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College Savings Program Board
Investment Advisory Committee Meeting

State Treasurer's Conference Room
1 S. Pinckney Street, Third Floor
Madison, Wisconsin

February 7, 2011
1:00 p.m.

Minutes

I. **Call to Order and Roll Call** at 1:05 p.m. (Ken Johnson, Chair)
Present: Ken Johnson, Debbie Durcan, Kurt Schuller, Michael Wolff, Scott Feldt, Linda Schlissel and John Smith (Evaluation Associates), Sarah Henriksen [Wells Fargo, by phone], and Jim DiUlio.

II. **Agenda Approval and Public Posting Report** (Chair, staff)
Suggestion by Chair Johnson to add an update from Wells Fargo on last year's Morningstar rating experience. Added to Old Business and motion by *Wolff*, second by *Durcan* to approve. Carried.

III. **Approval of Committee Minutes for November 2, 2010**
Accepted and motion by *Wolff*, second by *Durcan* to approve with two editorial corrections. Carried.

IV. **Public Presentations** (if requested in advance) none.

V. **Old Business**

A. Update on Morningstar's ratings. *Henriksen* began by stating that there has not been much movement from Morningstar on reviewing their rating process. She said that data problems were discovered in their reviews of other plans, shared during two national 529 calls in which she and *DiUlio* participated. Another call is coming up with the College Savings Foundation addressing this problem. Morningstar has updated our plans' performance data as of December on their site, but has not returned calls regarding ranking.

As an aside, she said that Joe Hurley's *Saving for College* website has just ranked *Tomorrow's Scholar* as number one for one-year performance, attracting some attention. *DiUlio* added that he raised this ratings concern as a session topic for the College Savings Plan Network meetings coming in May. Other members of CSPN's program committee said that previous attempts in this direction were not productive. *Johnson* then reviewed for the group the Board's consensus that Wells Fargo take the lead in questioning and correcting the data with Morningstar. Conversation then led to the group still expressing their concern, but a letter or communication from the Board to Morningstar would not be productive at this point. This will be in the Director's report to the Board next week.

B. Fourth Quarter 2010 Investment Performance Reports and Annual Review (combined points). It was a great year, began *Schlissel*, with stocks up fifteen percent and bonds up in the high single digits, following a very good 2009. The *EdVest* portfolios did well for the year, including the Legg Mason fund which does well in this type of market. In view of discussion later about it place in the plan, its NAV is near the 2004-05 high points, but has doubled from low in 2008. Performance numbers in the multi-fund portfolios are in line with expectations in a rising market. The bond portfolios were hurt a bit by Treasuries and maturities, but generally did well too. The CDs reflected a slight return while the money market remained at zero. Question by *Wolff* as to how much Wells Fargo is absorbing to keep the money market value stable. *Henriksen* responded that the amount for both plans' money markets is about $40,000. The *EdVest* underlying growth funds did well, *Schlissel* continued, and the large cap value did too, in a difficult category this year. The higher quality stocks helped carry the rally's performance. The midcaps underperformed their benchmarks, but turned in impressive 20% numbers. Bond portfolios did well. The nearly 200 point outperformance in the WF Short-term bond fund can be attributed to security selection. The portfolio peer performance numbers over three and five years continue to improve. The *Tomorrow's Scholar* portfolios also had a good year. Its underlying funds have also done well, including Columbia Marsico Growth. The Harbor International fund showed a higher relative return over benchmark than the WF Diversified International, due to greater emerging markets exposure, *Schlissel* added.

C. Watch List Update, Review, Recommendations to Board, Recommended changes, additions, or deletions. *Schlissel* reviewed the multiple step process EAI uses to identify early watch candidates and concerns prior to a formal watch list recommendation. At this time there are no funds to add to the watch list. The WF Diversified International will remain on watch until the March 2011 data comes in, recalling the committee's earlier discussion. It is likely that the improvement will be apparent by then and could be an action item at the May meeting. At this time EAI is recommending to the Board that no changes be made.

No action by the committee regarding the watch list. No vote.

D. Review of Proposed Enhancements to EdVest plan. *Johnson* began by recalling the committee's work for the past year or so, seeking advice from the public and industry professionals regarding the plan's investment choices. No large review had been taken since Wells Fargo joined the program. The process moved from finding a way to talk about change, to incorporating an online participant survey, then to action. The survey identified a desire for some low-cost index choices, as well as specific international or emerging market selections. He added the program manager contract extension provides an opportunity to seek changes, adding advice of Evaluation Associates and Wells Fargo. It is his desire to present a recommendation to the Board at next week's meeting.

Schlissel began with a review of the existing EdVest plan design, based on her November 2009 report. She pointed out the unique feature of different risk tracks in each age band, although it makes things more complicated for comparisons. Under the fixed allocation choices, additional low-cost index selections are recommended so that an investor may create an all-index asset allocation. The underlying funds' asset classes are well represented with the exception of international emerging markets. Also missing are mid- and small-cap growth funds, but their absence is not as critical with blend funds currently in those categories.

