MINUTES

BOARD OF REGENTS’ COMMITTEE ON BUDGET AND FINANCE MEETING

JANUARY 8, 2015

I. CALL TO ORDER

Committee Chair Jan Sullivan called the meeting to order at 10:01 a.m. on Thursday, January 8, 2015 at University of Hawai‘i at Mānoa, Information Technology Building, 1st Floor Conference Room 105A, 2420 Correa Road, Honolulu, Hawai‘i 96822.

Committee members in attendance: Committee Chair Jan Sullivan; Committee Vice Chair Barry Mizuno; Regent Coralie Matayoshi; Regent Lee Putnam.

Committee members excused: Regent Peter Hoffmann.

Others in attendance: Chair Randy Moore, Regents Stanford Yuen, Helen Nielsen, and Simeon Acoba (Ex-Officio committee members); President David Lassner; Vice President for Legal Affairs and University General Counsel, Darolyn H. Lendio; Vice President for Research, Vassilis Syrmos; Vice President for Budget & Finance/Chief Financial Officer, Kalbert Young; UH Mānoa Interim Chancellor Robert Bley-Vroman; UH Hilo Chancellor, Don Straney; Executive Administrator and Secretary of the Board of Regents, Cynthia Quinn; and others as noted.

II. APPROVAL OF MINUTES OF DECEMBER 4, 2014 MEETING

Chair Moore moved to approve the minutes of December 4, 2014, Regent Matayoshi seconded the motion, and the motion carried by unanimous approval.

III. PUBLIC COMMENT PERIOD

Executive Administrator and Secretary of the Board of Regents, Cynthia Quinn announced that written testimony from 10 individuals and late written testimony from 2 individuals in support of fossil fuel divestment had been received and distributed to the board, including a supplemental binder of materials from DivestUH, along with 477 emails received from faculty, students, staff, and other constituents encouraging UH/UHF to divest from fossil fuel stocks.

The following persons provided oral testimony in support of fossil fuel divestment:

2. Representative Chris Lee, Chair of the House Committee on Energy & Environmental Protection, testified from a policy perspective for Hawai‘i on what divestment could mean for the state, the cost to taxpayers for adapting to the impact from climate change and the funding taken from other needs, and asked UH to lead the way.
3. Elliot Van Wie, UH alumni, encouraged the university to lead by example on fossil fuel divestment.

4. Michelle Tigchelaar, President of GSO, presented a resolution to cease new investment in fossil fuels in 5 years which was adopted unanimously by the GSO general assembly in December due to climate change threat, irresponsible businesses, the financial viability of fossil fuel companies, and the university’s commitment to sustainability as a global leader and model for integration of sustainability.

5. Javier Mendez, a UH alumni who was working on establishing a UH Mānoa Biology alumni association, encouraged divestment to show leadership for the state, the Pacific, and the world.

6. Dr. John Webster, former public affairs executive at IBM and KPMG, highlighted the testimony of Michael Kramer of Natural Investments and Paul Solli of Aperio Group and recognized the symbolic importance of institutions taking a principled stance on major public policy issues to affect good solutions. He noted that Mr. Kramer was an accredited financial fiduciary who supports divestment, encourages investment social guidelines, and getting rid of fossil fuel companies.

7. Sara Hoerlein presented testimony from Dr. Serene Jones of Union Theological Seminary regarding faith based communities and organizations that are divesting and have found that divestment can still allow an organization to be fiscally responsible and respect the health of the whole.

8. Dr. Joe Mobley, a UH Mānoa professor and researcher in marine mammal behavior, testified about climate change degrading the ocean habitat and presented testimony from Donald P. Gould, a trustee of Pitzer College, that urged UH to divest of fossil fuel stocks as one element of a comprehensive sustainability program, which could be done at no cost and with negligible impact to an investment portfolio.

9. Michelle Garcia, a mother and business owner, testified on how she divested her personal portfolio of fossil fuels companies that are eroding the viability of life and the security of the future despite the current understanding of the consequences. She also presented testimony of Rinaldo Brutoco, Founding President of the World Business Academy, supporting divestment as a way to address global warming.

10. Dr. Mark Hixon, UH Mānoa professor, testified about witnessing first hand human caused climate destruction destroy a tropical ecosystem and read from his article “Garden of ghosts” describing the destruction from global warming due to fossil fuels as a warning.

