

BOARD OF REGENTS
BANKING COMMITTEE

September 16, 2003

The Banking Committee of the Board of Regents met on Tuesday, September 16, 2003, at Iowa State University, Ames.

Those present were:

Banking Committee members: Regents David Neil (interim chair), Mary Ellen Becker, Robert Downer, John Forsyth, and Deborah Turner as President Pro Tem (arrived at 4:14 p.m.).

Others in attendance were:

Board of Regents member Sue Nieland;

Institutional representatives: Doug True, Steve Parrott, Mark Schantz, Cynthia Bartels, Jean Robillard, Emmett Vaughan, Dan Fick, Gregory Geoffroy, Tom Hill, Warren Madden, Mark Chidister, Brad Dye, Joan Thompson, Margaret Pickett, Heather Phillips, Robert Koob, Tom Schellhardt, Gary Shontz, and Jim Heuer;

Barry Fick, Springsted, Inc.;

Ed Bittle, Ahlers law firm;

Mark Brubaker and Marc Friedberg, Wilshire Associates;

Board Office: Greg Nichols (arrived at 4:50 p.m.), Pamela Elliott, Charles Wright, Joan Racki, Deb Hendrickson, Barb Boose, Jean Friedrich, and Barb Briggie.

Regent Neil called the meeting to order at 4:05 p.m. He stated that Regent Arbisser, chair of the Banking Committee, was unable to attend the meeting. Therefore, he requested everyone's indulgence.

APPROVE MINUTES OF THE JULY 2003 BANKING COMMITTEE MEETING.

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

MOTION:

Regent Downer moved to approve the minutes of the July 16, 2003, Banking Committee meeting, as written. Regent Becker seconded the motion.
MOTION CARRIED UNANIMOUSLY.

SALE AND AWARD OF \$25,000,000 DORMITORY REVENUE BONDS, SERIES SUI 2003.

Vice President True stated the bonds would be sold to finance residence system projects including Burge Hall dining, fire protection upgrades for Rienow, Quadrangle and Parklawn Residence Halls, and improvements to Mayflower Residence Hall.

Mr. Fick stated that interest rates have risen since June. However, rates have stabilized in the past few weeks and there has been some decline. He noted that interest rates were still very low. There was strong interest in the sale from underwriters. Three separate syndicates have indicated interest in bidding on the bonds; bids would be received the following morning.

Mr. Bittle said the legal documents were prepared and were in order.

MOTION:

Regent Becker moved to recommend that the Board adopt the following resolutions, subject to receipt of acceptable bids: (1) A Resolution providing for the sale and award of \$25,000,000 Dormitory Revenue Bonds, Series S.U.I. 2003, and approving and authorizing the agreement of such sale and award. (2) A Resolution authorizing and providing for the issuance and securing the payment of \$25,000,000 Dormitory Revenue Bonds, Series S.U.I 2003, for the purpose of paying costs of repairing, remodeling, and constructing improvements to and equipping existing residence halls and related facilities located on the campus of The State University of Iowa, including funding the debt service reserve fund, and paying costs of issuing the Bonds. Regent Downer seconded the motion. MOTION CARRIED UNANIMOUSLY.

PRELIMINARY RESOLUTION FOR THE SALE OF UP TO \$7,000,000 REGULATED MATERIALS FACILITY BONDS, SERIES ISU 2003.

Vice President Madden stated the bonds were being sold to accommodate the University's environmental health and safety program. Hazardous waste chemicals and materials on campus will be stored and processed in the facility. Currently, those activities occur in various locations on campus. He noted that the Board had previously approved planning for the facility. He said the bonds will be repaid from revenues

generated through materials surcharges to campus users. University officials believe the financing plan is conservative. He noted that, if the facility is not built, some of the University's research activities cannot continue.

Regent Forsyth asked for the categories of accounts to which the surcharge would apply. Vice President Madden responded that the surcharge would apply to materials that become hazardous, typically chemicals. The University also buys some radiological materials.

