MEMORANDUM

To: Banking Committee

From: Board Office GSN

Subject: Revised Investment Policy

Date: December 4, 2003

Recommended Action:

Recommend that the Board approve for final reading Board of Regents Policy Manual §7.04, the investment policy.

Executive Summary:

Process

The Board, over the past year, has established a process for updating its Policy Manual, whereby changes are presented to the Board at one meeting but are not approved until a subsequent meeting. This procedure allows time for Board review and additional comments prior to final approval.

Review

Under Policy Manual §1.05, the Board has delegated to the Banking Committee the monitoring of institutional investment and treasury management practices.

The Banking Committee reviewed the initial changes to the Investment Policy (§7.04) at its October 2003 meeting. At that time, members requested further modifications to the proposed policy as well as input from the various fund managers authorized by the Board.

Board staff, Regent institution treasurers, and Wilshire Associates, the Board's investment advisor, have reviewed the proposed changes to the Board's investment policy.

The attached document reflects acceptance of all changes that were not questioned in October. The changes requested by the members and fund managers were addressed. Policy sections affected by changes are highlighted.

Analysis:

Fund Manager Comments

The following information was provided by Wilshire after consultation with the fund managers.

Comments/ Wilshire's Response (proposed changes to investment policy)

BlackRock

- Is there a minimum duration for the Operating Portfolio? / No (no change)
- Does the 63-month maximum effective maturity restriction apply at the time of purchase? / Yes (no change)
- Old guidelines looked at Moody's, S&P or a Nationally Recognized Statistical Rating Organization (NRSRO) for credit rating which provided more flexibility. / Proposed change (added language to allow for this)
- What happens with a downgrade? / Already articulated in policy (no change)
- Interest rate futures are allowed in the Endowment, but not the Operating. / Interest rate futures are not currently permitted in the Endowment, but may be at the Board's discretion (no change)
- Credit quality limits exist in the Endowment, but not Operating i.e. 20% A and BBB. / Proposed change (added this restriction to Operating guidelines)

Wellington

- Is the benchmark the Merrill 1-3 Year Gov't Corp or the 1-3 Year Gov't? / 1-3 Year Gov't Corp (no change)
- Requested the use of interest rate futures / No (no change)

INVESCO

- Language "20% of the total endowment portfolio may be invested in bonds rated A and BBB" implies that it is the total Endowment and not just fixed income. / Proposed change (modified language to clarify)

Reams

- AA average quality restriction specifically noted in the Operating guidelines, but not in Endowment. / Proposed change (added restriction to the Endowment guidelines)

LSV

- No comment.

Seneca

- Wanted to clarify that the 1% restriction to IPOs applies at the total Endowment level because they sometimes buy IPOs. / Yes, 1% limit applies at the total Endowment level (no change)

AllianceBernstein

- Requested following change: "No more than five percent of the portfolio at market at the time of purchase and ten percent at market value shall be invested in securities issued by one company."/ No. Language will remain 5% of the market value of the portfolio for risk control purposes. (no change)

7.04 Investment Policy

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7.04 Investment Policy

A. Introduction

The Board of Regents establishes policy and sets objectives for the University of Iowa, Iowa State University, The University of Northern Iowa, Iowa Braille and Sight Saving School, and Iowa School for the Deaf.

The objective of the Board's investment policy is to ensure compliance with investment practices that preserve principal, ensure liquidity sufficient for anticipated needs, and maintain purchasing power of its investable assets.

Deleted: to ensure the financial health of the institutions it governs. The Board therefore seeks

The Board delegates to its Banking Committee the authority for monitoring institutional investment and treasury management practices, for monitoring investment and treasury management performance, and for ensuring compliance with Board policy.

This policy statement identifies the broad investment strategy to be followed in the investment of the assets and any general limitations on the discretion given to the institutions' investment managers (both internal and external). The investment policy contains the Board's objectives of satisfying certain needs for both operating and endowment funds. (I.C. §12B.10)

The institutions under the governance of the Board of Regents and its Banking Committee control two broad categories of investments--operating assets and endowment assets, both restricted and unrestricted.

