

KANSAS BOARD OF REGENTS  
**Retirement Plan Committee**  
MINUTES  
March 22, 2016

The March 22, 2016, meeting of the Kansas Board of Regents Retirement Plan Committee was called to order by Regent Bangerter at 12:30 p.m.

Members Participating:

Regent Shane Bangerter  
Michele Sexton, PSU

Dr. Dipak Ghosh, ESU  
Madi Vannaman, KBOR

Gary Leitnaker, KSU

Members participating by conference call were Mike Barnett, FHSU; Dr. Rick Lecompte, WSU; and Stacey Snakenberg representing KU Medical Center. Because of schedule conflicts these members were not able to attend: Regent Ann Brandau-Murguia; President Schulz, KSU; and Theresa Gordzica, KU.

Also present from TIAA were Nicolette Dixon, Senior Relationship Manager; and Tom Carmody, Senior Director, Sales; from Voya, John O'Brien, Regional Vice President; Cindy Delfelder, Client Relations; Brian Merrick, Strategic Relationship Manager; Amy Goodale, Strategic Relationship Manager; and Theresa Schwartz, Associate General Counsel for the Board of Regents.

**Minutes**

The minutes from the September 15, 2015, meeting were approved unanimously.

**Segal Semi-Annual Review through December 31, 2015**

Craig Chaikin discussed the financial environment for the last six months of calendar year 2015.

Regent Bangerter asked how fees impact investments in cash or money market funds and whether those participants investing in money market accounts would stay above water. Craig Chaikin responded that historically money market funds have had to maintain a dollar net asset value. With the new money market regulations taking effect in October, many types of money market funds will move to a floating Net Asset Value and possible liquidity fees and redemption gates. Institutional prime and municipal will be affected by all three; retail prime and municipal by fees and gates; government funds by none of them. It's possible that depending on the type of money market fund, a participant could lose money. Additionally, if a participant is invested 100% in money market funds, with inflation running just under 2% and the fund earning 0%, the participant is in effect losing 2% for the year. Any additional fees would exacerbate the situation. Money market fees are very low because cash is generally easier to manage than longer duration fixed income and equities. In the KBOR plan, the stable value funds are currently crediting more than what cash is earning. For the next RPC meeting, Craig Chaikin will provide information on the money market reforms and the impact to the Plan so the RPC can discuss potentially replacing money market funds with other options.

Gary Leitnaker asked about non-US markets. Craig Chaikin responded that emerging markets look much worse than developed markets from a return perspective. The struggle is their economies are largely based on commodities such as oil and many have China as a major trading partner. The decline in oil prices and China's slowdown have caused headwinds. Segal Rogerscasey believes now is likely a good opportunity to get into emerging markets as the fundamentals are not broken but are, instead, a reflection of external factors. Developed markets have their own issues, but most major central banks have implemented "bail-out" packages similar to what the Fed implemented in

2009. Several countries even have negative interest rates to incentivize consumers and businesses to put money to work. As these policies take effect, there could be opportunities.

Specific to the KBOR Mandatory Retirement Plan, Craig Chaikin commented about these TIAA funds, indicating that there is no recommendation to make a change at this time:

1. Wells Fargo Advantage Growth – This large cap fund significantly underperformed the benchmark for the one-year period. For the year, a smaller capitalization bias relative to the benchmark detracted from results since larger names tended to outperform. Stock selection in Industrials and Consumer Discretionary, especially Chipotle, hurt returns. The three-year number is heavily influenced by the one-year number.
2. Royce Opportunity Fund – This fund has been struggling over the last five years as a quality bias has been out-of-favor with the market. An underweight in the health care sector in 2015 along with commodity exposure detracted from one-year results.

