BOARD OF REGENTS
BANKING COMMITTEE

May 16, 2001

The Banking Committee of the Board of Regents met on Wednesday, May 16, 2001, at the Iowa School for the Deaf, Council Bluffs, Iowa.

Those present were:

Banking Committee members: Regents David Fisher (chair), Amir Arbisser, Mary Ellen Becker, David Neil and Owen Newlin.

Others in attendance were:

Regent Sue Nieland;

Institutional representatives: Mary Sue Coleman, Douglas True, Ann Madden Rice, Richard Seagrave (arrived at 8:18 a.m.), Warren Madden (arrived at 8:18 a.m.), Robert Koob, Eunice Dell, Jim Heuer;

Mark LeMay, Springsted;

Board Office: Frank Stork, Pamela Elliott, Joan Racki, Deb Hendrickson and Barb Briggle.

Regent Fisher called the meeting to order at 8:12 a.m.

APPROVE MINUTES OF THE APRIL 2001 BANKING COMMITTEE MEETING.

MOTION: Regent Neil moved to approve the minutes of the April 18, 2001, Banking Committee meeting, as written. Regent Newlin seconded the motion. MOTION CARRIED UNANIMOUSLY.

REIMBURSEMENT RESOLUTION – RESIDENCE SYSTEM PROJECTS (SUI).

Vice President True stated that efforts are made to time bond issues to avoid federal arbitrage rules. The adoption of a reimbursement resolution allows costs that are incurred to be reimbursed from future bond issues. Residence system reserves would be used to fund the projects until bond proceeds are available. He noted that the Board of Regents has a complex bond schedule; sometimes compromises are made as to when bonds are sold. Reimbursement resolutions provide assurance that the institution can be reimbursed for internal funds expended on a project. He said the four projects for which the reimbursement resolution was presented this month were all for the University's residence system. He described the purpose of each project.

Mr. LeMay, upon the request of President Newlin, provided the following explanation of "arbitrage". With certain exceptions, if the interest rate earned on bond proceeds is greater than the interest rate paid on the bonds sold, the excess earnings from the rate differential have to be paid to the federal government.

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 Residence System for certain original expenditures paid in connection with specified projects. Regent Newlin seconded the motion. MOTION CARRIED UNANIMOUSLY.

FIXED INCOME MANAGER.

Director Elliott stated that, as indicated in the meeting materials, the Regent institutions maintain two investment portfolios – operating and endowment. Since 1989, the Board of Regents has hired fund managers to invest the endowment funds. Invesco, the Board's balanced portfolio fund manager since 1989, handles 84.2 percent or $243.8 million of the Board's endowment and quasi-endowment portfolios. University of Iowa officials requested that the Banking Committee authorize the addition of a second fixed income manager for the University to use for new deposits into its quasi-endowment portfolios. The University maintains two quasi-endowment portfolios: Quasi I – 50 percent fixed income and 50 percent equities, which totaled $49.1 million and Quasi II – 100 percent fixed income, which totaled $52.1 million. She noted that the request for an additional fixed income manager related only to the University of Iowa.

After consultation with institutional officials, Wilshire Associates recommended that the Board of Regents consider hiring an additional fixed income manager to run a portion of the fixed income assets in order to reduce risk. Wilshire listed three fixed income management firms - BlackRock, Western Asset Management, and Reams Asset Management - to consider interviewing at its June meeting.

Regent Becker asked for the difference between an endowment and a quasi-endowment. Vice President True responded that the difference has to do with the life of the endowment. An endowment is for perpetuity. A quasi-endowment is one in which there are no donor requirements; therefore, the funds are more flexible and the timeline is less than perpetuity. He noted that the University of Iowa's endowment funds are overweighted with Invesco. Both of its quasi-endowments are invested through Invesco. University officials would like to divide the fixed income account and have a portion of it invested by a second fixed income manager. This action would provide diversification for fixed income assets as is currently done with equities. Diversity has value. He said the issue was totally about diversification of the University's fixed income assets. He noted that Iowa State University officials supported the University of Iowa's request.

