A special conference call meeting of the Kansas Board of Regents Retirement Plan Committee on October 9, 2014 was called to order at 2:00 p.m.

Members Participating:
Regent Ann Brandau-Murguia, Chair  Regent Kenny Wilk
Dr. Dipak Ghosh, ESU  Theresa Gordzica, KU
Dr. Rick LeCompte, WSU  Gary Leitnaker, KSU
President Kirk Schulz, KSU  Michele Sexton, PSU
Madi Vannaman, KBOR

Because of scheduling conflicts, Mike Barnett, FHSU, was unable to participate in the meeting. Participating in the meeting were Segal Rogerscasey’s Craig Chaikin; Voya’s Lisa Gilarde, Vice President Mutual Fund Information Services; Bernie Heffernon, Head of Distribution Management; Brian Merrick, Strategic Relationship Manager; and John O’Brien, Regional Vice President; and Theresa Schwartz, KBOR’s Associate General Counsel.

**PIMCO Funds in the KBOR Mandatory Retirement Plan Line-up - Voya**

At the September 16, 2014, RPC meeting, Craig Chaikin shared the following information about the PIMCO funds: “Despite the short-term numbers, there are no long-term concerns. PIMCO continues to be watched because of the turnover at the top of the organization, the abrupt departure of the co-CIO in the first quarter of 2014 and significant level of outflows. However, the firm has a deep, experienced team and can handle these departures at this time. The outflows, at this point, are not concerning to Segal because the fund is very big.”

On September 29, 2014, Mr. Chaikin emailed Madi Vannaman a “PIMCO Rating Change” document reflecting analysis of Bill Gross’ departure from PIMCO which stated that Gross’ departure “comes on the heels of significant organizational changes that took place earlier this year” and noted that the departure “comes at an inopportune time for PIMCO” because “recent performance results have been mixed and PIMCO mutual funds have been experiencing prolonged outflows. In our view, Gross’ resignation has further negative implications for PIMCO.” The report went on to site three reasons: “…that Gross’ departure heightens the business risk for the firm…and we anticipate a heightened risk of increased outflows from PIMCO…which will have a negative impact on the profitability of the firm and, therefore, its ability to retain and attract talented investment professionals.” “Second…it is unclear if other PIMCO employees will join Gross…the nature of the strategy and the geographic location implies that Gross will be assembling an investment team; our concern is that PIMCO would be fertile soil for recruitment for the new franchise.” “Finally, Gross’ departure leaves PIMCO with uncertainty regarding the future investment leadership of the firm.”

The report stated that “Given the foregoing, we are downgrading to Not Recommended all PIMCO products, except for the All Asset and All Asset All Authority global tactical asset allocation (‘GTAA’)… Our research team will be having a call with Research Affiliates shortly and will issue a separate memo with their assessment. We believe that Gross’ departure, coupled with negative developments experienced over the last year, highlights systemic challenges faced by the PIMCO organization and its investment team. As such, while we are not advising an urgent divestiture, we recommend clients invested in PIMCO products other than GTAA discuss with their consultants
alternate Recommended-rated strategies that may represent higher conviction options for their individual portfolios.”

**RPC Discussion**

Mr. Chaikin shared that on September 26th PIMCO announced that Bill Gross was leaving to join Janus. This announcement was a shock to the market, because Gross had co-founded PIMCO, had been there for 40+ years and was one of the key figures in the investment process. His departure came on top of significant top departures earlier this year. PIMCO has over 900 investment professionals and multiple portfolio managers that implement the ideas of the CIO committee that was created after the departures earlier in the year. Gross’ departure heightened some of the business risks of the firm, resulting in increased outflows and a lot of headline news and risks.

Since Gross’ departure, some rumors that have not been confirmed indicate that PIMCO was going to terminate Gross and his speedy departure was his last hurrah. There were reports of PIMCO’s and Allianz’s concerns with the difficulty in working with Gross and his growing eccentricities. The Board questioned the long-term success of the firm and fund if he continued at PIMCO’s helm.

Segal Rogerscasey downgraded to “not recommended,” which means they are not going include the Total Return Fund in new searches, and they will use other funds in which they have more conviction. This downgrade does not mean sell, but recognizes there are serious concerns moving forward.

Gary Leitnaker asked how many KBOR assets are in the PIMCO funds. Mr. Chaikin responded $17 million in Total Return Fund, which is the only fund directly managed by Gross, and about $12 in Real Return Bond fund.

President Schulz asked what percentage of the portfolio that represented. Mr. Chaikin responded that as of June 30, 2014, there was approximately $460.9 million in Voya platform, so the two PIMCO funds with approximately $29 million represent about 6% of the total Voya assets.

