MINUTES

BOARD OF REGENTS COMMITTEE ON BUDGET AND FINANCE MEETING

MARCH 8, 2018

I. CALL TO ORDER

Committee Chair Wayne Higaki called the meeting to order at 10:01 a.m. on Thursday, March 8, 2018, at the University of Hawaiʻi at Mānoa, Information Technology Building, 1st Floor Conference Room 105A/B, 2520 Correa Road, Honolulu, Hawaiʻi 96822.

Committee members in attendance: Committee Chair Wayne Higaki; Committee Vice Chair Benjamin Kudo; Regent Simeon Acoba; Regent Michael McEnerney; Regent Douglas Shinsato; Regent Michelle Tagorda.

Others in attendance: Board Chair Jan Sullivan; Board Vice Chair Randy Moore; Regent Brandon Marc Higa; Regent Lee Putnam, Regent Ernest Wilson, Jr.; Regent Stanford Yuen (ex officio committee members); President/Interim UH-Mānoa (UHM) Chancellor David Lassner; Vice President for Legal Affairs/University General Counsel Carrie Okinaga; Vice President for Academic Planning & Policy Donald Straney; Vice President for Research & Innovation Vassilis Syrmos; Vice President for Information Technology/Chief Information Officer Garret Yoshimi; Vice President for Budget & Finance/Chief Financial Officer Kalbert Young; Interim UH-Hilo (UHH) Chancellor Marcia Sakai; UH-West Oʻahu (UHWO) Chancellor Maenette Benham; UHM Vice Chancellor for Research/Interim Vice Chancellor for Academic Affairs Michael Bruno; Executive Administrator and Secretary to the Board of Regents Kendra Oishi; and others as noted.

II. APPROVAL OF MINUTES OF THE JANUARY 11, 2018 MEETING

Regent Shinsato moved to approve the minutes of the January 11, 2018 meeting, seconded by Committee Vice Chair Kudo, and the motion carried unanimously.

III. PUBLIC COMMENT PERIOD

Executive Administrator and Secretary to the Board, Kendra Oishi announced that the Board Office received no written testimony, and no individuals had signed up to give oral testimony.

IV. AGENDA ITEMS

A. For Information & Discussion

1. FY18 Second Quarter Operating Budget Variance Report

VP Young presented the FY18 Second Quarter Operating Budget Variance Report through December 31, 2017. Through the 2nd quarter, revenues are slightly higher than projected, with the exception of revenue for the Research Training & Revolving Fund (RTRF), although that is a projection issue rather than a collection issue. The increase in general fund revenues is due mainly to fiscal year appropriations to fund collective bargaining increases associated with this time period. Revenue amounts in special and revolving funds have remained largely static compared to previous fiscal years. Tuition & Fee Special Fund (TFSF) revenue collections are strong for the first half of FY 2018 as budgeted, but unlike the three previous fiscal years, there is no tuition increase for the current fiscal year. Therefore, actual overall tuition revenues are expected to be less than previous years' levels. Expenditures were slightly lower than projected, with the means and measures for reducing expenditures against the forecast varying by individual campuses. Most of the campuses have planned and executed well, despite the enrollment trajectories. Third quarter revenues and expenditures are likely to be impacted by the Governor's release of the 5% contingency restriction, which has bolstered general fund revenue contributions for the current fiscal year, and UH is currently on par with the prior fiscal year.

Questions and comments were raised regarding whether positive 2nd quarter results will persist going forward; the impact of the Governor's 5% contingency restriction; the definition of hard versus soft restriction; whether there has been any reaction from the Legislature regarding fiscal improvements; commending administration and campuses for their efforts in controlling expenditures; whether the $4.4 million in contingency restriction funds were pre-allocated to campuses or does the president have discretion to manage distribution; why the systemwide budget is so big and what is the money used for; and the importance of informing the Legislature regarding improvements made and actions taken.

VP Young explained that for the revenue forecast, UH will likely finish the fiscal year, at best, on target with the prior fiscal year. UH is managing its expenditures well, and with proactive measures UH could finish the fiscal year strong. Although the revenue condition is relatively flat, UH could end the fiscal year with comparatively less revenues dependent upon net expenditures.

The early release of the 5% contingency restriction helps UH much more significantly than later in the fiscal year. The state Department of Budget & Finance (B&F) restricted 10% of legislative appropriations to all agencies, 5% of which was a "hard" restriction and 5% was a "soft" restriction. Generally, state agencies should not count on getting any portion of the 5% "hard" restriction; however, B&F and the Governor may be inclined but is not committed to releasing part of the 5% "soft" restriction, depending on tax revenue collections. VP Young noted that it was still early in the fiscal year, and some of the variances are due to timing issues related to forecasts. The Legislature appears to be cognizant of better fiscal management by campuses and programs. The contingency restriction is applied to each program identification with individual campuses imposing the restrictions, so the $4.4 million has already been distributed or signaled for distribution by campuses.