The sources of operating assets are state appropriations, student tuition fees, university sales and services (most notably the University of Iowa Hospitals and Clinics), government and other sponsored research grants, federal appropriations, bond issue proceeds, and other income sources. Operating assets comprise the majority of institutional investments. The balance of institutional investments is endowment assets.

The primary sources of endowment assets are donor gifts and other funds received for specific purposes. Some of the endowment assets are restricted to certain investment types and may also be restricted to certain spending purposes. Different attributes of the institutions' operating and endowment assets lead to differing investment policies.

Restricted funds have externally imposed guidelines for investment. Restricted funds are defined as those funds existing within both the operating and endowment portfolios which are restricted for investment purposes as imposed by contractual or legal requirements, such as bond indentures, loan or grant agreements, or donor instructions. The restrictions imposed by external donors and funding agencies may both constrain a manager's ability to invest the portfolio assets and may have a corresponding impact on portfolio performance. The investment of sinking funds, bond reserve funds, and bond proceeds shall comply with I.C. §12C.9.

Therefore, the investment performance of restricted funds should be judged in light of these constraints. If this policy and the above restrictions are in conflict, the most restrictive requirements shall apply.

The institutions, and any designated external investment agents, shall exercise the judgment and care, under the circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in their own affairs. (I.C. §§633.123(1), 262.14(3), and 12B.10(2)). The investment managers are responsible for complying with all provisions contained in this policy. The Board Office is responsible for reviewing investment reports provided by the institutional treasurers, communicating with the Banking Committee, and assisting the Banking Committee and the Board in meeting its public responsibilities.

B. Authority

The legislature of the State of Iowa delegates to the Board of Regents the authority to govern the University of Iowa, Iowa State University, University of Northern Iowa, Iowa Braille & Sight Saving School, and Iowa School for the Deaf. It is the responsibility of the Board of Regents and its Banking Committee to set investment policy in accordance with I.C. Chapter 12B, establish objectives, delegate authority, and ensure that the institutions carry out their responsibilities.

The Banking Committee is delegated authority by the Board of Regents for the review of investment and treasury management activities of each institution. The Committee shall ensure that the institutions, through the vice presidents of finance and treasurers, comply with Board policy and perform as can reasonably be expected.

The Board delegates management and oversight authority for the investment program at each institution to the vice president for finance. The Board appoints the treasurers for each institution who are delegated authority by the vice president for finance to operate the investment and treasury management activities of the institution within the policy and procedures defined by the Board of Regents and the respective institution and to perform all related activities as specified in I.C. §262.14(3).

The Auditor of State is responsible for providing auditing services to institutions governed by the Board which include reporting to the Board any non-compliance with investment policy and state law. The Board of Regents is responsible for remedying any non-compliance with its policies and state law. (I.C. §11.2)

Deleted: The Auditor shall report any non-compliance with state law and Regents investment policy.

C. Risk Tolerance

The treasurers, as well as external investment managers, with input from the investment advisor, are directed to manage the investment portfolios for the use and benefit of the respective institutions in a manner that recognizes the following characteristics in determining the risk tolerance of each portfolio:

1. Exposure to purchasing power risk
2. Regulatory and legal considerations
3. Liquidity requirements
4. Need for income stability
5. Return objectives
6. Investment time horizon

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The institutions are directed to maintain security safe-keeping controls and internal controls to prevent losses.

D. Asset Class Objectives

1. The purpose of cash equivalent investments (defined as those securities maturing within one year) is to provide liquidity and preserve capital.
2. The purpose of fixed income investments (defined as those securities with maturities greater than one year) is to provide stability and generate income.
3. The purpose of equity investments is primarily to provide capital appreciation. It is recognized that this requires the assumption of greater market variability and risk than is the case with fixed income investments.
4. The overall objective is for the asset classes to work in concert to manage market fluctuations and their impact on the value of the portfolio.
5. Individual asset class performance will be measured in the short-term and long-term against applicable component benchmarks.

E. Operating Funds Investment Guidelines

1. Overview

For investment purposes, operating funds are defined as those general use and restricted funds not included in the institutions' endowment portfolio. The operating portfolio shall consist of investments which are needed to meet underlying cash requirements of the institutions.