11. Dr. Dawn Morais Webster, a UH alumna, adjunct faculty member, and businesswoman, recognized Brodie Lockhart, founder of the local chapter of 360.org, for her leadership of this cause. She testified about how fossil fuel companies contribute to global warming and how UH could be a visionary leader by divesting of fossil fuels and inspire others to combat and mitigate climate change.

12. Kristen Jamieson, a UH Mānoa student, testified about climate change being a universal thread in her studies, and urged UH to divest from fossil fuels and practice what is being taught in the classrooms about addressing climate change.

13. Doorae Shin, the Student Sustainability Coordinator of the UH System, testified about Hawai‘i being the most dependent state on fossil fuel imports, the most
vulnerable to climate change, and having the most potential and highest need to become energy independent.

14. Amelia Bierly, a UH Mānoa student, testified on how fossil fuels are dominating environmental destruction and wealth.

15. Duane Preble, UH Mānoa Emeritus Professor, testified about personally getting out of fossil fuels with a water catchment, solar panels, an electric car, and divesting in socially responsible funds. As a trustee, he convinced the Academy of Art to completely overhaul its electrical system, air conditioners and lights at a savings of over $500,000 per year.

16. Leilei Joy Shih, a UH Mānoa graduate student, presented testimony from the Sierra Club in support of divestment and urged UH to follow other universities who have divested.

IV. AGENDA ITEMS

1. Discussion on Climate Change and Investment in Fossil Fuels

Committee Chair Sullivan, on behalf the Budget & Finance Committee, thanked everyone for putting in the time and effort to testify today and for providing all the thoughtful, well-organized materials that were submitted to educate the committee. She provided background on the board policy to give context to the matter before giving her recommendation. In current board policy, the Budget & Finance Committee is responsible to look at matters regarding endowment funds. She noted that Vice President for Budget & Finance/CFO Kalbert Young would explain the background on the board legacy and University of Hawai‘i (UHF) endowments. This committee was charged with recommending to the board approval of how funds are managed and guidelines and performance goals for investments. The current investment policies are specific, and require the board to seek the highest expected total return to ensure long term growth and continued annual payout of not more than 5% of market value. In addition, the policy states the board must follow the Prudent Man Rule, and gives guidelines on investment responsibility which say the primary fiduciary responsibility of the board is to attain adequate financial return, with appropriate risk, but if practices cause social injury the board shall give independent weight on voting proxies. The policy also states that if the board concludes that a company’s activities or policies cause substantial social injury, the board has the option to direct managers to sell in a reasonable time and prudent manner.

In addition to the investment guidelines, the board also adopted a sustainability policy. There are multiple parts to the mission, and after reviewing the mission it was relevant to note that one of the parts called for the university to serve as a leader in how it stewards the resources for the benefit of all. Committee Chair Sullivan felt that divestment was a symbolic measure, and was one of multiple measures the university should be looking at in the context of sustainability. She noted the discussion on sustainability began last year and the mission was amended to incorporate sustainability, and wants to recommend that the university consider taking further steps. In the past, the university has led the state in major public policy issues, and climate change is clearly one of the biggest policy issues facing the world today. However, divestment is not a simple issue because there are investment policies and managers, and the committee needs to evaluate what currently exists and what other universities have done. She suggested the committee recommend the board appoint a task group to evaluate divestment, energy reductions and broader
sustainability policies and practices. The task group would be comprised of representatives from the Budget & Finance Committee, the board, administration, ASUH, GSO and DivestUH in the spirit of shared governance. She had conducted basic research on what other universities had done and UH was far behind and had done very little, considering it was one of the largest consumers of fossil fuels in the state.

Regent Matayoshi agreed with Committee Chair Sullivan and even though divestment was a symbolic gesture, it would speak volumes for the university to adhere to the mission of including sustainability as a priority. She also felt it would be hypocritical not to put metrics to things that the university could do such as recycling bins and solar panels. She added that she was in favor of the inclusivity of the task force.

Regent Putnam noted the complexity of the issue and suggested it might be useful to have separate task groups on divestment and options. Committee Chair Sullivan responded that it was reasonable to agree upon a schedule of priorities for what needs to be addressed.

Regent Nielsen concurred with expanding the goals of the task force beyond divestment and noted that she personally divested of fossil fuel investments years ago and was fully behind that measure and the recommendations.

Regent Yuen noted this issue has bothered him for decades and concurred that something needs to be done. He added that divestment would be a good symbol of support of this effort and suggested that administration brief the board on various energy alternatives to fossil fuels.

