The University of Texas Investment Management Company

Presentation Materials
Board of Directors Meeting

May 6, 2004

UTIMCO BOARD OF DIRECTORS
MEETING AGENDA

May 6, 2004

UTIMCO
221 W. 6th Street, Suite 1700
Austin, Texas

Time Begin	Time End	Item #	Agenda Item
			Open Session:
2:30 p.m.	2:35 p.m.	1	Call to Order/Consideration of Minutes of April 8, 2004, Meeting*
2:35 p.m.	4:30 p.m.		Discussion and Consideration of UT System Board of Regents Agenda Items:
		2	- Recommending Amendments to the Permanent University Fund and General Endowment Fund Investment Policy Statements*
		3	- Recommending Amendments to the Short Intermediate Term Fund Investment Policy Statement*
		4	- Approval of Restatement of Historical Endowment Policy Portfolio Returns*
4:30 p.m.			Adjournment

*Action by resolution required

Members of the Committee may attend the meeting by telephone conference call pursuant to Tex. Educ. Code Ann. § 66.08(h)(2)(B). The telephone conference will be audible to the public at the meeting location specified in this notice during each part of the meeting that is required to be open to the public.

Next Scheduled Meeting: May 26, 2004

TAB 1

Resolution No. 1

RESOLVED, that the minutes of the meeting of the Board of Directors held on **April 8, 2004** be, and are hereby, approved.

**MINUTES OF THE MEETING OF
THE BOARD OF DIRECTORS OF
THE UNIVERSITY OF TEXAS
INVESTMENT MANAGEMENT COMPANY**

The Board of Directors (the "Board") of The University of Texas Investment Management Company (the "Corporation") convened in an open meeting at 10:05 a.m. on the **8th day of April 2004**, in the offices of the Corporation, Town Lake Conference Room, 221 West 6th Street, Austin, Texas, 78701, said meeting having been called by the Chairman, Woody L. Hunt, with notice provided to each member in accordance with the Bylaws.

Participating in the meeting were the following members of the Board:

Woody L. Hunt, Chairman
J. Luther King, Jr., Vice-Chairman
Mark G. Yudof, Vice-Chairman for Policy
Susan M. Byrne
Rita C. Clements
J. Philip Ferguson
I. Craig Hester
R. H. (Steve) Stevens, Jr.

thus, constituting a majority and quorum of the Board. Director James R. Huffines joined the meeting at the point indicated below. Also, attending the meeting were R. D. Burck, Advisory Director and John Barnhill, U. T. System Regent; Bob Boldt, President, Chief Executive Officer and Chief Investment Officer of the Corporation; Joan Moeller, Secretary and Treasurer of the Corporation; Christy Wallace, Assistant Secretary of the Corporation; Cathy Iberg, Managing Director – Marketable Alternative Investments and Deputy CIO; Larry Goldsmith, Managing Director of Public Markets; Andrea Reed, Risk Manager; Sara McMahon and Trey Thompson, Managing Directors – Non-Marketable Alternative Investments of the Corporation; Bill Edwards – Managing Director Information Technology; Greg Lee, Manager of Finance and Administration; Gary Hill, Manager of Investment Reporting; Jerry Turner, legal counsel for the Corporation; Philip Aldridge, Charlie Chaffin, Sandra Neidhart, Jerry Modjeski, and Michael Warden of U. T. System Administration; Bruce Myers of Cambridge Associates; Michael Sebastian of EnnisKnupp; and Charles Szalkowski of Baker Botts. Mr. Hunt called the meeting to order at 10:05 a.m. Copies of materials supporting the Board meeting agenda were previously furnished to each Director or distributed at the meeting.

Minutes

The first matter to come before the Board was approval of the minutes of the meeting of the Board of Directors held on January 13, 2004. Upon motion duly made and seconded, the following resolution was unanimously adopted:

> RESOLVED, that the minutes of the meeting of the Board of Directors held on **January 13, 2004** be, and are hereby, approved.

Public Markets Investment

Mr. Hunt turned the meeting over to Mr. Goldsmith to present a proposed Public Markets investment of up to $100 million in the GMO Emerging Country Debt Fund. Mr. Goldsmith reported that GMO has successfully invested in the Emerging Markets Debt sub-asset category since 1994 and that the proposed investment vehicle is a ten-year old institutional mutual fund offering daily liquidity. After discussion, Mr. Goldsmith answered the Directors' questions. Upon motion duly made and seconded, the following resolution was unanimously adopted:

> WHEREAS, the Board has reviewed the Corporation's Investment Recommendation to use PUF and GEF assets to acquire up to a $100 million institutional investment interest (the "Investment") in **GMO's Emerging Country Debt Fund**; and
>
> WHEREAS, the Corporation has determined that the Investment does not constitute an agreement or transaction entered into in violation of Subsection 66.08(i) of the <u>Texas Education Code</u>;
>
> NOW, THEREFORE, BE IT RESOLVED, that the terms and provisions of the proposed investment as described in the Investment Memorandum dated March 10, 2004 for **GMO's Emerging Country Debt Fund** be approved; and be it further
>
> RESOLVED, that the President and CEO, and any Managing Director of this Corporation be, and each of them hereby is, authorized to make such further revisions to the terms and provisions as may be necessary or in the best interests of this Corporation, excluding an increase in the amount of the capital commitment to **GMO's Emerging Country Debt Fund**; and be it further
>
> RESOLVED, that the President and CEO, any Managing Director, and the Secretary of this Corporation be, and each of them hereby is, authorized and empowered (any one of them acting alone) to do or cause to be done all such acts or things and to sign and deliver, or cause to be signed and delivered, all such documents, instruments and certificates (including, without limitation, all notices and certificates required or permitted to be given or made under the terms of the Investment), in the name and on behalf of the Corporation, or otherwise, as such officer of this Corporation may deem necessary, advisable or appropriate to effectuate or carry out the purposes and intent of the foregoing resolutions and to perform the obligations of this Corporation under the Investment and the instruments referred to therein.

Performance and Asset Allocation Reports

Mr. Hunt asked Mr. Boldt to give a report on performance and asset allocation. The reports presented reflected the proposed restatement of the Endowment Policy Portfolios or benchmarks. The latest performance information was presented. Mr. Boldt reported value added under the Corporation's management for the period ended February 29, 2004. The net performance for the one-month period ended February 29, 2004, for the PUF and the GEF were 2.49%, and 2.33%, respectively. The net performance for one-year ended February 29, 2004, for the PUF and GEF were 31.74% and 32.56%, respectively. The Short Intermediate Term Fund's (SITF) performance was 0.50% versus benchmark return of 0.52% for the one-month period, and was 2.43% versus benchmark return of 2.26% for the one-year period ended February 29, 2004. Performance for the Short Term Fund (STF) was 0.08% versus 0.07% for its benchmark for the one-month period, and was 1.08% versus benchmark return of 1.12% for the one-year period ended February 29, 2004. A handout was distributed that presented restatement numbers, value added tactical asset allocation decisions, manager history performance summary and downside risk models. Chancellor Yudof asked that a risk chart run against VAR be included in next meeting's information.

Liquidity Profiles

Reports on PUF and GEF liquidity profiles as of February 29, 2004 were presented to the Board by Mr. Boldt. In response to questions, Mr. Boldt stated that pursuant to the Liquidity Policy, the actual profile of the funds and compliance with the liquidity policy will be reported to the Board at least on a quarterly basis. The Managing Directors will provide evidence that they concur with the liquidity classification, and the liquidity reports will now be certified by the Staff's Risk Manager and Chief Compliance Officer. The Staff will provide a report of illiquid investments that the UTIMCO Board has approved or delegated since the last report, any changes to the liquidity classification and liquidity will be included in the monthly newsletter sent out by the President.

External Investment Consultant Report

A comprehensive report on Cambridge Associates, the Corporation's external investment consultant, was provided to the Board to satisfy the annual requirement in the Delegation of Authority Policy. The report included description of services provided in the contract covering general consulting services, as well as consultant services in the Non Marketable and Marketable Alternative Investment areas.

Appointment of Officers

The next item to come before the Board was the appointment of officers for the Corporation. Mr. Hunt requested that Mr. King remain as Vice Chairman of the Board until a Director has been named to replace him. Upon motion duly made and seconded, the following resolution was unanimously adopted:

> RESOLVED, that the following persons are hereby appointed to the respective office or offices of the Corporation set forth opposite their names, to serve until the next Annual Meeting of the Corporation or until their resignation or removal.

Name	Office or Offices
Woody L. Hunt	Chairman
J. Luther King	Vice-Chairman
Mark G. Yudof	Vice-Chairman for Policy
Bob Boldt	President
Cathy Iberg	Managing Director
Bill Edwards	Managing Director

Larry Goldsmith	Managing Director
Sara McMahon	Managing Director
Joan Moeller	Managing Director, Treasurer and Secretary
Andrea Reed	Risk Manager
Trey Thompson	Managing Director
Christy Wallace	Assistant Secretary

Designation of Key Employees

The next item to come before the Board was the designation of Key Employees for the Corporation. Upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED, as required by the Corporation's Code of Ethics the Board shall designate, by position, key employees of the Corporation.

Bob Boldt	President, Chief Executive Officer and Chief Investment Officer
Cathy Iberg	Managing Director - Marketable Alternative Investments/Deputy CIO
Bill Edwards	Managing Director - Information Technology
Larry Goldsmith	Managing Director – Public Markets Investments
Sara McMahon	Managing Director - Non-Marketable Alternative Investments
Joan Moeller	Managing Director - Accounting, Finance and Administration
Andrea Reed	Risk Manager
Trey Thompson	Managing Director - Non-Marketable Alternative Investments
Greg Cox	Portfolio Manager - Equity Investments
Russ Kampfe	Senior Portfolio Manager - Fixed Income Investments
Harland Doak	Portfolio Manager - Fixed Income Investments
Debbie Childers	Manager of Portfolio Accounting and Operations
Gary Hill	Manager of Investment Reporting
Greg Lee	Manager - Finance and Administration
Christy Wallace	Executive Assistant

Reappointment of Advisory Director

The next item on the agenda was the recommendation to reappoint Mr. R. D. Burck as an Advisory Director to the Corporation. Upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED, that the Board of Directors hereby reappoints Mr. R. D. Burck to serve as Advisory Director to the Corporation for a term ending April 1, 2005; and be it

FURTHER RESOLVED, that while Mr. Burck shall not be entitled to vote on any matters coming before the Board of Directors, it is the desire of the Board of Directors that Mr. Burck attend all Board meetings and participate fully in all discussions and briefings incident to such meetings; and be it

FINALLY RESOLVED, that Mr. Burck shall not be entitled to receive any fees or compensation for his service as an Advisory Director to the Corporation, other than reimbursement for expenses incurred in attending Board meetings.

Statement of Appreciation

Mr. Hunt acknowledged Mr. J. Luther King's contributions made during his long tenure as a board member of the Corporation. The following Resolution of Appreciation honoring Mr. King was read, and the resolution upon motion duly made and seconded, was unanimously adopted:

WHEREAS, J. Luther King, Jr. graduated from Texas Christian University with B.S.C. and M.B.A. degrees, then embarked upon a highly successful and distinguished career in investment management, which began in 1963 as a credit analyst at First National Bank of Fort Worth, continued in 1970 as a mutual fund manager for Shareholders Management Company (which became part of American General Insurance Company), and further progressed in 1973 when Mr. King joined Lionel D. Edie & Company (a New York-based investment firm), where he eventually became a Director and Manager of the Dallas office; and

WHEREAS, in March 1979, Mr. King formed his own investment advisory firm, Luther King Capital Management, which manages approximately $5.4 billion on behalf of employee benefit plans, corporations, foundations, endowments and high net worth individuals and is the largest employee-owned investment advisory firm in the Dallas-Fort Worth area; and

WHEREAS, as a result of his vast business experience and extraordinary talent, Mr. King was appointed by the Board of Regents of The University of Texas System to the Board of Directors of The University of Texas Investment Management Company in 1996 and was re-appointed by the Regents to serve another term on the Board of UTIMCO in 1999; and

WHEREAS, Mr. King served UTIMCO in many roles, including as Vice-Chairman of the Board, as Chairman and Member of the Board's Compensation Committee, as Chairman of the Board's Executive Officer Search Committee and as a Member of the Board's Strategic Review Committee, providing outstanding leadership and guidance to UTIMCO by drawing upon his substantial business background listed above and his additional service as a Director of numerous public and private companies and philanthropic organizations; and

WHEREAS, Mr. King's commitment and service as a Director of UTIMCO was exemplary, reflecting his deep devotion to higher education and the excellence and advancement of the investment profession, evidenced by his service as Trustee of Texas Christian University, as Chairman and Member of the Board of the Investment Counsel Association of America and as Chairman and Trustee of the Investment Advisory Committee for the Employees Retirement System of Texas; and

WHEREAS, during Mr. King's tenure on the Board, UTIMCO managed the Permanent University Fund and other investments of the UT System with the highest standards of integrity, professionalism and competency, earning wide praise and recognition from UTIMCO's investment beneficiaries, namely the UT System and The Texas A&M University System, as well as the alumni and patrons of such Systems, the State's legislative leaders, the national credit rating agencies and the capital markets and investment community generally; and

WHEREAS, much of the credit for UTIMCO's success is directly attributable to Mr. King's leadership, judgment, direction and commitment; and

WHEREAS, to the great regret of the UTIMCO Board and Staff, Mr. King's term as a member of the UTIMCO Board expired as of April 1, 2004, and, due to term limits, Mr. King is not eligible for a successive term on the Board; NOW, THEREFORE

BE IT RESOLVED, that the Directors of The University of Texas Investment Management Company, on behalf of the grateful people of the State of Texas, particularly the Boards of Regents and Administrators of The University of Texas System and The Texas A&M University System, do hereby express to J. Luther King, Jr. their sincerest appreciation and gratitude for his vision, leadership and service that have contributed to UTIMCO's past successes; and

BE IT FURTHER RESOLVED, that all persons who read this Resolution should know that through his outstanding service to UTIMCO, Mr. King has made a lasting and fundamental contribution to improve the manner in which public university endowments are invested and managed in the State of Texas, to the benefit of all of the citizens of the State, particularly the students and faculty of the UT System and the A&M System.

Mr. King voiced his appreciation for the opportunity to serve on the Corporation's Board to the benefit of the U. T. and Texas A&M Systems. He has been a part of UTIMCO since inception and stated what tremendous strides and dynamic changes have been made by quality staff and dedicated Board members. He stressed that independence of UTIMCO must be kept to ensure compounding performance over the next 15-20 years. Several Directors bestowed gratitude for his service, elaborated on his many fine qualities, and stated that he had been a mentor for many in a leadership role. He has been important to the State of Texas by giving true public service as a member of the Board for so many years and will be missed. At this point, Director Huffines joined the meeting.

The U. T. System Short Intermediate Term Fund Issues

Mr. Boldt offered to answer any questions of the Board regarding the letter sent out by the Chairman of the U. T. System Board of Regents and attached report written by EnnisKnupp regarding the Short Intermediate Fund. A concern was raised that the SITF performance during 2001 and 2002 underperformed its benchmark. A discussion ensued regarding the management of the SITF following the objectives stated in the SITF Investment Policy Statement. The Board directed the Corporation's Staff to work with EnnisKnupp and Mr. Aldridge to clarify ambiguous language in the SITF Policy Statement.