Regent Forsyth asked what percentage of the surcharge fee revenue would come from students. Vice President Madden responded that 5 to 10 percent of the revenue would come through laboratory fees.

Regent Forsyth asked if a new student fee would be created. Vice President Madden responded that materials fees and laboratory fees are currently paid to departments. The student fee related to this activity would be relatively small. University officials do not believe that student fees would increase significantly.

Regent Forsyth asked for confirmation that there was not a presupposition that the Board would approve any changes in student fees. Vice President Madden responded that there was no such presupposition.

Regent Forsyth asked if a student fee would be indicated as a back-up funding source for debt service on the bonds. Vice President Madden responded affirmatively, noting that the pledge of a fee as a back up for bond repayment improves the bond rating for self-liquidating bonds. He stated that, in all the years that he has been involved in Iowa State University bond sales, the University has never requested that the Board implement a student fee as a back-up funding source.

Mr. Fick said the bonds for this facility have been structured so the three percent surcharge is significantly in excess of the amount needed for the debt service payment. There should not be a need to resort to either of the back-up options referenced in the write-up. The rating agencies have informed Regent representatives that the inclusion of a back up student fee benefits the bond rating. The rating on these bonds should be at or near the general University rating.

MOTION: Regent Forsyth moved to recommend that the Board adopt A Resolution authorizing the Executive Director to fix the date or dates for the sale of up to \$7,000,000 Regulated Materials Facility Revenue Bonds, Series I.S.U. 2003.

Regent Downer seconded the motion. MOTION
CARRIED UNANIMOUSLY.

**PRELIMINARY RESOLUTION FOR THE SALE OF UP TO \$8,000,000 ACADEMIC
BUILDING REVENUE BONDS, SERIES ISU 2003.**

Vice President Madden provided some history of the financing for the Engineering and Teaching Research, Phase II project. In 1997, the legislature appropriated capital funds for construction of the project. He stated that \$7 million of the appropriation was transferred to the FY 2002 General Fund by the 2002 General Assembly. The 2002 General Assembly authorized the issuance of Academic Building Revenue Bonds and appropriated FY 2004 funds to replace the deappropriation. Short-term project notes were sold to provide interim financing. The FY 2004 appropriation by the 2002 General Assembly from the Rebuild Iowa Infrastructure Fund was deappropriated by the 2003 General Assembly, which required that bonds be issued to replace the project note financing.

Mr. Fick stated the bond issuance would be structured to provide permanent financing for the Engineering and Teaching Research, Phase II project.

Regent Neil asked, if the legislature chose to meet its obligation to fund the project, the bonds could be paid off early. Mr. Fick responded that the bond issue would include a call date of approximately 10 years hence.

Regent Neil asked if the legislature was aware that the bonds were going to be sold. Mr. Bittle responded affirmatively.

MOTION: Regent Forsyth moved to recommend that the Board adopt A Resolution authorizing the Executive Director to fix the date or dates for the sale of up to \$8,000,000 Academic Building Revenue Bonds, Series I.S.U. 2003. Regent Downer seconded the motion. MOTION CARRIED UNANIMOUSLY.

REIMBURSEMENT RESOLUTION, UTILITIES – POWER PLANT TURBINE GENERATOR #6, IOWA STATE UNIVERSITY.

Vice President Madden stated that Iowa State University officials plan to replace a 3 megawatt generator with a 12 megawatt generator. The change will result in lower utility costs which will benefit the University, especially since utility costs are projected to increase.

Regent Forsyth stated the information on the return on investment should have been included in the information presented to the Banking Committee. Vice President Madden responded that University officials can provide that information. He noted that the bonds will include the return on investment information.

Regent Becker asked if there were any implications for the environment of the change in generators. Vice President Madden responded that the environmental implications were positive. He said today's generators are more environmentally friendly.

Mr. Bittle stated that adoption of the reimbursement resolution was required under federal tax law.

