THE UNIVERSITY OF TEXAS SYSTEM
INTERMEDIATE TERM FUND
INVESTMENT POLICY STATEMENT

Purpose and Structure

The University of Texas System Intermediate Term Fund (ITF) was established by the Board of Regents of The University of Texas System (Board of Regents) as a pooled fund for the collective investment of operating funds and other intermediate and long-term funds held by U. T. System institutions and U. T. System Administration.

ITF Organization

The ITF functions as a mutual fund in which each eligible account purchases and redeems ITF units as provided herein. The ownership of ITF assets shall at all times be vested in the Board of Regents. Such assets shall be deemed to be held by the Board of Regents, as a fiduciary, regardless of the name in which the assets may be registered.

ITF Management

Article VII, Section 11b of the Texas Constitution authorizes the Board of Regents, subject to procedures and restrictions it establishes, to invest the Permanent University Fund (the “PUF”) in any kind of investment and in amounts it considers appropriate, provided that it adheres to the prudent investor standard. This standard provides that the Board of Regents, in making investments, may acquire, exchange, sell, supervise, manage, or retain, through procedures and subject to restrictions it establishes and in amounts it considers appropriate, any kind of investment that prudent investors, exercising reasonable care, skill, and caution, would acquire or retain in light of the purposes, terms, distribution requirements, and other circumstances of the fund then prevailing, taking into consideration the investment of all the assets of the fund rather than a single investment. Pursuant to Section 51.0031(c) of the Texas Education Code, the Board of Regents has elected the PUF prudent investor standard to govern its management of the ITF.

Ultimate fiduciary responsibility for the ITF rests with the Board of Regents. Section 66.08, Texas Education Code, as amended, authorizes the Board of Regents, subject to certain conditions, to enter into a contract with a nonprofit corporation to invest funds under the control and management of the Board of Regents.

Pursuant to an Investment Management Services Agreement between the Board of Regents and The University of Texas Investment Management Company (UTIMCO), the ITF shall be managed by UTIMCO, which shall a) recommend investment policy for the ITF, b) recommend specific asset allocation targets, ranges, and performance benchmarks consistent with ITF objectives, and c) monitor ITF performance against ITF objectives. UTIMCO shall invest the ITF assets in conformity with this Policy Statement. All changes to this Policy Statement or the exhibits to this Policy Statement, including
changes to asset allocation targets, ranges and performance benchmarks, are subject to approval by the Board of Regents.

UTIMCO may select and terminate unaffiliated investment managers subject to the Delegation of Authority Policy approved by the UTIMCO Board. Managers shall be monitored for performance and adherence to investment disciplines.

**ITF Administration**

UTIMCO shall employ an administrative staff to ensure that all transaction and accounting records are complete and prepared on a timely basis. Internal controls shall be emphasized so as to provide for responsible separation of duties and adequacy of an audit trail. Custody of ITF assets shall comply with applicable law and be structured so as to provide essential safekeeping and trading efficiency.

**Funds Eligible to Purchase ITF Units**

No account shall be eligible to purchase units of the ITF unless it is under the sole control, with full discretion as to investments, by the Board of Regents. Any account whose governing instrument contains provisions which conflict with this Policy Statement, whether initially or as a result of amendments to either document, shall not be eligible to purchase or hold units of the ITF.

**ITF Investment Objectives**

The ITF consists of intermediate and long-term funds held by the U. T. System Board of Regents, as a fiduciary, for the benefit of U. T. System institutions, U. T. System Administration, and other affiliated funds. ITF assets are pooled for efficient investment purposes and managed by UTIMCO over the intermediate to longer term.

The primary investment objective of the ITF is to preserve the purchasing power of ITF assets by earning a compound annualized return over rolling three-year periods, net of all direct and allocated expenses, of at least inflation as measured by the Consumer Price Index (CPI-U) plus 3%. The ITF’s success in meeting this objective depends upon its ability to generate higher returns in periods of low inflation that will offset lower returns generated in years when the capital markets under-perform the rate of inflation.

