

Meeting No. 978

THE MINUTES OF THE BOARD OF REGENTS
OF
THE UNIVERSITY OF TEXAS SYSTEM

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April 29, 2004

Austin, Texas

MEETING NO. 978

THURSDAY, APRIL 29, 2004.--The members of the Board of Regents of The University of Texas System convened this special called meeting at 10:22 a.m. on Thursday, April 29, 2004, on the Ninth Floor, Ashbel Smith Hall, 201 West Seventh Street, Austin, Texas, with the following in attendance:

ATTENDANCE.--

Present
Chairman Miller, presiding
Vice-Chairman Clements
Vice-Chairman Hunt
Vice-Chairman Krier
Regent Barnhill
Regent Caven
Regent Craven
Regent Estrada
Regent Huffines

Absent

Counsel and Secretary Frederick

In accordance with a notice being duly posted with the Secretary of State and there being a quorum present, Chairman Miller called the meeting to order.

U. T. Board of Regents: Discussion regarding Board's ongoing review of The University of Texas Investment Management Company (UTIMCO) issues including Board oversight, contractual relationship, and the structure of UTIMCO and approval of general recommendations from UTIMCO Working Group Report

A Resolution passed unanimously by the U. T. Board of Regents on December 19, 2003, directed the Board to examine and evaluate the structure and services of The University of Texas Investment Management Company (UTIMCO). Chairman Miller appointed a UTIMCO Working Group as announced on February 3, 2004, to review issues including Board oversight, contractual relationship, and the structure of UTIMCO. A Report of the Working Group entitled "[Report of the UTIMCO Working Group to the Board of Regents of the University of Texas System Regarding Certain Investment Management and Oversight Issues](#)" (UTIMCO Working Group Report) was provided to the Board prior to the meeting and is on file in the Office of the Board of Regents.

Prior to providing opening remarks, Chairman Miller stated that the Working Group was asked to conclude work in time for discussion by May 1. He said unless there were objections, he wanted this meeting to be more flexible than formal and asked that any action be held until later in the meeting.

Opening Statement by Chairman Miller

I would like to briefly describe the reasons for the review and say some things we already talked about in December (2003) for the general public who may not have heard that. Many functions of The University of Texas System have been or are being subjected to review. It has been good business to do that; good organizational business, and for the time period where those kinds of things may be more necessary or more understood than previous periods. I am going to read these out loud because I think it is important for people to see the sense of that and put that in the context of what we are doing here today. In recent past, the U. T. System has been extensively engaged in examining and bringing up-to-date many of its oversight and governance functions including

- Update and revision of the Regents' Rules and Regulations
- Full outside audit of the U. T. System
- Creation of the Audit, Compliance, and Management Review Committee
- Development of a public institution version of the Sarbanes-Oxley oversight process
- Development of the policy of conducting a Management Audit upon change of senior management at U. T. System institutions
- Development of a policy of providing U. T. System-assisted Management Audit teams to institutions facing extraordinary circumstances
- Creation of a performance review process for evaluation of institutional and leadership performance
- Project to review Executive Compensation
- Creation of a Higher Education Accountability System for U. T. and for the State of Texas

- Extensive review of the structure and governance of internal foundations and related organizations
- Management review of University Lands – West Texas Operations
- Extensive review and evaluation of the individual institutions' Boards of Visitors and similar entities
- Reorganization of The University of Texas System staff and its financial structure
- Technology transfer review
- External Affairs/Communications Plan
- Task Force on “Closing the Gaps” Capital Funding for Academic Institutions
- Review of UTIMCO

There are also recent examples of failures of outside organizations that abound, virtually unlimited in number and in scope, in the corporate, nonprofit, and government areas. The New York Stock Exchange, churches, the United Nations, banks, investment banks, mutual funds, hedge funds; virtually every day we read something about essentially failures of government and oversight. I think that puts us in a position and a timeframe where those kinds of things must need attention, no matter who you are or what you do. Those are required activities, and we have had numerous examples of policy and operational issues regarding UTIMCO over the years and some remain unresolved. I believe the focus today will be on what are policies and procedures the Board of Regents can implement to properly carry out its fiduciary duty.