CORE Fund Strategy

Mr. Hunt asked Mr. Boldt to begin discussion of the CORE Fund Strategy. The presentation included research completed by Staff on new investment options for System operating funds currently invested in the Short Term Fund, the Short Intermediate Term Fund, the Bond Index Fund, and the Equity Index Fund. Mr. Boldt presented projected gains from implementing the new Funds, discussed transition and strategic issues with the new alternatives, presented advantages and disadvantages and answered the Directors' questions.

The meeting was recessed at 12:20 p.m.

The Board of the Corporation reconvened in an open meeting at 1:20 p.m.

Working Group Report

Mr. Hunt deferred to Mr. Szalkowski of Baker Botts to update the Board of the progress of the Working Group. The Working Group was authorized by the UT System Board of Regents on December 19, 2003 and appointed on February 4, 2004 to review investment operations of UTIMCO. Mr. Szalkowski stated that the Group had met several times and were reviewing information compiled from several requests. The Group would prepare a written report to be provided to the UT System Board of Regents in time for the special called Board of Regents meeting to be held on April 29, 2004. He and Mr. Aldridge answered the Directors' questions. Mr. Szalkowski stated that two members of the Working Group had resigned, Professors Stark and Brown, because of "time commitments". In response to a question from Director Stevens regarding the participation of Greg Anderson as the Texas A&M representative on the Working Group, Mr. Aldridge stated that Mr. Anderson had been regularly updated on discussions with the Working Group. Several Directors expressed concern that no Board members had been contacted by the Working Group, and Director Huffines encouraged the Working Group to meet with all members of the UTIMCO Board prior to completing their report.

CORE Fund Strategy cont.

Mr. Hunt asked Mr. Boldt to continue with information regarding the new creative, substitute strategy for investing the System operating funds. Technical and transitional issues were discussed. At this point, Director Huffines left the meeting. An advisory committee of Chief Business Officers of the components was suggested to provide insight from the institutional level. Although no action was necessary, the Board encouraged Mr. Boldt and his staff to proceed with contacting and educating the Chief Business Officers with the new options and prepare a final report for the Board. Directors Yudof and Byrne left the meeting during the discussion.

PUF Distribution Amount and PHF and LTF Payout Rates

Mr. Hunt asked Ms. Moeller to present to the Board the Staff's recommendation of the Permanent University Fund distribution amount and the Permanent Health Fund and the Long Term Fund payout rates or the fiscal year ending August 31, 2005. Upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED, that the annual distribution amount for the Permanent University Fund be decreased from $348,033,578 to $341,174,270, for fiscal year 2005, effective with the September 1, 2004 distribution and the distribution rate for the Long Term Fund be increased from $0.2645 per unit to $0.2697 per unit, and the Permanent Health Fund remain at current payout rate of $.047 per unit for fiscal year 2005, effective with the November 30, 2004 distributions.

BE IT FURTHER RESOLVED, that the annual distribution amount for the Permanent University Fund and the distribution rates for the Long Term Fund and Permanent Health Fund be approved and adopted by this Corporation's Board of Directors, subject to approval by The University of Texas System Board of Regents.

Restatement of Historical Endowment Policy Portfolio Return

Mr. Hunt asked Ms. Moeller to continue with presenting the detailed analysis of the proposed restatement of the Endowment Policy Portfolio (EPP). Ms. Moeller reported that the Staff completed a thorough review of the asset class weighs and benchmarks used in the establishment of the EPP's and worked to resolve technical benchmark issues to result in more accurate performance comparisons in the future. Also discussed was the new asset allocation approved in December 2003, and its phase-in process.

Liquidity Committee Report

Mr. Hunt asked Mr. Hester, Chairman of the Liquidity Committee to report on the meeting of the Liquidity Committee. Mr. Hester reported that the committee had held its first meeting on March 23, 2004. The Committee agreed to meet at least quarterly, and more often should the need arise due to changes within the liquidity percentage ranges, to review the certified report of illiquid investments since the last report, any changes to the liquidity classification, and current liquidity state. A Charter of the Liquidity Committee was presented to the Committee and approved. The Charter had been reviewed by Cambridge Associates, EnnisKnupp and Vinson and Elkins. Upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED, that the Charter of the Liquidity Committee be and is hereby approved in the form submitted to the Board.

Audit and Ethics Committee Report

Mr. Stevens, Chairman of the Audit and Ethics Committee, reported that the Committee met prior to the Board meeting and approved that the firm of Ernst & Young, LLP be appointed as the independent auditor of the Corporation for the year ended August 31, 2004. Upon motion duly made and seconded; the following resolution was unanimously adopted:

RESOLVED, that the firm of Ernst & Young, LLP be and is hereby appointed as the independent auditor of the Corporation for the year ended August 31, 2004, as submitted by the Audit and Ethics Committee be, and is hereby, approved.

Mr. Hunt thanked both Mr. Hester and Mr. Stevens for their leadership roles on the Committees.

There being no further business to come before the Board of Directors, the meeting was adjourned at approximately 3:30 p.m.

Secretary: ____________________________
Joan Moeller

Approved: ______________________________ Date: ________________
Woody L. Hunt
Chairman, Board of Directors of
The University of Texas Investment
Management Company

TAB 2

Resolution No. 2

RESOLVED, that the amendments to the Investment Policy Statements for the Permanent University Fund, and the U. T. System General Endowment Fund as presented be, and are hereby, approved, subject to approval by the U. T. System Board of Regents.

Agenda Item
UTIMCO Board of Directors Meeting
May 6, 2004

Agenda Item:	Approval of Amendments to the Permanent University Fund (PUF) and the U. T. System General Endowment Fund (GEF) Investment Policy Statements
Developed By:	Boldt, Moeller
Presented By:	Boldt
Type of Item:	Action required by UTIMCO Board; Action required by U. T. System Board of Regents
Description:	Section 3(a) of the Investment Management Services Agreement dated March 1, 1996, second amended and restated effective August 7, 2003, between the Board of Regents of The University of Texas System and UTIMCO provides that UTIMCO shall review the investment policies of the assets under its management and recommend any changes of such policies for approval by the U. T. Board of Regents. The attached item is the actual agenda item to be presented at the Board of Regents' meeting scheduled for May 12 -13, 2004.
Recommendation:	UTIMCO staff recommends approval of changes to the Asset Allocation and Policy section of the Investment Policy Statements and Exhibit A, as presented.
Discussion:	The recommended changes to the PUF and GEF Investment Policy Statements segregate two individual asset categories which were grouped together under broader asset classes in the Policy Statements approved by the Board of Regents at their December 19, 2003 meeting. In addition, asset definitions and benchmarks are provided for the revised asset categories. The proposed definitional changes are reflected in Exhibit A of both the PUF and GEF Investment Policy Statements. Finally, a change in the benchmarks for Private Equity and Venture Capital asset categories as reported in Exhibit A is proposed.
Reference:	U. T. System Board of Regents Agenda Item: Approval to Amend the Permanent University Fund and General Endowment Fund Investment Policy Statements PUF and GEF Investment Policy Statements approved by Board of Regents on December 19, 2003

U. T. Board of Regents: Approval to amend the Permanent University Fund and General Endowment Fund Investment Policy Statements

RECOMMENDATION

The Board of Directors of The University of Texas Investment Management Company (UTIMCO) recommends that the U. T. Board of Regents approve the proposed amendments to the following Investment Policy Statements as set forth in congressional style in the excerpt of the Investment Policy Statements included in the Background Information to this item:

a. Permanent University Fund (PUF)

b. General Endowment Fund (GEF)

It is further recommended that the U. T. Board of Regents approve the revised Exhibit A of the PUF Investment Policy Statement and the GEF Investment Policy Statement as set forth in congressional style in the Background Information to this item.

BACKGROUND INFORMATION

Section 3(a) of the Investment Management Services Agreement dated March 1, 1996, second amended and restated effective August 7, 2003, between the Board of Regents of The University of Texas System and UTIMCO provides that UTIMCO shall review the investment policies of the assets under its management and recommend any changes of such policies for approval by the U. T. Board of Regents. The Investment Policy Statements for the PUF and the GEF provide that UTIMCO "shall ... determine specific asset allocation targets, ranges, and performance benchmarks consistent with PUF (and GEF) objectives ..." The Board of Regents adopted amendments to the Investment Policy Statements for the PUF and GEF at its December 19, 2003 meeting which established new asset allocation targets for several asset categories. However, there were also changes made to performance benchmarks and asset category definitions in the revised Investment Policy Statements which the UTIMCO Board believes would have negative unintended consequences. In exercising its delegated responsibility to determine benchmarks, UTIMCO recommends the technical corrections to the PUF and GEF Investment Policy Statements set forth in this agenda item. Note that there are no changes to any Regents approved asset allocation targets recommended in this agenda item. There are no changes to the expected return or expected risk measures. The only recommended changes are technical corrections to benchmark categories and definitions.

The recommended changes to the PUF and GEF Investment Policy Statements segregate two individual asset categories which were grouped under broader asset classes, and provide asset definitions and benchmarks for the revised asset categories. The proposed definitional changes are reflected in Exhibit A of both the PUF and GEF Investment Policy Statements. In addition, a change in the benchmarks for Private Equity and Venture Capital asset categories as reported in Exhibit A is proposed.

During the construction of the new policy portfolio, it became apparent that two unintended consequences resulted from the movement of REITS and TIPS from the inflation hedge asset category to the US Equities and Fixed Income categories, respectively. The benchmarks of the US Equities and Fixed Income classes were not adjusted correspondingly to account for the asset allocation percentage weights of the asset categories added.

1) Under the asset classification scheme of the new Investment Policy Statement, the actual US Equities portfolio for the PUF and GEF would consist of approximately 21.6% of REITS (REITS' value of $859.2 versus total US Equities with REITS of $3,974.1 as of March 31, 2004) while the Benchmark for the asset class, the Russell 3000 Index, has a weight of approximately 2% in REITS. This difference in weights between the actual portfolios and the policy portfolios creates a substantial risk concentration requiring transactions totaling more than $1.5 billion to correct. In addition to the expenses associated with the transactions which would total several million dollars, there would be three additional negative effects:
    a. REITS have been an important part of the endowment funds' portfolios for more than 10 years. They are the endowments' only investment in real estate and substantially reducing this position would lower the diversification and increase the risk of the overall portfolios with no expected increase in returns.
    b. Because the proceeds of the sale of the existing REIT portfolio would be transferred from internal management to external active management, the total UTIMCO and Fund budgets would immediately increase by about 8.7% (approximately $2.7 million per year), reflecting the difference in costs between internal and external active management. In addition, total internally managed assets would be reduced by about one-third with no decrease in costs.
    c. An important source of value added over the past two years, REITS managed internally by Greg Cox, would be reduced to about one tenth of its previous weight, thus limiting UTIMCO's ability to add value in the future.

2) The second issue relates to Treasury Inflation Protection Securities (TIPS). Although UTIMCO does not currently have a TIPS position in the endowment portfolios, the intention was to introduce TIPS as part of the portfolio allocation, and a 5% allocation was originally approved by the UTIMCO Board. However, moving TIPS to the Fixed Income category would make it unlikely that the intended 33.3% allocation to TIPS (5% for TIPS out of 15% total for fixed income) would occur since the Lehman Brothers Bond Index does not contain any TIPS in its construction. TIPS would be more appropriately measured against the Lehman Brothers US TIPS Index. Therefore, implementing the 5% allocation to TIPS intended by the Asset Allocation Policy would create a substantial risk concentration position relative to the Lehman Brothers Aggregate Bond benchmark, making it less likely that TIPS would actually be purchased under the risk budgeting procedure used by UTIMCO. This would be an unintended negative result because TIPS have unique and attractive strategic characteristics which would improve diversification and lower the overall risk of the portfolio. The Investment Policy should encourage, not discourage, a TIPS position. The changes recommended in this agenda item would encourage TIPS positions.

The following changes to the Asset Allocation and Policy sections of the PUF and GEF Investment Policy Statements are proposed to correct the negative unintended consequences:

Asset Allocation and Policy

Asset allocation is the primary determinant of the volatility of investment return and, subject to the asset allocation ranges specified in Exhibit A, is the responsibility of UTIMCO. Specific asset allocation positions may be changed from time to time, within the ranges specified in Exhibit A, based on the economic and investment outlook.

PUF (and GEF) assets shall be allocated among the following broad asset classes based upon their individual return/risk characteristics and relationships to other asset classes:

A. U. S. Equities - U. S. equities represent ownership in U. S. companies that are traded in public markets~~.~~: ~~Equities include stocks that are further identified by size of the company and are classified as large capitalization, medium capitalization, and small capitalization. U. S. equities may further be delineated by style (growth or value). Warrants, rights, options, futures and hedge funds are also included if the underlying assets are equities. In addition, Derivative Applications approved by the UTIMCO Board that serve~~

~~as a U. S. equity substitute will be classified as U.S. equities. Equities provide both current income and growth of income.~~

Traditional U.S. Equities – Traditional U.S. equities include common stocks and derivatives based on common stocks including warrants, rights, options, exchange traded funds, and futures. In addition, Derivative Applications approved by the UTIMCO Board that serve as a U.S. Equity substitute will be classified as traditional U.S. equity. Equities provide both current income and growth of income.

REITS – REITS are real estate investment trusts. REITS are companies which own, and in most cashes operate, income producing real estate.

B. Global ex U. S. Equities – Global ex U. S. equities represent ownership in global companies that are traded in public markets. The global ex U. S. markets include established and emerging markets. ~~Equities include stocks that are further identified by size of the company and are classified as large capitalization, medium capitalization, and small capitalization. Global ex U. S. equities may further be delineated by style (growth or value) or region (Latin America, Asia etc.) or state of economic development (Emerging Markets).~~ Warrants, rights, options, exchange traded funds, and futures ~~and hedge funds~~ are also included if the underlying assets are equities. In addition, Derivative Applications approved by the UTIMCO Board that serve as a Global ex U. S. equity substitute will be classified as Global ex U. S. equities. Equities provide both current income and growth of income.

C. Hedge Funds – Hedge funds are broadly defined to include nontraditional investment strategies whereby the majority of the underlying securities are traded on public exchanges or are otherwise readily marketable.

Equity Hedge Funds – Equity hedge fund investments include U. S. and international long/short equity strategies. These strategies attempt to exploit profits from stock selection skills by taking long and short positions in various equity securities. These strategies may also include fund of hedge fund investments. Equity hedge fund investments are made through private placement agreements.

Absolute Return Hedge Funds – Absolute return hedge fund investments include arbitrage and event driven strategies. Arbitrage strategies attempt to exploit pricing discrepancies between closely related securities, utilizing a variety of different tactics primarily within equity, fixed income and convertible securities markets. Event driven strategies attempt to exploit discreet events such as bankruptcies, mergers, and takeovers. Absolute return hedge funds may include fund of hedge fund investments. Absolute return hedge fund investments are made through private placement agreements.

