

SCFA RETIREMENT SUBCOMMITTEE
MINUTES OF MEETING
MARCH 5, 2012

[In these minutes: Securian Annual Review, Monte Carlo-Like Simulator Demonstration]

[These minutes reflect discussion and debate at a meeting of a committee of the University of Minnesota Senate; none of the comments, conclusions or actions reported in these minutes represent the views of, nor are they binding on, the Senate, the Administration or the Board of Regents.]

PRESENT: Daniel Feeney, chair, Wendy Berkowitz, Jane Carlstrom, Thomas Schenk, Nancy Fulton, Joe Jameson, Jackie Singer, Chris Suedbeck, Vernon Cardwell, Murray Frank, Kathryn Hanna, Harvey Keynes, Andrew Whitman, Vernon Eidman

REGRETS: James Cotter

ABSENT: Barry Melcher

OTHERS ATTENDING: Michelle Johnson, retirement plan administrator

GUESTS: Securian representatives: John Leiviska, vice president and portfolio manager, Corporate Bonds (Advantus); Richard Manke, vice president, Securian Retirement; Sean O'Connell, vice president and portfolio manager, Real Estate and Structured Credit (Advantus); Blake Reigert, manager, U of M Retirement Plans; Warren Zaccaro, executive vice president and chief financial officer

I). Professor Feeney convened the meeting, and welcomed those present. Before calling for introductions, Professor Feeney asked if any committee members would be available to attend the March 7, 2012 2:30 – 4:30 Senate Committee Chair's Meeting that will be held in the Boardroom of Coffman Memorial Union in his stead as he has a clinic commitment. He requested that anyone who is available talk to him after the meeting.

Professor Feeney then turned members' attention to materials provided by Securian that shows where money is being invested in the retirement plans, Faculty 403(b) and 401(a) Plans, Optional Retirement Plan and the Section 457 Deferred Compensation Plan. He noted that this information will be used to inform the committee's future discussions. Professor Feeney requested members bring these materials to the committee's next meeting.

Before commencing the Securian annual review, Professor Feeney called for a round of introductions. Following introductions, Professor Feeney reminded members that the committee annually meets with Securian (in addition to the Office of Investments and Banking periodic meetings with Securian) to keep a pulse on fund performance and the overall financial strength of Securian. He then welcomed the guests from Securian and turned the meeting over to Dick Manke, vice president, Securian Retirement. Mr. Manke began by noting in some detail that for calendar year 2011, Securian continued to show very strong performance, particularly in sales

and business retention, and that for the fourth year in a row, Securian paid no fines to any insurance regulator and had no class-action lawsuits or regulatory investigations or enforcement actions against any of its businesses.

Mr. Manke then turned to Chris Suedbeck, director of investments, Office of Investments and Banking, University of Minnesota, to share his impression of Securian. Mr. Suedbeck reported that he and Stuart Mason, chief financial officer, Office of Investments and Banking, meet semi-annually to review the University's investment portfolio with Securian. While he and Mr. Mason came away from the most recent meeting very optimistic and having no major concerns, Mr. Suedbeck stated that he is bothered by the low interest rates, which will make it difficult to replace some of the yields on the longer dated positions that are rolling off the General Account portfolio. Participants should expect to see their higher yields (on older deposits of funds) going down for a period of time.

Next, Mr. Manke called on Warren Zaccaro, executive vice president and chief financial officer, to provide information about Securian's financial strength. Mr. Zaccaro began by noting that Securian's core objective is to honor its promise to pay. He then highlighted some of the key metrics he looks at to gauge Securian's financial strength:

- Top-line growth or revenue growth is typically targeted to grow 8% - 12% per year. Good, appropriate measured growth is important for Securian's continued viability.
- Growth of capital, which increases Securian's "cushion" to fulfill its promise to pay. Over the last 10 years, capital growth has increased. Even in 2008 when the market took a dip, Securian maintained a "cushion" during this volatile period.
- Capital and surplus to liabilities ratio is a ratio used to denote capital inflows in excess of capital outflows. Securian leads its peer companies on this measure, and has consistently done so for a number of years.
- Risk-based capital ratio is the amount of capital based on an assessment of risks that a company should hold to protect customers against adverse developments. Securian is consistently in the top quartile of its peer group.
- Current ratings from a financial strength and claims-paying ability are also used to demonstrate Securian's financial strength. Outlooks by the rating agencies for Securian are stable. Securian maintains very high ratings from each of the rating agencies, and currently ranks 15th among insurers rated by all four agencies.
- Comdex ranking provides a numerical composite ranking of ratings. Securian's Comdex ranking compares very favorably to its peers, and has actually increased since the 2008 financial crisis.

