

Tax-Sheltered Annuity Review Committee

Minutes

November 2, 2007

Members Present: Kevin Bahr, Robert Carney, Howard Erlanger, Carol Fischer, Kathleen Kelley (Chair), Robert Kunkel, Valeriy Sibilkov, Donna Weber

Members Absent: David Porter, Randall Ryder (Ex-officio)

Staff: Chris Ashley, Sue Chamberlain, Terry Lauber, Rose Stephenson

TSA Vendors: Jeff Janechek, Eva Spenny, Ameriprise/RiverSource; Peter Palmieri, Dreyfus; Garrett Feldkamp, Bob Jenkins, Eric Kline, Fidelity; Betty Custer, Lynn Gump, Lincoln; Doug DiCocco, TIAA-CREF

Guests: Rollie Junke, Past Chair, TSARC; Kara Webber Schiro, UW Service Center

Kate Kelley called the meeting to order at 10:05 a.m.

1. Introductions

The TSA Review Committee, UW System staff, and guests introduced themselves.

2. Approval of Minutes

MOTION: Carol Fischer moved approval of the minutes of the April 27, 2007 TSARC meeting as submitted. Kevin Bahr seconded. Motion passed unanimously.

3. Target Retirement Date Funds, Fidelity Freedom Funds

The Pension Protection Act gave plan sponsors the ability to allow their investment companies to use age appropriate retirement-date funds (also known as lifecycle funds) as default funds.

Garrett Feldkamp, Fidelity's Client Relationship Manager to the UW System, introduced Bob Jenkins, Investment Director for the Asset Allocation Group of Fidelity Investments. Mr. Jenkins presented a bound report "Fidelity Freedom Funds – The Past, Present and Future of Retirement Investing" dated September 2007 to the committee. He talked about the value of lifecycle funds and highlighted parts of the report. Fidelity launched its original five Freedom Funds in 1996 to take the complexity of investing out of the investor's hands. The lifecycle funds are in five-year increments. The Freedom Funds are composed of three elements: asset allocation, portfolio construction, and monitoring & management. A lifecycle product goes from a more risky exposure at the beginning of the investment horizon and gradually moves to a more conservative allocation over time. Mr. Jenkins explained that Fidelity's team tries to do its best to neutralize risk exposures across the style sectors and capitalizations. A retirement age of 65 is assumed. Actuarial data suggest that individuals survive to a life expectancy of age 85, given a 65 retirement. One of the biggest risk factors is longevity.

Fidelity surveyed default investors and found that default investors in a typical retirement plan are looking for a pension-type solution where their investments are taken care of for them. They want the comfort and security of knowing that the decisions are being made, and that they are the best decisions in general. Bob Jenkins stated his belief that now that lifecycle funds have been given the final blessing of Congress to be the primary default vehicle, in five to ten years increasingly they are going to be a primary source of people's retirement savings. Once participants invest in the Freedom Funds approximately 85% stay with them.

Rose Stephenson had mailed to the committee Fidelity's Regulatory & Legislative Update regarding the Department of Labor's issuing a final regulation relating to Qualified Default Investment Alternatives in participant-directed individual account plans. She reported that our default fund with Fidelity is the Fidelity Retirement Government Money Market Fund (FRGMMF). Even though Fidelity sends out three letters to participants who defaulted into the FRGMMF, participants do not always respond. The FRGMMF is very secure, but it does not have a robust return. With the other investment companies, even though a person is defaulted into a money market fund, that person has to make an active fund decision within the Department of Labor guidelines of less than 120 days. The people who are invested in the FRGMMF have often been in the fund much longer than 120 days – in spite of the three letters Fidelity sends out.

Since we are a public institution and a governmental plan, our non-ERISA status is assured, and there is nothing within reason that could endanger it. The bulletin that the Department of Labor issued does not apply specifically to us; however, it does describe best practices for plans.

When contributions are defaulted into a lifecycle fund, it is assumed that the person is retiring at age 65. That is the only option under safe harbor.

MOTION: Howard Erlanger moved that the Fidelity Freedom Funds be the Fidelity default effective November 2, 2007. Robert Kunkel seconded. Motion passed unanimously.

