UNIVERSITY OF CALIFORNIA GENERAL ENDOWMENT POOL
INVESTMENT POLICY STATEMENT

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PLEASE NOTE:

* These Appendices and Guidelines are in separate documents and are incorporated by reference. Appendices (4-8) to Investment Policy Statements of UCRP and GEP

Introduction and Purpose

This Investment Policy Statement ("Policy" or "IPS") provides the framework for the management of the investments of the University of California General Endowment Pool ("GEP"). The purpose of a policy statement is to document the investment management process by

- Identifying the key roles and responsibilities relating to the ongoing management of the GEP's assets;
    - Recognize and ameliorate the agency issues among the parties responsible for various aspects of investment management;
- Setting forth an investment structure for the GEP's assets;
    - This structure includes various asset classes and acceptable ranges that, in aggregate, are expected to produce a sufficient investment return over the long term while prudently managing risk;
    - This strategy should provide guidance in all market environments, and should be based on a clear understanding of worst case outcomes;
- Establishing formalized criteria to measure, monitor, and evaluate GEP performance results on a regular basis; and

d. Under the Bylaw Section 12.5.c, the Committee is directed to establish a system of custodianship for all securities.

e. Under University Bylaw Section 21.4, The Regents has delegated to the Chief Investment Officer general responsibility for all investment matters, including the implementation of investment policies established by the Committee for the GEP. References to the "Chief Investment Officer" below shall be understood, depending on the context, to mean the "Office of the Chief Investment Officer."

The philosophy for the management of the GEP assets is as follows.

f. The investment philosophy of the Committee is to create a management process with sufficient flexibility to capture investment opportunities as they may occur, yet maintain reasonable parameters to ensure prudence and care in the execution of the investment program.

g. The Committee seeks a return on investment consistent with levels of investment risk that

l. *Total active risk* refers to the volatility of the difference between the return of the GEP policy benchmark (see Appendix 1) and the actual return. It incor

Officer is delegated the responsibility of managing total and active risk within the ranges set by the Committee (see Appendices 1 and

h. The Chief Investment Officer shall prepare quarterly and annual reports for the Committee and The Regents on the investment program, including
    i. The achievement of overall performance objectives
    ii. The type and amount of risk taken to achieve those objectives
    iii. Attribution of returns to various investment decisions and risks
    iv. Adherence to budgets set for total and active risk
    v. Compliance with policy guidelines, particularly asset allocation policy, and
    vi. The costs of managing the GEP's assets.

i. Investment performance results shall be calculated and verified at least monthly by an external, independent performance consultant.

j. The Chief Investment Officer, in conjunction with the various investment consultants, will monitor the investment managers for compliance with their investment guidelines, achievement of specific objectives, and individual risk exposures.

k. The Chief Investment Officer shall monitor the conduct of the custodian of the GEP.

l. The Chief Investment Officer shall adopt the CFA Institute Code of Ethics and Standards of Professional Conduct for all employees of the Chief Investment Officer and relevant consultants and managers. These are found at http://www.cfainstitute.org/cfacentre/pdf/English2006CodeandStandards.pdf and incorporated by reference. The Chief Investment Officer shall develop and enforce other ethics guidelines for the employees of the Chief Investment Officer as needed, consistent with other University policies and guidelines.

m. The Committee will review this Policy from time to time to determine if modifications are necessary or desirable.

4. Performance Objectives

Performance objectives shall be established for the total GEP, asset class composites and individual manager portfolios. These objectives will be incorporated in the quarterly reviews of the GEP's performance.

The investment strategy articulated in the asset allocation policy found in Appendix 1 has been the investments to achieve the necessary performance to meet desired spending. The result is that either spending policy has to be changed, contributions increased or risk tolerance changed.

Rates of return will be calculated based on a time-weighted rate of return formula as recommended by the CFA Institute. Returns will be calculated by the performance consultant and will be reported net of all fees and costs.

