KANSAS BOARD OF REGENTS
**Retirement Plan Committee (RPC)**
MINUTES
March 19, 2019

Regent Bangerter called the March 19, 2019, meeting of the Kansas Board of Regents Retirement Plan Committee to order at 12:30 p.m.

Members Participating:

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| Regent Shane Bangerter, Chair | President Allison Garrett, ESU |
| Dr. Dipak Ghosh, ESU | Diane Goddard, KU |
| Dr. Rick Lecompte, WSU | Gary Leitnaker, KSU |
| Madi Vannaman, KBOR | |

RPC members Mike Barnett, FHSU; Michele Sexton, PSU, and Stacy Snakenberg, KUMC, participated by phone.

Also present were Brad Tollander and Bernie Heffernon, Advanced Capital Group consultants. From TIAA: Nicolette Dixon, Senior Relationship Manager; Maggie Dehn, Managing Director, Institutional Relationships; Tom Carmody, Managing Director, Retirement Plan Sales; Stephanie Mishak, Director, Financial Consulting and Ciaran Murphy, Senior Director, Investment Strategist. From Voya: John O'Brien, Regional Vice President; and Cindy Delfelder, Client Relations. From the Board Office: Natalie Yoza, Associate General Counsel, and Elaine Frisbie, Vice President Administration and Finance.

**Minutes**
The minutes from the September 18, 2018, meeting were approved unanimously.

**Executive Session**
At 12:40 p.m., President Garrett moved, followed by the second of Gary Leitnaker, to recess into executive session for 15 minutes to discuss matters deemed confidential in the attorney-client relationship. The subject of this executive session was to receive an update on plan responsibilities and the purpose was to protect the attorney-client privilege. Participating in the executive session were members of the RPC and Associate General Counsel Natalie Yoza. At 12:55 p.m., the meeting returned to open session.

**KBOR Document Review Update**
Natalie Yoza provided the RPC with an update about the Plan document review. An RPC sub-committee will meet this summer to continue work on the Plan documents for inclusion in the September RPC meeting agenda.

**Fiduciary Duty & the Kansas Tort Claims Act**
Natalie Yoza provided information related to the Committee members' fiduciary duties and the Kansas Tort Claims Act.

**Industry Trends Update – ACG**
Bernie Heffernon provided an update about higher education litigation, the cyber security questionnaire provided to TIAA and Voya, plan document review update. TIAA and Voya were subsequently requested to provide information about capturing participant data so that targeted information can be provided to enhance participation and outcomes and that topic will be covered in this summer's sub-committee meeting.

**Recap of Markets and Economy**

Brad Tollander provided a recap of the markets and economy for 4th quarter 2018 into the 1st quarter 2019.

**Outstanding Items from Last RPC meeting**

Dimensional Target Date Retirement Funds

The RPC had requested an evaluation of the DFA Target Date Retirement Income Fund at the September meeting and for ACG to provide feedback on whether they should be considered for possible inclusion in the Mandatory Plan. Due to the fund's limited history (inception in November 2015), ACG recommended that a full evaluation of the funds be made at the Spring RPC meeting.

ACG commented that DFA has an interesting concept that sets it apart from other target date fund competitors, but it is a potentially complicated concept that may prove difficult to explain to participants. Overview information about the fund, as well as its glide path and evaluation of the fund, were discussed.

Based on the limited track record, small asset base, and differing investment approach of the DFA Target Date Funds relative to the existing strategies offered by Voya and TIAA, ACG recommends that the DFA Target Date Retirement Income Funds not replace either of the existing target date funds. And, ACG advises against adding the DFA funds to the lineups as a complimentary target date suite to the existing target date funds.