Chair Moore concurred with having one task group, and suggested expanding it to look at what the university can be do in addition to divestment. He felt divestment was fairly straight forward, and the committee should seek guidance from UBS, the university’s investment manager on how it could be done. He said that the university’s legacy endowment was fairly small and entirely invested in funds, with no direct investment in fossil fuel companies. He noted there were alternative funds with no fossil fuels investment and it would be a matter of UBS figuring out how to migrate. He indicated that UHF had four to five times the investments, which were significantly more complex and illiquid, but the board could encourage UHF to look into divestment but could not direct them to do so, since UHF is a separate entity with its own fiduciaries who must decide the best course of action. He suggested adding some UHF trustees on the task group. He then explained the limitations of a task group as a permitted action group under the Sunshine Law. Finally, he added that divestment in and of itself does not reduce emissions, it needs to be uneconomic for companies use fossil fuels through public policy changes and behaviors.

Regent Acoba recognized that Chair Moore does not use fossil fuel to travel to meetings and concurred with the recommendation to form a task force because of the board’s fiduciary duty with respect to the financial impact divestment might have and to ensure might have and to ensure there was negligible impact on finances. He added that the challenge would be how UBS would extract the funds that have no relationship to fossil fuels and what would be the feasibility and impact on investments.
Regent Tagorda said she attended today's meeting because of the issue surrounding divestment and sustainability. She commended the students for their due diligence in providing information and evidence surrounding climate change and supported the formation of a task group.

Committee Vice Chair Mizuno noted his entire career was in the alternative energy business, starting with bagasse and then geothermal, so he was an advocate for alternative energy and moving away from fossil fuels. He noted it was a state policy as well and expressed his support of forming a task group.

Committee Vice Chair Mizuno moved that the committee approve a recommendation to the board to appoint a task group to evaluate divestment, energy reductions and broader sustainability policies and practices. Regent Putnam seconded, and the motion carried unanimously.

Committee Chair Sullivan noted the recommendation would go to the full board at the next meeting. Chair Moore indicated that board must vote to set up the task group, appoint the members and set the charge. Between now and the next board meeting the committee would work on identifying the members of the task group.

At 11:11 a.m. the board took a break. The board reconvened at 11:24 a.m.

2. **UBS Quarterly Report on Legacy Endowment Fund**

Representatives of the Kikawa Group (Paul Yamashita, Ron Kikawa, and Karen Yasukawa), the institutional division for UBS, the investment manager for the UH endowment fund, stated that they have other clients from socially responsible organizations that were concerned with the environment and have divestment policies for those accounts in areas such as drugs and defense contractors. They noted that fossil fuel divestment, while a relatively new area, is becoming more prominent. Divestment from fossil fuels would not be difficult and UBS would present information on the cost and timeliness to the newly formed task group.

The committee indicated they would want UBS to provide assurance there would be no downside to divesting from an investment standpoint to ensure the board could fulfill its fiduciary responsibilities. UBS had looked at possible performance effects both at present and going back 5 to 20 years, and only about 6% of portfolio was in the energy-related sector, so the impact of divestment would not be significant. UBS defined “energy-related” sectors utilizing reports from Morningstar, an independent agency, which breaks investment information down by sectors. The financial impact of divesting from a performance perspective, based on studies, depended on the timeframe. Going back to the inception, energy sector funds had outperformed other funds, and applying that to the 6% weighted portfolio, the impact of divestment would be less than $100,000. It was noted that some pro-green companies might be included in the energy-related sector definition, so UBS would need to carefully research to determine the composition of a particular energy sector to identify pro-green companies. There were currently only approximately six new funds that specifically divest fossil fuels. Due to the small size of UH’s account, institutional funds or exchange-traded funds (ETFs) would be needed to bring down total costs.
UBS provided a summary of the quarterly funding report as of September 30, 2014. The managers reported that the markets had mixed performance during the period, but overall the fund had outperformed the benchmark by 8 basis points. As of March 2014, when UBS started managing the portfolio, to present, the fund had outperformed the benchmark by 24 basis points. UBS also reported that the fund was compliant with all investment policies statement guidelines.

