KANSAS BOARD OF REGENTS
**Retirement Plan Committee**
MINUTES
September 15, 2009

The September 15, 2009, meeting of the Kansas Board of Regents Retirement Plan Committee was called to order by Regent Lykins at 12:30 p.m. The meeting was held in Board offices at the Curtis State Office Building, 1000 S.W. Jackson, Suite 520, Topeka.

Members Participating:

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| Regent Dan Lykins, Chair | Mike Barnett, FHSU |
| Dr. Dipak Ghosh, ESU | Theresa Gordzica, KU |
| Dr. Rick LeCompte, WSU | Gary Leitnaker, KSU |
| Rick Robards, KUMC | Michele Sexton, PSU |
| Madi Vannaman, KBOR | |

President Ed Hammond, FHSU, participated by telephone. Also present were Regent Jerry Boettcher; Deloitte Consulting's Brad Tollander and Dave Walczak; ING's Bernard Heffernon, Regional Vice President; John O'Brien, Regional Director and Cindy Delfelder, Client Relations Manager; TIAA-CREF's Adam Polacek, Director, Client Portfolio Management; Chris Godwin, Director; Chip Burciaga, Managing Consultant, and Nicolette Dixon, Consultant; and Theresa Bush, KBOR's associate general counsel.

**<u>Minutes</u>**
The February 12, 2009, RPC minutes were approved as distributed.

**<u>Bona Fide Separation from Service –</u>**
At the February 2009 meeting, the RPC discussed accessing KBOR retirement funds when there is no bona fide separation from service. Ice Miller had provided information that if the employee knows he/she will be rehired then it is not a bona-fide retirement and there technically is no distributable event. Ice Miller noted that although the IRS has never defined what constitutes "separation from service," based on case law and private letter rulings which are based on facts and circumstances, a "wink-wink type of retirement" is not bona fide.

The RPC requested staff to craft a retiree rehire policy for consideration by COBO and discussion at a future RPC meeting. After consideration, staff determined it would be difficult to develop a policy that would be universally supported, as there are many nuances and different perspectives. Additionally, it was unknown whether addressing this "employment" issue with a Board policy would be desired, as autonomy and flexibility are generally preferred.

As an alternative, an informational handout was drafted that campuses would provide to KBOR participants who are terminating employment. COBO reviewed the draft and suggested edits were incorporated. At the COBO meeting, representatives were encouraged to establish their own university policy/practice to address this issue.

Rick Robards asked whether a signature should be obtained from the participant receiving the information. Campuses should document that the participant received the information but a signature is not required and may be difficult to obtain in some circumstances.

Regent Lykins asked whether the document needed to be presented to the Board. Theresa Bush responded that this is not a Board policy being adopted or changed, but is advisory information on what the tax laws provide, that will be utilized by the campuses to communicate with participants and therefore did not need to be approved by the Board.

The RPC voted unanimously to approve the document and it will be distributed to the HR/Benefits Offices at the state universities.

**KBOR Voluntary 403(b) Retirement Plan**
In 2008, the Board of Regents approved utilizing Planwithease.com (PWE) as its third party administrator for 403(b) compliance. Investment Providers were approved to remain as authorized providers based on their agreement to comply with PWE requirements for electronic data sharing.

Several Investment Providers that initially indicated they would comply with PWE requirements have not done so or have not provided the electronic data in good order.

A. Action already taken:
1. **#775 Fidelity –** informed PWE that it would not provide electronic data for the KBOR plan and Fidelity was removed as an approved provider with the 8/21/09 paycheck.

B. Action needed:
**1.** **#743 USAA Life –** *frozen* company, 1 participant. PWE indicates that they have not been cooperating with PWE regarding electronic data sharing.
2. **#057 AUL –** *frozen* company, 5 participants. PWE indicates they have provided updated test files and remaining changes that need to be made are minor.
3. **#843 MetLife Investors** *active* company with 65 participants; **#446 Met Life Insurance**, *frozen* company with 19 participants and **#842 New England Financial**, *frozen* company, 17 participants. MetLife has indicated that the earliest they will have electronic files ready is March or April 2010.
4. **#321 Ameriprise –** *active* company, 71 participants. Initial testing file was in good order, but subsequent production files have not been in good order. The issue is with SPARK formatting, the industry-wide format standard.

