

***The University of Texas Investment  
Management Company***



***Presentation Materials***

***Board of Directors Meeting***

***October 7, 2005***

**UTIMCO BOARD OF DIRECTORS  
MEETING AGENDA  
October 7, 2005**

UTIMCO  
Town Lake Conference Room  
221 West Sixth Street, Suite 1700  
Austin, Texas

Time		Item #	Agenda Item
Begin	End		
2:00 p.m.	2:05 p.m.	1	<b>Open Session:</b> Call to Order/Consideration of Minutes of September 14, 2005 Meeting*
2:05 p.m.	4:00 p.m.	2	Discussion and Consideration of Proposed Changes to Policies and Corporate Documents: <ul style="list-style-type: none"> <li>- Investment Policy Statements*, **</li> <li>- Delegation of Authority*</li> <li>- Derivative Policy*, **</li> <li>- Liquidity Policy*, **</li> <li>- Charter of the Risk Committee*</li> <li>- Investment Management Services Agreement*, **</li> </ul>
4:00 p.m.			Adjournment

\* Action by resolution required

\*\*Resolution requires further approval from the U. T. System Board of Regents

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.

<b>Next Scheduled Meeting: November 16, 2005</b>
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TAB 1

<b>RESOLUTION RELATED TO MINUTES</b>
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RESOLVED, that the minutes of the meeting of the Board of Directors held on **September 14, 2005**, 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 9:35 a.m. on the **14th day of September 2005**, at the Whitney Meeting Room of the Four Seasons Hotel, 1300 Lamar, Houston, Texas, said meeting having been called by the Chairman, Woody L. Hunt, with notice provided to each member in accordance with the Bylaws. The audio portion of the meeting was electronically recorded.

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

Woody L. Hunt, Chairman  
H. Scott Caven, Jr., Vice Chairman  
J. Philip Ferguson  
Erle Nye  
Robert B. Rowling  
Charles W. Tate

thus, constituting a majority and quorum of the Board. Director Nye attended the meeting by telephone conference call which was audible to the public at the meeting location during each part of the meeting that was required to be open to the public. Director Clint Carlson joined the meeting at the point indicated below. Vice Chairman for Policy Mark Yudof was not present at the meeting. Also attending the meeting were R. D. Burck, Advisory Director; 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; Bill Edwards, Managing Director of Information Technology; Larry Goldsmith, Managing Director of Public Markets; Andrea Reed, Risk Manager; Sara McMahan and Trey Thompson, Co-Managing Directors – Non-Marketable Alternative Investments of the Corporation; several staff members of the Corporation; Jerry Turner, legal counsel for the Corporation; Keith Brown of the McCombs School of Business at UT Austin; Philip Aldridge, Amy Barrett, and Cathy Swain of UT System Administration; and Bruce Myers and Hamilton Lee of Cambridge Associates. Mr. Hunt called the meeting to order at 9:35 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 meetings of the Board of Directors held on July 21, 2005. 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 July 21, 2005, be, and are hereby, approved.

### **Corporate Resolution**

The next item to come before the Board was a resolution to appoint new officers to the Corporation. Mr. Hunt read the resolution proposing that Director Caven be named Chairman of the Corporation and that Mr. Hunt be appointed as Vice Chairman. Upon motion duly made and seconded, the following resolution was unanimously adopted:

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

<u>Name</u>	<u>Office or Offices</u>
H. Scott Caven, Jr.	Chairman
Woody L. Hunt	Vice-Chairman

At this time, Mr. Hunt passed the chairmanship responsibilities to Mr. Caven.

### **Audit and Ethics Committee Report**

Mr. Caven asked for a report from the Audit and Ethics Committee. Director Nye, Chairman, reported that the Audit and Ethics Committee had met the day before, September 13, 2005. The committee received reports of financial statements, an update of the Corporation's Compliance, Reporting and Audit Issues, and a thorough report and update of the implementation of the Sarbanes-Oxley Act of 2002, including a report that documentation of the major processes for the Corporation and the Permanent University Fund had been completed. Director Nye reported that the UT System Audit Office had reviewed and tested these processes and provided a very good report to the Committee. At this point, Director Carlson joined the meeting. Upon motion duly made and seconded, the Board adopted the Committee report.

### **Asset Allocation, Risk and Performance**

Mr. Caven asked Mr. Boldt to report on the Corporation's asset allocation, risk and performance. Mr. Boldt began by discussing portfolio policy ranges and policy targets, and then presented the Market Exposure chart showing market exposure and deviations from policy targets within tactical policy ranges. He continued by discussing relative risk analysis, the peer universe and value added. Mr. Boldt reported Cumulative Value Added under the Corporation's management for periods ended July 31, 2005. He also handed out preliminary performance information for August 31, 2005. The net performance for the one-month period ended July 31, 2005, for the PUF was 2.29% and for the GEF was 2.23%, versus benchmark returns of 2.00% for each fund. The net performance for the one-year period ended July 31, 2005, for the PUF and GEF were 17.56% and 17.49%, respectively, versus benchmark returns of 15.12% for each fund. The Short Intermediate Term Fund's (SITF) performance was -.34% versus its benchmark return of -0.28% for the one-month period, and was 2.24% versus its benchmark return of 1.22% for the one-year period

ended July 31, 2005. Performance for the Short Term Fund (STF) was 0.27% versus 0.23% for its benchmark for the one-month period, and was 2.31% versus a benchmark return of 2.27% for the one-year period ended July 31, 2005. Also presented was performance attribution, statistics on liquidity, total derivatives by type and application, and actions taken under the Delegation of Authority. In reporting the manager history performance summary, it was noted that Davis Hamilton Jackson was terminated effective August 11, 2005. Mr. Boldt, Mr. Goldsmith, Ms. Reed, and Mr. Myers answered the Directors' questions.

### **Investing in Affiliated Foundation Funds**

Mr. Caven asked Mr. Boldt to continue with the next item. Several associations and foundations have expressed interest in the Corporation managing the funds under their control. Mr. Boldt provided the Board with an update on actions taken by the Staff and UT System Office of General Counsel to allow the Corporation to manage funds held by foundations and associations established to benefit UT System Institutions. The UT System Board of Regents would have full discretion to set all investment, administrative and distribution policies of any arrangements made with each fund's trustees. Mr. Boldt and Ms. Moeller answered the Directors' questions.

### **Derivative Application**

Mr. Boldt then gave a brief background of the Board approval process with regards to derivative applications. Mr. Boldt then introduced a proposed derivative application that would allow Staff to use structured notes and swaps as instruments to gain direct or overlay-related investment exposure on behalf of the UT Endowments or Operating Funds Investments. Mr. Goldsmith presented details of the specific derivative application proposed to the Board. Mr. Boldt, Mr. Goldsmith and Ms. Reed answered the Directors' questions during a lengthy discussion. There was no motion or action taken on this item.

### **Pooling of Hedge Funds**

Mr. Caven asked Ms. Iberg to introduce the next item. Ms. Iberg explained that the Staff was proposing to pool for investment purposes the Permanent University Fund (PUF) and General Endowment Fund's (GEF) hedge fund investments as further defined in the investment policies as Directional Hedge Funds and Absolute Return Hedge Funds. The Staff recommended approval to establish up to three internally managed commingled funds for the purpose of holding hedge fund investments. Creating internally managed commingled hedge fund pools will streamline the recordkeeping, reporting and administrative functions associated with hedge fund investments for the PUF and other Board of Regents' investment funds, such as an Intermediate Term Fund ("ITF") currently under consideration. Mr. Hunt noted that the Corporation's Compensation Plan does not take into account ITF performance and that the Compensation Committee should develop a recommendation on whether to include ITF performance as a measurement in the Compensation Plan. After discussion, one requested change was made to the UTS Special Investments Hedge Fund Pool deleting "existing" PUF and GEF non public investments and add "made prior to implementation of the Intermediate Term Fund" with regards to certain hedge fund managers. Upon motion duly made and seconded, the following resolution was unanimously adopted:

RESOLVED, that the Corporation Board approves creation of three internally-managed commingled funds for the purpose of pooling existing hedge fund investments, currently held by the Permanent University Fund (PUF) and the General Endowment Fund (GEF), and for the purpose of making additional hedge fund investments or redeeming hedge fund investments; and, be it further

RESOLVED, that one of such funds shall be designated "The University of Texas System Directional Hedge Fund Pool," which shall be used for pooling existing and future directional hedge fund investments; and, be it further

RESOLVED, that one of such funds shall be designated "The University of Texas System Absolute Return Hedge Fund Pool," which shall be used for pooling existing and future absolute return hedge fund investments; and, be it further

RESOLVED, that one of such funds shall be designated "The University of Texas System Special Investments Hedge Fund Pool," which shall be used for pooling PUF and GEF non-public investments with certain hedge fund managers made prior to implementing the Intermediate Term Fund and a revenue sharing arrangement with Protégé Partners LLC; and, be it further

RESOLVED, that the foregoing resolutions shall be implemented in accordance with the recommendation of the Corporation staff submitted to the Corporation Board and shall supersede all prior resolutions of the Corporation Board to the extent any such resolutions authorized an existing hedge fund investment for only the PUF or the GEF or prescribed a stated amount or percentage of a hedge fund investment for the PUF or the GEF.

The meeting was recessed at 11:40 p.m. Mr. Nye left the meeting at this time. The Board of the Corporation reconvened in an open meeting at the same meeting location at 12:40 p.m.

### **Discussion of Leverage**

Mr. Caven asked Mr. Boldt and Ms. Reed to present a discussion of leverage. Mr. Boldt and Ms. Reed presented the concepts of leverage including various definitions, various accounting-based and risk-based measures of leverage and led a discussion on the role of leverage in the UT Endowment Portfolios. Mr. Boldt and Ms. Reed answered the Directors' questions.

### **Discussion of Private Equity Exposure**

Mr. Caven asked Mr. Thompson and Ms. McMahon to provide information related to the Corporation's exposure to private equity versus the 15% target. They presented a program overview and the endowments' current exposure to private equity and explained why the endowments are under-allocated to the asset class relative to the 15% target. Over the past two years the Corporation's general partners have made significant distributions to the PUF and GEF, thereby decreasing the endowments' exposure to private equity investments. Furthermore, the total value of the endowments has increased more than the



forecasted 8.36% in the 2003 asset allocation study. Mr. Boldt, Mr. Thompson and Ms. McMahon answered the Directors' questions and Mr. Thompson and Ms. McMahon shared their plan for increasing the endowments' exposure to the 15% target.

### **Discussion of Investment Environment and Opportunities**

Mr. Boldt stated that he would like time set aside each meeting to provide an opportunity for an open-ended discussion on issues, expectations, and opportunities in the current investment environment. Concerns in the hedge fund area were discussed with Directors and Staff participating in the discussion.

### **Policies and Corporate Documents**

Mr. Caven asked to defer consideration of the Derivative Policy and the Delegation of Authority. He then asked Mr. Boldt to present the proposed Intermediate Term Fund (ITF) Investment Policy Statement. The ITF Investment Policy Statement is proposed to establish the ITF as a pooled operating fund for the collective investment of operating funds and other intermediate and long-term funds held by UT System institutions and System Administration. After discussion, consideration of the policies and corporate documents were tabled until the next meeting of the Board which will be scheduled in October.

### **Executive Session**

Mr. Caven, at 3:10 p.m., announced that, "the Board of Directors of The University of Texas Investment Management Company having been duly convened in Open Session and notice of this meeting having been duly given, I hereby announce the convening of a closed meeting as an Executive Session of the Board, for the purpose of deliberating personnel compensation matters for corporation employees. This Executive Session meeting of the Board is authorized by Texas Government Code, Section 551.074 (Personnel Matters). The time is now 3:10 p.m."

In Executive Session, the Board discussed matters regarding personnel compensation matters. No action was taken and no vote was called for or taken by the Board.

### **Reconvene in Open Session**

The Board reconvened at 3:22 p.m. in open session and Mr. Caven announced that, "the Open Session of the Board of Directors of The University of Texas Investment Management Company is now reconvened. The time is now 3:22 p.m. During the Executive Session, the Board discussed matters regarding personnel compensation matters, but did not take any votes."

### **Compensation Committee Report**

Mr. Caven asked for a report from the Compensation Committee. Director Ferguson, Chairman, reported that the Compensation Committee had held a meeting the day before, on September 13, 2005. At the

Committee meeting, the Committee members reviewed and approved two amendments to the UTIMCO Compensation Plan subject to approval by the Board. They also approved Exhibit 2 for the 2005/2006 Plan and the President and CEO's performance goals for the period ending June 30, 2006, both subject to final approval by the Board. The Committee recommended all items for approval by the Board. Upon motion duly made and seconded, the following resolutions were unanimously adopted:

Two amendments to the UTIMCO Compensation Plan:

WHEREAS, Section 7.2 of the UTIMCO Compensation Program (the "Plan") provides that UTIMCO, by action of its Board of Directors (the "Board"), has the right in its discretion to amend the Plan or any portion thereof from time to time; and

WHEREAS, UTIMCO and the Board wish to amend the Plan in certain respects; and

WHEREAS, the Compensation Committee of the Board has reviewed the proposed amendments to the Plan and has recommended that such amendments be adopted by the Board;

NOW, THEREFORE, be it:

RESOLVED, that the "First Amendment to UTIMCO Compensation Program," a copy of which is attached hereto and which is directed to be marked for identification and filed with the records of UTIMCO, is hereby approved and adopted, effective as of September 1, 2004; and

RESOLVED, that the "Second Amendment to UTIMCO Compensation Program," a copy of which is attached hereto and which is directed to be marked for identification and filed with the records of UTIMCO, is hereby approved and adopted, effective as of the dates specified therein; and

RESOLVED, that the appropriate officers of UTIMCO be, and they hereby are, authorized and directed to do and perform all such acts and things, to execute all documents and instruments, and to take all other steps as they or any of them may deem necessary, advisable, convenient, or proper to effectuate the same and accomplish the purposes of the foregoing resolutions, and to comply with all applicable provisions of all related documents and all applicable law, and any and all such actions heretofore taken shall be, and they hereby are, ratified and approved, and

Exhibit 2 for the 2005/2006 Plan:

WHEREAS, Section 5.3(a) of the UTIMCO Compensation Program (the "Plan") provides that the Board will confirm the "Eligible Positions" for participation in the Plan each Performance Period; and

WHEREAS, Section 5.3(a) of the Plan provides that a UTIMCO employee must be selected by the Board in order to become a "Participant" in the Plan; and

WHEREAS, Section 5.5(a) of the Plan provides that the Board will determine the "Incentive Award Opportunity," including a threshold, target, and maximum award, for each Participant each Performance Period; and

WHEREAS, the Compensation Committee of the Board has reviewed the proposed Eligible Positions, Participants, and Incentive Award Opportunities for the 2005/2006 Performance Period and has recommended that the Board approve the same;

NOW, THEREFORE, be it:

RESOLVED, that the Eligible Positions for the 2005/2006 Performance Period as set forth on Exhibit 2 attached hereto are hereby approved, effective as of July 1, 2005, except as any other effective date is specified on such Exhibit 2; and

RESOLVED, that the UTIMCO employees set forth on Exhibit 2 attached hereto are hereby selected or reconfirmed, as applicable, as Participants in the Plan, effective as of July 1, 2005, except as any other effective date is specified on such Exhibit 2; and

RESOLVED, that the Eligible Positions and the associated Incentive Award Opportunities for the 2005/2006 Performance Period as set forth on Exhibit 2 attached hereto are hereby approved, effective as of July 1, 2005, except as any other effective date is specified on such Exhibit 2, and

President and CEO's performance goals for the period ending June 30, 2006:

WHEREAS, Section 5.4(c) of the UTIMCO Compensation Program (the "Plan") provides that the Board will determine the "Performance Goals" of the President and CEO for each Performance Period; and

WHEREAS, the Compensation Committee of the Board has reviewed the proposed Performance Goals for the President and CEO for the 2005/2006 Performance Period and has recommended that the Board approve the same;

NOW, THEREFORE, be it:

RESOLVED, that the Performance Goals for the President and CEO for the 2005/2006 Performance Period as set forth in Section 5.8(b)(1) of the Plan and on Exhibit 1 and the individual Performance Goals document as presented to the Board are hereby approved, effective as of July 1, 2005.

