UNIVERSITY OF CALIFORNIA

BLUE AND GOLD POOL

ASSET AND RISK ALLOCATION POLICY

Effective: November 15, 2018

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POLICY SUMMARY/BACKGROUND

The purpose of this Asset and Risk Allocation Policy (Policy) is to define the asset types, strategic asset allocation, risk management, benchmarks, and rebalancing for the University of California BLUE AND GOLD POOL (BGP).

POLICY TEXT ASSET CLASS TYPES

Below is a list of asset class types in which BGP may invest so long as they do not conflict with the constraints and restrictions described in the BGP Investment Policy Statement. The criteria used to determine which asset classes may be included are:

- Positive contribution to the investment objective
- Widely recognized and accepted among institutional investors
- Low cross-correlations with some or all of the other accepted asset classes
- Highly liquid
- Highly transparent
- Available at minimal expense

Based on the criteria above, the types of assets for building the portfolio allocation are:

1. Growth

Includes publicly traded common stock of issuers domiciled in U.S., Non-U.S., and Emerging Markets. The objective of the growth portfolio is to generate investment returns while maintaining high levels of liquidity and transparency through a diversified portfolio of common stocks.

2. Income

Income includes a variety of income-related asset types. The portfolio will invest in interest-bearing and income-based instruments such as corporate and government bonds, inflation-linked securities, cash, and cash equivalents. The objective of the income portfolio is to provide interest income and necessary liquidity for cash flows and portfolio rebalancing needs and to diversify the risks present in the growth portfolio.

3. Derivatives

A derivative is a contract or security whose value is derived from another security or risk factor. There are three fundamental classes of derivatives – futures, options, and swaps – each with many variations; in addition, some securities are combinations of derivatives or contain embedded derivatives. Use of derivatives to create economic leverage is prohibited, except for specific strategies only. Permitted applications for derivatives are: efficient substitutes for physical securities, managing risk by hedging existing exposures, to implement arbitrage or other approved active management strategies.

Given the mandate for liquidity, transparency, and minimal expense, a passive implementation of all assets is expected. Derivatives are expected to be used to improve liquidity and minimize tracking error to passive indices.

Each asset class is assigned a benchmark that represents the opportunity set and risk and return characteristics associated with the asset class.

RISK MANAGEMENT

Three principal factors affect BGP's financial status: 1) budget use, 2) payout, and 3) investment performance. The level of risk tolerance will take account of all three factors. At certain levels of assets and a given payout policy, it could be possible that the investments do not achieve the necessary performance to meet the spending budget. The result would be that either payout policy, use in budget, or risk tolerance would have to be changed.

There are different types of risk tied to various responsible parties at each level of BGP investment management. Thus, different risk metrics are appropriate at each level.

The **principal risks** that impact the BGP, and the parties responsible for managing them are as follows:

- Capital market risk is the risk that the investments decline in value or do not create a positive real rate of return over a full market cycle. Responsibility for determining the overall level of capital market risk lies with the Board at the recommendation of the Investments Subcommittee. The implementation of this risk is the responsibility of the Chief Investment Officer who will employ a passive investment program.

- Liquidity risk is the risk that investments cannot be liquidated in time to meet requested redemption requests.

Although the management of investment portfolios may be outsourced, investment oversight and risk management are primary fiduciary duties of the Board that are delegated to and performed by the Chief Investment Officer. The Chief Investment Officer shall report on risk exposures and the values of the several risk measures to the Board.

Product level (Board, Investments Subcommittee, and Office of the Chief Investment Officer)

- Payout Risk (insufficient assets to meet planned payout)
    - Measures the risk of inappropriate investment policy and strategy
    - Loss of purchasing power and loss of capital
- Total Investment Risk (volatility of total return)
    - Measures the risk of asset allocation policy

Implementation level (Office of the Chief Investment Officer)

- Active Risk or "Tracking Error" (volatility of deviation from style or benchmark)
    - Measures the risk of unintended exposures or ineffective implementation
    - If passive implementation is used, active risk also captures tracking error caused by asset allocation deviations from the strategic allocation
- Liquidity Risk

Risk Measures:

Tracking Error: BGP shall be managed so that its annualized tracking error budget shall not exceed 100 basis points. This budget is consistent with the ranges around the combined asset classes and incorporates asset / sector allocation and security selection differences from the aggregate benchmark.