The RPC discussed options including temporarily freezing participation with these companies until they met the PWE electronic data sharing requirements or "putting bite into our bark" and establishing a firm deadline as we should not have active companies that are not meeting the basic requirements.

President Hammond recommended that a deadline be established and if not met the company would be removed as an approved vendor, for purposes of future contributions. Cindy Delfelder, speaking on behalf of PWE, stated that a September 30$^{th}$ deadline would be workable and she believes that both AUL and Ameriprise should be ready by that date while the other companies have indicated they will not be ready. The RPC unanimously voted September 30, 2009, as the deadline for companies to meet PWE's requirements. For those companies that do not meet that deadline, the last remittances will be made from the November 13, 2009 check. Participants will be informed that they have until October 31, 2009, to select a new voluntary 403(b) investment provider for remittances beginning with the November 27, 2009, check

**Roth 403(b)**
TIAA-CREF proposed implementing the Roth 403(b) option in the KBOR Voluntary 403(b) Plan to provide plan participants the opportunity to invest after-tax dollars that are distributed tax-free, as long as the investments are held in the plan for a minimum of five years from the date of the first

contribution. The earnings limits that apply to Roth IRAs do not apply to Roth 403(b) contributions. The Roth 403(b) would afford high income earners the ability to accumulate tax-free income not available through a traditional Roth IRA. Employees who are concerned with the possibility of future higher tax brackets also would find this plan a viable and attractive option.

Mike Barnett asked if there are models to help determine the tax bracket where it becomes beneficial to participate in a Roth versus a pre-tax 403(b). Chip Burciaga responded that would be an individual determination as other assets and plan participation, along with goals, would impact the individual's decision.

Dr. Ghosh asked if funds from a Roth 403(b) could be rolled over into Roth IRA and not be subject to minimum distribution rules. Mr. Burciaga responded yes, roll over is permitted and minimum distribution would not apply because the plan is funded with pre-tax dollars.

Rick Robards stated that although there are no income limits, as a practical matter the 402(g) and 415 limits create a limit for high income earners. He asked for those in a high income group, would the Roth 403(b) take potential contributions away from the voluntary 403(b) plan or would the Roth 403(b) be used as a supplemental retirement plan vehicle? Mr Burciaga responded that most likely both would occur; for those participating in the voluntary 403(b) plan they will have another option and for those not participating, the Roth could encourage them to contribute for the first time.

The RPC discussed whether the tax-free distribution philosophy would continue in the future or, if changed, whether those plans would be grandfathered. It is unknown what the political decision will be at a future date and how retirement plans will be impacted.

The RPC voted unanimously to explore offering a Roth 403(b) plan. Both ING and TIAA-CREF stated that funds used would be the same funds offered under the voluntary 403(b) plan. Theresa Bush was asked to review whether KBOR has statutory authority to implement a Roth 403(b) plan and what actions would be necessary.

**<u>TIAA-CREF – change in share class</u>**

TIAA-CREF has added a new share class, the Premier Share Class, for their mutual fund products which will be priced at approximately 10 basis points below the current Retirement Share Class. This change would provide KBOR participants lower expenses on their mutual fund investments.

Chip Burciaga stated that TIAA-CREF has undertaken many initiatives to enhance products and address the issue of cost and pricing. The new Premier Share Class is available for the mutual funds approved under the KBOR plan. This share class is not available to all customers, but is offered to premier clients based on the economics of serving the plan and assets under management.

Rick Robards asked why the class was not available for annuity fund options. Mr. Burciaga responded that all annuity accounts are priced at cost. Mutual funds have various share classes associated with them, and they would be impacted by the Premier Share Class change. All contributions, including accumulations, will receive the new Premier Share Class.

Adam Polacek stated that participants looking at the fund's performance outside of the customized KBOR website will see experience since the inception date of the fund only (9/14/09) and not the blended rate using the prior share class information. Participant statements and the customized website will reflect the blended, historical performance information.

Rick Robards asked if there would be any circumstances in which TIAA-CREF would remove KBOR funds from the Premier Share Class in the future. Mr. Burciaga responded no, that if approved, all accumulations would be moved to the new share class and would not be reversed.