There are costs to this Working Group. I want to comment on those up front. The estimated cost I have on hand now would be somewhere between \$350,000 and \$375,000. That is expensive; however, the cost of not doing it is significantly higher, financially and otherwise. Our beneficiaries, people who get the income from the funds we have, spend \$25 to \$35 million at UTIMCO annually, not counting embedded trading costs and other indirect costs, and that is equal to the funds we spend from those safe fiduciaries for managing the U. T. System entirely, and we have not fully resolved some of those issues. I think

that gives a perspective of what the cost for this is. The other question is are these expenditures immune from our full duty to oversee them, and I think we all know the answer to that -- they are not.

There were four presentations by members of the UTIMCO Working Group: Baker Botts L.L.P., Ennis Knupp + Associates, Interim Vice Chancellor Aldridge, and Professor Henry T. C. Hu as follows:

Baker Botts L.L.P.

Mr. Charles Szalkowski, Partner, Baker Botts L.L.P., thanked Chairman Miller and introduced the other members of the UTIMCO Working Group:

Mr. Philip Aldridge, Interim Vice Chancellor for Business Affairs

Mr. Charles Chaffin, Chief Audit Executive

Mr. Cullen M. (Mike) Godfrey, Vice Chancellor and General Counsel (not in attendance at this meeting)

Ms. Francie Frederick, Counsel and Secretary to the Board

Mr. Steve Voss, Consultant, Ennis Knupp + Associates

Mr. Mike Sebastian, Consultant, Ennis Knupp + Associates

Mr. Kevin Hegarty, Vice President and Chief Financial Officer, U. T. Austin

Professor Henry T. C. Hu, Allan Shivers Chair in the Law of Banking and Finance, School of Law, U. T. Austin

Mr. Christopher Brown, Partner, Baker Botts L.L.P.

With assistance from:

Ms. Sandra Neidhart, Assistant Director of Audits, U. T. System

Ms. Shannon Brinkley, Executive Associate, U. T. System

Mr. Charles Szalkowski said topics on which the Working Group was asked to report were divided among members who independently worked on separate reports, meeting weekly by telephone and three times in person. He noted the Working Group was not asked to and did not attempt to reach consensus on every section.

He said the Working Group wished to express appreciation for the responsiveness, cooperation, and assistance of UTIMCO staff; Cambridge Associates; U. T. System staff, including staff from the campuses; and Ms. Melissa Russell, Baker Botts L.L.P., who headed the team that produced the Report.

Mr. Szalkowski said improvements made by the Board of Regents, U. T. System staff, and UTIMCO staff outlined in the Baker Botts report from Spring 2003 are listed behind Tab 1 of the UTIMCO Working Group Report and he expressed

appreciation for the diligence of the Board of Regents, U. T. System staff, and UTIMCO staff in addressing the comments. He then highlighted the following points from the Baker Botts section behind Tab 12 of the Report:

- The UTIMCO arrangement is a good one and one that could be made better. How the Board handles and oversees delegation of funds management is crucial.
- The Board of Regents' primary structural control is through the UTIMCO Board of Directors who work for the Board of Regents. The process for recruiting and selecting those directors can be improved, but there is a chain of command from the U. T. Board of Regents to the UTIMCO Board of Directors to the UTIMCO management and to the outside money managers.
- As a primary tool, the Board of Regents has adopted formal written investment policies, and it seems logical to compare the policies periodically with whether what the UTIMCO Board is doing actually complies and review those written policies to see whether they still reflect the Board's wishes. The Board should have an understanding of the policies and be comfortable with the policies and with the delegated responsibilities they imply to the UTIMCO Board and management.
- There are two different qualities associated with oversight of the Board's delegates -- internal control and investment results.
- There clearly needs to be more interaction between the Board of Regents and their delegates, the UTIMCO directors and their top-level delegates, and UTIMCO management.

