

BOARD OF REGENTS
BANKING COMMITTEE

December 15, 2003

The Banking Committee of the Board of Regents met on Monday, December 15, 2003, at Iowa State University, Ames.

Those present were:

Banking Committee members: Regents Amir Arbisser (chair), Robert Downer, John Forsyth and David Neil.

Others in attendance were:

Board of Regents member Sue Nieland (arrived at 4:35 p.m.);

Institutional representatives: David Skorton (arrived at 4:24 p.m.), Doug True, ~~Carol Senneff~~, Terry Johnson, Cynthia Bartels, Anthony DeFurio, Gregory Geoffroy, Ben Allen, Warren Madden, Tom Hill, Joan Thompson, Mark Chidister, Sheryl Rippke, Brad Dye, Robert Koob, Tom Schellhardt, Aaron Podolefsky, Gary Shontz, Doug Jensen, Jeanne Prickett, Jim Heuer, Dennis Thurman (arrived at 4:35 p.m.), Luann Woodward;

Barry Fick, Springsted, Inc.;

Ed Bittle and Bill Noth, Ahlers law firm;

Mark Brubaker, Wilshire Associates;

Board Office: Greg Nichols, Joan Racki, Deb Hendrickson, Andrea Anania and Barb Briggie.

Regent Arbisser called the meeting to order at 4:10 p.m.

APPROVE MINUTES OF THE NOVEMBER 2003 BANKING COMMITTEE MEETING.

Regent Arbisser asked for additions or corrections to the minutes. There were none.

MOTION: Regent Forsyth moved to approve the minutes of the November 11, 2003, Banking Committee meeting. Regent Arbisser seconded the motion.
MOTION CARRIED UNANIMOUSLY.

REIMBURSEMENT RESOLUTION – SUI CHILLED WATER PLANT.

Vice President True stated that the proposed resolution would permit the University's utility system to be reimbursed from a future utility system bond issue for expenditures between now and March associated with the West Campus Chilled Water Plant project.

MOTION: Regent Neil moved to recommend that the Board adopt A Resolution declaring an official intent under Treasury Regulation 1.150-2 to issue debt to reimburse the University of Iowa Utility System for certain original expenditures paid in connection with specified projects. Regent Downer seconded the motion. MOTION CARRIED UNANIMOUSLY.

MASTER LEASE.

(a) Extension of Agreement with Wells Fargo. Associate Director Racki presented the Board Office recommendation to extend the master lease agreement with Wells Fargo for an additional three-year term as provided in the current agreement. She said the agreement provides favorable interest rates and Wells Fargo personnel have been flexible in meeting the needs of the Regent institutions.

MOTION: Regent Neil moved to recommend that the Board seek to extend the master lease agreement with Wells Fargo for the three-year extension period provided under the current agreement. Regent Downer seconded the motion. MOTION CARRIED UNANIMOUSLY.

(b) Jack Trice Stadium Deferred Maintenance. Vice President Madden presented Iowa State University's request to utilize \$850,000 in master lease financing to provide deferred maintenance improvements to Jack Trice Stadium. University officials proposed to finance the project over a ten-year period, with the final interest rate set per the master lease agreement at the time the borrowing commitment is executed.

Regent Forsyth stated the master lease agreement concept is outstanding. He then said he assumed that someone has given the master lease agreement a "clean bill of health" with regard to accounting standards.

Vice President Madden responded that there are no particular accounting issues related to the master lease agreement.

Mr. Bittle stated those issues were addressed at the beginning of the master lease agreement.

MOTION: Regent Forsyth moved to authorize Iowa State University to utilize master lease financing in the amount of \$850,000 to provide deferred maintenance improvements to four concession/toilet buildings at Jack Trice Stadium, with the understanding that there are no accounting issues or concerns. Regent Downer seconded the motion. **MOTION CARRIED UNANIMOUSLY.**

SAVINGS FROM BOND REFUNDINGS.

Associate Director Racki reviewed the information on savings from bond refundings. She said the present value savings from refunding bonds total \$8.1 million for calendar years 2001 – 2003, of which \$5.7 million in savings were from Academic Building Revenue Bond refundings. The savings from Academic Building Revenue Bond refundings directly reduce the tuition replacement appropriations needed from the state in future years.

ACTION: Regent Arbisser stated the Banking Committee received the report on the savings from the issuance of refunding bonds, by general consent.

QUARTERLY INVESTMENT AND CASH MANAGEMENT REPORTS.