D. Private Capital - Private Capital investments include the illiquid debt and equity securities of private or publicly-traded companies. Private Capital investments consist of two sub-asset class categories: Venture Capital and Private Equity.

Venture Capital – Venture capital investments consist of investments in companies, both U. S. and non-U. S. that are in the early stages of development. Venture Capital investments are held either through limited partnership or as direct ownership interests.

Private Equity – Private Equity investments consist of investments in the equity securities of private businesses, both U. S. and non-U. S., that are considered to be in the post-start-up phase and that are profitable and generating income. Private Equity investments are held either through limited partnerships or as direct ownership interests. The classification of private equity also includes mezzanine and opportunistic investments. Mezzanine consists of investments in funds that make subordinated debt or minority equity investments in private companies. Opportunistic investments are limited to illiquid assets and may include distressed debt or secondary private equity partnerships.

E. Commodities – Natural resource investments which include oil and gas interests, commodities, and other hard assets.

F. Fixed Income – Fixed income investments include debt issued by the U. S. Treasury, various government agencies and domestic and foreign corporations.

Traditional Fixed Income - The principal securities include bonds, notes, bills and mortgage and asset-backed securities. ~~Fixed income investments also include hedge funds if the underlying assets are fixed income investments, and treasury inflation protected securities (TIPS) which are marketable securities with a return linked to the inflation rate.~~ In addition, Derivative Applications approved by the UTIMCO Board that serve as a fixed income substitute will be classified as traditional fixed income.

TIPS - TIPS are treasury inflation protected securities which are marketable securities with a return linked to the inflation rate.

G. Cash & Equivalents – Cash & equivalents consist of money markets, deposit of the Texas State Treasury, foreign currencies and other overnight funds that have not been allocated to a specific asset class.

- excerpt end -

We are also proposing to clarify the use of the Venture Economics Benchmark for the Private Capital asset category. During the recently completed Asset Allocation Review process, a new benchmark based on Venture Economics data was approved. The UTIMCO Board approved the use of Venture Economics' Vintage Year Venture Capital Index for the benchmark of Venture Capital and the use of Venture Economics' Vintage year Private Equity Index for Private Equity. At the time of the approval, the UTIMCO Board noted that staff would have to determine the most appropriate way to incorporate the Venture Economics benchmark into the endowment policy portfolio benchmark. The incorporation of Private Capital returns into the overall policy portfolio presents technical challenges due to differences in the methodology used to calculate return.

The best solution to the technical challenges is to use the Venture Economics' Periodic IRR Index for the entire Private Capital asset category rather than separate indices for venture capital and private equity. Although still not a perfect solution to the benchmarking problems of private equity, the Venture Economics Index does have an important characteristic necessary in any good benchmark: high correlation with the actual portfolio segment for which it has been selected as the benchmark. The table below indicates the correlation of actual private equity returns in the endowment funds with the Venture Economics Index over individual 1, 3, and 5 year periods over the past 10 years:

Correlation Coefficients	UTIMCO and Venture Economics
1 Year	0.9229
3 Years	0.8931
5 Years	0.9520

Correlation coefficients are statistical measures of how closely two variables change as measured at different points in time. A correlation coefficient of 1.0 indicates the two variables are moving in exact lockstep; a correlation coefficient of 0.0 indicates the two variables are moving completely independently. The high correlation measures above for the historical returns of the private capital portfolios and the Venture Economics benchmark indicate that the Venture Economics benchmark should be an effective benchmark for the endowments' private capital investments.

EXHIBIT A

POLICY TARGETS, RANGES AND PERFORMANCE OBJECTIVES

Asset Category	Percent of Portfolio (%) Policy Targets	Policy Ranges	Benchmarks
US Equities:	**25.0**	**15 to 45**	Combination benchmark: 80% Russell 3000 Index plus 20% Wilshire Associates Real Estate Securities Index ~~Russell 3000 Index~~
Traditional US Equities	20.0	15 to 45	Russell 3000 Index
REITS	5.0	0 to 10	Wilshire Associates Real Estate Securities Index
Global ex US Equities:			MSCI All Country World Index ex US
Non-US Developed Equity	10.0	5 to 15	
Emerging Markets Equity	7.0	0 to 10	
Total ~~Traditional~~ Equity	**42.0**	**20 to 60**	
Equity Hedge Funds	10.0	5 to 15	90 Day T-Bills + 4%
Absolute Return Hedge Funds	15.0	10 to 20	90 Day T-Bills + 3%
Total Hedge Funds	**25.0**	**15 to 25**	
Venture Capital	6.0	0 to 10	~~Venture Economics Vintage Year Venture Capital Index~~
Private Equity	9.0	5 to 15	~~Venture Economics Vintage Year Private Equity Index~~
Total Private Capital	**15.0**	**5 to 15**	Venture Economics' Periodic IRR Index
Commodities	**3.0**	**0 to 5**	GSCI minus 1%
Fixed Income:	**15.0**	**10 to 30**	Combination benchmark: 66.7% Lehman Brothers Aggregate Bond Index plus 33.3% Lehman Brothers US Tips Index ~~Lehman Brothers Aggregate Bond Index~~
Traditional Fixed Income	10.0	10 to 30	Lehman Brothers Aggregate Bond Index
TIPS	5.0	0 to 10	Lehman Brothers US Tips Index
Cash	**0.0**	**0 to 5**	90 Day T-Bills

Expected Annual Return (%)	**8.36**
Downside Deviation (%)	**4.22**
Standard Deviation (%)	**10.30**

THE UNIVERSITY OF TEXAS SYSTEM
PERMANENT UNIVERSITY FUND
INVESTMENT POLICY STATEMENT

Purpose

The Permanent University Fund (the "PUF") is a public endowment contributing to the support of institutions of The University of Texas System (other than The University of Texas-Pan American and The University of Texas at Brownsville) and institutions of The Texas A&M University System (other than Texas A&M University-Corpus Christi, Texas A&M International University, Texas A&M University-Kingsville, West Texas A&M University, Texas A&M University-Commerce, Texas A&M University-Texarkana, and Baylor College of Dentistry).

PUF Organization

The PUF was established in the Texas Constitution of 1876 through the appropriation of land grants previously given to The University of Texas at Austin plus one million acres. The land grants to the PUF were completed in 1883 with the contribution of an additional one million acres of land. Today, the PUF contains 2,109,190 acres of land (the "PUF Lands") located in 24 counties primarily in West Texas.

The 2.1 million acres comprising the PUF Lands produce two streams of income: a) mineral income, primarily in the form of oil and gas royalties and b) surface income, in the form of surface leases and easements. Under the Texas Constitution, mineral income, as a non-renewable source of income, remains a non-distributable part of PUF corpus, and is invested in securities. Surface income, as a renewable source of income, is distributed to the Available University Fund (the "AUF"), as received.

The Constitution prohibits the distribution and expenditure of mineral income contributed to the PUF. The Constitution also requires that all surface income and investment distributions paid to the AUF be expended for certain authorized purposes.

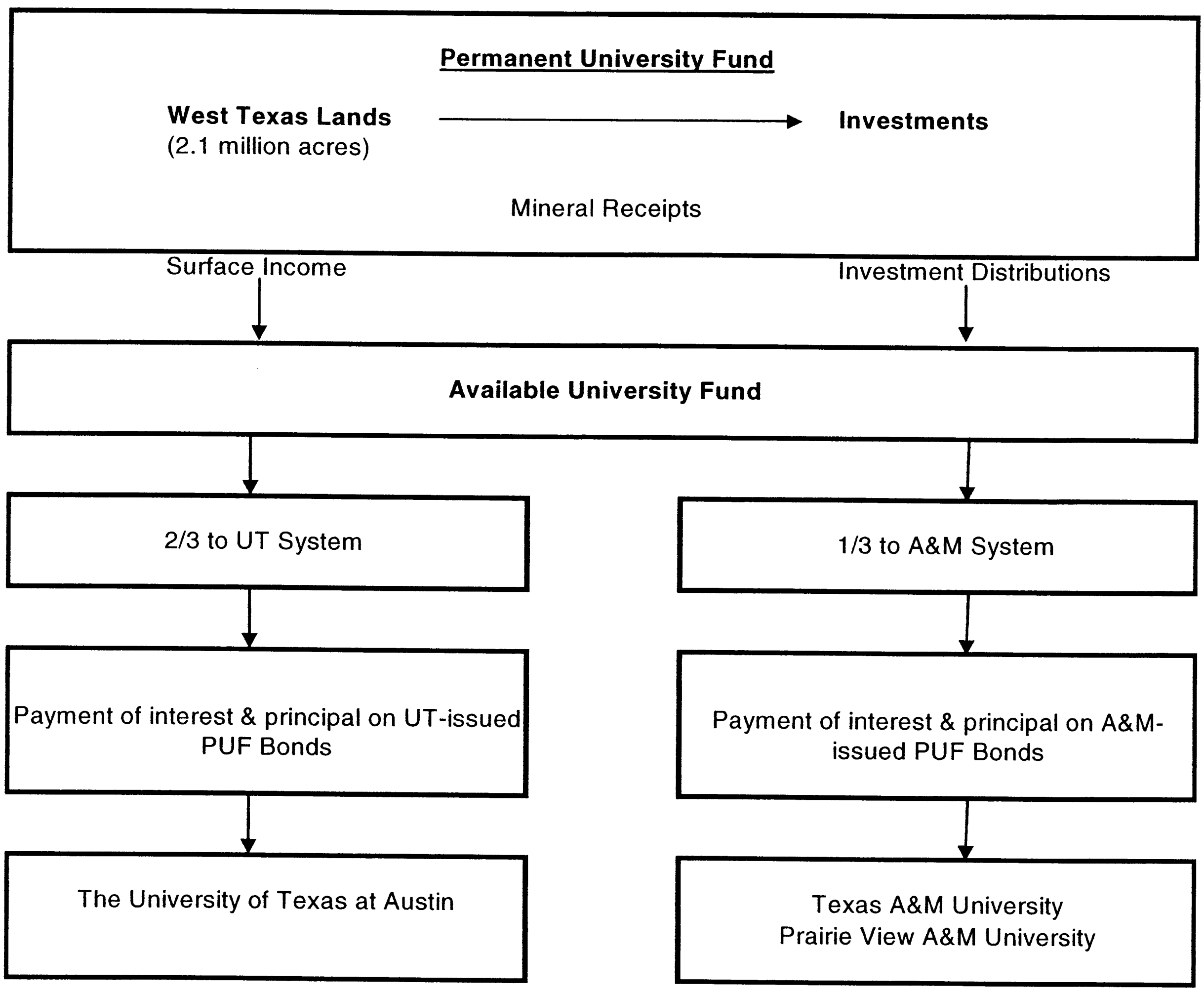
The expenditure of the AUF is subject to a prescribed order of priority:

First, following a 2/3rds and 1/3rd allocation of AUF receipts to the U. T. System and Texas A&M University System, respectively, expenditures for debt service on PUF bonds. Article VII of the Texas Constitution authorizes the Board of Regents and the Texas A&M University System Board (the "TAMUS Board") to issue bonds payable from their respective interests in AUF receipts to finance permanent improvements and to refinance outstanding PUF obligations. The Constitution limits the amount of bonds and notes secured by each System's interest in divisible PUF income to 20% and 10% of the book value of PUF investment securities, respectively. Bond resolutions adopted by both Boards also prohibit the issuance of additional PUF parity obligations unless the projected interest in AUF receipts for each System covers projected debt service at least 1.5 times.

Second, expenditures to fund a) excellence programs specifically at U. T. Austin, Texas A&M University and Prairie View A&M University and b) the administration of the university systems.

The payment of surface income and investment distributions from the PUF to the AUF and the associated expenditures is depicted below in Exhibit 1:

Exhibit 1



PUF Management

Article VII of the Texas Constitution assigns fiduciary responsibility for managing and investing the PUF to the Board of Regents. Article VII authorizes the Board of Regents, subject to procedures and restrictions it establishes, to invest the PUF in any kind of investments and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the Board of Regents, in making investments, may acquire, exchange sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill, and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all the assets of the fund rather than a single investment.

Ultimate fiduciary responsibility for the PUF rests with the Board of Regents. Section 66.08 of the Texas Education Code authorizes the Board of Regents to delegate to its committees, officers or employees of the U. T. System and other agents the authority to act for the Board of Regents in investment of the PUF. The PUF shall be managed through The University of Texas Investment Management Company ("UTIMCO") which shall a) recommend investment policy for the PUF, b) determine specific asset allocation targets, ranges and performance benchmarks consistent with PUF objectives, and c) monitor PUF performance against PUF objectives. UTIMCO shall invest the PUF's assets in conformity with investment policy.

UTIMCO may select and terminate unaffiliated investment managers subject to the Delegation of Investment Approval Authority approved by the UTIMCO Board. These guidelines are intended to ensure that the appropriate managers are retained to pursue a defined investment strategy within the PUF's portfolio structure and to define the general conditions under which a portfolio manager may be placed on a watch list or terminated. Such managers shall have complete investment discretion unless restricted by the terms of their management contracts. Managers shall be monitored for performance and adherence to investment disciplines.

PUF Administration

UTIMCO shall employ an administrative staff to ensure that all transaction and accounting records are complete and prepared on a timely basis. Internal controls shall be emphasized so as to provide for responsible separation of duties and adequacy of an audit trail. Custody of PUF assets shall comply with applicable law and be structured so as to provide essential safekeeping and trading efficiency.

PUF Investment Objectives

The primary investment objective shall be to preserve the purchasing power of PUF assets and annual distributions by earning an average annual real return of 5.1 % over rolling ten-year periods or longer. This 5.1% target was derived by adding the current target distribution rate of 4.75% plus an annual expected expense of .35%. The PUF's success in meeting its objectives depends upon its ability to generate high returns in periods of low inflation that will offset lower returns generated in years when the capital markets underperform the rate of inflation.

The secondary fund objective is to generate a fund return in excess of the Policy Portfolio benchmark over rolling five-year periods or longer. The Policy Portfolio benchmark will be established by UTIMCO and will be comprised of a blend of asset class indices weighted to reflect PUF asset allocation policy targets.

Asset Allocation and Policy

Asset allocation is the primary determinant of the volatility of investment return and, subject to the asset allocation ranges specified in Exhibit A, is the responsibility of UTIMCO. Specific asset allocation positions may be changed from time to time, within the ranges specified in Exhibit A, based on the economic and investment outlook.

PUF assets shall be allocated among the following broad asset classes based upon their individual return/risk characteristics and relationships to other asset classes:

A. U. S. Equities - U. S. equities represent ownership in U. S. companies that are traded in public markets. Equities include stocks that are further identified by size of the company and are classified as large capitalization, medium capitalization, and small capitalization. U. S. equities may further be delineated by style (growth or value). Warrants, rights, options, futures and hedge funds are also included if the underlying assets are equities. In addition, Derivative Applications approved by the UTIMCO Board that serve as a U. S. equity substitute will be classified as U.S. equities. Equities provide both current income and growth of income.

