SCFA RETIREMENT SUBCOMMITTEE
MINUTES OF MEETING
OCTOBER 15, 2003

[In these minutes: Call to Order, Personnel Changes at Minnesota Life and What this Means for the University's Retirement Plans]

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

PRESENT: Richard Goldstein, Gavin Watt, Barry Melcher, Jackie Singer, Chris Suedbeck, Gordon Alexander, Daniel Feeney, Kathryn Hanna, Jean Kinsey, Michael Murphy, Herbert Pick, Warren Ibele

ABSENT: Dwight Purdy

REGRETS: Robert Jones, Fred Morrison

I). Professor Feeney called the meeting to order.

II). Professor Feeney called on Chris Suedbeck from the Office of Asset Management and Jackie Singer of Employee Benefits to speak to recent personnel changes at Minnesota Life and what this means for the University's retirement plans. According to Mr. Suedbeck one reason this is important is because Advantus helps manage the assets of the general account and general account limited. The Office of Asset Management also is concerned because Advantus was recently hired to manage a portion of the fixed income allocation for its endowment fund.

Mr. Suedbeck distributed several handouts for members to review. He asked members to refer to a chart that illustrates what comprises the General Account funds. While a vast majority of the General Accounts are made up of fixed income type securities such as corporate bonds, mortgages, government bonds, etc. there remains a significant portion of the fund comprised of 'Other' securities. The University asked Minnesota Life what types of securities are included in the 'Other' category, which totals $554 million or 5.8% of the General Account.

In addition, after further investigation, it was discovered that securities in the

General Accounts have had a rather poor rate of return, which was alarming. Mr. Suedbeck announced that the University and Minnesota Life will hold their annual meeting in November and this is an issue that needs to be addressed. Besides needing to know what assets are included in the 'Other' category of the General Account/General Account Limited funds, the University needs to establish targeted investment returns for these funds. Mr. Suedbeck and Ms. Singer believe it is imperative that the University develop benchmarks to determine how well the General Account and General Account Limited funds are performing. Except for the General Account and General Account Limited funds, the University has benchmarks for all of its other investment options, which it uses for comparison purposes to rate how a fund is performing. These concerns have prompted Ms. Singer to have a conversation with TIAA CREF to determine if their Supplemental Retirement Account would be available to the University's Faculty Retirement Plan.

Mr. Suedbeck also noted that Faculty Retirement Plan (the "Plan") participants may be under the impression that General Account returns are guaranteed, and this is not true. He added that while there is minimum guaranteed level of income this is only backed by Minnesota Life, a AA rated company. Professor Feeney added that the Minnesota Insurance Guarantee Association also protects accounts up to $100,000.

Next, the discussion turned to recent ERISA lawsuits and their outcomes. While the University's Faculty Retirement Plan is not an ERISA plan, the University's counsel, Gray, Plant, Mooty, advised the University to have an investment policy in place to ensure oversight of the Plan. If the University's behavior is ERISA-like, this could provide some protection from lawsuits.

Next, Ms. Singer provided members with a handout, which outlines accounts offered by TIAA CREF and Minnesota Life. Of particular concern to Ms. Singer is the lack of information on many insurance-type accounts, including fees and performance. As a result, more formal controls need to be put in place to monitor investment performance. Unfortunately, the University does not yet have an investment policy for its various funds.

What prompted the University to turn its attention to the General Account?

1. The University was notified in November 2002 that Minnesota Life would no longer manage in-house equities. This resulted in major lay-offs to the Minnesota Life equity teams.

2. Minnesota Life's Total Return Group was bought out by AXA. This pretty much decimated Minnesota Life's ability to handle Total Return investments, which are very labor intensive and require a keen understanding of the market. In contrast to the Total Return philosophy of managing fixed assets, many insurance companies choose to practice the Buy & Hold approach. This strategy involves buying high yielding bonds and holding these bonds until they mature.

Next, Ms. Singer distributed a handout comparing the University's TIAA CREF and Minnesota Life investment accounts. Part of the reason the turnover at Minnesota Life raised eyebrows at the University is because Minnesota Life does not have the national presence that TIAA CREF holds. Thus, the University's investments with TIAA CREF do not represent nearly the percentage of that company's assets that the University's investments with Minnesota Life represent. The University holds a very large proportion of the assets in the Minnesota Life General Account and General Account Limited funds.