There being no further business to come before the Board of Directors, the meeting was adjourned at approximately 3:25 p.m.

Secretary: \_\_\_\_\_  
Joan Moeller

Approved: \_\_\_\_\_ Date: \_\_\_\_\_  
H. Scott Caven, Jr.  
Chairman, Board of Directors of  
The University of Texas Investment  
Management Company

TAB 2

**Agenda Item**  
UTIMCO Board of Directors Meeting  
October 7, 2005

**Agenda Item:** Discussion and Consideration of Policies and Corporate Documents

**Developed By:** Staff

**Presented By:** Moeller, Goldsmith, Reed

**Type of Item:** Action Required by UTIMCO Board; Action Required by Board of Regents

**Description:** The following describes the policies and corporate documents enclosed for UTIMCO Board action and further approval by Board of Regents:

- Proposed Intermediate Term Fund (ITF) Investment Policy Statement for the centralized investing of the Operating Funds
- Proposed amendments to the Short Term Fund (STF) Investment Policy Statement
- Proposed amendments to the Derivative Policy
- Proposed amendments to the Liquidity Policy
- Proposed changes to the Investment Management Services Agreement (IMSA)

The following describes the corporate documents enclosed for UTIMCO Board action:

- Proposed amendments to the Delegation of Authority
- Charter of the Risk Committee

**Recommendation:** UTIMCO staff recommends approval of amendments to the STF Investment Policy Statement, Delegation of Authority, Derivative Policy, Liquidity Policy, and Charter of the Risk Committee. Staff also recommends approval of proposed ITF Investment Policy Statement.

The Risk Committee reviewed the Liquidity Policy and Charter of the Risk Committee at its July 19, 2005 meeting and recommends approval of the Liquidity Policy and Charter of the Risk Committee. The Risk Committee recommended a change in the Liquidity threshold from the charts presented to the Risk Committee. The requested change to an illiquidity threshold of 25% to 35% has been incorporated in the Liquidity Policy and the Charter reflects adding the Intermediate Term Fund to the responsibilities of the Risk Committee.

The UTIMCO staff is requesting ratification of the IMSA approved by the Board of Regents on August 11, 2005, as well as requesting approval of additional language amending the IMSA related to the adoption of the Intermediate Term Fund.

**Discussion:** The following is a brief discussion of the items being proposed:

## **Agenda Item**

UTIMCO Board of Directors Meeting  
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- The ITF Investment Policy Statement is proposed to establish the ITF as a pooled operating fund for the collective investment of operating funds and other intermediate and long-term funds held by U.T. System institutions and System Administration. The Policy Targets, Ranges and Performance Objectives were reviewed by the UTIMCO Board at its July 19, 2005 meeting. The proposed changes related to the targets requested by the UTIMCO Board at this meeting have been incorporated in Exhibit A.
- The STF's proposed changes include language to clarify when the funds of a foundation may invest in the STF, change the definition of cash and cash equivalents, removal of derivative language since derivatives will not be used in the STF, and removal of eligible investment language.
- The Delegation of Authority Policy in its current format was approved by the UTIMCO Board on November 15, 2004. During the past ten months as the new Delegation has been followed, certain issues have come to staff's attention which staff is proposing amendments to clarify.
- The Derivative Policy's proposed changes include the addition of the ITF and other items as follows:
  - Expanding the scope to cover external managers and distinguish between external managers operating under an agency agreement from a limited liability entity
  - Clarifying under the definition section that derivatives may be purchased through a national exchange or through an over the counter direct arrangement with a counterparty
  - Clarifying the difference in approving internal versus external derivative applications
  - Expanding and clarifying the controls related to counterparty risks and global risk limitations
  - Added a section on risk management and compliance
  - Added a reporting section to clarify reporting to the UTIMCO Board
- The proposed amendments to the Liquidity Policy and Charter of the Risk Committee relate to the addition of the ITF.
- The Board of Regents adopted certain changes to the IMSA which are red-lined in the document. Staff is requesting changes on page 3 which have been shaded to incorporate the ITF as a new fund to be included in the IMSA. Also, staff is requesting language to clarify meaning of Section 3 (g) related to Disclosure of Information.

**Reference:** Investment Policy Statements for the ITF and STF; Liquidity Policy; Delegation of Authority Policy; Derivative Policy; Charter of the Risk Committee; Investment Management Services Agreement

## INTERMEDIATE TERM FUND



## **RESOLUTION RELATED TO INVESTMENT POLICY STATEMENTS**

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

RESOLVED, that the resolutions of the Board adopted on January 18, 2005, are rescinded for Investment Policy Statements for the proposed CORE Fund, the proposed Core Guarantee Fund, the proposed CORE Plus Fund, the proposed Equity Fund, the Proposed Balanced Fund, a proposed Liquidity Policy for the CORE Fund and Balanced Fund, and a proposed Swap Agreement.

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

**Purpose and Structure**

The University of Texas System Intermediate Term Fund (the "ITF") 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 intermediate and long-term funds held by U. T. System institutions and System Administration.

**ITF Organization**

The ITF functions as a mutual fund in which each eligible account purchases and redeems ITF units as provided herein. The ownership of ITF 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.

**ITF Management**

Article VII, Section 11b of the Texas Constitution authorizes the Board of Regents, subject to procedures and restrictions it establishes, to invest the PUF in any kind of investment 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. Pursuant to Section 51.0031(c) of the Texas Education Code, the Board of Regents has elected the PUF prudent investor standard to govern its management of the ITF.

Ultimate fiduciary responsibility for the ITF 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.

Pursuant to an Investment Management Services Agreement between the Board of Regents and The University of Texas Investment Management Company ("UTIMCO"), the ITF shall be managed by UTIMCO, which shall a) recommend

investment policy for the ITF, b) recommend specific asset allocation targets, ranges and performance benchmarks consistent with ITF objectives, and c) monitor ITF performance against ITF objectives. UTIMCO shall invest the ITF assets in conformity with this Policy Statement. All changes to this Policy Statement or the exhibits to this Policy Statement, including changes to asset allocation targets, ranges and performance benchmarks, are subject to approval by the Board of Regents.

UTIMCO may select and terminate unaffiliated investment managers subject to the Delegation of Authority Policy approved by the UTIMCO Board. Managers shall be monitored for performance and adherence to investment disciplines.

### **ITF 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 ITF assets shall comply with applicable law and be structured so as to provide essential safekeeping and trading efficiency.

### **Funds Eligible to Purchase ITF Units**

No account shall be eligible to purchase units of the ITF unless it is under the sole control, with full discretion as to investments, by the Board of Regents.

Any account 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 ITF.

### **ITF Investment Objectives**

The investment objective shall be to earn annual returns over inflation (as measured by the Consumer Price Index) plus 3%, as measured over five-year rolling periods at risk levels below the PUF and GEF.

### **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. The asset allocation is designed to accommodate the intermediate investment horizon of the ITF assets with enhanced returns at moderate managed risk levels. UTIMCO is responsible to measure actual asset allocation at least

monthly, incorporating the impact of internal derivative positions, and to report the actual portfolio asset allocation to the UTIMCO Board and the Board of Regents at least quarterly. While specific asset allocation positions may be changed within the ranges specified in Exhibit A based on the economic and investment outlook from time to time, the range limits cannot be intentionally breached without prior approval of the Board of Regents.

In the event that actual portfolio positions in asset categories move outside the ranges indicated in Exhibit A due to market forces that shift relative valuations, UTIMCO staff will immediately report this situation to the UTIMCO Board Chairman and take steps to rebalance portfolio positions back within the policy ranges in an orderly manner as soon as practicable. Extenuating circumstances that could cause immediate rebalancing to be irrational and detrimental to the interest of the ITF asset values could warrant requesting approval of the UTIMCO Board Chairman for remedial action.

ITF 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. U.S. equities include common stocks, exchange traded funds, and derivatives based on common stocks, including warrants, rights, options, and futures. In addition, derivative applications that serve as a U.S. equity substitute will be classified as traditional U.S. equity. Global mandates that include a majority of U.S. equities will be included in U.S. equities. U.S. equities provide both current income and capital gains.

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 (non-U.S. developed) and emerging markets. Global ex U.S. equities include common stocks, exchange traded funds, and derivatives based on common stocks, including warrants, rights, options, and futures. In addition, derivative applications that serve as a Global ex U.S. equity substitute will be classified as Global ex U.S. equities. Global mandates that include a majority of Global ex U.S. equities will be included in Global ex U.S. equities. Global ex U.S. equities provide both current income and capital gains.

Non-U.S. Developed Equity – Non-U.S. developed equities represent ownership in companies domiciled in developed economies (countries) included in the MSCI All – Country World Equity Index – excluding those classified as part of the MSCI Emerging Markets Equity Index. These securities are typically constituents of countries in Europe, the Americas (North/Latin/South) and the Far East with high per-capita income, mature

capital markets, and stable governments. The benchmark for this asset category will be the MSCI EAFE Index, with net dividends.

Emerging Markets Equity – Emerging markets equities represent ownership in companies domiciled in emerging economies as defined by the current composition of the MSCI Emerging Markets Equity Index. In addition, such definition will also include those companies domiciled in economies that have yet to reach MSCI Emerging Markets Equity Index qualification status (either through financial or qualitative measures). The benchmark for this asset category will be the MSCI Emerging Markets Equity Index, with net dividends.

- 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.

Directional Hedge Funds – Directional hedge fund investments include U.S. and international long/short equity or fixed income strategies and other such strategies that exhibit directional market characteristics using commodities, currencies, derivatives, or other global market instruments. These strategies attempt to exploit profits from security selection skills by taking long and short positions in various securities. These strategies may also include fund of hedge fund investments. Directional hedge fund investments are made through private placement agreements. Directional hedge fund investments may be held in an internal commingled investment fund managed by UTIMCO.

Absolute Return Hedge Funds – Absolute return hedge fund investments include arbitrage, event driven strategies and other relative value 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 discrete events such as bankruptcies, mergers, and takeovers. Absolute return hedge funds may include multi-strategy managers and fund of hedge fund investments. Absolute return hedge fund investments are made through private placement agreements. Absolute return hedge fund investments may be held in an internal commingled investment fund managed by UTIMCO.

- D. Inflation Linked – Inflation linked investments are intended to provide some degree of inflation protection and generally consist of assets with a higher correlation of returns with inflation than other eligible asset classes. Inflation linked investments include:

REITS – REITS are real estate investment trusts that may be held as either trust certificates, derivative investments, or exchange traded funds. REITS own, and in most cases operate, income producing real estate.

Commodities – Commodities include natural resource investments including oil and gas interests and other hard assets. These investments may be held through partnerships, derivative investments, exchange traded funds or direct investments.

TIPS - TIPS are inflation protected securities with a return linked to the inflation rate. For diversification purposes, TIPS may include non-U.S. inflation protected fixed income securities as well as nominal fixed income securities.

- E. Fixed Income – Fixed income investments include debt (whether U.S. or foreign) issued by Governments, various government enterprises and agencies, and domestic and foreign corporations. The principal securities include bonds, notes, bills and mortgage and asset-backed securities. In addition, derivative applications that serve as a fixed income substitute may be classified as fixed income.
- F. Cash and Cash Equivalents – Short-term (generally securities with time to maturity of three months or less), highly liquid investments that are readily convertible to known amounts of cash, and which are subject to a relatively small risk of changes in value.

### **Performance Measurement**

The investment performance of the ITF will be measured by the ITF's custodian, an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, compared against the stated investment benchmarks of the ITF, as indicated in Exhibit A (incorporating the impact of internal derivative positions) and reported to the UTIMCO Board and the Board of Regents at least quarterly. Monthly performance data and net asset values will be available on the UTIMCO web site within a reasonable time after each month end.

### **Investment Guidelines**

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

Investment guidelines include the following:

General

- Investment guidelines for index, commingled funds, and limited partnerships managed externally shall be governed by the terms and conditions of the respective investment management contracts or partnership agreements.
- All investments will be U.S. dollar denominated assets unless held by an internal or external portfolio manager with the authority to invest in foreign currency denominated securities.
- Investment policies of any unaffiliated liquid investment fund must be reviewed and approved by UTIMCO's chief investment officer prior to investment of ITF assets in such liquid investment fund.
- No securities may be purchased or held which would jeopardize the ITF's tax-exempt status.
- No internal investment strategy or program may purchase securities on margin or use leverage unless specifically authorized by the UTIMCO Board.
- No internal investment strategy or program employing short sales may be made unless specifically authorized by the UTIMCO Board.
- The ITF's investments in warrants shall not exceed more than 5% of the ITF's net assets or 2% with respect to warrants not listed on the New York or American Stock Exchanges.
- The ITF may utilize derivatives to: a) simulate the purchase or sale of an underlying market index while retaining a collateral 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) hedge risks associated with ITF investments; or f) adjust the market exposure of the asset allocation, including the use of long and short strategies and other such strategies provided that the ITF's use of derivatives complies with the Derivative Investment Policy approved by the UTIMCO Board and the Board of Regents. The Derivative Investment Policy shall serve the purpose of defining permitted applications under which derivatives can be used, which applications are prohibited, and the requirements for the reporting and oversight of their use. Derivative applications implemented in compliance with the Derivative Investment Policy shall be deemed to be specifically authorized by the UTIMCO Board for purposes of this Policy Statement. 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:

- Highly liquid internal pooled investment funds managed by UTIMCO.
- Unaffiliated liquid investment funds as approved by UTIMCO's chief investment officer.
- ITF's custodian late deposit interest bearing liquid investment fund.
- Municipal short-term securities.
- Commercial paper 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 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.
- Repurchase agreements and reverse repurchase agreements 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 ITF 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 ITF's fixed income assets.
- Overnight repurchase agreements may not exceed 25% of the ITF'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

Permissible securities for investment include the securities within the component categories of the Lehman Brothers Aggregate Bond Index (LBAGG). These component categories include investment grade government and corporate securities, agency mortgage pass-through securities, and asset-backed securities. These sectors are divided into more specific subsectors: 1) Government securities: Treasury and Agency; 2) Corporate securities: 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 BBB- or better by Fitch Investors Service at the time of acquisition. An external investment manager may be authorized by the terms of an investment advisory agreement to invest up to a maximum of 50% of the total fixed income portfolio 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.

### Non-U.S. Fixed Income

Non-dollar denominated bond investments shall be restricted to bonds rated equivalent to the same credit standard as the U. S. Fixed Income Portfolio unless an investment manager has been authorized by the terms of an investment advisory agreement to invest in below investment grade bonds.

- Not more than 50% of the ITF's fixed income portfolio may be invested in non-U.S. dollar denominated bonds.
- Not more than 15% of the ITF's fixed income portfolio may be invested in emerging market debt.
- International currency exposure may be hedged at UTIMCO's discretion or delegated by UTIMCO to an external investment manager.

### Equities

The ITF shall:

- 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, or
- hold no more than 5% of its equity securities in the securities of one corporation at cost.

### **ITF Accounting**

The fiscal year of the ITF shall begin on September 1st and end on August 31st. Market value of the ITF shall be maintained on an accrual basis in compliance with Government Accounting Standards Board Statements, Financial Accounting Standards Board Statements, or industry guidelines, whichever is applicable. The ITF's financial statements shall be audited each year by an independent accounting firm selected by the Board of Regents.

### **Valuation of ITF Assets**

As of the close of business on the last business day of each month, UTIMCO shall determine the fair market value of all ITF net assets and the net asset value per unit of the ITF. The final determination of ITF net assets for a month end close shall normally be completed within six business days but determination may be longer

under certain circumstances. Valuation of ITF assets shall be based on the books and records of the custodian for the valuation date.

The fair market value of the ITF's net assets shall include all related receivables and payables of the ITF 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.

### **ITF Distributions**

There will not be any planned distributions from the ITF. The earnings of the ITF will be reflected in the net asset value per unit of the ITF.

### **Purchase and Redemption of ITF Units**

The ITF participants may purchase units on the first business day of each month upon payment of cash to the ITF, at the net asset value per unit of the ITF as of the prior month ending valuation date. Such purchase commitments are binding.

The ITF participants may redeem ITF units on a monthly basis. The unit redemption shall be paid in cash as soon as practicable after the month end valuation date of the ITF. Redemptions from the ITF shall be at the market price per unit determined at the time of the redemption. Such redemption commitments are binding.