Underutilized Funds

Several funds in both the TIAA and Voya fund line-up are not heavily utilized (participants and assets). The RPC requested that ACG review the underutilized funds, excluding the Amana funds from the review. ACG identified three funds in each of the TIAA and Voya line-ups that were underutilized:

*TIAA*
Wells Fargo Growth (815 participants, $27.7M assets)
Royce Opportunity (579 participants, $6.5M assets)
AB Small Cap Growth (921 participants, $11.1 assets)

*Voya*
Vanguard Treasury Money Market (144 participants, $3.6M assets)
Champlain Mid Cap (776 participants, $10.2M assets)
American Beacon Small Cap Value (227 participants, $1.5M assets)

ACG's recommendation is to keep the following: (TIAA) Royce Opportunity Fund, AB Small Cap Growth; (Voya) Champlain Mid Cap, American Beacon Small Cap Value. These funds are found in asset classes which are not commonly popular with plan participants, however they do offer diversification benefits when combined with other funds to create a portfolio. The removal of these funds would eliminate the sub-asset class category from the Plan and potentially lead to less efficient portfolios.

Discussion about the other funds is included in the retirement company Fund Menu Analysis below.

*Underperforming funds*
Brad Tollander reviewed the funds newly added to the Watch List, as of December 31, 2018: TIAA-CREF Large-Cap Value Instl, TIAA-CREF Mid-Cap Value Instl and Voya Small Cap Opportunities Port 1.

**TIAA Proposed Fund Menu Analysis**
*Add:* Core Plus Bond Fund to provide participants with access to high yield and emerging debt plus sectors. ACG agreed that the current plan options, the CREF Bond Market Fund, is a traditional intermediate investment grade bond fund which tracks closely with the Bloomberg Barclays Aggregate Index. Core Plus managers have wider latitude to invest outside of traditional fixed income sectors such as Treasuries, Agencies, Mortgages and investment grade corporates to add value. These less traditional sectors such as high yield and foreign debt can add different sources of return as well as improved diversification to a portfolio.

TIAA provided a number of options that ACG narrowed down to a manageable number by reviewing risk-adjusted performance, consistency of performance, fees and management team skill. ACG recommends adding the PGIM Total Return Bond R6 Fund (PTRQX) to the TIAA lineup for the following reasons:

- Solid consistency of returns
- Sound risk-adjusted results
- Long-tenured management team
- Reasonable fees
- Lower correlation of results

Gary Leitnaker asked about demand for the fund. Brad Tollander responded that he did not expect the fund to take off. New participants may look at it and choose it because of its returns over the CREF Bond Market Fund but TIAA indicates 47% of flows are going into target dated funds. Rick LeCompte stated that the addition provides diversification for bond funds and will be beneficial to have choice. It is a five star rated fund.

*Do not add*: International Fixed Income Fund. ACG does not recommend adding this fund because adding a core-plus bond strategy should reduce the need for either a foreign or high-yield bond fund.

*Add*: Small Cap Foreign Equity Fund for diversification benefits. Despite having four investment options covering the foreign equity category (TIAA-CREF International Index, American Funds EuroPacific Growth, CREF Global Equities and DFA Emerging Markets), the largest small cap exposure from any of the four funds is 2% (CREF Global Equities). TIAA provided a number of options and ACG narrowed the list to a manageable number by reviewing risk-adjusted performance, consistency of performance, fees and management team. ACG recommends adding the Pear Tree Polaris Foreign Value Small Cap R6 Fund (QUSRX) to the TIAA lineup for the following reasons:

- Only true actively managed fund evaluated
- Value-orientation missing from the foreign lineup
- Strong trailing performance results; 3-year, 5-year, 10-year
- Relatively small asset base at just over $1 billion
- Long-tenured management team

*Add:* Mid Cap Blend Index Fund to offer a low-cost option other than an active Mid Cap fund. TIAA offers both domestic large cap and small cap indexes. Mid Cap is the only cap-range without a dedicated passive (index) option. Given some recent struggles with the TIAA Mid-Cap Value and Mid Cap Growth Funds, there is likely to be some outflows from them to a Mid-Cap index option. ACG recommends adding the Vanguard Mid Cap Index Adm Fund (VIMAX) to the TIAA fund lineup for the following reasons:

- Low cost at 5 basis points
- Low tracking error relative to the index
- Introduces further fund family diversification

*Remove*: Close the CREF Money Market Fund as participants have individual contracts so assets cannot be mapped. No new contributions would be allowed into the fund. TIAA offers three principal preservation offerings and this may be a source of confusion to participants: TIAA Traditional, TIAA Stable Value and TIAA Money Market. A 2017 MetLife survey showed that the number of defined contribution plans offering money market funds had decreased since the 2015 money market reform. The survey showed 36% of plans had both Stable Value and Money Market, 46% had Stable Value only, 16% had Money Market only and 2% had other. Due to liquidity restrictions on the TIAA Traditional, it's prudent to have a second principal preservation offering. The plan currently offers three options. ACG's recommendation is to close the CREF Money Market R3 for the following reasons:

- Due to the difference in the duration of the underlying portfolio, stable value funds generally yield approximately 1.00% more return annually over the market cycle relative to money market funds.
- The CREF Money Market fund is fully liquid to participant transfers and withdrawals.

*Do not remove*: Wells Fargo Growth Fund and map assets to CREF Growth Fund. The Wells Fargo Growth Fund went through a three-year period (2014 – 2016) of underperformance relative to the Russell 3000 Growth benchmark and average large cap growth peer group manager. This was followed by a top-decile 2017 return, a top-quartile 2018 return and top-decile 2019 YTD return through March 8. As a result of the recent strong returns, the fund's one, three, ten and fifteen-year results easily surpass the Russell 3000 Growth benchmark and place the fund in or near the top-quartile of its large growth peers during these periods. ACG recommends re-evaluating the fund in twelve months.

**Voya Proposed Fund Menu Analysis**

*Add*: Core bond index fund – as a low-cost alternative to the Core Plus – PIMCO Total Return Fund. The Voya lineup does not currently offer a passively managed (index) option in the fixed income category. There are a growing number people that would prefer to have a low-cost investment alternative with the sole objective to provide a rate of return similar to that of a benchmark. Please note, there have been many articles over the past several years documenting the struggles of active managers trying to outperform their index counterparts. These have mainly been on the equity side. Active fixed income managers have generally underperformed their active manager counterparts on a longer-term basis. However, this hasn't dampened the enthusiasm for core fixed income index funds. Voya provided two options for consideration the Fidelity U.S. Bond Index priced at 3 basis points and the Vanguard Total Bond Market Index Admiral share class priced at 5 basis points. ACG's recommendation is to add the Fidelity U.S. Bond Index Fund (FXNAX) to the Voya fund lineup for the following reasons:

- Less expensive: 3 basis points vs. 5 basis points
- Similar low overall tracking
- Similar securities lending practices by both Vanguard and Fidelity
- Returns are similar, however over the past 32 rolling 5-year time periods (1-month shifts) the Fidelity U.S. Bond Fund has outperformed the Vanguard Total Bond Market Index Adm. in each of the 32 periods.

*Replace*: PIMCO Real Return Fund's total expense ratio increased from 0.46% to 0.88%. The Financial Industry Regulatory Authority (FINRA) issued new guidance in July that indicated that costs associated with interest expense and dividends on borrowed securities had to be included in a fund's annual report and prospectus net expense ratios. For the PIMCO Real Return Fund and other bond funds the cost associated with reverse-repos also needed to be reflected in the expense ratio. As a result, the Fund's expense ratio jumped by 42 basis points over night, despite no change in the fund's investment approach. ACG has had numerous discussions with PIMCO to see if they plan on altering their investment strategy to possibly reduce the current expense ratio and the answer thus far has been no. Unfortunately, perception is reality, and most investors will only see that the fund has nearly doubled its fee and won't ask why. Given this reality, ACG recommends replacing the Fund. Voya provided three options for consideration; the American Funds Inflation Linked Bond Fund (expense 0.36%), the DFA Inflation-Protected Securities (expense 0.12%) and the Fidelity Inflation-Protected Bond Index (Expense 0.05%). ACG recommends replacing the PIMCO Real Return with the American Funds Inflation Linked Bond R6 (RILFX) in the Voya fund lineup for the following reasons:

