

C. *Other Matters*

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**1. APPROVE INVESTMENT PROVIDERS/BOARD OF REGENTS
MANDATORY RETIREMENT PLAN**

Summary and Staff Recommendation

The Retirement Plan Committee (RPC) reviewed proposals submitted by the four, current Investment Providers for the KBOR Mandatory Retirement Plan and analysis of those proposals by the Board’s consultant, Deloitte Consulting. The RPC’s unanimous recommendation is to move from four to two Investment Providers for the Mandatory Plan, retaining TIAA-CREF and ING, assuming contractual negotiations proceed satisfactorily. Existing contracts with the other Investment Providers will be frozen – no new participants and no new money will be permitted. Staff concurs.

Kansas Board of Regents Mandatory Retirement Plan

The Kansas Board of Regents Mandatory Retirement Plan was established in 1962 by the Kansas Legislature under Internal Revenue Code Section 403(b) to provide a retirement program for the unclassified employees of the state universities. Then, as now, this Plan is an essential tool used to attract and retain quality faculty and unclassified professional staff to the state universities and to the Board Office.

Eligible employees are required to contribute a percentage of their compensation to the Mandatory Plan (currently 5.5%). The employer, whether it is a state university or the Board Office, is required to contribute an additional percentage (currently 8.5%). Thus, employees have a total of 14% of their compensation directed as pretax contributions into their retirement account.

Today the Board contracts with four retirement companies to provide investment options for the Mandatory Plan: ING, Lincoln National, Security Benefit Group and TIAA-CREF. As of December 31, 2005, total accumulations in the Mandatory Plan with these Investment Providers (IPs) were \$2.042 billion dollars.

KBOR Mandatory Retirement Plan – State Universities and KBOR Office

<u>Investment Provider</u>	<u># of Participants</u>	<u>% of Participant Total</u>	<u>Plan Assets</u>	<u>% of Asset Total</u>
ING	819	10.0%	\$ 144,903,537	7.1%
Lincoln National	798	9.8%	\$ 118,875,039	5.8%
Security Benefit	529	6.5%	\$ 76,005,872	3.7%
TIAA-CREF	<u>6,012</u>	73.7%	<u>\$1,702,219,163</u>	83.4%
TOTALS	8,158		\$2,042,003,611	

Participation numbers as of January 2006; asset information as of December 2005.

Addressing Fiduciary Responsibility

Over the past several years, the Board has more closely examined its Retirement Plan and established a formal governance structure to help the Board manage its fiduciary responsibilities. To best ensure that it is meeting its fiduciary duties for the Mandatory Plan, the Board has delegated responsibilities to the Retirement Plan Committee, currently chaired by Regent Galle, to actively oversee the Mandatory Plan, and keep the interests of the participants foremost when reviewing the Plan or making any changes.

This governance structure allows the Board to maintain final decision-making authority over its Retirement Plan yet delegate some of its administrative and fiduciary duties to the RPC. RPC duties include overseeing the Plan, its administration, and its investments, reviewing plan documents and investment provider agreements, recommending an investment policy with performance standards, and reviewing the investment performance on a semi-annual basis.

The RPC has been working on the development of plan documents, provider agreements and an investment policy with the assistance of Deloitte consulting who was hired by the Board to provide consulting services. To date the RPC has presented three Plan Documents to the Board for approval: an Investment Policy Statement, approved in December 2005; and the Mandatory Plan Document and Investment Provider Agreement, both approved in March 2006. Deloitte reports to the RPC semi-annually, at a minimum, regarding their monitoring and analysis of the IPs and their funds that are included in the Plan's fund lineup. If issues arise with the IPs and/or their funds, fees or services as a result of these reports, such as a perceived need to add or subtract to the funds available under the Plan, the RPC will bring recommendations to the Board to address those concerns.

In its periodic reports to the RPC, Deloitte rates the proposed fund lineups for compliance with the Board's Investment Policy Statement. The IPS has two primary functions: 1) to establish roles and responsibilities between the Board and the RPC and demonstrate that the Board is fulfilling its fiduciary duties for the Plan; and 2) to establish criteria against which IPs and their funds will be measured in order to be included in the Mandatory Plan.

Request for Information (RFI)

In November 2005, the four IPs received an RFI from Deloitte on behalf of the Board. The RFI's primary objective was to improve the Plan for employees by gaining an understanding of services and approaches not currently used for retirement benefit delivery and evaluating fund alternatives for the Plan. The RFI asked each IP to propose a new product for the Mandatory Plan and to demonstrate the IP's ability to deliver higher performing investment funds, lower fees and enhanced services. The IPs were asked to propose funds for sixteen various asset classes reflecting a wide spectrum of options to ensure diversification opportunities for participants. Deloitte was to provide an analysis of the companies and funds determining how the proposed fund lineups complied with the Board's Investment Policy Statement.

