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College Savings Program Board
Investment Advisory Committee Meeting

State of Wisconsin Department of Administration Building
101 E Wilson Street; Madison, Wisconsin

August 19, 2013 -- 10:00 a.m.

Minutes

I. **Call to Order and Roll Call** at 10:00 a.m. (Ken Johnson, Chair)
Present: Ken Johnson, Debbie Durcan, Bill Oemichen, Rob Kieckhefer, Michael Wolff, Annoesjka West, Paula Smith, Paul Zemsky, Kerry Alexander, and Jim DiUlio

II. **Agenda Approval and Public Posting Report** (Chair, staff) Meeting has been posted properly. <u>Agenda approved by voice vote</u>.

III. **Approval of Committee Meeting Minutes for May 20, 2012** Correction will be made to the draft minutes where February was used in the date instead of May. <u>*Motion by Oemichen, second by Wolff to approve the minutes. Carried.*</u>

IV. **Public Presentations** There were none requested.

V. **Old Business**

A. **Second Quarter 2013 Investment [**Callan Associates] *Annoesjka West* will give her market overview comments at the Board meeting to follow, but generally for the quarter, equity performance was very positive. In international markets, we've seen Europe and Japan struggle while emerging markets have lagged. Weakness in Brazil and other places continue. Fixed income in the quarter dropped as interest rates rose, including the 10-year Treasury yield up one percent. Moving to the plans, Tomorrow's Scholar saw some internal shifts toward the more active portfolios. The added choices may have been a factor, as owners may be diversifying their accounts. The equity funds were positive, but some lagged their benchmark. Small caps sometimes suffer due to sector selection. International equity, fixed income, and real estate were all down for the quarter. The Edvest plan saw assets increase overall, which includes new contributions. As with the other plan, equities did well and fixed income lagged as reflecated in the multifund portfolios. There were some manager additions to two of the underlying funds, but nothing of concern at this point.

Johnson asked about the graphic table showing one-year risks, specifically those falling into the low quartile. *West* replied that three- and five-year numbers are better measures, but one-year history is all we have now and is not of great concern.

B. **Watch List, Recommendations** At this point, underperformance in small caps will be monitored, *West* stated. Conversation among the group agreed that it may be too early to draw conclusions. Callan's watch recommendations are usually based on three year history and longer, and at this time they do not see any fund qualifying for watch status.

C. **Investment Policies and Procedures document** – *DiUlio* reviewed the history of the document's development from when the program was at the Treasurer's Office and EAI was our investment consultant. Asking TIAA-CREF for any comments as this nears completion, they recently responded with a heavily edited revision. *Johnson* commented that the document is intended to serve purposes more than interaction with the program manager. The expectations of the program director, the relationship with the investment consultant, and limits of Board action are other elements. He recalled the situation where a previous program manager ran into trouble and there were not clear lines of responsibility. Guidance for Board members is the goal. *Oemichen* agreed with *Johnson's* view, adding that a document incorporating what has been current Board practice will supplement Statutes. This document can reference other documents or contracts, and does not need to include every small item. *Kerry Alexander* responded that TIAA-CREF's legal and other teams looked at this in terms of their relationship to Wisconsin, as they have with other states. However, he added, they defer to the Board's guidance as there is a built-in conflict with a contractor determining policy affecting its work. *Johnson* appreciated the efforts they have put into their comments. *DiUlio* and staff will coordinate the editing process to capture the Board's concerns, and bring a final draft to the December 2 meetings.

VI. New Business

A. **Tomorrow's Scholar plan highlights --** *Paul Zemsky,* the CIO of ING US Investment Management's Multi-Asset Strategies team was introduced by *Paula Smith*. He began explaining the structure of the company, his team, and the current spin off from the Dutch parent. He said that activity will have no effect on us. He then discussed ING's internal research and other capabilities. They feel what makes Tomorrow's Scholar stand out in the 529 world is open architecture, adding managers where ING does not have strengths. The age-based and risk portfolios are designed to minimize value fluctuations in the years just before college. In those years, he said, the value of a dollar gained is not as important as the risk of losing a dollar. *Oemichen* asked if they were managing long, medium and short bonds in the portfolios for age 17 and 18. Yes, replied *Zemsky*, and also using high yield as a cushion. Their internal process schedules a complete optimization for the portfolios every fall, with resets as needed.

He pointed out that along with moving to a lower equity mix in the later year portfolios, the underlying funds also shift to more conservative equity, without emerging markets and real estate. Looking ahead, ING is noting high yield and short term fixed, along with international markets as categories to adjust. *Johnson* asked if stable value has been considered as part of the mix. *Zemsky* replied not at this time, due to the expense and locking-in at low rates. He added that the fixed market is relatively expensive, and as in ING's other target portfolios, equities are a better value unless there is a present need for the money. Responding to a question from *West,* he said they do not do tactical moves, only the annual optimization process.