The secondary ITF objective is to generate a return, net of all direct and allocated expenses, measured monthly by the independent custodian and reported at least quarterly, in excess of the approved Policy Portfolio benchmark over rolling three-year periods. The Policy Portfolio benchmark will be maintained by UTIMCO and will be comprised of a blend of asset class indices reported by the independent custodian and weighted to reflect ITF’s approved asset allocation policy targets as defined in Exhibit A.

Limiting factors are that prudent diversification within each approved asset class and that a projected portfolio risk profile within the approved Policy Portfolio risk range, as
defined in Exhibit A and measured at least monthly by UTIMCO’s risk model, should be sustained at all times. Liquidity of the ITF will be governed by the Liquidity Policy, overseen by the Risk Committee of the UTIMCO Board.

ITF return, asset allocation, and risk targets are subject to adjustment from time to time by the U. T. System Board of Regents.

**Asset Allocation and Policy**

Asset allocation is the primary determinant of the volatility of investment return and, subject to the asset allocation ranges specified in Exhibit A, is the responsibility of UTIMCO. The asset allocation is designed to accommodate the intermediate investment horizon of the ITF assets with enhanced returns at moderate managed risk levels. UTIMCO is responsible for measuring actual asset allocation at least monthly (incorporating the impact of derivative positions covered under the Derivative Investment Policy), and for reporting the actual portfolio asset allocation to the UTIMCO Board and the Board of Regents at least quarterly. While specific asset allocation positions may be changed within the ranges specified in Exhibit A based on the economic and investment outlook from time to time, the range limits cannot be intentionally breached without prior approval of the Board of Regents.

In the event that actual portfolio positions in asset categories or projected portfolio risk move outside the ranges indicated in Exhibit A due to market forces that shift relative valuations, UTIMCO staff will immediately report this situation to the UTIMCO Board Chairman and take steps to rebalance portfolio positions back within the policy ranges in an orderly manner as soon as practicable. Extenuating circumstances that could cause immediate rebalancing to be irrational and detrimental to the interest of the ITF asset values could warrant requesting approval of the UTIMCO Board Chairman for remedial action.

ITF assets shall be allocated among the following broad asset classes based upon their individual return/risk characteristics and relationships to other asset classes:

A. **U.S. Equities** – U.S. equities represent ownership in U.S. companies that are traded in public markets. U.S. equities include common stocks, exchange traded funds, and derivatives based on common stocks, including warrants, rights, options, and futures. In addition, derivative applications that serve as a U.S. equity substitute will be classified as traditional U.S. equity. Global mandates that include a majority of U.S. equities will be included in U.S. equities. U.S. equities provide both current income and capital gains.

B. **Global ex U.S. Equities** – Global ex U.S. equities represent ownership in global companies that are traded in public markets. The global ex U.S. markets include established (non-U.S. developed) and emerging markets.
Global ex U.S. equities include common stocks, exchange traded funds, and derivatives based on common stocks, including warrants, rights, options, and futures. In addition, derivative applications that serve as a Global ex U.S. equity substitute will be classified as Global ex U.S. equities. Global mandates that include a majority of Global ex U.S. equities will be included in Global ex U.S. equities. Global ex U.S. equities provide both current income and capital gains.

Non-U.S. Developed Equity – Non-U.S. developed equities represent ownership in companies domiciled in developed economies (countries) included in the MSCI All – Country World Equity Index – excluding those classified as part of the MSCI Emerging Markets Equity Index. These securities are typically constituents of countries in Europe, the Americas (North/Latin/South) and the Far East with high per-capita income, mature capital markets, and stable governments. The benchmark for this asset category will be the MSCI EAFE Index, with net dividends.