B. Global ex U. S. Equities – Global ex U. S. equities represent ownership in global companies that are traded in public markets. The global ex U. S. markets include established and emerging markets. Equities include stocks that are further identified by size of the company and are classified as large capitalization, medium capitalization, and small capitalization. Global ex U. S. equities may further be delineated by style (growth or value) or region (Latin America, Asia etc.) or state of economic development (Emerging Markets). Warrants, rights, options, futures and hedge funds are also included if the underlying assets are equities. In addition, Derivative Applications approved by the UTIMCO Board that serve as a Global ex U. S. equity substitute will be classified as Global ex U. S. equities. Equities provide both current income and growth of income.

C. Hedge Funds – Hedge funds are broadly defined to include nontraditional investment strategies whereby the majority of the underlying securities are traded on public exchanges or are otherwise readily marketable.

Equity Hedge Funds – Equity hedge fund investments include U. S. and international long/short equity strategies. These strategies attempt to exploit profits from stock selection skills by taking long and short positions in various equity securities. These strategies may also include fund of hedge fund investments. Equity hedge fund investments are made through private placement agreements.

Absolute Return Hedge Funds – Absolute return hedge fund investments include arbitrage and event driven strategies. Arbitrage strategies attempt to exploit pricing discrepancies between closely related securities, utilizing a variety of different tactics primarily within equity, fixed income and convertible securities markets. Event driven strategies attempt to exploit discreet events such as bankruptcies, mergers, and takeovers. Absolute return hedge funds may include fund of hedge fund investments. Absolute return hedge fund investments are made through private placement agreements.

D. Private Capital - Private Capital investments include the illiquid debt and equity securities of private or publicly-traded companies. Private Capital investments consist of two sub-asset class categories: Venture Capital and Private Equity.

Venture Capital – Venture capital investments consist of investments in companies, both U. S. and non-U. S. that are in the early stages of development. Venture Capital investments are held either through limited partnership or as direct ownership interests.

Private Equity – Private Equity investments consist of investments in the equity securities of private businesses, both U. S. and non-U. S., that are considered to be in the post-start-up phase and that are profitable and generating income. Private Equity investments are held either through limited partnerships or as direct ownership interests. The classification of private equity also includes mezzanine and opportunistic investments. Mezzanine consists of investments in funds that make subordinated debt or minority equity investments in private companies. Opportunistic investments are limited to illiquid assets and may include distressed debt or secondary private equity partnerships.

E. Commodities – Natural resource investments which include oil and gas interests, commodities, and other hard assets.

F. Fixed Income – Fixed income investments include debt issued by the U. S. Treasury, various government agencies and domestic and foreign corporations.

The principal securities include bonds, notes, bills and mortgage and asset-backed securities. Fixed income investments also include hedge funds if the underlying assets are fixed income investments, and treasury inflation protected securities (TIPS) which are marketable securities with a return linked to the inflation rate. In addition, Derivative Applications approved by the UTIMCO Board that serve as a fixed income substitute will be classified as fixed income.

G. Cash & Equivalents – Cash & equivalents consist of money markets, deposit of the Texas State Treasury, foreign currencies and other overnight funds that have not been allocated to a specific asset class.

Performance Measurement

The investment performance of the PUF will be measured by the PUF's custodian, an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, and compared against the stated investment benchmarks of the PUF, as indicated in Exhibit A.

Investment Guidelines

The PUF must be invested at all times in strict compliance with applicable law.

Investment guidelines include the following:

General

- Investment guidelines for index and other commingled funds managed externally shall be governed by the terms and conditions of the Investment Management Contract.
- All investments will be U. S. dollar denominated assets unless held by an internal or external portfolio manager with discretion to invest in foreign currency denominated securities.
- Investment policies of any unaffiliated liquid investment fund must be reviewed and approved by the chief investment officer prior to investment of PUF assets in such liquid investment fund.
- No securities may be purchased or held which would jeopardize the PUF's tax-exempt status.
- No investment strategy or program may purchase securities on margin or use leverage unless specifically authorized by the UTIMCO Board.
- No investment strategy or program employing short sales may be made unless specifically authorized by the UTIMCO Board.

- The PUF's investments in warrants shall not exceed more than 5% of the PUF's net assets or 2% with respect to warrants not listed on the New York or American Stock Exchanges.

- The PUF may utilize Derivative Securities to: a) simulate the purchase or sale of an underlying market index while retaining a cash balance for fund management purposes; b) facilitate trading; c) reduce transaction costs; d) seek higher investment returns when a Derivative Security is priced more attractively than the underlying security; e) index or to hedge risks associated with PUF investments; or f) adjust the market exposure of the asset allocation, including long and short strategies and other strategies provided that the PUF's use of derivatives complies with the Derivative Investment Policy approved by the UTIMCO Board. The Derivative Investment Policy shall serve the purpose of defining the permitted applications under which derivative securities can be used, which applications are prohibited, and the requirements for the reporting and oversight of their use. The objective of the Derivative Investment Policy is to facilitate risk management and provide efficiency in the implementation of the investment strategies using derivatives.

<u>Cash and Cash Equivalents</u>

Holdings of cash and cash equivalents may include the following:

- Internal short term pooled investment funds managed by UTIMCO.

- Unaffiliated liquid investment funds as approved by the chief investment officer.

- Deposits of the Texas State Treasury.

- The PUF's custodian late deposit interest bearing liquid investment fund.

- Commercial paper must be rated in the two highest quality classes by Moody's Investors Service, Inc. (P1 or P2) or Standard & Poor's Corporation (A1 or A2).

- Negotiable certificates of deposit must be with a bank that is associated with a holding company meeting the commercial paper rating criteria specified above or that has a certificate of deposit rating of 1 or better by Duff & Phelps.

- Bankers' Acceptances must be guaranteed by an accepting bank with a minimum certificate of deposit rating of 1 by Duff & Phelps.

- Repurchase Agreements and Reverse Repurchase Agreements must be transacted with a dealer that is approved by UTIMCO and selected by the Federal Reserve Bank as a Primary Dealer in U. S. Treasury securities and rated A-1 or P-1 or the equivalent.

    - Each approved counterparty shall execute the Standard Public Securities Association (PSA) Master Repurchase Agreement with UTIMCO.

    - Eligible Collateral Securities for Repurchase Agreements are limited to U. S. Treasury securities and U. S. Government Agency securities with a maturity of not more than 10 years.

    - The maturity for a Repurchase Agreement may be from one day to two weeks.

    - The value of all collateral shall be maintained at 102% of the notional value of the Repurchase Agreement, valued daily.

    - All collateral shall be delivered to the PUF custodian bank. Tri-party collateral arrangements are not permitted.

- The aggregate amount of Repurchase Agreements with maturities greater than seven calendar days may not exceed 10% of the PUF's fixed income assets.

- Overnight Repurchase Agreements may not exceed 25% of the PUF's fixed income assets.

- Mortgage Backed Securities (MBS) Dollar Rolls shall be executed as matched book transactions in the same manner as Reverse Repurchase Agreements above. As above, the rules for trading MBS Dollar Rolls shall follow the Public Securities Association standard industry terms.

<u>Fixed Income</u>

<u>Domestic Fixed Income</u>

Holdings of domestic fixed income securities shall be limited to those securities a) issued by or fully guaranteed by the U. S. Treasury, U. S. Government-Sponsored Enterprises, or U. S. Government Agencies, and b) issued by corporations and municipalities. Within this overall limitation:

- Permissible securities for investment include the components of the Lehman Brothers Aggregate Bond Index (LBAGG): investment grade government and corporate securities, agency mortgage pass-through securities, and asset-backed securities. These sectors are divided into more specific subindices 1) Government: Treasury and Agency; 2) Corporate: Industrial, Finance, Utility, and Yankee; 3) Mortgage-backed securities: GNMA, FHLMC, and FNMA; 4) Asset-backed securities; 5) Taxable Municipal securities; and 6) Commercial Mortgage-backed securities. In addition to the permissible securities listed above, the following securities shall be permissible: a) floating rate securities with periodic coupon changes in market rates issued by the same entities that are included in the LBAGG as issuers of fixed rate securities; b) medium term notes issued by investment grade corporations; c) zero coupon bonds and stripped Treasury and Agency securities created from coupon securities; and d) structured notes issued by LBAGG qualified entities.

- U. S. Domestic Bonds must be rated investment grade, Baa3 or better by Moody's Investors Services, BBB- by Standard & Poor's Corporation, or an equivalent rating by a nationally recognized rating agency at the time of acquisition. This provision does not apply to an investment manager that is authorized by the terms of an investment advisory agreement to invest in below investment grade bonds.

- Not more than 5% of the market value of domestic fixed income securities may be invested in corporate and municipal bonds of a single issuer provided that such bonds, at the time of purchase, are rated, not less than Baa3 or BBB-, or the equivalent, by any two nationally-recognized rating services, such as Moody's Investors Service, Standard & Poor's Corporation, or Fitch Investors Service.

<u>Non-U. S. Fixed Income</u>

- Not more than 50% of the PUF's fixed income portfolio may be invested in non-U. S. dollar bonds. Not more than 15% of the PUF's fixed income portfolio may be invested in bonds denominated in any one currency.

- Non-dollar bond investments shall be restricted to bonds rated equivalent to the same credit standard as the U. S. Fixed Income Portfolio.

- Not more than 15% of the PUF's fixed income portfolio may be invested in Emerging Market debt.

- International currency exposure may be hedged or unhedged at UTIMCO's discretion or delegated by UTIMCO to an external investment manager.

<u>Equities</u>

The PUF shall:

A. hold no more than 25% of its equity securities in any one industry or industries (as defined by the standard industry classification code and supplemented by other reliable data sources) at market

B. hold no more than 5% of its equity securities in the securities of one corporation at cost unless authorized by the chief investment officer.

Members of UTIMCO management, with the approval of the UTIMCO Board, may serve as directors of companies in which UTIMCO has directly invested PUF assets. In such event, any and all compensation paid to UTIMCO management for their services as directors shall be endorsed over to UTIMCO and applied against UTIMCO management fees. Furthermore, UTIMCO Board approval of UTIMCO management's service as a director of an investee company shall be conditioned upon the extension of UTIMCO's Directors and Officers Insurance Policy coverage to UTIMCO management's service as a director of an investee company.

PUF Distributions

The PUF shall balance the needs and interests of present beneficiaries with those of the future. PUF spending policy objectives shall be to:

A. provide a predictable, stable stream of distributions over time

B. ensure that the inflation adjusted value of distributions is maintained over the long term

C. ensure that the inflation adjusted value of PUF assets after distributions is maintained over the long term.

The goal is for the PUF's average spending rate over time not to exceed the PUF's average annual investment return after inflation and expenses in order to preserve the purchasing power of PUF distributions and underlying assets.

The Texas Constitution states that "The amount of any distributions to the available university fund shall be determined by the board of regents of The University of Texas System in a manner intended to provide the available university fund with a stable and predictable stream of annual distributions and to maintain over time the purchasing power of permanent university fund investments and annual distributions to the available university fund. The amount distributed to the available university fund in a fiscal year must be not less than the amount needed to pay the principal and interest due and owing in that fiscal year on bonds and notes issued under this section. If the purchasing power of permanent university fund investments for any rolling 10-year period is not preserved, the board may not increase annual distributions to the available university fund until the purchasing power of the permanent university fund investments is restored, except as necessary to pay the principal and interest due and owing on bonds and notes issued under this section. An annual distribution made by the board to the available university fund during any fiscal year may not exceed an amount equal to seven percent of the average net fair market value of permanent university fund investment assets as determined by the board, except as necessary to pay any principal and interest due and owing on bonds issued under this section. The expenses of managing permanent university fund land and investments shall be paid by the permanent university fund."

Annually, the Board of Regents will approve a distribution amount to the AUF.

In conjunction with the annual U. T. System budget process, UTIMCO shall recommend to the Board of Regents in May of each year an amount to be distributed to the AUF during the next fiscal year. UTIMCO's recommendation on the annual distribution shall be an amount equal to 4.75% of the trailing twelve quarter average of the net asset value of the PUF for the quarter ending February of each year.

Following approval of the distribution amount, distributions from the PUF to the AUF may be quarterly or annually at the discretion of UTIMCO Management.

PUF Accounting

The fiscal year of the PUF shall begin on September 1st and end on August 31st. Market value of the PUF shall be maintained on an accrual basis in compliance with Financial Accounting Standards Board Statements, Government Accounting Standards Board Statements, industry guidelines, and state statutes, whichever is applicable. Significant asset write-offs or write-downs shall be approved by the chief investment officer and reported to the UTIMCO Board of Directors. The PUF's financial statements shall be audited each year by an independent accounting firm selected by the Board of Regents.

Valuation of Assets

As of the close of business on the last business day of each month, UTIMCO shall determine the fair market value of all PUF net assets. Valuation of PUF assets shall be based on the books and records of the custodian for the valuation date. Valuation of alternative assets shall be determined in accordance with the UTIMCO Valuation Criteria for Alternative Assets.

The fair market value of the PUF's net assets shall include all related receivables and payables of the PUF on the valuation. Such valuation shall be final and conclusive.

Securities Lending

The PUF may participate in a securities lending contract with a bank or nonbank security lending agent for either short-term or long-term purposes of realizing additional income. Loans of securities by the PUF shall be collateralized by cash, letters of credit or securities issued or guaranteed by the U. S. Government or its agencies. The collateral will equal at least 100% of the current market value of the loaned securities. The contract shall state acceptable collateral for securities loaned, duties of the borrower, delivery of loaned securities and collateral, acceptable investment of collateral and indemnification provisions. The contract may include other provisions as appropriate.

The securities lending program will be evaluated from time to time as deemed necessary by the UTIMCO Board. Monthly reports issued by the agent shall be reviewed by UTIMCO to insure compliance with contract provisions.

Investor Responsibility

As a shareholder, the PUF has the right to a voice in corporate affairs consistent with those of any shareholder. These include the right and obligation to vote proxies in a manner consistent with the unique role and mission of higher education as well as for the economic benefit of the PUF. Notwithstanding the above, the UTIMCO Board shall discharge its fiduciary duties with respect to the PUF solely in the interest of PUF unitholders and shall not invest the PUF so as to achieve temporal benefits for any purpose including use of its economic power to advance social or political purposes.

Amendment of Policy Statement

The Board of Regents reserves the right to amend the Investment Policy Statement as it deems necessary or advisable.

Effective Date

The effective date of this policy shall be December 19, 2003.

EXHIBIT A

POLICY TARGETS, RANGES AND PERFORMANCE OBJECTIVES

	Percent of Portfolio (%)		
Asset Category	**Policy Targets**	**Policy Ranges**	**Benchmarks**
US Equities	25.0	15 to 45	Russell 3000 Index
Global ex US Equities:			MSCI All Country World Index ex US
Non-US Developed Equity	10.0	5 to 15	
Emerging Markets Equity	7.0	0 to 10	
Total Traditional Equity	**42.0**	**20 to 60**	
Equity Hedge Funds	10.0	5 to 15	90 Day T-Bills + 4%
Absolute Return Hedge Funds	15.0	10 to 20	90 Day T-Bills + 3%
Total Hedge Funds	**25.0**	**15 to 25**	
Venture Capital	6.0	0 to 10	Venture Economics Vintage Year Venture Capital Index
Private Equity	9.0	5 to 15	Venture Economics Vintage Year Private Equity Index
Total Private Capital	**15.0**	**5 to 15**	
Commodities	**3.0**	**0 to 5**	GSCI minus 1%
Fixed Income	**15.0**	**10 to 30**	Lehman Brothers Aggregate Bond Index
Cash	**0.0**	**0 to 5**	90 Day T-Bills

Expected Annual Return (%)	**8.36**
Downside Deviation (%)	**4.22**
Standard Deviation (%)	**10.30**

THE UNIVERSITY OF TEXAS SYSTEM
GENERAL ENDOWMENT FUND
INVESTMENT POLICY STATEMENT

Purpose

The General Endowment Fund (the "GEF"), established by the Board of Regents of The University of Texas System (the "Board of Regents") March 1, 2001, is a pooled fund for the collective investment of long-term funds under the control and management of the Board of Regents. The GEF provides for greater diversification of investments than would be possible if each account were managed separately.