The Wells Fargo proposal was to add three index funds: domestic small cap equity, international equity, and a US bond portfolio. Then two current portfolios would be removed: Baird Bond, since there is another strong-performing bond choice with Wells Fargo, and also removing Legg Mason Aggressive. Replacing with index funds would reduce expenses for the consumer in these categories. Wells Fargo would also be able to trim another basis point across ten *EdVest* and *Tomorrow's Scholar* portfolios. There was no mention of an emerging market option. The WF-proposed index funds from SSgA are common trust funds (CTFs), not mutual funds, similar in construction but different in some respects. CTFs are a bank product and geared toward institutional use. *Schlissel* then discussed ETF products for comparison. ETFs have tracking error, commissions, and registration problems, all a negative when compared to index funds or CTFs and should not be considered for the plans. She then briefly reviewed each of the proposed SSgA CTFs. She again discussed emerging markets portfolios, both from current professional thinking, as well as from our participant survey responses. EAI recommends a standalone fund in which investors could allocate 1-3% of their assets, or as an alternative, increasing the category to an existing portfolio. *Wolff* asked about the category in the EdVest small allocation. *Schlissel* said it is at zero now and has been usually under five percent, but it is allowed to go to twenty. Currently, in international funds that allow the category, the investment is ranges from 17% to an allowed 20 to 35%. *Smith* then explained why many portfolios over the past 15 years limit emerging markets exposure to 25%, mostly due to volatility, however quality of multinational companies in these portfolios is a positive factor. *Schlissel* said that a current rule of thumb for portfolios is that in international funds, about one-third should be in emerging markets, even though most only allocate 10 to 20%. Short discussion followed about how countries sort into developed and emerging categories.

The Baird Bond fund currently holds about $15 million, and performance has varied over the previous three years with its credit bonds. Account numbers are low, with most participants doing their fixed allocation through the age-based portfolios. If the fund was retained while adding an index bond fund, the numbers could drop further. *Johnson* then remarked that Baird's total fee of 60 basis points is expensive to investors, compared to index funds.

The credit union CD option yields are low, *Schlissel* continued, with extreme difficulties placing the money. With another insured choice at bank CDs, investors would still have an option if the credit union portfolio was dropped. *Henriksen* and *DiUlio* shared numbers showing the decline in invested assets as credit unions are not renewing notes. *Johnson* stated that closing the credit union portfolio is permitted by statute; both CD portfolios exist independently of each other. The committee then discussed the mechanics of moving the credit union accounts to the bank portfolio. *Henriksen* said that Wells Fargo's operations team will prepare plans to make the change, both initially and following Board action.

The Legg Mason fund's inconsistent performance and tracking error make it a good candidate for replacement, *Schlissel* said. Very volatile when compared with the other fund in the category, WF Opportunity fund and its good track record. She said the Legg Mason volatility will continue to be a concern in its peer group.

Discussion then moved to responding to Wells Fargo's proposed changes as a package. WF's original proposal had some built-in sharing charges for those who chose non-WF products, such as from SSgA, in order to recoup some of the expenses from funds not managed by WF. Using products from other fund companies' such as Vanguard would require a per-account fee to make up the difference. *Henriksen* explained the rationale for constructing the proposal this way. Further discussion continued focusing on the costs to the consumer for each proposed portfolio or alternative, including breakpoints. *Johnson* brought the conversation back to the initial concept of providing the consumer with low cost index fund options. Looking at both the SSgA proposal and Vanguard alternatives, after stripping away the various program fees, one is identical and two SSgA portfolios are 8 points cheaper. However the per-account fee is still unresolved. Also discussed was whether the Vanguard name was a positive thing, or since it exists in 30-plus other 529 plans, would it not be unique. *Schlissel* then said she would prepare new matrix materials for the next meeting, following today's discussion of index funds. Consensus to meet next Monday, just prior to the Board meeting to vote on recommendations.

For the next meeting: The emerging market component is something that *Henriksen* will discuss with the Wells Fargo managers. Regarding the Baird fund, *Henriksen* said that most of the transactions are exchanges, with only $400,000 of new money last year—the greatest in some time. Legg Mason's fund, as discussed earlier, continues to be a concern. The committee felt that replacing both with index alternatives would best serve the program, along with the earlier discussion of moving the credit union investors to the bank choice. *Henriksen* and *Schlissel* will research the various breakpoint tiers and report back next Monday.

Finally, the committee agreed to schedule meetings for the remainder of the year on May 9, August 8, and November 7. They are all on Mondays, a week prior to the regular meetings of the Board.

VI. New Business

None

VII. Future Committee Agenda Discussion Items

None

VIII. Announcements

NEXT MEETING: The committee will continue discussion next Monday, February 14, just prior to the Board meeting at 12:30 p.m. The next regularly scheduled committee meeting will be May 9 at 1:00 p.m.

IX. Adjournment

<u>Motion by Wolff, second by Johnson to adjourn. Unanimous voice vote. Meeting adjourned at 3:06 p.m.</u>

NOTE: ***The Committee may recess into closed session, pursuant to the exemptions contained in s. 19.85, Wis. Stats. for deliberation of investment of public funds or other business where competitive reasons are an issue.***