Contact: Patrice Sayre

MINUTES OF DECEMBER 10, 2008
AUDIT/COMPLIANCE AND INVESTMENT COMMITTEE
BOARD OF REGENTS, STATE OF IOWA
MAUCKER UNION, UNIVERSITY OF NORTHERN IOWA
CEDAR FALLS, IOWA

Committee Members

Jack Evans (Chair)	Michael Gartner	Craig Lang
Bonnie Campbell (absent)	Ruth Harkin	David Miles
Robert Downer	Greta Johnson	Rose Vasquez

Staff Members
Bob Donley, Patrice Sayre

Others
Mike Dudkowski, Wilshire Consulting

The corresponding docket memorandum for each agenda item, an integral component of the minutes, is available on the Board of Regents website: www2.state.ia.us/regents. Copies of these memoranda can also be obtained from the Board Office by calling 515-281-3934.

Chair Evans called the meeting to order at 3:45 p.m.

Approve Minutes from October 29, 2008, Committee Meeting

➢ MOVED by DOWNER, SECONDED by GARTNER, to approve the minutes of the October 29, 2008, meeting. Chair Evans asked for a correction on page 3 as follows: "The State Treasurer administers the program and any public funds held in Iowa ~~financial~~ *banking* institutions that become at risk may be made whole" (correction in italics). Motion APPROVED as corrected by GENERAL CONSENT.

Investment and Cash Management Report for the Quarter ended September 30, 2008

Mike Dudkowski of Wilshire Consulting covered the report, but first talked about recent performance and market issues. Mr. Dudkowski reported there was little to be said about financial markets that was uplifting or successful. However, he said he would speak about things the Board of Regents does to help mitigate problems in the current financial market and things to do to implement the asset allocation strategy. The latter will take time to implement, as a cautious approach is needed. Mr. Dudkowski reported on three areas: the market in general and externally-managed funds, asset allocation strategy implementation, and a recommendation on fund managers:

o The market in general and externally-managed funds – realizing that a September report is a bit stale in light of the continuing significant amount of economic weakness, Mr. Dudkowski listed off a number of market statistics:

- S&P fell 38%
- Non-U.S. Equities fell year-to-date 46%
- Lehman Aggregate was up 2.6%
- Unemployment is at 6.7% and almost certain to go higher
- Yesterday's Four-week Treasury auction yielded 0%
- Yesterday's Ten-year Treasury yield was at 2.67%
- The Federal Funds target rate is 1%
- Three-month LIBOR is at 2.16%

All of this indicates a flight to quality and that institutions are unwilling to lend to each other. Under this setting, Mr. Dudkowski took the Regents through the Investment and Cash Management Report for the quarter ended September 30, 2008 noting the variances from the benchmarks for the Regent institutions. SUI investments returned -8.6% for the quarter; -15.3% year-to-date; and -16.9% at the end of one year. ISU had similar results. He noted that if these numbers were rolled forward to December, there would be bigger losses as U.S. Equity markets have declined almost 20% since September.

Quasi-endowment funds are handled by two Fixed Income managers; Reams, and Dodge and Cox. These funds are significantly overweighted to credit and spread sectors as opposed to the Treasury and agency composition of the benchmark. This spread is typical among Fixed Income managers, and in the current market has a significant impact relative to the benchmark.

External Managers handle operating funds and, on the whole, these managers have made high quality buys. These managers tend to underweight government securities and overweight corporate and other spread sectors. Their performance fell below existing benchmarks.

The Commonfund Intermediate Fund was put into the position of cutting off redemptions from investors when their Short-term Fund closed. As the Intermediate Fund is not as liquid, investors were initially allowed to redeem only 30%. Wilshire advised the Regent institutions to take the 30% redemption and they did so. The remaining securities are illiquid, or if sold, would likely be sold at sub-par prices and are being held by Commonfund for now.

Mr. Dudkowski returned to endowment fund performance saying active fund managers suffered the most, especially in the third quarter, due to significant de-leveraging of hedge funds and the removal of risky investments from the balance sheet by banks and financial institutions. In this market environment, active managers are forced to sell off investments that have typically held up the best. Another phenomenon has been the reversal of performance – those that benefited in the first half of 2008 through investing in commodities, materials, and energy stocks, suffered in the second half.

