SCFA RETIREMENT SUBCOMMITTEE
MINUTES OF MEETING
APRIL 7, 2008

[In these minutes: Securian Annual Review]

[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: Michael Murphy, chair, Gavin Watt, Nancy Fulton, Joe Jameson, Barry Melcher, Jackie Singer, Chris Suedbeck, Gordon Alexander, Daniel Feeney, Kathryn Hanna, Dian Lopez, Burt Sundquist

REGRETS: Richard Goldstein, Kathleen Hansen, Fred Morrison

OTHERS: Rosalie OÕBrien, counsel to the committee, Harvey Keynes, Shonna Schroeder, Michelle Johnson

GUESTS: Securian representatives: Randy Wallake, Vice Chairman & President; Warren Zaccaro, Executive Vice President & CFO; Greg Strong, Senior Vice President, Chief Actuary and Treasurer; Dick Manke, Vice President, Securian Retirement; Blake Reigert, Manager, U of M Retirement Plans

Advantus representatives: David Kuplic, Executive Vice President; Sean O'Connell, Vice President, Director of Real Estate and Structured Finance; Lynne Mills, Senior Vice President, Portfolio Manager Minnesota Life General Account

I). Professor Murphy called the meeting to order, and asked those present introduce themselves.

II). Professor Murphy welcomed today's guests from Securian and Advantus. He then called on Dick Manke, vice president, Securian Retirement, who briefly highlighted their agenda.

Mr. Manke turned to Securian Vice Chairman & President Randy Wallake and requested that he provide the committee with a Securian update. Mr. Wallake highlighted the following:

- Total sales in 2007 of all products distributed by Securian Financial Group and its subsidiaries increased by 19% totaling over $6 billion. Sales are important because they are a leading indicator of revenue growth.
- Life insurance sales represent the primary financial protection provided by Securian. Total life insurance in force increased 10%, to nearly $635 billion. Life insurance represents a significant portion of Securian's revenue growth.
- In 2007, Securian's revenue growth increased 12%, and totaled $2.9 billion, including $2 billion of premium and fee income, and $546 million of net investment income. Premium growth contributed to this increase. Revenue growth directly impacts Securian's capital growth.

- Securian realized a 6% increase in capital for 2007. Total 2007 capital was $2.8 billion. This money is excess capital over and above the normal reserves that Securian is required to set up. Securian's capital balance should be looked at as the company's financial cushion.
- Securian's marketing and business operations include:
    - Individual business – This is primarily Securian's retail business, e.g. individual life insurance, individual long-term care insurance. Total sales of all products in this category increased 21%, with sales by Securian's broker-dealer increasing 27% to a record $3.2 billion, marking the fifth consecutive record year. Securian's individual business impacts its total revenue picture.
    - Group Life Insurance – Securian's target market for group life insurance is Fortune 1,000 companies. It now ranks as the fifth largest administer of Group Life Insurance in ths industry.
    - Financial Services – This is a middle market, credit, life and income protection operation, e.g. credit life insurance, mortgage life insurance.
    - Retirement – This operation includes the University's Faculty Retirement Plan (FRP), 401(k) business and individual annuity business. In 2007, all totaled, Securian had in excess of $13 billion under management in this area. Sales in this area topped $1 billion for the first time in 2007, a 21% increase over 2006.
    - Asset Management or Advantus – This operation set a record for the 4th year in a row with sales reaching $1.2 billion.
    - Securian is a mutual company, which exists to pay benefits. In 2007, Securian paid $3.6 billion in total benefits to policyholders and beneficiaries.
    - Securian met its annual objective of being among the 25 most highly rated insurance companies that are rated by all four major rating agencies. Year-end 2007, Securian ranked as the 16th most highly rated company.
- Total assets under management in 2007 increased by 9% to approximately $30 billion.
- In 2007, Securian's capital and surplus liability ratio was over 26%, ranking it the highest among the companies it benchmarks itself against.

Next, David Kuplic, Executive Vice President, Advantus Capital Management, provided the committee with Advantus' economic and investment outlook. He began by noting that there are currently issues in the subprime market that are causing financial issues across the county.

The subprime disruption, which is being caused by the cooling of the housing market and inappropriate lending/borrowing, is expected to result in $200 - $500 billion in losses to the economy. The economy is experiencing a significant number of losses from many different sources, which are primarily being driven by lending standards that were too loose. What makes this disruption different from previous years is that losses have been distributed throughout the entire financial system.

Federal Reserve Chairman Benjamin Bernanke, in Mr. Kuplic's opinion, has done a good job of taking corrective action, e.g. cut Federal Fund Rate by 2.25% as of March 18, 2008, and the Federal Reserve Bank expanded the discount window and started term auction funding, which allows non-banks to borrow from the Fed.