President Schulz stated that PIMCO is not going away as it still has a pretty talented group of fund managers but wondered what will happen six months from now when senior management issues settle down and how performance will look moving forward. How much should we be concerned now as opposed to six months from now? Mr. Chaikin stated that in terms of performance he could not answer that because predicting the markets is not possible. Recent performance for the Total Return Fund has struggled as several of the firm’s top-down decisions have not played out. However, the new CIO group, which includes Dan Ivascyn, a Morningstar manager of the year in 2013, has individuals with strong track records on other funds. As such, Mr. Chaikin foresees no additional danger six months from now given the current information. There have been cash flow concerns, but PIMCO has $1.97 trillion in assets under management, with $223 billion in the Total Return Fund, making it easily the largest bond fund in the world. All of their positions are fully liquid so the ability to handle investor redemptions is not out of the question. There has been a lot of talk that the fund might have grown too big so there may be benefit to make the fund more nimble. Mr. Chaikin acknowledged that his response to the question might appear to be wishy-washy, but what will happen with the market is not definitive and given the “what if” questions this situation imposes.
Dipak Ghosh asked about a Wall Street Journal article that indicated there was $22-23 billion in outflows in September and the new Gross fund with Janus had $66 million inflow. Professor Ghosh remarked that the money does not seem to be following Gross. Mr. Chaikin stated he did not think the money leaving PIMCO is solely because Gross left. Money has previously been leaving because other leaders, such as El-Erian and Seidner, had left and other bond funds have shown better performance. Recent flows have accelerated because of PIMCO’s top-down investment approach and some investor concerns that the organizational instability and headline risk is not worth it. Janus has not seen huge inflows, because the unconstrained fund Mr. Gross is now managing has very few assets and no track record. Assets are going to more established, stable bond shops.

Rick LeCompte commented that Gross’ departure appears to be the “last shoe dropping,” following several months of stories about PIMCO infighting and anarchy. Professor LeCompte stated he does not think the funds are following Gross and Mr. Chaikin agreed.

Mr. Leitnaker asked whether the SEC and Federal Reserve had been warning investors about the consequences of pulling funds out. Mr. Chaikin stated he had not seen that information and that neither of those entities would likely impose consequences but may have indicated that because with $220 billion in the fund, massive outflows could influence market prices.

Lisa Gilarde stated that during Voya’s conference call with PIMCO representatives they were informed that PIMCO had a succession plan in place for several years because Gross is in his 70s. Gross’ departure resulted in implementation of their established plan. They have over 400 portfolio managers and a lot of them are very experienced so the actual movement is not of immediate concern, but on-going oversight of the team and their performance would be prudent. PIMCO acknowledged the headline risk and management of the outflows. They have a very good liquidity manager with experience with a lot of outflows over the last few years because of performance issues. The large question is have you lost confidence in the fund overall, and does the headline risk concern you given that PIMCO is not going anywhere.

Ms. Vannaman asked if no action is taken today, what would trigger a review before the standard review period at the March RPC meeting. Mr. Chaikin stated that such a review should occur if any of the new CIOs left before the next standard review or if somehow the outflows pick up significantly such that PIMCO could not handle it (which he did not foresee happening). The outflows have slowed down slightly from last week but have not stopped. Most investors cannot move money quickly because of notice periods and time delays.

John O’Brien stated that the funds recommended by Segal Rogerscasey are on the Voya platform. The normal process to replace funds would require 45 days to communicate information to participants and to map the assets from the closed funds to the new funds. But, Voya may be able to expedite the process to 30 – 45 days.

Mr. Leitnaker asked whether the fund performance would warrant taking action and Mr. Chaikin responded no. Professor LeCompte asked how the Total Return Fund had performed against its benchmark and Mr. Chaikin responded that the Total Return Fund has performed better at the 1, 3 and 5 year mark and year to date it is slightly behind (4.6 to 4.4.), acknowledging the short term performance struggles.
Regent Murguia asked if the PIMCO funds were replaced, what would happen with the assets in those funds. Mr. Chaikin stated that the assets would be mapped to the new, replacement funds. Participants would be given the option to elect which funds those assets would go into, but if the participant did not take any action, the funds would be moved from the closed fund to the replacement fund.

President Schulz stated that the PIMCO funds should be flagged to be watched and reviewed during the standard period, at the March RPC meeting, with action taken if the same issues remain. Regent Murguia echoed that sentiment.

Mr. Leitnaker moved that the PIMCO funds be placed on watch and that the RPC wait to see if there is a drastic move in the market or in the fund before it is revisited. Dr. LeCompte seconded the motion and it passed unanimously.

Ms. Vannaman asked both Mr. Chaikin and the Voya representatives to contact the RPC in the event actions occur that should cause review of this issue prior to the March RPC meeting.

**Next RPC meeting:**
The next RPC meeting is tentatively scheduled for 12:30 p.m. on Tuesday, March 10, 2015, in the Board Room.