Gary Leitnaker commented that TIAA-CREF is requesting this share class change with a reduction in fees and asked if TIAA-CREF would ask the RPC before increasing fees. Mr. Burciaga responded that for annuity products, expenses are based on cost and there is no ability to differentiate among customers. It is possible that they could provide information about expense estimates, but it would be impossible to ask for approval for new fees as they are set automatically based on experience. For mutual funds, TIAA-CREF has some flexibility such as offering premier clients a different share class.

Rick Robards responded that there had been angst surrounding the lack of information/communication about previous expense increases resulting in the RPC being unaware of the increases. Mr. Burciaga acknowledged the need to ensure that the RPC is provided information ahead of scheduled changes.

The RPC voted unanimously to move TIAA-CREF mutual funds to the new Premier Share Class. TIAA-CREF will work with staff to determine the earliest effective date and communication strategy.

Gary Leitnaker asked if there is a share class better than Premier. Mr. Burciaga responded yes, the Institutional Share Class for those plans with investment-only mandates, which is more often seen in the 401(k) arena, where the only service provided is to cover management fees, with no employee counseling or wealth management services and no website. TIAA-CREF will provide the differential between the Institutional and Premier Share classes.

**ING Ratings**

In March and April 2009, the RPC was informed about downgrades to ING ratings by Standard & Poor’s and A.M. Best. Brad Tollander and Dave Walczak previously provided analysis and assessment relative to the KBOR retirement plan. On August 12th, both Moody's and Fitch re-evaluated their ING ratings, and Deloitte was requested to provide information about these rating actions at the September RPC meeting.

Dave Walczak presented information about the “mess” in the industry overall, the outlook for the industry, upcoming new regulations and the response of the rating companies. Mr. Walczak commented that both ING and T-C are probably in a little better shape than 5 weeks ago and that many fine companies have been downgraded within the last year as a result of rating agency reaction to missing the boat previously. Not many companies escaped unscathed the rating agency scrutiny.

Mr. Walczak stated that continuing any relationship with a provider should be predicated on current evidence and a positive outlook of both financial position and management plans for prudent action. ING is showing a strong pattern of Risk Based Capital ratio, having moved from 350% to just shy of 400%. Historically, 275% is used as the gold standard or rule of thumb as an internal measure of adequate capitalization. It was noted that both ING and TIAA-CREF have fine RBC ratios; diversification and being a large stable company are key.

In conclusion, Mr. Walczak stated that capital ratios look great; rating agencies have downgraded ING and other companies but still hold them in the top 20% percentile of companies rated and consider them to be blue chip. For the foreseeable future, both companies look like they will be able to back up stable value and fixed value promises.

Regent Lykins asked whether more federal regulation of the insurance industry is on the horizon or whether that would continue to be left to the states. Mr. Walczak responded that there is such a strong lobby right now against a federal regulator, for various reasons, and each state doesn't want to give up power it currently has to protect its citizens.

Regent Lykins expressed his concern about the rating companies and the lack of confidence in them now. Mr. Walczak responded that he believes the rating agencies should have been more aware and that they are now more conservative in their approaches.

**<u>Deloitte's semi-annual review through June 30, 2009</u>**
Brad Tollander focused his comments on funds designated as "yellow" or "red."

**<u>I. ING</u>**
ING fixed Plus III – yellow. This guaranteed product is compared against a peer group that is gross of fees. It continues to be a solid fund in the principal protection offering.

ING Intermediate Bond fund – red (improving) Six months ago this fund was imploding. A number of changes have occurred including an investment manager change in January 2009. Discussions have been held with the portfolio manager about the new team approach being used. A dramatic improvement in relative performance has occurred; through 9/11/09, 9.24% versus 5.24% for the benchmark. The recommendation is that KBOR continue with this fund as there is more upside in trying to get this fund back to medium versus going to a top quartile fund and trying to ride those coattails.

President Hammond asked whether ING had other bond funds under management. John O'Brien stated ING has relationships with other outside fund managers and could utilize those funds to replace the ING core bond fund if necessary. President Hammond asked whether KBOR should hold the course even in this marketplace where bonds will become more important. Mr. Tollander responded yes, and he believes ING has learned that it needs a more diversified approach going forward.