MOTION:

Regent Forsyth 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 Iowa State University of Science and Technology Utility System for certain original expenditures paid in connection with specified projects. Regent Becker seconded the motion. MOTION CARRIED UNANIMOUSLY.

SAVINGS FROM BOND REFUNDINGS.

Associate Director Racki presented the report which provided savings information on refundings in July of Academic Building Revenue Bonds for the University of Northern Iowa. She stated that, for calendar year 2001-03 to date, a total of \$5.7 million in present savings was realized from Academic Building Revenue Bond refundings, which reduces by \$5.7 million the total tuition replacement requirement for the remaining maturities of the bonds.

Regent Forsyth stated that the savings from bond refundings was outstanding. He questioned whether the public and legislators are aware of this cost-savings activity.

Director Elliott responded that news releases regarding the most recent bond refunding savings data were distributed at the July Board of Regents meeting. She said Regent Arbisser also sent a letter to the editors of 28 Iowa newspapers.

Regent Neil suggested the Banking Committee members should inform legislators, on a personal basis, of the savings because it is a savings to the state as a whole, not just to the Regents.

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

INVESTMENT AND CASH MANAGEMENT REPORT FOR THE QUARTER ENDED JUNE 30, 2003.

Director Elliott summarized briefly the information contained in the meeting materials on the portfolio totals, the operating portfolios return compared with industry standards, and manager performance.

Mr. Friedberg first presented a market review for the quarter ended June 30, 2003, and an update as of the previous day. He said there was a reversal of the negative correlation between equity and fixed income markets in the last quarter. The markets have been up in all asset classes in which the institutions are invested. Standard & Poor's 500 returns are 15.4 percent while the fixed income return is 2.5 percent. In the last year, bonds continued to outperform stocks by 10.2 percent and, for the last 3 years, the out-performance has been by 21.3 percent. He noted that international stocks were strong in the last quarter, at 19.9 percent, 11.1 percent for the year to date, and 3.2 percent for 10-year returns.

Mr. Friedberg provided an update of equity market returns through the previous day: Standard & Poor's 500 was up 15.3 percent. International stocks were up 16.5 percent year to date.

Mr. Friedberg next addressed fixed income returns. He stated the Lehman Aggregate Bond index was up 2.5 percent for the quarter and 3.9 percent year-to-date through June 30, 2003. Since then, bond returns have declined, with year-to-date performance at 2.4 percent. He next discussed risk versus return of the major asset classes, and noted that Standard & Poor's 500 remained the highest-returning asset class.

With regard to domestic equity markets, Mr. Friedberg stated that every sector produced positive returns. The most significant out-performance was in the non-

technology sectors. He discussed charts and graphs which illustrated returns of small cap versus large cap stocks and growth versus value stocks. He said those factors would become evident when reviewing individual manager performance. For example, Seneca has a large cap and growth bias; small value outperformed small growth stocks.

Mr. Friedberg stated that the fixed income environment had changed in the last 1-1/2 months. The Fed cut interest rates to the lowest level in over 40 years. Through July, interest rates increased but, in the last couple of weeks, have declined some. He said Reams continues to underperform its benchmark, and Wilshire is monitoring Reams closely.

Mr. Friedberg presented information on individual portfolio and manager performance. The University of Iowa returned 13.10 percent for the quarter, outperforming the policy benchmark by 0.60 percent. He stated that \$21.2 million was gained, net of fees, in the University of Iowa portfolio. For Iowa State University, the portfolio returned 13.31 percent for the quarter, outperforming the policy benchmark by 0.81 percent. He said \$12.9 million was gained, net of fees, in Iowa State University's portfolio. He noted that, even with the negative returns of the past three years, the since-inception returns remain in the top quartile of the universities' peers.

Mr. Friedberg presented the composite performance for all asset classes. He stated that fixed income has experienced some underperformance for the quarter.

Mr. Friedberg again referenced Reams' underperformance, stating the underperformance was mostly due to duration position and the fact that they were weighted heavier in government and agencies when credits rebounded. Wilshire continues to monitor Reams but, at this point, were not recommending that any action be taken.