Madi Vannaman asked about the current S-3 “D” rating for the TIAA-CREF Bond Market fund. Craig Chaikin responded the fund received an F style score based largely on the quality of bonds in the portfolio. The fund has a higher percentage of BB, B and below B securities than peers, which is not necessarily bad as this is how the fund is currently looking for additional yield. The allocation is consistent with how the team manages the portfolio. Additionally, the fund’s performance results are slightly below benchmark for all time periods as the overall conservative nature of the fund has it track closely with the benchmark. Segal Rogerscasey is keeping an eye on the fund and since there is no change in how TIAA is managing the portfolio currently has no long-term concerns. Also, for the rest of the lineup there are no current concerns based on the Segal Rogerscasey S-3 scores.

Craig Chaikin discussed the Voya funds and performance specifically noting the following funds. There are no long term concerns for the funds and no recommendations for change:

1. PIMCO Total Return Fund – this fund is currently on the watch list. It has been just over a year since the departure of Mr. Gross, the experienced and long-term manager. The S-3 score is a “D” and reflects the new manager’s short tenure even though the team that took over the fund is very experienced. The funds higher standard deviation and downside capture also negatively impact the score.
2. The PIMCO Real Return Fund – this fund is not 100% TIPS like its benchmark which accounts for some of the negative results relative to the benchmark and peer group.
3. The Parnassus Socially Responsible fund was underweight to consumer discretionary and overweight to industrials, which detracted. Having no exposure to Facebook or Amazon, two of the best performers for the year, hurt results.

### **Mandatory Plan Fund Recommendations**

Recommended changes submitted for the Mandatory Plan fund line-up were reviewed.

### **TIAA-CREF Lifecycle Funds 2055 and 2060**

Segal Rogerscasey agrees with TIAA’s recommendation to complete the Lifecycle Funds suite by adding two new Institutional Share Class funds that will allow the Plan to better accommodate current and future KBOR employees who primarily fall in the millennial generation and will also provide greater flexibility for those employees with specific time horizons.

The TIAA-CREF Lifecycle Funds consist of a series of target-date funds in 5-year increments that seek to deliver competitive, risk-adjusted returns through the participant's working years and into retirement.

The Lifecycle Funds invest in a carefully constructed selection of equity and fixed-income TIAA-CREF Funds, providing a diversified, professionally managed portfolio. The overall asset allocation of each Lifecycle Fund, which includes the selection, portfolio weight and mix among the equity and fixed-income funds, evolves as each Lifecycle Fund approaches its target retirement date.

Over time, as longer dated funds are added and shorter dated funds roll off, Craig Chaikin recommended that the TIAA Lifecycle and Voya Target Date suites of funds be automatically added to the lineup when they are available and the shorter dated funds be eliminated with movement into the income fund. No future investment decision would need to be made if the suite of funds is approved.

Rick LeCompte asked when the 2015 fund expires, what happens? Craig Chaikin responded that ten years out, in 2025, the 2015 fund assets would be merged with the income fund, the most conservative option for the lifecycle (target date) funds, which has the least amount of equity exposure and the most amount of fixed income and cash exposure. Rick LeCompte indicated the income fund would be comprised of 40% equity/60% fixed income and cash.

Mike Barnett asked why the funds would be moved to the income fund; why not let the shorter dated funds remain? Craig Chaikin responded the movement would help to simplify and minimize the number of funds in the lineup. Mike Barnett asked how TIAA would communicate such a change to participants. Nicolette Dixon responded that she will verify that a notice is sent to participants, in addition to having that information included in the fund prospectus.

The RPC unanimously supported the motion made by Gary Leitnaker, seconded by Dipak Ghosh, to recommend to the Board that the TIAA Lifecycle Fund 2055 - (TTRIX) and the TIAA-CREF Lifecycle Fund 2060 - (TLXNX) be added to the suite of Lifecycle Funds and that future Lifecycle Funds be automatically added to the suite as they become available.