The performance of the overall GEP will be measured relative to:

- Inflation
- Policy benchmarks

a. Total GEP return should exceed the Consumer Price Index on a consistent basis over time.
   - This objective is to achieve a positive return above inflation. The GEP's assets are invested with an infinite time horizon, and failure to keep pace with inflation may jeopardize the endowments' intended purposes.

b. Total GEP return should match or exceed the total GEP weighted benchmark return, net of all fees and expenses on a consistent basis over time. See Appendix 1 for the composition and calculation of the GEP policy weighted benchmark.
   - This objective is to match or exceed a passively managed fund with a similar asset mix, net of all fees and expenses. The value added above the policy benchmark measures the effectiveness of the Chief Investment Officer's implementation and management decisions. The policy benchmark should also be adjusted for the costs of passive investing.

Additional metrics with respect to risk are found in the Risk Policy Appendix 2.

5. Asset Class and Manager Guidelines

The general guidelines that apply to all investment managers are:

a. Subject to constraints and restrictions imposed by the manager guidelines, all decisions regarding sector and security selection, portfolio construction, and timing of purchases and sales are delegated to the investment manager.

b. The purchase of securities issued by tobacco companies is prohibited in separately managed accounts. The Regents have defined a tobacco company as "a company which derives its revenues from the manufacture and distribution of tobacco products or, if a diversified company, that no other business line contributes more revenues or earnings than tobacco products." The Chief Investment Officer will determine what constitutes a tobacco company based on standard industry classification of the major index providers (e.g., Russell, MSCI) and communicate this list to investment managers annually and whenever changes occur. The Committee recognizes that the establishment of social investing restrictions limits investment opportunities and should be accompanied by adjusting performance evaluation standards appropriately.

c. The direct purchase of property owned or a security issued by the University, its subsidiaries and affiliates, is prohibited

d. The purchase of non-negotiable securities is prohibited in the equity and fixed income asset classes.

e. The use of derivative securities or contracts to create economic leverage in the portfolio is prohibited. Acceptable and prohibited uses of derivatives are found in the derivatives policy in Appendix 4.

f. Transactions that involve a broker acting as a "principal", where such broker or an affiliate is also the investment manager, who is making the transaction, are prohibited.

g. Transactions shall be executed at the lowest possible total cost, which includes commissions, efficiency of execution, and market impact.

h. Any investment or action with respect to investment not expressly allowed is prohibited, unless presented to and approved prospectively by the Committee. All guidelines must be adhered to; however, if from time to time a manager shall deem an exception to the guidelines appropriate, the Chief Investment

APPENDIX 1
Effective: July 19, 2012
Replaces Version Effective: January 1, 2012

ASSET ALLOCATION, PERFORMANCE BENCHMARKS, AND REBALANCING POLICY

Based on the risk budget for the GEP, the Committee has adopted the following asset allocation policy, including asset class weights and ranges, benchmarks for each asset class, and the benchmark for the total GEP.

Criteria for including an asset class in the strategic policy include:

- Widely recognized and accepted among institutional investors
- Has low correlation with other accepted asset classes
- Has a meaningful performance history
- Involves a unique set of investors

The Current Policy Allocation recognizes the current under-investment in illiquid asset classes (real estate, real assets) and the corresponding need to set rebalancing ranges around this effective policy allocation until such time as long-term policy weights in these classes are achieved. The allowable ranges for each asset class and in total have been chosen to be consistent with budgets and ranges for total and active risk.

A. Strategic Asset Allocation and Ranges

	Current Policy Allocation	Long-Term Target Allocation	Allowable Ranges	
			Minimum	Maximum
U.S. Equity	18.5%	13.5%	13.5	23.5
Developed Non US Equity	16.0	8.0	11.0	21.0
Emerging Mkt Equity	6.0	7.0	4.0	8.0
Global Equity	2.0	0.0	1.0	3.0
US Fixed Income	5.75	5.0	2.75	8.75
High Yield Fixed Income	3.0	2.5	2.0	4.0
Emerging Mkt Fixed Income	3.0	2.5	2.0	4.0
TIPS	4.0	2.5	2.0	6.0
Private Equity	9.0	9.0	6.0	12.0
Absolute Return – Diversified	23.5	23.5	18.5	28.5
Cross Asset Class	2.0	5.0	0.0	7.0
Opportunistic Equity	0.0	10.0	0.0	12.0
Real Assets	1.25	3.0	0.25	2.25
Real Estate	6.0	8.5	3.0	9.0
Liquidity	0.0	0.0	0.0	10.0
TOTAL	100%	100%		

