

**Minutes
Investment Committee
December 16, 2013**

IN ATTENDANCE:

Investment Committee Members:	Carol Martin Gatton, Chair William C. Britton Mark P. Bryant William S. Farish, Jr. James W. Stuckert
Community Advisory Members:	James F. Hardymon Henry Clay Owen
Investment Staff & Consultants:	Susan I. Krauss Kimberly C. Lush Rob Palmeri (R.V. Kuhns & Associates) Dan Krivinskas (R.V. Kuhns & Associates)

Mr. Gatton called the meeting to order at 1:30 p.m. He explained that the Investment Committee (the “Committee”) needed to go into closed session to discuss responses to the request for proposal for the hiring of Real Estate managers for the University. He stated that only those persons necessary to provide information to the Committee and appropriate staff may be present, that nothing else would be discussed in the closed session and that no votes would be taken. Mr. Gatton then made a motion to go into closed session pursuant to KRS 61.180 (1) (K). Mr. Gatton also cited KRS 45A.085 (7) and KRS 45A.695 of the Kentucky Model Procurement Code, which allows information derived from a request for proposal submitted by all of the competing offerors to be discussed in closed session. Mr. Stuckert seconded the motion and all approved.

The closed session concluded at 2:10 p.m. Mr. Gatton stated that the Committee would proceed with the open session. Mr. Gatton then made a motion to approve the minutes from the Committee meeting on September 09, 2013. Mr. Britton seconded and all approved.

Ms. Krauss introduced the next agenda item, IC 1, authorization for investment staff to enter contract negotiations with three new real estate managers for the management of non-core strategies. One manager is subject to final approval by the investment staff and R.V. Kuhns pending further due diligence. The University plans to commit \$50,000,000 to the managers: \$20,000,000 to two managers and \$10,000,000 to one manager. Mr. Farish made a motion to approve IC 1 and Mr. Britton seconded. The motion was approved.

Mr. Gatton introduced the next agenda item, IC 2, the approval of a Student Managed Investment Funds (SMIF) program. Ms. Krauss provided background information regarding the SMIF program. She reported that the Gatton College has managed a SMIF program for the past 15 years at the undergraduate level. The existing program has been sponsored by the Tennessee Valley Authority. The recommendation was that the College expand the current undergraduate SMIF program and establish a new graduate SMIF program. The program will be phased in over the next 18 months as follows: up to \$700,000 in January 2014 (the amount needed to bring the current SMIF value up to \$1,100,000), \$1,100,000 in August 2014 and \$3,300,000 in August 2015. The total value of the SMIF investment accounts could be up to \$5,100,000. The accounts will be managed in a U.S. large cap equity strategy. The current TVA investment guidelines will be followed. The Treasurer will execute an Investment

Management Agreement (IMA) with the Gatton College for two years. The initial term of the agreement will be from January 1, 2014 through December 31, 2015. In late 2015, terms of the program will be reevaluated and a new IMA will be negotiated for the subsequent two years.

Ms. Krauss introduced David Blackwell, Dean of the Gatton College, and Brad Jordan, Chair of the Finance department in the Gatton College and the faculty advisor for the current SMIF program, to provide additional background information regarding the current program. Dean Blackwell stated that the program is an essential ingredient for the University to be competitive nationally and that the five million dollar amount will make the University visible among other institutions offering this type of program, as well as give participating students a realistic feel of the investing experience. Mr. Jordan added that the program is considered to be honors level coursework and admission to the class is by faculty invitation. Two current students in the program, Robert Burrus and Daniel McCoy, were also in attendance. They provided a presentation on why E-bay is a good current stock to purchase. Mr. Stuckert inquired about SMIF reporting to the Committee. He asked if there could be a separate line item per individual account. Ms. Krauss acknowledged his request. Mr. Gatton made a motion to approve IC 2, the establishment of a new SMIF program for the management of up to \$5,100,000 in a U.S. large-cap equity strategy. Mr. Britton seconded the motion and all agreed.

Ms. Krauss introduced the next item on the agenda, IC 3, a recommendation to approve a revised endowment investment policy. The revised policy reflects changes to the Investment Staff and Delegation of Authority sections to clarify that going forward the investment staff will have responsibility for hiring and terminating investment managers. It also defines the endowment investment staff as the Treasurer and Chief Investment Officer. Additionally, an updated manager structure is included that reflects minor revisions based on the implementation of new asset allocations.

Ms. Krauss stated that Trustee Britton had raised some concerns to her prior to the meeting related to the proposed language in the Delegation of Authority section. The revision states that "Staff will be responsible for selection and oversight of the vendors." Trustee Britton's concern was that the above statement may conflict with the governing regulation included in the section of the policy for Responsibilities of the Investment Committee, which states that the Investment Committee is responsible for "appointing, monitoring and evaluating investment managers and consultants." Ms. Krauss stated that the objective of the revision to delegate hiring decisions to the Staff is based on best practice in the industry and that the Investment Committee should be responsible for establishing the asset allocation for the endowment while the Staff should be responsible for implementation of the approved asset allocation. Mr. Britton stated that the policy should include that the Committee delegates the authority to the Staff for selection and oversight. Mr. Stuckert suggested adding wording to state that the Staff would conduct the selecting and overseeing in conjunction with the University's consultants. This would illustrate that there is additional input. Ms. Krauss stated that she has spoken with Bill Thro, University General Counsel, and that we would consider other modifications to the policy language to clarify the delegation. After much discussion, action related to IC 3 was deferred until the Committee's next meeting on January 30, 2014. Ms. Krauss stated that her objective is to have the revised policy in place prior to hiring the Chief Investment Officer, so the January 30th timing would be fine.

