

KANSAS BOARD OF REGENTS
Retirement Plan Committee (RPC)
MINUTES
September 19, 2017

Regent Bangerter called the September 19, 2017, meeting of the Kansas Board of Regents Retirement Plan Committee to order at 12:30 p.m.

Members Participating:

Regent Shane Bangerter, Chair	Mike Barnett, FHSU
President Allison Garrett, ESU	Dr. Dipak Ghosh, ESU
Dr. Rick Lecompte, WSU	Gary Leitnaker, KSU
Michele Sexton, PSU	Madi Vannaman, KBOR

RPC members participating by conference call were Regent Joe Bain; Leisa Julian, KU; and Stacy Snakenberg, KU Medical Center.

Also present were Craig Chaikin, Segal Marco Advisors consultant. From TIAA: Nicolette Dixon, Senior Relationship Manager; Patty Harte, Regional Managing Director; and Tom Carmody, Managing Director, Institutional Sales. From Voya: John O'Brien, Regional Vice President; Cindy Delfelder, Key Account Manager; and Bernie Heffernon, Senior Vice President, Tax Exempt Markets. From the Board Office: Julene Miller, General Counsel; Theresa Schwartz, Associate General Counsel and Elaine Frisbie, Vice President Administration and Finance.

Introductions –Regent Bangerter introduced Regent Joe Bain who will be serving on the RPC.

Minutes

The minutes from the March 16, 2017, meeting were approved unanimously.

Segal Semi-Annual Review through June 30, 2017

Craig Chaikin reviewed information contained in the June 30, 2017, semi-annual report, highlighting information in the Executive Summary.

The Committee approved specific actions that will be taken with regard to the following funds:

A. TIAA – Remove Royce Opportunity from the watch list due to competitive peer results. Keep Wells Fargo Advantage Growth on the watch list due to 3 and 5-year under performance.

B. Voya – Place Voya Real Estate on the watch list due to under-performance versus both its benchmark and peer group over all time periods.

KBOR Mandatory Plan Fund Lineup Change Recommendations

A. Voya Mid Cap fund option

The VY FMR Diversified Mid Cap Portfolio (IFDIX) was part of the KBOR Mandatory investment menu and on July 14, 2017, it was merged into the Voya Mid Cap Opportunities Portfolio (NMCIX). Voya completed this action because it believed the merger would address the Mid Cap Portfolio's limited prospects for future sales and long-term viability and provide participants with potential for improved performance over time by having the opportunity to invest in a larger, actively managed Voya Mid Cap Opportunities Portfolio, which has a substantially similar investment objective. KBOR participants with funds in the VY FMR Diversified Mid Cap Portfolio were informed about the merger and had those assets moved to the Voya Mid Cap Opportunities Portfolio.

When Voya informed Craig Chaikin about the merger, he and the Segal Marco research team recommended performing a search for a Mid Cap option due to the change in portfolio manager team and investment philosophy and process. After considering three potential fund replacements, Segal Marco's recommendation is to replace the Voya Mid Cap Opportunities Portfolio with the Champlain Mid Cap Fund (CIPIX). The Champlain Mid Cap Fund seeks to invest in companies with the ability to grow and outperform the market consistently, regardless of major market events. Of the three funds under consideration, it is the most conservative fund with the best downside protection and the only fund to post a positive information ratio across all time periods. While year-to-date performance has been below median, performance across longer time periods is consistently in the first quartile. This fund has seen the greatest growth over the last 10 years.

Gary Leitnaker asked Voya representatives to comment on this change. John O'Brien stated that although the merger of the Mid Cap Fund was appropriate for the majority of Voya plans that were impacted, larger plan sponsors such as KBOR have other Mid Cap funds to select from and as such Voya supports this recommendation by Segal Marco Advisors.