Ennis Knupp + Associates

Mr. Steve Voss provided background regarding Ennis Knupp's involvement with the review of UTIMCO issues. He said Ennis Knupp was hired by the Board of Regents in August 2003 to serve as the Board's independent investment consultant to provide assistance with matters of oversight of UTIMCO, policy development, and other issues and was asked to participate in the Working Group.

As detailed in Ennis Knupp's section behind Tab 4 of the UTIMCO Working Group Report, Mr. Voss reviewed current objectives for the different investment funds the Board has established through the statement of investment policy and whether those objectives have been met.

Mr. Voss said with regard to investment policy setting, Ennis Knupp found some of the documentation rather vague and roles and responsibilities for setting policy not clear in the minds of all participants, those being the Board of Regents, the UTIMCO

Board, and UTIMCO management. He said Ennis Knupp envisions the Board of Regents having a joint meeting with the UTIMCO Board and U. T. System staff and consultants to determine and communicate objectives and to develop policy.

Mr. Voss stated that in terms of oversight and reporting, Ennis Knupp would like to structure a relationship that is much more collaborative in nature, working closely with UTIMCO as issues are being developed and with U. T. System staff to provide a high-level, streamlined analysis.

In Ennis Knupp's assessment of the investment management options available, Mr. Voss said a separate investment management group is in the best interest of U. T. System with some of the improvements advocated in the UTIMCO Working Group Report. He said preserving the UTIMCO structure makes sense and maintaining a separate entity provides the ability to create an investment management culture, which means an entity focused on policy and performance. UTIMCO can provide a competitive performance-based fee for the investment professionals at the asset management organization and make some attempt to isolate the investment management function from noninvestment concerns.

Interim Vice Chancellor Philip Aldridge

Interim Vice Chancellor Aldridge said 18 months ago the Board of Regents asked him to serve on a part-time basis as staff liaison to UTIMCO. At that time, the investment oversight function at U. T. System Administration was limited primarily to the Chancellor's attendance at UTIMCO Board meetings and in fact, when the liaison role was established, it was considered a somewhat radical idea that a U. T. System staff member attend a UTIMCO Board meeting.

He said Board of Regents' efforts in the oversight of UTIMCO have produced tangible results as illustrated in the list included in the UTIMCO Working Group Report behind Tab 1 entitled "Board of Regents – UTIMCO – Notable improvements since February 2003 Report". Many of these improvements were a direct result of the review conducted by Baker Botts last year at the Board's direction, and almost all of these changes related to greater involvement in noninvestment policy decisions, such as the Regents' hiring of the outside auditor for the invested funds, have been implemented by U. T. System staff in support of the Board's directives.

Mr. Aldridge then discussed the recommendations contained in Section 4 behind Tab 2 of the UTIMCO Working Group Report entitled "U. T. System Staff Observations and Recommendations on UTIMCO Review Issues". He said the document has been reviewed by all members of the Working Group and has the general agreement of the entire Group. The Working Group believes these recommendations are important to the future success of the U. T. System and constitute another step forward in the creation of a more productive relationship between the Board of Regents and its sole investment manager -- a relationship that must be built on clarity, transparency, accountability, and sustainability.

Professor Henry T. C. Hu

Remarks by Professor Henry T. C. Hu

We know that risk exists. There is an absolutely fundamental mathematical issue that cannot be avoided, and the issue is how much risk is appropriate in terms of the investments that the Board of Regents is responsible for. For instance, as a Permanent University Fund (PUF), is the safety of that fund only of moderate importance, or is it of the highest importance or is it something in between? The various investment policies relating to the PUF by the combination of the investment policy statement, the derivatives policy, and the liquidities policy are not 100% clear in terms of what the answer is, of how much risk is appropriate. This is money that the Board of Regents is responsible for; the Board of Regents has to decide how much risk should be taken with the PUF, the patrimony of the State of Texas, because the devil is in the details. The Board of Regents has to be pretty specific in terms of the limits and the constraints of risk-taking in terms of these three investment policies.