Questions/comments from members included:

- At what point do the regulators become concerned about a company's risk-based capital ratio? Regulators become concerned whenever they see a significant drop in a company's risk-based capital ratio and/or the ratio drops to 200 or below, stated Mr. Zaccaro. Securian's risk-based capital ratio for 2011 was 516.
- What is the definition of risk-based capital? Mr. Zaccaro stated that the numerator is statutory capital and the denominator is the risk factor that is assigned to the asset, policy, or liability classes. Put differently, stated Mr. Zaccaro, statutory capital is what Securian has on its financial statements. For each asset class, regulators assign a risk factor that

companies need to hold in capital relative to that asset class. At the request of Professor Frank, Mr. Zaccaro agreed to provide the committee with definitions for the different metrics discussed today to illustrate Securian's financial strength.

- What prevents Securian from being ranked higher than 15th by all four rating agencies? Mr. Zaccaro stated that Securian's size is probably the primary deterrent to being ranked higher. In addition, the rating agencies also look at level of earnings, and because Securian is a mutual company, its focus is on capital and financial strength versus level of earnings.
- In response to a question about the steepness of Securian's decline in capital growth during the 2008 financial crisis as compared to its peers, Mr. Zaccaro explained that when the financial crisis hit, many companies in the industry went out and raised capital, e.g., borrowed from the Federal government, and by doing so lessened the decline of their capital growth. Securian did not have to borrow money. Alternatively, he noted that a number of companies in the industry went to their state insurance commissioners and requested to deviate from the industry rules for capital. Securian did not feel the need to request a permitted statutory accounting practice. Despite Securian's steeper capital growth decline in 2008 than its peers, its capital growth has rebounded nicely.

Hearing no further questions, Mr. Manke turned members' attention to the metrics Securian provides the University's Office of Investments and Banking on a quarterly basis. As mentioned earlier, stated Mr. Manke, Mr. Suedbeck and Mr. Mason from the Office of Investments and Banking meet with Securian semi-annually to dig deeper into Securian's financial performance.

Next, John Leiviska, vice president and portfolio manager, Corporate Bonds (Advantus) and Sean O'Connell, vice president and portfolio manager, Real Estate and Structured Credit (Advantus), provided information on the General Account (GA). Salient highlights from their presentation included:

- The GA is a high quality, diversified portfolio that is well positioned for slow growth.
- The GA has very little European exposure. European exposure stands at approximately \$200 million or 2% of the total portfolio. Overwhelmingly, the vast majority of this exposure is in the United Kingdom, which has similar accounting standards and legal practices to the U.S. Advantus has no Greece, Portugal or Italy exposures as well as no European bank exposure at this time.
- Approximately 84% of the GA portfolio is invested in fixed income assets and the breakdown is:
 - Corporate bonds – 50%.
 - Commercial real estate (commercial mortgage-backed securities, and a direct commercial loan portfolio) – 22%.
 - Residential real estate securities (agency, which includes Fannie Mae, Freddie Mac and Ginnie Mae and also non-agency, which include non-guaranteed residential mortgages) – 20%.
 - Non-residential asset-backed securities – 2%.
 - Governments – 2%.
 - Cash – 4%.

- The GA portfolio is extremely diversified across sectors. While Advantus is not paid to avoid risks, it is paid to underwrite them and to make the best relative value decisions possible.
- Ninety-five percent of the GA portfolio bonds are rated investment grade versus the industry as a whole, which is at about 93%. Five percent of the GA bonds are invested in below investment grade bonds as compared to the industry, which is at 6.9.
- The corporate and structured internal watch lists have been substantially reduced from 2010 to 2011. The total watch list holdings are down to \$191 million, a \$135 million reduction from \$326 million. As a percentage of the overall assets, the corporate and structured watch listed securities represent less than 2% of the GA portfolio.
- The commercial whole loan portfolio is very diversified and is valued at \$1.4 billion. The largest loan in this portfolio is \$22 million. This is a very thoughtful portfolio that has been built over time.

Members' questions and comments included:

- Please elaborate on Mr. Suedbeck's earlier comments about low GA interest rates and talk about what the rollover situation might look like. If Ben Bernanke, chairman, Federal Reserve Board, keeps his word about interest rates, what will be the effect on the yield on the GA over the next three years? Because fixed income is indexed to the ten-year treasury, noted Mr. O'Connell, any fixed income investment or risk asset will be spread over this ten-year period. Currently, the ten-year Treasury note trades between 1.9 – 2.05. Out of approximately an \$11 billion portfolio, roughly \$900 million rolls over every year and will need to be reinvested. If the current rate environment stays where it is over time, on a yearly basis the GA portfolio yield will continue to decline. While it is impossible to predict interest rates, from a risk mitigation position, a lot of time is spent thinking about what to do if the rate environment continues to be low. Regarding effects on the GA yield, stated Mr. Leiviska, Advantus estimates that the average portfolio yield will face a decline; however, a majority of the portfolio is invested longer-term. Mr. Leiviska estimates the decline will be about 15 basis points per annum if the rates stay where they are currently at. Mr. Manke reminded members that the GA and GA Limited have a 3% minimum guarantee.
- What is the average loan to value on the GA portfolio? Approximately 55%, stated Mr. O'Connell.
- Were any losses/write-offs taken in 2011? The total portfolio investment loss, according to Mr. O'Connell, including loans and bonds was \$12 million, which includes \$3 million from the commercial whole loan portfolio.
- How does index life insurance play into the GA portfolio? Mr. Leiviska stated that index life insurance is an emerging product in the industry. The assets from index life insurance go into the GA. The duration of these liabilities is longer, and Advantus actually tries to buy assets to match the liabilities. It is not a segmented portfolio, but it is a GA obligation. This product also employs hedging.
- Regarding the current crediting rates for the GA, which is at 3% for new money, how long is it projected to stay at this level? If the rate environment stays where it is today Advantus will be able to invest dollars in the market at rates higher than 3%, stated Mr. Leiviska. Mr. Manke clarified that rates over 3% are the gross rates, and expenses,

contributions, and surplus still need to be factored in. With that said, it is likely the GA will remain at 3% for awhile, stated Mr. Manke.

- Does Securian plan to make any political contributions in the foreseeable future? Mr. Manke stated that it is his understanding that Securian has not made any recent political contributions and has no plans to do so at this time. If Securian's position changes, Mr. Manke agreed to let the committee know.

Professor Feeney thanked Mr. O'Connell and Mr. Leiviska for the presentation.

Moving on, Blake Reigert, manager, U of M Retirement Plans, briefly highlighted Securian's 2011 service highlights, which included:

- Implemented the personal rate of return calculator. With the personal rate of return calculator, participants are able to calculate returns using account activity from January 2002 to present. The results can be viewed at an individual holding level (one fund), plan level, or across all plans a participant has with Securian.
- Distributed an educational newsletter to all participants titled, "*Money management today for a better retirement tomorrow,*" and delivered educational inserts in all quarterly statements.
- Conducted over 300 one-on-one retirement plan review meetings with University participants.
- Implemented enhancements to show participants General Account and General Account Limited balances by individual crediting rate on their quarterly account statements.

Mr. Reigert then turned members' attention to the statement educational insert schedule for 2012 through second quarter 2013. The purpose of these statements is to help further educate plan participants about general retirement planning topics. Mr. Reigert encouraged members who have suggestions for other educational inserts to contact him.

Professor Feeney asked if Securian keeps a library of the educational inserts on its website so participants can refer back and/or new participants can read about past topics. Mr. Reigert noted that this is a good idea, but currently the inserts are not on Securian's website.

II). Next, Mr. Reigert demonstrated a prototype of Securian's newest calculator, a Monte Carlo-type simulation, which employs a computerized mathematical technique that allows people to account for risk in quantitative analysis and decision making. The simulation provides participants with extreme possibilities for rates of return — a high market return, median market return and a low market return.

Members' comments/questions included:

- The simulation assumes a blended portfolio, but in reality members will likely be skewing to different asset classes. Mr. Reigert stated that the simulation uses the six asset classes, and is unable to get to the granular level of detail to further segment an asset class. The amount of variation over the long-term will yield less variation and the likelihood of a material impact on a participant's portfolio is less; however, in the short-term there would definitely be greater variation.

- Will participants have the ability to adjust the confidence level of the simulation? Also, does the model have the capability to show how many occurrences happened outside the projections? Currently, stated Mr. Reigert, the simulation has a 95% confidence level that the rate of return will fall somewhere between the high and low projections. This confidence level is not adjustable at this time. According to Professor Frank, regarding the question about occurrences outside the Monte Carlo-like projections, such information could be misleading.
- The language on the calculator, “*All information and assumptions are based on historical and standard deviation data,*” is vague and difficult to interpret. Please make sure that if participants are interested in knowing more about the methodology behind the calculator that it is available to them. Mr. Reigert stated that there will be a link on the calculator site so members can get a more in depth explanation about the methodology.
- Please be sure participants have access to their total contribution figure when using this calculator.
- The calculator should be able to allow for multi-year withdrawals for the years that participants are in retirement.
- When will the calculator be rolled out? Mr. Manke stated that the calculator will be launched by the end of the calendar year if not before.
- Please comment on the speed of the calculator. Mr. Reigert stated that as designed the speed is very fast, but the number and complexity of the calculations will ultimately dictate speed. Professor Feeney suggested keeping it practical.
- Encourage the programmers to explore having the calculator be able to choose the mandatory withdraw rate after the person enters his/her age.

Before adjourning, Professor Feeney suggested that Securian come back in May and demo the calculator again before it is finalized.

III). Hearing no further business, Professor Feeney adjourned the meeting.

Renee Dempsey
University Senate