GEF Organization

The GEF is organized as a mutual fund in which each eligible account purchases and redeems GEF units as provided herein. The ownership of GEF assets shall at all times be vested in the Board of Regents. Such assets shall be deemed to be held by the Board of Regents, as a fiduciary, regardless of the name in which the assets may be registered.

GEF Management

Ultimate fiduciary responsibility for the GEF rests with the Board of Regents. Section 66.08, Texas Education Code, as amended, authorizes the Board of Regents, subject to certain conditions, to enter into a contract with a nonprofit Corporation to invest funds under the control and management of the Board of Regents.

The GEF shall be governed through The University of Texas Investment Management Company ("UTIMCO"), a nonprofit Corporation organized for the express purpose of investing funds under the control and management of the Board of Regents. UTIMCO shall a) recommend investment policy for the GEF, b) determine specific asset allocation targets, ranges, and performance benchmarks consistent with GEF objectives, and c) monitor GEF performance against GEF objectives. UTIMCO shall invest the GEF assets in conformity with investment policy.

UTIMCO may select and terminate unaffiliated investment managers subject to the Delegation of Investment Approval Authority approved by the UTIMCO Board. These guidelines are intended to ensure that the appropriate managers are retained to pursue a defined investment strategy within the GEF's portfolio structure and to define the general conditions under which a portfolio manager may be placed on a watch list or terminated. Such managers shall have complete investment discretion unless restricted by the terms of their management contracts. Managers shall be monitored for performance and adherence to investment disciplines.

GEF Administration

UTIMCO shall employ an administrative staff to ensure that all transaction and accounting records are complete and prepared on a timely basis. Internal controls shall be emphasized so as to provide for responsible separation of duties and adequacy of an audit trail. Custody of GEF assets shall comply with applicable law and be structured so as to provide essential safekeeping and trading efficiency.

Funds Eligible to Purchase GEF Units

No fund shall be eligible to purchase units of the GEF unless it is under the sole control, with full discretion as to investments, by the Board of Regents and/or UTIMCO.

Any fund whose governing instrument contains provisions which conflict with this Policy Statement, whether initially or as a result of amendments to either document, shall not be eligible to purchase or hold units of the GEF.

GEF Investment Objectives

The primary investment objective shall be to preserve the purchasing power of GEF assets by earning an average annual real return of 5.1 % over rolling ten-year periods or longer. This 5.1% target was derived by adding the current target distribution rate of 4.75% plus an annual expected expense of .35%. The GEF's success in meeting its objectives depends upon its ability to generate high returns in periods of low inflation that will offset lower returns generated in years when the capital markets underperform the rate of inflation.

The secondary fund objectives are to generate a fund return in excess of the Policy Portfolio benchmark and the average median return of the universe of the college and university endowments as reported annually by Cambridge Associates and NACUBO over rolling five-year periods or longer. The Policy Portfolio benchmark will be established by UTIMCO and will be comprised of a blend of asset class indices weighted to reflect GEF's asset allocation policy targets.

Asset Allocation and Policy

Asset allocation is the primary determinant of the volatility of investment return and, subject to the asset allocation ranges specified in Exhibit A, is the responsibility of UTIMCO. Specific asset allocation positions may be changed from time to time, within the ranges specified in Exhibit A, based on the economic and investment outlook.

GEF assets shall be allocated among the following broad asset classes based upon their individual return/risk characteristics and relationships to other asset classes:

A. U. S. Equities - U. S. equities represent ownership in U. S. companies that are traded in public markets. Equities include stocks that are further identified by size of the company and are classified as large capitalization, medium capitalization, and small capitalization. U. S. equities may further be delineated by style (growth or value). Warrants, rights, options, futures and hedge funds are also included if the underlying assets are equities. In addition, Derivative Applications approved by the UTIMCO Board that serve as a U. S. equity substitute will be classified as U. S. equities. Equities provide both current income and growth of income.

B. Global ex U. S. Equities – Global ex U. S. equities represent ownership in global companies that are traded in public markets. The global ex U. S. markets include established and emerging markets. Equities include stocks that are further identified by size of the company and are classified as large capitalization, medium capitalization, and small capitalization. Global ex U. S. equities may further be delineated by style (growth or value) or region (Latin America, Asia etc.) or state of economic development (Emerging Markets). Warrants, rights, options, futures and hedge funds are also included if the underlying assets are equities. In addition, Derivative Applications approved by the UTIMCO Board that serve as a Global ex U. S. equity substitute will be classified as Global ex U. S. equities. Equities provide both current income and growth of income.

C. Hedge Funds – Hedge funds are broadly defined to include nontraditional investment strategies whereby the majority of the underlying securities are traded on public exchanges or are otherwise readily marketable.

Equity Hedge Funds – Equity hedge fund investments include U. S. and international long/short equity strategies. These strategies attempt to exploit profits from stock selection skills by taking long and short positions in various equity securities. These strategies may also include fund of hedge fund investments. Equity hedge fund investments are made through private placement agreements.

Absolute Return Hedge Funds – Absolute return hedge fund investments include arbitrage and event driven strategies. Arbitrage strategies attempt to exploit pricing discrepancies between closely related securities, utilizing a variety of different tactics primarily within equity, fixed income and convertible securities markets. Event driven strategies attempt to exploit discreet events such as bankruptcies, mergers, and takeovers. Absolute return hedge funds may include fund of hedge fund investments. Absolute return hedge fund investments are made through private placement agreements.

D. Private Capital - Private Capital investments include the illiquid debt and equity securities of private or publicly-traded companies. Private Capital investments consist of two sub-asset class categories: Venture Capital and Private Equity.

Venture Capital – Venture Capital investments consist of investments in companies, both U. S. and non-U. S. that are in the early stages of development. Venture capital investments are held either through limited partnership or as direct ownership interests.

Private Equity – Private equity investments consist of investments in the equity securities of private businesses, both U. S. and non-U. S. that are considered to be in the post-start-up phase and that are profitable and generating income. Private Equity investments are held either through limited partnerships or as direct ownership interests. The classification of private equity also includes mezzanine and opportunistic investments. Mezzanine consists of investments in funds that make subordinated debt or minority equity investments in private companies. Opportunistic investments are limited to illiquid assets and may include distressed debt or secondary private equity partnerships.

E. Commodities – Natural resource investments which include oil and gas interests, commodities, and other hard assets.

F. Fixed Income – Fixed income investments include debt issued by the U. S. Treasury, various government agencies and domestic and foreign corporations. The principal securities include bonds, notes, bills and mortgage and asset-backed securities. Fixed income investments also include hedge funds if the underlying assets are fixed income investments, and treasury inflation protected securities (TIPS) which are marketable securities with a return linked to the inflation rate. In addition, Derivative Applications approved by the UTIMCO Board that serve as a fixed income substitute will be classified as fixed income.

G. Cash & Equivalents – Cash & equivalents consist of money markets, foreign currencies and other overnight funds that have not been allocated to a specific asset class.

Performance Measurement

The investment performance of the GEF will be measured by the GEF's custodian, an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, and compared against the stated investment benchmarks of the GEF, as indicated in Exhibit A.

Investment Guidelines

The GEF must be invested at all times in strict compliance with applicable law.

Investment guidelines include the following:

General

- Investment guidelines for index and other commingled funds managed externally shall be governed by the terms and conditions of the Investment Management Contract.

- All investments will be U. S. dollar denominated assets unless held by an internal or external portfolio manager with discretion to invest in foreign currency denominated securities.

- Investment policies of any unaffiliated liquid investment fund must be reviewed and approved by the chief investment officer prior to investment of GEF assets in such liquid investment fund.

- No securities may be purchased or held which jeopardize the GEF's tax exempt status.

- No investment strategy or program may purchase securities on margin or use leverage unless specifically authorized by the UTIMCO Board.

- No investment strategy or program employing short sales may be made unless specifically authorized by the UTIMCO Board.

- The GEF's investments in warrants shall not exceed more than 5% of the GEF's net assets or 2% with respect to warrants not listed on the New York or American Stock Exchanges.

  The GEF may utilize Derivative Securities to: a) simulate the purchase or sale of an underlying market index while retaining a cash balance for fund management purposes; b) facilitate trading; c) reduce transaction costs; d) seek higher investment returns when a Derivative Security is priced more attractively than the underlying security; e) index or to hedge risks associated with GEF investments; or f) adjust the market exposure of the asset allocation, including long and short strategies and other strategies provided that the GEF's use of derivatives complies with the Derivative Investment Policy approved by the UTIMCO Board. The Derivative Investment Policy shall serve the purpose of defining the permitted applications under which derivative securities can be used, which applications are prohibited, and the requirements for the reporting and oversight of their use. The objective of the Derivative Investment Policy is to facilitate risk management and provide efficiency in the implementation of the investment strategies using derivatives.

Cash and Cash Equivalents

Holdings of cash and cash equivalents may include the following:

- Internal short-term pooled investment funds managed by UTIMCO.

- Unaffiliated liquid investment funds as approved by the chief investment officer.

- The GEF's custodian late deposit interest bearing liquid investment fund.

- Commercial paper must be rated in the two highest quality classes by Moody's Investors Service, Inc. (P1 or P2) or Standard & Poor's Corporation (A1 or A2).

- Negotiable certificates of deposit must be with a bank that is associated with a holding company meeting the commercial paper rating criteria specified above or that has a certificate of deposit rating of 1 or better by Duff & Phelps.

- Bankers' Acceptances must be guaranteed by an accepting bank with a minimum certificate of deposit rating of 1 by Duff & Phelps.

- Repurchase Agreements and Reverse Repurchase Agreements must be transacted with a dealer that is approved by UTIMCO and selected by the Federal Reserve Bank as a Primary Dealer in U. S. Treasury securities and rated A-1 or P-1 or the equivalent.

    - Each approved counterparty shall execute the Standard Public Securities Association (PSA) Master Repurchase Agreement with UTIMCO.

    - Eligible Collateral Securities for Repurchase Agreements are limited to U. S. Treasury securities and U. S. Government Agency securities with a maturity of not more than 10 years.

    - The maturity for a Repurchase Agreement may be from one day to two weeks.

    - The value of all collateral shall be maintained at 102% of the notional value of the Repurchase Agreement, valued daily.

    - All collateral shall be delivered to the GEF custodian bank. Tri-party collateral arrangements are not permitted.

- The aggregate amount of repurchase agreements with maturities greater than seven calendar days may not exceed 10% of the GEF's fixed income assets.

- Overnight Repurchase Agreements may not exceed 25% of the GEF's fixed income assets.

- Mortgage Backed Securities (MBS) Dollar Rolls shall be executed as matched book transactions in the same manner as Reverse Repurchase Agreements above. As above, the rules for trading MBS Dollar Rolls shall follow the Public Securities Association standard industry terms.

Fixed Income

Domestic Fixed Income

Holdings of domestic fixed income securities shall be limited to those securities a) issued by or fully guaranteed by the U. S. Treasury, U. S. Government-Sponsored Enterprises, or U. S. Government Agencies, and b) issued by corporations and municipalities. Within this overall limitation:

- Permissible securities for investment include the components of the Lehman Brothers Aggregate Bond Index (LBAGG): investment grade government and corporate securities, agency mortgage pass-through securities, and asset-backed securities. These sectors are divided into more specific subindices 1) Government: Treasury and Agency; 2) Corporate: Industrial, Finance, Utility, and Yankee; 3) Mortgage-backed securities: GNMA, FHLMC, and FNMA; 4) Asset-backed securities; 5) Taxable Municipal securities; and 6) Commercial Mortgage-backed securities. In addition to the permissible securities listed above, the following securities shall be permissible: a) floating rate securities with periodic coupon changes in market rates issued by the same entities that are included in the LBAGG as issuers of fixed rate securities; b) medium term notes issued by investment grade corporations; c) zero coupon bonds and stripped Treasury and Agency securities created from coupon securities; and d) structured notes issued by LBAGG qualified entities.

- U. S. Domestic Bonds must be rated investment grade, Baa3 or better by Moody's Investors Services, BBB- by Standard & Poor's Corporation, or an equivalent rating by a nationally recognized rating agency at the time of acquisition. This provision does not apply to an investment manager that is authorized by the terms of an investment advisory agreement to invest in below investment grade bonds.

- Not more than 5% of the market value of domestic fixed income securities may be invested in corporate and municipal bonds of a single issuer provided that such bonds, at the time of purchase, are rated, not less than Baa3 or BBB-, or the equivalent, by any two nationally-recognized rating services, such as Moody's Investors Service, Standard & Poor's Corporation, or Fitch Investors Service.

Non-U. S. Fixed Income

- Not more than 50% of the GEF's fixed income portfolio may be invested in non-U. S. dollar bonds. Not more than 15% of the GEF's fixed income portfolio may be invested in bonds denominated in any one currency.
- Non-dollar bond investments shall be restricted to bonds rated equivalent to the same credit standard as the U. S. Fixed Income Portfolio.
- Not more than 15% of the GEF's fixed income portfolio may be invested in Emerging Market debt.
- International currency exposure may be hedged or unhedged at UTIMCO's discretion or delegated by UTIMCO to an external investment manager.

Equities

The GEF shall:

A. hold no more than 25% of its equity securities in any one industry or industries (as defined by the standard industry classification code and supplemented by other reliable data sources) at market

B. hold no more than 5% of its equity securities in the securities of one corporation at cost unless authorized by the chief investment officer.

Members of UTIMCO management, with the approval of the UTIMCO Board, may serve as directors of companies in which UTIMCO has directly invested GEF assets. In such event, any and all compensation paid to UTIMCO management for their services as directors shall be endorsed over to UTIMCO and applied against UTIMCO management fees. Furthermore, UTIMCO Board approval of UTIMCO management's service as a director of an investee company shall be conditioned upon the extension of UTIMCO's Directors and Officers Insurance Policy coverage to UTIMCO management's service as a director of an investee company.

GEF Accounting

The fiscal year of the GEF shall begin on September 1st and end on August 31st. Market value of the GEF shall be maintained on an accrual basis in compliance with Financial Accounting Standards Board Statements, Government Accounting Standards Board Statements, or industry guidelines, whichever is applicable. Significant asset write-offs or write-downs shall be approved by the chief investment officer and reported to the UTIMCO Board of Directors. The GEF's financial statements shall be audited each year by an independent accounting firm selected by the Board of Regents.