Mr. Gatton asked what percentage of endowments valued at \$500,000 to \$1,500,000 have a CIO, and what their results are compared to endowments that do not have a CIO. Ms. Krauss stated that a majority of endowments greater than \$1 billion have a CIO, and most endowments with a CIO position clarify within their investment policy that the Investment Committee sets the asset allocation and the Staff is responsible for implementation. Ms. Krauss stated that she viewed the policy revision as an evolution in the University's governance process. Mr. Palmeri agreed with that assessment, stating that the University currently has 30 managers, which is a number that will grow as the endowment continues to grow. He added that the proposed revision is a more efficient process and is considered a best practice in the industry.

Mr. Stuckert inquired as to how a CIO will add value. He asked how many institutions have a CIO and if they have better results because of having a CIO. Ms. Krauss indicated she would report on CIO performance data at the next meeting. Mr. Britton stated that he would like to have a discussion regarding the hiring of a CIO. Ms. Krauss responded that the University has operated with a single person investment office for the past ten years. Ms. Krauss added that the University is clearly understaffed per benchmarking she has conducted. She added that it is common practice among institutions with endowments similar in size to the University's to assume a greater fiduciary responsibility and to take a more active role in the due diligence process of selecting and monitoring managers. With the hiring of a CIO, the external consultant would not be replaced however the University would become a more involved participant in the due diligence process. Ms. Krauss stated that another responsibility of the CIO would be to focus on the investment of operating funds. This is an area where additional risk could be taken to increase returns.

Prior to discussion of IC 4, Rob Palmeri and Dan Krivinskas from R.V. Kuhns and Associates voluntarily left the room. Ms. Krauss introduced IC 4, a recommendation that the Investment Committee authorize the Treasurer to extend the contract with R.V. Kuhns & Associates to provide consulting and performance measurement services for the University of Kentucky Endowment for the period of July 1, 2014 through June 30, 2015, subject to the terms and conditions of the existing contract. This would represent the seventh year of a maximum eight year term, leaving one more renewal that could be executed. The final one-year renewal period would be fiscal year 2015 - 16. Ms. Krauss provided background information regarding R.V. Kuhns, noting the University hired the company in 2007. The initial term was for four years and the contract included up to four one-year renewals. It is an all-inclusive retainer that includes performance reporting, asset allocation and manager searches. Mr. Stuckert made a motion to extend the contract with R.V. Kuhns for another year. Mr. Britton seconded the motion and all others agreed.

Ms. Krauss provided a review of the endowment asset allocation and transition plan. She stated that the transition is well underway. She noted that the relationship with Capital Guardian had recently been terminated and \$107.5M had been withdrawn. The withdrawn funds will be used to fund the new long/short equity investments. She continued by saying that the transition plan is currently in Phase I, which involves implementing the liquid strategies. The majority of transactions will occur at the end of December. Ms. Krauss added that a decision was made to terminate Prisma, primarily because they do not have a long/short commingled fund-of-funds option. She added that there will be a transition with Grosvenor during the next few months to implement direct investments with their approved managers. Ms. Krauss stated that over the next six to nine months, due diligence will be conducted on their approved managers and selections will be made for placing direct investments. She stated that a segregated See Blue B Fund will be used for the direct investments with no management fee, making the overall effective rate for Grosvenor approximately 58 basis points, including the See Blue A Fund. Ms. Krauss reported that action will be deferred on Private Equity until 2014. The target for Private Equity has been increased from 8% to 12% and there will be an in-depth review of Private Equity at the Committee's January meeting. Mr. Britton asked why the endowment would be getting out of the U.S. Equities market, as it has been the strongest performing asset class this year. Ms. Krauss stated that while the U.S. Equity target is being reduced from 20% to 12%, the undertarget private equity and real estate allocations, or approximately \$100M, will be invested in the U.S. and non-U.S. equity IMI indices so there will still be significant equity exposure. Mr. Palmeri added that the new global long/short equity managers are being given the flexibility to hedge, which is good in a volatile market. He also made the point that overall equity exposure is not being reduced, but the form is changing. Ms. Krauss continued by discussing the Real Return / Diversified Inflation Strategies, which has a 10% allocation. She stated that an on-site visit had been conducted with Wellington in October and a decision was made to divide the 7% liquid portion as follows: 4% will be allocated to Diversified Inflation Hedges and 3% to Real Total Return. An RFP will be issued early next year for the 3% illiquid component to commit to private real asset funds. It

could take a couple years to deploy the funds. In the interim, the funds will be invested in the Wellington Real Total Return.

Ms. Krauss provided a review of the 2014 meeting schedule. She stated that a Private Equity and Real Estate update is scheduled for January 2014. However, this could be broken into two separate sessions, with the Real Estate update deferred until mid-year. Brien Smith and associates from Neuberger Berman will be attending to discuss the progress of the NB Wildcats fund in January. In March, Wellington will attend the Committee meeting to provide an update on the various strategies they manage. In May, Grosvenor will attend the meeting to discuss their funds. In September and throughout the remainder year, there will be several RFP's in process and updates will be provided on the various manager searches. Additionally, fiscal year 2014-15 is the final year of the contract with Northern Trust so an RFP will be issued in the fall of 2014 for a custodian.

Ms. Krauss provided a review of the performance of operating fund investments. She also reported that a new investment account was being established with Reams in the amount of \$50M. It will be a low duration pool and more credit risk will be assumed in an effort to improve returns.

The meeting adjourned at 3:48 p.m.

Respectfully submitted,
Kimberly C. Lush
Office of the Treasurer