To:	**Board of Regents, State of Iowa – Banking Committee**
cc:	Pamela Elliott
From:	Mark E. Brubaker
Phone:	(412) 434-1580
Date:	October 6, 2003
Subject:	***Proposed Changes to the Investment Policy Statement for Endowment and Operating Funds***

Wilshire Associates and Board staff are recommending that the Banking Committee of the Board of Regents State of Iowa adopt the attached revisions to the Investment Policy for Endowment and Operating Funds. The revisions that are being proposed are designed to achieve the following primary objectives:

- Enhance the clarity of the document by separating the investment guidelines of the operating and endowment funds and adding additional descriptive language where appropriate
- Modify the investment guidelines to allow for increased diversity and appropriate risk controls.

The most meaningful changes to the policy are summarized below:

- ***Guidelines specific to either the Operating Funds or Endowment Funds have been separated in sections E. and F. of the Policy***. This change is intended to make it easier for all users of the Policy to distinguish which restrictions and authorized investments apply to each Fund.

- ***For the Operating Fund, we changed the 63 month maximum maturity restriction to a 63 month maximum restriction on effective maturity***. We also clarified that for purposes of callable securities such as mortgages, effective maturity would be defined as average life. These changes will now allow for the purchase of mortgage-backed securities, which under the old Policy language was severely restricted. Mortgages account for roughly 40% of the intermediate fixed income market and are an integral part of most institutional fixed income portfolios. It is important to note that this change does not increase the interest rate risk of the overall portfolio because in conjunction, we have also added an overall duration limitation for each Operating Fund, which shall be no more than 20% longer than the Merrill 1-3 Year Government/Corporate Index.

- ***We have added language to allow the purchase of Rule 144A Fixed Income Securities***. Rule 144A was introduced by the SEC to allow corporations to place securities privately with large, sophisticated institutional investors, without extensive registration documents. Rule 144A securities make up a significant portion of the investment grade fixed income market and are commonly used by institutional fixed income managers.

- ***We have lowered the minimum credit quality for Asset-Backed Securities (ABS) from AAA to A*** to be more consistent with the credit guidelines for corporate bonds (must be investment grade, i.e. BBB- or better) and to broaden the universe of ABS that may be used. At present, there is a very limited number ABS rated AAA and this segment of the fixed income market has not played much of a role in the portfolio as a result. ***It is important to note that new language has also been added to better manage credit risk by requiring average credit quality of the Operating and Endowment Funds fixed income portfolios to be at least AA.***

- ***Investment grade Yankee bonds (Operating and Endowment Funds) and convertible securities (Endowment Funds only) are now explicitly permitted*** where in the past, the policy was silent regarding these sectors of the fixed income market. Yankee bonds are dollar-denominated bonds issued in the U.S. by foreign corporations, banks and governments. Convertibles are corporate bonds that can be exchanged, at the option of the holder, for a specific number of shares of the company's preferred or common stock.

- ***The international equity guidelines were modified to eliminate the Board specifying which countries were permissible for investment***. This restriction was replaced by the requirement that eligible countries must be developed markets and included in the MSCI World ex-U.S. index of all non-U.S. developed markets. This change will make the document more flexible going forward as new countries achieve developed market status (most recently, Greece was added to the index).

- ***The target allocation to each asset class and investment style was added along with the minimum and maximum allocation and appropriate benchmark for each. The rebalancing policy was also included to document this important discipline.***

We believe the above changes represent meaningful improvement over the original document. The broadening of the permissible fixed income sectors (mortgages, A-rated ABS, Yankees and convertibles), when combined with the new duration and average credit quality restrictions imposed at the total Fund level, should serve to reduce risk by allowing broader diversification within the fixed income portfolios.

Please feel free to call me on (412) 434-1580 should you have any questions or comments regarding the revised Investment Policy.