

**THE UNIVERSITY OF TEXAS SYSTEM  
PERMANENT HEALTH FUND  
INVESTMENT POLICY STATEMENT**

**Purpose**

The Permanent Health Fund (the “PHF”), established by the Board of Regents of The University of Texas System (the “Board of Regents”), is a pooled fund for the collective investment of certain permanent funds for health-related institutions of higher education created, effective August 30, 1999, by Chapter 63 of the *Texas Education Code*. The permanent health funds which have assets in the PHF are:

- A. The Permanent Health Fund for Higher Education (the “PHFHE”), the distributions from which are to fund programs that benefit medical research, health education, or treatment programs at 10 health-related institutions of higher education; and
- B. Eight of the thirteen separate Permanent Funds for Health Related Institutions (the “PFHRIs”), the distributions from which are to fund research and other programs at health-related institutions of higher education that benefit public health. The PFHRIs invested in the PHF are:

- U. T. Health Science Center - San Antonio
- U. T. M. D. Anderson Cancer Center
- U. T. Southwestern Medical Center
- U. T. Medical Branch - Galveston
- U. T. Health Science Center - Houston
- U. T. Health Science Center - Tyler
- U. T. El Paso
- Regional Academic Health Center

The PHF provides for greater diversification of investments than would be possible if each account were managed separately.

**PHF Organization**

The PHF functions like a mutual fund in which each eligible fund purchases and redeems PHF units as provided herein.

## PHF Management

Chapter 63 of the *Texas Education Code* designates: a) the Board of Regents as the administrator for the PHFHE and b) the governing board of an institution for which a PFHRI fund is established as the administrator for its own PFHRI, or if the governing board so elects, the Comptroller of Public Accounts (State Comptroller). It permits the State Comptroller, in turn, to contract with the governing board of any institution that is eligible to receive a grant under Chapter 63. Pursuant to the foregoing and an Investment Management Services Agreement between the Board of Regents and the State Comptroller, the Board of Regents is the administrator responsible for managing the PHF. Chapter 63 further states that the Board of Regents may manage and invest the PHF in the same manner as the Board of Regents manages and invests other permanent endowments. It also requires that the administrator invest the funds in a manner that preserves the purchasing power of the funds' assets and distributions. It further requires that the administrator make distributions in a manner consistent with the administrator's policies and procedures for making distributions to the beneficiaries of its own endowments in the case of the PHFHE or the funds themselves in the case of the PFHRI funds.

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 Chapter 63 of the *Texas Education Code*, the Board of Regents has elected the PUF prudent investor standard to govern its management of the PHF.

Ultimate fiduciary responsibility for the PHF 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 PHF shall be managed by UTIMCO which shall: a) recommend investment policy for the PHF; b) recommend specific Asset Class and Investment Type allocation targets, ranges, and performance benchmarks consistent with PHF objectives; and c) monitor PHF performance against PHF objectives. UTIMCO shall invest the PHF assets in conformity with this Policy Statement. All changes to this Policy Statement or the exhibits to this Policy

Statement, including changes to Asset Class and Investment Type allocation targets, ranges and performance benchmarks, are subject to approval by the Board of Regents.

### **PHF 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 PHF assets shall comply with applicable law and be structured so as to provide essential safekeeping and trading efficiency.

### **Funds Eligible to Purchase PHF Units**

No fund shall be eligible to purchase units of the PHF unless it is a permanent health fund established pursuant to Chapter 63 of the *Texas Education Code*, under the control, with full discretion as to investments, of the Board of Regents.

Any fund 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 PHF.

### **PHF Investment Objectives**

The primary investment objective shall be to preserve the purchasing power of PHF assets and annual distributions by earning an average annual real return over rolling ten-year periods or longer at least equal to the target distribution rate, plus the annual expected expense. The current target rate is 5.2%. The target is subject to adjustment from time to time consistent with the primary investment objective of the PHF.

