KANSAS BOARD OF REGENTS
Retirement Plan Committee
MINUTES
March 12, 2013

The March 12, 2013, 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 at the Oread Hotel adjacent to the campus of the University of Kansas.

Members Participating:
Regent Dan Lykins, Chair
Dr. Dipak Ghosh, ESU
Dr. Rick LeCompte, WSU
Rick Robards, KUMC
Madi Vannaman, KBOR
Mike Barnett, FHSU
President Hammond, FHSU
Gary Leitnaker, KSU
Michele Sexton, PSU

Also present were Segal Rogerscasey's Frank Picarelli and Craig Chaikin; ING's John O'Brien, Regional Vice President/Tax Exempt Markets and Cindy Delfelder, Regional Director/Tax Exempt Markets; TIAA-CREF's Greg Johnson, Director, Institutional Relationship; Nicolette Dixon, Relationship Manager; Adam Polacek Managing Director Client Portfolio Management and Michelle Buckalew, Senior Manager Communications Consultant; and Theresa Schwartz, KBOR's associate general counsel. Theresa Gordzica, KU, was unable to attend the meeting.

Minutes

The minutes from the September 18, 2012 meeting and the November 2, 2012 conference call were approved.

Segal's Semi-Annual Review Through December 31, 2012

Mr. Chaikin provided an overview of the December 31, 2012 semi-annual report. Dr. LeCompte requested that the plan activity page include a net change column for easier comparison of data. Ms. Vannaman noted that the September 2011 RPC minutes state that the Vanguard wrap fees will be included in the weighted average expense ratio information, and that this information was not in the information now being provided to the RPC. Mr. Chaikin indicated that information would be included in Segal's future reports.

Mr. Chaikin provided additional information about the Segal S3 "C" ratings for two ING funds. The American Century Mid Cap Value received the rating because relative performance has been close to its benchmarks and peers but has trailed in six of the last eight years on a calendar year basis. This fund has had very good downside protection and, when the market has gone down, has performed better. When the market has rallied, the fund has trailed its benchmarks and peers. The PIMCO Real Return fund also received a "C" rating because it is more diversified than its benchmark, investing in developed market and emerging market debt and is therefore a little more volatile than its peer group.

For the TIAA-CREF plan performance information, Mr. Barnett asked whether the information reflected a net change instead of a net return. Mr. Chaikin responded yes, the information basically reflects the average assets in the fund, the return and the percentage of the return and is not reflective of an investor's return.

Mr. Chaikin provided additional information about the Segal S3 "C" ratings for four TIAA-CREF funds. The TIAA real estate account is very unique in the industry as it invests directly in real estate

properties. TIAA holds a 15-20% cash buffer, which allows TIAA to provide a daily NAV (valuation) which is a constraint its benchmark does not have. The fund has a different risk profile and there is no direct comparison. The Sentinel Small Company fund is ranked a C due to the departure of the team at the end of 2012 and poor relative performance results. This fund was replaced by Alliance Bernstein Small Growth in January 2013. The TIAA-CREF Mid-Cap Growth fund also received a "C" rating because, although the manager has been there for seven years, the tenure is shorter than the peer group average and its risk statistics have lagged its peers and benchmark. TIAA-CREF's Bond fund received a "C" rating because it has a slightly higher percentage of corporate bonds than its benchmark and peers.

Mr. Chaikin reviewed information for the frozen vendors, noting that the ending value for both Lincoln National and Security Benefit Group reflected a $1 million and $3.2 million decrease respectively. Ms. Dixon stated that for the September 2013 RPC meeting, both ING and TIAA-CREF will provide additional information about the "make-whole" campaign, which began in October 2012 and ends in March 2013 that specifically targeted assets held in KBOR contracts with those deselected vendors.

ING's Investment Proposal

ING did not present an investment proposal change. Mr. Chaikin noted that there are no issues with fund style or manager changes and the ING funds are performing well.

TIAA-CREF's Investment Proposal

After performing its annual review, TIAA-CREF identified an enhancement for consideration and submitted a proposal to replace and map current assets from the TIAA Stable Return account to the recently introduced TIAA Stable Value account. The proposal noted that the Stable Value account is also a guaranteed annuity product that provides a guaranteed minimum credit rate of between 1.00% and 3.00% and the opportunity for actual crediting rates that exceed the minimum.