Valuation of Assets

As of the close of business on the last business day of each month, UTIMCO shall determine the fair market value of all GEF net assets and the net asset value per unit of the GEF. Valuation of GEF assets shall be based on the books and records of the custodian for the valuation date. Valuation of alternative assets shall be determined in accordance with the UTIMCO Valuation Criteria for Alternative Assets.

The fair market value of the GEF's net assets shall include all related receivables and payables of the GEF on the valuation date and the value of each unit thereof shall be its proportionate part of such net value. Such valuation shall be final and conclusive.

Purchase of GEF Units

Purchase of GEF units may be made on any quarterly purchase date (September 1, December 1, March 1, and June 1 of each fiscal year or the first business day subsequent thereto) upon payment of cash to the GEF or contribution of assets approved by the chief investment officer, at the net asset value per unit of the GEF as of the most recent quarterly valuation date. Each fund whose monies are invested in the GEF shall own an undivided interest in the GEF in the proportion that the number of units invested therein bears to the total number of all units comprising the GEF.

Redemption of GEF Units

Redemption of GEF units shall be paid in cash as soon as practicable after the quarterly valuation date of the GEF. Withdrawals from the GEF shall be at the market value price per unit determined for the period of the withdrawal.

Securities Lending

The GEF may participate in a securities lending contract with a bank or nonbank security lending agent for either short-term or long-term purposes of realizing additional income. Loans of securities by the GEF shall be collateralized by cash, letters of credit, or securities issued or guaranteed by the U. S. Government or its agencies. The collateral will equal at least 100% of the current market value of the loaned securities. The contract shall state acceptable collateral for securities loaned, duties of the borrower, delivery of loaned securities and collateral, acceptable investment of collateral and indemnification provisions. The contract may include other provisions as appropriate.

The securities lending program will be evaluated from time-to-time as deemed necessary by the UTIMCO Board. Monthly reports issued by the agent shall be reviewed by UTIMCO to insure compliance with contract provisions.

Investor Responsibility

As a shareholder, the GEF has the right to a voice in corporate affairs consistent with those of any shareholder. These include the right and obligation to vote proxies in a manner consistent with the unique role and mission of higher education as well as for the economic benefit of the GEF. Notwithstanding the above, the UTIMCO Board shall discharge its fiduciary duties with respect to the GEF solely in the interest of GEF unitholders and shall not invest the GEF so as to achieve temporal benefits for any purpose including use of its economic power to advance social or political purposes.

Amendment of Policy Statement

The Board of Regents reserves the right to amend the Investment Policy Statement as it deems necessary or advisable.

Effective Date

The effective date of this policy shall be December 19, 2003.

EXHIBIT A

POLICY TARGETS, RANGES AND PERFORMANCE OBJECTIVES

	Percent of Portfolio (%)		
Asset Category	**Policy Targets**	**Policy Ranges**	**Benchmarks**
US Equities	25.0	15 to 45	Russell 3000 Index
Global ex US Equities:			MSCI All Country World Index ex US
Non-US Developed Equity	10.0	5 to 15	
Emerging Markets Equity	7.0	0 to 10	
Total Traditional Equity	**42.0**	**20 to 60**	
Equity Hedge Funds	10.0	5 to 15	90 Day T-Bills + 4%
Absolute Return Hedge Funds	15.0	10 to 20	90 Day T-Bills + 3%
Total Hedge Funds	**25.0**	**15 to 25**	
Venture Capital	6.0	0 to 10	Venture Economics Vintage Year Venture Capital Index
Private Equity	9.0	5 to 15	Venture Economics Vintage Year Private Equity Index
Total Private Capital	**15.0**	**5 to 15**	
Commodities	**3.0**	**0 to 5**	GSCI minus 1%
Fixed Income	**15.0**	**10 to 30**	Lehman Brothers Aggregate Bond Index
Cash	**0.0**	**0 to 5**	90 Day T-Bills

Expected Annual Return (%)	**8.36**
Downside Deviation (%)	**4.22**
Standard Deviation (%)	**10.30**

TAB 3

Resolution No. 3

RESOLVED, that the amendments to the Investment Policy Statement for the U. T. System Short Intermediate Term Fund as presented be, and are hereby, approved, subject to approval by the U. T. System Board of Regents.

Agenda Item
UTIMCO Board of Directors Meeting
May 6, 2004

Agenda Item:	Approval of Amendments to the U. T. System Short Intermediate Term Fund (SITF) Investment Policy Statement
Developed By:	Boldt, Goldsmith, Moeller
Presented By:	Boldt
Type of Item:	Action required by UTIMCO Board; Action required by U.T. System Board of Regents
Description:	Section 3(a) of the Investment Management Services Agreement dated March 1, 1996, second amended and restated effective August 7, 2003, between the Board of Regents of The University of Texas System and UTIMCO provides that UTIMCO shall review the investment policies of the assets under its management and recommend any changes of such policies for approval by the U. T. Board of Regents. The attached item is the actual agenda item to be presented to the Board of Regents' meeting scheduled for May 12 -13, 2004.
Recommendation:	UTIMCO staff recommends approval of changes to the SITF Investment Objectives section of the Investment Policy Statement.
Discussion:	The recommended changes to the SITF Investment Policy Statement are intended to clarify the Investment Objectives statement of the Investment Policy. These changes would make the policy objectives consistent with the preferences of the current large unitholders in the SITF.
Reference:	U. T. System Board of Regents Agenda Item: Approval to amend the Short Intermediate Term Fund Investment Policy Statement The University of Texas System Short Intermediate Term Fund Investment Policy Statement approved by Board of Regents on August 8, 2003

U. T. Board of Regents: Approval to amend the Short Intermediate Term Fund Investment Policy Statement

RECOMMENDATION

The Board of Directors of The University of Texas Investment Management Company (UTIMCO) recommends that the U. T. Board of Regents approve the proposed amendments to the Short Intermediate Term Fund (SITF) Investment Policy Statement.

BACKGROUND INFORMATION

Section 3(a) of the Investment Management Services Agreement dated March 1, 1996, second amended and restated effective August 7, 2003, between the Board of Regents of The University of Texas System and UTIMCO provides that UTIMCO shall review the investment policies of the assets under its management and recommend any changes of such policies for approval by the U. T. Board of Regents.

The UTIMCO Board of Directors recommends these changes to clarify the investment objectives of the SITF Investment Policy. Following is the excerpt from the SITF Investment Policy with recommended changes black lined. The excerpt is from page 2 and 3 of the investment policy.

SITF Investment Objectives

The primary investment objective shall be to provide both income through investment in high grade fixed income and floating rate obligations and capital appreciation when consistent with income generation. ~~, reasonable preservation of capital and maintenance of adequate SITF liquidity. In seeking to achieve its objectives, the SITF shall attempt to minimize the probability of a negative total return over a one-year period.~~ Within the exposure limits contained herein, investments shall be diversified among authorized asset classes and issuers (excluding the U. S. Government) in order to minimize portfolio risk for a given level of expected return. This objective will be achieved by adding value through active management including duration and yield curve management, sector rotation, security selection, and cost efficient trading.

Achievement of this objective shall be defined by a fund return over a market cycle in excess of the STF and the Policy Portfolio benchmark. ~~and the average return of the median manager of the MorningStar universe of government bond funds restricted to an average maturity of less than or equal to three years.~~ The SITF will attempt to achieve a return in excess of the STF primarily through a longer average maturity/duration and through UTIMCO active portfolio management efforts. The Policy Portfolio benchmark will be established by

UTIMCO and will be comprised of a blend of asset class indices weighted to reflect SITF asset allocation policy targets.

<u>It is important to note that the SITF return will be more volatile than the STF fund returns, and under very unusual capital market conditions, the total return of the SITF could be negative over a 12 month period.</u>

-End of excerpt-

THE UNIVERSITY OF TEXAS SYSTEM
SHORT INTERMEDIATE TERM FUND
INVESTMENT POLICY STATEMENT

Purpose

The Short Intermediate Term Fund (the "SITF"), was established by the Board of Regents of The University of Texas System (the "Board of Regents") as a pooled fund for the collective investment of operating funds and other short and intermediate term funds held by U. T. System component institutions and System Administration with an investment horizon greater than one year.

SITF Organization

The SITF is organized as a mutual fund in which each eligible account purchases and redeems SITF units as provided herein. The ownership of SITF assets shall at all times be vested in the Board of Regents. Such assets shall be deemed to be held by the Board of Regents, as a fiduciary, regardless of the name in which the assets may be registered.

SITF Management

Ultimate fiduciary responsibility for the SITF rests with the Board of Regents. Section 163 of the Texas Property Code authorizes the Board of Regents to delegate to its committees, officers or employees of the U. T. System and other agents the authority to act for the Board of Regents in the investment of the SITF. The SITF shall be governed through The University of Texas Investment Management Company ("UTIMCO") which shall a) recommend investment policy for the SITF, b) determine specific asset allocation targets, ranges and performance benchmarks consistent with SITF objectives, and c) monitor SITF performance against SITF objectives. UTIMCO shall invest the SITF assets in conformity with investment policy.

Unaffiliated investment managers may be hired by UTIMCO to improve the SITF's return and risk characteristics. Such managers shall have complete investment discretion unless restricted by the terms of their management contracts. Managers shall be monitored for performance and adherence to investment disciplines.

SITF Administration

UTIMCO or its agent shall employ an administrative staff to ensure that all transaction and accounting records are complete and prepared on a timely basis. Internal controls shall be emphasized so as to provide for responsible separation of duties and adequacy of an audit trail. Custody of SITF assets shall comply with applicable law and be structured so as to provide essential safekeeping and trading efficiency.

Funds Eligible to Purchase SITF Units

No fund shall be eligible to purchase units of the SITF unless it is under the sole control, with full discretion as to investments, by the Board of Regents and/or UTIMCO.

Any fund whose governing instrument contains provisions which conflict with this Policy Statement, whether initially or as a result of amendments to either document, shall not be eligible to purchase or hold units of the SITF.

The funds of a foundation which is structured as a supporting organization described in Section 509(a) of the Internal Revenue Code of 1986 which supports the activities of the U. T. System and its component institutions, may purchase units in the SITF provided that:

A. the purchase of SITF units by foundation funds is approved by the chief investment officer

B. all members of the foundation's governing board are also members of the Board of Regents

C. the foundation has the same fiscal year as the SITF

D. a contract between the Board of Regents and the foundation has been executed authorizing investment of foundation funds in the SITF

E. no officer of such foundation, other than members of the Board of Regents, the Chancellor, the chief investment officer or his or her delegate shall have any control over the management of the SITF other than to request purchase and redemption of SITF units.

SITF Investment Objectives

The primary investment objective shall be to provide both income through investment in high grade fixed income and floating rate obligations and capital appreciation when consistent with income generation, reasonable preservation of capital and maintenance of adequate SITF liquidity. In seeking to achieve its objectives, the SITF shall attempt to minimize the probability of a negative total return over a one-year period. Within the exposure limits contained herein, investments shall be diversified among authorized asset classes and issuers (excluding the U. S. Government) in order to minimize portfolio risk for a given level of expected return.

Achievement of this objective shall be defined by a fund return in excess of the Policy Portfolio benchmark and the average return of the median manager of the MorningStar universe of government bond funds restricted to an average maturity of less than or equal to three years. The Policy Portfolio benchmark will be established by UTIMCO and will be comprised of a blend of asset class indices weighted to reflect SITF asset allocation policy targets.

Asset Allocation

Asset allocation is the primary determinant of investment performance and subject to the asset allocation ranges specified herein is the responsibility of UTIMCO. Specific asset allocation targets may be changed from time to time based on the economic and investment outlook.

SITF assets shall be allocated among the following broad asset classes based upon their individual return/risk characteristics and relationships to other asset classes:

1. Cash and Cash Equivalents - are highly reliable in protecting the purchasing power of current income streams but historically have not provided a reliable return in excess of inflation. Cash equivalents provide the best combination of income and liquidity under both deflation and inflation conditions.

2. Fixed Income Investments - offer predictable income streams without the remarketing risk often associated with cash and cash equivalents.

3. Floating rate securities - offer protection from unanticipated inflationary pressures.

Asset Allocation Policy

The asset allocation policy and ranges herein seek to protect the SITF against illiquidity in both normal and extraordinary markets.

The Board of Regents delegates authority to UTIMCO to establish specific asset allocation targets and ranges within the broad policy guidelines described above. UTIMCO may establish specific asset allocation targets and ranges for or within the asset classes listed above as well as the specific performance objectives for each asset class. Specific asset allocation policies shall be decided by UTIMCO and reported to the Board of Regents.

Performance Measurement

The investment performance of the SITF will be measured by the SITF's custodian, an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, and compared against the stated investment objectives of the SITF. Such measurement will occur at least annually, and evaluate the results of the total SITF, major classes of investment assets, and individual portfolios.

Investment Guidelines

The SITF must be invested at all times in strict compliance with applicable law. The primary and constant standard for making investment decisions is the investment standard set forth in the Uniform Management of Institutional Funds Act (§163.007, Texas Property Code)

Investment guidelines include the following:

<u>General</u>

- All investments will be U. S. dollar denominated assets unless held by an internal or external portfolio manager with discretion to invest in foreign currency denominated securities.

- Investment policies of any unaffiliated liquid investment fund must be reviewed and approved by the chief investment officer prior to investment of SITF assets in such liquid investment fund.

- No securities may be purchased or held which would jeopardize the SITF's tax-exempt status.

- No investment strategy or program may purchase securities on margin or use leverage unless specifically authorized by the UTIMCO Board.

- No investment strategy or program employing short sales may be made unless specifically authorized by the UTIMCO Board.

- The SITF may utilize Derivative Securities with the approval of the UTIMCO Board to; a) simulate the purchase or sale of an underlying market index while retaining a cash balance for fund management purposes; b) to facilitate trading; c) to reduce transaction costs; d) to seek higher investment returns when a Derivative Security is priced more attractively than the underlying security; e) to index or to hedge risks associated with SITF investments; or f) to adjust the market exposure of the asset allocation, including long and short strategies; provided that; i) no leverage is employed in the implementation of such Derivative purchases or sales; ii) no more than 5% of SITF assets are required as an initial margin deposit for such contracts; iii) the SITF's investments in warrants shall not exceed more than 5% of the SITF's net assets or 2% with respect to warrants not listed on the New York or American Stock Exchanges.

- Such Derivative Securities shall be defined to be those instruments whose value is derived, in whole or part, from the value of any one or more underlying assets, or index of assets (such as stocks, bonds, commodities, interest rates, and currencies) and evidenced by forward, futures, swap, cap, floor, option, and other applicable contracts.

  UTIMCO shall attempt to minimize the risk of an imperfect correlation between the change in market value of the securities held by the SITF and the prices of Derivative Security investments by investing in only those contracts whose behavior is expected to resemble that of the SITF's underlying securities. UTIMCO also shall attempt to minimize the risk of an illiquid secondary market for a Derivative Security contract and the resulting inability to close a position prior to its maturity date by entering into such transactions on an exchange with an active and liquid secondary market. The net market value of exposure of Derivative Securities purchased or sold over the counter may not represent more than 15% of the net assets of the SITF.