### **Asset Allocation and Policy**

PHF assets shall be allocated among the following investments:

- A. Cash and Cash Equivalents - Cash and Cash Equivalents has the same meaning as given to the term "Cash" in the Liquidity Policy.
- B. U. T. System General Endowment Fund (GEF) - See Exhibit B for the current GEF allocation, which is subject to changes by the Board of Regents. Upon any change to the GEF asset allocation, Exhibit B shall be revised accordingly.

In the event that actual Cash and Cash Equivalents positions move outside the range 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 the Cash and Cash Equivalents positions back within the policy range 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 PHF asset values could warrant requesting approval of the UTIMCO Board Chairman to waive immediate remedial action.

### **Performance Measurement**

The investment performance of the PHF will be measured by the PHF's custodian, an unaffiliated organization, with recognized expertise in this field and reporting responsibility to the UTIMCO Board, and compared against the stated Policy Benchmarks of the PHF, as indicated in Exhibits A and B (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 PHF must be invested at all times in strict compliance with applicable law. Investment guidelines for the U. T. System GEF shall be as stated in the GEF Investment Policy Statement.

### **PHF Distributions**

The PHF shall balance the needs and interests of present beneficiaries with those of the future. PHF spending policy objectives shall be to:

- A. provide a predictable, stable stream of distributions over time;
- B. ensure that the inflation adjusted value of distributions is maintained over the long term; and
- C. ensure that the inflation adjusted value of PHF assets after distributions is maintained over the long term.

The goal is for the PHF's average spending rate over time not to exceed the PHF's average annual investment return after inflation and expense ratio in order to preserve the purchasing power of PHF distributions and underlying assets.

UTIMCO shall be responsible for calculating the PHF's distribution percentage and determining the equivalent per unit rate for any given year. Unless otherwise recommended by UTIMCO and approved by the Board of Regents, PHF distributions shall be based on the following criteria:

The annual unit distribution amount shall be adjusted annually based on the following formula:

- A. Increase the prior year's per unit distribution amount (cents per unit) by the average inflation rate (C.P.I.) for the previous twelve quarters. This will be the per unit distribution amount for the next fiscal year. This amount may be rounded to the nearest \$.0005 per unit.
- B. If the inflationary increase in Step A results in a distribution rate below 3.5% (computed by taking the proposed distribution amount per unit divided by the previous twelve quarter average market value price per unit), the UTIMCO Board may recommend an increase in the distribution amount as long as such increase does not result in a distribution rate of more than 5.5% (computed in the same manner).
- C. If the distribution rate exceeds 5.5% (computed by taking the proposed distribution amount per unit divided by the previous twelve quarter average market value price per unit), the UTIMCO Board may recommend a reduction in the per unit distribution amount.

Notwithstanding any of the foregoing provisions, the Board of Regents may approve a per unit distribution amount that, in their judgment, would be more appropriate than the rate calculated by the policy provisions.

Distributions from the PHF to the unit holders shall be made quarterly as soon as practicable on or after the last business day of November, February, May, and August of each fiscal year.

### **PHF Accounting**

The fiscal year of the PHF shall begin on September 1st and end on August 31st. Market value of the PHF shall be maintained on an accrual basis in compliance with Generally Accepted Accounting Principles ("GAAP"), Governmental Accounting Standards Board Statements, industry guidelines, or state statutes, whichever is applicable. Significant asset write-offs or write-downs shall be approved by UTIMCO's Chief Investment Officer and reported to the UTIMCO Board. Assets deemed to be "other than temporarily impaired" as defined by GAAP shall be written off and reported to UTIMCO's Chief Investment Officer and the UTIMCO Board when material. The PHF's financial statements shall be audited each year by an independent accounting firm selected by the Board of Regents.

### **Valuation of Assets**

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

The fair market value of the PHF's net assets shall include all related receivables and payables of the PHF 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.