The February 19, 2013 "Manager Focus" stated that Segal Rogerscasey met with TIAA-CREF representatives to compare and contrast the product design of the two funds: the Stable Return account has $52 million in assets and 27 plans; the Stable Value account has $112 million in assets and 119 plans. In 2012, three plans left Stable Return due to a vendor change and accumulated assets declined over 30%. As a result, TIAA-CREF indicated fees are likely to increase due to economies of scale to run and service the product. Currently KBOR is the largest client in the Stable Return account, representing approximately half of the accumulated assets and Stable Return is closed to new plan offers. Segal Rogerscasey feels that "TIAA-CREF's commitment to Stable Return is waning and KBOR is at risk of TIAA-CREF eventually forcing assets to move into an alternate product."

The Stable Value has four advantages over Stable Return:

i) The primary collateral account is a TIAA Separate Account and plan assets are protected from claims by TIAA's creditors or General Account policyholders. Additionally, TIAA's General Account guarantees any shortfall of assets in the Separate Account to support contractual obligations. The TIAA Stable Return's collateral account is not separate from the TIAA General Account, and thus does not benefit from the same level of protection.

ii) The crediting rate structure for the Stable Value fund is simpler than Stable Return: current assets and new money contributed during the rate period earn the current crediting rate, which is reset semiannually and may therefore offer an opportunity to better capture the

current rate environment. The Stable Return has a complex vintage structure with a crediting rate determined as frequently as monthly for new money contributions, which may result in up to twelve different crediting rates for various "buckets" of money.

iii) All fees for Stable Return are implicit in the declared crediting rate spread, meaning investors have no visibility to the fee structure. Stable Value discloses contract fees in the contract, giving investors a level of transparency and those fees are less due to reduced production costs of recordkeeping crediting rate structures.

iv) Stable Value offers increased liquidity by allowing transfers in 30 days following a transfer out whereas Stable Return has a 90 day waiting period for participant-directed transfers-in following a transfer-out (subject to contractual "equity wash" provisions).

Mr. Chaikin stated that the Stable Value's product design is superior to that of Stable Return. Investment in Stable Value will protect plan assets from credit claims on the General Account, simplify the crediting rate structure, clarify fees and supply greater liquidity. It possesses streamlined recordkeeping and valuation for crediting rates, and more liberal discontinuance/mapping features, making it more portable to a new provider, if needed.

Mr. Barnett asked what the average credit rating was, and Mr. Chaikin stated that the average credit rating was AA+ for Stable Return and A for Stable Value. The increased risk is limited and while the average credit rating is currently slightly lower, it is not below investment grade.

Mr. Polacek stated that Stable Return has been managed with a very high credit quality bias, while the proposed Stable Value does not currently maintain the same bias. Mr. Chaikin stated that current rates are close to zero, and they can only go up and holding higher yielding bonds is likely to be more beneficial to participants than a higher crediting rate when changes to the bond market occur. Stable Value does not sacrifice significant quality to provide higher diversification and rates.

Mr. Polacek stated that both products guarantee at book value and a guaranteed 1%-3% minimum return (defined within the contract). Stable Return is a general account product, which means the financial strength and stability of the insurance company, TIAA, is of paramount importance, as it stands behind the product's guarantees. . The proposed Stable Value goes one step further and has a separate account structure as the first line of collateral in order to meet contractual guarantees so that its assets are insulated from the broader General Account assets. This structure offers an additional layer of protection to meet the product's guarantees. Stable Value currently has a slightly lower credit quality profile, but offers the ability to invest across a broad array of high credit quality assets (including treasury, agency, corporate, and other spread securities) as well as offering doubly secure protection.

Mr. Robards asked whether we are essentially in a "cul-de-sac" with TIAA-CREF migrating away from the Stable Return product in all its books of business. Mr. Polacek responded that it is possible that the product could be phased out at some point in the future, and Mr. Chaikin stated the opinion that TIAA-CREF may likely be closing this account at some point and then all assets would need to be moved.

Dr. LeCompte asked whether Stable Value would always have a lower crediting rate than TIAA Traditional Annuity. Mr. Polacek said that the duration is shorter with Stable Value, so the statement would likely be correct nearly all of the time. Such an anomaly could be imagined, if there was an inversion of the yield curve with the near term rates remaining higher than long term

rates for an extended period. Mr. Chaikin commented that if that happened, there would be more issues to discuss.