Participants of the ITF are required to provide notification of purchases and redemptions based on specific notification requirements as set forth in The University of Texas System Allocation Policy for Non-Endowment Funds.

### **Securities Lending**

The ITF may participate in a securities lending contract with a bank or nonbank security lending agent for purposes of realizing additional income. Loans of securities by the ITF 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 lending agent shall be reviewed by UTIMCO staff to insure compliance with contract provisions.

### **Investor Responsibility**

As a shareholder, the ITF 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 ITF. Notwithstanding the above, the UTIMCO Board shall discharge its fiduciary duties with respect to the ITF solely in the interest of ITF unitholders, in compliance with the Proxy Voting Policy, and shall not invest the ITF 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 November 10, 2005, except for Exhibit A. Adherence to the policy targets and ranges may not be fully effective throughout the first six months after initial funding (expected February 1, 2006) as new portfolio investments are phased in. The selection of the effective date of Exhibit A, to be no later than September 1, 2006, shall be determined by UTIMCO's Chief Investment Officer and notification to the Chairmen of the UTIMCO Board and the Board of Regents shall occur at least 30 days prior to the effective date.

**EXHIBIT A**

**INTERMEDIATE TERM FUND**

**POLICY TARGETS, RANGES, AND PERFORMANCE OBJECTIVES**

Asset Category	Percent of Policy (%)		Benchmarks
	Policy Targets	Policy Ranges	
<b>US Equities</b>	<b>15.0</b>	<b>5 to 20</b>	Russell 3000 Index
<b>Global ex US Equities</b>	<b>10.0</b>	<b>0 to 15</b>	
Non-US Developed Equity	5.0	0 to 10	MSCI EAFE Index with net dividends
Emerging Markets Equities	5.0	0 to 10	MSCI Emerging Markets Index with net dividends
<b>Hedge Funds</b>	<b>25.0</b>	<b>10 to 27.5</b>	
Directional Hedge Funds	12.5	5 to 20	Combination index: 50% S&P Event-Driven Hedge Index plus 50% S&P Directional/Tactical Hedge Fund Index
Absolute Return Hedge Funds	12.5	5 to 20	Combination index: 66.7% S&P Event-Driven Hedge Fund Index plus 33.3% S&P Arbitrage Hedge Fund Index
<b>Inflation Linked</b>	<b>25.0</b>	<b>10 to 35</b>	
REITS	10.0	0 to 15	Dow Jones Wilshire Real Estate Securities Index
Commodities	5.0	0 to 10	Combination Index: 66.7% GSCI minus .5% plus 33.3% DJ-AIG Commodity Index
TIPS	10.0	5 to 15	Lehman Brothers US TIPS Index
<b>Fixed Income</b>	<b>25.0</b>	<b>15 to 40</b>	Lehman Brothers Aggregate Bond Index
<b>Cash</b>	<b>0.0</b>	<b>0 to 20</b>	90 Day T-Bills

Expected Annual Return (%)	7.08
Target Risk: 1 yr Downside Deviation (%)	-5.0
Target Risk: Standard Deviation (%)	7.5

		% of Target Risk
Upper Risk Bound: 1 yr Downside Deviation (%)	-6.4	127%
Lower Risk Bound: 1 yr Downside Deviation (%)	-3.5	69%

## SHORT TERM FUND

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

**Purpose**

The Short Term Fund (the "STF") 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 less than one year.

**STF Organization**

The STF functions like a mutual fund in which each eligible account purchases and redeems STF units as provided herein. The ownership of STF 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.

**STF Management**

Article VII Section 11b of the Texas Constitution authorizes the Board of Regents, subject to procedures and restrictions it establishes, to invest the Permanent University Fund (the "PUF") in any kind of investment 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. Pursuant to Section 51.0031(c) of the Texas Education Code, the Board of Regents has elected the PUF prudent investor standard to govern its management of the STF.

Ultimate fiduciary responsibility for the STF 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.

Pursuant to an Investment Management Services Agreement between the Board of Regents and The University of Texas Investment Management Company ("UTIMCO"), the STF shall be managed by UTIMCO, which shall: a) recommend

investment policy for the STF, b) determine specific asset allocation targets, ranges and performance benchmarks consistent with STF objectives, and c) monitor STF performance against STF objectives. UTIMCO shall invest the STF assets in conformity with this Policy Statement.

UTIMCO may select and terminate unaffiliated investment managers subject to the Delegation of Investment Approval Authority approved by the UTIMCO Board. Managers shall be monitored for performance and adherence to investment disciplines.

### **STF 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 STF assets shall comply with applicable law and be structured so as to provide essential safekeeping and trading efficiency.

### **Funds Eligible to Purchase STF Units**

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

Any account 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 STF.

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 STF provided that a contract between the Board of Regents and the foundation has been executed authorizing investment of foundation funds in the STF.

- ~~A. the purchase of STF units by foundation funds is approved by UTIMCO's 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 STF;~~
- ~~D. a contract between the Board of Regents and the foundation has been executed authorizing investment of foundation funds in the STF; and~~



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

### **STF Investment Objectives**

The primary investment objective shall be to maximize current income consistent with the absolute preservation of capital and maintenance of adequate STF liquidity. The STF shall seek to maintain a net asset value of \$1.00.

Achievement of this objective shall be defined as a fund return in excess of the average gross return of the median manager of an approved universe of institutional only money market funds.

### **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.

STF assets shall be allocated to the following broad asset class:

Cash and Cash Equivalents — Short-term (generally securities with time to maturity of three months or less), highly liquid investments that are readily convertible to known amounts of cash, and which are subject to a relatively small risk of changes in value. ~~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 good liquidity under both deflation and inflation conditions.~~

### **Performance Measurement**

The investment performance of the STF will be measured by an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, and compared against the performance benchmarks of the STF. Such measurement will occur at least quarterly.

### **Investment Guidelines**

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

Investment guidelines include the following:

#### General

- All investments will be U.S. dollar denominated assets.
  - Investment policies of any unaffiliated liquid investment fund must be reviewed and approved by the chief investment officer prior to investment of STF assets in such liquid investment fund.
  - No securities may be purchased or held which would jeopardize the STF'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 STF 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) facilitate trading; c) reduce transaction costs; d) 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 STF investments; or f) 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 STF assets are required as an initial margin deposit for such contacts; and iii) the STF's investments in warrants shall not exceed more than 5% of the STF'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 STF and the prices of derivative security investments by investing in only those contracts whose behavior is expected to resemble that of the STF'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. Derivative securities purchased or sold over the counter may not represent more than 15% of the net assets of the STF.~~

- ~~In the event that there are no derivative securities traded on a particular market index, the STF 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 STF will not be able to meet its obligation to the counterparty by investing the STF in the specific asset for which it is obligated to pay a return or by holding adequate short term investments.~~

### Eligible Investments

~~The weighted average maturity of the portfolio shall not be more than 60 days. Individual securities shall have a remaining maturity not longer than 397 days. The maturity of a portfolio security shall be deemed to be the period remaining (calculated from the trade date or such other date on which the STF's interest in the security is subject to market action) until the date noted on the face of the security as the date on which the principal amount must be paid, or in the case of a security called for redemption, the date on which the redemption payment must be made, except that: a) a variable rate security, the principal amount of which is scheduled on the face of the security to be paid in 397 days or less, shall be deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate; b) a variable rate security that is subject to a demand feature shall be deemed to have a maturity equal to the longer of the period remaining until the next readjustment of the interest rate or the period remaining until the principal amount can be recovered through demand; c) a floating rate security that is subject to a demand feature shall be deemed to have a maturity equal to the period remaining until the principal amount can be recovered through demand; d) a repurchase agreement shall be deemed to have a maturity equal to the period remaining until the date on which the repurchase of the underlying securities is scheduled to occur, or, where no date is specified, but the agreement is subject to a demand, the notice period applicable to a demand for the repurchase of the securities. A demand feature shall mean a put that entitles the holder to receive the principal amount of the underlying security or securities and that may be exercised either at any time on no more than 30 days notice or at specified intervals not exceeding 397 days and upon no more than 30 days notice.~~

### Cash and Cash Equivalents

Holdings of cash and cash equivalents may include the following:

- Unaffiliated liquid (Money Market Funds) investment funds rated AAA<sub>M</sub> by Standard & Poor's Corporation.
- 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 STF 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 STF's total assets.
  - Overnight repurchase agreements may not exceed 50% of the STF's total assets.

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 Fed Fund 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 Mortgage Backed Securities ("MBS"), not derivatives.~~

### **STF Distributions**

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

### **STF Accounting**

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

### **Valuation of Assets**

All investments are stated at amortized cost, which in most cases approximates the market value of securities. The objective of the fund is to maintain a stable \$1.00 net asset value; however, the \$1.00 net asset value is neither ~~not~~ guaranteed nor insured by UTIMCO.

The STF's net assets shall include all related receivables and payables of the STF 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 STF Units**

Purchase of STF units may be made on each business day upon payment of cash to the STF or contribution of assets approved by UTIMCO's chief investment officer, at the net asset value ~~\$1.00~~ per unit of the STF as of the most recent valuation date.

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

### **Redemption of STF Units**

Redemption of units may be made on each business day at the net asset value ~~\$1.00~~ per unit.

### **Securities Lending**

The STF 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 STF solely in the interest of STF unitholders and shall not invest the STF 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 12, 2004~~ November 10, 2005.

## DELEGATION OF AUTHORITY

**RESOLUTION RELATED TO DELEGATION OF AUTHORITY POLICY**

RESOLVED, that amendments to the Delegation of Authority Policy be, and are hereby, approved in the form submitted to the Corporation's Board of Directors



**The University of Texas Investment Management Company  
Delegation of Authority Policy**

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Effective Date of Policy: ~~November 15, 2004~~October 7, 2005

Date Approved by UTIMCO Board: ~~November 15, 2004~~October 7, 2005

Supersedes: Delegation of Authority Policy approved by the UTIMCO Board on ~~April 25, 2003~~November 15, 2004

**Purpose:**

The purpose of the Delegation of Authority Policy is to provide a clear delineation of responsibilities of the UTIMCO Board of Directors and the UTIMCO staff. Section 66.08 (d) of the Texas Education Code provides that UTIMCO's duties to the U. T. System Board of Regents with respect to the management of investment funds shall be governed by a contract between the two parties. UTIMCO provides various investment management services to the U. T. System Board as more fully described in the Investment Management Services Agreement by and between the U. T. System Board and UTIMCO. The UTIMCO Board is responsible for management and investment oversight of UTIMCO. The UTIMCO Board recommends amendments to the Investment Policies for approval by the U. T. System Board. The UTIMCO Board is responsible for overseeing the investment process to execute the established Investment Policies. However, in order to enhance the competitiveness of the investment process, improve management and operational efficiency, and in order to define and concentrate accountability for performance, certain duties and responsibilities are delegated by the UTIMCO Board to UTIMCO Management. This Policy Statement defines the delegation of authority in the two primary areas of UTIMCO operations:

- (1) Management, Operations, and Finance; and
- (2) Investments.

**Objective:**

By clearly defining the limits of delegated authority of UTIMCO Management, this Policy Statement enhances operational efficiency and timeliness in decision making, thereby enhancing competitiveness, as well as establishing a framework for the evaluation of UTIMCO Management in the assigned tasks.

**Scope:**

This Policy applies to all matters under UTIMCO control. The only delegations of authority granted by the UTIMCO Board are enumerated in this Policy and any authority not specifically granted in this Policy is retained by the UTIMCO Board acting as agent for the U. T. Board of Regents, provided that nothing contained in this Policy Statement is intended to, or shall, limit any delegation of authority otherwise set forth in the UTIMCO Bylaws, the Investment Management Services Agreement, any Committee Charter, any Investment Policy, or any formal policy adopted by the UTIMCO Board.

**Authority Delegated to UTIMCO Management:**

The primary functions of the UTIMCO Board are to formulate, revise, implement and conduct ongoing oversight of the policies it has established for UTIMCO. The duties and responsibilities of the UTIMCO Board are enumerated in the UTIMCO Bylaws, Articles of Incorporation, Committee Charters, Investment Management Services Agreement, and in UTIMCO policies. In order to more efficiently execute its responsibilities, the UTIMCO Board has delegated the authority to implement

## The University of Texas Investment Management Company Delegation of Authority Policy

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UTIMCO policies to UTIMCO Management in two primary areas: Management, Operational, and Financial Authority, and Investment Authority.

***Management, Operational, and Financial Authority:*** Final authority for the functions listed below rests with the UTIMCO Board:

- Administration, Accounting and Financial Management;
- Systems Technology Management;
- Personnel Management;
- Compliance;
- Client Relations and Reporting; and
- Public Relations.

However, the UTIMCO Board hereby delegates authority to UTIMCO Management in each functional area as specified below:

*Administration, Accounting and Financial Management:* The UTIMCO Board hereby delegates all day to day operational decisions to UTIMCO Management. This delegation includes, but is not limited to, all administrative decisions regarding the management of endowment and operating funds as well as all administrative and financial decisions associated with the operation of the UTIMCO organization. This delegation includes the authority to execute all contracts and agreements, subject to the limitations defined below.

*Systems Technology Management:* The UTIMCO Board hereby delegates all decisions regarding the operation and management of all systems technology assets to UTIMCO management. This delegation includes the authority to execute all contracts and agreements, subject to the limitations defined below.

*Personnel Management:* The UTIMCO Board hereby delegates to the UTIMCO Chief Executive Officer all personnel management decisions regarding positions included in approved UTIMCO operating budgets, and grants authority to the Chief Executive Officer to add non-budgeted personnel as necessary on an emergency basis, subject to review in the following budget cycle, provided that the addition of any non-budgeted personnel shall be promptly reported to the UTIMCO Board. All compensation decisions for officers of UTIMCO are excluded from this delegation.

*Compliance:* The UTIMCO Board hereby delegates all compliance operations to UTIMCO management, while retaining all oversight functions as specified in UTIMCO policies.

*Client Relations and Reporting:* The UTIMCO Board hereby delegates all client relations and reporting decisions to UTIMCO management.

*Public Relations:* The UTIMCO Board hereby delegates to the UTIMCO Chief Executive Officer all decisions regarding public relations issues, except for those issues that are reserved for decisions by the UTIMCO Vice Chairman for Policy.

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Delegation of Authority Policy**

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In addition, in order to facilitate the execution of the authority granted above, the UTIMCO Board hereby delegates the following specific duties and responsibilities to UTIMCO Management:

- **Contracts:** The UTIMCO Board hereby delegates to the UTIMCO Chief Executive Officer the authority to execute on the behalf of UTIMCO all contracts, leases, or other commercial arrangements (except investment management agency contracts, partnership agreements, investment consultant agreements and agreements with independent auditors) for a total obligation of \$1 million or less during the contract term, provided that notice of any such contracts, leases, or other commercial arrangements shall be promptly reported to the UTIMCO Board at its regularly scheduled meetings.

**Investment Authority:** The UTIMCO Board hereby delegates the following specific duties and responsibilities to UTIMCO Management:

- **Tactical Asset Allocation:** Without limitations of timing, procedures, or vehicles utilized (including short sales of securities to offset existing long positions for risk control purposes), decisions regarding tactical asset allocation within the ranges established in Investment Policy Statements, including rebalancing portfolio weights to Policy Target Weights or actively deviating from Policy Weights as market conditions dictate, are hereby delegated to the UTIMCO Chief Executive Officer, as long as any decisions do not violate established Investment Policies.
- **Risk Management:** The UTIMCO Board hereby delegates all decisions regarding the design and operation of any risk management system to UTIMCO management.
- **New Investment Vehicle and Manager Selection:** The UTIMCO Board hereby delegates to the UTIMCO Chief Executive Officer the authority to commit UT System funds to new relationships with internal or external investment managers or to new mandates with external investment managers already under existing relationships with UTIMCO, and the accompanying authority to negotiate and execute agency and partnership agreements as necessary, subject only to the following limitations:
  - **Public Markets Investments:** Any new commitments exceeding (i)(a) \$200 million for an individual external manager or (b) 20% of the total assets under management ~~in a~~ under the specific investment mandate asset categories of U.S. equity, non U.S. equity, and fixed income by an external manager or (ii) \$100 million for a particular active internal management application will require approval under the process defined in Appendix A.
  - **Marketable Alternatives Investments:** Any new commitments exceeding (i) \$100 million or (ii) 20% of the total assets of the same investment vehicle will require approval under the process defined in Appendix A, and an opinion from the external UTIMCO consultant shall be required for any marketable alternative investment managed by a manager not otherwise managing marketable alternative investments for UTIMCO. Otherwise, the decision as to whether an

**The University of Texas Investment Management Company  
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opinion regarding the new investment from the external UTIMCO consultant is necessary is delegated to the UTIMCO Chief Executive Officer.