2. Fund Objectives

The primary goals of investment prudence shall be based in the following order of priority (I.C. §12B.10):

a. Safety of principal.
b. Maintaining the necessary liquidity to match expected liabilities.
c. Obtaining a reasonable return.

The operating portfolio shall be managed to ensure funds are available to support operational needs.

3. General Restrictions and Other Provisions

a. The operating portfolio shall not be invested in securities that at the time of purchase have effective maturities exceeding sixty-three months. (I.C. §12B.10.6.d.4) The effective maturity shall be defined as weighted average life.
b. The maximum duration of each institution's operating portfolio shall not exceed the duration of the Merrill 1-3 year Government/Corporate Index by more than 20%.
c. The weighted average credit quality of each institution's operating portfolio shall be AA or Aa as rated by Standard & Poor's or Moody's, respectively.
d. UP to 20 percent of each institution's operating portfolio may be invested in bonds rated A and BBB in order to enhance portfolio yield. Any bonds downgraded below investment grade subsequent to purchase shall be reviewed in accordance with section I, Performance Evaluation Standards, of this policy statement.

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e. Short sales, purchase of private placements (other than Rule 144A Fixed Income Securities), stock index and interest rate futures, purchases of securities on margin credit, purchase of options or investments in commodities or transactions of a similar nature are not authorized investments unless undertaken by an open-end management company or the Common Fund for Non-Profit Organizations.

f. There shall be no borrowing for investment purposes.

g. Diversification by the number of individual securities, industry, economic sector, and within governmental issues is viewed as desirable.

h. Except for Treasury or Agency debentures, pass-throughs or REIMICs, no more than 5% of the portfolio shall be invested in securities of a single issuer.

i. Any gift accepted by the Board of Regents for the use and benefit of any institution under its control may be invested in securities designated by the donor; but whenever such gifts are accepted and the money invested according to the request of the said donor, neither the state, the Board of Regents, nor any member thereof, shall be liable therefore or on account thereof.

j. The institutions may charge a reasonable management fee to offset expenses.

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4. Authorized Investments (I.C. §§12B.10.6d and 12B.10A.4d)

a. Obligations of the United States government, its agencies and instrumentalities.

b. Certificates of deposit and other evidences of deposit at federally insured depository institutions approved pursuant to I.C. Chapter 12C.

c. Prime bankers' acceptances that mature within two hundred seventy days and that are eligible for purchase by a federal reserve bank, provided that at the time of purchase no more than thirty percent of the investment portfolio shall be in investments authorized by this paragraph and that at the time of purchase no more than five percent of the investment portfolio shall be invested in the securities of a single issuer.

d. Commercial paper or other short-term corporate debt that matures within two hundred seventy days that is rated within the two highest classifications, as established by at least one of the standard rating services approved by the Superintendent of Banking by rule adopted pursuant to chapter 17A, provided that at the time of purchase no more than five percent of all amounts invested in commercial paper and other short-term corporate debt shall be invested in paper and debt rated in the second highest classification, and provided further that at the time of purchase no more than thirty percent of the investment portfolio shall be in investments authorized by this paragraph and that at the time of purchase no more than five percent of the investment portfolio shall be invested in the securities of a single issuer.

e. Repurchase agreements whose underlying collateral consists of the investments set out in paragraphs "a" through "d" if the treasurer of the instiutiton takes delivery of the collateral either directly or through an authorized custodian. Repurchase agreements do not include reverse repurchase agreements.

f. Investments authorized for the Iowa Public Employee Retirement System, not otherwise restricted in this policy, in section 97B.7A.

g. Corporate debt with a maturity of greater than 270 days that is rated investment grade by Standards & Poor's or Moody's (at least BBB- or Baa3, respectively), or by another Nationally Recognized Statistical Rating Organization (NRSRO), including Rule 144A Securities that are deemed to be of investment grade credit quality by the external or internal investment manager, at the time of purchase. Rule 144A was introduced by the SEC to allow corporations to place securities privately with large sophisticated institutional investors without extensive registration documents.

