Reports from the Endowment Funds Investment Managers

Mr. Sakai explained that the reason for this meeting was to receive performance reports from the various investment managers for the past two quarters ending June 30, 2002. It was also an opportunity to ask the various investment managers about their thoughts on the Board’s current investment policy, particularly in light of current market conditions following September 11th.
Mr. Bittman reported on the performance of Jurika & Voyles, indicating that the portfolio managed by Jurika was currently up by 1.9 percent. He explained that the company is primarily research focused in determining its purchases. Equity investments are in consumers, financials, and industrials while their fixed income is primarily in corporates.

Regent Kurisu asked if the Board policy was too restrictive given today’s market. Mr. Bittman stated that he did not feel that it was, and that to the contrary, the trend among many college and university portfolios is to be more restrictive with a little more latitude in the fixed income sector. As an example, he suggested that one might consider allowing the purchase of B-rated bonds. However, Mr. Bittman stated that in general the Board of Regents’ policy allows for enough flexibility.

Jurika’s performance is -9.2 percent but the benchmark is -10.2 percent. Jurika has done better in difficult times and therefore performing better than some of the other managers. Mr. Bittman stated that he foresees the market recovering in the near future and that the Jurika portfolio is positioned for this upturn. It has, nevertheless, held up well in the bad environment.

Reporting for Brandes, Mr. Leonard explained that foreign investments helped in diversifying one’s portfolio and thus reduces risk. The company tries to identify intrinsic value in selecting their stocks.

Regent Kurisu asked if Brandes takes into consideration foreign accounting systems. Mr. Leonard stated that they do in order to account for the differences between the American and foreign accounting systems. Currently Brandes is -10.9 percent while the benchmark is at -11.5 percent. He explained that this was primarily due to the telecom providers which had significant negative returns.

Regent McElrath asked if politics affect purchasing on the foreign market. Mr. Leonard explained that it does, however, in many cases Brandes adheres to certain guidelines established by the respective institutions.

Reporting for Pacific Century, Mr. Champion provided an overview of the market explaining that in the next twelve months the market will begin to grow. He explained that Pacific has underperformed in the latest quarters at -10.05 percent. Nevertheless, Pacific’s balanced portfolio is positioned for a market recovery and Pacific’s performance should show better results in the next quarters.

Mr. Sakai asked if the Board’s policy range was too restrictive. Mr. Champion stated that they never go to the limits of both ranges, therefore, the policy of thirty to seventy percent was more than enough latitude for investment managers. He suggested that the University consider establishing long term targets to accommodate the payouts.

Reporting for Bishop Street, Mr. Ratte explained that Bishop had underperformed
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dramatically in the last quarters. Performing at -7.85 percent while the benchmark was at -8.44 percent. This was due to Bishop not having enough people in the process and no independent research being conducted. He assured that they have since added 10 professionals and where controls were not in place, it is now a separate role from portfolio managers.

Mr. Sakai asked if the range of thirty to seventy percent was adequate. Mr. Ratte indicated that it was and there would be no need to change the Board’s policy at this time. He added that balanced manager portfolios are a plus due to performance and it is appropriate for the Board to raise a red flag at this time on Bishop Street. He stated that Bishop Street had expected it, felt it was appropriate to give them a warning, and welcomed the challenge of turning things around in the next quarters. He expressed his appreciation for the Board’s patience and promised that with the new team it would be prudent to stick with Bishop Street.

Mr. Sakai introduced guidelines he had drafted for the Committee’s review. He informed that if the Committee were to place Bishop on probation that he already had developed some guidelines to insure that any corrective action be rendered in a systematic and fair manner. In explaining his guidelines, he stated that the performance of the Fund’s investment managers would be monitored on an ongoing basis and investment managers may be placed on probation or terminated. The Regents may place a manager on probation or terminate a manager at any time.