Combined Public Equity	42.5	28.5	32.5	52.5
Combined Fixed Income	15.75	12.5	10.75	20.75
Combined Alternatives*	41.75	59.0	26.75	56.75

* Alternatives category including, but not limited to: Real Estate, Private Equity, Real Assets, and Absolute Return Strategies

B. Asset Class Performance Benchmarks

The Committee has adopted the following performance benchmarks for each asset class. Criteria for selection of a benchmark include:

- Unambiguous: the names and weights of securities comprising the benchmark are clearly delineated
- Investable: the option is to forego active management and simply replicate the benchmark
- Measurable: it is possible to readily calculate the benchmark's return on a reasonably frequent basis
- Appropriate: the benchmark is consistent with The Committee's investment preferences or biases
- Specified in Advance: the benchmark is constructed prior to the start of an evaluation period
- Reflecting Current Investment Opinion: investment professionals in the asset class should

Notes on asset class benchmarks:
1. Global Equity: The Chief Investment Officer will determine what constitutes a tobacco company based on standard industry classificatio

APPENDIX 2

- GEP level
    - o Spending Risk (insufficient assets to meet planned spending)
    - o Measures the risk of inappropriate investment policy and strategy
- Asset class level
    - o Total Investment Risk (volatility of total return)
    - o Measures the risk of ineffective implementation of strategy
- Portfolio level
    - o Active Risk or "Tracking Error" (volatility of deviation from style or benchmark)
    - o Measures the risk of unintended exposures or inadequate diversification

- <u>Spending risk</u>

The Chief Investment Officer shall report on this measure to the Committee annually, in conjunction with endowment financial reviews. However, no objective levels (budget) will be set for this metric due to the separation of responsibility for investment management and spending policy, and the unpredictability of donor contributions. Thus results will be presented for information and use in policy reviews.

- o Metric: Projected year-to-year change in real spending per student, over a long term forecast horizon

- <u>GEP Total Investment risk</u>

The basis for the risk budget at the total asset level is the Policy benchmark, or neutral position. Thus the risk budget starts with the risk of the benchmark index. Assuming an expected benefit from active management, the impact of deviations from the benchmark is added to the benchmark risk to derive the total risk budget. The Chief Investment Officer shall report on this metric to the Committee quarterly.

- o Metric: GEP Total Investment Risk, defined as the annualized standard deviation of the monthly GEP returns, exponentially weighted over the previous 12 months. Benchmark Risk (i.e., the Capital Market risk of the strategic asset allocation) is measured similarly (using returns on the policy benchmark).
- o Budget: GEP Total Investment Risk shall be maintained at a level equal to the square root of the sum of the squares of Benchmark Risk and the Active Risk budget (see below).
- o Range: If GEP Total Investment Risk is greater (less) than 20% above (below) the budgeted level at any quarterly measurement date, the Chief Investment Officer will take appropriate steps to reduce (increase) total GEP risk to its budget level, including but not limited to rebalancing asset class weights within allowable ranges. (For example, if the [illegible]

3. Aggregate active manager risks [Manager value-added risk], including
   - Aggregate portfolio systematic exposures different from the benchmark
   - Aggregate portfolio security selection decisions
   - Aggregate portfolio currency exposures different from the benchmark

The Chief Investment Officer shall report on this metric to the Committee quarterly.

   - Metric: Tracking Error, defined as annualized standard deviation of the difference between monthly GEP returns and monthly policy benchmark returns, exponentially weighted over the previous 12 months
   - Budget: Tracking Error budget shall be 3.0% annual standard deviation. It is understood that this budget may change when there is a change in
     - asset allocation, or
     - risk tolerance
   - Range: If Tracking Error is greater (less) than 1.0% (one percentage point) above the budget level at any quarterly measurement date, the Chief Investment Officer will take appropriate steps to reduce tracking error to its budget level, including but not limited to rebalancing asset class and/or manager weights within allowable ranges.

Both Total Investment Risk and Active Risk for the GEP shall be computed without the impact of Private Equity. For this calculation, it will be assumed that Total Fund performance excludes Private Equity performance and the Total Fund benchmark has no Private Equity component. Private Equity is the asset class defined in Appendix 7K.