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h. External investment managers overseeing operating portfolio funds may purchase mortgage pass-through securities and asset-backed securities that are issued by U.S. government agencies or carry an A rating at the time of purchase from Standard & Poor's or its equivalent as defined by Moody's or another Nationally Recognized Statistical Rating Organization (NRSRO).

i. "Yankee" bonds – dollar-denominated bonds issued in the U.S. by foreign corporations, banks, and governments that meet the credit quality guidelines outlined in this policy.

j. An open-end management investment company organized in trust form registered with the federal Securities and Exchange Commission under the federal Investment Company Act of 1940, 15 U.S.C. Section 80(a), and operated in accordance with 17 C.F.R. Section 270, 2a-7.

k. Shares issued by open-end management investment companies and exchange traded funds registered with the federal Securities and Exchange Commission and whose investments are limited to those set forth in sections a through j above.

l. The Common Fund for Non-Profit Organizations.

F. Endowment Funds Investment Guidelines

1. Overview

The endowment funds of the institutions, in recognition of their long-term charters, shall be managed with the intention of obtaining the highest possible total return (current income plus net realized and unrealized appreciation), while adhering to the Investment Policy set by the Board. The real value of the endowment funds should be preserved over time; that is, a sufficient portion of total return should be reinvested on average over time to keep pace with cost increases or to sustain program objectives.

The endowment income should be sufficient to meet the reasonable spending needs of the various endowment funds. These funds should be invested in an Endowment Portfolio consisting of authorized investments defined in this policy statement.

The Board endorses a long-term approach to managing the endowment assets but believes this should not be viewed as justification for exposing the endowment assets to levels of volatility that might significantly affect the principal value of the endowments.

Quasi-endowment funds are similar to endowment funds; however, there is no externally imposed restriction that the principal remain intact in perpetuity. The different attributes of the quasi-endowment fund may lead to a different asset allocation than the endowment. Therefore, individual quasi-endowment funds may be invested in either the endowment portfolio, a fixed income portfolio, or some combination thereof.

Notwithstanding the potential difference in asset allocation, it is the Board's intention to manage the quasi-endowment funds in accordance with the restrictions and authorized investments outlined below for the endowment funds.

2. Fund Objectives

a. In recognition of their long-term charters, these funds shall be managed actively with the intention of obtaining the highest possible total return (current income plus a net realized and unrealized appreciation) while accepting only prudent risk.

b. These funds shall be managed to maintain and preserve over time the real (i.e., net of inflation) value of the funds.

c. Investment policy must be integrated with the spending policy of the endowment fund. The purpose of the spending rate formula is to provide a stable income stream that keeps pace with inflation and does not degrade the real value of the corpus of the endowment over time. The spending formula and spending rate for the endowment will be periodically reviewed by the Banking Committee. Spending policies shall be in accordance with the Uniform Management of Institutional Funds Act, I.C. 540A.

d. The fund shall consist of a prudent, diversified investment portfolio.

3. General Restrictions and Other Provisions

a. Short sales, purchase of private placements (other than Rule 144A Fixed Income Securities), stock index and interest rate futures, purchases of securities on margin credit, purchase of options or investments in commodities or transactions of a similar nature are not authorized investments unless undertaken by an open-end management company, the Common Fund for Non-Profit Organizations as specifically noted in this policy.

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b. There shall be no borrowing for investment purposes.

c. Diversification by the number of individual securities, industry, economic sector, and within governmental issues is viewed as desirable.

d. The following restrictions shall apply to each individual endowment portfolio and shall be measured by the total market value of each endowment:

1) Except for Treasury or Agency debentures, pass-through or REIMCs, no more than 5% of the portfolio shall be invested in securities of a single issuer.

Deleted: No more than five percent of the portfolio shall be invested in securities issued by one company.

2) No more than ten percent of any outstanding issue shall be held.

3) No more than five percent of the portfolio shall be invested in initial common stock offerings sold to the public within the prior 12 months.

4) No more than one percent of the portfolio shall be invested in any initial offering of common stock.

5) Common and preferred stocks and convertible bonds shall not normally comprise more than 70 percent of the total value of all endowment funds.

