

Minutes are intended to note (a) the date, time and place of the meeting; (b) those members of the public body who were present and those who were absent; and (c) the substance of all matters proposed, discussed and/or action was taken on. Minutes are not intended to be a verbatim report of a meeting. An audiotape recording of the meeting is available for inspection by any member of the public interested in a verbatim report of the meeting. These minutes are not final until approved by the Board of Regents at the March 2016, meeting.

**BOARD OF REGENTS* and its
INVESTMENT AND FACILITIES COMMITTEE
NEVADA SYSTEM OF HIGHER EDUCATION**
System Administration, Las Vegas
4300 South Maryland Parkway, Board Room
Friday, October 23, 2015

Members Present: Mr. Kevin C. Melcher, Chair
 Mr. Robert M. Davidson, Vice Chair
 Mr. Cedric Crear
 Dr. Jason Geddes
 Mr. Trevor Hayes
 Ms. Allison Stephens *{via telephone}*

Other Regents Present: Mr. Sam Lieberman

Others Present: Ms. Brooke Nielsen, Vice Chancellor for Legal Affairs
 Mr. Vic Redding, Vice Chancellor, Business and Finance
 Mr. Jamie Hullman, Director of Finance, NSHE
 Mr. R. Scott Young, Acting Chief of Staff to the Board of Regents
 Dr. Marc A. Johnson, President, UNR
 Mr. Chester Burton, President, WNC
 Mr. Russell Campbell, Your Second Opinion, LLC

For others present, please see the attendance roster on file in the Board office.

Chair Kevin C. Melcher called the meeting to order at 12:46 p.m. with all members present.

1. Information Only-Public Comment – None
2. Information-NSHE Investment Pool-Outsourced Chief Investment Officer Model – After discussion regarding the NSHE Investment Pool Outsourced Chief Investment Officer model, the Committee directed System staff to proceed processing a Request for Proposal (RFP) to bring to the December 2015 meeting (*Ref. IF-2 on file in the Board office*).

Chair Kevin C. Melcher asked the Vice Chancellor of Business and Finance, Vic Redding, to give an overview and explain the Outsourced Chief Investment Officer (OCIO) model.

2. Information-NSHE Investment Pool-Outsourced Chief Investment Officer Model –
(continued)

Vice Chancellor Redding stated the Investment and Facilities Committee is unique, given the Regents' role and charge. He said there are routinely action items on the operation and management of the Operating Pool and the Endowment which are specialized and different from most other Regents' committee activity. Life was simpler when the Committee was formed in the 1980's – the Endowment was one-tenth of what it is today – today there is money in over 30 managers with complex investment vehicles. Vice Chancellor Redding stated the current model is not broken or otherwise not functional. He said, even during the recession, the Endowment was able to maintain spending for all but a few of the accounts that were underwater.

Vice Chancellor Redding explained the Committee time lines and agendas do not move at the same real time pace of the investment world, which prompted looking into a different model. The short version is the Committee makes all the operational decisions for the management part of investible funds in addition to all the policy and governance work, which causes some issues because of built-in constraints of what can be done. He, Chair Melcher and Regent Wixom spent time over the past year talking to industry experts to see if there might be a better way of managing funds. Vice Chancellor Redding said Your Second Opinion LLC was selected through a competitive process to facilitate a discussion to help navigate the process, understand what the model may or not have, and if the Committee chooses, to help craft the RFP and evaluate respondents for an OCIO. He stated Mr. Russell Campbell from Your Second Opinion, LLC, will explain the functional differences between the advisory model the System now has, and an outsourced or discretionary model.

Mr. Campbell said he tries to take an even-handed look at appointing an OCIO and felt there is the matter of balance and possibilities. He referred to the reference material use as a guide. Mr. Campbell said the first part will speak of investment models in general, specifically focusing on the governance aspect. The second part gets into the meat of what an OCIO is, what the various types are, and what it means to delegate to a third party.

Mr. Campbell stated the Board of Regents and the Committee have delegated certain investment activities to others. For example, investment managers select individual securities. These investment managers remain accountable for their actions to the NSHE Board of Regents. However, not all investment activities are delegated. The Board does not delegate critical functions such as asset allocation and money manager selection and, from a governance perspective, delegating these responsibilities could be considered best practice.