- Non-Marketable Alternatives Investments: Any new commitments exceeding (i) \$50 million or (ii) 20% of the total assets of the same investment vehicle will require approval under the process defined in Appendix A, and an opinion from the external UTIMCO consultant shall be required for any non-marketable alternative investment managed by a manager not otherwise managing non-marketable alternative investments for UTIMCO. Otherwise, the decision as to whether an opinion regarding the new investment from the external UTIMCO consultant is necessary is delegated to the UTIMCO Chief Executive Officer. All new commitments to direct, non-marketable investments will require approval under the process defined in Appendix A.
- Other Investments: Any investments in asset categories not currently defined in the Policy Portfolio must receive specific UTIMCO Board approval regardless of size.
- Any commitment that would otherwise be permitted under this delegation, but which violates any UTIMCO Policy, is not permitted.
- The UTIMCO Chief Executive Officer will promptly notify the UTIMCO Board at its regularly scheduled Board meetings regarding all decisions made under this delegated authority.
- Changing Allocations of Investment Funds Among Existing Internal and External Managers and Partnerships: The UTIMCO Board hereby delegates to the UTIMCO Chief Executive Officer the authority to increase or decrease investments or commitments to existing internal or external investment managers, and the accompanying authority to renegotiate existing agency and partnership agreements as necessary, subject only to the following limitations:
  - Public Markets Investments: Any ~~increases~~ changes to existing funds under management by any individual external manager exceeding \$200 million or by internal management in a particular active application exceeding \$100 million, or which increases the total assets managed to more than (i) \$400 million with an individual external manager or a larger amount approved by the the Board for manager exceptions or to more than (i) \$400 million or (ii) 20% of the total assets in a specific investment mandate under the specific asset categories of U.S. equity, non U.S. equity, and fixed income at an external manager responsible for more than one UTIMCO mandate, will require approval under the process defined in Appendix A.
  - Marketable Alternatives Investments: Any ~~increases~~ changes to existing funds under management exceeding \$100 million, or which increase the total assets managed to more than \$200 million with an individual manager or to more than 20% of the total assets in a specific investment mandate at a manager responsible for more than

**The University of Texas Investment Management Company  
Delegation of Authority Policy**

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one UTIMCO mandate, will require approval under the process defined in Appendix A.

- Non-Marketable Alternatives Investments: Any increaseschanges to existing funds under management exceeding \$50 million in an existing partnership or direct investment, or which increase the total UTIMCO investment in a single partnership or direct investment to more than (i) \$100 million or (ii) 20% of the total assets of the same investment vehicle, will require approval under the process defined in Appendix A.
  - Any increasechange that would otherwise be permitted under this delegation, but which violates any UTIMCO Policy, is not permitted.
  - The UTIMCO Chief Executive Officer will promptly-notify the UTIMCO Board at its regularly scheduled Board meetings regarding all decisions made under this delegated authority.
- **Manager and Partnership Monitoring and Termination:** The UTIMCO Board hereby delegates to the UTIMCO Chief Executive Officer all decisions regarding monitoring and termination of existing internal or external investment managers.
  - **Internal Investment Management:** The UTIMCO Board hereby delegates to the UTIMCO Chief Executive Officer all decisions associated with the direct management of assets by UTIMCO staff.
  - **Management of UTIMCO's External Investment Consultant:** The UTIMCO Board hereby delegates to the UTIMCO Chief Executive Officer the authority to direct the day-to-day work product of the UTIMCO consultant, provided that the UTIMCO consultant shall continue to have primary reporting responsibility to the UTIMCO Board.
  - **Management of UTIMCO's External Counsel:** The UTIMCO Board hereby delegates to the UTIMCO Chief Executive Officer the authority to direct the day-to-day work product of the UTIMCO external counsel, provided that the UTIMCO external counsel shall continue to have primary reporting responsibility to the UTIMCO Board.

**Documentation and Controls:**

All UTIMCO Management decisions made under this Delegation of Authority Policy will be monitored by UTIMCO's Chief Compliance Officer. Any exceptions to this Policy will be reported to the Chief Executive Officer immediately. The CEO will develop a remedy to the exception, if possible, and report the exception and the remedy to the UTIMCO Board promptly.

**Reporting:**

The Chief Compliance Officer will provide a list of any exceptions to this policy on at least an annual basis to the Audit and Ethics Committee of the UTIMCO Board.

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**Appendix A  
Investment Vehicle and Manager Selection**

Except for the specific terms of delegation defined in this Policy, the UTIMCO Board shall be responsible for the selection of internal and external portfolio managers and partnerships to invest assets managed for the U.T. Board of Regents.

The process for new manager or partnership selection shall include the following steps:

1. Extensive due diligence by UTIMCO staff, and in some cases by the UTIMCO consultant.
2. Preparation of a complete due diligence report that will be considered by the UTIMCO Chief Executive Officer. Changes or updates to the due diligence report may be made as a result of the CIO review.
3. At the discretion of the UTIMCO Chief Executive Officer, a due diligence report by the UTIMCO external consultant may be required.
4. In cases in which the investment decision has been delegated to the UTIMCO Chief Executive Officer under this Policy, a Certificate of Compliance will be sent to each UTIMCO Board member with an executive summary of the due diligence report prepared by the UTIMCO Staff and external consultant (if required by the CEO).
5. In cases in which delegation is not permitted under this Policy, a Certificate of Compliance will be sent to each UTIMCO Board member with the complete due diligence report prepared by the UTIMCO Staff and external consultant (if required by the CEO). The Certificate of Compliance will have a checkbox to allow any UTIMCO Director to request a complete review of the investment at a subsequent Board meeting prior to making the investment, and two checkboxes to delegate the decision to UTIMCO Management, with or without a subsequent presentation of the investment at a future UTIMCO Board meeting.
  - a. If any Director has requested Board review, staff will provide a complete presentation, which may include a representative of the proposed manager or partnership, at the next UTIMCO Board meeting. If after hearing the presentation, a majority of Directors do not feel the investment is appropriate, the investment will not be made.
  - b. If no Director has requested a prior Board Review, the investment will be negotiated by staff and assets will be invested.



**RESOLUTION RELATED TO MANAGER EXCEPTION LIST**

RESOLVED, that the Manager Exception List as designated in the Delegation of Authority Policy be, and is hereby, approved in the form submitted to the Corporation's Board of Directors



## Manager Exception List

Manager	Current Exposure August 31, 2005 (\$ Millions)	Proposed Exception Amount (\$ Millions)
<b>Barclays Global Investors</b>		
BGI S&P 400	\$ 46.8	
BGI S&P 500	73.3	
BGI Russell 3000 Alpha Tilts	298.1	
BGI Russell 2000 Alpha Tilts	211.5	
BGI EAFE Index Fund	194.8	
BGI EAFE Alpha Tilts	308.2	
BGI Market Neutral Overlay	65.8	
BGI Emerging Structured Tier	103.2	
BGI Unequitized Global Market Neutral	201.4	
	<b>\$ 1,503.1</b>	<b>\$ 2,000.0</b>
<b>Pacific Investment Management Co.</b>		
Pimco Fixed Income	\$ 771.8	
Pimco Real Return	262.9	
Pimco TIPS	296.1	
	<b>\$ 1,330.8</b>	<b>\$ 2,000.0</b>

## DERIVATIVE POLICY

**RESOLUTION RELATED TO DERIVATIVE INVESTMENT POLICY**

RESOLVED, that amendments to the Derivative Investment Policy be, and are hereby, approved in the form submitted to the Corporation's Board of Directors, subject to approval of the U.T. System Board of Regents.

# The University of Texas Investment Management Company

## Derivative Investment Policy

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Effective Date of Policy: ~~November 10, 2005~~ August 11, 2005  
Date Approved by UTIMCO Board: ~~October 7, 2005~~ July 21, 2005

### **Purpose:**

The purpose of the Derivative Investment Policy is to enumerate the applications, documentation and limitations for investment in derivatives in the Permanent University Fund (PUF), ~~and the General Endowment Fund (GEF), and the Intermediate Term Fund (ITF),~~ hereinafter referred to as the Funds. The Board of Regents approved investment policy guidelines for the Funds allow for investment in derivatives provided that their use is in compliance with UTIMCO's Board approved Derivative Investment Policy. This Derivative Investment Policy supplements the Investment Policy Statement for the Funds.

### **Objective:**

The objective of investing in derivatives is to facilitate risk management and provide efficiency in the implementation of various investment strategies for the Funds. Through the use of derivatives, the complex risks that are bound together in traditional cash market investments can be separated and managed independently. Derivatives provide the Funds with the most economical means to improve the Funds risk/return profile.

### **Scope:**

Except where specifically noted, this Policy applies to all derivative transactions in the Funds executed by internal UTIMCO staff and by external managers operating under an Agency Agreement. ~~This Policy applies to internal management of derivatives at UTIMCO only. This Policy does not apply to external managers operating under limited partnership agreements, offshore corporations, or other Limited Liability Entities that limit the liability exposure of the Funds' investments.~~ Derivatives policies for external managers are established on a case by case basis with each external manager, as described below.

This Policy applies to both exchange traded derivatives and over the counter (OTC) derivative instruments. This Policy shall not be construed to apply to index or other common or commingled funds in which the Funds typically invest. These commingled investment vehicles are governed by separate investment policy statements.

### **External Managers:**

External managers are selected to manage the Funds' assets under either an Agency Agreement or through a Limited Liability Entity. An external investment manager of public market investments employed by UTIMCO under an Agency Agreement may engage in derivative transactions only if the transactions are consistent with the overall investment objectives of the account. Derivative applications shall be approved only with investment managers that demonstrate investment expertise in their use, and have appropriate risk management policies and procedures to effectively monitor and control their use. ~~Disclosure of permitted derivative applications with external investment managers of public market investments shall be made to UTIMCO's Board.~~

Selecting and monitoring external managers through a Limited Liability Entity. ~~The due diligence process in the selection of managers of alternative marketable equities employed by UTIMCO requires a clear understanding of the managers' use of derivatives, particularly as it relates to various risk controls and leverage. UTIMCO will invest in such strategies exclusively through limited partnership agreements, offshore corporations or other legal entities that limit the Funds' exposure to its investment in the strategy. Disclosure of derivative applications with alternative marketable equity managers shall be made to UTIMCO's Board.~~ These managers typically have complete delegated authority, and monitoring of risk exposures and leverage is done on both an individual entity and aggregate basis. The permitted uses of derivatives and leverage are fully documented in the limited liability agreements with these managers.

# The University of Texas Investment Management Company

## Derivative Investment Policy

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### Definition of Derivatives:

Derivatives are financial instruments whose value is derived, in whole or part, from the value of any one or more underlying securities or assets, or index of securities or assets (such as a bonds, stocks, commodities, and currencies). For the purposes of this Policy, derivatives shall include futures contracts, forward contracts, swaps and all forms of options, but shall not include a broader range of securities including mortgage backed securities, structured notes and convertible bonds. Derivatives may be purchased through a national exchange or through an OTC direct arrangement with a counterparty. (Refer to the attached exhibit for a glossary of terms.)

### Permitted Derivative Applications:

Derivative applications may be used:

- To implement investment strategies in a low cost and efficient manner;
- To alter the Funds market (systematic) exposure without trading the underlying cash market securities through purchases or short sales, or both, of appropriate derivatives;
- To construct portfolios with risk and return characteristics that could not be created with cash market securities;
- To hedge and control risks so that the Funds' risk/return profile is more closely aligned with the Funds' targeted risk/return profile through purchases or short sales, or both, of appropriate derivatives; or
- To facilitate transition trading.

The primary intent of derivative transactions should be to hedge risk in portfolios or to implement investment strategies more effectively and at a lower cost than would be possible in the cash market. Only the above derivative applications are permitted until such time as this policy is amended and approved by UTIMCO's Board. The Chief Investment Officer shall recommend and the UTIMCO Board must approve any new internal derivative applications prior to implementation, after fully considering the permissibility, merits, and compliance with all documentation and controls requirements of the application. Permissible derivative applications for external managers must be approved by the Chief Investment Officer.

### Derivative Applications Not Permitted:

Derivative applications shall not be used to invest in asset classes that are not consistent with the Funds' policy asset categories, implementation strategies and risk/return characteristics.

### Documentation and Controls:

Prior to the implementation of a new internal derivative application, UTIMCO shall document the purpose, justification, baseline portfolio, derivative application portfolio, risks (including at a minimum modeling, pricing, liquidity and legal risks), the expected increase or reduction in systematic and specific risk resulting from the application, ~~the acceptable criteria for counterparties in over the counter derivative applications,~~ and the procedures in place to monitor and manage the derivative exposure. Internal control procedures to properly account and value the Funds' exposure to the derivative application shall be fully documented. UTIMCO shall establish an appropriate risk management procedure to monitor compliance and will take corrective action if necessary.

~~UTIMCO shall make a comprehensive report of all derivative applications to the UTIMCO Board on at least a quarterly basis.~~

### Limitations:

Economic Impact and Leverage: Leverage is inherent in derivatives since only a small cash deposit is required to establish a much larger economic impact position. Thus, relative to the cash markets, where in most cases the cash outlay is equal to the asset acquired, derivatives applications offer the possibility of establishing substantially larger market risk exposures with the

## The University of Texas Investment Management Company Derivative Investment Policy

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same amount of cash as a traditional cash market portfolio. Therefore, risk management and control processes must focus on the total risk assumed in a derivatives application, which is the sum of the application-specific risk and the market (systematic) risk established by the derivative application. In order to control and limit the leverage risk, each internal derivative application must specify a baseline portfolio, and risk measures such as Value at Risk (VAR) will be employed to assure that the total economic impact risk of the derivative application portfolio relative to the baseline portfolio will not exceed 20% of the underlying value of the baseline portfolio. The total relative economic impact risk of each derivative application will be monitored on a daily basis by the most appropriate risk management tools for the particular derivative s application.

**Counterparty Risks:** In order to provide additional global information, the gross and net notional value will be provided as part of the comprehensive report of all derivative applications. As an additional global limitation, the total gross value (without netting counter positions) of all internal derivatives positions shall not exceed 45% of the net asset value of the Funds.

In order to limit the financial risks associated with derivative applications, rigorous counterparty selection criteria and netting agreements shall be required to minimize counterparty risk for over the counter derivatives. Any counterparty in an OTC derivative transaction with the Funds must have a credit rating of at least A- (Standard and Poor's) or A3 (Moody's). All OTC derivative transactions must be subject to established ISDA Netting Agreements and have full documentation of all legal obligations of the Funds under the transactions. The counterparty must be an investment grade credit and the agreement must be marked to market no less frequently than monthly. The net market value of all OTC derivative positions for any individual counterparty may not exceed 10% of the total market value of the Funds.

**Global Risk Limitations:** Notwithstanding other limitations in this Derivative Policy, no derivative transaction may be taken that would cause the aggregate risk exposure of the Funds to exceed the aggregate risk limits established by the current asset allocation policies of the Funds.

### **Risk Management and Compliance:**

To ensure compliance with all terms and limitations of this Policy, all internally managed and externally managed derivatives in accounts under Agency Agreements will be marked to market on a daily basis by the Funds' external custodian, and these daily reports will be reviewed for accuracy by the UTIMCO Risk Manager. Compliance with the conditions of this Policy will be monitored by the UTIMCO Chief Compliance Officer using data provided by the external custodian and the external risk model. Data from the external risk model will be reviewed for accuracy and completeness by the UTIMCO Risk Manager. Any violations of the terms in this Policy will be reported immediately to the Chief Investment Officer, who will determine the appropriate remedy and report promptly to the Risk Committee and the UTIMCO Board.

### **Reporting:**

UTIMCO shall provide a comprehensive report of all approved derivative applications for both internal managers and external managers under Agency Agreements. UTIMCO shall also provide a comprehensive report of all outstanding derivatives positions established by internal managers and external managers under Agency Agreements. These reports will be provided at least on a quarterly basis to the UTIMCO Board and the Risk Committee.

