

KANSAS BOARD OF REGENTS

Retirement Plan Committee

MINUTES

February 16, 2010

The February 16, 2010, meeting of the Kansas Board of Regents Retirement Plan Committee was called to order by Regent Boettcher 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:

Regent Jerry Boettcher	Mike Barnett, FHSU
Dr. Dipak Ghosh, ESU	President Ed Hammond, FHSU
Dr. Rick LeCompte, WSU	Gary Leitnaker, KSU
Rick Robards, KUMC	Madi Vannaman, KBOR

Regent Dan Lykins, Chair, and Theresa Gordzica, KU, were unable to attend. Michele Sexton, PSU, participated by telephone. Also present were Deloitte Consulting's Brad Tollander and Steve Manthie; ING's Bernard Heffernon, Regional Vice President; John O'Brien, Regional Director and Cindy Delfelder, Client Relations Manager; TIAA-CREF's Chris Godwin, Director; Chip Burciaga, Managing Consultant; Nicolette Dixon, Consultant; Lori McGeehon, Director and Adam Polacek, Director; and Theresa Schwartz, KBOR's associate general counsel.

Minutes

President Hammond made a motion, seconded by Rick LeCompte, to approve the September 15, 2009, minutes. The motion passed unanimously.

Inquiry about the TIAA-CREF fund lineup

An inquiry from Mark Ballard, KU, about the TIAA-CREF funds available in the KBOR Mandatory Plan was shared with the RPC as well as the response provided.

Deloitte's semi-annual review through December 31, 2009

Steve Manthie provided the economic overview stating that, in Deloitte's opinion, the economy is not getting as much credit as it should (the Rodney Dangerfield recovery). Brad Tollander provided information about the KBOR funds, stating that participants' risk appetite is returning with an increase in equity exposure and a corresponding decrease in money market and stable value assets. He also noted the decrease in real estate exposure by KBOR participants, driven primarily by recent weakness in the TIAA Real Estate fund. ING's total average investment expense is 0.71% (down from 0.77% six months ago), while total average fees expense is 0.88% (down from 0.90% six months ago). TIAA-CREF's total average investment expense is .50% (down from .55% six months ago) reflecting several reductions in basis points on their annuity products.

I. ING

Brad Tollander stated they were very happy with ING funds; those funds that underperformed do not pose any concerns.

ING Intermediate Bond fund – was red for the June 30, 2009, analysis and has been changed to yellow. Since the last review, the fund has rebounded nicely. The fund was able to outperform the benchmark by nearly 7% for the one-year period ended December 31, 2009. Despite the improved near-term results, it will need some above average performance the next few quarters to make up ground on both the benchmark and median peer group manager on a longer-term basis. Investment management expenses increased on the fund, which is a by-product of operating costs. John

O'Brien explained that all mutual funds have fixed costs, so as assets decrease the expense amount assessed has to increase.

American Century Equity Growth – continues to be yellow. The fund has struggled over the past year and underperformed both the benchmark and median peer group manager. The fund's quantitative investment approach kept it from investing in riskier stocks (stocks with poor prospects) that performed strongest during last year's low quality rally. Over longer time periods, the fund struggles against the benchmark and median peer group manager as well. The fund continues to post above-average to strong rolling results relative to the benchmark and median peer group manager. The fund has below average risk-adjusted performance over the past 5 years. The fund does, however, display solid risk statistics of beta, downside risk and standard deviation.

ING Fixed Plus III –yellow. Although there are no concerns with this fund, its very measured approach offers protection and a fair amount of yield. Deloitte is still looking for a more appropriate benchmark. The fund is able to outperform the benchmark over all observed cumulative periods but places towards the bottom of its peers over most periods. The fund is a fixed annuity account backed by the financial strength and claims-paying ability of ING. Despite the downgrades over the past year, fund management seems to be stable.

PAX World Balance (balanced/socially responsible) – yellow. This fund had a solid year, slightly trailing its peers on 3 and 5 year basis with mixed rolling returns. The fund outperforms the benchmark for the year but places in the 66th percentile relative to its peers. Longer-term results are mixed but it should be considered that this fund follows a more socially responsible focus than its peers. The fund displays somewhat mixed rolling returns relative to both the benchmark and peer group. The fund has slightly higher measures of downside risk and standard deviation than its peers. The fund also has weaker risk-adjusted performance when compared to its peers.