#### **Replace the VY FMR Diversified Mid Cap (IFDIX) with the VY Baron Growth Fund**

Voya recommended that assets and future contributions currently invested in the VY FMR Diversified Mid Cap Fund be mapped into the VY Baron Growth Fund. This proposal is primarily intended to streamline the menu as VY Baron Growth Fund has drifted to a Mid-Cap Growth fund resulting in two funds in that space in an otherwise lean menu. Upon review, Segal Rogerscasey instead recommends keeping the VY FMR Diversified fund due to its higher style consistency, long manager tenure and deep portfolio team, better investment results and lower expense ratio.

#### **Replace VY Baron Growth Fund with the Voya Small Cap Opportunities Fund**

Due to the style drift of the VY Baron Growth Fund, there is no option in the Small Cap Growth style box. After performing research and fund evaluation, Segal Rogerscasey reviewed three candidates for inclusion and recommended replacing the current fund and mapping assets to the Voya Small Cap Opportunities (IVSOX) fund for the following reasons:

- deep, experienced investment team
- consistent philosophy and implementation

- strong absolute and risk adjusted track record.

Segal Rogerscasey recommends mapping the Baron assets and future contributions to the Voya Small Cap Opportunities fund. Voya agreed with Segal Rogerscasey's updated recommendations.

John O'Brien commented that another Voya client addressed this same Small Cap Growth fund issue, utilizing a different consultant, and arrived at the same fund recommendation. In response to Gary Leitnaker's question about expenses and performance, Craig Chaikin responded that the cost for the Voya fund is 89 basis points versus 98 for the Baron fund, resulting in a cost savings. For performance, over the 1-year period, Voya's return was -.9% and Baron's -4.76%; over the 3 year Voya's return was 13.3% and Baron's 11.5%; and over a 5 year period, Voya's return was 11.1% vs Baron's 11.2%.

### **Vanguard Target Retirement 2055 Fund Investor Class/ Vanguard Target Retirement 2060 Fund Investor Class**

Segal Rogerscasey agrees with Voya's recommendation to add the Vanguard Target Retirement 2055 Fund Investor Class and the Vanguard Target Retirement 2060 Fund Investor Class to round out the existing Target Date suite to add options for younger participants. The Vanguard Target Date suite continues to perform well and represents an excellent value from a net expense stand point. As provided by Voya, this suite of Vanguard Target Retirement Funds is considered a "through" suite that reaches the final allocation 7 years beyond their target date. This offers a diversified portfolio within a single fund that adjusts its underlying asset mix over time. Once a fund has passed its designated date, such as the 2010 Fund, its allocation is gradually adjusted to match that of the Target Retirement Income Fund and will merge with that fund in seven years (2017 for this fund).

The RPC unanimously supported the motion made by Gary Leitnaker, seconded by Michele Sexton, to recommend to the Board to:

1. Replace the VY Baron Growth Fund with the Voya Small Cap Opportunities Fund (IVSOX) and map the assets and future contributions to the Voya Small Cap Opportunities Fund.
2. Add the Vanguard Target Retirement 2055 Fund Investor Class and the Vanguard Target Retirement 2060 Fund Investor Class to the Target Date suite and automatically add new Target Date Funds to the suite as they become available.

### **ERISA-related Lawsuits**

Craig Chaikin provided information about pending lawsuits impacting retirement plans. Unlike the KBOR plan, the retirement plans involved are subject to ERISA and the outcomes will help shape best practices.

#### 1. Bell et al. v Anthem

Anthem's 401(k) plan, with Vanguard as its recordkeeper, is being sued alleging the funds could have been provided cheaper. Although the plan had recently moved to a lower share class, the lawsuit contends that the move should have been sooner and that collective investment trusts should have been utilized to further lower costs. Additionally, the lawsuit contends the per participant administrative cost of \$42 per participant should have been \$30. This is difficult to determine given the nuances of participant directed plans and the challenges in benchmarking. The outcome has the potential to determine whether just lowest cost is the standard or if getting additional value for the cost will be sufficient.