**The University of Texas Investment Management Company**  
**Derivative Investment Policy**

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**Derivative Investment Policy Exhibit**  
**Glossary of Terms**

**Agency Agreement** – A form of legal agreement that typically grants limited investment discretion to an external investment manager to act as the investment agent of the Funds but does not limit the liability of the Funds for actions taken by that agent.

**Application-specific risk** – The portion of total risk in a derivatives application which is due to factors unique to the application as opposed to more systematic, market-related factors. For example, in an option on a specific stock, the risk associated with the specific business results of the company which issued the stock underlying the option would be application-specific risk, as opposed to the overall risk of the stock market which would be Systematic Risk.

**Baseline portfolio** – The cash-market based portfolio which will serve as the basis for calculating the relative risk level of an equivalent derivatives application.

**Cash equivalents** – Includes cash, short term fixed income instruments, accruals, variation margin and one day deposits in transit to the account.

**Cash market** - The physical market for a commodity or financial instrument.

**Counterparty** - The offsetting party in an exchange agreement.

**Delta Equivalent Value** – The delta of an option is a measure of the change in price of an option with a small change in the value of the security underlying the option as implied by the Black-Scholes theory. The delta is a function of the volatility of the underlying security, the dividend rate of the underlying security, the strike price of the option, the time to maturity of the option, and the risk free interest rate. The delta then defines the value of the underlying security that would be necessary to fully hedge the option position, the delta equivalent value. For example, if an option on a stock has a notional value of \$100 but would change in price by \$6 when the value of the underlying stock changes by \$10, then the delta equivalent value of the option is \$60.

**Derivative application** – A definition of the intended use of a derivative-based position such as replication or enhancing index returns, asset allocation or completion fund strategies, and various alpha transport strategies.

**Derivative application portfolio** – The portfolio including derivative instruments, cash equivalents, and other cash market assets established to replicate a specified baseline portfolio.

**Economic exposure** - The total effective exposure of a derivative position. The economic exposure is the product of the dollar value of the exposure and the market or systematic risk level of the exposure. A common method of measuring economic exposure is with risk management tools such as “value at risk.”

**Exchange traded derivatives** - A derivative instrument traded on an established national or international exchange. These instruments “settle” daily in that cash exchanges are made between the exchange and parties to the contracts consistent with the change in price of the instrument. Fulfillment of the contract is guaranteed by the exchange on which the instruments are traded. Examples include S&P 500 futures contracts and Goldman Sachs Commodities Index futures contracts.

## The University of Texas Investment Management Company Derivative Investment Policy

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**Forward contract** - A non-standardized contract for the physical or electronic (through a bookkeeping entry) delivery of a commodity or financial instrument at a specified price at some point in the future.

**Futures contract** - A standardized contract for either the physical delivery of a commodity or instrument at a specified price at some point in the future, or a financial settlement derived from the change in market price of the commodity or financial instrument during the term of the contract.

**ISDA Netting Agreement** - The International Swaps and Derivatives Association (ISDA) is the global trade association representing participants in the privately negotiated derivatives industry, covering swaps and options across all asset classes. ISDA has produced generally accepted "Master Agreements," a 1992 Master Agreement and a 2002 Master Agreement, that are used by most counterparties in OTC derivatives transactions. Netting agreements are terms within the applicable Master Agreement that deal with the calculation of exposure for each counterparty. These netting agreements require that exposures between counterparties will be "netted" so that payables and receivables under all existing derivative transactions between two counterparties are offset in determining the net exposure between the two counterparties.

**Limited Liability Entity** – A legal entity created to define how assets contributed to the entity by external partners to the agreement will be managed by the manager of the entity. These entities are typically limited liability partnerships, corporations, or other such entities that limit the liability of external investors to the current value of the external investors' investment in the entity.

**Option** - An instrument that conveys the right but not the obligation to buy or deliver the subject financial instrument at a specified price, at a specified future date.

**Over the counter (OTC) derivatives** - A derivative instrument which result from direct negotiation between a buyer and a counterparty. The terms of such instruments are non-standard and are the result of specific negotiations. Settlement occurs at the negotiated termination date, although the terms may include interim cash payments under certain conditions. Examples include currency swaps and forward contracts, interest rate swaps, and collars.

**Swap** - A contract whereby the parties agree to exchange cash flows of defined investment assets in amounts and times specified by the contract.

**Systematic risk** – The non-diversifiable risks associated with an investment in a particular asset market. For example the financial, political, and other risks associated with a portfolio of common stocks are known as "market" or systematic risks.

**Value at risk (VAR)** – An established method of measuring economic exposure risk. The measure conveys the maximum potential loss (in dollars or percent of total assets) for a particular investment position, for a particular period of time, for a particular level of confidence.



# LIQUIDITY POLICY

**RESOLUTION RELATED TO LIQUIDITY POLICY**

RESOLVED, that the amendments to the Liquidity Policy as presented be, and are hereby, approved subject to approval by the U. T. System Board of Regents.

# The University of Texas Investment Management Company

## Liquidity Policy

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Effective Date of Policy: ~~November 10, 2005~~ August 11, 2005

Original Effective Date of Policy: August 7, 2003

### **Purpose:**

The purpose of this Liquidity Policy is to establish limits on the overall liquidity profile of investments in (1) the Permanent University Fund (PUF) and the General Endowment Fund (GEF), hereinafter collectively referred to as the Endowment Funds and, (2) the Intermediate Term Fund (ITF). For the purposes of this policy, "liquidity" is defined as a measure of the ability of an investment position to be converted into a cash position. The established liquidity profile limits will act in conjunction with, but do not supercede, the Investment Policies adopted by the U. T. System Board of Regents.

### **Objective:**

The objective of this Liquidity Policy is to control the element of total risk exposure of the Endowment Funds and the ITF stemming from the uncertainties associated with the ability to convert longer term investments to cash to meet immediate needs or to change investment strategy, and the potential cost of that conversion.

### **Scope:**

This Liquidity Policy applies to all PUF, ~~and~~ GEF, and ITF investments made by The University of Texas Investment Management Company (UTIMCO), both by internal and by external managers. Policy implementation will be managed at the aggregate UTIMCO level and will not be a responsibility of individual internal or external managers managing a portion of the aggregate assets.

### **Definition of Liquidity Risk:**

"Liquidity risk" is defined as that element of total risk resulting from the uncertainty associated with both the cost and time period necessary to convert existing investment positions to cash (or cash equivalents). Liquidity risk can result in lower than expected returns and reduced opportunity to make changes in investment positions to respond to changes in capital market conditions. Modern finance theory asserts that liquidity risk is a systematic risk factor that is incorporated into asset prices such that future longer-term returns will be higher for assets with higher liquidity risk, although that may not be the case in the short term.

### **Liquidity Risk Measurement-The Liquidity Profile:**

Capital market theory does not provide a precise technique to measure liquidity risk. For the purposes of this Liquidity Policy, potential liquidity risk will be monitored by measuring the aggregate liquidity profile of the Endowment Funds and ITF. All individual investments within the Endowment Funds and ITF will be segregated into two categories:

- **Liquid:** Investments that could be converted to cash within a period of one day to three months in an orderly market at a discount of 10% or less.
- **Illiquid:** Investments that could be converted to cash in an orderly market over a period of more than three months or in a shorter period of time by accepting a discount of more than 10%.

The measurements necessary to segregate all investments into one of the two categories assume normally functioning capital markets and cash market transactions. In addition, swaps, derivatives, or other third party arrangements to alter the status of an investment classified as illiquid may be considered, with the

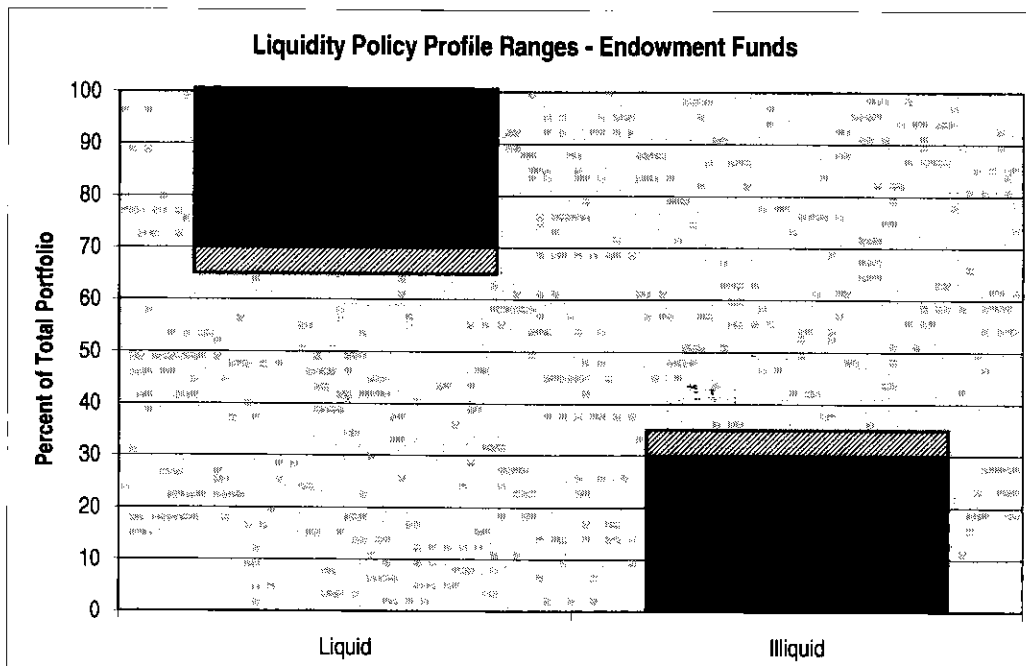
## The University of Texas Investment Management Company Liquidity Policy

prior approval of the UTIMCO Board or the Risk Committee<sup>1</sup>, in determining the appropriate liquidity category for each investment.

The result of this liquidity risk measurement process will be a liquidity profile for the Endowment Funds and the ITF which indicates the percentage of the total portfolio assets within each liquidity category. This Liquidity Policy defines the acceptable range of percentage of total assets within each liquidity category, specifies “trigger zones” requiring special review by UTIMCO staff and Board, and specifies the method of monitoring and presenting actual versus policy liquidity profiles.

### Liquidity Policy Profile:

The current Liquidity Policy Profile ranges and trigger zones for each of the Endowment Funds are defined by the chart below:

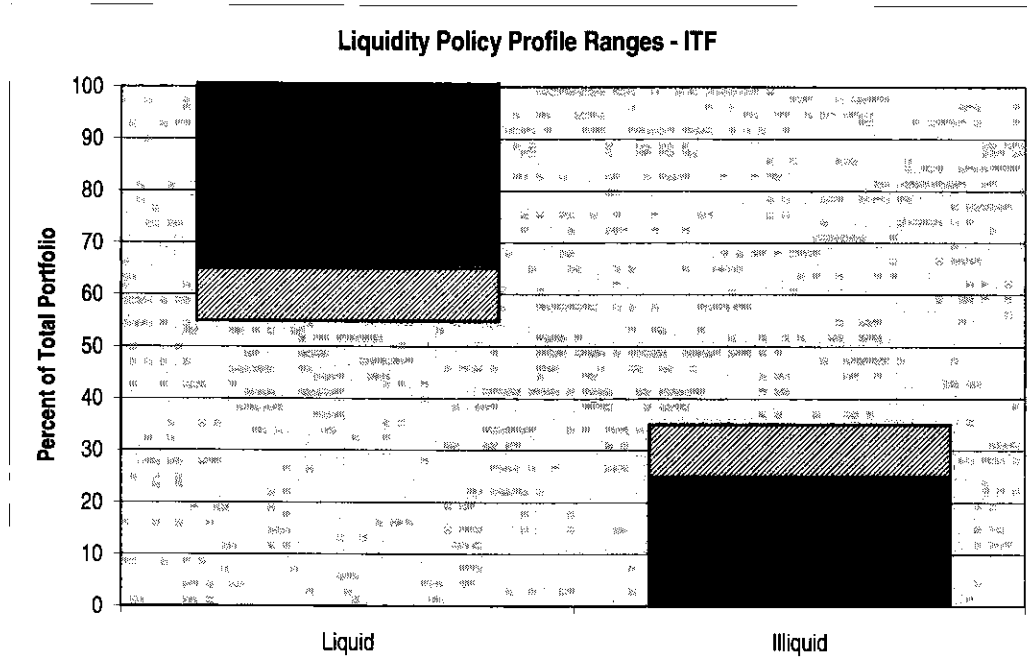


The green bar indicates the Policy range for investments categorized as “liquid” by the definition presented earlier. The red bar indicates the Policy range for investments categorized as “illiquid” by earlier definition. The shaded sections of the green and red bars indicate trigger zones requiring special action by the UTIMCO Board or the Risk Committee. For example, the allowable range for illiquid investments is 0% to 35% of the total portfolio. However, any illiquid investments made in the 30% to 35% trigger zone requires prior approval by the Risk Committee or the UTIMCO Board. Risk Committee review of new investments in the illiquid trigger zone will supplement, rather than replace, the procedures established by the UTIMCO Board for the approval of new investments.

<sup>1</sup> The Risk Committee (formerly, the Liquidity Committee) was appointed by the UTIMCO Board of Directors and is subject to a Risk Committee Charter first approved by the UTIMCO Board of Directors on April 8, 2004. The Risk Committee consists of at least three members of the Board and provides oversight and monitoring of the liquidity of the policy portfolio in accordance with this Liquidity Policy.

## The University of Texas Investment Management Company Liquidity Policy

The current Liquidity Policy Profile ranges and trigger zones for the ITF are defined by the chart below:



The allowable range for illiquid investments is 0% to 35% of the total portfolio for the ITF. However, any illiquid investments made in the 25% to 35% trigger zone require prior approval by the Risk Committee or the UTIMCO Board. Risk Committee review of new investments in the illiquid trigger zone will supplement, rather than replace, the procedures established by the UTIMCO Board for the approval of new investments.

### Documentation and Controls:

Managing Directors responsible for each asset class are responsible for determining the liquidity category for each investment in that class. These classifications will be reviewed by the Risk Manager and must receive final approval from the Chief Investment Officer. Classifications and weights within each liquidity category will be updated and reported on a monthly basis. The monthly liquidity reports will include certification by each Managing Director, the Risk Manager, the Chief Compliance Officer, and the President of UTIMCO that all investments are properly categorized and reported. All new investments considered will be categorized by liquidity category, and a statement regarding the effect on overall liquidity of the addition of a new investment must be an element of the due diligence process and will be a part of the recommendation report to the UTIMCO Board.