Each company responded timely and in full proposing funds in each investment category, describing services to be provided and fees to be charged. In February 2006, the RPC met with Deloitte to examine the RFI responses. Subsequently, each IP was informed that the RPC would consider as few as two vendors. The RPC's reasons supporting consolidation include:

1. the recognition that consolidation is an ongoing trend in the industry.
2. the desire to offer differing investment styles – active and passive investing -- but not to duplicate types of investment styles within the Plan.
3. the opportunity to leverage buying power to reduce fees and increase services from the remaining IPs.
4. to provide for more efficient and streamlined Plan administration.
5. to improve the Board’s ability to monitor investments, fees and services provided by the IPs.
6. to provide participants with a less complicated Plan while still providing appropriate diversification opportunities to meet their investing needs.
7. to select IPs who will provide quality investment products as well as high quality “high touch” service to participants.

Additionally, because multiple proposals eliminated all embedded fees, the expectation expressed was that the final proposals would not contain such fees. A request was made to present each IP’s “best and final” proposal for the Mandatory Plan.

Presentations Made by the Four IPs to the RPC

After all companies responded to the “best and final” proposal timely and in full, on May 8, 2006, representatives from each of the IPs made presentations to the RPC on their final proposals, having the opportunity to distinguish themselves as an IP that KBOR should retain. In addition, Deloitte provided the RPC with an analysis of the funds, fees and services proposed by each IP.

Selecting the IPs to Recommend for Inclusion in the KBOR Mandatory Plan

TIAA-CREF: After the presentations and review of Deloitte’s analysis, there was unanimous agreement about the top IP to retain, TIAA-CREF. The decision was straightforward and based upon a strong fund lineup, low fees, improved service and greatest market penetration (see table above). Further, TIAA-CREF’s investment approach represented a more passive style of investing.

Security Benefit Group: The RPC was unanimous about removing the IP with the weakest fund lineup, highest fees, least comprehensive service and smallest market penetration, SBG.

SBG’s proposed fund lineup was rated not as highly as the other lineups, and in Deloitte’s words had “challenges.” Of thirteen funds rated by Deloitte, eight were ranked “green” (indicates compliance with the Board’s IPS); three were “yellow” (indicates concern relative to the IPS); and two were identified as “red” (indicates serious concern relative to the IPS). None of the other IP’s proposals had funds rated “red.”

In addition, SBG proposed a service delivery model that only provided the same level of services as the other IPs with an additional 0.65% fee on all assets. This fee would not be assessed if an employee elected SBG’s “self service plan,” thereby foregoing a local representative for personal counseling and planning. Even with that fee reduction, SBG’s fees were higher than the other proposals. SBG’s average expense ratio is 1.09%, compared with Lincoln’s .87%; ING’s .74%; and TIAA-CREF’s .50%.

ING and Lincoln National: ING and Lincoln National were close for second with only little to distinguish one from the other. Both represented an active style of investing. As such, the RPC determined that there was insufficient benefit to employees to offer two IPs that were so similar. The proposed fund lineups in number of offerings and performance were comparably competitive; the differences in fee structure and net returns were negligible; and the long-term financial soundness of the companies was equivalent. However, because nearly 30% of current participants elected an IP other than TIAA-CREF, the RPC decided it was important to continue offering an option to TIAA-CREF.

The RPC selected ING over Lincoln National as the second company to retain based upon its conclusion that ING proposed stronger support services, has consistently provided good customer service in the past, and offers a slightly lower average expense ratio than Lincoln. Further, ING demonstrated technological robustness and its ability to affect transactions by making them efficient and effective and to minimize associated costs.

RPC Recommendations

The RPC's recommendation is to move from four to two IPs for the Mandatory Plan, retaining TIAA-CREF and ING, assuming contractual negotiations with the two companies proceed satisfactorily. The RPC bases its recommendation on the RFI process which allowed each IP ample opportunity to propose funds, fees and services for the Board's Mandatory Plan as well as thorough analysis by Deloitte and review by the RPC. The RPC's recommendations reflect the Board's fiduciary duties including the duty of loyalty – to act solely in the interests of the participants as these recommendations were made by keeping the participants' interests foremost in mind.

The RPC recommends that existing contracts with Lincoln National and SBG be frozen – no new participants and no new money will be permitted. Participants will not be mandated to move existing funds out of Lincoln National or SBG.

The RPC also recommends that the Board contract with TIAA-CREF and ING contingent on the RPC reaching what it deems satisfactory written agreements, which agreements shall include how to transition from four to two IPs, branding the Board's Mandatory Retirement Plan, web development, employee communications, and other issues required for implementation, and contingent on review and approval by General Counsel. The RPC will bring other recommendations to the Board as appropriate, such as which funds to include in the lineup from each provider.

Staff concurs with the RPC's recommendations.