Mr. Brubaker presented the third quarter 2003 performance review. He began by providing information on market returns, and noted that returns were up 24 percent through the previous day. He noted that technology-driven companies are leading the market rebound, similar to what occurred at the end of the 1990s. He said the rebound has been broad-based, with all sectors doing well and reported that international equity markets remain strong although fixed income had a difficult quarter.

Mr. Brubaker next addressed total fund results, noting there were a few manager issues to be discussed. He said the 10-year returns rank the portfolios' performance in the top quartile, and the long-term results are quite good.

Regent Forsyth referred to comparison of returns with peer endowments, and asked if the data is adjusted for asset allocation. Mr. Brubaker responded that the data were not adjusted for asset allocation. Typically, each endowment has a unique asset mix.

Regent Forsyth pointed out that Wilshire's report presented a review of the managers relative to the indexes but did not include manager universe comparisons which rank managers relative to their peers. He said it would be helpful to see the data both ways. Mr. Brubaker offered to add that information.

Mr. Brubaker addressed the underperformance of the University of Iowa quasi endowment portfolio, which is entirely in fixed income. He said the underperformance has been driven by both managers, Invesco and Reams. He presented a chart which illustrated both managers' performance compared to the quasi composite index.

Regent Forsyth questioned the different rates of return for Vanguard and Invesco in the University of Iowa and Iowa State University portfolios. Director Bartels said one factor was that withdrawals occurred at different times. Mr. Brubaker explained how Wilshire's calculation methodology takes cash flows into consideration and thus results in slight differences. He pointed out that Wilshire also uses a time-weighted return methodology.

Mr. Brubaker next addressed the international equity portfolios, and stated that Sanford Bernstein's returns continue to be quite strong, despite the underweighting to Japan. Sanford Bernstein's stock selection has been superb. Sanford Bernstein is ranked in the top 15 percent of all internal equity managers.

Mr. Brubaker presented a style map that compared the equity managers to the indexes.

Vice President True pointed out that when Seneca Capital Management was hired, the firm had a smaller cap bias. He asked if there has been a drift in Seneca's strategy. Mr. Brubaker responded that there has been a drift but the drift was within the bounds of acceptability. Seneca's holdings are currently at the larger end of the mid caps.

Mr. Brubaker stated that two of the Board's fund managers have been in the news. He said the Securities and Exchange Commission (SEC) has brought charges against both Invesco and Alliance Capital Management. That morning's Wall Street Journal reported that Alliance Capital Management has settled, without admitting any wrongdoing, with both the SEC and with Elliott Spitzer of the New York Attorney General's Office relating to improper trading of hedge funds. Alliance Capital Management is paying a fine to the SEC of approximately \$250 million. The settlement with Elliott Spitzer will involve lowering the fees. He noted that last week the Wall Street Journal ranked Alliance

Capital Management's mutual fund fees at the top of most other firms. He stated that Wilshire Associates is keeping a close watch on the firm.

Mr. Brubaker offered the following as possible mitigating factors related to the Board's specific portfolios with Alliance Capital Management. He stated that the institutional investment arm and the mutual fund arm are completely separate and distinct products within Alliance Capital Management. Also, the portfolios originated with Sanford Bernstein which, two years ago, merged with Alliance. The SEC charges relate to the Alliance Capital Management mutual fund. Therefore, Wilshire Associates recommends that the firm continue to be watched closely for any unfavorable developments that might have a direct impact on the Regents' portfolios.

Regent Forsyth stated that the Regents cannot be associated with companies that have ethical lapses, and that the relationships with both of the firms should immediately be terminated. If it takes some time to move to another active manager, then the funds should be indexed. He said the Board probably should not have been using Invesco for the last couple of years because of its poor performance.

Regent Forsyth stated the Board should immediately sever the relationships with both Alliance Capital Management and Invesco, and determine a way to index the funds while selecting new managers.

Regent Downer stated the Board of Regents is a public body. He said it was not appropriate to continue doing business with the firms, not only because of the allegations but also because of the way in which the firms have dealt with the allegations. He expressed support for the position of Regent Forsyth.

MOTION: Regent Forsyth moved to immediately sever the relationships with Alliance Capital Management and Invesco, and to index the funds while selecting new managers. Regent Downer seconded the motion. MOTION CARRIED UNANIMOUSLY.

Vice President True asked if there would be some reasonable period of time in which to work through the directives of the Banking Committee. Regent Forsyth responded that the changes should take place as soon as practical. He said those types of contracts typically have a 30-day cancellation clause.

Mr. Brubaker stated that the 30-day cancellation requirements are rarely enforced. The firms might enforce the payment of fees for thirty days but would not compel the assets to remain with the firms.

Vice President True stated that institutional officials will make sure that the assets are properly reinvested.