Mr. Campbell continued a dedicated OCIO would have the time, resources and expertise to manage, not just oversee, the most critical investment tasks. The challenge is that the cost of hiring a qualified internal Chief Investment Officer and needed staff is high. Many Endowments, and the owners of similar asset pools, have chosen to outsource critical investment responsibilities, instead of adding to their own staff.

2. Information-NSHE Investment Pool-Outsourced Chief Investment Officer Model –
(continued)

Mr. Campbell pointed out not all responsibilities can, or should, be delegated to an OCIO. Developing an investment policy, vetting and monitoring staff and service providers are examples of responsibilities that cannot be delegated. He stated an OCIO is not for everyone – but, an OCIO offers a solution that is perceived as effective by many other funds similar to NSHE. Before considering any changes to an investment model it is important to review the effectiveness of the existing approach. It is evident that NSHE has had policies and procedures in place that have helped the Endowment and Operating Pools to achieve their goals.

Mr. Campbell said NSHE is responsible for overseeing a large Endowment Pool and a large Operating Pool. The staff supporting this effort is small, and has multiple responsibilities. There has been turnover in staff over the years, which means that institutional and investment knowledge is lost each time someone leaves. Similarly, the Committee has a broad mandate and limited time. The investment consulting firm that is retained by NSHE is a linchpin offering both continuity and expertise but their missing role is accountability. All of the major responsibilities rest directly and solely with the Committee.

Vice Chancellor Redding would like to discuss what would be policy and governance versus operational and transactional functions of the Committee. Mr. Campbell said the Committee can make the decision of what responsibilities it would want to retain and what to delegate. For instance, the Committee could say “manager selection will be delegated to a third party, but the Committee wants to be informed of changes,” or “why changes are needed,” or “tell us once a year after the changes have been made.”

Mr. Campbell re-emphasized nothing is broken. Before considering any changes to an investment model, it is helpful to review the results of the existing approach. The System has policies and procedures in place that have helped the Endowment and Operating Pools to achieve their goals. Investment performance has been excellent since inception in comparison to both the policy benchmark and the performance of other Endowments.

Mr. Campbell said McKinsey and Company in 2014 examined the performance of 40 of the world’s largest institutional investors from 2004 to 2011. The group was split into overachievers and underachievers. The investment performance of the two groups was similar, but the overachievers were able to earn their returns with half of the volatility of the underachievers. Mr. Campbell stated the overachievers focused on the governance of four principles: clear accountability, Board competence, efficient decision-making, and effective fiduciary control. He felt lower volatility is important for the NSHE Endowment and Operating Pools as it ensures stability for the spending rate.

Mr. Campbell believed asset allocation and manager selection are two of the most critical positions in an investment portfolio. Asset allocation has been determined strategic with 77% equities and 23% bonds. He pointed out every consultant and every investment model in the world creates an expectation for future returns, gets plugged into

2. Information-NSHE Investment Pool-Outsourced Chief Investment Officer Model –
(continued)

the model then spits out what the Asset Allocation should be. These computer models are built on three main inputs: 1) expected return from an asset class; 2) expected volatility for each asset class; and 3) interaction between asset classes. He reminded the Committee that the number is fairly precise, but it may not be the perfect number because reality may intervene in the future. Mr. Campbell said other factors that may take place are potential dramatic changes like a major decline in the stock market or a major increase in the interest rates – which might be an opportunity as well as a risk – to possibly take advantage of. He noted it is important to have the procedures in the process and the ability to make those decisions. Mr. Campbell indicated on the manager's side there is overlap and the overlaps will change. At times the managers will move in synchronization and sometimes not. The message is – making predictions is complicated.

Chair Melcher noted the Board is elected and there is the Open Meeting Law. The Board is continually changing with no guarantee of having investment people or there could be a multitude of investment people. Additionally, the Investment and Facilities Committee could change every year. The consistency of people and ability to act concerns Chair Melcher. Mr. Campbell believed it was important to supplement those variables by having expertise in the background – expertise that is accountable.