ING Oppenheimer Global (Global Equity) – yellow. The fund's performance is improving and needs better consistency with rolling returns. There is nothing wrong with the fund, but longer-term, the fund is at the median. The fund had a very strong year by outperforming both the benchmark and median peer group manager by posting a return close to 40%. The fund has average risk-adjusted performance and slightly worse downside protection as compared to its peers.

II. TIAA-CREF

Stable Return annuity – continues to be yellow. There are no concerns with this fund. The fund is able to outperform its benchmark but trails the median peer group manager. The fund is a fixed annuity account backed by the financial strength and claims-paying ability of TIAA. Unlike the TIAA Traditional, this fund offers complete liquidity to participants. The tradeoff for the increased liquidity is a lower overall yield.

CREF Global Equity – continues to be yellow. Performance was solid for the year, and the management team celebrated its third anniversary. Expenses were reduced from 0.65% to 0.51%. The fund is a little conservative and does not have much emerging market exposure which can be a drag when that market is doing well. Deloitte would like to see continued trailing return improvement.

Real Estate – red. As has always been noted, this fund is a “little different animal” with no good benchmarks, as it invests 75% of assets in physical real estate which is an “apples to oranges

comparison” with real estate investment trusts. With quarterly appraisals, the fund should bottom out quicker than the benchmark.

The fund struggled for the year with the difficult commercial property market. Long-term results are slightly more favorable. The fund’s quarterly valuations have forced it to recognize property valuation losses much more quickly than managers valuing properties less frequently. This should prove beneficial when property values begin to increase. The fund’s risk statistics are mixed, but it is difficult to compare this fund to benchmarks and peer groups given its unique investing style.

Adam Polacek stated that directly held real estate is different from REIT funds and much of the difference is attributable to how the product is valued (vs. REITs). For directly-held commercial real estate products (most of which are available via a GP/LP product arrangement), TIAA-CREF leads the industry with frequency and thoroughness of appraisals and each quarterly appraisal is performed by a third party. And, if something occurs intra-quarter, appraisals will be done more frequently. In the past, the fund typically was structured with 70% in directly held, 5% liquid (REITs) and 20-25% cash. Because of participant redemptions out of this product, the cash balance declined and resulted in a greater percentage in directly held properties. In contrast, REITs are publicly traded and can be significantly more volatile than directly-held products such as the TIAA Real Estate Account due to the fact that investors influence the value of REITs by bidding up or down the price due to the currently available information on the market today as well as the anticipated future environment. REITs a year ago today were almost on the brink of bankruptcy but were able to recapitalize themselves by tapping secondary markets to bolster balance sheets and became solvent and bid up, with the markets looking beyond the abyss.

Jerry Boettcher asked whether it would be possible to quantify the cost of such frequent appraisals and the impact on expense ratio. Adam Polacek stated it is more expensive but not exorbitantly so. With 105-107 properties, the impact is not significant to the 101 basis points which is very inexpensive for this type of product.

Rick LeCompte asked whether the higher-end properties might have further to fall than lower end properties. Adam Polacek acknowledged that TIAA does buy higher end, class A property. When capital is tight, capital is tighter for lower quality properties. Time will tell whether the bottom across the board will be seen at the same time.

Jerry Boettcher asked whether the fund has significant international holding, and Adam Polacek replied that it has approximately 3-4% in international properties, in Paris and London, and is geographically diversified in the U.S., especially along the coasts and Sunbelt areas.

CREF Bond market (Core bond), yellow. This is a solid fund that is slightly ahead of the index, is duration neutral and is not a risk taker. The fund’s conservative investment approach provided it with strong relative performance results in 2008. In 2009 however, the bond market rewarded riskier bond sectors, and as a result the fund trailed a number of its more aggressive peers.

Rick LeCompte asked whether the expenses were fairly low for a managed bond fund, and Brad Tollander responded yes.

T-C Large Cap Value (large cap value), yellow. The managers’ approach to buy the “unloved” was beneficial as the fund has done very well. Assets were trimmed from “lower quality” stocks during

the fourth quarter and reinvested in what the manager believes are “higher quality” stocks. Despite a poor showing for 4th quarter, the fund had a great year by posting over a 30% return and placing in the 11th percentile relative to its peers. Long-term performance for this fund is average relative to its peers. Rolling results are somewhat mixed, but improved from 4th quarter 2008.