6) No more than ten percent of the portfolio shall be invested in an international equities fund, as specified by the Board.

e. Notwithstanding the above general restrictions and the following list of authorized investments, it is the intent of the Board that portfolios be broadly diversified. The approach to investment shall be disciplined and consistent over time and among asset classes. Allocations among asset classes shall be modified or new classes or investment strategies added when such actions are expected to produce incremental returns, to reduce risk, or both. Opportunities for specific investments requiring changes in investment restrictions will be considered when consistent with overall policy and will be subject to evaluation by institutional treasurers and to approval of the Board of Regents based upon the recommendations of the Banking Committee and Board Office.

f. Notwithstanding provision 3.a above, the Banking Committee may authorize covered call writing and the use of stock index and interest rate futures and options for endowment purposes only. A decision to authorize these derivative instruments shall be for particular and limited purposes and shall be justified in writing. Authorized derivative instruments are to be used exclusively for hedging purposes and not for speculative designs.

g. 2) The institutions may continue to hold in their endowment funds any gifts-in-kind where it is prudent to do so, without regard to the following list of authorized investments. I.C. §§262.14.4 and 633.123.2-4). Gifts accompanied by donor instructions to purchase an unauthorized investment are allowed if the investment is carefully evaluated as to its investment merit by the institution and if notice of such investment is provided immediately to the Executive Director of the Board and the Banking Committee. Unrestricted gifts to endowments shall be incorporated into the asset allocation outlined under this policy statement as soon as is practical.

h. The institutions may charge a reasonable fee to offset management and other donor related expenses.

i. Exceptions to the restrictions noted above may occur when stocks or bonds are donated to the endowment funds or as a result of significant price movements in the market or in a particular issue. The Executive Director of the Board and Banking Committee shall be informed immediately of any exception.

4. Authorized Investments

a. All investments designated as qualified investments for the institutions' operating portfolios as defined in section E.4 of this policy.

b. <u>Domestic Equities</u>.

1) Stocks of companies listed on the New York Stock Exchange, American Stock Exchange, or National Association of Security Dealers Automatic Quotation System. ADRs existing prior to 1984 are exempt in accordance with SEC rules.

2) Real Estate Investment Trusts listed on the New York Stock Exchange, American Stock Exchange, or National Association of Security Dealers Automatic Quotation System.

3) New issues of high quality common stock registered with the Securities and Exchange Commission.

c. International Equities.

1) The restrictions on the purchase of domestic equities for the endowment portfolio do not apply to international equities.

2) The Fund Manager is responsible for maintaining the character of the portfolio in accordance with the investment guidelines, as stipulated in the agreement between the University and the Manager, and the following:

a). The Fund Manager shall invest only in developed market countries that are included in the MSCI World ex-US Index.

b) The Fund Manager may engage in currency hedging transactions in so far as the transactions shall be for investment not speculative purposes, and intended only to protect expected earnings.

3. Exceptions to this approach must be approved in advance by the Banking Committee, noted in the Committee minutes, and provided in writing to the Fund Manager and the university treasurers.

d. Fixed Income.

1) Investment grade corporate bonds. Investment grade bonds are defined as being those rated at or better than BBB ("regarded as having an adequate capacity to pay interest/dividends and repay principal") as defined by Standard and Poor's or its equivalent by Moody's or another Nationally Recognized Statistical Rating Organization. Up to 20 percent of the total endowment fixed income allocation may be invested in bonds rated A and BBB in order to enhance portfolio yield. Any bonds downgraded below investment grade subsequent to purchase shall be reviewed in accordance with section I, Performance Evaluation Standards, of this policy statement.

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2) Zero-coupon securities otherwise authorized in this policy.

3) Convertibles – corporate bonds that can be exchanged, at the option of the holder, for a specific number of shares of the company's preferred stock or common stock.

4) There is no explicit limit on the average maturity of fixed income securities in the endowment portfolios. The effective duration of each fixed income portfolio shall be within a range of plus or minus 25% of the duration for that portfolio's established benchmark.

5) The weighted average credit quality of each institution's endowment fixed income portfolio shall be AA or Aa as rated by Standard & Poor's or Moody's respectively.

e. Mutual funds/exchange traded fund

Shares issued by open-end management investment companies and exchange traded funds registered with the federal Securities and Exchange

Commission and whose investments are limited to those set forth in sections a through d above.