Mr. Chaikin stated that the disclosed fees for Stable Return are at 49 basis points, but that does not take into account the underlying, undisclosed fees as it is a general account product. For the Stable Value there are 72 basis points of fees before the crediting rate is set and an additional 50 basis points (10 for revenue sharing and 40 because of the multi-vendor environment fee) would be subtracted once the rate is set. The current gross rate for Stable Value is 1.70% and the net rate is 1.20%. Mr. Polacek stated that because ING also offers a stable value product, participants could try to time the market between vendors and arbitrage back and forth. Because that risk cannot be easily mitigated there is a 40 basis point fee for this multi-vendor environment.

Ms. Vannaman noted that Stable Value was not approved in Texas or Puerto Rico. Mr. Polacek stated that the insurance based vehicles must get individual state approval. Although he did not know why this product had not been approved in those locations, he would provide additional information. Mr. Barnett asked if a retiree moved to Texas, would the retiree be affected? Mr. Polacek and Mr. Chaikin stated that it was their belief that the approval is based on where the plan is domiciled and not where the participant resides. Mr. Polacek agreed to follow up with the committee with a firm response.

Mr. Barnett moved that TIAA Stable Value account be recommended to the Board of Regents to replace Stable Return account and that assets be mapped from the closed fund to the new fund. After a second by Dr. Ghosh, the RPC unanimously supported the motion. This change, under the Board's Vendor Management Document, would be effective July 1, 2013. With the biweekly payroll schedule, July 1st falls within the pay period June 23 to July 6, paid on July 19th. With Board approval, ING and TIAA-CREF will be authorized to make this change no sooner than June 23th and no later than July 1st or the first business day following July 1st.

Moody's Investor Service Rating of TIAA

On December 6, 2012, Moody's affirmed the Aaa insurance financial strength rating of TIAA, however, their outlook was downgraded to negative from stable. Mr. Polacek noted that TIAA-CREF manages over $500 billion in assets (more than any time in its history) with approximately $215 billion in TIAA general account assets with an incredibly strong reserve position (approximately $33 billion in reserves which is $10 billion more than five years ago).

Moody's view is that TIAA's credit profile as very strongly linked to the U.S. government and that no U.S. domiciled company can have a rating higher than that of its government, thus affecting all U.S. domiciled AAA rated life insurance companies. The credit linkages between the U.S. government and TIAA are not unique. In conjunction with their announcement on TIAA's outlook, Moody's changed their outlook to negative for two additional life insurers: New York Life Insurance Company and Northwestern Mutual Life Insurance Company. Many state and local municipalities are constrained by the rating of U.S. sovereign debt, as well as other insurance firms.

Regent Lykins asked whether the negative outlook impacted the KBOR retirement plan. Mr. Chaikin and Mr. Polacek responded no.

ING Settlement with U.S. Department of Labor

Regents Lykins shared that he was alerted to the settlement from information provided in a letter to his law firm from the American Bar Association about its retirement funds. Regent Lykins express concern that this information had not been conveyed to the RPC from ING or Segal.

In February 2013, the U.S. Department of Labor (DOL) announced a settlement agreement with ING Life Insurance and Annuity Company that provides a $5.2 million payment to certain ERSIA retirement plan clients adversely affected by its undisclosed practice of keeping investment gains achieved when the company failed to process requested transactions in a timely manner.

Mr. O'Brien stated that the information had not been communicated because it affected ERISA plans but he apologized stating that he now recognized that the information should have been communicated. The DOL audit looked at ING's process for crediting investments and the trade date utilized. The DOL did not question the process but determined that communication about the process should have been clearer, as ERISA standards are high. The $5.2 million settlement represented net gains kept by ING that resulted from the manner in which certain transaction processing errors were handled during 2008-2011 and an additional $524,509 civil penalty.