  In the event that there are no Derivative Securities traded on a particular market index, the SITF may utilize a composite of other Derivative Security contracts to simulate the performance of such index. UTIMCO shall attempt to reduce any tracking error from the low correlation of the selected Derivative Securities with its index by investing in contracts whose behavior is expected to resemble that of the underlying securities.

- UTIMCO shall minimize the risk that a party will default on its payment obligation under a Derivative Security agreement by entering into agreements that mark to market no less frequently than monthly and where the counterparty is an investment grade credit. UTIMCO also shall attempt to mitigate the risk that the SITF will not be able to meet its obligation to the counterparty by investing the SITF in the specific asset for which it is obligated to pay a return or by holding adequate short-term investments.

  The SITF may be invested in foreign currency forward and foreign currency futures contracts in order to maintain the same currency exposure as its respective index or to protect against anticipated adverse changes in exchange rates among foreign currencies and between foreign currencies and the U. S. dollar.

- The duration of any eligible investment shall not exceed 10 years.

<u>Risk Management</u>

- Credit risk shall be controlled by UTIMCO who is responsible for the development and maintenance of credit quality standards for the SITF.

- Interest rate risk shall be controlled by limiting the option-adjusted duration of the portfolio between one-half year and four years unless approved in advance by the UTIMCO Board.

- Not more than 5% of the total value of the securities in the SITF shall be placed with any one issuer (i.e. Commercial Paper, Certificates of Deposit, or Bankers Acceptances) other than the U.S. Treasury, U.S. Agency, or Government Sponsored entities.

- Counterparty exposure in the area of Repurchase Agreements and Reverse Repurchase Agreements shall be not more than 5% of the total value of the securities in the SITF shall be placed with any one counterparty.

Eligible Investments
Holdings of cash and cash equivalents may include the following:

- Unaffiliated liquid (Money Market Funds) investment funds rated AAA_M by Standard & Poor's Corporation.

- Internal short term pooled investment fund managed by UTIMCO.

- Commercial paper, negotiable certificates of deposit, and Bankers' Acceptances must be rated at least A-1 by Standard & Poor's Corporation and P-1 by Moody's Investors Service, Inc

- Floating rate securities, if they meet the single security duration criteria and are based on a spread over or under a well known index such as LIBOR or a Constant Maturity Treasury index. No internally leveraged floating rate securities are permitted (i.e. a coupon equivalent to a formula that creates a multiplier of an index value). The following types of floating rate securities are not eligible for investment; inverse floaters, non-money market based floaters, interest only or principal only floaters, non-dollar based floaters, and range note floaters.

- Repurchase Agreements and Reverse Repurchase Agreements must be transacted with a dealer that is approved by UTIMCO and selected by the Federal Reserve Bank as a Primary Dealer in U. S. Treasury securities and rated A-1 or P-1 or the equivalent.

    - Each approved counterparty shall execute the Standard Public Securities Association (PSA) Master Repurchase Agreement with UTIMCO.

    - Eligible Collateral Securities for Repurchase Agreements are limited to U.S. Treasury securities and U.S. Government Agency securities with a maturity of not more than 10 years.

- The maturity for a Repurchase Agreement may be from one day to two weeks.
- The value of all collateral shall be maintained at 102% of the notional value of the Repurchase Agreement, valued daily.
- All collateral shall be delivered to the SITF custodian bank. Tri-party collateral arrangements are not permitted.
- Reverse Repurchase Agreements shall be used to fund the liquidity facility for the University of Texas System revenue financing notes.
- The aggregate amount of repurchase agreements with maturities greater than seven calendar days may not exceed 10% of the SITF's total assets.
- Overnight repurchase agreements may not exceed 25% of the SITF's total assets.

Holdings of eligible fixed income securities shall be limited to the following:

- Securities issued by or fully guaranteed by the U. S. Treasury, U. S. Government-Sponsored Enterprises, or U. S. Government Agencies. The latter two categories include U. S. Government Agency Mortgage Backed Securities ("MBS").

Holdings of eligible fixed income derivative securities shall be limited by the following guidelines:

With prior written approval of the UTIMCO Board, the Portfolio Manager may enter into derivatives transactions utilizing exchange traded fixed income futures contracts or options on fixed income futures contracts; provided that such derivatives transactions are designed to control duration or manage risk.

Such derivatives transactions shall be established on a case by case basis. These contracts shall include but shall not be limited to Ten-Year Treasury Futures, Eurodollar Futures, or Treasury Bill Futures, provided that the futures exchanges are rated AAA or the equivalent as determined by UTIMCO.

Such derivatives shall be priced daily.

Market risk shall be measured in dollar duration equivalent values or in the case of options in delta or percentage of equivalent futures contracts.

For the purpose of this policy Collateralized Mortgage Obligations ("CMOs") are considered to be MBS, not derivatives.

SITF Distributions

Distributions of income from the SITF to the unitholders shall be made as soon as practicable on or after the last day of each month.

SITF Accounting

The fiscal year of the SITF shall begin on September 1st and end on August 31st. Market value of the SITF shall be maintained on an accrual basis in compliance with Financial Accounting Standards Board Statements, Government Accounting Standards Board Statements, or industry guidelines, whichever is applicable. Significant asset write-offs or write-downs shall be approved by the chief investment officer and reported to the UTIMCO Board. The SITF's financial statements shall be audited each year by an independent accounting firm selected by the Board of Regents.

Valuation of Assets

UTIMCO shall determine the fair market value of all SITF net assets and the net asset value per unit of the SITF no less than once a week and on the last business day of each month. Such valuation of SITF assets shall be based on the bank trust custody agreement in effect at the date of valuation.

The fair market value of the SITF's net assets shall include all related receivables and payables of the SITF on the valuation date and the value of each unit thereof shall be its proportionate part of such net value. Such valuation shall be final and conclusive.

Purchase of SITF Units

Purchase of SITF units may be made no less than once a week and on the last business day of each month upon payment of cash to the SITF or contribution of assets approved by the chief investment officer, at the net asset value per unit of the SITF as of the most recent weekly or end of month valuation date.

Each fund whose monies are invested in the SITF shall own an undivided interest in the SITF in the proportion that the number of units invested therein bears to the total number of all units comprising the SITF.

Redemption of SITF Units

Redemption of SITF units shall be paid in cash as soon as practicable after the most recent weekly or end of month valuation date of the SITF.

Securities Lending

The SITF may not participate in a securities lending contract with a bank or nonbank security lending agent.

Investor Responsibility

The UTIMCO Board shall discharge its fiduciary duties with respect to the SITF solely in the interest of SITF unitholders and shall not invest the SITF so as to achieve temporal benefits for any purpose including use of its economic power to advance social or political purposes.

Amendment of Policy Statement

The Board of Regents reserves the right to amend the Investment Policy Statement as it deems necessary or advisable.

Effective Date

The effective date of this policy shall be August 7, 2003.

SHORT INTERMEDIATE TERM FUND

SPECIFIC ASSET ALLOCATION TARGETS, RANGES, AND PERFORMANCE OBJECTIVES

	Target	Range	Performance Objective
U.S. Treasuries	60%	0%-100%	(1)
U.S. Government Agencies	40%	0%-80%	(2)
Mortgage Backed Securities	0%	0%-60%	
STIF	0%	0%-40%	
Corporate Cash Equivalents	0%	0%-40%	
Repurchase Agreements	0%	0%-33%	
TOTAL ASSETS	**100%**		

(1) .1 x M.L. 91-day U.S. Treasury Bill Index + .1 x M.L. 6 mo. U.S. Treasury Bill Index + .3x M.L. 1-3 yr. U.S. Treasury Index + .1 x M.L. 3-5 yr. U.S. Treasury Index

(2) .3 x M.L. 1-3 yr. U.S. Federal Agencies Index + .1 x M.L. 3-5 yr. U.S. Federal Agencies Index

Achievement of these performance objectives is most appropriately evaluated over a full market cycle of roughly five years.

TAB 4

Resolution No. 4

RESOLVED, that the restatement of the Endowment Policy Portfolio Returns, and the two separate restated Endowment Policy Portfolios be recognized as the proper benchmarks to compare the performance of the Permanent University Fund and the U. T. System General Endowment Fund, as presented be, and are hereby, approved, and will be presented as an information item to the U. T. System Board of Regents.

Agenda Item
UTIMCO Board of Directors Meeting
May 6, 2004

Agenda Item: Approval of Restatement of Historical Endowment Policy Portfolio Returns

Developed By: Boldt, Moeller, Hill

Presented By: Boldt

Type of Item: Action required by UTIMCO Board; Information item to the U. T. System Board of Regents

Description: The attached item is the actual Board of Regents Agenda item to be presented at the Board of Regents' meeting scheduled for May 12 - 13, 2004. The restatement of the Endowment Policy Portfolio (EPP) is the result of a thorough review by UTIMCO staff of the asset class weights and benchmarks used in the establishment of the EPPs. The overall issues were:

- With the first Policy Portfolio published in 1997, return for periods prior to 1997 were calculated using the policy portfolio allocation which existed in 1997, not to policy allocations that actually existed in the prior periods. In periods after 1997, the target weights approved by the UTIMCO Board were used immediately in calculating EPP returns rather than incorporating a phase-in period
- Establishing the same target weights in a single EPP for the PUF and GEF/LTF without consideration that the PUF was not managed as a total return fund prior to November 1999 although the LTF/GEF was managed as a total return fund.
- Appropriateness of the benchmarks used for Private Capital in the EPPs.

Recommendation: Staff recommends that the UTIMCO Board approve the restatement of the EPPs and recognize the two separate restated EPPs as the proper benchmarks to compare the performance of the PUF and the GEF (LTF and PHF).

Discussion: UTIMCO staff presented a detailed analysis of the proposed restatement of the EPPs to the UTIMCO Board at its April 8, 2004 meeting. Bruce Myers of Cambridge Associates also participated in the review and discussion of the restatement. As a follow-up to the meeting held on April 8, 2004, UTIMCO staff met with Philip Aldridge, Interim Vice Chancellor for Business Affairs and EnnisKnupp representatives. Mr. Aldridge recommended that the restatement be presented to the Board of Regents as an information item.

Reference: Board of Regents Agenda Item: Presentation of Restatement of Historical Endowment Policy Portfolio Returns

U. T. Board of Regents: Presentation of Restatement of Historical Endowment Policy Portfolio Returns

PURPOSE

The Board of Directors of The University of Texas Investment Management Company (UTIMCO) presents the Restatement of Historical Endowment Policy Portfolio (EPP) Returns for the Permanent University Fund (PUF) and the General Endowment Fund (GEF) as an information item to the U. T. Board of Regents. The Endowment Policy Portfolios (EPPs) are the policy benchmarks against which the returns of the PUF, GEF, the Long Term Fund (LTF) and the Permanent Health Fund (PHF) are measured. The establishment of EPPs for the PUF and GEF and monitoring performance of the Funds relative to stated objectives are delegated to UTIMCO by the Investment Policy Statements of the PUF and GEF.

BACKGROUND INFORMATION

The reasonableness of the historical benchmark returns has been questioned by the State Auditors as well as others. The State Auditors report, *A Report Comparing Texas's Five Largest Long-Term Investment Funds*, issued February 2003, noted that the PUF and LTF underperformed when compared with the returns of their policy index and briefly discussed the reasons. In response in the comment section, UTIMCO agreed that it would attempt to deal with several technical benchmark issues in order to provide more accurate performance comparisons in the future. UTIMCO has now completed a thorough review of the asset class weights and benchmarks used in the establishment of EPPs. The overall issues with the EPPs were:

- With the first Policy Portfolio published in 1997, return for periods prior to 1997 were calculated using the policy portfolio allocation which existed in 1997, not to policy allocations that actually existed in the prior periods. In periods after 1997, the target weights approved by the UTIMCO Board were used immediately in calculating EPP returns rather than incorporating a phase-in period.
- Establishing the same target weights in a single EPP for the PUF and LTF/GEF without consideration that the PUF was not managed as a total return fund prior to November 1999 although the LTF/GEF was managed as a total return fund.
- Appropriateness of the benchmarks used for Private Capital in the EPPs.

Issues:

- Using the target weights approved by the UTIMCO Board immediately in calculating EPP returns rather than incorporating a phase in period.

EPP returns are calculated on a monthly basis by multiplying the policy weights of each asset category with Asset Allocation Policy times the return for the benchmark index defined for each asset category and summing the results. UTIMCO began reporting EPP returns in 1997. At that time, the method used to calculate EPP returns prior to 1997 was to apply the asset allocation targets in existence in 1997 to selected benchmark returns in previous years. In years subsequent to 1997, it was standard procedure to apply then-current asset allocation targets to then-defined benchmarks. As asset allocation targets were changed through time, the changes were reflected immediately in the EPPs. Because benchmark changes were reflected immediately in historical EPPs but actual portfolios changed more gradually as investments were made at a measured pace, particularly in the relatively illiquid alternative asset categories, there was often a mismatch between the composition of the benchmark portfolio and actual portfolios, and hence differences in actual versus policy index returns. In periods where the benchmark returns of the illiquid asset categories are increasing rapidly relative to other categories in the policy portfolio, the comparison between actual returns and policy portfolio returns will be unrealistically biased in favor of the policy benchmark portfolio return. Of course, the opposite bias would occur in the opposite market conditions. The combination of these two factors incorrectly biased return comparisons for both the LTF/GEF and the PUF relative to the Policy Portfolio.

- Establishing the same target weights in a single EPP for the PUF and LTF/GEF without consideration that the PUF was not managed as a total return fund prior to November 1999 although the LTF/GEF <u>was</u> managed as a total return fund.

Before the passage of the constitutional amendment in November 1999, achievement of the PUF's investments objectives was substantially hindered by the inability to make distributions to the Available University Fund on a total return basis. The objective of preserving the purchasing power of the distribution stream subordinated the PUF's allocation among various asset classes to the production of current income to meet distribution needs. In the environment of low or declining interest rates which has existed in the past several years, a higher than optimal percentage of PUF investment assets were allocated to higher-yielding, fixed income securities in order to maintain distributions on a level-dollar basis. Throughout the 1980s and through 1992, in order to maintain above average payout rates, the majority of the LTF/GEF was invested in fixed income securities. After 1992, a more aggressive asset rebalancing program was put into place. Under the amended provisions of the Texas Uniform Management of Institutional Funds Act, which were amended in 1993, the Board of Regents was permitted to adopt a total return investment strategy. The Board of Regents adopted a total return spending policy in February of 1995 and recommended a long-term equity allocation goal to be achieved in five years. Accordingly, the LTF/GEF portfolio often differed in composition as compared to the PUF over the period 1993 through 1999. Therefore, it is inappropriate to compare past results of the PUF and LTF/GEF to the same policy benchmark. Because the 1999 Constitutional amendment converted PUF distributions to a total return basis, recent results are identical for the PUF and LTF/GEF benchmarks.

- Appropriateness of the benchmarks used for Private Capital in the EPP.