5. Asset Allocation Guidelines

The allocation ranges shown below are intended to serve as a guide to the individual institutions in formulating asset mixes for their portfolios and may in the future be changed.

Asset Class	Target	Allowable Range	Benchmark
U.S Equities	63%	58-68%	Wilshire 5000
Large Cap Core	35	30-40	S&P 500 Index
Large Cap Index	13	10-16	S&P 500 Index
Mid Cap Growth	10	8-12	Russell 2500 Growth
Small Cap Value	5	3-7	Russell 2500 Value
U.S. Bonds	30%	25-35%	
Core	30	25-35	Lehman Aggregate
International Equities	7%	4-10%	MSCI EAFE
Other *	0%	0-15%	

* Other asset classes to be added in the future.

The treasurers shall rebalance to the established targets during the quarter following the quarter ended whenever the asset class allocation falls outside of the allowable range specified above.

G. Selection of External Providers

Preference shall be given to purchasing services from Iowa based businesses if the bids submitted therefore are comparable in price to bids submitted by out-of-state businesses and otherwise meet the required specifications. (A.I.C. 681-8.1(1)a) Selections shall be made in a manner that will enhance the economy of this state, and in particular, will result in increased employment of the residents of this state.

1. Investment Advisor

Selection of external Investment Advisors shall take place in accordance with [Policy Manual Section 7.05.E.8], Professional Service Contracts. For the Investment Advisor, a competitive Request for Proposal (RFP) process shall occur no less than every five years.

2. External Investment Managers

The institutions may employ and discharge, subject to approval by the Banking Committee and the Board, external managers to assist in the management of endowment and operating assets. This may be done to provide the institutions with the benefit of external managers' special skills and diverse investment thinking. The external managers should supplement the internal investment management resources of the institutions. The external managers are under no obligation to consider the strategy or tactics of any other manager in reaching decisions for the assets assigned to them. Each manager is to be judged on the basis of individual performance relative to the guidelines contained in this policy.

3. Brokerage Firms

   The institutions shall have the discretion to execute transactions with brokerage firms approved by the Banking Committee and the Board. Selection of brokerage firms shall be based on the quality of execution rendered, the value of research information provided, the financial health of the brokerage firm, the general business integrity of the firm, the cost of services and the overall efficiency in transacting business. After a brokerage firm is approved by the Board, the Banking Committee shall be notified if any of the above factors change and the institution no longer wants to execute transactions through that firm.

4. Public Fund Custodial Agreements

   The institutions under the control of the Board of Regents shall utilize public funds custodial agreements in compliance with rules promulgated by the Treasurer of State under I.C. §12B.10C and A.I.C 781— 15]

H. Execution of Transactions

Execution of transactions will seek to achieve a balance between reduction of commission costs and "best price."

The institutions shall not do business with any brokerage firm that mandates binding arbitration as the only recourse for settlement of a disputed claim.

Deleted: There are no specific restrictions on portfolio turnover; however, the Board anticipates that longer term performance will result from conservative investment strategies, not trading strategies. Trading done for the purpose of arbitrage or short term speculative gain is prohibited.)

The institutions and the brokers with whom they execute transactions shall exercise their best efforts in minimizing transaction costs and market impact while achieving executions at competitive prices.

The institutions shall regularly solicit competitive bids from two or more brokers before executing transactions, and shall require that the brokers provide confirmations of trades to the treasurers except in the following circumstances:

a. The security is a new offering of direct obligations of the U.S. government or agencies of the U.S. government.

b. The security is maturing within one year from the purchase date.

c. It is deemed in the best interest of the institution and is approved in writing by the Treasurer or Vice President for Finance, i.e. where timing or placement is a concern and additional solicitation would likely have a detrimental effect or loss of opportunity.

I. External Investment Managers

With the assistance of the Board's investment advisor and the Board Office, the institutions shall be responsible for evaluating and selecting external managers as the need arises, subject to Banking Committee and Board approval. The Banking Committee shall be offered an opportunity to participate in the interview and selection of external managers.

Any written agreement executed between an institution and external manager shall be reviewed by the Board Office.