The platform uses a number of non-ING managers in categories where they have better expertise. Since the October transition, a few of the ING portfolios have added sub managers or changed slightly in response to manager transitions, fund size, or cost concerns. There will likely be some more outside managers added, he said, to give the portfolios more flexibility. *West* asked if international small cap is being considered. *Zemsky* replied maybe in the fall or in the next few years, but not right now. They are currently watching European banks.

Smith said naming the multi-managers in the portfolio titles is important as the concept is promoted. There are some legal issues ING is working on to allow more use of the names.

Kiekhefer asked about the proportions of small- and mid-cap allocations. *Zemsky* said while small-caps represent about 10% of the index, they allocate less and have a preference for mid-caps currently. There is also the added volatility of small-caps to consider, he said.

The 21 additional single fund options provide advisors additional menu choices for their clients. *Wolff* and *West* commented about 'choice paralysis' with so many options; *Zemsky* said that's also concern with target funds, but in the hands of an advisor with Tomorrow's Scholar that is a lesser issue. *Oemichen* added the once-yearly investment change rule also limits activity. *Johnson* asked about the presence of indexing in large cap funds and *Zemsky* replied that some advisors have a preference for them. The current fund lineup includes both styles. Currently, contributions are flowing into the index choices each month, likely due to continuing AIPs or internal exchanges.

In response to a question from *Kiekhefer, Zemsky* said he considered it as his responsibility to fire a fund manager if needed. A manager could also be terminated by the Board through the Watch List process.

Participant fees have dropped by an average of 27% overall in Tomorrow's Scholar following the management transition, *Smith* said.

Zemsky outlined the process to determine the glidepath allocations, including seven to 10-year forecasts, stochastic or monte carlo stress testing, TIAA-CREF's college inflation forecasts, and other statistical tools. Using nine age bands, higher equity allocations in early years, and the optimization process help make a smoother path, he said. The process on a more granular level includes experienced analyst teams, monitoring individual issues, and internal rebalancing monthly.

The open architecture of the plan resonates when talking to advisors, he said. They see the value of quality managers in each category. From ING's point of view, those needs can be met quickly from the outside rather than developing a team in areas where they don't have expertise.

In response to final questions, he said he is not as worried about stable value from the risk side since 2008-09, but the market side is still in process. Fees are going up. He said the current duration of ING's core/intermediate portfolio is about 4 to 5 years, with short-term at 2-plus.

B. **Edvest plan proposed changes --** *Kerry Alexander* reported an annual asset allocation discussion has started for the Edvest plan with *West* and *DiUlio*. A concern is with removing any of the funds, but would that be confusing for participants who just went through a large change? *West* also noted that the fixed choices from TIAA-CREF for the Edvest plan are not as wide as those in the advisor plan, and would there be an appreciable cost increase adding outside managers? *Alexander* said the typical process in other states with TIAA-CREF management is to begin identifying portfolios needing adjustments during the third quarter and then discussing with state staff and consultants. Upon agreements, the process takes about 90 days to take effect after proper notices. *West* said adjustments to the indexed portfolios may be just accomplished by using other index funds, but in the active portfolios there could be additional asset classes, likely in the fixed area with a slight increase in fees. Nationally, other 529 and retirement plans are considering similar adjustments. The group discussed investor behavior in light of any proposed changes we initiate or relaxation of the current 529 rules. There was consensus among the group to continue with the review of the current allocations, in response to current and projected conditions. Phone meetings may be scheduled prior to December's next regular meeting.

C. **Annual Morningstar Interviews –** The interviews begin Wednesday in Chicago, with Morningstar analysts covering Wisconsin's and California's TIAA-CREF plans; the Tomorrow's Scholar interview with ING will be on a date in September.

D. **Update on Edvest Bank CD portfolio** The ratio of placed certificates and cash continue to hold steady, with about $9 million in CDs. Renewals are coming in at 30 basis points. There was an announcement last week that SWIB will be working with Bankers Bank on floating rate CDs. There may be limitations, but they could be another way to add certificates to the portfolio.

VII. Discussion Items for Future Committee Meetings –*Alexander* explained the annual meetings TIAA-CREF portfolio managers hold for clients each fall at their New York offices. This year Wisconsin and Oregon's 529 plans are invited to meet with some the managers, along with national marketing staff. *Alexander* extended the invitation for subsequent meetings to this committee. *Johnson* thought visits like this would also benefit Board and Committee members, and *Smith* said ING's office is nearby to arrange a visit there.

VIII. Announcements The next meeting will be August 19.

IX. Adjournment Motion by *Oemichen*, second by *Kiekhefer* to adjourn. Carried. The meeting was adjourned at 12:05 p.m.