Regent Crear understood there would be a delegate to handle the day-to-day investment portfolio to monitor and have the autonomy to make adjustments as they see fit. He was not sure if a delegate would attend meetings to either update or seek approval from the Committee. He asked about the additional layer of having Cambridge Associates. Chair Melcher said the contract with Cambridge is ending in September 2016. A bid will go out for an OCIO at the appropriate time. The Committee will decide the criteria of when changes occur and when notifications go to Vice Chancellor Redding's office. He said Vice Chancellor Redding has a list of 10 possible areas of what amount of authority will be given to an OCIO, and what the Committee itself will retain to make determinations on. Vice Chair Davidson agreed about not layering consultants. Chair Melcher explained this process would replace what Cambridge is doing now with more responsibility.

Mr. Campbell explained the benefit of having an external advisor or even an internal chief investment officer is the person who would be responsible for 93 percent of the returns or for the problem. He said a clear accountability framework, not spending time worrying, timely decision making and effective fiduciary control are all benefits. Additionally, the System will have documentation, model presentations and results, allowing the Committee to spend time on other issues.

2. Information-NSHE Investment Pool-Outsourced Chief Investment Officer Model –
(continued)

Mr. Campbell stated reasons to take this step now is rising investment implementation complexity – investment products and services, investment vehicles, tactical options; volatile markets present both risk and extraordinary opportunities; increasing attention by fiduciaries to importance of good governance. He said the Board delegates many tasks already - but not the most critical and complex ones ((short-term) Asset Allocation, manager selection) that require tremendous resources, expertise and dedication.

Mr. Campbell pointed out there is headline risk – any one investment may appear, or even actually be risky, yet in a portfolio, it may lower overall risk through diversification. One high profile bad investment may present a challenge for the Board/Committee – which is currently solely accountable. Enhancing the governance framework can help to ensure that investment results continue to be good. Decisions like these should be made when conditions are calm – not under duress.

Vice Chair Davidson is in favor with the movement toward an OCIO, but it needs to be done with thought. He would like to see some recommendations of what responsibilities the Committee would retain, what would be delegated, and the terms of such delegation. Vice Chair Davidson is interested in fee structures and potential conflicts of interest. He felt there may be too many managers now but he does not have the specifics. He questioned if index funds would be retained because of the low fees and at times it is difficult for professional managers to beat index funds. He said other managed equities could be built around the index fund to get the asset diversification and allocation desired. He explained it is only a potential suggestion, but this is an example of what should be explored moving forward, particularly when considering which responsibilities should be retained by the System and how to work with an OCIO in a comfortable manner. Vice Chair Davidson believed it was necessary to take a very hard look at an OCIO. The Board is elected and it cannot be assumed the Committee is expert in investments or if it will be efficient or even practical to hire the kind of internal staff necessary to have the expertise found in a typical OCIO. Chair Melcher thought Vice Chair Davidson was on the mark and agreed these are all the factors the Committee will discuss.

Mr. Campbell said there are over 100 vendors of OCIO services. Current or former investment consulting firms such as the investment consulting firm retained by NSHE, often provide OCIO services. There are some similarities, but also some significant differences between retaining an investment consultant versus delegating to an OCIO as that and other information is outlined in the reference material.

Chair Melcher would like to have the opinions of Vice Chancellor Redding and Mr. Jamie Hullman, Director of Finance. Vice Chancellor Redding felt the System was not a small or large fund, but somewhere in between. He thought looking at it from that perspective would be a help to the efficiency of the operation. He did not believe the Finance Department has a fully functional internal chief investment officer and an OCIO would help. Mr. Hullman agreed the department would benefit from an OCIO,

2. Information-NSHE Investment Pool-Outsourced Chief Investment Officer Model –
(continued)

especially in the due diligence area for the auditors. The OCIO would trade funds at will within the NSHE policy and have responsibility for completing subscription documents and liability that would result from those documents. He added having an OCIO would halt some work being duplicated in the finance area. Vice Chancellor Redding thought by having an OCIO there would be more efficiency with internal staff and Committee time. He believed the Committee would have more time to review policy and governance issues.