Second, there are theoretical issues. What do we mean by risk? Is it just risk in terms of market risk, is it liquidity risk, is it credit risk or operational risk? There are lots of different kinds of risk. Just in terms of the kind of risk we normally talk about, in terms of the investments, that is market risk. In terms of that, do we simply mean risk in normal conditions, in terms of what measures like standard deviation in valiant risk, or do we care in terms of extreme events such as the 1984 jump in interest rates or the 1987 Stock Market crash? Do we care in terms of stress testing to find out how much we risk, how much risk we are undertaking when it really matters? It is a difficult issue, but the Board of Regents has inescapable fiduciary duties. For instance, as to the informational aspect of these kinds of risks, from UTIMCO and the UTIMCO Board, must come the information wholly, understandably, and succinctly as possible the information as to these kinds of risks and UTIMCO's compliance with the constraints on risk-taking and other constraints in the three investment policy statements. At the Board of Regents' level, not only must the Board of Regents review the information, but be in a position to understand at least the general implications of the information it is receiving. High risk does not necessarily mean high return. Indeed, there are some studies that show the kinds of returns we get in the long run. Even the most volatile stocks actually tend to be lower, but people like to gamble. There are very few free lunches in the capital markets. It is very hard to outperform in the long run.

Third, there are empirical issues. In terms of the real world, some of the nontraditional assets; things apart from stocks and bonds, hedge funds,

derivatives, and other exotic products have special kinds of risks. As opposed to the real world, theoretical economists construct these fancy models in terms of valuing derivatives and other fancy products, making all kinds of theoretical assumptions, and one assumption is particularly heroic: continuously trading markets. In terms of market stress, trading stops. Models only fail when it really matters. In terms of operational risks, there are some things to be said for absolute return strategies, market neutral long short hedge funds and so forth, but these safe long short hedge funds and the like have been known to go bankrupt; have been known to indeed deliberately misprice illiquid securities. One particular fund, just by one entity, happened to hit two hedge funds in its portfolio, and basically ended up in serious trouble. These kinds of products also pose difficult issues in the real world in terms of assessing risk. If you look at the standard deviations in terms of the performance of long-term capital, they have this beautiful curve, upward sweep, very low standard of deviation, extraordinary and incredibly alluring sharp ratios, but it collapsed. These old style measures don't capture a lot of the kinds of risks associated with some of these products. There is also a "circle of competence" issue, to use (Warren) Buffett's terms. Do the people investing in these nontraditional products have the expertise to properly assess the risk and possible returns of these financial products? Do the people monitoring the people investing in these products have the expertise to monitor these people when they engage in these products? These are important responsibilities in terms of the Board of Regents. They are like the board of directors of a bank holding company with respect to the operations of the 100% bank subsidiary involved in these products.

For the Board of Regents, this poses a difficult issue. If one is going to invest in these nontraditional assets -- hedge funds, derivatives, or others -- the Board of Regents has to be willing to spend the time and money to properly monitor the nontraditional risks associated with these nontraditional products. With regard to Enron, WorldCom, and other disasters, the interesting thing is that every one of the systems failed -- internal controls in terms of the staff, the various boards of directors, outside auditors, the entire elaborate superstructure of the U. S. Securities and Exchange Commission (SEC) disclosure in auditing, the institutional investors, and the supposedly independent securities analysts reviewing those disclosure documents. The lessons are that you do need a multiplicity of systems to monitor day-to-day management. In addition, it is critical that every one of those systems be made as effective as possible, that you end up not trying to meet some lower, minimal standard dictated by law on pain of violating fiduciary duty, but in fact to meet good best practices. In terms of these systems, it is not one size fits all. In terms of the multiplicity of systems,

they have got to be tailored to the particular circumstances at hand, the particular activities, the particular financial products, the particular incentive structures, and the particular liquidity profile.

I thank the Board of Regents and Chancellor Yudof for giving me the benefit of their insights and parachuting me into this dialogue at a very late stage. I believe that the three pages of the “U. T. System Staff Observations and Recommendations on UTIMCO Review Issues” would be consistent, would help us move in the right direction, and would emphasize we did receive a general consensus, a general agreement; every one of us in the Working Group basically thinks that would be helpful.