A motion was made by Mike Barnett, seconded by Gary Leitnaker, to recommend to the Board of Regents ("KBOR" or "Board") that it approve replacing the Voya Mid Cap Opportunities Portfolio (NMCIX) with the Champlain Mid Cap Fund (CIPIX) and to update the Board's Investment Policy Statement Appendix to add these funds. The motion passed unanimously.

B. Islamic Law Compliant Fund

In response to a request concerning Islamic faith investing requirements, Craig Chaikin was asked to work with TIAA and Voya to determine if there were any investment options that would be available for the KBOR Mandatory Retirement Plan lineup that met with Islamic law.

Segal Marco's research revealed that there are two major Islamic-compliant investment options accessible to 403(b) retirement plans: Saturna Capital and Azzad Asset Management. Both options are overseen by firms with strict investment processes in place to ensure compliance with applicable Islamic laws and are overseen by independent Boards of renowned professionals with experience in Islamic finance. Both firms follow the "Accounting and Auditing Organization for Islamic Financial Institutions" (AAOIFI) guidelines for Islamic investing.

Saturna Capital is the largest Islamic fund family offering available in the US and has \$3.4 billion in total assets under management. The firm's large cap Islamic compliant investments make up the bulk of assets; \$1.6 billion in Amana Growth and \$1.3 billion in Amana Income. The firm offers two additional Islamic compliant investments; an emerging market equity fund (Developing World) and a fixed income substitute (Participation Fund). A point of consideration is that there are only 14 analysts covering both equity and fixed income supporting 14 investment products.

Azzad Asset Management has only \$487 million in total assets: the Ethical fund (\$68 million) and the Wise Capital fund (\$104 million). The Ethical fund is mid cap equity and the Wise Capital fund is sukuk (Islamic compliant fixed income). Azzad now uses sub-advisors to manage the investments and primarily serves as the oversight to ensure compliance with AAOIFI. In 2013, Azzad's in-house investment teams were replaced Ziegler Capital on the Ethical fund and Federated Capital on the Wise Capital Fund. The recent changes to the investment manager and investment processes mean the longer-term track records are not attributable to the current investment manager teams.

Segal Marco's recommendation was to add the funds offered by Saturna Capital, Amana Growth Fund (AMIGX) and Amana Participation Fund (AMIPX), institutional share class. With more assets and more product offerings, Saturna appears to be a more stable firm than Azzad. The Saturna funds also have lower fees. Performance on the Saturna equity funds has been due to large cap equities' outperformance relative to mid cap. Performance on the sukuk funds has been similar. A consistent investment approach has been applied to both funds, and including both options allow an investor exposure to both equity and fixed income options that meet Islamic investment principles.

Craig Chaikin stated that both options meet the guidelines of the Board's Investment Policy Statement, but the Appendix to that Statement will need to be updated to include any additions to the line-up.

Nicolette Dixon asked whether the Board's Investment Policy Statement should be updated to allow a carve out for these investments whose performance might vary substantially from standard benchmarks due to restrictions imposed by complying with Islamic law. Craig Chaikin responded that the Investment Policy Statement already provides guidelines in terms of overall evaluation of investment options and their performance and that there is flexibility around the 3 and 5-year performance metrics when the RPC is making decisions related to the funds. These funds would fall under the part of the Policy concerning "specialty investments." He will review the Investment Policy Statement again to make a final determination as to whether some additional information should or must be included in the Policy Statement.

President Garrett asked if there would be other funds made available to the 403(b) market, in the future, to address this sector? Craig Chaikin responded that if there is enough demand, investment companies would be encouraged to offer such additional fund options.

Gary Leitnaker asked if the Plan was currently out of compliance. Julene Miller replied that adding these funds serves as a reasonable accommodation to a request made by one university's faculty member based on religion. The RPC's obligation is to look at what can be done to address the expressed concerns, but that does not mean the Plan has to be upended to get to that point. Ms. Miller also stated that the faculty member actually requested a waiver from participation in the Plan, but we are unable to honor this request because the controlling statute requires participation, after a one-year waiting period, as a condition of employment. Craig Chaikin shared that the addition of specific investment options to address the specific religious requirements of this faith is becoming more commonplace in higher education and governmental participant directed defined contribution plans, as a reasonable accommodation of religious objections.