Mr. Brubaker pointed out that the investment policy of the Board of Regents restricts any commingled fund investments; therefore, the assets would have to be invested in mutual funds.

Regent Forsyth suggested that the Banking Committee look to management to implement the changes in as timely a fashion as possible.

Mr. Brubaker said the issues that are going to come up are on the custodial side.

Regent Arbisser stated, for the record, that the total assets involved in this matter are quite substantial.

Mr. Brubaker said the transition is nearly as important as the ultimate replacement of the fund managers.

ACTION: Regent Arbisser stated the Banking Committee received the investment and cash management reports for the quarter ended September 30, 2003, by general consent.

REVISED INVESTMENT POLICY.

Associate Director Hendrickson stated that, in October, the Banking Committee reviewed the initial changes to the investment policy. Board members requested further modifications which were incorporated into the final draft. She said University of Iowa officials suggested an additional minor modification for further clarification of the operating funds investment guidelines. It would read "The Merrill Lynch 1-3 Year Government/Corporate will be the benchmark for the portion of operating funds under external management." If the Board approves the policy with the added language, it would represent final approval of the investment policy.

MOTION: Regent Forsyth moved to recommend that the Board approve for final reading Board of Regents Policy Manual §7.04, the investment policy, as presented. Regent Neil seconded the motion.
MOTION CARRIED UNANIMOUSLY.

STATE AUDIT REPORTS – REVENUE BOND FUNDS, ISU.

Vice President Madden offered to answer questions regarding the state audit reports.

Regent Forsyth noted that adjustments were required to both the Recreational Revenue Bonds and Telecommunications Revenue Bonds. He asked if issues of process improvement related to these bond issuances had been addressed. Vice President Madden responded affirmatively.

ACTION: Regent Arbisser stated the Banking Committee, by general consent, received the following Iowa State University revenue bond fund audit reports for the fiscal year ended June 30, 2003: (a) Academic Building, (b) Dormitory and Dining Services, (c) Hilton Coliseum, (d) Ice Arena Facility (note), (e) Indoor Multipurpose Use and Training Facility, (f) Parking System, (g) Recreational Facility, (h) Student Health Facility, (i) Telecommunications Facilities, and (j) Utility System.

EXTERNAL AUDIT REPORT – QUAD-CITIES GRADUATE STUDY CENTER.

Assistant Director Anania presented highlights of the external audit report of the Quad-Cities Graduate Study Center. She stated the audit report concluded that the financial statements presented fairly, in all material respects, the financial position of the Quad-Cities Graduate Center as of June 30, 2003 and 2002, and changes in its net assets and cash flows for the years then ended, in conformity with generally accepted accounting principles. There were no reported findings.

ACTION: Regent Arbisser stated the Banking Committee received the Quad-Cities Graduate Study Center audit report for the fiscal years ended June 30, 2003 and 2002, by general consent.

INTERNAL AUDIT REPORTS.

Assistant Director Anania stated that one original internal audit report and three follow-up internal audit reports were presented this month.

Director Rippke provided a summary of the sponsored programs internal audit report.

Regent Forsyth asked if the Banking Committee members should be concerned about the five findings related to sponsored research, which is a large aspect of the University's activities.

Director Rippke stated that the response of the University has been one of concern and immediate action. She said some of the issues were related to the University's decentralization.

Provost Allen stated there were two main issues: 1) communication and training and 2) continuous improvement. He said benchmarking with universities that have good track records will take place.

Regent Forsyth asked that Iowa State University officials return to the Banking Committee after benchmarking the best practices of other universities.

ACTION: Regent Arbisser stated the Banking Committee, by general consent, (1) received the sponsored programs internal audit report from Iowa State University and (2) received the report on the status of the internal audit follow-up reports, including three follow-up reports, two from the University of Iowa and one from Iowa State University.

MODIFICATION OF INSTITUTIONAL BANKING RELATIONSHIP.

Director Bartels presented the University's request for a temporary banking relationship with Bank of America.

President Skorton stated the request was to establish more stringent cash management for those attending the Outback Bowl. Banks on the current list of approved financial institutions currently do not have a presence in the State of Florida, where the game will take place.

MOTION: Regent Neil moved to recommend the Board approve the requested University of Iowa

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temporary banking relationship with Bank of America. Regent Downer seconded the motion.
MOTION CARRIED UNANIMOUSLY.

ADJOURNMENT.

The meeting of the Regents Banking Committee adjourned at 5:00 p.m. on December 15, 2003.



Pamela M. Elliott
Director, Business and Finance



Gregory S. Nichols
Executive Director

bb/f.winword/1203bank