Chairman Miller thanked the Working Group for their work and contributions.

Vice-Chairman Hunt said in a special role as a Regent and as UTIMCO Chairman, he would like to make a few comments specific to the presentations as detailed below:

Statement by Vice-Chairman Hunt

First, in relationship to Ennis Knupp and Steve Voss, the comments on performance related to benchmarks that were internally generated, both the 5.1% and the policy endowment benchmarks, are all our own that we generated ourselves and in some cases, as he pointed out, we exceeded benchmarks, and in other cases we didn't, partly dependent on the time period. When you view our performance against our peers, it is a different picture, and that picture is that over time, over the last 10 years, we have consistently done better. We have moved from a lower quartile performer to the last year when we have been in the top quartile. The performance for the last year through March 31 is a 34% return, and perhaps more interesting because some would say we have had strong markets, and we certainly have. Other than that 34%, almost 1/3 of it has been by us adding value back, exceeding our benchmarks, so we have had a very good year in an absolute year and also against benchmarks.

As far as Professor Hu's comments on risk, I would respond as follows. We cannot forget about opportunity cost or the cost of loss return. Risk is important but looking at some of Ennis Knupp's own research as they well point out, as comparing an endowment with a pension plan, 100% of their liabilities have to be met out of their investment return. Endowments are much less than that. Even the best private schools have maybe 30% of their expenses come out of their endowment. At U. T. System, it is 6%. So as Ennis Knupp pointed out, we are well prepared to take more risk, not only more risk in a public

pension plan, but much more risk in the typical endowment. And there is a cost, and that cost is lost opportunity of noncompetitive returns by being too risk-adverse.

To Charles Szalkowski, I would like to say that I have a very high opinion of all the members of the Working Group, both of their skills and intelligence, and the effort they have put in. There were a few things that were left out of the UTIMCO Working Group Report that I would like to draw attention to. One is with respect to Texas A&M University. Initially their representative, Greg Anderson, was listed as a representative, and along the way that became a liaison, and as I understand from the A&M representative on the UTIMCO Board, much to their dismay, there was no involvement by A&M in the Working Group. I would like to make sure that everyone is fully aware of that. It is also my understanding that some members of the Working Group were compensated. I assume they are a part of the overall cost that Chairman Miller mentioned earlier, and I think that should be noted. Also noted in the UTIMCO Working Group Report are the resignations of Dr. Keith Brown (Allied Bancshares Fellow & Professor of Finance, The University of Texas at Austin) and Dr. Laura Starks (Charles E. and Sarah M. Seay Regents Chair in Finance, U. T. Austin) for lack of time. I would like to make one comment because I did talk to Dr. Brown and his comment was as follows: They were fully engaged and they were prepared to proceed. They had the time and they resigned because their integrity was challenged. I will leave that at that, and you would have to talk to Dr. Brown and Dr. Starks for anything more.

Regent Huffines said he noticed there was only one outside UTIMCO director consulted and asked if there was any reason the Working Group did not consult other outside UTIMCO directors. Mr. Szalkowski said Baker Botts did consult a number of them a year ago for background information for the 2003 report, including Mr. R. H. Stevens, Jr., Mr. J. Luther King, Jr., Ms. Susan M. Byrne, and former Regent, Mr. Thomas O. Hicks.

Chairman Miller said he discussed a representative on the Working Group from Texas A&M University with Board of Regents' Chairman Lowry Mays, and Mr. Mays recommended Mr. Gregory R. Anderson, Associate Vice Chancellor and Treasurer. Mr. Aldridge contacted Mr. Anderson and invited him to provide information and join the telephone meetings. The Working Group also collected data about how Texas A&M managed their money. He said the Board was not looking for a UTIMCO review necessarily, but a review of the Board of Regents' fiduciary duties, and it was not necessary to have contact with everyone at UTIMCO. Mr. Miller stated he independently talked to several directors at UTIMCO before and after the review started, and Mr. Szalkowski said no one dictated who the Working Group should talk to or not talk to.