Michele Sexton asked whether a decision to allow this type of investment is consistent with the Investment Policy Statement and Craig Chaikin responded "yes." Nicolette Dixon stated the funds' performance could be trailing over multiple time periods because of the sector constraints. She expressed concern that other participants could find their way into the funds not fully understanding the specific investment parameters and risks. Rick LeCompte shared that information about the funds' purpose and sector is available in Morningstar. TIAA and Voya also pointed out that all participants in the Board's Retirement Plan can obtain fund performance history and other similar information from the either of the companies and their representatives.

John O'Brien indicated that Voya utilizes the Morningstar categories as part of their fund performance reporting to participants. The Amana funds would be shown in the performance

reporting under the appropriate Morningstar categories. Detail fund information on all investments can be found on the available fund facts sheets for this Plan.

A motion was made by Gary Leitnaker, seconded by President Garrett, to recommend that the Board of Regents add the Amana Growth Fund (AMIGX) and Amana Participation Fund (AMIPX), institutional share class, to the Plan's available investment options, and to update the Investment Policy Statement Appendix to add these funds. The motion passed unanimously. Board staff noted the recommendation will be presented to the Board at its next regularly scheduled meeting, which is planned for November.

Request for Information (RFI)

An RFI for the KBOR Mandatory Retirement Plan was issued on May 31, 2017, in an effort to benchmark administrative fees and services. This RFI was sent directly to seven companies, posted on the KBOR website and announced in the Kansas Register. Three of the companies directly contacted did not submit a response: Vanguard indicated it would not reply unless a move to a sole provider is certain and Transamerica and VALIC did not respond despite multiple follow-up attempts. Responses from Fidelity, Lincoln, TIAA and Voya were received on June 29, 2017.

Regent Bangerter asked if it is true that the way to get the lowest priced fees would be to go with one vendor, what are the reasons for staying with two record keepers? Craig Chaikin responded that there were several reasons for staying with two vendors. Since consolidation of the Plan in 2006, 25% of the eligible population has selected Voya, even though TIAA is the default vendor when a company is not selected. Both companies offer different servicing models and Voya's higher touch approach is attractive to and is clearly valued by a certain percentage of the population. Fund line-up differences also provide diversification as Voya does not offer annuity products.

Regent Bangerter asked if the same lineup of fund options could be retained if there was only one record keeper? Craig Chaikin responded yes, but funds in the CREF accounts could not be moved to another record keeper, without participant direction, as they are in individual contracts. Nicolette Dixon responded that TIAA offers an open architecture structure and can record keep the universe of non-proprietary mutual funds on the platform.

Regent Bangerter asked Mike Barnett, a member of the RPC sub-committee, to provide his perspective as to why two vendors should be retained rather than going to only one. Mike Barnett shared that the sub-committee reviewed the fees, services and structures of the current vendors, as well as the percentage of assets participants have invested with both vendors. Some of the biggest factors in the decision to retain the current two-vendor structure were that a two-vendor option provides a choice to participants and helps to ensure healthy competition. The fees of both TIAA and Voya will be reduced as a result of the RFI process. The subcommittee discussed this topic and concluded that the two vendor format best serves and protects all of the retirement participants.

Craig Chaikin commented that questions about the number of vendors may be a result of the 403(b) lawsuits, some of which address multiple vendors. Those lawsuits have been generally process orientated, alleging plan sponsors did not perform due diligence and did not review expenses for funds and record keeping. From a process perspective, the RPC is doing what it should be doing in terms of review and documentation. There is no guidance that states a plan sponsor must provide or offer the cheapest option available, as costs must be weighed against value.