Regent Forsyth asked if either of the fixed income managers are in the top quartile of performance. Mr. Brubaker responded that neither of the fixed income managers is in the top quartile. He stated that Invesco's performance was reviewed in depth two years ago, when the decision was made to hire Reams as an additional fixed income manager. At that time, Invesco's performance numbers warranted the potential for termination. Invesco subsequently made some organizational changes. Its fixed income management moved to its Louisville office where there are strong capabilities. He considers Invesco to still be "on watch", although the organizational changes were a positive move. With respect to Reams, at the time Reams was hired, it was historically a top quartile fixed income manager. Reams was hired at the onset of a very rough time for the organization. This most recent four quarters is likely the worst four-quarter period in Reams' history. He said Reams' longer-term fixed income numbers are still quite strong.

Mr. Friedberg stated that, for the short term, Invesco ranks around the median in total performance. Reams was most likely in the bottom quartile.

Regent Forsyth asked why the investment advisors were not more concerned about Invesco considering the history of poor performance. Mr. Friedberg responded that the changes made by Invesco 1-1/2 to 2 years ago were a step in the right direction.

Regent Forsyth asked when Wilshire would "call the question" in a situation such as is being experienced with Invesco. Mr. Brubaker said it could be time with Invesco. With regard to Reams, Wilshire still thinks it is a top-shelf fixed income manager.

Regent Forsyth questioned whether he was correctly interpreting the remarks of Wilshire representatives regarding the underperformance of the fixed income managers. Mr. Friedberg stated the recent severe underperformance has been with Reams.

Regent Forsyth asked when the Banking Committee would review the fixed income managers. Director Elliott responded the allocation to Invesco was split less than two years ago. However, there is no set time for reviewing the managers.

Mr. Brubaker stated that, in this case, it is getting to be time. He said it was a matter of the amount of patience of the Banking Committee.

Regent Forsyth noted there are better fixed income managers. Mr. Brubaker agreed with Regent Forsyth's statement.

Regent Downer asked over what period of time the investment advisors could perform an evaluation and prepare a recommendation for consideration by the Banking Committee. Mr. Brubaker responded that Wilshire Associates could have a recommendation to the Banking Committee within months. He noted that a fixed income manager search was conducted two years ago when the fixed income account was split. If the Banking Committee desires, he said Wilshire could conduct a search to replace Invesco and have it completed fairly quickly. He noted that, if it were up to Wilshire, Invesco would be given another 6-12 months.

Regent Neil stated there was a loss of confidence in Invesco, even on the part of Wilshire Associates. It was apparent to him that it was time to make the move.

Regent Forsyth asked that at a future meeting of the Banking Committee, Wilshire present a reassessment of Invesco along with a recommendation.

Regent Becker asked for the costs of switching from Invesco to another fixed income manager. Mr. Brubaker responded that the costs of transitioning a fixed income portfolio are minimal.

Mr. Friedberg concluded his presentation by stating that the fixed income portfolio was a concern.

Mr. Friedberg stated that Sanford Bernstein was hired as international equities manager four years ago. In its second quarter as international equities manager, Sanford Bernstein was 13.4 percent behind its benchmark. Since that time, Sanford Bernstein has had 14 consecutive quarters of significant out-performance.

Mr. Friedberg said there are individual pieces of the U.S. equity portfolios that have struggled.

Regent Neil thanked Wilshire representatives for the good news, for the most part.

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

IOWA MUTUAL MEDICAL INSURANCE COMPANY, UNIVERSITY OF IOWA.

General Counsel Schantz first introduced those who were involved in the development of the Iowa Mutual Medical Insurance Company. He made special mention of Professor Emmett Vaughan, who specializes in insurance, without whom it make have taken another year to complete the task. He then summarized two changes in the plan that had occurred since earlier informal discussions. The layering of coverage is different and none of the tail is being transferred to St. Paul.