Ms. Singer reviewed the University's existing investment options with the Subcommittee. She noted, historically, when funds have been added to the investment options, existing funds have not been eliminated. Ms. Singer would like to engage the Subcommittee at a future meeting in a discussion of reconsidering this practice. While replacing a fund creates a risk because people are being forced to potentially take a loss, Ms. Singer argued that there is also a risk in retaining a fund for investment even if future contributions are frozen. She noted that if contributions to a fund are being frozen, there is a reason why this happening e.g. poor performance, turnover in managers, too much risk for the returns that are being recognized, etc.) If there is a reason to freeze contributions then there is a corresponding reason to not offer the investment in the Plan. Mr. Suedbeck added that as long as the University has plan participants in a frozen fund, it has a fiduciary responsibility to continue monitoring that fund.

Towards the end of last year, the question came before the Retirement Subcommittee whether mid-cap funds can be added to the University's investment line-up. Based on information collected, institutions that are offering both 'value' and 'growth' funds tend to offer a balance of the two. In addition, several institutions are offering 'blended' funds because they cover both extremes and not as many investment options are needed. In Ms. Singer's opinion, as long as the University continues to offer blended funds in its stock/equity investment portfolio it does not need to worry about adding value and growth funds. Currently, the University has:

- Several large cap stock/equity investment options
- A lack of mid-cap stock/equity value options
- No small-cap stock/equity investment options
- Gaps in its Global (includes United States) and Foreign bond/money market investment options

The Subcommittee's input was solicited to help guide Ms. Singer and Mr. Suedbeck in their efforts to expand the University's investment line-up. Mr. Suedbeck noted it will be important to offer a nice selection of opportunity for plan participants, but, if too much is offered, participants may chase what was "hot" last year, which is more than likely not what is "hot" this year e.g. fixed-income. Mr. Suedbeck suggested that he and Ms. Singer look into offering Plan participants small-cap and global long-term options.

Professor Feeney provided some historical perspective to the discussion by noting that in the early to mid 1990s arguments were made to offer small-cap funds. Concern was raised because technically it would be possible for someone that lacks investment knowledge to lose his or her entire retirement account if it was unwisely invested in a small-cap fund. If this happens, what would be the University's liability? Mr. Suedbeck believes that if a fund manager is chosen wisely and the University offers an index fund, which is constrained to the benchmark, risk is limited.

A member noted having a difficult time finding a short-term bond option in the investment line-up. Again, Professor Feeney noted that this concern had been raised in the past as well. At that time, it was decided that the cost of adding this type of fund was not worth the limited number of participants that would choose it because there was not much return differentiation from the General Account or General Account Limited funds.

In response to concerns over the University's liability, Ms. Singer noted that the University has several educational processes in place which include prospectus releases, the faculty retirement booklet, the availability of benefits counselors for one-on-one counseling sessions, educational seminars, etc., to help protect it.

Dr. Feeney summarized the two issues before the Subcommittee:

1. How should the Minnesota Life situation be handled?
2. What should be done about the University's investment line-up? Should funds be added?

Next, Ms. Singer distributed a draft of the *Investment Policy Guidelines for the Faculty Retirement Plan.* TIAA CREF shared their investment policy guidelines template with Mr. Suedbeck and Ms. Singer who fine-tuned and structured it according to the University's Plan. Ms. Singer asked members to review these guidelines and recommended that at a future meeting an investment policy draft be brought forward for discussion. On a side note, Ms. Singer pointed out that many TIAA CREF clients are reluctant to invest in funds with less than $100 million in overall assets. They want something larger because they do not want to be such a significant piece of the pie. Currently, the University has two funds with Minnesota Life where the funds are not worth more than $100 million, the Advantus Bond Fund and the Advantus Money Market Fund. (This relates to the issue concerning what portion of the University's assets comprises the General Account). Regarding investment policy, Mr. Suedbeck added that the Office of Asset Management, at the request of the Board of Regents, recently outlined a policy for managing all the University's assets (not only the endowment but other funds as well). This was a very valuable exercise in clarifying roles. In the long run, these efforts will help the University be more effective at managing its assets. Having just completed a similar exercise he reaffirmed the importance of the Subcommittee putting their investment policy guidelines on paper as another safety net for the University.