Regent Bangerter questioned why Vanguard would only bid if KBOR was moving to a single vendor environment. Craig Chaikin responded that Vanguard is not very flexible and takes a more cookie cutter approach. That company will no longer accommodate working in a multi-vendor environment, does not provide the level of onsite servicing as the current vendors, and their communication and education programs are also more cookie-cutter and inflexible.

Regent Bangerter asked about the industry trend toward per participant flat fees. Craig Chaikin responded that the change to flat fees is happening, but it is a slow move for the industry. Some lawsuits have challenged the concept of revenue sharing in general, which could help force the change.

Mike Barnett asked whether a flat fee is equitable if it is charged regardless of assets. Craig Chaikin responded that smaller account balances would be paying a higher percentage of their account relative to those with larger balances. However, over time, a flat fee may minimize administrative costs since contributions and market appreciation are removed from the cost of administration. Tiered fee structures are also possible (smaller account balances pay a lower fee) to be less impactful on smaller balances.

Gary Leitnaker expressed concern that a flat fee might negatively impact the level of services provided and might not result in a savings to the entire population, as participants could literally “get what they pay for.” Craig Chaikin stated that a flat fee should not compromise services and the fee paid would include all the services requested by the Plan. Nicolette Dixon stated that if fees are charged directly, with two record keepers, two different flat fees could confuse plan participants.

Rick LeCompte equated the flat fee approach to banking fees, which many people hate. People are resistant to paying such fees, although they are often already paying a few but may not realize it because those fees are not as readily transparent when part of the overall cost of services.

Tom Carmody stated the market has evolved significantly with regard to fee transparency and methodology and the RPC might want to further discuss and explore this issue in the future. There are lots of options and flexibility, including fee-leveling mechanisms, which may address equitability based on asset size.

A motion was made by Mike Barnett, seconded by Rick LeCompte, to accept the following RPC sub-committee recommendations:

- A. Retain the current two-vendor structure with TIAA and Voya as the vendors;
- B. Implement the fees and services proposed in the RFI responses; and
- C. Amend existing contracts or other documents, if necessary, to reflect the new administrative fees and pricing and to implement any additional services contained in the information submitted by the two current vendors in response to the RFI, such as increasing onsite education services.

The motion passed unanimously.

Executive Session

At 1:50 p.m., Michele Sexton moved, followed by a second by Rick LeCompte, to recess into executive session for 15 minutes starting at 1:52 p.m. to discuss attorney-client privileged matters with its legal counsel. Participating in the executive session were members of the RPC, Associate General Counsel Theresa Schwartz and to aid the discussion, Board staff member Madi Vannaman.

At 2:05 p.m., the meeting returned to open session.

Initiating a “Request for Proposals” (RFP) for Consulting Services

In light of all that is going on in the 403(b) retirement plan arena, and the work that was done in connection with the RFI, the RPC discussed whether it is appropriate to now issue an RFP for consulting services. In issuing the RFP, the RPC’s goal and objective is to ensure that KBOR is meeting its fiduciary duty to plan participants and is receiving high quality services and investments in all areas involving the Retirement Plan. The market place has changed significantly and a consulting RFP will allow the RPC to comprehensively review and obtain the appropriate level of services related to KBOR’s Retirement Plan. The RPC members agreed on the need to obtain services that not only include review of investment performances, but also makes sure that the appropriate resources are in place to help guide the Committee and Board in fulfilling all related fiduciary duties.

Mike Barnett moved to approve Board staff taking the necessary steps to go out for bid for consulting services. Gary Leitnaker seconded and the motion passed unanimously.

Regent Bangerter accepted volunteers for a RPC sub-committee to assist staff in this process to include Gary Leitnaker, Michele Sexton, and Rick LeCompte.

Next RPC meeting:

The next regular RPC meeting is scheduled for 12:30 p.m. on Tuesday, March 20, 2018, *location to be determined* (either Topeka or Lawrence).