Regent Acoba asked what the target was in terms of growth for return, what the return was for the time UBS managed the fund, and what the investment approach for the portfolio was. UBS indicated the target was a combination of a 6% return and the benchmark, the year to date return was approximately 4%. UBS reminded the committee that even though the target was 6%, they are at the mercy of the market and clarified that they have to follow investment guidelines set by the board, which has been especially difficult to reach regarding the fixed income investments. UBS clarified there were board guidelines on investments, currently targeting a 60/40 mix of stocks to bonds. UBS selects a mix of funds. A low cost way is using exchange-traded funds that are inexpensive to implement, and iShares for mutual funds. Currently, UH pays UBS 36 basis points to manage all the funds, which is pretty low by industry standards. Over the last 5 years when the market was strong, statistics show that 75% to 80% of average active managers had not beaten benchmark indexes. However, UBS utilized low cost indexes and have been able to meet or exceed the benchmark index, but the indexes still need to perform to reach the 6% target. The international index was down this year, which does not help returns, even for equity investments. The fixed investments was also down due to the strong dollar; so the international bonds decreased and currency losses exceeded any coupon yields. It was a tough year to get a 6% return, unless invested primarily in U.S. stocks, and the portfolio was heavier in equity than fixed income.

Regent Yuen asked what strategy and risk was used to offset market drops. UBS responded that they do not use any leverage in the portfolio; the ETFs mimic the underlying index, and in terms of the mix between international and the U.S., they try to keep international down on the fixed side. High yields have beat the traditional aggregate index in the past, and have cut back on high yield exposure because it had started to deteriorate. UBS was making changes within the portfolio when they see where performance can be enhanced versus what is not performing.


VP Young recognized Director of Financial Management & Controller Susan Lin and her team for the effort they put into the presentation, which gave a high level overview of the fund, spending guidelines, spending distribution process, examples of restricted and unrestricted funding sources, and an update on use of the funds. The total endowment equals $330 million, as of June 30, 2014. The majority of the funds, slightly over $264 million, are managed by UHF, and the remaining $66 million is in the legacy endowment. He gave a historical account of fund sources and indicated that UBS was the current fund manager. The president determines the percentage distribution for the year, which per policy shall not exceed 5% based on a 5-year moving average of market value of portfolio at the time spent. Of all funds in legacy endowment, there were two types of distribution based on whether the contributions were unrestricted or donor restricted.
Regent Matayoshi reiterated her concern about the amount of total scholarships and how scholarships fit into the overall budget. President Lassner explained that a deep dive on financial aid is being planned.

Regent Putnam referred to the spending guidelines and asked about the source and use of the $50,000 per year for president’s projects. President Lassner responded that he only recently became aware of this fund so the principal had built up because nothing was being spent. He added that the fund was set by board policy.

Regent Nielsen noted the annual 5% payout rate was based loosely on protecting the corpus, and based on how investments have been going was there a need to adjust the payout. VP Young responded that performance depended on the period of time, within the last 5 years performance exceeded payout. He was unsure on the origin of the 5% payout limit, but the board’s decisions have always been less than 5%, and the corpus grown over that same period of time. President Lassner clarified that the Chief Financial Officer actually generates a recommendation to the president and final decision is usually set at below 5% to protect the corpus.

Committee Chair Sullivan indicated the investment policy was evaluated and revised last year and was something the newly formed task group would be looking at.

4. Discussion on Research Indirect Cost Rates

Committee Vice Chair Sullivan said this item was on the agenda because it is part of the Hawai‘i Innovation Initiative (HII), which had the stated goal of creating more high quality jobs and diversifying the economy by leading the development of a $1 billion innovation research, education, and training enterprise. Indirect cost recovery was an important part of reaching this goal otherwise research would be need to be subsidized with nonresearch funds, which would impact the overall budget.

VP Syrmos noted that monies collected through the indirect cost rate (aka F&A rate) go into the research training revolving fund (RTRF). He reviewed the purpose of the F&A rate and the formula used to determine the rate (denominator is research expenditures for base year being negotiated, and numerator is research investments of UH for administration of extramurally funded research projects). It is important to not leave money on the table and to make sure money is utilized correctly for the research being conducted. He indicated that not all research is extramurally funded, but indirect cost recovery can only occur if UH invests back into research that is extramurally funded. Over the past 20 years, the F&A rate at UH was between 35% and 40%, and during that same time research expenditures have almost doubled, which is bad if investments are not being made back into extramurally funded projects. He said Mānoa’s F&A rate is fairly low compared to peer institutions, which means faculty have performed well even with average facilities and conditions.

Committee Vice Chair Sullivan noted that time was running short and said she would like to defer this item to the next Budget & Finance Committee meeting.
V. ADJOURNMENT

There being no further business, upon motion by Regent Matayoshi, seconded by Committee Vice Chair Mizuno, and with unanimous approval, the meeting was adjourned at 12:09 p.m.

Respectfully Submitted,

/S/

Cynthia Quinn
Executive Administrator and
Secretary of the Board of Regents