VP Young indicated that the systemwide budget (UH900) funds centralized services (e.g., debt management, financial accounting services system, payroll, human resources, capital improvement projects, legal services, research compliance, etc.) that benefit all campuses. These costs are not passed onto campuses via an assessment because the UH System receives general funds for most of the services it provides. For services funded by non- general funds, there may be a partial assessment (e.g., some IT services). Looking only at the amount of general fund appropriations to UOH900 as an indication of whether System is large is fallacious. There are fair amounts of appropriations and expenses that are either placed at System for the benefit of campuses or are simply a pass through from System for distribution to campuses. For example, the Legislature appropriated $3 million for UH athletics via UH900, which the UH System then distributes en masse to UHM and UHH. Similarly, the Hawaiʻi Promise appropriation is to the UH System, but the UH System distributes the funds to the community college campuses. These reports do not provide a full appreciation that System operations and expenditures are far less than the appropriations. VP Young cautioned that when looking at the amount of system appropriation being so large compared to the amount of people budgeted in system, it can be easy to draw the wrong conclusion that UH is administratively top heavy.

2. FY18 Q2 Legacy Endowment Fund Investment Performance Report

UBS representatives provided a brief update on the economy and markets; reviewed investment performance and compliance; and shared next steps. As of December 31, 2017, the portfolio is up 3.97%, which is slightly above benchmarks. The quarterly compliance review of the high-level endowment fund and underlying individual investments show no material changes in ownership, investment management team, or pending litigation. All equity funds are in compliance with the board's investment policy, and all fixed income funds are in compliance except for the Schwab Short Term US Treasures fund. UBS is comfortable holding this investment because it was added to the portfolio as a placeholder until the new portfolio structure is implemented, and the benchmark is more aggressive and UBS wants to choose a low-risk fixed-income investment.

The investment policy states that weighted energy should be below 1% by June 30, 2018, and the weighted energy position is currently at 2.56%; however, the new portfolio structure should help attain that goal fairly efficiently. Regarding the overall asset composition, total cash was 0.3%, fixed income was 38.3%, equities were 61.4%, and the portfolio is in compliance with the policy statement. The Vanguard Mid Cap ETC position was reduced to be more aligned with what UBS deems as appropriate asset allocations, and to raise funds of just under $900,000 in scholarship distributions last year.

Questions and comments were raised regarding impact and plans for dealing with a possible trade war and major tax on steel and aluminum imports, and the outlook for the market.

UBS explained that they are monitoring trade tariffs, but they do not expect a major impact on the current portfolio and the individual positions owned as there are varied diversified positions throughout the portfolio. UBS is keeping an eye on potential broader implications, but the new portfolio structure will provide more flexibility on individual positions in individual sectors. UBS is cautiously optimistic regarding the market, and forecasts the market ending calendar year 2018 higher than today's relatively flat market.

Additional comments and questions were raised regarding UBS still measuring energy when the investment policy directive is to reduce fossil fuel producing companies; investments should refer to bonds as well as stock; the need to include cash held by managers in the total cash holdings for the entire portfolio; rationale for UBS maintaining equities at approximately 60% throughout the life of the portfolio; and who constructed the benchmarks, how relevant the benchmarks were to the market, and would the new portfolio structure have different benchmarks.

UBS explained that staying near 60% equities in the long term is a good place for UH in terms of risks and from a return perspective given the annual 4.5 to 5.0% endowment distributions. Once the new portfolio structure is approved, UBS will provide more guidance regarding recommendations for short, medium, and long-term outlook on asset allocations. The previous UBS investment team initially set up Benchmarks 1 and 2 to be alignment with a 60% equities/40% fixed income ratio. The proposed new portfolio structure will provide more transparency, and UBS will be able to provide more relevant and appropriate benchmarks that are accurately correlated with what is in the portfolio.

B. Recommend Board Approval

1. UBS Contract Revision – Institutional Consulting Services

VP Young explained that administration is requesting the committee recommend board approval to retain UBS to provide institutional consulting services in managing and overseeing the investment and performance of the Legacy Endowment portfolio, consistent with the terms contained in the agreement for services, and authorize the president and/or the chief financial officer to continue any negotiations necessary to execute agreements related to the new services platform and any other related documents or agreements to effectuate that level of service. The new portfolio structure will provide UBS with the opportunity to make the portfolio more efficient and to better position the portfolio for improved returns and achieving the UH's investment policy directives.

Questions and comments were raised regarding whether the mandates on types of investments were part of the contract; the possibility of amending the fossil fuel-free mandate should be amended to say "if possible"; expressing concerns about the limited number of quality fossil fuel-free investments available in the market and potential impact on portfolio returns; concerns over the fees paid to individual fund managers, and the possibility of setting a ceiling on aggregate fees; and the possibility stating a targeted rate of return in the contract.

VP Young clarified that the mandates on investment types were one of the requirements of the current agreement and the same requirements would apply to any other platform UH pursues with UBS. The portfolio is in compliance with the current fossil fuel-free mandate because the policy statement gave time to migrate investments. UBS added that under the new portfolio structure of separately managed accounts, investment managers will be able to identify investments that better and more accurately meet the mandate of having less than 1% investment in fossil fuel producers by June 30, 2018 while still having exposure to energy in the portfolio. This type of mandate is not unique, other endowments and foundations are looking at similar mandates.