Professor Feeney noted at one point there was talk of going out to bid for a General Account equivalent. Is this still a consideration? Mr. Singer is in the process of securing a purchasing exception, which would permit a re-bid as necessary but would not require that a re-bid be conducted every so many years. From a fiduciary standpoint, it is not prudent to set up a regular re-bid schedule for its investment funds. It would not necessarily be in the University's best interest to purchase funds with the lowest basis point fees. Ms. Singer plans to talk to the University's vendors to determine what assets they offer are biddable. Ms. Singer does not want to panic the vendors, so she is waiting for the Regents' exemption to proceed further. Ms. Singer is concerned with the General Account Limited fund. Because of the way the contract is written, if a decision was made to take money out of the General Account Limited fund, it would be subject to negotiated fees with Minnesota Life. The University could face significant penalties for pulling monies from the General Account Limited fund. More than likely this contract restricts withdrawal because Minnesota Life invested the money in longer-term options in order to pay higher returns. Therefore, it is likely there would be penalties for pulling money from the General Account Limited fund. Professor Feeney offered another option and suggested rather than pulling the money from the General Account Limited fund, assuming a better option is found, prohibiting new money from being invested in the account.

Replacing a fund is a very fine line according to Ms. Singer. It is not wise to wait until returns have dropped off to the point of no return before a fund is replaced. However, at the same time, the investment management turnover at Minnesota Life may have no impact whatsoever on the General Account and General Account Limited funds. Ms. Singer recommends proceeding with caution and carefully watching the returns on the funds over the next quarter or two before pulling the University's funds. Mr. Suedbeck concurred with Ms. Singer noting that the University has no benchmark in place to determine whether it is getting the return it should. He added that Minnesota Life is aware that the University is concerned with their turnover.

Mr. Suedbeck encouraged the Committee to:

- Set targets and benchmarks for the General Account.
- Consider setting investment restrictions to the General Account and General Account Limited funds.

Mr. Suedbeck solicited input from others on items that should be addressed with Minnesota Mutual at the annual meeting in November. The following topics were raised:

- Fee structure – with Minnesota Life holding over $1 billion of University participants' money, it may be a time to renegotiate their fee structure. Is the University of Minnesota, Minnesota Life's largest client?
- Composition of the asset allocations within the General Account and General Account Limited funds.

Mr. Suedbeck and Ms. Singer will work towards setting up the semi-annual meeting with Minnesota Life.

To summarize, Professor Goldstein noted the following concerns with respect to the funds being managed by Minnesota Life include:

- Safety of the funds.
- Rate of return.

Mr. Suedbeck explained when monies have been moved from one manager to another within the endowment fund, the entire portfolio had to be moved to a transition manager and the transition manager was responsible for liquidating the assets involved. Because transition managers are paid based on the liquidation of those assets, they tend not to fire sale these assets. Ms. Singer added that if the University chooses not to liquidate its accounts with Minnesota Life and go out to bid, the University would be less attractive in the market and the fee structure offered by recordkeepers would be directly proportional to the type of assets they have for management. It is important to note, if the University decides to go to bid and decides not move its funds after the bidding process, the University would have to find a recordkeeper that would be willing to keep records on another vendors funds. Another consideration is the cost of these services. Mr. Suedbeck believes that Fidelity, Vangard and TIAA CREF would probably all be interested in offering recordkeeping services to the University. According to Ms. Singer, although Fidelity has expressed an interest in doing master recordkeeping for the University, it has not indicated how much it will cost.

Ms. Singer proposed that she and Mr. Suedbeck conduct a fund analysis and at a future meeting bring back various fund options to expand the investment line-up. Quality options will be brought forward for the Subcommittee to consider in terms of small cap funds, global bonds, etc. Mr. Suedbeck urged caution in terms of choosing an actively managed account versus index account because of performance issues that may arise.

It was also suggested that Gray, Plant, Mooty General Counsel Dick Hackett be invited to a future meeting to help members understand what they need to know in order to exercise their fiduciary responsibility. Ms. Singer noted that basic fiduciary responsibility involves keeping the participants' interests first in mind. In addition, it was suggested that it would be helpful to have Mr. Hackett speak to the impact of ERISA as well.

Ms. Singer suggested that Minnesota Life be invited to the University in November to conduct their investment review. Then, schedule a separate meeting to for the Subcommittee to discuss the General Account and investment options, etc.

Professor Goldstein would like to get the following items on future Retirement Subcommittee agendas:

- Waiting period for new faculty to participate in the faculty Retirement Plan.
- Discuss the proposal of taking 1/2% out of the 13% that is contributed into the Faculty Retirement Plan and putting that 1/2% into a Post Retirement Health Care Savings Plan.

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

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