Liquidity Risk: BGP shall be managed so that at least 20% of its total assets can be liquidated within 3 business days.

The Office of the Chief Investment Officer (OCIO) is responsible for managing risk and shall implement procedures and safeguards so that the combined risk exposures of all portfolios taken together are kept within risk bands. Further, within limits of prudent diversification and risk budgets, total and active risk exposures are fungible. That is, the OCIO may allocate risk exposures within and between asset types in order to optimize return.

STRATEGIC ALLOCATION

The purpose of the Strategic Asset Allocation is to reflect BGP's purpose and objectives, as well as the investment beliefs and organizational capability of the OCIO. The actual portfolio exposures will deviate from the Strategic Asset Allocation as a result of price drifts, opportunity set, and value-adding activities of the OCIO.

The investment strategy of BGP will incorporate the risk tolerance of the Board, Finance and Capital Strategies Committee, and the Investments Subcommittee, the relationship between current and projected assets, evolution of the University's financial needs, namely BGP payout, budget, contributions, and growth expectations.

Below are the strategic asset allocation long-term weights and allowable ranges:

Table 1

	Strategic Asset Allocation	Allowable Ranges Minimum	Allowable Ranges Maximum
Growth	**70%**	**60%**	**80%**
Income	**30%**	**20%**	**40%**
Total	**100%**		

The program will invest primarily in liquid, low cost, marketable securities.

BENCHMARKS

The following criteria have been adopted for the selection of benchmark indices. It is understood that not all benchmarks will meet the entire list of criteria, but ideally, benchmarks that meet most of the criteria will be selected. There may be instances where tradeoffs are made between benchmarks that meet some of the criteria but not others.

1. **Unambiguous**: the names and weights of securities comprising the benchmark are clearly delineated.

2. **Investable**: is possible to replicate the benchmark performance by investing in the benchmark holdings.

3. **Measurable**: it is possible to readily calculate the benchmark's return on a reasonably frequent basis.

4. **Appropriate**: the benchmark is consistent with investment preferences or biases.

5. **Specified in Advance**: the benchmark is constructed prior to the start of an evaluation period.

6. **Reflects Current Investment Opinion**: Investment professionals in the asset class should have views on the assets in the benchmark and incorporate those views in their portfolio construction.

Benchmarks are a tool against which to measure the effectiveness of investment strategy either at a total fund level, at an asset class or strategy level, or at the mandate level. Based on the benchmark selection criteria, the following strategic policy benchmarks have been chosen:

Table 2

Asset Class	**Benchmark**
Growth	MSCI All Country World Index (ACWI) Investable Market Index (IMI) Tobacco Free - Net Dividends
Income	Bloomberg Barclays US Aggregate Index

The **Total Portfolio Benchmark** is a weighted average consisting of each of the monthly returns of the benchmarks noted above weighted by the Strategic Asset Allocation percentages.

REBALANCING

There will be periodic deviations in actual asset weights from the strategic target weights. Causes for periodic deviations are market movements, cash flows, tactical tilts, and asset selection. Significant movements from the asset class policy weights will alter the intended expected return and risk of BGP. Accordingly, BGP may be rebalanced when necessary to ensure adherence to this policy and the Investment Policy.

The OCIO will monitor the actual asset allocation. The Board directs the OCIO to take all actions necessary, within the requirement to act prudently, to implement the asset allocation in a manner that ensures that BGP achieves its risk and return objectives.

The OCIO shall assess and manage the trade-off between the cost of rebalancing and the active risk associated with the deviation from Strategic Asset Allocation weights. The Chief Investment Officer may delay a rebalancing program when the Chief Investment Officer believes the delay is in the best interest of BGP.

COMPLIANCE/DELEGATION

The BGP Asset and Risk Allocation Policy Statement should be reviewed at least annually and updated as necessary. The Investments Subcommittee may recommend action which will be placed on the Consent Agenda for approval by the Board.

NO RIGHT OF ACTION

This policy is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the University of California or its Board of Regents, individual Regents, officers, employees, or agents.

PROCEDURES AND RELATED DOCUMENTS

BGP Investment Policy Statement

Investment Implementation Manual*

*Changes to the Investment Implementation Manual do not require Regents approval, and inclusion or amendment of references to that document can be implemented administratively by the Office of the Chief Investment Officer.