The following probation/termination guidelines were formulated to facilitate the achievement of the fund’s investment objective within the fund’s risk tolerance. There are various factors that should be taken into account when considering probation or termination of a manager. These can be separated into two broad categories – qualitative and quantitative conditions. The former focuses on personnel, or organizational and legal issues while the latter concerns performance. Placing a manager on probation is an intermediate step towards either ameliorating the situation or terminating the manager.

I. Qualitative Conditions

A. Violation of Investment Guidelines
When the investment manager is in violation of the Fund’s investment guidelines, the violations should be reviewed with the manager. Consideration may be given to re-establish appropriate guidelines. The manager will be placed on probation for one year. If further violations occur, the manager will be (may be) terminated.

B. Changes in Ownership
The investment manager must immediately notify the Regents of any
pending changes in ownership. This notification places the investment manager on probation. If the change is expected to have a detrimental effect on performance, the manager will be (may be) terminated.

C. Turnover of Key Personnel
Upon hiring of the investment manager, a list of key personnel will be provided by the manager to the Regents. This will be ordered according to authority. The manager is responsible for updating the list on an as needed basis. If 60% of the key personnel or two of the three top personnel listed have departed from the firm, the manager will be (may be) terminated.

D. Litigation
The investment manager must immediately notify the Regents of any pending litigation. Based on the gravity of the suit the possible impact on the investment process, the manager may be placed on probation or terminated.

II. Quantitative Conditions

A. Specific Performance Tests
While the Regents reserve the right to terminate a manager at any time, the Regents intend to evaluate the manager’s investment performance on a trailing 3 year basis. The specific performance tests to determine whether a manager should be placed on probation or terminated will be based on a comparison of the annualized time-weighted total rate of return of the manager’s total portfolio on a trailing 3 year basis against the following standards:

1. Equity/Balanced Managers
   a. Annualized return no lower than 30% below the return of the Policy Index, gross of fees.
   b. Ranking no lower than the 65th percentile of a universe of peers

2. Fixed Income Managers
   a. Annualized return no lower than 10% below the return of the Policy Index, gross of fees
   b. Ranking no lower than the 65th percentile of a universe of peers

B. If the manager fails both of the applicable performance tests described above, the manager will be (may be) placed on probation for 6 months. For this 6 month period, the manager’s performance is expected to rank at the 50th percentile or better, or be equal or better than the Policy Index. If this
objective is not met, the manager will be (may be) terminated. If this objective is achieved, the manager’s probationary period will be extended for an additional 6 months.

C. After the second 6 month period, the manager’s trailing 12 months performance is expected to rank at the 50th percentile or better, or equal or better the Policy Index.

1. If the 12 month objective is not attained, the manager will be (may be) terminated
2. If the 12 month objective is achieved and the fund’s trailing 3 year performance has been met, probationary status will be removed.
3. If the 12 month objective is achieved, but the fund’s investment objective over 3 years has not been met, the manager’s probationary period will be (may be) extended for an additional 12 months. After this 12 month extension, the fund’s last 24 month performance is expected to rank at the 50th percentile or better, or be equal or better than the Policy Index. If these objectives are met, the probationary status will be removed. If it is not attained, the manager will be (may be) terminated.

D. The manager is allowed only one 12 month probationary period over any 6 year period. Any subsequent failure of the specific performance tests stated in Sector II.A. within a 6 year period after a 1 year probation is considered reason for termination.

E. Four quarters of consecutive underperformance relative to any or all of the above referenced benchmarks will trigger a review with the offending investment managers. All of the qualitative criteria should be reviewed along with an explanation of the underperformance from the manager.

Regent Kurisu thanked Mr. Sakai for his recommendation. It will be considered at a future meeting of the Committee.

There being no further business before the Committee, the meeting was adjourned at 11:30 a.m.

Respectfully submitted,
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David Iha, Secretary

Dated:  September 19, 2002

C: Chairperson Bert A. Kobayashi
Members, Committee on Finance and Facilities
President Evan S. Dobelle
Vice President James R. W. Sloane
Associate Vice President Allan Ah San