It is the Board's desire that each manager clearly understand the role of investment policy. Each manager shall communicate individual portfolio strategy and performance results to the respective institution and to the Banking Committee.

Additional protocols applying to external investment managers are as follows:

a. The investment managers may, within policies and guidelines determined by the Banking Committee and the institution and approved by the Board, have full discretion to buy, sell, invest and reinvest in investment assets on behalf of the institutions, or only be granted advisory authority.

b. Specific guidelines for each manager on the selection and use of appropriate investments shall be incorporated in the investment manager agreement. Guidelines and standards will be developed for each manager, and will be subject to periodic review with each investment manager to confirm their continuing adequacy.

c. Any fundamental amendments in strategy will be discussed among the Banking Committee, Board Office, the institutions and the external managers prior to implementation.

d. The institutions will inform the investment mangers as soon as practical of anticipated major additions to or withdrawals from the portfolio. Routine additions to and withdrawals from the portfolio will be reported by the institutions to the managers. The managers will be free to determine the most appropriate use of cash and securities additions within the established guidelines and will similarly determine the most appropriate manner in which to raise cash for withdrawals. Monthly accounting statements and investment reviews will be provided to the institutions by the external managers.

e. The Banking Committee and the institutions intend to maintain open communication with the external investment managers. The focus of these exchanges will be to understand the managers' expectations for the economy and capital markets and how these are reflected in the portfolio. A necessary part of the communication process is the evaluation of the progress of the portfolio, and to this end, investment results will be reviewed quarterly.

f. Any extraordinary losses or conditions which could reasonably be expected to lead to an extraordinary loss or any violation of the policies set forth above shall be reported immediately by the investment manager to the institutional officers and Board Office.

g. Analysis of performance will be within the context of the manager's particular investment objectives as determined by the institution and the Banking Committee.

h. All contracts or agreements with an investment entity or investment professional employed by an institution governed by the Board of Regents shall require the investment entity or investment professional employed by an institution governed by the Board of Regents to notify in writing the Board of Regents within thirty days of receipt of all communications from an independent auditor or the Auditor of State or any regulatory authority of the existence of a material weakness in internal control structure, or regulatory orders or sanctions against the investment entity or investment professional, with regard to the type of services being performed under the contracts or agreements. This provision shall not be limited or voided by another contractual provision. (I.C. §11.2)

J. Performance Evaluation Standards

Analysis of performance will always be within the context of the prevailing investment environment. Specific performance indices will be selected for each institution's operating assets and endowment assets, and incorporated into the investment guideline statements prepared for each institution. The investment performance of the institutional portfolios will be evaluated relative to, and be expected to exceed, the following standards:

Deleted: It is not anticipated that comparisons with market indices and peer groups will be favorable in every single quarter or year. It is, however, expected that they will be favorable over a full market cycle or a three-year period, whichever is shorter.

For all portfolios:

1. Each investment manager strategy will be evaluated against the established benchmark for that component asset class.
2. The entire portfolio return will be evaluated against a weighted average benchmark using the strategic asset allocation within this policy statement.

Deleted: The 50th percentile of the investment return distribution for representative funds over longer time periods.

The aspects of each manager relationship will be monitored through frequent oral and written contacts by each manager and through quarterly performance evaluations. Qualitative assessments will focus on organizational and staff stability, adherence to investment philosophy and process, asset/client turnover, and the quality of client service.

A significant and potentially adverse event related to, but not limited to, any of the following qualitative issues or events will generally cause the outside manager to be reviewed, depending on the impact of the event or issue:

- A significant change in firm ownership and/or structure.
- The loss of one or several key personnel.
- A significant loss of clients and/or assets under management.
- A profound shift in the firm's philosophy or process.
- A significant and persistent lack of responsiveness to client requests.
- A change in the Board's asset allocation which eliminates the need for a particular manager's investment style or strategy.
- Chronic violations of the investment guidelines outlined in this Policy Statement.

The Investment Advisor and each Investment Manager are responsible for monitoring and reporting on any qualitative issues.