Although the settlement did not apply to the KBOR plan as it is a non-ERISA plan, the settlement impacted ING (one of the two KBOR approved retirement plan investment companies) and members of the committee expressed interest in receiving additional information about this specific settlement and anything like it that might occur in the future. It is imperative that information about events affecting the KBOR Mandatory Retirement Plan investment companies be shared timely with the RPC. Ms. Vannaman stated that it is the expectation that Segal provide to the RPC information about either of the two KBOR mandatory retirement companies. Mr. Picarelli stated that Segal would only know about this type of information after the fact. Ms. Vannaman noted that both ING and TIAA-CREF provide information to consultants that work with their organizations alerting them to information and when Mr. Picarelli was asked about the ING settlement he suggested that additional information be secured directly from ING and did not provide Segal's independent assessment.

Mr. Robards asked whether the circumstances resulting in the settlement exist in the KBOR plan; are there retained investment gains in the KBOR plan like those discovered in the DOL audit? Mr. O'Brien responded that the same process is applied across ING's book of business and the crux of the settlement was not the process but the communication. This issue is not currently an open item on ING's non-ERISA plans. Mr. Picarelli stated that the practice and procedure ING followed is the same that is used across the industry.

Ms. Sexton asked whether the settlement would impact the KBOR plan by increasing (or decreasing) fees that KBOR participants would be expected to cover. Mr. O'Brien stated there would be no such impact.

Mr. Robards asked that both Segal and ING provide a written summation of this situation, indicate if any of it pertains to or will impact the KBOR plan and help determine whether the plan documents or contracts provide the language necessary pertaining to "hold harmless" and "in good order." Mr. O'Brien stated that he would provide such information to the RPC. Regent Lykins reiterated this request stating that we should ensure that the KBOR plan, although not subject to ERISA, provides the same type of protection for participants and requested that ING and Segal provide information

with suggestions about whether there are ERISA-related aspects that should be considered for the KBOR plan. Mr. Picarelli stated that some plans hire auditors to conduct periodic compliance audits to validate, the service providers' procedures that they employ to process participant transactions.

Dr. LeCompte asked how many assets ING has in ERISA covered plans. Mr. O'Brien stated there are approximately 35,000 ERISA plans but did not know how many assets were covered.

KBOR Retirement Plan-Related Expenses

Updated information about the KBOR expenses related to administration and oversight of the KBOR retirement plan was shared with the RPC. Mr. O'Brien reiterated ING's previous proposal to provide an annual reimbursement which is the lesser of $25,000 or the actual administrative and outside consultant expenditures per year, capped at $25,000. That amount was derived by using an estimated 27% plan participation number, which is higher than ING's assets percentage in the KBOR Mandatory Plan, and multiplying that percentage by $80,000 for estimated plan related expenses.

President Hammond stated that amount was a fair and equitable number but asked if additional funds were needed would they be provided. Mr. O'Brien responded yes.

Ms. Dixon explained that for TIAA-CREF the plan economics are reviewed annually, and from the 2012 revenue credit, TIAA-CREF would take a portion to pay the plan related expenses and distribute the excess to plan participants. The 2012 revenue credit will be $1,184,385 which is less than the 2011 revenue credit of $1.38 million that was distributed to plan participants in September 2012, pro rata based on each participant's individual account balance.

Mr. Johnson stated that a decrease in the revenue credit is to be expected as TIAA-CREF determines what it costs to record keep the plan and compares that to the plan assets and expense revenue generated. Due to the favorable plan economics within the plan, the mutual funds offered through the plan are the lowest cost share class which typically has zero revenue sharing towards the recordkeeping costs of the plan. As new assets flow to these mutual fund options we would expect the amount of revenue being generated toward the recordkeeping cost to decrease.

Mr. Picarelli stated that the industry trend is to have the investment company provide information about its cost to run the plan. With that information, the client can see how much revenue is generated from fund expenses and determine what excess revenue sharing is available. With greater transparency about record keeping costs and revenue generated from the funds, the client can arrive at an annual budget.

Mr. Johnson stated that TIAA-CREF is ready to disclose that information but noted the unique nature of TIAA and CREF annuities, which do not have separate share classes. Those TIAA funds generate 15 basis points and those CREF funds generate 24 basis points. Even though plan expenses may continue to decrease for the foreseeable future, the annuity investment options will continue to generate a large revenue credit within the KBOR plan. TIAA-CREF is looking at whether it can add additional share classes for the annuities, but it is a complex issue.

President Hammond expressed discomfort at using the revised plan related expenses provided by the KBOR Office. Mr. Barnett suggested that actual expenses could be determined at the end of the fiscal year with the payment from ING and TIAA-CREF being made in arrears.