Fidelity will still send out letters to contributors when they are defaulted. Rose will have an article in the Spring TSA *Investor* newsletter that Fidelity's default is the Fidelity Freedom Funds. Fidelity will communicate with employees that are currently in the FRGMMF.

4. Final 403(b) Regulations Summary and Discussion

Rose Stephenson reported on the final 403(b) regulations in her memo dated October 29, 2007 and also provided her September 24, 2007 memo to the approved and frozen UW System TSA investment providers concerning Information Sharing Agreements.

a. Transfers from former providers – Information Sharing Agreements

Rose stated that we are in relatively good shape. We have faxed notifications to all our providers. The contracts that we have in place with our approved TSA investment providers (vendors) in our plan serve as Information Sharing Agreements; however, many of these are quite old and all will need to be reviewed and assessed. We may need to enter into new agreements with some of our providers. We will also need to assess how to enter into ISA with our “frozen vendors” Scudder, American United Life, Wells Fargo, and Security Benefit Life. When the IRS issues the model language, we will review it and proceed from there.

b. Loans and Hardship Withdrawals

The area of greatest concern, in Rose's opinion, is how we can coordinate loans and hardship withdrawals. The provisions will be effective January 1, 2009, so we have some time to work this out. In the past, employees have been able to “self-certify” hardship withdrawals, which will no longer be allowed. Staff will examine if there is a way to certify hardship withdrawals in the future. A process to exchange information with our current and frozen vendors will also be required to coordinate the application and approval of loans. The loan maximum from all sources that an employee is allowed is \$50,000.

IRS guidelines are not yet developed. The investment companies do not know yet how they are going to approach these problems. Sue Chamberlain requested that, once our investment companies know what other higher education institutions decide to do, our investment company representatives forward the information to us. Sue will also bring the issues of certifying hardship withdrawals and coordinating loans to the Consortium of Big Ten Human Resource Directors that meets twice a year. This issue will be revisited at the April meeting.

c. Other issues

The Plan document will need to be reviewed and revised to ensure it is compliant with the final regulations and reflects all individually agreed upon vendor contracts. EGTRRA provisions in the final section should also be fully incorporated into the document.

The committee broke at 12:05 and re-adjourned at 12:30 with a working lunch.

5. Implementing Provisions from the Pension Protection Act – Non-Spouse Beneficiary Rollovers

Rose made recommendations to the committee in her memo dated October 26, 2007 regarding the Pension Protection Act – rollover to non-spouse beneficiary and hardship distribution based on hardships experienced by a participant's designated beneficiary. The article "Domestic Partners' Rights Expand Under PPA Distribution Provisions" by Todd Soloman and William Hansen from the April 2007 *Pension Plan Fix-It Handbook* was provided to the committee. A non-spouse can include a domestic partner. There was discussion on the second recommendation, since it concerned hardship withdrawals – an issue previously addressed that will be revisited.

MOTION: Carol Fischer moved to adopt the recommendations with a friendly amendment of "through 2008" to the second recommendation permitting hardship distributions. Robert Carney seconded. Motion passed unanimously.

6. Insurance Ratings Report – Are ratings a reliable predictor of insolvency?

At the April 27, 2007 meeting committee members requested information about the rating services and how well they predict a company's demise. Bob Carney reported to the committee.

Bob provided two handouts:

- 1) Life and Health Insurer Failures – Weiss Rating at Failure (from TheStreet.com)
<http://www.weissratings.com/FailedCompanis.asp?ind=ins&type=LH>
- 2) Weiss Ratings, Inc. – U.S. GAO Ratings Study: Appendix I (from TheStreet.com)
http://www.weissratings.com/gao_Appendix1.asp

Professor Carney noted the life insurance ratings are only relevant to fixed annuity products and the guaranteed death benefit portion of variable annuity products that are backed by the company itself. Bob Carney explained that in researching information that addressed the accuracy of the ratings in predicting insolvency, he discovered that most research is relevant for ratings companies, but not for committees like ours. He did discover a textbook published by Professor Scott Harrington (from N.C.) and colleague that is useful. Harrington notes that the peak in insolvency occurs generally just before a recession – there seems to be a correlation. The life insurance company insolvencies seemed to result from excessive investment risk, which led to a decline in asset values. That resulted in a rating change to vulnerable or insecure, which then seems to lead to a run on the company. Had the run not occurred, it might not have led to insolvency.