Emerging Markets Equity – Emerging markets equities represent ownership in companies domiciled in emerging economies as defined by the current composition of the MSCI Emerging Markets Equity Index. In addition, such definition will also include those companies domiciled in economies that have yet to reach MSCI Emerging Markets Equity Index qualification status (either through financial or qualitative measures). The benchmark for this asset category will be the MSCI Emerging Markets Equity Index, with net dividends.

C. Hedge Funds – Hedge funds are broadly defined to include nontraditional investment strategies whereby the majority of the underlying securities are traded on public exchanges or are otherwise readily marketable.

Directional Hedge Funds – Directional hedge fund investments include U.S. and international long/short equity or fixed income strategies and other such strategies that exhibit directional market characteristics using commodities, currencies, derivatives, or other global market instruments. These strategies attempt to exploit profits from security selection skills by taking long and short positions in various securities. These strategies may also include fund of hedge fund investments. Directional hedge fund investments are made through private placement agreements. Directional hedge fund investments may be held in an internal commingled investment fund managed by UTIMCO.

Absolute Return Hedge Funds – Absolute return hedge fund investments include arbitrage, event driven strategies, and other relative value strategies. Arbitrage strategies attempt to exploit pricing discrepancies between closely related securities, utilizing a variety of different tactics primarily within equity, fixed income, and convertible securities markets. Event driven strategies attempt to exploit discrete events such as bankruptcies, mergers, and takeovers. Absolute return hedge funds may include multi-strategy managers and fund of hedge fund investments. Absolute return hedge fund investments are made through private
placement agreements. Absolute return hedge fund investments may be held in an internal commingled investment fund managed by UTIMCO.

D. **Inflation Linked** – Inflation linked investments are intended to provide some degree of inflation protection and generally consist of assets with a higher correlation of returns with inflation than other eligible asset classes. Inflation linked investments include:

- **REITS** – REITS are real estate investment trusts that may be held as either trust certificates, derivative investments, or exchange traded funds. REITS own, and in most cases operate, income producing real estate.

- **Commodities** – Commodities include natural resource investments including oil and gas interests and other hard assets. These investments may be held through partnerships, derivative investments, exchange traded funds or direct investments.

- **TIPS** - TIPS are inflation protected securities with a return linked to the inflation rate. For diversification purposes, TIPS may include non-U.S. inflation protected fixed income securities as well as nominal fixed income securities.

E. **Fixed Income** – Fixed income investments include debt (whether U.S. or foreign) issued by Governments, various government enterprises and agencies, and domestic and foreign corporations. The principal securities include bonds, notes, bills and mortgage and asset-backed securities. In addition, derivative applications that serve as a fixed income substitute may be classified as fixed income.

F. **Cash and Cash Equivalents** – Short-term (generally securities with time to maturity of three months or less), highly liquid investments that are readily convertible to known amounts of cash, and which are subject to a relatively small risk of changes in value.

**Performance Measurement**

The investment performance of the ITF will be measured by the ITF’s custodian, an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, compared against the stated investment benchmarks of the ITF, as indicated in Exhibit A (incorporating the impact of internal derivative positions) and reported to the UTIMCO Board and the Board of Regents at least quarterly. Monthly performance data and net asset values will be available on the UTIMCO website within a reasonable time after each month end.
Investment Guidelines

The ITF must be invested at all times in strict compliance with applicable law. Investment guidelines include the following:

General

- Investment guidelines for index, commingled funds, and limited partnerships managed externally shall be governed by the terms and conditions of the respective investment management contracts or partnership agreements.
- All investments will be U.S. dollar denominated assets unless held by an internal or external portfolio manager with the authority to invest in foreign currency denominated securities.
- Investment policies of any unaffiliated liquid investment fund must be reviewed and approved by UTIMCO’s chief investment officer prior to investment of ITF assets in such liquid investment fund.
- No securities may be purchased or held which would jeopardize the ITF’s tax-exempt status.
- No internal investment strategy or program may purchase securities on margin or use leverage unless specifically authorized by the UTIMCO Board.
- No internal investment strategy or program employing short sales may be made unless specifically authorized by the UTIMCO Board.
- The ITF’s investments in warrants shall not exceed more than 5% of the ITF’s net assets or 2% with respect to warrants not listed on the New York or American Stock Exchanges.
- The ITF may utilize derivatives to: a) simulate the purchase or sale of an underlying market index while retaining a collateral balance for fund management purposes; b) facilitate trading; c) reduce transaction costs; d) seek higher investment returns when a derivative security is priced more attractively than the underlying security; e) hedge risks associated with ITF investments; or f) adjust the market exposure of the asset allocation, including the use of long and short strategies and other such strategies, provided that the ITF’s use of derivatives complies with the Derivative Investment Policy approved by the UTIMCO Board and the Board of Regents. The Derivative Investment Policy shall serve the purpose of defining permitted applications under which derivatives can be used, which applications are prohibited, and the requirements for the reporting and oversight of their use. Derivative applications implemented in compliance with the Derivative Investment Policy shall be deemed to be specifically authorized by the UTIMCO Board for purposes of this Policy Statement. The objective of the Derivative Investment Policy is to facilitate risk management and provide efficiency in the implementation of the investment strategies using derivatives.
Cash and Cash Equivalents

Holdings of cash and cash equivalents may include the following:

- Highly liquid internal pooled investment funds managed by UTIMCO.
- Unaffiliated liquid investment funds as approved by UTIMCO’s chief investment officer.
- ITF’s custodian late deposit interest bearing liquid investment fund.
- Municipal short-term securities.
- Commercial paper rated in the two highest quality classes by Moody’s Investors Service, Inc. (P1 or P2) or Standard & Poor’s Corporation (A1 or A2).
- Negotiable certificates of deposit with a bank that is associated with a holding company meeting the commercial paper rating criteria specified above or that has a certificate of deposit rating of 1 or better by Duff & Phelps.
- Repurchase agreements and reverse repurchase agreements transacted with a dealer that is approved by UTIMCO and selected by the Federal Reserve Bank as a Primary Dealer in U.S. Treasury securities and rated A-1 or P-1 or the equivalent.
  - Each approved counterparty shall execute the Standard Public Securities Association (PSA) Master Repurchase Agreement with UTIMCO.
  - Eligible collateral securities for repurchase agreements are limited to U.S. Treasury securities and U.S. Government Agency securities with a maturity of not more than 10 years.
  - The maturity for a repurchase agreement may be from one day to two weeks.
  - The value of all collateral shall be maintained at 102% of the notional value of the repurchase agreement, valued daily.
  - All collateral shall be delivered to the ITF custodian bank. Tri-party collateral arrangements are not permitted.
  - The aggregate amount of repurchase agreements with maturities greater than seven calendar days may not exceed 10% of the ITF’s fixed income assets.
  - Overnight repurchase agreements may not exceed 25% of the ITF’s fixed income assets.
- Mortgage Backed Securities (MBS) dollar rolls shall be executed as matched book transactions in the same manner as reverse repurchase agreements above. As above, the rules for trading MBS dollar rolls shall follow the Public Securities Association standard industry terms.
Fixed Income

Domestic Fixed Income

Permissible securities for investment include the securities within the component categories of the Lehman Brothers Aggregate Bond Index (LBAGG). These component categories include investment grade government and corporate securities, agency mortgage pass-through securities, and asset-backed securities. These sectors are divided into more specific sub-sectors:

1) Government securities: Treasury and Agency;
2) Corporate securities: Industrial, Finance, Utility, and Yankee;
3) Mortgage-backed securities: GNMA, FHLMC, and FNMA;
4) Asset-backed securities;
5) Taxable Municipal securities; and
6) Commercial Mortgage-backed securities.