K. Reporting Requirements

1. Extraordinary Losses and Policy Violations

   Any extraordinary losses or conditions which could reasonably be expected to lead to an extraordinary loss or substantial violation of the Board's investment policies shall be reported immediately by:

   a. External investment managers to the institutional officers and Board Office.

   b. The Executive Director of the Board shall consult immediately with the Chair of the Banking Committee and the Board President.

   In such cases, the institutions and the Board Office, in consultation with the investment advisor, shall recommend corrective action to avoid imminent losses, to prevent further losses, or to correct a substantial policy violation. The resolution of the issue shall be the express responsibility of the institutional treasurers, vice presidents for finance, with the active consultation and consent of the Executive Director of the Board, the Chair of the Banking Committee and the Board President.

Issues of losses or imminent losses shall be addressed and shall progress toward speedy resolution as soon as practicable. Policy violations shall be addressed immediately and a process initiated to resolve the violation.

2. Institutions

The vice presidents for finance and treasurers shall prepare reports on all internally invested funds no less frequently than quarterly.

The report format developed by the Board Office and institutional treasurers shall contain information requested by the Banking Committee.

More detailed investment policies and procedures adopted by individual institutions shall be submitted to the Banking Committee for review and approval.

3. Internal Auditor

The internal auditor of each institution shall quarterly review and report on compliance with the Board of Regents investment policy and periodically assess internal controls over investments.

4. Investment Advisor

The Board's investment advisor will present annually to the Banking Committee a comprehensive evaluation of the performance of the Board's external portfolio managers. The investment advisor's evaluation will include, at a minimum, all of the elements listed above for the investment managers' quarterly reports, as well as evaluations of the managers' performance including comparisons to performance of relevant market segment indices. The review will contain specific recommendations by the investment advisor with regard to maintaining or modifying investment strategies, and asset allocation, and continuing or terminating contracts with portfolio managers.

The Board's investment advisor shall prepare reports on all invested funds no less frequently than quarterly and collaborate as needed with the vice president for finance and treasurer of each institution and the Board Office regarding any changes required to the report content or format. The report format developed by the Board Office and institutional treasurers shall contain information requested by the Banking Committee. The objective of the reports shall be to assist the Banking Committee in assessing the performance of each institution's portfolios.

5. External Investment Managers

The managers will be expected to meet with the Banking Committee, Board Office and institutional representatives annually or upon request to review the investment outlook, structure of their portfolios and past results. At a minimum, the review will include:

a. A review of the investment results achieved over recent time periods such as the prior quarter and year in relation to the managers' investment views and internal policies in effect prior to, and during the periods;

b. The managers' current outlook for the economy and capital markets over the next 6-12 months;

c. The internal investment policies that have been adopted in response to these expectations;

d. The appropriateness of the present portfolio given the expectations and internal policy;

e. A review of the guidelines given to the investment manager to determine if changes are necessary.

f. Any substantive changes expected in the portfolio or in the organization prior to the next review setting.

g. The amount of funds authorized for investment by the manager.

L. Policy Review

These policies are approved by the Board of Regents and are effective upon Board approval, and are provided to the president, vice president for finance, treasurer and other appropriate officials at each institution. It is the intention of the Board to review these policies formally with the vice presidents for finance/ treasurers, investment advisor, and any external managers annually to reaffirm their relevancy or revise them as appropriate. Board members, the Banking Committee and the institutions may suggest revisions as changes are warranted.

7.07 Compliance and Reporting

I. Banking Activity

1. The Board shall collect the highest rate of interest, consistent with safety, obtainable on daily balances in the hands of the treasurer of each institution. (Code 262.9[10])
2. Demand deposit accounts and other similar accounts can only be established at banks approved pursuant to I.C. 12C and previously approved by the Board. Proposed changes in the banking relationships shall be reviewed by the Banking Committee and approved by the Board. (I.C. §12C.2)
3. A deposit of public funds in a depository pursuant to this chapter shall be secured as follows (I.C. §12C.1.3):
   a. If a depository is a credit union, then public deposits in the credit union shall be secured pursuant to sections 12C.16 through 12C.19 and sections 12C.23 and 12C.24.
   b. If a depository is a bank, public deposits in the bank shall be secured pursuant to sections 12C.23A and 12C.24.