

UNIVERSITY OF MINNESOTA

BOARD OF REGENTS

Finance & Operations Committee

May 9, 2002

A meeting of the Finance & Operations Committee of the Board of Regents was held on Thursday, May 9, 2002, at 2:15 p.m. in the East Committee Room, 600 McNamara Alumni Center.

Regents present: Michael O'Keefe, presiding; Anthony Baraga, Frank Berman, Jean Keffeler, H. Bryan Neel, and Lakeesha Ransom.

Staff present: Executive Director Ann Cieslak; Associate Vice President Richard Pfitzenreuter.

Student Representatives present: Gina Nelson and Aaron Street.

Regent O'Keefe introduced Gina Nelson, Twin Cities campus, and Aaron Street, Twin Cities campus, the new Student Representatives to the Finance Committee.

INVESTMENT STRATEGY, PART III, AND

SEMI-ANNUAL INVESTMENT CONSULTANT REPORT: CAMBRIDGE ASSOCIATES

Regent O'Keefe stated that the Investment Strategy, Part III, would be presented in conjunction with the Semi-Annual Investment Consultant Report from Cambridge Associates. Materials for both presentations are on file in the Board Office. O'Keefe introduced Asset Management Director Sheila Warness and Steven Symchych of Cambridge Associates to make the presentation.

Symchych reported that the University's assets declined 15.9% in market value over the year ending December 31, 2001, compared to a 4-5% decline for similarly-sized institutions. He noted that the University's performance over five-year and ten-year timeframes has been at or above that of comparable institutions. The greater decline in value is due to the University's higher asset allocation in U.S. equities and non-U.S. equities and its lower allocation in total alternative assets than other peer institutions.

Warness summarized information from previous investment strategy discussions, highlighting the following:

- the relationship between the range of expected standard deviation in an asset class and its volatility;
- the importance of diversification across asset classes to control risk;
- the use of statistical correlation between asset classes to help control portfolio risk without sacrificing return; and
- the inclusion of riskier asset classes with low correlation to benefit a well-diversified portfolio by improving the return and/or reducing the risk of the overall portfolio.

Warness described the portfolio model that is used to develop asset allocation targets in Board of Regents Policy: *Consolidated Endowment Fund*. Such a portfolio is based upon an acceptable asset allocation level generating the greatest returns possible without surpassing a specific risk level. Symchych indicated that care should be taken when using this model, as it assumes that assets are efficiently priced and that markets are efficient, which is not the case in all alternative asset

classes.

In response to a question from Regent O'Keefe regarding the University's current asset allocation, Symchych recommended that the University consider increasing its exposure to hedge funds and consider placing more emphasis on emerging international markets within the portfolio's non-U.S. equity component. He indicated that emerging international markets are a good source of diversification, and that this is an opportune time to invest due to their lower price. He added that since the U.S. equities market is currently overpriced, the University may want to consider other equity asset classes, such as real estate.

The committee's ensuing policy discussion focused on the appropriateness of current target allocations and the role of the Investment Advisory Committee (IAC) in any contemplated changes.

In response to a question from Regent Keffeler, Pfutzenreuter remarked that once the committee comes to consensus on a level of risk it can support, the administration and the IAC would work together to develop different allocation models for the committee's consideration.

Regent O'Keefe indicated that he would seek the recommendation of the IAC regarding portfolio models and the appropriate level of risk and would report back to this committee.

RESERVES STRATEGY, PART II

Associate Vice President Pfutzenreuter continued the discussion from a previous meeting on current institutional and unit level reserves, as found in the materials on file in the Board Office.

Pfutzenreuter presented an overview of Board of Regents Policy: *Central Reserves Management*, and summarized recent central reserves balances. He indicated that central reserves are unrestricted funds spread throughout the institution, and are used both to protect the institution against financial risks and to enable it to take advantage of unexpected opportunities. He summarized the different types of potential major risks at both the institutional and unit levels and outlined a two-year rebuilding plan for central reserves to ensure sufficient resources to meet the potential risks.

Regent Keffeler stressed the importance of ensuring that the strategic resources of the institution are aligned with its strategic priorities.

After a lengthy discussion, Regent O'Keefe summarized the following policy issues for the committee's deliberation:

- What is the appropriate level of reserves to hold centrally and at the unit level?
- How can the Board assess the institution's strategic capacity both to manage risk and to take advantage of unexpected opportunities?
- How does the Board meet its oversight responsibilities in a highly decentralized institution; how does it ensure that units have adequate reserves both to manage risks and to take advantage of opportunities?

CONSENT REPORT

Review/Action

Associate Vice President Pfutzenreuter presented the Consent Report, as found in the docket materials, which included:

Purchases of goods and services over \$250,000:

- \$301,800 to Dell USA LP for 200 Latitude C610 Laptop computers for use by University of Minnesota Extension Service Regional Extension Educators and County Extension Directors. Dell computers are covered under a University-wide contract.
- \$270,000 to University Corporation for Advanced Internet Development (UCAID) for the connection fee to the Abilene computer network for the Office of Information Technology (OIT) for the period of March 2002 through March 2003. Vendor selected through a competitive process.

A motion was made, seconded, and the committee voted unanimously to recommend approval of the Consent Report.

INFORMATION ITEMS

Associate Vice President Pfitzenreuter reported that there were no Information Items this month.

The meeting adjourned at 4:00 p.m.

ANN D. CIESLAK

Executive Director and

Corporate Secretary

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