President Newlin stated that in a regular endowment the corpus cannot be spent. In a quasi-endowment, the donor makes no designation about the corpus. Vice President True stated that the University of Iowa has some quasi-endowment funds that are so much like an endowment fund that University officials invest the funds like an endowment.

Vice President True said there is currently $73 million in fixed income, and the amount is growing. By the time the new manager is selected and on board, the University of Iowa may have nearly $100 million in fixed income. University officials would divide those funds between the new manager and Invesco to provide diversity. At this time, University officials requested permission to interview in June the three managers that were recommended by Wilshire Associates. He noted that it was important to make the fund manager change prior to July 1.

President Newlin asked for a description of diversity in fixed income management styles. Vice President True offered the following characterization of Invesco's style. Invesco evaluates the sectors and monitors the actions of the Federal Reserve Board. It does not make interest rate picks. Invesco reviews historical data and recent trends in spreads between different sectors in making its investment decisions.

President Newlin asked about the different investment styles. Vice President True responded that the differences are more subtle with fixed income managers. The diversification is more narrow, but it still exists.

Vice President True noted that Invesco had a bad year two years ago. If the endowment portfolios had been diversified, there would not have been as deep a disappointment in that year.

The Banking Committee members discussed the process for interviewing candidate firms. Regent Fisher stated that the interviews would take place in Des Moines at the Board Office prior to the June Board meeting in Ames. He asked that the Board Office set aside three hours for the interviews. President Newlin indicated a desire to serve on the interviewing committee and Regent Fisher said he would also participate in the interviews. Any other members of the Banking Committee who wished to participate in the interviews were encouraged to attend.

Director Elliott stated that, included in Wilshire's recommendation for the additional fixed income manager, was a recommendation to change benchmarks for the fixed income managers. Lehman Government/Corporate Index is currently used. Wilshire recommended changing to the Lehman Aggregate Index.

Director Elliott said the Board Office recommended the Banking Committee recommend that the Board request a comprehensive review of its investment policy in relation to its endowment and quasi-endowment portfolios to evaluate asset allocation, risk management, benchmarks, and manager allocations.

Vice President True referred to the recommendation to change benchmarks for the fixed income managers from the Lehman Government/Corporate Index to the Lehman Aggregate Index. He said representatives of Wilshire and Invesco as well as the Regent universities support such a benchmark change. The Lehman Aggregate represents more of the total U.S. fixed income market. Discussion about changing benchmarks has taken place for several years. He said the change seemed timely with the hiring of a new fixed income manager.

Director Elliott suggested that the effective date for the new benchmark be set for July 1, 2001.

MOTION: Regent Newlin moved to recommend that the Board request a comprehensive review of its investment policy in relation to its endowment and quasi-endowment portfolios to evaluate asset allocation, risk management, benchmarks, and manager allocations, and to approve the change in fixed income benchmark from the Lehman Government/Corporate Index to the Lehman Aggregate Index effective July 1, 2001. Regent Neil seconded the motion. MOTION CARRIED UNANIMOUSLY.

Regent Fisher asked that the Board Office ensure that at least two or three Banking Committee members attend the fixed income manager interviews.

INTERNAL AUDIT REPORTS.

Director Elliott stated that no new internal audits were presented this month. A follow-up audit was reported. She noted that another University of Iowa follow-up report was closed. In July, the internal audit plans of the three universities will be presented to the Banking Committee.

Regent Fisher stated, for the benefit of the new members of the Banking Committee, that the table of outstanding follow-up audit reports used to be much longer. Great strides have been made. Within the next 90 days, all but one follow-up internal audit will be closed.

ACTION: Regent Fisher stated the Banking Committee received the report on the status of internal audit follow-up, by general consent.

ADJOURNMENT.

The meeting of the Regents Banking Committee adjourned at 8:43 a.m. on May 16, 2001.

Pamela M. Elliott

Frank J. Stork
Executive Director