Vice-Chairman Clements asked whether the \$350,000 to \$375,000 figure Chairman Miller provided for the cost of the UTIMCO review included the first Baker Botts report and the Ennis Knupp work. Chairman Miller responded that is a current estimate and includes only the costs of Baker Botts, Ennis Knupp, and Professor Hu plus minor expenses for the Working Group. He said the estimate does not include U. T. System costs. He clarified that earlier work by Baker Botts was under a different contract.

Regent Huffines said in reviewing the notable improvements mentioned in the UTIMCO Working Group Report it appeared there is some duplication, and many improvements recommended by the Working Group have already been made. Mr. Szalkowski said the Working Group recommendations begin at Spring 2004 and move forward. There have been improvements, and there are a few things that could be made better. Chairman Miller said there were recommendations in the first Baker Botts report that were not implemented well but were critical such as selecting directors for the UTIMCO Board. He said it is the Board of Regents' duty to appoint directors for the UTIMCO Board; thus, the Board of Regents makes the final decision, but most nominations come from UTIMCO.

Vice-Chairman Hunt agreed the most important function of the Board of Regents in reference to UTIMCO is the selection of outside directors, and while it is clear the Board of Regents has been in control of the selection process, a formal process has been lacking.

Regent Caven said his concern is if there is an entirely transparent process of nominations of directors, possible candidates may not allow their names to be included in the nomination process. Chairman Miller responded that if UTIMCO makes a selection, they are no more protected from openness and are bound by the open meetings and open records statutes. He said he would be supportive of a process to protect candidates and bring them on board and still fit the duty of transparency.

Regent Estrada commented on the Working Group recommendations as included below:

Statement by Regent Estrada

I would like to commend the staff in particular for their recommendations that focus so much on improving communications. I don't think there is any organization, no matter how old, that can't somehow tweak the way they communicate internally and externally and make some improvements. I think that is a good focus, especially the focus I see on education and training. I want to share with my fellow Board members an observation that has only been developed recently in my own business. One of the most coveted things we have as a system is our Triple A Bond rating, the PUF, and the debt that we issue, and it was intriguing to me that very recently we took some of our clients that are public entities and counties typically, but in this case a city that went to

New York to make presentations on their bond rating to Moody's Investors Service, Inc. and Standard & Poor's and all of the typical players. One of the transactions contemplated for these debt issues by a public body was the possible utilization of a derivative product, an interest rate swap specifically, and the analyst at the ratings agencies started questioning and really pinning down the elected representatives that were there as part of that presentation, on did they understand what a swap is and did they really think through the derivative policy that they had adopted that their hired experts were possibly going to implement. It was a very integral part of the analysis and ultimately what they write up and say about you in terms of your fiscal management was going to be focused on how were the decision-makers understanding and deducting the right decision based on that, and they didn't expect the elected officials to know every detail of how the rates get set and how you negotiate the fee and the term of the swap and all of those things, but they were expecting the elected officials, the Board members, to know what they had adopted and understand it enough to know what it is about. There really is a new standard we are seeing among public bodies that already exists for the professionals. State law requires investment officers to get continuing education and training every year, so I think this focus from these recommendations is on teaching all of us, even those of us who do this on a day-to-day basis more than others, just giving all of us continuing education and updates and more training, whether it is this Board or the UTIMCO Board, is a very important focus, and it was encouraging to me that it was a major focus of these recommendations.

Regent Estrada moved that the Board

- a. approve the general recommendations contained in Sections 4.1 through 4.15 of the document entitled "U. T. System Staff Observations and Recommendations on UTIMCO Review Issues" and listed behind Tab 2 of the "Report of the UTIMCO Working Group to the Board of Regents of the University of Texas System Regarding Certain Investment Management and Oversight Issues".
- b. authorize Chancellor Yudof and the U. T. System staff at his direction to recommend to the Board of Regents, in its fiduciary role, an effective oversight system for the proper management of UTIMCO, including, but not limited to, authority for investment policies; clear procedures for the selection of outside UTIMCO directors; process for budget review; and periodic review of the Investment Management Services Agreement, and any revisions thereto; and other matters consistent with the recommendations cited above.