### **Compliance**

Compliance with this Policy will be monitored by UTIMCO's Chief Compliance Officer. UTIMCO's Chief Executive Officer, the UTIMCO Board, and the UTIMCO Audit & Ethics Committee will receive regular reports on UTIMCO's compliance with this Policy. All material instances of noncompliance, as determined by UTIMCO's Chief Compliance Officer and the Chair of the UTIMCO Audit & Ethics Committee, will require an action plan proposed by UTIMCO's Chief Executive Officer and approved by the Chairman of the UTIMCO Board with timelines for bringing the non-compliant activity within this Policy.

### **Purchase of PHF Units**

Purchase of PHF units may be made on any quarterly purchase date (September 1, December 1, March 1, and June 1 of each fiscal year or the first business day subsequent thereto) upon payment of cash to the PHF or contribution of assets approved by UTIMCO's Chief Investment Officer, at the net asset value per unit of the PHF as of the most recent quarterly valuation date.

Each fund whose monies are invested in the PHF shall own an undivided interest in the PHF in the proportion that the number of units invested therein bears to the total number of all units comprising the PHF.

### **Redemption of PHF Units**

Redemption of PHF units shall be paid in cash as soon as practicable after the quarterly valuation date of the PHF. If the withdrawal is greater than \$10 million, advance notice of 60 business days shall be required prior to the quarterly valuation date. If the withdrawal is for less than \$10 million, advance notice of five business days shall be required prior to the quarterly valuation date. If the aggregate amount of redemptions requested on any redemption date is equal to or greater than 5% of the PHF's net asset value, the Board of Regents may redeem the requested units in installments and on a pro rata basis over a reasonable period of time that takes into consideration the time frame to liquidate illiquid investments and the best interests of all PHF unit holders. Withdrawals from the PHF shall be at the market value price per unit determined for the period of the withdrawal.

### **Investor Responsibility**

As a shareholder, the PHF 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 PHF. Notwithstanding the above, the UTIMCO Board shall discharge its fiduciary duties with respect to the PHF solely in the interest of PHF unit holders, in compliance with the Proxy Voting Policy then in effect, and shall not invest the PHF 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 September 1, 2011, except for Exhibit B. Exhibit B follows the effective date of Exhibit A of the GEF

EXHIBIT A

PHF ASSET ALLOCATION

POLICY TARGETS, RANGES AND PERFORMANCE OBJECTIVES  
EFFECTIVE DATE SEPTEMBER 1, 2008

|                            | Neutral Allocation | Range      | Benchmark Return           |
|----------------------------|--------------------|------------|----------------------------|
| GEF Commingled Fund        | 100.0%             | 95% - 100% | Endowment Policy Portfolio |
| Cash and Cash Equivalents  | 0.0%               | -1% - 5%   | 90 day T-Bills             |
| Unencumbered Cash          |                    |            |                            |
| Temporary Cash Imbalance*  |                    |            |                            |
| Net non-trading receivable |                    |            |                            |

The endowment policy portfolio is the sum of the neutrally weighted benchmark returns for the GEF.

\*3 trading days or less

EXHIBIT B - GENERAL ENDOWMENT FUND

ASSET CLASS AND INVESTMENT TYPE TARGETS, RANGES, AND PERFORMANCE OBJECTIVES

EFFECTIVE SEPTEMBER 1, 2011 except Min and Max Ranges and Risk Bounds are Effective August 15, 2011

| POLICY PORTFOLIO              | FYE 2012 |        |       |
|-------------------------------|----------|--------|-------|
|                               | Min      | Target | Max   |
| <u>Asset Classes</u>          |          |        |       |
| Investment Grade Fixed Income | 5.0%     | 9.5%   | 25.0% |
| Credit-Related Fixed Income   | 0.0%     | 5.5%   | 30.0% |
| Real Estate                   | 0.0%     | 5.5%   | 10.0% |
| Natural Resources             | 5.0%     | 11.5%  | 25.0% |
| Developed Country Equity      | 30.0%    | 48.5%  | 60.0% |
| Emerging Markets Equity       | 5.0%     | 19.5%  | 25.0% |
| <u>Investment Types</u>       |          |        |       |
| More Correlated & Constrained | 35.0%    | 47.0%  | 60.0% |
| Less Correlated & Constrained | 25.0%    | 30.0%  | 37.5% |
| Private Investments           | 17.5%    | 23.0%  | 32.5% |