Mr. Barnett moved that i) the Board Office calculate the actual plan related expenses at the end of each fiscal year and then ask ING and TIAA-CREF to pay for those expenses, pro-rata, based on KBOR Mandatory Plan participation percentages; and ii) the TIAA-CREF 2012 revenue credit will be used to pay for the plan related expenses with the excess distributed to TIAA-CREF participants on a pro-rata share in September 2013. After a second by Ms. Sexton, the RPC approved the motion unanimously. For calendar year 2013, the pro-rata share will be 27% for ING and73% for TIAA-CREF.

Mr. Barnett asked whether the investment returns and fees reported by Segal were net of the revenue credit amounts. Mr. Johnson indicated that the returns, as well as the investment expenses, would not be net of the returned revenue credit and indicated that Mr. Barnett was correct to point out that the return of the revenue credit to the participants does mean that they are effectively paying lower fees overall. Mr. Johnson said that it is a direct reduction in the "all in" basis point fee being paid. For example, if the revenue credit is five basis points then the total cost of the plan would be five basis points lower. Mr. Barnett asked what the amount is for this plan and Mr. Johnson indicated that he did not have the exact number but would provide it.

KBOR Target Date Funds

Ms. Delfelder and Ms. Dixon provided information about participants utilizing the target date/lifecycle funds. Both stated they believe the current information provided by each company is sufficient to provide participants with information about those funds and another brochure is not needed. A draft brochure was provided to show the RPC what a KBOR-branded educational piece might look like, but the draft version would need to be refined to ensure it was not a "sales piece," to meet the desired objectives and to pass through compliance screens for both companies.

Regent Lykins asked if a pattern was detected indicating that new participants were having problems or needed encouragement to make changes. Ms. Dixon stated that patterns indicate that participants are pretty well diversified and seem to gravitate toward the lifecycle funds as it requires one choice and the fund rebalances itself. The challenge seems to be with the voluntary plan and encouraging people to save enough for retirement.

Dr. LeCompte noted the glide path on the draft target date brochure. Mr. Polacek indicated that the glide path is for the Vanguard lifecycle funds utilized by ING which differ from TIAA-CREF's lifecycle funds which are a "to and through" glide path. Mr. Polacek stated he would provide an illustration of the TIAA-CREF glide path.

TIAA-CREF's 2013 Communication Education & Advice Program

Ms. Buckalew reviewed TIAA-CREF's plan for 2013 to communicate, educate and provide advice to plan participants through segmentation based on life stage; diversification by age, gender and fund utilization and saving attitudes. Various programs will be developed and delivered, including targeted programs to address various life stage groups and savings and allocation needs of women. An Early Engagement program will be implemented to ensure new enrollees are on-boarding into the plan appropriately.

Ms. Dixon noted that the RPC had previously asked about money market assets. The allocation from contributions to the Money Market Fund was 3.9% in 2010, 2.9% in 2011 and 2.1% in 2012. Money market assets were 2.4% in 2010, 2.7% in 2011 and 2.3% in 2012. TIAA-CREF will develop KBOR-branded communication targeted to those with 100% invested in the money market

fund and also will develop communication targeted to those with 100% invested in TIAA Traditional or 50/50 invested in TIAA Traditional and CREF Stock. Ms. Sexton asked whether communication would be in written form only, and Ms. Dixon responded that telephone outreaches targeted to this group will also be planned throughout the year.

Ms. Dixon stated that the Participant Insight information would also be broken down for and provided to each campus as different strategies might need to be developed to address campus identified communication and education programs.

It was noted that the benchmark population used in the Participant Insights data was the higher education sector with assets over $500 million which includes 131 institutions. Ms. Vannaman asked whether a different benchmark should be utilized as the KBOR plan has about $3 billion in assets. Ms. Buckalew responded that the data was analyzed to determine if any differences existed between higher education institutions over $500 million in assets with higher education institutions with more than $1 billion in assets and no material difference was found. As this data continues to be produced in future years, benchmark data will be reviewed to ensure the correct standards are being measured.

Next RPC meeting:

The next RPC meeting is *tentatively scheduled* for 12:30 p.m. on Tuesday, September 17, 2013, in the Board Room.