- c. authorize Chancellor Yudof to put procedures in place concerning the assignment of U. T. System staff and consultants related to UTIMCO activities.

The motion was duly seconded by Vice-Chairman Krier.

[Counsel and Secretary's Note: See Page 15 for information on the modifications to the motion regarding Sections 4.5 and 4.10, as finally approved by the Board of Regents.]

Vice-Chairman Hunt asked if the cost of the oversight proposed in the motion had been priced out, and Chairman Miller said the Board would delegate that to the U. T. System staff who have some discretion through a budget, and noted the Board could always intervene. He said his great concern is not spending dollars on oversight because the Board needs all of the confidence possible that competitive money management has been put in place. The details need to be understood sufficiently well to know that the integrity of the decision-making process from the UTIMCO Board to the CEO to the staff and their ability to control their consultants and compensation is intact.

Regent Craven expressed concern as to the degree and thoroughness with which Regents could monitor the funds.

Regent Huffines asked if the Board of Regents could appoint more than three Regents to the UTIMCO Board. Mr. Szalkowski said the answer is clearly that the Board could. Regent Huffines asked if having five members of the Board of Regents serve on the UTIMCO Board would satisfy the fiduciary responsibility. Mr. Szalkowski responded that the Regents as a collective group need to be comfortable with whatever is set up, and if there were five Regents who were experts in investments, that might be all that is needed. The Board would have to assess from time to time the capacities of the people on the Board and staff support, either from U. T. System staff or UTIMCO staff, to assist them in making informed decisions. Chairman Miller said that comes close to an in-house entity and, even if there were five Regents on the UTIMCO Board, he would still want some of these other things done.

Vice-Chairman Krier said compared to lost opportunities in investments, she sees this in terms of lost opportunities to work together, to understand each other's perspectives, and to collaborate. She said she hopes setting up the oversight structure will provide opportunity for greater understanding and better communication, and that the additional positions will complement what UTIMCO is doing and not create another hurdle, take additional time, or cost additional money, but that it truly makes this a better, overall unit, as parties work together to benefit the PUF bottom line, the students, and the people on all of the campuses.

Regent Estrada said he would like to clarify that his intent in supporting the recommendations is to not duplicate efforts and costs and still provide the Board comfort going forward.

Regent Barnhill provided comments as stated below:

Statement by Regent Barnhill

UTIMCO has many strong and impressive qualities -- overall successful growth and return on investments in recent years, generally positive comments from the components on their relationship with UTIMCO in a survey, a strong position when comparing investments at peer institutions, and what appears to be a very dedicated, professional staff. Additionally, there appears to be respect from other professional money managers and institutions regarding the expertise and success of UTIMCO. The UTIMCO Board has strong leadership, and the fact that there are three Regents and the Chancellor on the Board, gives me the confidence that these people have the best interest of the U. T. System and the people of Texas at heart.

However, it is apparent from the response of a number of people who were involved in the Working Group, that there is room for improvement, as there is in any program, and some of the issues are differences of opinion and different philosophies. From the beginning, there appears to be a strong need for oversight by the Board of Regents; it is a question of degree. We have a strong start with the three Regents and the Chancellor serving on the UTIMCO Board and after that, it is a question of which of the Working Group recommendations we can all feel comfortable with, which would be necessary and helpful in the oversight of UTIMCO, and which ones would put undue restraint on Bob Boldt and his staff for performing their jobs effectively. I agree with the motion, and I have great respect for what has been done by UTIMCO.

Chancellor Yudof said his interest is primarily in the fiduciary obligations of the Board of Regents and the Chancellor and how those duties are discharged. He said the primary problem is and it is partly an internal UTIMCO problem, that he views the lawyers and the consultants as working for the UTIMCO staff, and not advising him as a UTIMCO Board member. He also said the accountability system is not finely tuned. Annual reviews of the contract and a closer look at the budget will help build an accountability system. If the Board and the Chancellor are going to be held accountable, reasonable monitoring and not duplication should be in place.