There does seem to be some direct correlation between highly rated companies and less likelihood that they will go into insolvency; however, there seems to be no evidence to suggest that you can measure with any precision the difference between a B+ and an A- rating depending on the scale you use. The companies listed in the handout "Life and Health Insurer Failures" tend to be very small companies that at the time of bankruptcy had very low ratings. By watching the ratings one would have some signal that there were serious problems. You would have time to get the word to people to get out.

The second handout, a Weiss document quoting a US Government Accountability Office (GAO) report, is interesting because the GAO did its own analysis and chose to classify the companies a little bit differently than we do; they use bands. The GAO considers "secure" companies in bands 1, 2 and 3. Bob's sources of research suggested that this band approach was specifically agreed to by all the companies – that they thought this was reasonable in terms of "secure" and "vulnerable." Bob took the Lincoln and RiverSource ratings and used the GAO analysis. (The GAO does not use Fitch.)

Lincoln – Best's rating puts Lincoln in band 1; the Moody's, S&P and Weiss rating put Lincoln in band 2. They would all be considered secure – and not on the bottom of secure, but rather in the middle.

Ameriprise/RiverSource – the Best rating is band 1 and all the rest are band 2.

Bob reported there is a strong correlation between drops in ratings and subsequent insolvency. A pattern of multiple downgrades that end up with a rating in the vulnerable category seems to be a good predictor of subsequent insolvency. Weiss reports that they rate more companies; however, the extra companies they rate are the less credit worthy. If the principal raters are rating the relative top tier of companies, even if they were being accurate, they would still have a higher overall average than Weiss, not because they have a different standard, but simply because they are looking at a different pool. With that said, it is generally agreed if you look at GAO language, that Weiss is a little bit tougher than other rating agencies. The GAO study further makes reference to the fact that raters agreed from 89% to 100% of the time when placing insurers in "secure" or "vulnerable" categories. In summary, Bob commented that the TSA RC tries to avoid being the analyst and instead relies on the experts; however, he felt we should keep a close eye on the sub-prime mess, which may result in multiple downgrades for some life insurers.

Rose pointed out that a number of minimum service requirements were implemented to gauge adequate performance by the companies. The requirements include providing investment education, as well as retaining and recruiting participants in the plan. There are many other measures of adequate performance besides just ratings. We do receive the September Special Ratings Issue of the Insurance Forum by Joseph Belth, and we can request that companies simply update us with any and all ratings changes that they get.

7. Update from Insurance Companies on Ratings

Rose provided to the committee her memo dated November 2, 2007 incorporating the section of the TSA Criteria concerning insurance ratings and listing the current insurance company ratings.

a. Lincoln

Betty Custer presented a memo dated November 2, 2007 from Lincoln Financial Group/Lincoln National Life Insurance Company regarding the ratings update and reported that Lincoln's ratings have not changed. Betty noted that in a spring 2007 statement, Weiss reports that Lincoln generates 13% of its business from reinsurance; however, Lincoln completely exited the reinsurance business in 2001. Lynn Gump, Midwest Director, National Accounts, added that Lincoln is frustrated with this.

b. Ameriprise/RiverSource

Jeff Janecek stated the ratings for Ameriprise/RiverSource have stayed the same through the last five years. Ameriprise is meeting with Moody's in November and with Best and S&P in December. No downward changes are expected. Ameriprise is comfortable with their ratings. The third quarter earnings report was a very good report, which is a factor the ratings services will be looking at.