In the State Auditor's report, the benchmark utilized for Private Capital was an absolute return of 17%. The 17% was established by applying a 400-500 basis point premium to an estimated public markets return of 12%-13%. This static benchmark proved to be problematic given the reality of dynamic public market returns. To improve the benchmark, the Wilshire 5000 plus 4% was implemented in August 2002 to replace the static 17%. Although an improvement over the 17%, the Wilshire 5000 plus 4% is still problematic over shorter periods as a result of the inherent valuation lag between the private markets and the public markets.

The third item, the appropriateness of the benchmark for Private Capital, has been problematic since the inception of the asset class, not just for UTIMCO but for all other investment funds benchmarking a similar private capital portfolio. It has been recognized by the UTIMCO Board for some time that the previous benchmarks used were not appropriate for comparison, especially over periods of less than 10 years. In fact, the private equity industry uses an entirely different method of calculating returns than the traditional public markets industry. The challenge for funds incorporating both private equity and public market assets has been, and continues to be, to integrate the two different return calculation methodologies to produce a composite return for the funds. In situations where returns are evaluated only over very long time periods such as 10 years, a public markets based proxy such as Wilshire 5000 plus 4% might be appropriate. However, for short time period comparisons such as 1 to 5 years, the use of a more direct measure of the actual conditions in the private equity market is essential to avoid inappropriate conclusions. An important function of a policy benchmark is to provide a reliable yardstick for observers to judge how well UTIMCO management is performing relative to reasonable objectives. These comparisons are often made over periods as short as one year or less. Therefore, the proxy benchmarks, such as Wilshire 5000 plus 4%, and the flat rate benchmark, such as 17%, are inappropriate for the shorter term evaluations and may result in incorrect conclusions by these observers. As the table below indicates, both the flat 17% and the Wilshire 5000 + 4% benchmarks have low correlations to the actual historical private capital returns in the endowment portfolios.

Correlation Coefficients	UTIMCO and Venture Economics	UTIMCO and Wilshire +4%	UTIMCO and 17%
1 Year	0.9229	0.5162	0.0000
3 Years	0.8931	0.8882	0.0291
5 Years	0.9520	0.9710	0.0000

Correlation coefficients measure the statistical tendency of two variables to move in tandem over certain time periods. Two variables moving in perfect synchronization (but not necessarily at the same level) would have a correlation coefficient of 1.0; two variables with no relationship would have a correlation coefficient of 0.0. The table shows correlation coefficients for the actual UTIMCO private capital returns and returns for three benchmarks for all 1, 3, and 5 year time periods over the past 10 years. Returns for a well defined benchmark will have a relatively high correlation with the actual portfolio returns being evaluated by the benchmark. Note that the flat 17% is a poor benchmark over all time periods. The Wilshire 5000 + 4% benchmark has a high correlation for longer periods such as 5 years, but is a poor choice for shorter time periods. Only the Venture Economics Index meets the criteria of having high correlations across all time periods.

The Venture Economics Index has an important additional advantage relative to the Wilshire 5000 + 4% proxy benchmark. Since all private capital portfolios have well known valuation issues in calculating interim performance results, comparing actual private capital returns in the endowment portfolios to the Wilshire-based proxy index, which as a public markets index has no such valuation issues, could magnify the effects of the valuation issues. On the other hand, comparing the endowment funds' private capital results to the Venture Economics Index, which has the same valuation issues since it is based on all private capital investments in the marketplace, would effectively offset the valuation problems, and thus provide a more reliable measure of the relative performance of the private capital portion of the endowment portfolios.

UTIMCO recognizes that it is unusual to restate EPP or benchmark returns. However, this restatement addresses errors in the construction of the EPP and inappropriate benchmark selections. Because UTIMCO regularly provides returns for periods including one month, one quarter, one year, three years, five years and ten years, it is important not only to adopt appropriate benchmarks for future returns, but to restate prior benchmark returns as well so that observers have a correct basis for comparison not only prospectively, but for the past as well. The problems with phase-ins of asset allocation changes will be treated carefully in the future, but adjustments to past benchmark returns are necessary for data integrity. Because both the PUF and GEF are now total return Funds, there will be no need to maintain different EPPs in the future, however, because historical returns are shown for periods before 1999, it will be necessary to show two distinct historical EPP return series until at least 2009. The private capital benchmark issue is so severe, and would result in materially misleading comparisons over shorter term time periods, that, in UTIMCO's opinion, the change to the Venture Economic Index is essential for both future and past comparisons.

It is important to note that accounting rules recognize and require restatement in accounting situations similar to this. Accounting Principles Board (APB) pronouncements #9 and #20 address changes and corrections to previously reported information. Generally, these pronouncements state that if the impact of the restatement would be material, which is the case with the performance difference in this scenario, restatement is required.

The rules from the Association for Investment Management Research (AIMR) regarding benchmark constructions and restatement are less clear. UTIMCO requested an opinion from AIMR regarding the appropriateness of restating benchmarks and received the following reply:

> "Please see Standard 5.A.7., which provides, in part, that if the firm changes the benchmark that is used for a given composite in the performance presentation, the firm must disclose both the date and the reasons for the change.
>
> A benchmark can serve as a tool that measures the firm's effectiveness in implementing a style or strategy, or it can serve as the defining style to which the portfolios in the composite are managed. If a change in the benchmark represents a change in the composite's investment style or strategy, the firm must create a new composite.
>
> If the investment management style has not changed but the firm believes a new benchmark is a more appropriate comparative measure for the composite, the firm must explain in the composite presentation its reasons for changing the benchmark. In most cases, the firm should change the benchmark going forward and not change historical presentations of the original benchmark. However, because benchmarks are continually evolving, if the firm deems the new benchmark to be a better representation of an investment strategy, the firm may consider changing the benchmark retroactively. Firms must disclose any changes to the benchmark over time. The firm must disclose the date the benchmark is changed and the reason it has been retroactively applied. In addition, firms are encouraged to continue to present the old benchmark. Changes to the benchmark primarily intended to make historical performance look better by lowering the benchmark return, violate the spirit of the Standards."

For the reasons identified earlier, UTIMCO believes that the benchmark changes indicated would provide a much more accurate and reliable representation of the endowment funds investment strategy both prospectively and retrospectively, are not being done primarily to make investment results look better, meet both

Accounting Principles Board and AIMR standards for being retroactively applied, and are therefore appropriate and in the best interests of the endowment funds.

The specific actions taken to restate EPP returns were:

- To correct the issues of using 1997 asset allocation targets for all prior Policy Portfolio calculations, not incorporating appropriate phase in periods, and establishing the same target weights for the PUF and GEF/LTF, UTIMCO staff consulted Board of Regents and UTIMCO Board minutes and materials to determine the policy provisions in place through the period under review. Quarterly reports from 1992 through the current period were accumulated to determine actual asset allocations for the PUF and LTF/GEF for the same quarterly periods as the policy allocations. The PUF and LTF/GEF were treated differently in regards to a phase in. Based on the fact that PUF was restrained due to the distribution of income requirement, the benchmark weights were phased in more closely with actual percentage weights of the PUF. In the asset classes, such as the Private Capital area, where it was not possible to build a portfolio immediately, LTF/GEF asset allocations were phased in straight-line over time periods that were deemed reasonable in consideration of the time it would take to adjust the actual Fund allocation to reflect those changes. The benchmark indices used in the calculations were those approved in the Policy statements except for Private Capital. By the year 2000, the benchmarks have been completely phased in.
- To correct the problem with the Private Capital benchmark, the prior period benchmark indices were replaced with the Venture Economics Periodic IRR index. This replacement occurred in both the PUF and LTF/GEF policy portfolios beginning with 1993.

The results of these restatements are indicated in the table below for several periods ending February 29, 2004:

	Periods Ended February 29, 2004 (Returns for Periods Longer Than One Year are Annualized)						
	One Month	Three Months	Six Months	One Year	Three Years	Five Years	Ten Years
Permanent University Fund	2.49	8.34	15.49	31.74	5.29	6.05	9.74
Permanent University Fund Policy Portfolio	1.36	5.50	10.64	21.34	1.63	5.12	10.48
General Endowment Fund	2.33	8.22	15.61	32.56	5.89	N/A	N/A
Permanent Health Fund	2.31	8.15	15.45	32.31	5.74	N/A	N/A
Long Term Fund	2.31	8.14	15.45	32.38	5.81	7.56	10.44
General Endowment Fund Policy Portfolio	1.36	5.50	10.64	21.34	1.69	5.34	10.44
Policy Portfolio Before Restatement	1.36	6.12	11.89	27.38	4.21	5.37	10.41

The general form of performance reporting, including a footnote indicating that benchmarks were restated and offering restatement details and prior Policy Portfolio returns, is presented on the following page:

	Periods Ended February 29, 2004 (Returns for Periods Longer Than One Year are Annualized)						
	One Month	Three Months	Six Months	One Year	Three Years	Five Years	Ten Years
Permanent University Fund	2.49	8.34	15.49	31.74	5.29	6.05	9.74
Permanent University Fund Policy Portfolio *	1.36	5.50	10.64	21.34	1.63	5.12	10.48
General Endowment Fund	2.33	8.22	15.61	32.56	5.89	N/A	N/A
Permanent Health Fund	2.31	8.15	15.45	32.31	5.74	N/A	N/A
Long Term Fund	2.31	8.14	15.45	32.38	5.81	7.56	10.44
General Endowment Fund Policy Portfolio *	1.36	5.50	10.64	21.34	1.69	5.34	10.44

* Policy Portfolio returns for the PUF and GEF were restated in 2004 to correct errors in benchmark construction and calculation. Results were restated for all periods beginning June, 1993. The complete details of the restatement as well as prior Policy Portfolio returns are available upon request.

If additional information is requested, a document in the form of attachment A will be provided.

UTIMCO requested Bruce Myers of Cambridge Associates, Inc. to review the methodology and supporting calculations and documentation and opine on restatement of EPPs. Mr. Myers explained that although it may not be general industry practice to restate benchmarks, he concurred with this retroactive restatement and the methodology used since it corrected errors in the construction of the historical EPP returns and would result in a more fair and accurate representation of historical relative performance for the endowment funds.

Attachment A

Procedures Used to Restate Prior Policy Portfolio Returns

Policy Portfolio returns for all periods beginning June 1993 were restated in 2004 to correct three technical errors in previously reported Policy Portfolio returns:

1. UTIMCO began publishing Policy Portfolio returns in 1997. At that time, Policy Portfolio returns for periods prior to 1997 were calculated using the policy asset allocation targets in place in 1997 rather than the actual approved allocations in prior years. In addition, when changes were made in asset allocation targets subsequent to 1997, those changes were implemented immediately in calculating Policy Portfolio returns, despite that fact that the changes might take years to actually implement especially in less liquid asset categories. As a result, prior Policy Portfolio returns did not accurately reflect either the true Asset Allocation Policies in place at each point in time in history or the practical implementation of those Policies. In order to correct these errors, UTIMCO analyzed Board of Regents minutes, UTIMCO Board minutes, and actual quarterly asset statements for the PUF and GEF/LTF for the period 1992 through 2003. Changes in Policy Allocations for liquid asset categories such as public equities and bonds were implemented almost immediately in the LTF/GEF's Policy Portfolio. However, changes in allocations to the LTF/GEF's private equity and hedge funds were phased in on a straight-line basis over time periods that were deemed reasonable to reflect the actual time it would take to implement those changes in the actual endowment portfolios. The PUF was phased-in more closely aligned with actual asset allocation due to the restraints placed on it from the distribution requirements. A senior consultant at Cambridge Associates reviewed the phase in procedures and found them to be reasonable.
2. Since the time it began reporting Policy Portfolio returns in 1997, UTIMCO has reported a single Policy Portfolio return for each time period for comparison to both the PUF and GEF/LTF. However, prior to Texas State Proposition 17 in 1999, the PUF asset allocation was constrained by the necessity to maintain a relatively level annual distribution which could be paid only out of current income. Proposition 17 converted the PUF to a so-called "total return" basis in which distributions could be paid out of either income or principal. The GEF/LTF had paid distributions on a "total return" basis since 1987. In a period of generally declining interest rates over the late 1990's, the PUF was forced into asset allocation positions that differed substantially from stated Investment Policy Targets which were apparently set without consideration of the income requirements (there was no differentiation in Asset Allocation Policy for the PUF and the GEF/LTF) in order to meet income requirements to pay distributions. To correct this error in Policy Portfolio construction, the phase-in process described above was done differently for the PUF Policy Portfolio than for the GEF/LTF Policy Portfolio, resulting in different returns for the two benchmarks. Phase-ins for the PUF were defined to more closely mirror the actual holdings in the PUF since the need to generate current income sometimes precluded a smooth linear phase-in as used in the case of the GEF/LTF. A senior consultant from Cambridge Associates reviewed the assumptions for both the PUF and GEF/LTF and found them to be appropriate.
3. Like many investors in the private capital asset category, UTIMCO has had difficulty determining an appropriate benchmark for the asset category. Over the 1993 through 2004 time period, UTIMCO has used at various times a flat 17% benchmark, a Wilshire 5000 +4% benchmark, and has recently adopted the Venture Economics Periodic IRR Index to evaluate actual private capital performance. Both the flat 17% benchmark and the Wilshire 5000 + 4% proxy benchmark have serious flaws. An essential trait of any appropriate benchmark is that returns for the benchmark should have a high degree of correlation with the actual returns of the portfolio to which the benchmark is being used as a comparison. As the table below indicates, the flat 17% and Wilshire 5000 + 4%

benchmarks fail this essential test, especially over shorter time frames. These correlation measures were calculated from actual data over the 1993 to 2003 time period.

Correlation Coefficients	UTIMCO and Venture Economics	UTIMCO and Wilshire +4%	UTIMCO and 17%
1 Year	0.9229	0.5162	0.0000
3 Years	0.8931	0.8882	0.0291
5 Years	0.9520	0.9710	0.0000

While the Wilshire proxy benchmark might be appropriate for longer term time periods such as 5 to 10 years, it is clearly not appropriate over shorter time periods such as one year. The flat 17% benchmark is not appropriate over any time period. On the other hand, the Venture Economics Index passes this important test over all time periods. Since we know that this Index has been a good benchmark over the ten year period that historical results are provided by the statistics above, the Venture Economics Index has been applied retroactively as the private capital asset category benchmark.

The composite result of the restatements of historical Policy Portfolio returns are indicated in the table below. The table also presents Policy Portfolio returns under the prior methods of calculation.

	Periods Ended February 29, 2004 (Returns for Periods Longer Than One Year are Annualized)						
	One Month	Three Months	Six Months	One Year	Three Years	Five Years	Ten Years
Permanent University Fund	2.49	8.34	15.49	31.74	5.29	6.05	9.74
Permanent University Fund Policy Portfolio	1.36	5.50	10.64	21.34	1.63	5.12	10.48
General Endowment Fund	2.33	8.22	15.61	32.56	5.89	N/A	N/A
Permanent Health Fund	2.31	8.15	15.45	32.31	5.74	N/A	N/A
Long Term Fund	2.31	8.14	15.45	32.38	5.81	7.56	10.44
General Endowment Fund Policy Portfolio	1.36	5.50	10.64	21.34	1.69	5.34	10.44
Policy Portfolio Before Restatement	1.36	6.12	11.89	27.38	4.21	5.37	10.41