Ed Hammond noted that the Deloitte economic and market review stated that equity rebalancing may be called for in the current economy, and he asked which products would be best for rebalancing in light of the fact that the TIAA bond account is yellow and real estate is red. Steve Manthie stated that if asset allocation strategy was not rebalanced during market troubles and if all appreciation has been captured, participants should rebalance because asset allocation would be inflated.

Chip Burciaga and Adam Polacek stated that the menu of options available through TIAA-CREF is well diversified, with little if any overlap. The concept of rebalancing is a frequent topic during individual counseling sessions, but that decision is more so influenced by participants reassessing their own risk tolerance, while focusing on a desired outcome. Counseling, coupled with the use of objective tools, is very effective in determining an allocation that is appropriate to meet individual goals.

Ed Hammond asked whether there is a product that TIAA-CREF offers, that is not in the current KBOR array, which could be utilized given the fact that there may be a lot of interest in rebalancing. Chip Burciaga responded that TIAA-CREF submitted a proposal to offer additional bond funds for that purpose after identifying some gaps in the fixed income category of the Mandatory Plan menu. To add perspective, he contrasted how higher education approaches retirement from how the private sector does in managing 401(k) plans which have very limited fund offerings and no orientation towards achieving secure retirement income. Higher education plan participants have always had more choices and they are requesting more. Because KBOR offers a retirement plan that is self-directed, there are high expectations for their providers to offer sound guidance and advice to plan participants on a very broad scale.

TIAA-CREF new fund proposals

Steve Manthie stated that the proposed funds addressed fixed income options. High yield bond funds are much more common followed by short-term bond funds; global bond funds seem to be seldom offered and are mainly in plans with very large numbers of investment options.

1. TIAA-CREF High Yield Fund – The addition of this fund would fill a void in the fixed income space by adding diversification, as this fund seeks high yields by investing in lower grade or non-investment grade debt securities. Though the volatility can be significant through various market cycles, it would afford participants the opportunity for potentially higher returns in a way that does not generally correlate to equity based investments. Deloitte Consulting recommends adding this fund.

2. TIAA-CREF Short-Term Bond Fund – The addition of this fund would provide participants with the opportunity for potentially higher yields above what are currently available in money market funds by providing exposure to high quality securities with short maturities. Deloitte Consulting does not recommend adding this fund, given the amount of fixed options and the fund did not perform as well in the 3-year period and risk measurements were mixed.

3. Templeton Global Bond Fund A – The addition of this fund would fill another gap in the fixed income category by affording participants exposure to non US fixed income securities. As a global fund, it is an aggressive option in the fixed income category, by virtue of its exposure to currency risk and debt securities issued by foreign governments and other entities. Deloitte Consulting recommends adding this fund.

Steve Manthie stated there are no issues with any of the funds proposed, based on performance, organizational stability and manager. The only concern is whether additional options should be added. If all three were added, the number of options might overwhelm participants in the fixed income space because differentiating among the funds is harder. Equities can be differentiated and are accumulated for retirement whereas fixed income options are not used to accumulate for retirement as growth opportunities have been limited historically.

Mike Barnett stated that the timing to add these funds seems to be off, because of the potential for inflation. Rick LeCompte stated his concern that participants will chase rates, as there is now only one way to go for performance. He agreed with the timing aspect, as well as noting the high manager turnover, which he stated is different than holding a regular bond, as bond managers often do not recapture on both directions. If mistakes are made, the investor will not be able to make it back; thus, it's the wrong time for the high yield.

Chip Burciaga stated that participant behavior would not likely result in a 100% transfer of funds chasing performance, reiterating that both providers under the Mandatory Plan have robust employee communication and education services for participants. In response to the concerns surrounding the timing of adding these funds, Chip Burciaga noted that because KBOR's plan is not static and it covers participants in all age groups and income levels, one cannot look at certain point in time to say this is a bad time; anyway you can slice it - (age, lifestyle, income, risk) – the KBOR program is self-directed by design with asset allocation decisions left to the participant. KBOR, in turn, looks to the companies they have entrusted to provide participants with the proper guidance, education and support to make the decisions that will lead to the best chance of achieving their desired outcome.