For the Regents institutions portfolio, the endowment funds for Real Assets and Private Equity are in good shape with no liquidity problems. In Private Equity, SUI has less than $7 million in uncalled commitments, while ISU has less than $4 million. From a liquidity standpoint, the institutions are in a good position and have greater flexibility than many peer endowments that moved to very high positions in alternative and illiquid investments, many above 50% of their portfolio. One sector not listed is the Commonfund Natural Resources, as funds have not yet been transitioned to this class. The investments that will be made in this class will hedge against inflation.

o Asset Allocation Strategy Implementation– Mr. Dudkowski outlined the work being done to implement the asset allocation strategy adopted by the Board of Regents at the September 17-18, 2008 meeting. He noted that Wilshire recommended a strategy that included an option for hedge funds, feeling they can be beneficial if used in a controlled manner to reduce risk away from equities and act essentially as a Fixed Income substitute. Wilshire would like to pursue this discussion and is planning to provide more education. Further work is to be done on Public Equities to reallocate the portfolio for U.S Equities and non-U.S. Equities from 60% to 50%, doing an even split between the two; and designating 10% each for Private Equities and Real Assets, including real estate. The latter helps protect the real value of the portfolio if inflation rises; there are specific opportunities within real estate where the distress in the markets can create some opportunities to focus on.

Regent Lang asked if the institutions owning hard assets aren't in competition with the private market, and if so, questioned if they should be part of the Regents portfolio. Regent Gartner remarked that allowable competition was clearly outlined by statute; institutions are entitled to compete in dairy, radio, and a couple other areas. Tom Evans agreed that there were restrictions on competition with private agencies. President Miles said he believed the talk was about two different things; the question on real assets is what distinguishes that investment class from any other asset class in which Regents participate. He cited as an example that Regents capital invested in stocks could have an influence on pricing as we could buy stocks a private investor might also buy. However, the Regents institutions themselves are not going out and buying individual hard assets.

Mr. Dudkowski elaborated that this strategy designates to investment managers the ability to make investments in tangible assets such as timber, oil, and gas – infrastructure types of investments.

Regent Lang agreed that as long as the investment is through an asset manager, he could support the investment. Chair Evans added that the Regents retain the principal and the managers invest it for us.

o Fund Manager Reviews – Mr. Dudkowski reported that Wilshire, university financial staff, and Board Office staff met recently to interview two Small Cap fund managers and review the underperformance of current managers LSV and Artisan. The focus was looking at strategies for growth and value in this sector of the portfolio. After considering the incumbent managers and interviewing two new fund managers, Delaware Investment and Dimensional Fund Advisors, a decision was made to hire Delaware Investment, whose strategy is a fundamental, bottom up, active manager of Small Cap securities that includes growth and value styles. To transition to Delaware, Wilshire recommends consolidating the LSV and Artisan funds to reduce fees and to move funds when the market condition is appropriate, probably mid-January.

Chair Evans said he would entertain a motion to remove from the Small Cap Core portfolio two fund managers, LSV and Artisan, and replace them with Delaware Investment.

- MOVED by HARKIN, SECONDED by JOHNSON, to remove from the Small Cap Core portfolio two fund managers, LSV and Artisan, and replace them with Delaware Investment. MOTION APPROVED by MAJORITY; LANG abstained.

- MOVED by DOWNER, SECONDED by HARKIN to receive the Investment and Cash Management Report for the quarter ended September 30, 2008.

President Miles asked for a review of the Endowment Asset Class Allocation Policy for the Private Equity target and allowable range. Mr. Dudkowski suggested that the lower limit should be zero for now as Wilshire looks for investments and fund managers. The allowable range will be changed from 10-20% to 0-15%.

Chair Evans noted that in the operating fund there is a small investment in Municipals and asked if these were taxable. Doug True answered affirmatively.

The Committee agreed to receive the report with the change in the allowable range. MOTION APPROVED by CONSENSUS.

Meeting adjourned at 4:45 p.m.