In addition to the permissible securities listed above, the following securities shall be permissible:

a) Floating rate securities with periodic coupon changes in market rates issued by the same entities that are included in the LBAGG as issuers of fixed rate securities;
b) Medium term notes issued by investment grade corporations;
c) Zero coupon bonds and stripped Treasury and Agency securities created from coupon securities; and
d) Structured notes issued by LBAGG qualified entities.

- U.S. Domestic Bonds must be rated investment grade, Baa3 or better by Moody’s Investors Services, BBB- by Standard & Poor’s Corporation, or BBB- or better by Fitch Investors Service at the time of acquisition. An external investment manager may be authorized by the terms of an investment advisory agreement to invest up to a maximum of 50% of the total fixed income portfolio in below investment grade bonds.

- Not more than 5% of the market value of domestic fixed income securities may be invested in corporate and municipal bonds of a single issuer.

Non-U.S. Fixed Income

Non-dollar denominated bond investments shall be restricted to bonds rated equivalent to the same credit standard as the U. S. Fixed Income Portfolio unless an investment manager has been authorized by the terms of an investment advisory agreement to invest in below investment grade bonds.

- Not more than 50% of the ITF’s fixed income portfolio may be invested in non-U.S. dollar denominated bonds.
Intermediate Term Fund Investment Policy Statement (continued)

- Not more than 15% of the ITF’s fixed income portfolio may be invested in emerging market debt.

- International currency exposure may be hedged at UTIMCO’s discretion or delegated by UTIMCO to an external investment manager.

Equities

The ITF shall:

- Hold no more than 25% of its equity securities in any one industry or industries (as defined by the standard industry classification code and supplemented by other reliable data sources) at market, or

- Hold no more than 5% of its equity securities in the securities of one corporation at cost.

ITF Accounting

The fiscal year of the ITF shall begin on September 1st and end on August 31st. Market value of the ITF shall be maintained on an accrual basis in compliance with Government Accounting Standards Board Statements, Financial Accounting Standards Board Statements, or industry guidelines, whichever is applicable. The ITF’s financial statements shall be audited each year by an independent accounting firm selected by the Board of Regents.

Valuation of ITF Assets

As of the close of business on the last business day of each month, UTIMCO shall determine the fair market value of all ITF net assets and the net asset value per unit of the ITF. The final determination of ITF net assets for a month end close shall normally be completed within six business days but determination may be longer under certain circumstances. Valuation of ITF assets shall be based on the books and records of the custodian for the valuation date.

The fair market value of the ITF’s net assets shall include all related receivables and payables of the ITF on the valuation date and the value of each unit thereof shall be its proportionate part of such net value. Such valuation shall be final and conclusive.

ITF Distributions

The ITF shall provide monthly distributions to the unitholders. The UTIMCO Board will recommend the annual distribution (%) rate to the Board of Regents. Distributions from the ITF to the unitholders shall be made monthly on the first business day of each month. To calculate the monthly distribution, the distribution rate (%) divided by 12) will be multiplied by each unitholder’s account, determined as follows:
• Net asset value of each unitholder’s account on the last business day of the second prior month;
• Plus value of each unitholder’s net purchase/redemption amount on the first business day of the prior month;
• Less the distribution amount paid to each unitholder’s account on the first business day of the prior month.

**Purchase and Redemption of ITF Units**

The ITF participants may purchase units on the first business day of each month upon payment of cash or reinvestment of distributions to the ITF, at the net asset value per unit of the ITF as of the prior month ending valuation date. Such purchase commitments are binding. The ITF participants may redeem ITF units on a monthly basis. The unit redemption shall be paid in cash as soon as practicable after the month end valuation date of the ITF. Redemptions from the ITF shall be at the market price per unit determined at the time of the redemption. Such redemption commitments are binding.

Participants of the ITF are required to provide notification of purchases and redemptions based on specific notification requirements as set forth in The University of Texas System Allocation Policy for Non-Endowment Funds.