8. TSA Investment Companies

a. Ameriprise; status of areas of concern

1) Rose informed the committee that in September there were two instances in which Ameriprise/RiverSource allowed transfers to non-approved companies. Jeff reported that in both instances Ameriprise/RiverSource went to the companies, canceled the transfers, and made the employees completely whole. The second transfer was discovered because it was a husband and wife situation. There is a "restrict code" on the internal screens which Jeff was unaware could be overridden. Jeff stressed that Ameriprise understands the importance of complying with plan rules; they will reinforce the training for the employees processing requests to ensure that all transfers for University of Wisconsin employees go only to an approved company. Eva Spenny, Vice President of Marketing Strategy and Retail Retirement, announced that Ameriprise/RiverSource is undertaking a multi-million dollar rebuilding of its infrastructure. The UW will benefit as tighter controls will be put in place. Full implementation will occur June to August of next year. Part of the rebuilding includes being able to identify the employee's organization. Jeff also noted that Ameriprise is changing its transfer form to include a spot for employer information. If the employer information is not provided within two weeks, the transfer form will be rejected.

2) Rose reported that Jeff provided a list of Ameriprise/RiverSource agents who are authorized to work with the UW TSA plan, and she has distributed the list to the campuses.

b. TIAA-CREF – Update and mutual funds available in the UW TSA plan

Rose recommended adding to the line-up of TIAA-CREF funds in her memo to the committee dated October 25, 2007. She provided to the committee the 6/30/2007 returns for current TIAA-CREF funds in the UW TSA program. She also provided an Investment Performance Summary for period ending September 30, 2007 for the proposed funds.

Doug DiCocco stated that two years ago the TIAA-CREF investments line-up was expanded to include a group of mutual funds. He proposed that the investment options again be expanded to include the two most widely requested funds, International Equity and Social Choice Equity, along with the Large-Cap Value, Small-Cap Growth Index, Small-Cap Equity and Small-Cap Value Index Funds. He also requested having the Lifecycle Funds approved in general to allow for additional funds as time passed.

Rose noted that she had been in contact with David Porter, unable to attend the meeting due to flu. He expressed a concern that one of the things that can stall people from getting into the plan is the number of funds – keeping the process as simple as possible is more important than increasing the number of choices. David was in favor of adding the new target date funds but not the additional mutual funds.

Robert Kunkel provided a Morningstar X-Ray Overview printed October 30, 2007, which showed the Morningstar style box. The large-cap market showed 23% value, 24% core and 25% growth; the mid-cap showed 6%, 7% and 8%, respectively; the small-cap market showed 3%, 3% and 3%. There was discussion concerning the number of types of TIAA-CREF funds available compared to the market in general. Doug DiCocco pointed out most TIAA-CREF options are in large-cap. He noted that TIAA-CREF was attempting to stay competitive – younger, savvier investors want the small-cap funds because of the possibility of a greater return on those investments.

MOTION: Robert Carney moved to approve the International Equity, Social Choice Equity, Large-Cap Value, Small-Cap Growth Index, Small-Cap Equity and Small-Cap Value Index TIAA-CREF Funds and that TIAA-CREF be authorized to offer additional Target Retirement Date Funds as appropriate. Donna Weber seconded. Motion passed.

9. Communication Plan – Report on Initiatives and Results

Rose Stephenson reported on the initiatives of the communications plan in her memo dated October 24, 2007 to the committee. A detailed spreadsheet showing the results of the new employee mailing sent the end of 2006 and beginning of 2007 was also provided. The mailing was sent approximately 90 days after hire. Waiting to send the mailing until an employee has been employed for six months was suggested. Other methods used to communicate with employees are the *TSA Question and Answer Guide*; the *Save Smart, Save Early* flyer; providing individual counseling sessions and workshops; the *TSA Inve\$tor* newsletter; distributing broadcast emails and printing messages on employees' earnings statements.

10. Review of Educational Initiatives

Terry Lauber reviewed the UW TSA educational initiatives. She provided a printout of the UW System website dated October 23, 2007, listing the Individual TSA Counseling Sessions and Group Seminars available to employees. Each of the investment companies also attended fall Benefit Fairs at a minimum of two campuses, many companies attended four or five. A list of the 2007 Campus Visits by UW-System Administration Staff to date was also provided; 223 employees attended these sessions. More visits are planned in 2007.

11. Next Meeting The spring TSA Review Committee meeting will be April 11, 2008.

12. Motion to Adjourn

MOTION: Carol Fischer moved that the meeting be adjourned. Kevin Bahr seconded the motion. Motion passed unanimously. The meeting was adjourned at 2:05 pm.