VP Young explained that under the current contract UH pays UBS an annual fee at the rate of 0.20% (20 basis points), which is relatively low and reasonable for an institutional account of this type. There is an additional expense ratio for each of the individual fund managers that varies depending on the specific investment. The new portfolio platform will be structured similarly, with the expense ratio varying depending on the individual fund manager selected. UBS explained that there are two sets of fees, 0.20% (20 basis points) goes to UBS, and underlying investments fees of 0.23%, for an aggregate expense ratio of 0.43%. UBS has negotiated with investment managers to reduce their portion of the fees, and with the new recommendations the total cost for the portfolio would be somewhere between 0.45% and 0.55%. The expense ratio will vary, and the expense ratio for individual fund managers could exceed the stated range in the action memo, but UBS is working on managing the aggregate so the weighted net expense ratio can be managed to less than 0.55%. It was noted that a targeted rate of return is not stated in the contract, the return is measured to the benchmarks, there are consequences for failing to meet the benchmarks, and returns are dependent on the larger market. UBS is aware that there are annual draws from the portfolio, and UH needs to see a level of return to at least cover the 4.5% to 5.0% annual draw.

In light of the Administration and UBS negotiating a contract revision and that the new approach will be used to satisfy the fossil fuel-free mandate in regent policy, VP Young indicated that the Administration and UBS will be working to get the arrangement in order with sufficient time to migrate the portfolio in compliance with the mandate. However, if that process were to take or require more time, the Administration would reserve the right to come back and ask the Board to consider a revision or extension to the investment policy.

Questions were raised regarding how often UBS will utilize subcontractors to manage the portfolio and the possibility of amending board policy to remove the requirement for the board to approve selection of policy managers.

UBS explained that once the contract is approved they will present recommendations for investment managers, including costs, at the next committee meeting. UBS did not anticipate changing investment managers very frequently, unless the manager underperformed for at least two consecutive quarters. VP Young explained that current board policy requires the board approve the selection of fund managers, which is cumbersome and not very nimble for investments. The process is similar for the Associated Students of the University of Hawaiʻi stadium stock fund.

Committee Vice Chair Kudo moved to recommend board approval of the retention of UBS to provide institutional consulting services, seconded by Regent Shinsato.

Regent Acoba stated his concerns over the lack of a cap on the range of fees to be paid to individual managers and the prudent determination clause in the major term sheet as expressing the board's obligation to be prudent managers of the university's assets, and indicated he would be voting against the motion.

There having been a motion that was moved and seconded, the motion was put to a vote and passed with Regent Acoba voting no.

2. Approval of Procurement Contract to Provide Credit Card Services for the University of Hawaiʻi, RFP No. 18-0148

VP Young provided the committee with background information on the current credit card services contract; scope of the contract; selection criteria; responses to the request for proposal (RFP); proposed contract rates; and recommendation for approval of the procurement contract to provide credit card services for the UH for a three-year fixed contract (May 1, 2018 through April 30, 2021), with the option to renew for two additional twelve-month periods upon mutual agreement.

The proposal is to contract with Bank of Hawaiʻi, the current service provider, to allow the university to accept VISA, Mastercard, and debit cards as forms of payment for tuition and fees, room and board, dining, merchandise, and other goods and services. The proposed contract rate is based as a percentage of transactions, so there are only fees when a transaction occurs. The proposed contract rates are more than what UH is currently paying, but the proposed rates are in alignment with the rate of escalation that UH is currently paying and the selected vendor submitted the least expensive proposal. Board approval of this service contract is required because the estimated annual cost for the initial year will exceed the $3 million threshold stated in board policy, and could exceed more than $5 million threshold for the three-year term.

Questions and comments were raised regarding the proposed contract rates for the next closest bidder; concerns about the appearance that a single financial institution has a monopoly on the university's business; UH's plans for the future in terms of alternative payment methods (e.g., PayPal, Venmo, Apple Pay, etc.); and possibility of making a condition in the contract that if UH moves to alternative payment methods it would not engender a credit card fee.

Treasury Officer Joanne Yama explained that the next closest bidder had proposed a fixed rate for both debit and credit-based transactions, which meant the estimated total costs were higher. VP Young explained that there are no scheduled plans regarding alternative payment methods, but administration is examining whether any of those types of payment methods would alleviate UH from paying fees.

Committee Vice Chair Kudo moved to recommend board approval of the procurement contract to provide credit card services for UH, seconded by Regent McEnerney, and the motion carried unanimously.

V. <u>ADJOURNMENT</u>

There being no further business, Committee Vice Chair Kudo moved to adjourn, and Regent Tagorda seconded, and with unanimous approval, the meeting was adjourned at 11:38 a.m.

Respectfully Submitted,

/S/

Kendra Oishi
Executive Administrator and Secretary
to the Board of Regents