**Securities Lending**

The ITF may participate in a securities lending contract with a bank or non-bank security lending agent for purposes of realizing additional income. Loans of securities by the ITF shall be collateralized by cash, letters of credit, or securities issued or guaranteed by the U.S. Government or its agencies. The collateral will equal at least 100% of the current market value of the loaned securities. The contract shall state acceptable collateral for securities loaned, duties of the borrower, delivery of loaned securities and collateral, acceptable investment of collateral and indemnification provisions. The contract may include other provisions as appropriate.

The securities lending program will be evaluated from time to time as deemed necessary by the UTIMCO Board. Monthly reports issued by the lending agent shall be reviewed by UTIMCO staff to ensure compliance with contract provisions.

**Investor Responsibility**

As a shareholder, the ITF has the right to a voice in corporate affairs consistent with those of any shareholder. These include the right and obligation to vote proxies in a manner consistent with the unique role and mission of higher education as well as for the economic benefit of the ITF. Notwithstanding the above, the UTIMCO Board shall discharge its fiduciary duties with respect to the ITF solely in the interest of ITF unit-holders, in compliance with the Proxy Voting Policy, and shall not invest the ITF so as to achieve temporal benefits for any purpose including use of its economic power to advance social or political purposes.
Amendment of Policy Statement

The Board of Regents reserves the right to amend the Investment Policy Statement as it deems necessary or advisable.

Effective Date

The effective date of this policy shall be July 13, 2006 (except for benchmark of hedge funds in Exhibit A which is effective February 1, 2006).
## Exhibit A

**Intermediate Term Fund Investment Policy Statement**

**Policy Targets, Ranges, and Performance Objectives**

**Effective Date July 13, 2006**

<table>
<thead>
<tr>
<th>Asset Categories</th>
<th>Percent of Policy (%)</th>
<th>Benchmarks</th>
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<tr>
<td></td>
<td>Policy Targets</td>
<td>Policy Ranges</td>
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<tr>
<td>U.S. Equities</td>
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<td>5 to 20</td>
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<tr>
<td></td>
<td></td>
<td>Russell 3000 Index</td>
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<td>Global ex U.S. Equities</td>
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<td>0 to 15</td>
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<tr>
<td>Non - U.S. Developed Equity</td>
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<td>0 to 10</td>
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<td></td>
<td></td>
<td>MSCI EAFE Index with net dividends</td>
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<tr>
<td>Emerging Markets Equities</td>
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<td></td>
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<td>MSCI Emerging Markets Index with net dividends</td>
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<td>Hedge Funds</td>
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<td>10 to 27.5</td>
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<td>MSCI Investable Hedge Fund Index*</td>
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<td>Directional Hedge Funds</td>
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<td>Absolute Return Hedge Funds</td>
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<td>Inflation Linked</td>
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<td>REITS</td>
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<td>Dow Jones Wilshire Real Estate Securities Index</td>
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<tr>
<td>Commodities</td>
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<td>0 to 10</td>
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<td>Combination Index: 66.7% GSCI minus .5% plus</td>
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<td></td>
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<td>33.3% DJ-AIG Commodity Index</td>
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<td>TIPS</td>
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<td>Lehman Brothers US TIPS Index</td>
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<td>Fixed Income</td>
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<td>Lehman Brothers Aggregate Bond Index</td>
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<td>Unencumbered Cash</td>
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<td>90 Day T-Bills</td>
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<td>Temporary Cash Imbalance**</td>
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<td>Net non-trading receivable</td>
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<tr>
<th>Expected Annual Return (%)</th>
<th>7.08</th>
<th>% of Target Risk</th>
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<td>1 year Downside Deviation (%)</td>
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<td>Upper Risk Bound:</td>
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<td>Standard Deviation (%)</td>
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<td>1 year Downside Deviation (%)</td>
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<td></td>
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<td>Lower Risk Bound:</td>
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<td>1 year Downside Deviation (%)</td>
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* Changed with approval of Board of Regents on August 10, 2006, effective retroactively to February 1, 2006 for performance reporting purposes.

**3 trading days or less**