In terms of unemployment, March 2008 unemployment rates ticked up to 5.1%, which is not particularly good. In the 1980s and early 1990s, there were multiple months when there were 200,000 – 300,000 jobs lost. If the current economy is able to maintain job losses at 80,000 – 100,000 per month, while it will be painful, it does not suggest there will be a major downturn. On the other hand, if job loss figures rise into the 300,000 – 500,000 range, this would seriously impact the economy. When thinking in terms of jobs and job growth, generally speaking, 100,000 – 150,000 jobs, is decent growth. The Securian outlook is built around the belief that job growth will not fall off significantly.

Inflation is another concern of the Fed. Currently, the inflation rate is slightly above the 2% upper range that Mr. Bernanke prefers. New Personal Consumption Expenditures (PCE) Index figures will come out on April 30. According to Mr. Kuplic, it appears that inflation is pretty well contained. Certainly there is inflation on the commodity side of the economy, but there is not a lot of wage-based inflation, which is of greater concern.

Mr. Kuplic summarized the Advantus outlook by highlighting the following:

- Subprime contagion will continue through 2008.
- Markets are expected to stabilize in the second half of the year.
- There will be weak economic growth/recession in the first and second quarters of 2008, and below long-term trend for the next four quarters.
- Inflation will remain slightly elevated, but there is no high relative concern at this point.
- The Fed has done a good job at keeping the Fed Funds rate low.
- 10-year Treasury Rates are in the 3.3% to 3.8% range.

Next, Advantus Vice President, Director of Real Estate and Structured Finance Sean O'Connell provided information on the residential real estate market. As background, he walked members through the creation of securitization, a structured finance process, which involves pooling and repackaging of cash-flow producing financial assets into securities that are then sold to investors.

Mr. O'Connell described the different types of mortgage quality:

- Prime – Conform to Fannie Mae standards, which requires full documentation (verification of income and assets), and strong credit scores.
- Alt-A – Generally prime borrowers, but with a wrinkle, e.g. low documentation, vacation home.
- Subprime – Weak credit scores (below 620) and usually no verification of assets or income.
- Jumbo loan – Size of mortgage is over "conforming loan amount" – generally any loan above $417,000.

Types of mortgages include:

- Conventional – Fixed-rate mortgage, with equal monthly payments of principle and interest over a fixed period of years (generally 30 years).
- ARM – Adjustable rate mortgage - interest rate resets periodically, changing the monthly payment.
- Option ARM – Borrower has the option to make less than the scheduled monthly payment for a period of time; shortfall is added to the principal balance.

Using a diagram, Mr. O'Connell, using layman's terms, described the complicated bond structure. Then, using a chart he explained why credit scores matter. He noted that FICO scores, a measure of risk, significantly influence the total interest a borrower pays.

Moving on, copies of questions Professor Murphy asked Securian to address at today's meeting were distributed. These questions include:

- How has the General Account (GA) been affected by the decline in the residential mortgage market?
    - What are Securian's total holdings in residential mortgage securities? According to Lynne Mills, senior vice president, portfolio manager Minnesota Life General Account, Securian's total residential exposure is at approximately $1.7 billion. Of this $1.7 billion, $1.1 billion is agency-backed securities, Ginnie Mae, Fannie Mae, and Freddie Mac. The remaining $600 million is divided up into two categories, 1). prime, non-agency backed securities (first lean collateral that is not guaranteed), 2). non-prime exposure.
    - What is Securian's exposure to subprime mortgages? A chart detailing the different types of collateral that Securian has exposure to, and the ratings of these holdings was distributed to members. Securian's subprime and other non-prime mortgage exposure totals $338 million of book value noted Ms. Mills. She added that Securian's total subprime exposure is $68 million. Mr. Kuplic stated that Securian's subprime loan exposure is relatively small, and asked that members scale this exposure to the size of Securian's portfolio and capital. Securian is a very well capitalized company.
    - Does Securian anticipate that it will experience any additional losses on securities related to the residential mortgage market? Ms. Mills stated that Securian will likely experience more losses. Securian conducts detailed surveillance on all of its securities; it has a handful of residential securities that are not performing as desired. At this point these securities have not translated into any real losses, but it could. The bigger issue will likely be the market valuation of these securities.
    - Are there any other sectors or industries within the GA that have been affected by the problems in the residential mortgage market? What is the size of those exposures? Ms. Mills noted in its corporate bond portfolio, Securian has exposures in the financials industry, e.g. major banks and investment bankers. The other area that Securian is watching carefully is its homebuilder exposure - $22 million.