- Strongest trailing returns of the group
- Strongest three and five-year rolling returns
- Most favorable five-year risk-reward and up and down-market capture
- Strongest head-to-head rolling-period-of-time analysis

*Add*: Foreign Equity Index Fund as a low-cost alternative to the three actively managed foreign and global funds. Similar to ACG's comments in the core-bond index search, there are a growing number of investors that watched as higher-cost active managers struggled to outperform their low-cost index brethren on a consistent enough basis to justify their fees. The addition of a foreign index fund in the lineup will allow these participants the ability to get index like returns at a low price point. Voya provided two alternatives for consideration; the Fidelity International Index (expense = 5 bps.) which tracks the MSCI EAFE and the Vanguard Total International Stock Index – Adm. (expense = 11 bps) which tracks the FTSE Global All Cap ex US Index. ACG recommends adding the Vanguard Total International Stock Index – Adm. (VTIAX) to the Voya fund lineup for the following reasons:

- The decision came down to coverage and opportunity since a head-to-head comparison of the funds is difficult. Please note that both funds do a good job of tracking the performance of their underlying benchmarks.
- The Fidelity International Index is solely focused on developed market countries around the globe. Alternatively, the Vanguard Total International Stock Index fund invests in both developed and emerging markets around the world. Since it is a cap-weighted index as emerging (developing) countries continue to grow at a faster pace than developed countries, their representation within the index will continue to grow. ACG's recommendation is to cast as wide a net a possible from a diversification standpoint which means to select the Vanguard Total International Stock Index.

*Do not replace*: Vanguard Institutional Index with the lower cost Fidelity 500 Index, the Vanguard Mid-Cap Index with the lower cost Fidelity Mid Cap Index and Vanguard Small-Cap Index with the Fidelity Small Cap Index.

In the war of index price compression, Fidelity currently holds the upper hand. When reviewing Voya's proposal, it's easy to see the current price advantage Fidelity has:

| | Fidelity Exp. | Vanguard Exp. | Diff. Large Cap |
|---|---|---|---|
| Index | 0.015% | 0.035% | 0.02% |
| Mid Cap Index | 0.025% | 0.04% | 0.015% |
| Small Cap Index | 0.025% | 0.04% | 0.015% |

Based on KBOR assets held in all three funds ($66.24M) the potential cost savings is $10,679. This equates to $2.42 per participant based on the 4,394 participants currently invested in them. ACG's objections for not moving forward with this proposal are fairly simple: Vanguard's fees, although not the lowest, are very competitive and as a result are reasonable What is hard to quantify is the possible participant disruption replacing the Vanguard funds would cause for the 4,393 participants using them.

*Do not remove*: Vanguard Treasury Money Market Fund – Map assets to Voya Fixed Plus III. Although ACG agrees in principle, given the proximity of the fund change (Voya Money Market to the Vanguard Treasury Money Market in July 2019), ACG's recommendation is to have Voya bring a similar proposal to the RPC for consideration at the 2020 spring meeting. Voya offers two principal preservation offerings; Vanguard Treasury Money Market and Voya Fixed Plus III account. Currently there is a 90-day equity wash provision in place which prevents participants in the Voya Fixed Plus III account from going directly into the Vanguard Treasury Money Market fund. Some participants will try to game the system in periods of rising interest rates as money market funds are much quicker to adjust to rising rates than the longer-maturity fixed accounts. The elimination of the Vanguard Treasury Money Market fund will eliminate this restriction.

Rick LeCompte moved to approve all of Brad Tollander's recommendations. Diane Goddard, seconded the motion and it was approved unanimously. The RPC's recommendations will be presented to the Board of Regents at their April 2019 meeting.

**Next RPC meeting:**
The next regular RPC meeting will be scheduled for September 17, 2019, in the KBOR Board Room.