Jerry Boettcher noted that the short-term bond fund does not have a 5 year record. Adam Polacek stated that although TIAA managed a predecessor fund for over 10 years, the old share class previously was merged and therefore the 10 year record cannot legally be reported.

Rick Robards inquired whether these funds represent a new style box. Jerry Boettcher responded that fixed income markets are becoming more diversified, and the plan is missing a high yield fund box which, in hindsight, was the best place to be in 2009 (but not in 2008). Brad Tollander stated that the funds represent fixed income options. There is currently no exposure to high yield and this provides diversification. Whether the funds will be utilized remains to be seen. Other plan sponsors have been taking the lead and adding these funds. Deloitte's recommendations reflect the willingness to take the risk that these funds will complicate the plan, but participants should be utilizing the education and advice from sponsors.

Jerry Boettcher noted that the high yield bond fund has important equity-like characteristics. Rick LeCompte stated that the participant, by default, is the equity holder. Jerry Boettcher agreed, indicating that the participant would need to clearly understand the equity-like characteristics. Brad

Tollander added that it involves the portfolio manager as well and, when danger is on the horizon, movement needs to be made.

Ed Hammond stated that the amount of assets in the fixed accounts is substantial and because the advice is to rebalance, shouldn't fixed options be added? Jerry Boettcher agreed, stating there is a place for some fixed investment exposure for everyone.

Rick LeCompte stated that if each participant could be educated, these fund offerings would be fine. But, there are too many people who will misunderstand, who will chase the yield and will not look at the rest of the detail. Ed Hammond stated that any product can be misused by a consumer who is not well-informed and, with are a high percentage of retirements upcoming, those participants have lots of money in the fixed product which has a hole in its options. Jerry Boettcher stated that short-term bond funds provide a better option than having assets in the money market. Chip Burciaga noted that in the event that the committee declined to recommend these funds for the Mandatory Plan, TIAA-CREF has flexibility to add these additional options to its voluntary plan lineup.

Ed Hammond moved to recommend to the Board the addition of the TIAA-CREF High Yield Fund. No second was made, and the motion died. No other motions were made for the other proposed funds. Ed Hammond noted that these options should not be closed forever; some may believe the timing right now may not be right, but there is a definite hole in the fixed options offered.

Other Items

1. Deloitte Consulting's invoice reflecting charges for "additional services"

Deloitte's latest invoice was shared for review. The RPC noted the balance between exercising the RPC's fiduciary responsibility for the plan and asking the consultant for responses to issues raised. The invoice provided examples of the cost associated with some recent inquires raised and responded to. In the upcoming consulting RFP, we will attempt to address these types of costs by incorporating language to encompass questions that are raised and are specific to the investment providers (ING and TIAA-CREF) in the KBOR Mandatory plan.

2. Deloitte Consulting's contract

The contract extension for Deloitte Consulting expires November 30, 2010. A work group comprised of Michele Sexton, Theresa Schwartz and Madi Vannaman will begin working on the draft RFP for consulting services, using the current contract's scope of work as the template. RPC members who have other items they would like considered for the RFP should email those suggestions to Madi. A draft RFP will be distributed to the RPC for review and comment before the RFP is finalized. The work group will review RFP responses and make recommendations as to which organizations will make presentations to the RPC this summer.

3. ING survey

The RPC received the results shared by Bernie Heffernon from the survey constructed by the ING higher education market and the ING institute for research for behavior finance.

The RPC requested that both ING and TIAA-CREF provide information about participants and educational opportunities provided. The reports will be provided for the semi-annual meetings.

4. TIAA-CREF Town Hall meetings

Chip Burciaga shared that in April 2010, Ed Grzybowski, TIAA-CREF's Chief Investment Officer, will be in the Kansas City area to deliver a presentation at a conference. Mr. Grzybowski is responsible for investment policy, strategy and oversight of the company's more than \$428 billion in combined assets. TIAA-CREF will be scheduling "town hall" meetings, with a presentation followed by Q&A, at KSU, KU and KUMC. Faculty and staff will be invited to the town hall meetings, and the RPC and wealth management participants also will be invited to "VIP" functions.

Next RPC meeting:

The RPC will be informed about the progress of the RFP process during the summer. The next RPC meeting will be scheduled for 12:30 p.m. on the Tuesday afternoon prior to the Board's meeting in September 2010 (date to be determined).