As additional safeguards, trigger zones have been established as indicated above to trigger required review and action by the UTIMCO Board or the Risk Committee in the event any investment action would cause the actual investment position in illiquid investments to enter the designated trigger zone, or in the event market actions caused the actual investment position in illiquid investments to move into trigger zones. In addition, any proposed investment actions which would increase the actual investment position in illiquid investments in either any of the PUF, or the GEF, or the ITF by 10% or more of the total asset value of either such Fund would also require review and action by the UTIMCO Board or the Risk Committee prior to the change. Any actual positions in any trigger zones or outside the policy ranges will be communicated to the Chief Investment Officer immediately. The Chief Investment Officer will then determine the process

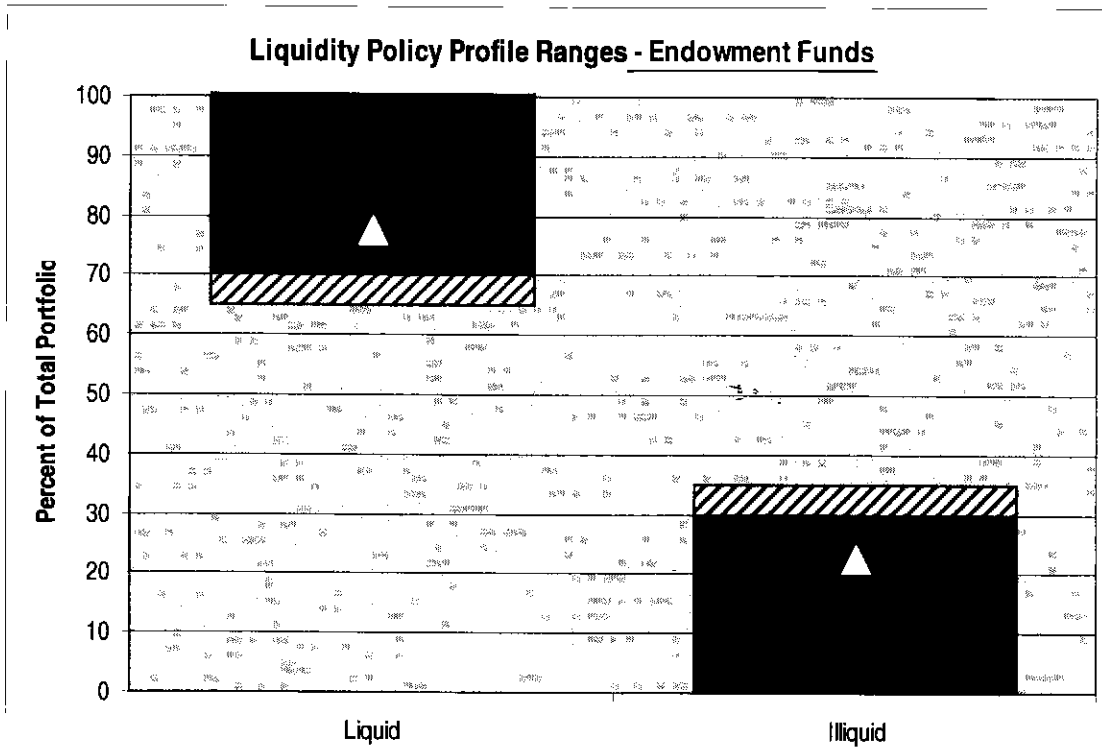
# The University of Texas Investment Management Company

## Liquidity Policy

to be used to eliminate the exception and report promptly to the UTIMCO Board and the Risk Committee the circumstances of the deviation from Policy and the remedy to the situation.

### Reporting:

The actual liquidity profiles of the Endowment Funds and the ITF, and compliance with this Liquidity Policy will be reported to the UTIMCO Board on at least a quarterly basis. Any exception to this Liquidity Policy and actions taken to remedy the exception will be reported promptly. An example of the method of reporting is shown below where the yellow points and number labels indicate current actual exposure levels within each Liquidity Policy Range for the Endowment Funds (numbers shown are examples only). For example, in this illustration the current exposure to "liquid" investments is 77.6%, while exposure to "illiquid" investments is 22.4% and both are within their respective allowable policy ranges and not in defined trigger zones.



# RISK COMMITTEE CHARTER

**RESOLUTION RELATED TO THE CHARTER OF THE  
RISK COMMITTEE**

RESOLVED, that the amendments to the Charter of the Risk Committee be, and are hereby, approved in the form submitted to the Corporation's Board of Directors.



# **The University of Texas Investment Management Company**

## **Charter of the Risk Committee**

### **Background**

The Board of Directors (the “Board”) of The University of Texas Investment Management Company (the “Corporation”) established a Liquidity Committee on November 20, 2003. The name of the Liquidity Committee was changed to the Risk Committee (the “Committee”) on May 19, 2005 to reflect the expanded responsibilities of the Committee. This Charter, originally adopted by the Board on April 8, 2004, and revised on September 29, 2004, ~~and~~ May 19, 2005 and October 7, 2005, sets forth the responsibilities of the Committee.

### **Purpose**

The primary purpose of the Committee is to provide oversight and monitor 1) liquidity of the Permanent University Fund (PUF), ~~and~~ the General Endowment Fund (GEF), and the Intermediate Term Fund (ITF)— in accordance with the Corporation’s Liquidity Policy, originally approved by the Board on June 26, 2003, and originally effective August 7, 2003; and 2) investment risk management in the PUF, ~~and~~ GEF, and ITF.

### **Composition**

The Committee shall be composed of at least three members of the Board appointed from time to time by a majority vote of the Board at a meeting at which a quorum is present. A member may be removed with or without cause at any time by a majority vote of the Board. Only members of the Board are eligible to serve on the Committee.

### **Meetings; Quorum; Etc.**

The Corporation’s Bylaws state that any committee created by the Board, including the Committee, shall (i) have a chairman designated by the Board, (ii) fix its own rules or procedures, (iii) meet at such times and at such place or places as may be provided by such rules or by resolution of the Committee or resolution of the Board, and (iv) keep regular minutes of its meetings and cause such minutes to be recorded in books kept for that purpose in the principal office of the Corporation, and report the same to the Board at its next succeeding meeting. At every meeting of the Committee, the presence of a majority of all the members thereof shall constitute a quorum, and the affirmative vote of a majority of the members present shall be necessary for the adoption by it of any action, unless otherwise expressly provided in the Committee's rules or procedures or the Bylaws of the Corporation or by the Board. The Board may designate one or

more Directors as alternate members of the Committee, who may replace any absent or disqualified member of the Committee. In the absence or disqualification of a member of the Committee, the member or members present at any meeting of the Committee and not disqualified from voting, whether or not constituting a quorum, may unanimously appoint the designated alternate Director to act at the meeting in the place of the absent or disqualified member.

## **Duties and Responsibilities**

*Investment Risk Management:* The Board has delegated the following duties and responsibilities to the Committee related to the oversight and monitoring of investment risk:

- The Committee will monitor actual risk levels in the PUF<sub>1</sub>, ~~and~~ GEF<sub>1</sub>, and ITF to assess whether current risk levels are within the bounds established by the Asset Allocation Policy adopted by the UT Board of Regents;
- The Committee will monitor trends and changes in actual risk levels in the PUF<sub>1</sub>, ~~and~~ GEF<sub>1</sub>, and ITF and report any significant changes to the Board; and
- The Committee will monitor the investment risk models, tools, and procedures used by Corporation staff for completeness and efficacy.

The Committee's duties are in investment risk management only and are not intended to duplicate the enterprise risk management duties of the Audit and Ethics Committee.

*Liquidity:* The UTIMCO Board has delegated the following duties and responsibilities to the Committee related to the oversight and monitoring of liquidity:

- The Committee must review and recommend for consideration to the Board any new investment that would cause the allocation for illiquid investments in ~~either~~ the PUF<sub>1</sub>, ~~or~~ GEF<sub>1</sub>, or ITF to exceed the lower illiquidity limit specified in the Liquidity Policy for the respective Fund's total portfolio.
- The Committee must review and approve, before any such action or actions are taken, any proposed changes in allocations among existing investments that would cause the allocation for illiquid investments in ~~either~~ the PUF<sub>1</sub>, ~~or~~ GEF<sub>1</sub>, or ITF to exceed the lower illiquidity limit specified in the liquidity policy for the respective ~~Fund's~~ total portfolio.
- The Committee must review and approve, before any such action or actions are taken, any proposed investment action or actions that would increase the actual investment position in illiquid investments in ~~either~~ the PUF<sub>1</sub>, ~~or~~ GEF<sub>1</sub>, or ITF by 10% or more of a Fund's total asset value.

- In the event that market actions cause actual investment positions in illiquid investments to exceed the upper illiquidity limit established by the Liquidity Policy or to move into the “trigger zone” defined as the allocation range between the lower and upper illiquidity limits established by the Liquidity Policy, the Committee must review and approve the Chief Investment Officer’s proposed remedy or strategy for complying with the required allocation range for liquid and illiquid investments before any such actions are taken.
- The Committee must approve the use of swaps, derivatives, or other third party arrangements to alter the liquidity status of any investment classified as illiquid.

Committee review of new investments in the illiquid trigger zone will supplement, rather than replace, the procedures established by the Board for the approval of new investments.

IMSA

**RESOLUTION RELATED TO THE INVESTMENT MANAGEMENT  
SERVICES AGREEMENT**

RESOLVED, that the amendments to the Investment Management Services Agreement as presented be, and are hereby, ratified except for any additional items approved by the Board which are subject to approval by the U. T. System Board of Regents; and be it

FURTHER RESOLVED, that the resolution of the Board adopted on January 18, 2005, for the Investment Management Services Agreement is rescinded.

## **INVESTMENT MANAGEMENT SERVICES AGREEMENT**

This Investment Management Services Agreement (this "Agreement") by and between the Board of Regents (the "U. T. Board") of The University of Texas System (the "U. T. System") and The University of Texas Investment Management Company ("UTIMCO"), a Texas nonprofit corporation, is effective September 1, 2005~~August 12, 2004~~ (the "Effective Date"), and supersedes all earlier agreements by and between the U. T. Board and UTIMCO regarding the subject matter hereof, ~~effective November 16, 2000.~~

### **RECITALS**

WHEREAS, the U. T. Board, pursuant to the Constitution and statutes of the State of Texas, is responsible for the investment of the Permanent University Fund, the local and institutional funds of the U. T. System and the funds of various trusts and foundations for which it serves as trustee, all of which funds are under the control and management of the U. T. Board;

WHEREAS, Section 66.08, Texas Education Code, as amended, authorizes the U. T. Board, subject to certain conditions, to enter into a contract with a nonprofit corporation for the corporation to invest funds under the control and management of the U. T. Board, as designated by the U. T. Board;

WHEREAS, UTIMCO has been organized under the laws of the State of Texas, including the Texas Non-Profit Corporation Act, Tex. Rev. Civ. Stat. Ann. art. 1396-1.01 et seq., for the express purpose of investing funds under the control and management of the U. T. Board, as designated by the U. T. Board, in accordance with the laws of the State of Texas;

WHEREAS, the U. T. Board desires to continue an Agreement with UTIMCO for UTIMCO to invest certain designated funds under the control and management of the U. T. Board;

WHEREAS, UTIMCO desires to enter into this Agreement with the U. T. Board and to invest certain designated funds under the control and management of the U. T. Board; and

WHEREAS, all conditions precedent to the execution and delivery of this Agreement have been fully satisfied and fulfilled, including, without limitations, the conditions established by Section 66.08, Texas Education Code, as amended.

NOW THEREFORE, for and in consideration of the premises and the mutual promises contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

## AGREEMENT

### **Section 1. Definitions.**

Accounts shall mean those funds for which the U. T. Board has responsibility, namely (a) the Permanent University Fund, excluding PUF Lands, (b) the Permanent Health Fund, (c) the U. T. Board Accounts and (d) the U. T. Board Trust Accounts.

Available University Fund or AUF shall mean the fund that consists of the distributions made to it from the total return on all investment assets of the Permanent University Fund, including the net income attributable to the surface of PUF Lands, all as provided by Article VII, Section 18 of the Texas Constitution.

Affiliate shall mean an entity directly or indirectly controlling, controlled by, or under common control with UTIMCO, including an entity with whom UTIMCO has an express or implied agreement regarding the direct or indirect purchase of investments by each from the other.

Cash Reserves shall mean cash on hand plus investments, plus prepaid expenses, less accounts payable, less other liabilities.

Claims shall mean all claims, lawsuits, causes of action and other legal actions and proceedings of whatever nature brought against (whether by way of direct action, counter claim, cross action, or impleader) any Indemnified Party and all requests or demands for indemnification made by any third party upon any Indemnified Party, even if groundless, false or fraudulent, so long as the claim, lawsuit, cause of action, other legal action or proceeding, request or demand is alleged or determined, directly or indirectly, to arise out of, result from, relate to or be based upon, in whole or in part, the duties, activities, acts or omissions of any person arising under this Agreement.

Custodian or Custodians shall mean a commercial bank, trust company or other entity selected by UTIMCO to hold and safekeep physical securities representing investment assets of any Account and to perform the other functions listed in Section 5 hereof.

General Endowment Fund or GEF shall mean the pooled fund for the collective investment of long-term funds under the control and management of the U. T. Board. The PUF, PHF, LTF or other long-term funds may invest in the GEF as authorized by the U. T. Board in each fund's investment policy statement.

Indemnified Parties shall mean UTIMCO and any of its officers, directors, employees and agents.

**Intermediate Term Fund** or **ITF** shall mean the intermediate term pooled investment fund for the collective investment of operating funds and other intermediate and long-term funds held by U.T. System institutions and U.T. System administration. In addition, the PUF and GEF may invest in the ITF.

**Investment Policies** shall mean the written investment policies determined and approved by the U. T. Board relating to the Permanent University Fund, General Endowment Fund, Permanent Health Fund, Long Term Fund, **Intermediate Term Fund**, Separately Invested Funds, Short Intermediate Term Fund and the Short Term Fund. Amendments may be presented by UTIMCO to the U. T. Board for review and approval.

**Long Term Fund** or **LTF** shall mean the long-term pooled investment fund previously established by the U. T. Board for the collective investment of all endowment and other long-term funds of ~~component~~ institutions of the U. T. System.

**Losses** shall mean losses, costs, damages, expenses, judgments and liabilities of whatever nature (including, but not limited to, attorneys', accountants' and other professionals' fees, litigation and court costs and expenses, amounts paid in settlement, amounts paid to discharge judgments and amounts payable by an Indemnified Party to any other person under any arrangement providing for indemnification of that person) directly or indirectly resulting from, arising out of or relating to one or more Claims.

**Permanent Health Fund** or **PHF** shall mean collectively the permanent funds for health-related institutions established pursuant to Chapter 63, **Texas Education Code**, for which the U. T. Board is an administrator.

**Permanent University Fund** or **PUF** shall mean the constitutional fund known by that name and established pursuant to Article VII, Section 11 of the Texas Constitution.

**Permanent University Fund Lands** or **PUF Lands** shall mean approximately 2.1 million acres of land located in 19 Texas counties, primarily in West Texas, and constituting a part of the Permanent University Fund.

**Separately Invested Funds** or **SIFs** shall mean U. T. System Funds or U. T. Board Trust accounts which, by election of the U. T. Board or by requirement of the trust indenture or donative instrument, are invested separately and apart from other U. T. System Funds and the PUF.

**Short Intermediate Term Fund** or **SITF** shall mean the short intermediate term pooled investment fund previously established by the U. T. Board for the collective investment of funds (other than endowment and other long-term funds, including the Permanent University Fund) of the ~~component~~ institutions of the U. T. System.



**Short Term Fund** or **STF** shall mean the money market mutual fund or funds approved by UTIMCO from time to time as an investment for U. T. System Funds.

**Surplus Cash Reserves** shall mean Cash Reserves on the last day of the fiscal year in excess of twenty-five percent (25%) of the upcoming fiscal year's projected operating budget plus approved capital expenditures budgeted for the upcoming fiscal year.

**U. T. Board Accounts** shall mean the investment assets of the General Endowment Fund and U. T. System Funds.

**U. T. Board Trust Accounts** shall mean the assets of charitable remainder trusts, foundations and other separately invested funds for which the U. T. Board serves as trustee on behalf of itself and other co-beneficiaries.

**U. T. System Funds** shall mean all funds under the control and management of the U. T. Board, other than the Permanent University Fund, the Permanent Health Fund and the U. T. Board Trust Accounts.

## **Section 2. Delegation of Investment Authority; Retention of Policy Setting Authority.**

The U. T. Board hereby appoints UTIMCO as its investment manager with complete authority to act for the Board in the investment of the Accounts, subject, however, to such limitations and restrictions as are set forth in the Investment Policies. UTIMCO shall furnish the U. T. Board with continuous investment management services and shall invest and reinvest the assets of the Accounts in such ways and at such times as are consistent with the Investment Policies and Section 4 hereof. UTIMCO shall be responsible for overall management of the U. T. Board's investment affairs as covered by this Agreement and shall manage each Account as a discretionary account.

The U. T. Board, as ultimate fiduciary for the Accounts, retains policy setting authority. Unless otherwise provided in writing by the U. T. Board, UTIMCO shall look to the Chancellor to provide primary oversight and management concerning matters other than the core investment duties delegated above, including relations with the media, legal issues (such as public disclosure of information), intergovernmental relations, ~~and policy issues other than those associated with investment allocation and/or return~~ and other matters arising out of UTIMCO's activities as investment manager under this Agreement that ~~implicate policies of the U.T. Board other than investment policy~~. The Board of UTIMCO and the President of UTIMCO shall be responsible for implementing the investment policy of the U. T. Board and performing those core investment duties delegated above. It shall be the responsibility of the President of UTIMCO to inform the Chancellor of unresolved policy issues not governed by the Investment Policies immediately so that appropriate oversight and management can be provided by the Chancellor. UTIMCO hereby agrees to abide by such oversight and management decisions made by the Chancellor.