At the request of Vice-Chairman Hunt, Mr. Estrada agreed to amend his motion to reflect amendments to Sections 4.5 and 4.10 of the "U. T. System Staff Observations and Recommendations on UTIMCO Review Issues" as shown below in congressional style:

- 4.5 System staff and its consultants should be ~~[intricately]~~ involved in UTIMCO issues, such as
- Key role regarding creation of investment policies, review of UTIMCO budget, and review of implementing statute and agreement
 - Work closely with UTIMCO staff to suggest needed changes to UTIMCO bylaws and internal policies
 - Work with UTIMCO staff concerning compliance with Texas Open Meetings Act and Texas Public Information Act
- 4.10 Seek Attorney General's opinion concerning ability of U. T. Board of Regents to discuss performance of external UTIMCO Directors ~~[and the UTIMCO CEO]~~ in closed meeting under provisions of the Texas Open Meetings Act.

The motion carried unanimously.

(See Page 12 for the original motion and second.)

Closing Statement by Chairman Miller

The Chairman has to be careful not to advocate. I have tried to give opinions different than that, but I would like to add for information a couple of things and then have a vote. In reality, we have a new organization. There was a UTIMCO that we set up eight years ago, but we have substantially different management, and I have no disagreement that they are improved, good, and excellent, but there is no real long-term record of the managers, of the individuals, or of the entity. In an environment like that, as prudent fiduciaries for \$15 or \$16 billion, I think there is a time period, particularly from now to three years from now, when we have an extra duty to be cautious and to be involved, and the Chancellor said it very well, not to directly micromanage but to be constantly aware because that is the way we can have accountability. Because of this hybrid structure, the outside directors are volunteers who agreeably say they are going to put their time and energy and expertise at our hand on our behalf. And we don't really have any way to hold them accountable; firing somebody like that does not exactly get the job done. That sort of ruins the idea of UTIMCO. You want people that will really sign up and volunteer so your option of, say, getting rid of a director, is not like a corporation. There is no price of a stock market, and we take care of most of the legal liabilities. We have virtually a total indemnification clause in our contract so the real accountability is this constant communication and information flow and sometimes oversight that is different because otherwise I couldn't fire a

Regent from that Board, and we don't want to fire the Chancellor over something at UTIMCO. So you really can't intervene very strongly or terminate the contract. It is very difficult to take those kinds of steps so what we want is this continuous process of information flow that I think could be very constructively done. It is the devil in the details that we do have to carry it out, and we have to do most of it in the next three months, but I think that oversight is so critical because we don't have the other options and because we do have a new organization. We have a different oversight environment in general, and we have a duty to do these things and to do them constructively.

Regent Huffines asked if it would be possible for the Chancellor to come back with recommendations by the August 2004 Board meeting. Chairman Miller agreed that was the timetable. Regent Huffines said it was his impression the Chancellor will come back with recommendations to the Board on how these procedures would work and not necessarily implement them immediately. Chairman Miller said his idea is that this is an investment policy issue so if there are changes recommended by UTIMCO or if we have any to come, we should be dealing with those constantly. Chancellor Yudof said he would meet with Mr. Bob Boldt and a few others and agree on a budget process to bring back to the Board of Regents.

Vice-Chairman Hunt said there is an incentive compensation plan passed by the UTIMCO Board on January 13, 2004, which the Board of Regents chose not to implement, and he hopes not to wait until August if there is support for it from the Board of Regents. Chairman Miller responded that he does not think putting a compensation plan in the middle of a fiscal year is good management, and the Board has not had a chance to look at the plan.

ADJOURNMENT.--Chairman Miller said an Executive Session was not needed and announced that the purpose for which this meeting was called had been completed. The meeting was duly adjourned at 1:05 p.m.

/s/ Francie A. Frederick
Counsel and Secretary to the Board

June 10, 2004