Regent Geddes felt the Committee has been discussing hiring an OCIO for a while and believed the Committee was on-board to commit. He would like to discuss what to pass on to the OCIO and what to keep in-house. Vice Chancellor Redding wondered, given the size of the Endowment and the size of investible funds in the Operating Pool, if the NSHE was large enough to get OCIO attention. Mr. Campbell stated OCIO's cover all sizes and all levels of complexity. Vice Chair Davidson thought the NSHE was more than large enough to get the attention of OCIO's. He felt the issue was what to keep in-house, what to outsource, and how to work with an OCIO. He suggested developing a process to be brought to the Committee in order to determine a comfort level and then put it out to bid. Vice Chair Davidson thought a basic decision is for the System to take responsibility for asset allocation. He also suggested the System might maintain a certain portion of the equity investment in Index Funds in order to pay substantially lower fees and have flexibility of liquidity and then give the rest out. Mr. Campbell said these governance decisions are very important and to have a fixed idea in advance of what will go to an OCIO because it will affect the RFP.

Vice Chancellor Redding said Cambridge's advice to support the spending rate was for a more active portfolio, but the spending rate was lowered. Vice Chancellor Redding believed asset allocation and the spending rate decisions should always be retained by the Committee. He felt the transactional functions would be all that would be considered outsourcing – like rebalancing, manager selection, evaluation and monitoring. Vice Chancellor Redding will ask Cambridge to look at a discussion on the passive and active roles of the portfolio if the Committee wishes.

Vice Chair Davidson did not think the Committee wanted to pick stocks – an Equity Index Fund is a different kind of animal. Vice Chancellor Redding said the System is fee sensitive. Regent Melcher wondered if indexing would be contracted out to an advisor or handled internally. Vice Chancellor Redding saw this as a dilemma to be discussed because there are no internal resources. Chair Melcher said there might be savings on fees but was not sure about overhead. Vice Chair Davidson thought indexing would be part of the advisory role as opposed to the day-to-day management of an individual investment manager's role. Mr. Campbell felt there would be enough vendors who could oversee the index even if they did not handle it themselves because there is a lot of flexibility and customization in the industry. Chair Melcher said another consideration in developing the RFP would be how many investments will be allocated to the index. Mr. Campbell thought attention should be given to fees, conflicts of interest, proprietary

2. Information-NSHE Investment Pool-Outsourced Chief Investment Officer Model –
(continued)

funds used by OCIO's and how they work, other sources of compensation and revenues, and basis point performance fees. Vice Chair Davidson has had experience with the performance fees and felt the fees are appropriate at times. He is somewhat concerned about the conflict of interest when the OCIO selects managers.

Mr. Campbell suggested thought be given to underlying pool funds with a number of investors because it could be difficult getting money out while a segregated account allows instant liquidation. Vice Chair Davidson recommended a guideline for underlying pool funds with the OCIO – there are plusses and minuses to the pool.

Regent Geddes asked about the distressed asset fund being passed to the OCIO. Vice Chancellor Redding said there are no particular managers to direct the OCIO to retain so the distressed asset fund would be included. Vice Chair Davidson said direction may be given to the OCIO on how to make transitions and over what time period. Mr. Campbell added there may be some funds that cannot be transitioned – the OCIO's are accustomed to this and do not charge a full fee, or may not charge a fee at all, because those funds were not chosen by them.

Chair Melcher thought the Committee had a good idea of what funds the System will retain and what funds would be passed to the OCIO. He instructed staff to draft an RFP for the next meeting. He suggested if any Committee member thinks of anything else to add to the RFP to contact Vice Chancellor Redding. Vice Chancellor Redding felt the information could be ready for presentation at the December 2015 meeting.

Mr. Campbell reported most people are generally happy with the OCIO process and reminded the Committee their decision is not forever and can always be changed.

3. New Business – None.

4. Public Comment – None.

The meeting adjourned at 2:14 p.m.

Prepared by: Nancy Stone
Special Assistant & Coordinator
to the Board of Regents

Submitted for approval by: Dean J. Gould
Chief of Staff and Special Counsel
to the Board of Regents