Questions/comments from members:

- What was Securian's capital position in 1999? Greg Strong stated that capital was below $2 billion in 1999; Securian is currently well above its previous 'high water' mark.
- Please speak to Securian's debt structure. Mr. Kuplic stated that their company has $125 million of surplus, most of which was issued 10 – 20 years ago. Interest rate on this debt is at 8.25%. Ideally, Securian would like to refinance this debt, but if it did a pre-payment penalty would be imposed. This is really the only debt the company has.
- In your opinion, Mr. Kuplic, has the subprime disruption been contained by the Feds' actions? Will the economy be able to pull out of this recession relatively smoothly, or is

it likely another shoe will drop? Mr. Kuplic stated that he believes the Fed avoided a financial system collapse, which would have/could have put the U.S. in a Great Depression situation. Mr. Bernanke averted this collapse, and it appears he is saying that he will not allow large financial institutions to fail. This does not mean that there will not be significant losses or that other institutions could follow down the Bear Sterns path. According to Mr. Kuplic, Mr. Bernanke has done a good job of averting a financial crisis. The reasonable question is whether he will be able to stimulate the economy to grow. Saving financial systems from being destroyed is different than keeping the economy from going through a recession. Mr. Kuplic believes that the economy is in a recession, but, due to the corrective action that has been taken, there will not be a major economic crisis.

- In terms of inflation, the PCE (Personal Consumption Expenditures) Index tells a different story than the CPI (Consumer Price Index), which is being driven up by gas and food. Does the PCE have a food and energy component? Mr. Kuplic stated that given the overall inflation figure, if the CPI number were closer to 4% that would be of greater concern. The long-term argument is that these figures cycle.
- How will the economy ever recover if the government continues to take over debt by coming to the rescue of financial institutions such as Bear Sterns, and the debt that is being created by the war? With the value of the dollar so low and the fact the U.S. has lost numerous manufacturing jobs, the U.S. essentially has limited exports. How should the government deal globally to protect its investments? Mr. Kuplic stated that the U.S. economy is in a conundrum for which there is no simple way out. The weak dollar is helping exports, but the U.S. is not the manufacturing economy it used to be 20 – 30 years ago. It is questionable as to whether services can be exported, e.g. health care expertise. The government is in a difficult position, and is faced with a lot of expenses. The lowering of the short-term rates has been part of the problem. If the short-term rates come back, there might be some improvement in the value of the dollar.
- How are commodity prices factored into to the Advantus economic outlook? Mr. Kuplic stated that this is a socio-economic question, which will need to be wrestled with. The competing use of commodities for food versus fuel (e.g. corn) will undoubtedly drive prices up. Hopefully in the long-term, wind and solar energy will be used to a greater degree than it is now.
- Reasonable adjustments to the assumptions put forward today could result in a completely different outlook for the economy that would be much more dower. Mr. Kuplic agreed, and stated that broad fixes in certain areas, e.g. energy, deficit, will need to occur in order for the economy to improve.
- What percentage of the entire mortgage market did subprime represent? Mr. O'Connell stated that subprime loans represent 7% of the mortgage market. This number is slowly coming down.
- Is it accurate to say that no lending agencies are originating subprime loans? No new subprime loans are being issued.
- Is it true that the actual number of loans involving fraud on the part of the borrower is relatively low? Probably, stated Mr. O'Connell, but the instances are fairly significant; for example, people collaborating to artificially inflate the price of a home, and go to a bank to get a mortgage knowing they will never pay that mortgage back.

- Rhetorically speaking, given that Wall Street created subprime mortgages (debt instruments), what are they creating now that will develop into a crisis?
- How did Securian arrive at the market values for their subprime and nonprime mortgage exposure? Securian uses a third party pricing service who has access to observable market trades. Securian does not necessarily agree with some of these valuations; the market value is soft.
- Please speak to CMBS and whole loan issues. Mr. O'Connell stated that a lot of this market is locked up, and there are not many identifiable cash trades.
- Most of the results that were shared in today's presentation are as of December 31, 2007, and a lot has happened in the last 3 months, which is very disconcerting. Mr. Kuplic stated that Securian is in the process of pulling together its quarterly numbers. He stated that based on the results he has reviewed; Securian is in good shape. The rating agencies have recently affirmed Securian's ratings. Securian has also benchmarked itself against competitors in the industry, and while a lot of that data used was from December 31, 2007, Securian was in excellent shape relative to the industry. Once industry data for the first quarter becomes available in a few months, Securian's position compared to the industry will be evaluated, but it is not expected to change. Mr. Kuplic stated he is very comfortable with Securian's position. Securian has a fundamental bottom/up style of investing; it spends a lot of time and energy analyzing the securities it purchases.

In light of time, Professor Murphy encouraged members to email him with any additional comments or questions they would like Securian to address. Then, maybe at future meeting, a subset of today's guests could return and continue today's discussion.

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

Renee Dempsey
University Senate

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* For more information about Securian's financial strength, please click here and click here.