The UTIMCO President shall consult with the Chairman and the Vice Chairmen of the UTIMCO Board, including the Chancellor as Vice Chairman for Policy, on the draft agenda for meetings of the UTIMCO Board at least two (2) weeks prior to each regular UTIMCO Board meeting.

### **Section 3. Description of Investment Management Services.**

During the term of this Agreement, UTIMCO shall provide the following services in conjunction with the investment of the Accounts:

a) **Investment Policies:**

UTIMCO shall review current investment policies for each Account, including without limitation policies concerning Asset Allocation, Liquidity, Proxy Voting, and Derivatives, at least annually by June 1 of each year. Such review shall include distribution (spending) guidelines, long-term investment return expectations and expected risk levels, asset allocation targets and ranges for each eligible asset class, expected returns for each asset class and fund, and designated performance benchmarks for each asset class. After UTIMCO completes its assessment, it shall forward any recommended changes to U. T. System staff with adequate time for review prior to being submitted to the U. T. Board for review and approval. ~~for discussion during an annual Joint Meeting between the U. T. Board and the UTIMCO Board of Directors.~~

b) **Investment Management:**

UTIMCO shall oversee the investment management process. Such oversight shall include the development of an investment outlook based on global economic and capital market forecasts, the rebalancing of allocations to each asset class within ranges in response to changes in the investment outlook, and the selection of a combination of portfolio managers to construct portfolios designed to generate the expected returns of each asset class.

c) **Investment Performance:**

UTIMCO shall monitor and report on investment performance for the PUF, PHF and U. T. Board accounts. Such responsibilities shall include the calculation and evaluation of performance of asset classes and individual portfolios, against established benchmarks over various periods of time, the periodic review of performance benchmarks, the reporting of investment performance of Separately Invested Assets and U. T. Board Trust Accounts as requested by the U. T. Board, and the reporting to regulatory agencies and others regarding investments under management to the extent required by applicable law.

d) **Operations:**

UTIMCO shall execute such operational responsibilities as the purchase and sale of investments, the settlement of all trades (to the extent such trades are not settled by the Custodian or brokers), the accounting for all transactions at the portfolio level in

accordance with generally accepted accounting principles, the preparation and delivery of periodic financial reports on all funds, and the maintenance of complete books and records (internally or through contract with the designated Custodian for the assets under management) reflecting transactions and balances of the Accounts.

e) **Maintenance of and Access to Books and Records:**

UTIMCO shall maintain the books and records for each Account on the basis of a fiscal year ending August 31st (or such other fiscal year as the U. T. Board may establish from time to time), and shall keep full separate records of all transactions with respect to each Account.

The books and records of the Accounts and any and all records concerning UTIMCO and UTIMCO's operations shall be available during normal business hours for inspection by an authorized representative of U. T. System. UTIMCO shall provide full audit access to any and all information concerning the operations of UTIMCO, including information necessary to review UTIMCO expenditures for compliance and reasonableness with the approved budget, to auditors representing the U. T. Board or the State Auditor.

f) **Reporting:**

In connection with the annual audited financial statements of UTIMCO, effective with the August 31, 2004 financial statements, the chief executive officer and the chief financial officer of UTIMCO shall provide certifications similar to those required by Section 302 of the Sarbanes-Oxley Act of 2002, Corporate Responsibility for Financial Reports. UTIMCO will follow the U. T. System compliance guidelines as outlined in the Action Plan to Enhance Institutional Compliance, as may be amended, including providing the U. T. Board or its designee with quarterly compliance reports.

g) **Disclosure of Information:**

The U. T. Board is committed to a policy of full and fair disclosure to the public. As part of that commitment with respect to private investments in the Accounts, ~~the following information shall be disclosed-~~ UTIMCO shall disclose to the public with respect to such private investments all information required to be disclosed pursuant to Section 552.0225 of the Texas Government Code regarding "Right of Access to Investment Information" ("private investment information"); ~~the name and purpose of each private investment entity; the names of the individual principals managing such private investment; the amount invested by UTIMCO in such private investments; the investment returns for such private investment, including internal rates of return; and remaining value information.~~ UTIMCO shall make no private investment with an entity unless the U. T. Board and UTIMCO ~~has~~ have clear and unequivocal authority to disclose to the public the private investment information, described immediately above, relating to such investment.

Before UTIMCO declines to disclose any information it has collected, assembled or maintained in its role as investment manager for the U. T. Board that is requested

under the Texas Public Information Act, the President of UTIMCO shall ~~consult~~ with-notify the U. T. System Vice Chancellor and General Counsel and solicit his or her input to the process. UTIMCO shall disclose the information unless (i) it is confidential and excepted as provided in Section 552.143 of the *Texas Government Code* regarding “Confidentiality of Certain Investment Information” or, (ii) as to any other information, the Vice Chancellor and General Counsel, after consultation with the Chancellor, approves a Public Information Act request to the Attorney General of Texas. In addition, the U. T. Board reserves the right and authority, in its sole discretion, to disclose, or direct the disclosure of, any information at any time, to the extent such disclosure would not result in a violation of applicable law or breach or result in a default under any agreement binding upon UTIMCO or the U. T. Board.

h) **Other Services:**

UTIMCO shall perform other investment management services including but not limited to 1) attending meetings of the U. T. Board and making such reports as the U. T. Board may request from time to time, 2) attending an annual Joint Meeting between the UTIMCO Board of Directors and the U. T. System Board of Regents as referenced in Article III, Section 7 of the UTIMCO Bylaws, 3) rendering services to managers of private equity investments in which UTIMCO has decided to invest, 4) attending meetings of governing bodies of companies in which UTIMCO’s managed Accounts have invested, 5) voting of securities (or proxies with respect thereto) held as investments of the Accounts according to written policies of the U. T. Board; 6) providing U. T. System ~~component~~—institutions with annual endowment reports reflecting, among other things, changes in the investment value of such ~~component~~institution’s endowment and distributions made to such ~~component~~institution to support the activities for which the endowment was established; 7) providing charitable trust administration services such as portfolio management, annual tax return preparation, annual trust reporting to donors and remittance of quarterly distributions; providing annual reporting of investment transactions and balances and distributing funds to authorized beneficiaries on foundation accounts; 8) effecting distributions directly or through the Custodian to U. T. System ~~component~~—institutions or other named beneficiaries from the Accounts; 9) supporting and maintaining on-line account information system for endowment accounts; and 10) any other services necessary to provide investment management of the Accounts.

**Section 4. Investment Manager as Fiduciary; Training and Education.**

UTIMCO acknowledges that it will be acting as a fiduciary with respect to managing the investments of the Accounts subject to the Investment Policies and applicable law. The U. T. Board recognizes that all individual investment transactions involve a variety of significant potential risks, including, without limitation, market risk, liquidity risk, credit risk, cash flow risk, operational risk and counterparty risk, although taken as a whole these transactions are also expected to manage risk. The U. T. Board agrees that (i) UTIMCO will not be liable for any losses incurred in the Accounts as a result of investments made pursuant to the Investment Policies, and (ii) UTIMCO will not be liable for actions of

co-fiduciaries. The U. T. Board also acknowledges that UTIMCO shall not be liable for, and, to the fullest extent authorized by the Constitution and laws of the State of Texas, agrees to hold UTIMCO harmless from the consequences of any action taken or omitted to be taken by the U. T. System or any of its employees or agents prior to March 1, 1996.

UTIMCO agrees to provide training and education to members of the UTIMCO Board of Directors to assure that all duties required of directors under the Texas Non-Profit Corporation Act and that matters related to legal and fiduciary responsibilities of the Directors, including current regulations for determining reasonable compensation, are outlined and discussed fully.

**Section 5. Custody of Assets.**

UTIMCO shall use custodians for safekeeping, settlement of security purchases, sales, collection of income and other duties as more fully described in the existing custody agreement between UTIMCO and the Custodian, which agreement, together with the U. T. Board's rights, duties and obligations thereunder, has been assigned to UTIMCO. In addition, UTIMCO may from time to time use a brokerage firm to settle security sales on behalf of the U. T. Board and may invest in a regulated mutual fund, externally managed commingled funds, or other investments in which assets are held outside of the bank custody relationship. Any physical certificates not held in safekeeping with a Custodian shall be held in safekeeping at a local bank as designated by UTIMCO.

**Section 6. Use of Unaffiliated Investment Managers.**

UTIMCO shall be entitled to use unaffiliated investment advisors to invest all or part of the Accounts and to perform other duties.

## **Section 7. Investment Management Fees; Direct Expenses.**

For services performed hereunder, UTIMCO shall be compensated in the amounts and in the manner set forth below:

a) **Annual Budget and Management Fee:**

UTIMCO shall submit to the U. T. Board its proposed annual budget for the following fiscal year (an "Annual Budget") within the time frame specified by the U. T. Board for other annual budget submissions. The Annual Budget shall include all estimated expenses associated with the management of the Accounts. The Annual Budget shall also include an annual UTIMCO management fee (an "Annual UTIMCO Management Fee") which shall include all operating expenses associated with the general management of the Accounts, including, without limitation, reasonable salaries, benefits and performance compensation of portfolio management and support personnel, expenses for consulting services, office space lease expenses, office furniture and equipment expenses, professional, legal, payroll, and other general services expenses, travel, insurance, capital expenditures, and other miscellaneous expenses incurred by UTIMCO in connection with the performance of its obligations hereunder.

At the same time that UTIMCO submits its Annual Budget, it shall also submit to the U. T. Board an allocation formula for charging the Annual Budget to the Accounts. Items proposed in the Annual Budget and the allocation formula may be approved, disapproved, or approved with modification by the U. T. Board. Any such Budget item or formula allocation that is disapproved or approved with modification may be promptly reviewed and revised by UTIMCO and resubmitted to the U. T. Board for additional consideration.

On or before the first day of each fiscal quarter, UTIMCO shall be entitled to charge each Account with its allocable share (determined in accordance with the allocation formula then in effect) of one-fourth of the amount of the Annual UTIMCO Management Fee to pay UTIMCO's operating expenses for the succeeding fiscal quarter. UTIMCO may, with the approval of the U. T. Board, revise the Annual UTIMCO Management Fee and allocation formula at any time during a fiscal year. Any statements for partial quarters at the beginning or end of this Agreement shall be prorated to reflect the actual time services were rendered during such partial quarters.

UTIMCO is hereby authorized to pay from each Account direct expenses incurred for portfolio management, custodian, auditing, and other services which are performed by external vendors specifically for each Account.

b) **Directors Fees:**

Members of UTIMCO management, with the approval of the UTIMCO Board, may serve as directors of companies in which UTIMCO has directly invested Account assets. In such event, any and all compensation paid to UTIMCO

management for their services as directors shall be endorsed over to UTIMCO and considered a part of UTIMCO's fee income and reflected in the Budget. Furthermore, UTIMCO Board approval of UTIMCO management's services as directors of investee companies shall be conditioned upon the extension of UTIMCO's Directors and Officers Insurance Policy coverage to UTIMCO management's services as directors of investee companies.

c) **Fees for Services Rendered:**

Members of UTIMCO management may perform services for which UTIMCO receives a fee ("Service Fees") from investment promoters or investee companies in consideration of the UTIMCO staff's private investment activities and/or investment origination activities. Such Service Fees shall be considered additional fee income to UTIMCO. UTIMCO may also receive commitment fees, standby fees and other similar fees ("Capital Fees") accruing or inuring to the capital invested on behalf of the Accounts managed by UTIMCO. Such Capital Fees shall be credited to the Accounts from which such investments are funded.

d) **Miscellaneous Fees:**

UTIMCO management may perform specialized services for accounts that are separately invested for which UTIMCO receives a fee from the account. These fees primarily relate to maintenance of computer programs for the separately invested accounts. Such Miscellaneous Fees shall be considered additional fee income to UTIMCO and reflected in the Budget.

e) **Cash Reserves:**

~~Surplus Cash Reserves are defined as Cash Reserves on the last day of the fiscal year in excess of 1/4 of the upcoming fiscal year's projected operating budget. Within 90 days after the end of each Fiscal Year 2004, UTIMCO will distribute back to the Accounts which generated the surplus \$4 million that portion of the Surplus Cash Reserves as may be directed by the U.T. Board, in its sole discretion, from time to time, back to the Accounts, which generated the surplus. Such distribution back to the Accounts shall be in the same proportion that the Accounts contributed to the Cash Reserves. In future fiscal years, the U. T. Board may direct UTIMCO to make additional distributions to the Accounts from Surplus Cash Reserves.~~

## **Section 8. Brokerage Commissions.**

The U. T. Board acknowledges and agrees that the investment management fees provided for in Section 7 are in addition to any compensation that may be due to a broker or dealer in effecting and executing transactions on behalf of UTIMCO. UTIMCO is hereby authorized and empowered, with full discretion, to issue instructions in accordance with the Investment Policies to such unaffiliated brokerage firms as may be selected by UTIMCO for the execution of orders for the purchase, sale, exchange and general investment of the Accounts; provided that UTIMCO shall not select a brokerage firm that is an Affiliate of UTIMCO. All orders for Account transactions shall be placed in such markets and through such brokers as UTIMCO determines will offer the most favorable price, execution and commission cost of each order. The U. T. Board acknowledges and agrees that UTIMCO, from time to time and in accordance with applicable law, may pay commissions to brokers that are higher than those that might be obtainable elsewhere in order to obtain from such brokers research and other services expected to enhance the long-term value of the Accounts.

## **Section 9. Valuation of Account Assets.**

The valuation of the account shall be determined in accordance with the Investment Policies approved by the U. T. Board for the account.

## **Section 10. Representations and Warranties of Parties.**

### **U. T. Board.**

- A. The U. T. Board (a) is duly established and validly existing under the laws of the State of Texas and is an agency of the State of Texas, (b) has all power and authority and all material government licenses, authorizations, consents and approvals required to carry on its business as now conducted, and (c) has full power and authority to execute, deliver and perform this Agreement.
- B. The execution, delivery and performance by the U. T. Board of this Agreement have been duly authorized by all necessary action and do not contravene, or result in the violation of or constitute a default under, any provision of applicable law or regulation, or any order, rule or regulation of any court, governmental agency or instrumentality or any agreement, resolution or instrument to which the U. T. Board is a party or by which it or any of its property is bound.
- C. No authorization, consent, approval, permit, license, or exemption of, or filing or registration with, any court or governmental department, commission, board, bureau, agency or instrumentality that has not been obtained or issued is or will be necessary for the valid execution, delivery or performance by the U. T. Board of this Agreement.
- D. This Agreement constitutes a valid and binding agreement of the U. T. Board.



- E. There is no action, suit or proceeding pending or, to the knowledge of the U. T. Board, threatened against or affecting the U. T. Board or the U. T. System, or relating to this Agreement, in any court or before or by any governmental department, agency or instrumentality which, if adversely determined, would materially affect the ability or authority of the U. T. Board to enter into, and perform its obligations under, this Agreement, or which in any manner questions the validity or enforceability of this Agreement.
- F. The U. T. Board has approved:
- (1) the Articles of Incorporation and Bylaws of UTIMCO;
  - (2) the Investment Policies;
  - (3) the Audit and Ethics committee of UTIMCO; and
  - (4) the Code of Ethics of UTIMCO.
- G. The U. T. Board has been provided with the opportunity to ask questions of, and it has received answers thereto satisfactory to it from, UTIMCO and its representatives regarding this Agreement and has obtained all additional information requested by it of UTIMCO and its representatives prior to entering into this Agreement.

#### **UTIMCO.**

- A. UTIMCO (a) is duly organized and validly existing as a Texas nonprofit corporation under the laws of the State of Texas, particularly the Texas Nonprofit Corporation Act, Tex. Rev. Civ. Stat. Ann. art. 1396-1.01 et seq., (b) has all corporate power and authority and all material government licenses, authorizations, consents and approvals required to carry on its business as now conducted, and (c) has full power and authority to execute, deliver and perform this Agreement.
- B. The execution, delivery and performance by UTIMCO of this Agreement have been duly authorized by all necessary action by UTIMCO and do not contravene, or result in the violation of or constitute a default under, any provision of applicable law or regulation, or any order, rule or regulation of any court, governmental agency or instrumentality or any agreement, resolution or instrument to which UTIMCO is a party or by which it or any of its property is bound.
- C. No authorization, consent, approval, permit, license, or exemption of, or filing or registration with, any court or governmental department, commission, board, bureau, agency or instrumentality that has not been obtained or issued is or will be necessary for the valid execution, delivery or performance by UTIMCO of this Agreement.
- D. This Agreement constitutes a valid and binding agreement of UTIMCO.