\*The total Asset Class & Investment Type exposure, including the amount of derivatives exposure not collateralized by Cash, may not exceed 105% of the Asset Class & Investment Type exposures excluding the amount of derivatives exposure not collateralized by Cash.

| POLICY BENCHMARK (reset monthly)                            | FYE 2012 |
|---|----------|
| Barclays Capital Global Aggregate Index                     | 7.5%     |
| FTSE EPRA/NAREIT Developed Index Net TRI USD                | 2.5%     |
| 50% Dow Jones-UBS Commodity Total Return Index and 50% MSCI |          |
| World Natural Resources Index                               | 6.5%     |
| MSCI World Index with net dividends                         | 18.5%    |
| MSCI Emerging Markets with net dividends                    | 12.0%    |
| Hedge Fund Research Indices Fund of Funds Composite Index   | 30.0%    |
| Venture Economics Custom Index                              | 20.0%    |
| NACREIF Custom Index  | 3.0%     |

| POLICY/TARGET RETURN/RISKS             | FYE 2012 |
|--|----------|
| Expected Annual Return (Benchmarks) ** | 8.81%    |
| One Year Downside Deviation            | 8.86%    |
| <b>Risk Bounds</b>                     |          |
| Lower: 1 Year Downside Deviation       | 75%      |
| Upper: 1 Year Downside Deviation       | 115%     |

\*\*Equal to nominal return, net of all investment-related expenses and assuming an inflation rate of 3%.

EXHIBIT B  
(continued)

GENERAL ENDOWMENT FUND

ASSET CLASS AND INVESTMENT TYPE TARGETS, RANGES AND PERFORMANCE OBJECTIVES

EFFECTIVE DATE SEPTEMBER 1, 2011 except Min and Max Ranges and Risk Bounds are Effective August 15, 2011

POLICY BENCHMARKS BY ASSET CLASS AND INVESTMENT TYPE: FYE 2012

| FYE 2012     |                   | More Correlated & Constrained  | Less Correlated & Constrained | Private Investments | Total         |
|--------------|-------------------|--|-------------------------------|---------------------|---------------|
| Fixed Income | Investment Grade  | Barclays Capital Global Aggregate Index (7.5%)   | 2.0%                          | 0.0%                | 9.5%          |
|              | Credit-Related    | 0.00%  | 3.0%                          | 2.5%                | 5.5%          |
| Real Assets  | Real Estate       | FTSE EPRA/NAREIT Developed Index Net TRI USD (2.5%)  | 0.0%                          | Custom NACREIF 3.0% | 5.5%          |
|              | Natural Resources | 50% Dow Jones-UBS Commodity Total Return Index and 50% MSCI World Natural Resources Index (6.5%) | 1.0%                          | 4.0%                | 11.5%         |
| Equity       | Developed Country | MSCI World Index with Net Dividends (18.5 %)   | 20.0%                         | 10.0%               | 48.5%         |
|              | Emerging Markets  | MSCI EM Index with Net Dividends (12.0%)   | 4.0%                          | 3.5%                | 19.5%         |
| <b>Total</b> |                   | <b>47.0%</b>   | <b>30.0%</b>                  | <b>23.0%</b>        | <b>100.0%</b> |

 Hedge Fund Research Indices Fund of Funds Composite Index  
 Venture Economics Custom Index

Investment Policy/Benchmarks are indicated in Black/Bold  
 Reportable Targets are indicated in Gray