Professor Vaughan discussed the reasons for choosing not to take the tail coverage and for the change in the \$3 million self insurance. He said both of the changes related to money and reduced costs. He noted that simulations have been undertaken and supported the establishment of a mutual insurance company as the practical approach. The anticipated expenses of operation are modest. The premiums for the medical liability coverage will pay the administrative costs.

Dean Robillard presented a brief historical background of medical malpractice insurance in the last 50 years. He expressed his belief that the mutual company will provide a financial benefit to the faculty practice plan. As a result of the malpractice insurance crisis in this country, over the last year a task force at the University of Iowa has

reviewed all of the possibilities and determined that the formation of the mutual company was the best option.

Regent Neil expressed agreement with Dean Robillard's last comment.

Professor Vaughan stated that University officials involved in the task force have continued to contact the insurance market to obtain quotations. The last quotation was for \$2.8 million, which would be the alternative to what was presented. He stated that the mutual medical insurance company proposal offered a real savings to the University.

Regent Forsyth asked Professor Vaughan to address the issue of governance. Professor Vaughan responded that the Iowa Mutual Medical Insurance Company will basically be owned by the policy holders, and operated and controlled by the College of Medicine. Clinical faculty within the College of Medicine and the faculty practice plan would be the policy holders. The faculty members will assign their member votes by proxy to the Dean of the College of Medicine. The initial Board of Directors will consist of seven members: five faculty in the College of Medicine and two members from the University administration outside the College of Medicine.

Regent Forsyth referred to 10 years from now when the University returns to the open market place, and asked if there will be an issue of reserves.

Professor Vaughan expressed his belief there would not be an issue of reserves. He said University officials would propose a mechanism to avoid the issue of demutualization or a hostile takeover. The surplus in the company would at all times be fully committed to the College of Medicine and the University of Iowa. Over time, it will likely be necessary to increase the surplus, but at no time would there be an accumulation of surplus that accrues to the benefit of policy holders.

Regent Forsyth stated that the proposal was outstanding.

MOTION:

Regent Forsyth moved to (1) recommend the Board authorize the University of Iowa to assist with the formation of a captive mutual insurance company for the purpose of providing medical liability insurance, within defined limits, for the participants of the Carver College of Medicine Faculty Practice Plan and (2) recommend the Board authorize the University of Iowa to purchase surplus notes from the mutual company to be formed in the amount of \$20 million to meet the

statutorily required insurance surplus. Regent Downer seconded the motion. MOTION CARRIED UNANIMOUSLY.

Regent Neil thanked University of Iowa officials for their work on the project.

INTERNAL AUDIT STATUS REPORT.

Director Elliott stated there were no new internal audits presented this month. Several new internal audits will be presented at next month's meeting.

Regent Downer asked if there was reasonable assurance that the first two items, as noted below, will be closed on schedule:

Food and Nutrition Gift Card Program (UIHC)
Patient Fiscal and Registration Services (UIHC)

Vice President True responded that Carol Senneff, the University of Iowa internal auditor, indicated to him that she expected to close out the audits in a timely way.

Regent Downer expressed concern about the length of time those two internal audits had been open. Vice President True said he would share Regent Downer's sentiment with Director Senneff. If there appears that the audits will not be closed out in the time frame that was indicated, he said the Banking Committee would be notified.

Regent Becker noted that the Patient Fiscal and Registration Services audit completion was delayed because of the new computerized system.

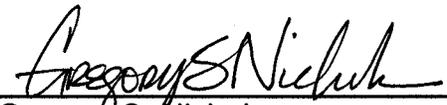
ACTION: Regent Neil stated the Banking Committee, by general consent, received the report on the status of internal audit follow-up reports, including six follow-up reports, five from the University of Iowa and one from Iowa State University.

ADJOURNMENT.

The meeting of the Regents Banking Committee adjourned at 5:06 p.m. on September 16, 2003.



Pamela M. Elliott
Director, Business and Finance



Gregory S. Nichols
Executive Director

bb/f.winword/903bank