

VII. STANDING COMMITTEES**B. Finance and Audit Committee**Portage Bay Insurance ReportInsurance Industry Environment

The insurance industry has begun to stabilize after several tumultuous years of investment loss, underwriting loss and soaring premiums. During those years, many large entities created captive insurance companies and assumed larger self-insured retentions, thus increasing their independence from the traditional cycles of commercial insurance pricing. The Board of Regents approved the creation of the University's captive insurance company, Portage Bay Insurance ("PBI") in June 2002. As a result, the University has, to a great extent, been able to optimize its risk financing program.

FY04 Asset/Liability Growth

PBI provides professional, general, automobile and employment practices liability insurance coverage for the University, its employees and students. Annual premiums are established through an independent actuarial study and are paid by the central administration and self-sustaining units. PBI will be in a rapid growth phase for the first four to six years of operation. At the end of FY04, assets were \$17 million (up 30% from FY03) and liabilities were \$7.9 million (down 4% from FY03). Funds are invested in fixed income securities. Cumulative investment return over the last 18 months has been 5.1%, outperforming the Lehman Bros. government credit benchmark by .63%.

Reinsurance

The existence of PBI allows the University to approach reinsurance companies as well as the traditional excess insurance companies for catastrophic coverage. This year, an underwriter with whom the University has a long-standing relationship left Lloyd's of London and joined a Bermuda reinsurer. His knowledge of the University and appetite for our account helped create competition with London carriers, resulting in a renewal without premium increase.

Regulatory and Audit

KPMG has issued an audit report with no findings. PBI is in full compliance with all regulatory requirements of Hawaii, its state of domicile.

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Governance

This year, mindful of the spirit of the Sarbanes-Oxley Act, the Membership of the Company elected an outside director, Ed Buchwald, who is now retired after a 30 year career with the Johnson & Higgins insurance brokerage firm.

Coming Year

A key milestone in the upcoming third year of operation is an expected ruling by the IRS that PBI qualifies as a tax exempt entity. Currently, proposals for a casualty insurance broker of record appointment are under review.