American Century Equity Growth – yellow. This fund has been trailing on a relative basis, but not by a significant amount. From a longer term perspective, performance is fine and risk adjusted performance is fine.

Small Cap Growth - yellow. The manager of this fund is a premier small cap picker, and through 9/11/09, the fund is up 26% compared to 25.2% peer.

**<u>II. TIAA-CREF</u>**
Stable Return annuity – yellow. Performance is lagging a little relative to the benchmark. This fund has no distribution restrictions unlike the Traditional fund. There are no concerns with this fund and ratings are solid.

CREF Growth account – yellow. Improved performance continues to be seen although the fund still trails 80% percentile, but near term performance has picked up. Participants unhappy with this fund can utilize the Growth Fund of America, although performance of American Funds has started to come back to earth.

Mid Cap Growth – yellow. No serious concerns with this fund. Relative to its benchmark, this fund is solid. Better performance would be nice to see; performance through 9/11/09, is up 34%.

Royce Opportunity – was red, now yellow. There is risk when micro-cap funds are not performing well but the upside of this fund is good. Performance through 9/11/09 is up 53% whereas the Russell 2000 is up 14%. There is concern that participants may try to chase returns.

CREF Global Equity – yellow. There was a manager change two years ago, and a little uptick continues to be seen. This fund is hurt because it cannot invest in emerging markets but it is doing well at 26% versus the benchmark at 22%.

Real Estate – yellow. This fund has had some issues of late. TIAA-CREF values property on a quarterly basis and the index values property annually. In a down market, the values decrease more quickly than the benchmark's values but eventually the benchmark will catch up.

Regent Lykins asked whether commercial property is selling. Adam Polacek responded that in the next 6-12 months they believe there will be a return to a more normal market place and that currently they are seeing a thaw in the previously frozen market.

**TIAA-CREF Expense for the Spread Product**

With both active and passive funds, Deloitte's assumption had been a 1% expense for the spread product. After recent discussions with TIAA-CREF representatives, Brad Tollander has changed that to 50 basis points. Brad Tollander stated they were using 1% expense for the ING spread products also and asked the ING reps to let him know if that information is incorrect.

**Default Fund for the Mandatory Retirement Plan**

With the addition of new ING lifecycle funds, ING recommended KBOR use the Vanguard Target Date funds as the default stating that they have a lower overall fund expense, a better overall risk/return profile and Vanguard brand recognition would be attractive to Plan participants.

Brad Tollander provided analysis of the options but stated there currently is not a lot of performance history for the funds. If performance is to be examined, the recommendation is to revisit after there is a five year return history. The glide paths were compared with both funds having significant equity exposure that reduces closer to retirement; the Vanguard approach is more conservative with a 30% equity exposure, whereas TIAA-CREF maintains higher equity exposure at 40% approximately 10 years after the retirement date is reached. TIAA-CREF's glide path was constructed based on the life expectancy of their annuitant population.

The underlying Vanguard funds are passively managed and provide one of the most diversified funds in the market place and are very competitively priced. TIAA-CREF provides a combination of actively and passively managed funds and uses their experience with annuities to design the guide path and hedge against longevity risk. Mr. Tollander stated that both are fine options and a determination could be based on whether a passive approach is desired (Vanguard) or if the potential for upside is desired (TIAA-CREF).

The RPC discussed the default fund decision previously made in 2008. Rick Robards asked how other clients have addressed this, and Brad Tollander responded that KBOR is their first client with this issue. Chris Godwin stated that other TIAA-CREF clients have determined whether a passive or active mandate (or other criteria) is important and what glide path is desirable and mentioned that they have an indexed strategy for lifecycle funds if that is desired.

After much discussion, the RPC voted unanimously to maintain the current default fund; revisit the topic after more performance history is available and, in the meantime, provide ING with names of participants who previously were defaulted into the Lifecycle funds and those who will be defaulted in the future so that outreach can be made by both ING and TIAA-CREF which should result in more service to and educational opportunities for participants.

**Next RPC meeting:**
The next RPC meeting will be scheduled after the Board's Thursday meeting on February 16, 2010, at 12:30 pm.