. Results of rebalancing will be reported to the Committee at quarterly meetings.