- a. Nicolette Dixon stated that a collective investment trust cannot be utilized in a 403(b)

plan and in order to determine whether fees are reasonable it is important to assess and balance the plan's objective and what investments fit into the overall goals. Tom Carmody stated that it is important to have a documented process that regularly reviews investment management expenses and fees so that the plan is comfortable in determining cost and value. When decisions are made based on good sound practices, they are defensible. Craig Chaikin will review whether a fee policy should be included in the investment policy statement to ensure that the costs are reasonable and that plan participants are getting what they are paying for.

- b. Brian Merrick pointed out the importance of utilizing an investment advisor or consultant if investment expertise is not resident on an oversight board or committee. Brian also noted that Voya's recordkeeping platform partners with fund companies to offer multiple share classes offered by fund families. This enables plan sponsors to reduce fees to participants when asset levels reach sufficient volume as determined in the fund prospectus.

2. Krikorian et al. vs Great-West Life & Annuity Insurance Company

Empower, another recordkeeper, is being sued for receiving excess fees from revenue sharing with the lawsuit contending it was a pay to play scheme. Although revenue sharing is a very common arrangement in the market place, the contention is that Empower should not have been receiving money through revenue sharing. Empower, like other ERISA recordkeepers, routinely discloses revenue and revenue sharing arrangements in its 408(b)(2) plan sponsor fee disclosures. It will be hard to determine whether the funds received were excessive or not. The decision may help determine whether using revenue sharing to cover costs is an appropriate practice.

- a. Nicolette Dixon stated that with fee leveling in the corporate marketplace, funds with the lowest expense ratios and zero revenue sharing are offered and then participants are charged a fee on the back end. The result is that participants, many of whom did not realize they were paying a fee for the plan, are now paying an explicit fee since it is no longer embedded in the investment expenses. Participants typically do not realize that they pay for administrative costs associated with their retirement plan and the impact of that cost on their retirement savings. Tom Carmody stated the net effect should be that the participant does not pay more or less but only in how fund expenses are paid. Craig Chaikin stated that for the next RPC meeting he will provide detail about the plan's fund expenses, including the breakdown between total expense ratio and revenue sharing. Because discussions about revenue and costs for the KBOR plan occur regularly, and the plan utilizes a consultant to review and document fund analysis and comparison to market costs, the plan is meeting its fiduciary duty under the law as it stands now, even under ERISA standards.
- b. Nicolette Dixon relayed that KBOR's use of the TIAA revenue credit follows best practice as those funds are used to pay qualified fund expenses with all remaining dollars returned to plan participants. Currently, the credit provided to participants is on a pro-rata basis but TIAA now has the ability to look at which funds are generating the revenue, and they will be able to return the credit to those participants using those funds.
- c. Theresa Schwartz asked for confirmation that the plan's administrative costs are really low compared to other retirement plans. Craig Chaikin responded yes and, from a straight investment perspective, having the ability to take advantage of the share classes available in the KBOR plan is a huge benefit for participants.

3. Deborah Bishop Bristol on behalf of the Arthur Gallagher & Company 401(k) Savings and Thrift Plan and all other similarly situated ERISA-covered employee pension-benefit plans vs Massachusetts Mutual Life Insurance Company  
Arthur Gallagher, consulting firm, lawsuit alleges that excessive revenue was generated from the stable value fund and pits state insurance law against SEC and DOL disclosure requirements. This case could potentially impact TIAA and Voya stable value funds and may result in forcing changes in the industry's disclosure of expense ratios.

**Good of the Order**

Gary Leitnaker asked about TIAA and Voya's efforts to increase participant engagement which had been tabled at the September 2015 meeting. Both TIAA and Voya responded that they have initiated their outreach campaigns and will have data and information to report at the September RPC meeting.

**Next RPC meeting:**

The next regular RPC meeting is *tentatively* scheduled for 12:30 p.m. on Tuesday, September 13, 2016, in the Board Room.