- E. There is no action, suit or proceeding pending or, to the knowledge of UTIMCO, threatened against or affecting UTIMCO, or relating to this Agreement in any court or before or by any governmental department, agency or instrumentality which, if adversely determined, would materially affect the ability or authority of UTIMCO to enter into, and to perform its obligations under, this Agreement, or which in any manner questions the validity or enforceability of this Agreement.

**Section 11. Compliance with Bylaws, Policies, Regulations and Financial Disclosure Requirements.**

In the performance of this Agreement, UTIMCO's Directors, Officers, and Employees shall abide by the following policies:

- a) UTIMCO Code of Ethics as approved by the U. T. Board
- b) UTIMCO Bylaws as approved by the U. T. Board
- c) All UTIMCO policies
- d) Applicable portions of Regents' Rules and Regulations.

Financial advisors and service providers as defined in Texas Government Code Section 2263.002 shall comply with the disclosure requirements contained in Texas Government Code Section 2263.005.

**Section 12. UTIMCO's Open Meeting Policy.**

Except as otherwise provided in Section 66.08, Texas Education Code, UTIMCO shall comply with all applicable provisions of the Texas Open Meetings Act, Chapter 551 of the Texas Government Code.

**Section 13. Prohibition Against Service to Other Clients.**

In accordance with Section 66.08, Texas Education Code, UTIMCO shall not engage in any business other than managing the Accounts under this Agreement.

**Section 14. Investment Company Act and State Securities Act.**

The parties to this agreement acknowledge that UTIMCO shall not be required to register as an "investment company" under Title 15 United States Code Section 80a-8 (the Investment Company Act of 1940), as amended, and Tex. Rev. Civ. Stat. Ann. art. 581-1 et seq. (The Securities Act).

**Section 15. Termination.**

The U. T. Board may terminate this Agreement at any time by written notice to UTIMCO, effective immediately upon receipt of such notice by UTIMCO, subject to reasonable allowance for settlement of pending trades. UTIMCO may terminate this Agreement upon ninety (90) days' written notice to the U. T. Board. There shall be no penalty for termination; however, UTIMCO shall be entitled to all management fees, compensation, and benefits earned prior to the effective date of termination.

**Section 16. Amendments.**

No amendment hereto shall be effective unless executed in the same manner as this Agreement.

**Section 17. Notices.**

All notices or communications hereunder shall be in writing and shall not be effective until hand delivered and receipted to the other party, or sent by overnight delivery, or sent by United States Certified or Registered Mail, postage prepaid, to the addressed party. The following are the designated addresses for such notices or communications and may only be changed by communication in the manner required by this paragraph:

To U. T. Board:

Board of Regents of The University of Texas System  
Attn: Counsel and Secretary  
201 West Seventh Street, Suite 820  
Austin, Texas 78701  
Tel. (512) 499-4402  
Fax. (512) 499-4425

To UTIMCO:

The University of Texas Investment Management Company  
Attn: President and CEO  
221 West Sixth St., Suite 1700  
Austin, Texas 78701  
Tel. (512) 225-1600  
Fax. (512) 225-1660

**Section 18. Non-Assignability.**

No Assignment of this Agreement by UTIMCO shall be made without having obtained the prior written consent of the U. T. Board nor is the Agreement assignable by the U. T. Board.

**Section 19. No Waiver of Breach.**

A waiver of a breach of any provision of this Agreement shall not constitute a waiver of any subsequent breach of that provision or a breach of any provision hereof. Failure of either party to enforce at any time or from time to time any provision of this Agreement shall not be construed as a waiver thereof.

**Section 20. Indemnification.**

a) **Agreements to Indemnify:**

To the fullest extent authorized by the Constitution and laws of the State of Texas, the U. T. Board shall indemnify and hold harmless each of the Indemnified Parties against any and all Losses, including Losses resulting from the negligence of the Indemnified Party claiming indemnification; provided, however, the U. T. Board shall not be obligated to indemnify an Indemnified Party against Losses to the extent such Losses are caused by (i) an act or omission that involves intentional misconduct or a knowing violation of law by the Indemnified Party claiming indemnification, (ii) a transaction from which the Indemnified Party claiming indemnification received an improper benefit, (iii) an act or omission for which the liability of the Indemnified Party claiming indemnification is expressly provided by an applicable statute, or (iv) an act or omission constituting gross negligence by the Indemnified Party claiming indemnification; provided further that indemnification payments by the U. T. Board shall be paid from the same sources as the Annual Fee pursuant to Section 7.

b) **Reimbursement:**

Each Indemnified Party shall reimburse the U. T. Board for payments made by the U. T. Board pursuant to this Section to the extent of any proceeds, net of all expenses of collection, actually received by it from any insurance with respect to any Loss. At the request and expense of the U. T. Board, each Indemnified Party shall have the duty to claim any such insurance proceeds and such Indemnified Party shall assign its rights to such proceeds, to the extent of such required reimbursement, to the U. T. Board.

c) **Notice:**

In case any Claim shall be brought or, to the knowledge of any Indemnified Party, threatened against any Indemnified Party in respect of which indemnity may be sought against the U. T. Board, such Indemnified Party shall promptly notify the U. T. Board in writing; provided, however, that any failure so to notify shall not relieve the U. T. Board of its obligations under this Section.

d) **Defense:**

The U. T. Board shall have the right to assume the investigation and defense of all Claims, including the employment of counsel and the payment of all expenses. Each Indemnified Party shall have the right to employ separate counsel in any such action

and participate in the investigation and defense thereof, but the fees and expenses of such counsel shall be paid by such Indemnified Party unless (i) the employment of such counsel has been specifically authorized by the U. T. Board, in writing, (ii) the U. T. Board has failed to assume the defense and to employ counsel, or (iii) the named parties to any such action (including any impleaded parties) include both an Indemnified Party and the U. T. Board, and such Indemnified Party shall have been advised by counsel that there may be one or more legal defenses available to it which are different from or additional to those available to the U. T. Board (in which case, if such Indemnified Party notifies the U. T. Board in writing that it elects to employ separate counsel at the U. T. Board's expense, the U. T. Board shall not have the right to assume the defense of the action on behalf of such Indemnified Party; provided, however, that the U. T. Board shall not, in connection with any one action or separate but substantially similar or related actions in the same jurisdiction arising out of the same general allegation or circumstances, be liable for the reasonable fees and expenses of more than one separate firm of attorneys for the Indemnified Parties, which firm shall be designated in writing by such Indemnified Parties).

e) **Cooperation; Settlement:**

Each Indemnified Party shall use reasonable efforts to cooperate with the U. T. Board in the defense of any action or Claim. The U. T. Board shall not be liable for any settlement of any action or Claim without its consent but, if any such action or Claim is settled with the consent of the U. T. Board or there be final judgment for the plaintiff in any such action or with respect to any such Claim, the U. T. Board shall indemnify and hold harmless the Indemnified Parties from and against any Loss by reason of such settlement or judgment as provided in Subsection (a) of this Section.

f) **Survival; Right to Enforce:**

The provisions of this Section shall survive the termination of this Agreement, and the obligations of the U. T. Board hereunder shall apply to Losses or Claims whether asserted prior to or after the termination of this Agreement. In the event of failure by the U. T. Board to observe the covenants, conditions and agreements contained in this Section, any Indemnified Party may take any action at law or in equity to collect amounts then due and thereafter to become due, or to enforce performance and observance of any obligation, agreement or covenant of the U. T. Board under this Section.

**Section 21. Claims By and Against Managed Funds.**

UTIMCO is authorized and empowered to seek, demand, collect, recover, and receive any and all sums of money, debts, dues, rights, property, effects, or demands due, payable, or belonging, or that may become due, payable, or belonging to the PUF or the U. T. Board from any person or persons as a result of any investment transaction and to execute any and all necessary or proper receipts, releases, and discharges therefor and any other instruments as may be necessary or appropriate from time to time relating to the handling, management, control, and disposition of any investment.

The authority granted in this Section does not include the authority to institute litigation on behalf of the U. T. Board or to settle contested claims or litigation that may result in UTIMCO receiving less than full value for the claim or the payment of damages or awards. The settlement of any contested claim or litigation for less than full value requires the prior approval of the U. T. System Vice Chancellor and General Counsel and appropriate System officials, as set out in the Regents' Rules and Regulations.

#### **Section 22. Communications.**

UTIMCO and U. T. System will assure that communications are clear and timely. UTIMCO will provide notice of actions taken in meetings of the UTIMCO Board and committees to members of the U. T. Board through the Office of the Board of Regents. U. T. will provide notice of actions taken by the U. T. Board related to UTIMCO issues to members of the UTIMCO Board of Directors through the President and CEO of UTIMCO.

#### **Section 23. Authority to Purchase, Exchange, and Sell Securities.**

UTIMCO may purchase, exchange, and sell, for and on behalf of the Permanent University Fund or the U. T. Board, any and all securities of any description whatever and from any source, including gifts and bequests, registered in the name of the PUF or the U. T. Board, or in any other form of registration of such securities held for the account of the PUF or the U. T. Board in whatever manner, including all fiduciary capacities and including those registered in the names of trusts or foundations managed and controlled by said U. T. Board. In addition, external investment managers appointed by UTIMCO may purchase, sell, or exchange securities, pursuant to written agreement with UTIMCO.

#### **Section 24. Authority to Assign and Transfer Securities.**

UTIMCO may assign and transfer any and all securities of any description whatever and from any source, including gifts and bequests, and execute any and all documents necessary to the consummation of any sale, assignment, or transfer of any securities registered in the name of the PUF or the U. T. Board, or in any other form of registration of such securities held for the account of the PUF or the U. T. Board in whatever manner, including all fiduciary capacities and including those registered in the names of trusts or foundations managed and controlled by said U. T. Board. In addition, custodian banks appointed by UTIMCO may assign and transfer securities and execute any and all documents necessary to the consummation of any sale, assignment, or transfer of any security owned by the U. T. Board.

#### **Section 25. Governing Law.**

This Agreement and all matters arising under it shall be governed by the Constitution and laws of the State of Texas. Venue for any action brought by any party hereto concerning the

subject matter of this Investment Management Services Agreement shall be in Travis County, Texas.

**BOARD OF REGENTS OF THE  
UNIVERSITY OF TEXAS SYSTEM**

Date: \_\_\_\_\_

By \_\_\_\_\_  
Chairman

**THE UNIVERSITY OF TEXAS  
INVESTMENT MANAGEMENT COMPANY**

Date: \_\_\_\_\_

By \_\_\_\_\_  
Chairman

TAB 3



**Agenda Item**  
UTIMCO Board of Directors Meeting  
October 7, 2005

**Agenda Item:** Presentation of a proposed investment in Cohen & Steers' U.S. Total Realty Fund

**Developed By:** Goldsmith

**Presented By:** Goldsmith

**Type of Item:** Action Required by UTIMCO Board

**Description:** U.S. Real Estate Investment Trusts (REIT)

**Recommendation:** UTIMCO staff recommends a \$722 Million (total internal REIT assets) commitment to Cohen & Steers U.S. Total Realty Fund

**Discussion:** As recently disclosed to the UTIMCO Board, Greg Cox, who has successfully managed the Endowments' REIT portfolios since 1993, will be departing UTIMCO to pursue other opportunities at the end of September 2005. Upon his announcement, staff began research into REIT investment alternatives to facilitate a low cost and PVA constructive transition of the REIT portfolio.

Staff strongly believes that Cohen & Steers - who has a successful long-term track record, extensive team depth and industry experience, and whose portfolio provides a near seamless transition from the current internal REIT portfolio - offers the optimal near-term solution in bridging the gap from current to future REIT management for the Endowments.

**Reference:** Delegation of Authority Policy; Investment Memorandum

**Cohen & Steers Capital Management**  
**Investment Recommendation**  
**Executive Summary**

UTIMCO Responsibility	Investment Description	Asset Category	Current/Pro Forma Exposure in Asset Category	Liquidity Profile	Existing Exposure	Proposed Investment	Total Proposed and Existing Exposure	Actual/Pro Forma Total Illiquidity
Inflation Hedging ("IF")	REIT	REIT	5.0%/5.0%	Liquid	\$0	\$722,000,000	\$722,000,000	N/A

### **BACKGROUND**

Greg Cox, who has successfully managed the Endowments' REIT portfolios since 1993, recently announced that he will be departing UTIMCO to pursue other opportunities at the end of September 2005. Upon this announcement, staff began researching REIT investment alternatives in order to facilitate a low cost and PVA constructive transition of the REIT portfolio. During this process, the Managing Director of Public Markets met with the principals and portfolio managers of the long-standing and highly regarded firm, Cohen & Steers. Staff believes that their successful long-term track record, extensive experience in the industry, emphasis on deep, fundamental research, and their breadth of size and staff offer the optimal near-term solution in bridging the gap from current to future REIT management for the Endowments.

*Please see Appendix A for Mr. Cox's opinion on the selection of Cohen & Steers as a near-term replacement manager for the Endowments' REIT assets.*

### **INVESTMENT SUMMARY**

#### **▪ COHEN & STEERS' MAIN COMPETITIVE ADVANTAGES**

1. Depth of resources and number of analysts in-the-field
2. Access to company management
3. Proprietary valuation model
4. Daily investment committee meeting as the fulcrum of their process

Cohen & Steers ("CNS") has one of the largest investment teams dedicated to real estate securities research, which allows for broader coverage of the investment universe and more time spent in-the-field visiting company managements, meeting with industry contacts, and evaluating pure real estate. Analysts are assigned coverage by property sector, which enables them to be experts in terms of both sector and company specific fundamentals.

CNS's focus, objectivity, longevity and size gives them immediate and incomparable access to company managements. Their relationships with managements provide them with a level of company understanding and in-the-field market insights that are not easily matched by their competitors. Their status means that REIT company management teams will often seek Cohen & Steers' advice on the potential effects of strategic issues on the attractiveness of their own stock.

CNS's proprietary valuation model drives all phases of their disciplined investment process. It is based on the belief that price-to-net asset values and price-to-cash flow multiples relative to long-term growth rates are the primary determinants of real estate security valuation. The model is used daily to determine relative valuations of property sectors and individual securities and serves to identify purchase/sale candidates, target weights and price limits.

CNS's investment committee meeting is the fulcrum of their investment process. All portfolio managers and research analysts gather on a formal basis to discuss macro property sector and company research, implement their valuation discipline, and execute portfolio decisions.

## ▪ EXPERIENCE

CNS employs experienced investment professionals whose backgrounds and experiences complement the philosophy of the firm. The firm's portfolio managers and analysts have extensive experience managing investment portfolios and/or researching potential holdings, have masters' degrees, and/or are chartered financial analysts, and have a demonstrated track record of success with fixed income investing. The two senior portfolio managers, Marty Cohen and Bob Steers have 29 and 28 years of specifically applicable experience, respectively. A more extensive list of CNS staff's organizational experience and background are outlined on page 4 and Appendix B.

## RECOMMENDATION

Staff believes that Cohen and Steers represents the optimal near-term choice to take over the active management of the Endowments' internal REIT portfolios. Their long-term track record of success, coupled with their depth of managerial experience, are the most obvious reasons. However, in addition, the similarity in structure and construction with the current UTIMCO REIT portfolio offers the added benefit of a relatively easy and low cost transition of assets – as well as a very low ongoing management fee (less than 30 bps, where most ETFs are 60 bps or higher and would require extensive costs to transition effectively).

Finally, the adoption of the National Association of Real Estate Investment Trusts Equity Index (NAREIT Equity REIT Index) as CNS's performance benchmark appears timely given the dramatic run-up of the internal portfolio over the last several years as benchmarked against the Wilshire Real Estate Securities Index (WARESI). *(See also Appendix B for a more detailed discussion of REIT benchmarks.)*

Going forward, with the assets effectively managed by Cohen and Steers, staff can more comfortably consider additional value-added constructs in this sub-asset class space – including non-U.S.- based REIT investments.